Accounting Standards Advisory Forum

Goodwill and Impairment

June 2017

Possible Approach for Addressing the "Too Little, Too Late" Issue

Accounting Standards Board of Japan

Objective of this paper

1. The purpose of this paper is to discuss the ASBJ's proposal[1] regarding a possible approach to address the concerns identified in the impairment model under current IAS 36 *Impairment of Assets* (hereinafter referred to as "IAS 36"), that impairment losses on goodwill are recognised too late or in amounts that are too small (hereinafter referred to as "the 'too little, too late' issue").

Background

2. The International Accounting Standards Board (IASB) added the Goodwill and Impairment project to its agenda to consider how to address the following three areas of focus identified in the Post-implementation review (PIR) of IFRS 3 *Business Combinations* (hereinafter referred to as "IFRS 3"):

   (a) whether changes should be made to the existing impairment testing requirements in IAS 36;

   (b) subsequent accounting for goodwill (including the relative merits of an impairment-only approach and an amortisation and impairment approach); and

   (c) the extent to which other intangible assets should be separated from goodwill.

3. Within these areas of focus, stakeholders around the world have opposing and strongly held views regarding the subsequent accounting for goodwill, as follows:

   (a) the Report and Feedback Statement "Post-implementation Review of IFRS 3 *Business Combinations*" issued in June 2015 (hereinafter referred to as "Feedback Statement of IFRS 3") indicated that investors held mixed views on the subsequent accounting for goodwill;

   (b) in past IASB Board meetings discussing the subsequent accounting for goodwill[2], IASB Board members held mixed views on reintroducing the amortisation of goodwill;

   (c) in past ASAF meetings discussing the subsequent accounting for goodwill[3], national

[1] This paper was approved for publication after deliberations by the Board members of the ASBJ. However, some Board members of the ASBJ did not agree with some of the proposals in this paper.
[2] The views of IASB Board members regarding the subsequent accounting for goodwill were stated at the October 2015 and the February 2016 IASB Board meetings, the May 2016 IASB Board meeting in which the ASBJ and European Financial Reporting Advisory Group (EFRAG) secretariat reported the results of its quantitative study on goodwill and impairment, and at the June 2016 joint Board meeting of the IASB and the U.S. Financial Accounting Standards Board (FASB).
[3] The views of the ASAF members regarding subsequent accounting for goodwill were stated at the ASAF meeting

accounting standards setters and regional bodies participating in the ASAF held mixed views;

(d) in the agenda paper for discussion at the March 2017 IASB Board meeting[4], the staff observed that, regarding the subsequent accounting for goodwill (especially whether to amortise or not), the feedback during the PIR of IFRS 3 did not provide evidence of decrease in the diversity of views and that the staff had not heard new conceptual arguments that would support the amortisation of goodwill since the June 2016 joint Board meeting of the IASB and the FASB; and

(e) regarding the views of preparers of financial statements, some participants of the Global Preparers Forum (GPF) stated that they supported the amortisation model[5] or the direct write-off model during the discussion held in March 2017, even though the discussion of the subsequent accounting for goodwill was not planned.

Identifying the Concerns

4. The comments made on the Request for Information for the Post-Implementation Review of IFRS 3 (hereinafter referred to as "the RFI") and the results of the research conducted by the ASBJ staff in the past, described in the following paragraphs, imply that the "too little, too late" issue exists under the current impairment-only model. The ASBJ thinks that the "too little, too late" issue indicates that it is necessary to reevaluate whether the current impairment test is sufficiently "rigorous and operational" (paragraph BC131G of IAS 36)[6] to justify non-amortisation, and whether the information provided from the subsequent accounting for goodwill is relevant to users of financial statements.

5. In the Feedback Statement of IFRS 3, the summary of the comments to the RFI indicated that "many participants think that there appears to be a 'lag' in the time between the impairment

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in December 2015.

[4] Agenda Paper 18.

[5] In the "Summary of Results of Questionnaire Survey on Goodwill Accounting" issued by the Subcommittee on Corporate Accounting of the Committee on Finance and Accounting of the Keidanren (Japan Business Federation), 29 out of 31 entities (entities applying Japanese GAAP : all 15 entities, entities applying and planning to apply IFRS : 11 out of 13 entities, entities applying U.S. GAAP : all 3 entities) which responded to the questionnaire survey responded that they supported the amortisation and impairment model. http://www.keidanren.or.jp/en/policy/2017/014.pdf.

[6] In the Basis for Conclusions discussing the basis for abolishing the amortisation of goodwill, paragraph BC131G of IAS 36 states, "if a rigorous and operational impairment test could be devised, more useful information would be provided to users of an entity's financial statements under an approach in which goodwill is not amortised, but instead tested for impairment annually or more frequently if events or changes in circumstances indicate that the goodwill might be impaired."

occurring and the impairment charge being recognised in the financial statements."

6. Furthermore, the European Securities and Markets Authority (ESMA) included in its comment to the RFI the reference to ESMA's report "European enforcers review of impairment of goodwill and other intangible assets in the IFRS financial statements" issued in January 2013, which stated its concern as to whether the level of impairment recognised in 2011 appropriately reflected the effects of the financial and economic crisis.

7. The ASBJ thinks that the following results of the research conducted in the past by the ASBJ staff also implies that the "too little, too late" issue exists:

   (a) In 2016, the ASBJ staff conducted a quantitative study on goodwill and impairment together with the EFRAG secretariat, and as a result, issued Research Paper No. 2 "Quantitative Study on Goodwill and Impairment" in October 2016[7] (hereinafter referred to as "ASBJ Research Paper No. 2"). The ASBJ is of the view that the following items described in Research Paper No. 2 imply that the effects of goodwill impairment risk on an entity's financial soundness is growing and that the time until goodwill is fully expensed under the impairment-only model is exceeding 20 years, which was the rebuttable presumption regarding the useful life of goodwill in the superseded standard, IAS 22 *Business Combinations* (hereinafter referred to as "IAS 22").

      - Looking at the individual companies that constituted each stock market index in 2014, 35% of the companies that constituted the stock market index of the United States and 33% of the companies that constituted the stock market index of Europe had goodwill that exceeded 50% of their net assets. Furthermore, 14% of the companies that constituted the stock market index of the Unites States and 11% of the companies that constituted the stock market index of Europe had goodwill that exceeded 100% of their net assets. A few companies that constituted the stock market indices in the United States, Europe and Australia had goodwill that exceeded 100% of their market capitalisation.

      - When dividing the goodwill amount at the end of the previous year by goodwill expensed (that is, either by impairment or amortisation, if applicable) during the period, the resulting ratio from 2006 to 2014 was 82 years for the stock market index of the United States, 37 years for the stock market index of Europe, 9 years for the stock market index of Japan and 34 years for the stock market index of Australia.

   (b) The ASBJ staff conducted in-depth interviews with analysts in Japan with the aim of

[7] https://www.asb.or.jp/en/discussions/papers/2016-1003.html.

understanding their current views on goodwill and impairment more thoroughly and issued Research Paper No. 3 "Analyst Views on Financial Information Regarding Goodwill" (hereinafter referred to as "ASBJ Research Paper No. 3") [8]. The ASBJ observes that the following observation in ASBJ Research Paper No. 3 indicates analysts' concerns that goodwill with impairment risk is included in the entity's financial statements.

- Many analysts thought that impairment losses on goodwill were recognised later than when they thought the deterioration in the value of goodwill had occurred. These analysts said that they incorporated the deterioration in the value of goodwill in their analyses before the impairment losses on goodwill were recognised.

8. The Feedback Statement of IFRS 3 also noted the concerns that the impairment test of goodwill under the current impairment model was complex and involved significant judgements. Accordingly, the ASBJ thinks that the subsequent accounting for goodwill should not be excessively complex nor should it impose undue practical burden on entities making judgements.

Alternatives for the Subsequent Accounting for Goodwill

9. The ASBJ identified the following three alternatives for subsequent accounting for goodwill, which had potential to address the "too little, too late" issue. All three alternatives would result in recognising expenses earlier than the impairment-only model under current IAS 36.

    (a) Direct Write-Off of Goodwill

    Within the three alternatives discussed in this paper, a direct write-off of goodwill would expense the initial amount of goodwill recognised in the most expeditious manner. (As IFRS 3 does[9], this paper assumes that goodwill meets the definition of an asset. Furthermore, although a direct write-off of goodwill may be achieved by reducing the carrying amount of goodwill through other comprehensive income (OCI) or by directly reducing equity, this paper assumes that goodwill will be expensed through profit or loss when it is initially recognised.)

    (b) Amortisation and Impairment Model

    The amortisation and impairment model would reduce the carrying amount of goodwill by amortising goodwill and recognising expenses and, in addition, would recognise

[8] https://www.asb.or.jp/en/discussions/papers/2017-0612.html.

[9] Refer to paragraph BC323 of IFRS 3.

impairment losses when the value of goodwill deteriorates below the carrying amount (after amortisation). Because goodwill would be amortised prior to the recognition of impairment losses under IAS 36, this model would result in recognising expenses earlier than the impairment-only model under current IAS 36.

(c) PH Approach

The pre-acquisition headroom approach (hereinafter referred to as "PH approach"), which the IASB is considering as a potential improvement to make the impairment test more effective, would result in recognising expenses earlier than the impairment-only model under current IAS 36. Under the PH approach, for the purpose of testing goodwill for impairment, the pre-acquisition headroom (PH) measured at the acquisition date would be added to the carrying amount of the cash generating unit (CGU) to which goodwill was allocated, and that amount would be compared to the recoverable amount of the CGU to which goodwill was allocated.

10. The ASBJ assessed whether the three alternatives regarding the subsequent accounting for goodwill had the potential to lead to an improvement to the impairment-only model under current IAS 36 from the perspective of providing relevant information to users of financial statements as well as from the perspective of complexity in the accounting and the practical burden associated with the judgements required.

(a) Direct Write-Off of Goodwill

- A direct write-off of goodwill is easy to apply because it does not require specific judgement in the accounting.
- On the other hand, a direct write-off of goodwill would produce the same results as not recognising goodwill as an asset but recognising expenses at the date of acquisition. This would mean that goodwill, which forms part of the consideration for the business combination, would not have any value as of the acquisition date, which is difficult to explain from the perspective of providing relevant information to users of financial statements.
- Additionally, when goodwill is directly written off, subsequent goodwill impairment losses would not be recognised. When goodwill impairment losses are considered to represent a signal that there was a failure in the investment (that is, the business combination), such signal would not be provided.

(b) Amortisation and Impairment Model

- By amortising goodwill, profit or loss would be calculated by matching the increases in income due to the business combination with the amortisation expense. This would allow management to explain the results of the business combinations using profit and loss that deducts amortisation expenses. Under the view that goodwill represents excess earnings power, the value of goodwill would normally deteriorate due to competition. Amortisation of goodwill would appropriately reflect such deterioration and at the same time would avoid the recognition of what is effectively internally generated goodwill.

- On the other hand, under the amortisation and impairment model, goodwill impairment losses are less likely to be recognised compared to when goodwill is not amortised, because the carrying amount of goodwill would be reduced by amortisation. When goodwill impairment losses are considered to represent a signal that there was a failure in the investment (that is, the business combination), it is less likely that such signal would be provided.

- When goodwill is to be amortised, the amortisation period would become an issue. The ASBJ thinks that estimating the amortisation period based on the management's estimate of the period for which the future net cash inflows would increase due to the business combination would provide users of financial statements with relevant information (See paragraph 43 in this paper).

(c) PH Approach

- It is considered that the PH approach would partly address the issue that the unrealised gains on the net assets and internally generated goodwill that are included in the existing CGU to which goodwill is allocated would shield the impairment of goodwill.

- Under the PH approach, goodwill impairment losses are recognised when the carrying amount of the CGU to which goodwill was allocated plus the PH (which is measured at the acquisition date and is "frozen") exceeds the recoverable amount of that CGU. However, it is difficult to explain what the carrying amount of goodwill after impairment losses recognised purports to represent from the perspective of providing relevant information to users of financial statements.

- Furthermore, the PH approach involves a complex measurement process, which is likely to lead to increased practical burden by requiring judgements related to the measurement of the PH as of the acquisition date (in particular, in the determination of the recoverable amount of the existing CGU before the business combination).

11. Based on the discussions above, the ASBJ thinks that, from the perspective of providing relevant information to users of financial statements, it would be difficult to conclude that neither the direct write-off of goodwill nor the PH approach would result in an improvement to the impairment-only model under current IAS 36.

12. Although it is not discussed in depth in this paper, the ASBJ is aware that, when discussing the subsequent accounting for goodwill, it is necessary to consider the identification of and the subsequent accounting for intangible assets other than goodwill. If a direct write-off of goodwill were to be required, this may provide an entity with an incentive to identify more intangible assets other than goodwill, so as to reduce the amount of goodwill that is immediately expensed (especially when the non-amortisation of intangible assets other than goodwill continued to be available). On the other hand, if all intangible assets, including those other than goodwill were to be amortised, it is less likely that the distinction between goodwill and intangible assets other than goodwill would become a significant issue.

Option to adopt the amortisation and impairment model

13. The ASBJ has been consistently supporting the amortisation and impairment model because it provides useful information to users of financial statements regarding the entity's financial performance after the business combination by reflecting the deterioration in the value of goodwill in profit or loss for each period through amortisation. From the analyses provided up to the preceding paragraph, the ASBJ thinks the amortisation and impairment model is an effective approach that would also address the "too little, too late" issue that is implied under the impairment-only model under current IAS 36. Regarding the subsequent accounting for goodwill, the ASBJ reaffirmed its position that the IASB should replace the impairment-only model under current IAS 36 with the amortisation and impairment model.

14. Notwithstanding the ASBJ's position in the preceding paragraph, as mentioned in paragraph 3 in this paper, the ASBJ acknowledges that stakeholders have opposing and strongly held views on the subsequent accounting for goodwill, and that there are concerns regarding the significant burden that would be imposed on entities change from the current impairment-only model to the amortisation and impairment model.

15. Considering the current situation regarding the appropriate subsequent accounting for goodwill, the ASBJ proposes considering an optional approach. Under this approach, an entity would be required to choose from either of the following two models based on what the entity thinks is useful to discharge its accountability responsibilities as an accounting policy:

(a) the impairment-only model under current IAS 36; or

(b) the amortisation and impairment model.

16. The advantages of this optional approach are discussed in detail from paragraph 19 of this paper and the concerns related to this optional approach are discussed in detail from paragraph 25 of this paper.

17. When both the impairment-only model under current IAS 36 and the amortisation and impairment model are used for the subsequent accounting for goodwill, instead of requiring entities to adopt either approach as an accounting policy, it may be possible, for example, to establish criteria to determine which model to use for each business combination (that is, for each goodwill recognised) and require entities to apply those criteria to determine which model to use. However, the ASBJ proposes to require entities to adopt either as an accounting policy and apply the same model to all of the reporting entity's business combinations consistently for the following reasons:

    (a) Considering the current situation that there are diverse views regarding the essential characteristics of goodwill (whether it deteriorates in value and whether it can be consumed) and the appropriate subsequent accounting for goodwill, it would be difficult to reach a consensus on the criteria to determine which model to use. Furthermore, depending on the criteria that would be developed, entities may be required to exercise significant judgement to determine which model to use and thus may increase the burden on entities. In addition, depending on the criteria that would be developed, the selection of the model may become arbitrary.

    (b) If the same model were not applied to all of the reporting entity's business combinations consistently, the carrying amount of goodwill would include goodwill that is amortised and goodwill that is not amortised. Moreover, goodwill impairment losses would include those arising from goodwill that is amortised and goodwill that is not amortised. It would be difficult to justify these amounts from the perspective of providing relevant information to users of financial statements.

    (c) By applying either model for all of the reporting entity's business combinations consistently as an accounting policy, management would be able to align the subsequent accounting for goodwill with its views on how to discharge its accountability responsibilities regarding the results of the business combinations.

18. The ASBJ acknowledges that the IASB is currently undertaking a project to simplify and improve the effectiveness of the impairment test under IAS 36. If the IASB changes the

requirements in IAS 36, the ASBJ thinks the improvements can be applied to both the impairment-only model and the amortisation and impairment model.

Advantages of the Optional Approach

19. The optional approach described in paragraph 15 of this paper has the following advantages:

    (a) management can choose the accounting model it thinks is useful to discharge its accountability responsibilities; and

    (b) preparers and investors can communicate more effectively.

Management can choose the accounting model it thinks is useful to discharge its accountability responsibilities

20. The ASBJ observes that diversity exists regarding how management views its accountability responsibilities related to the results of the business combinations, which can be summarised as follows:

    (a) The amortisation and impairment model is useful from the perspective of discharging accountability responsibilities related to the results of the business combinations.

        - The management can explain the results of the reporting entity's business combinations using profit or loss which would be calculated by matching the increases in income due to the business combination with the costs of goodwill (amortisation expenses), where such costs would be allocated over the period management estimates that future cash flows would increase.

        - It would be recognised and explained as a failure in the investment (that is, the business combination) when the value of goodwill deteriorates below the carrying amount of goodwill after amortisation.

        - By amortising goodwill, management can explain that they manage their acquirees in an orderly manner considering both the recoupment of the investment amount and the risk of impairment, thereby providing discipline in managing the entity.

    (b) The impairment-only model is useful from the perspective of discharging accountability responsibilities related to the results of the business combinations.

- It would be recognised and explained as a failure in the investment (that is, the business combination) when the carrying amount of goodwill without amortisation becomes unrecoverable with the future cash flows arising from the CGU to which goodwill was allocated.

- Management can provide a signal that there was a failure in the investment (that is, the business combination) when the value of goodwill deteriorated from the amount initially recognised.

- Management can explain the growth of the reporting entity's income and profit as a result of the business combinations, regardless of the amount of the initial investment or the amount of the expenses allocated.

21. Given the diverse views of management of the reporting entities, allowing an option to select the subsequent accounting for goodwill would provide management with different views to adopt the accounting they believe is useful to discharge their accountability responsibilities related to the results of their business combinations.

Preparers and investors can communicate more effectively

22. ASBJ Research Paper No. 3 states that the needs of analysts for the financial information regarding business combinations varied, and the way analysts used the financial information provided depended on the objectives of their analysis. It also stated that some analysts thought that information regarding the management's estimate of the period that future cash flows would increase due to the business combination was useful.

23. Because IFRS currently requires the impairment-only model under IAS 36, information regarding the management's estimate of the period that future cash flows would increase, as described in the preceding paragraph, is not necessarily provided to users of financial statements. Accordingly, by allowing management to choose from either the impairment-only model under current IAS 36 or the amortisation and impairment model as the reporting entity's subsequent accounting for goodwill, preparers can provide investors with financial information that is consistent with their views on how to evaluate the results of their business combinations.

24. By introducing the optional approach, it is expected that the approach would provide an opportunity for preparers and investors to communicate how preparers evaluate and explain the results of the business combinations, and this would make the communication between preparers and investors regarding the financial information prepared based on the selected accounting

policy more effective. As a result, it is expected that investors would be provided with information that would allow investors to better understand management behaviour as well as to enable investors' analyses and future forecasts related to the business combinations in a more sophisticated manner - more effectively and efficiently.

Concerns on the optional approach

25. The ASBJ acknowledges that, generally speaking, permitting alternatives in accounting standards is undesirable and that the IASB, after it was reorganised from the International Accounting Standards Committee (IASC), has completed its works on the Improvements project in 2003 to eliminate the alternatives that had existed in IASs.

    Nevertheless, the ASBJ thinks that, considering the balance between comparability and flexibility, there are circumstances where providing alternatives is warranted. In fact, under IFRS, the option to use either the cost model or the revaluation model is provided as the basis for the subsequent measurement of assets in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*.

26. According to ASBJ Research Paper No. 3, some equity analysts noted that "from the perspective of conducting analyses based on cash flow information, they were indifferent between amortisation and non-amortisation because neither affected cash flows." For those analysts, providing an option for the subsequent accounting for goodwill is likely to have a limited effect on their analyses of financial statements.

27. In introducing the optional approach, some may be concerned that additional burden would be imposed on users of financial statements because of the reduction in the comparability between entities. However, the ASBJ thinks the advantages of the optional approach, as discussed earlier, would outweigh this additional burden. In addition, the concerns may be alleviated to a certain extent by adding disclosure requirements to supplement information that is necessary to make comparisons among entities.

Discussion Point

- Regarding the subsequent accounting for goodwill, what are your views on the proposal to permit an entity to choose either the impairment-only model under current

IAS 36 or the amortisation and impairment model as an accounting policy?

Amortisation Period

Background

28. When the subsequent accounting for goodwill has been discussed, including when the amortisation of goodwill was abolished and in recent discussions, one of the main arguments raised against the amortisation of goodwill is that estimating the amortisation period is difficult and is arbitrary.

29. If the amortisation of goodwill were to be reintroduced, the ASBJ thinks that one of the main issues that need to be resolved is how to determine the amortisation period and, accordingly, the following paragraphs discuss this issue. The ASBJ acknowledges that other issues, such as the amortisation method, also need to be resolved if the amortisation of goodwill were to be reintroduced, but are not discussed in this paper.

Discussions to date

30. In 2004, the IASB superseded IAS 22 and rejected the amortisation and impairment model, primarily because the amount amortised in any given period can be described as at best an arbitrary estimate of the consumption of acquired goodwill during that period (paragraph BC131E of IAS 36).

31. In recent discussions regarding the subsequent accounting for goodwill, the IASB staff stated that "the useful life of acquired goodwill and the pattern in which it diminishes generally are not possible to predict with a satisfactory level of reliability" is a key argument[10] and that the majority of users of financial statements stated that "amortisation of goodwill over an arbitrary period does not provide decision useful information[11]".

32. Under U.S. GAAP, the FASB issued the Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (hereinafter referred to as "Statement No. 142") in 2001, which abolished the amortisation of goodwill. The reasons for reaching such conclusion were that the useful life of goodwill and its pattern of consumption cannot be predicted with sufficient reliability (paragraph B74 of Statement No. 142), as well as that the FASB Board agreed with respondents who stated that the amortisation of goodwill based on an arbitrary period does not reflect economic substance and thus does not provide useful information (paragraph B79 of Statement No. 142). In recent discussions, the FASB has indicated that estimating the

[10] Paragraph 14 of Agenda Paper 18A for discussion at the October 2015 IASB Board Meeting.
[11] Paragraph 7(a) of Agenda Paper 18B for discussion at the November 2015 IASB Board Meeting.

amortisation period is difficult and highly subjective[12] as views against the amortisation of goodwill.

How Accounting Standard Setters Have Prescribed the Amortisation Period

33. In the past, accounting standard setters have prescribed the determination of the amortisation period as follows:

Standard	Principle for Determination	Maximum Period	Rationale of Prescribing the Amortisation Period
Superseded Standards			
U.S. GAAP (APB Opinion No. 17, issued in 1970)	The period estimated to be benefited (paragraph 27)	40 years	・The estimated life of goodwill is neither infinite nor specifically limited, but is indeterminate (paragraph 22). ・Since the date at which the value becomes zero is indeterminate, the end of the useful life must necessarily be set arbitrarily at some point or within some range of time for accounting purposes (paragraph 23).
IFRS (IAS 22, revised in 1993)	Useful life (paragraph 42)	5 years (rebuttable but should not exceed 20 years)	・Because it is frequently difficult to estimate the useful life, for accounting purposes, the Standard specifies an arbitrary limit on the amortisation period (paragraph 45). ・The presumption in this Standard is that goodwill does not normally have a useful life in excess of five years (paragraph 45). ・There may be circumstances when the goodwill is so clearly related to an identifiable asset that it can reasonably be expected to benefit the acquirer over the useful life of the identifiable asset. Nevertheless, since an enterprise's planning horizon with respect to its operations as a whole is unlikely to exceed twenty years, projections as to the life of goodwill beyond this period are not

[12] Appendix B of Agenda Paper 18D for discussion at the June 2016 IASB–FASB Joint Board Meeting.

Standard	Principle for Determination	Maximum Period	Rationale of Prescribing the Amortisation Period
			sufficiently reliable to permit an amortisation period of longer than twenty years (paragraph 45).
IFRS (IAS 22, revised in 1998)	The best estimate of the period during which future economic benefits are expected to flow to the enterprise (paragraph 44)	20 years (rebuttable)	・The future economic benefits embodied in goodwill are always consumed. Although there may be no physical limit to the useful life of goodwill, infinite lives do not exist (paragraph 46(a)). ・As an enterprise's planning horizon for its operations as a whole is unlikely to exceed 20 years, projections of the life of goodwill beyond this period are not sufficiently reliable to permit an amortisation period of longer than 20 years (paragraph 47(a)).
Currently Effective Standards			
Japanese GAAP (Accounting Standard for Business Combinations, issued in 2003)	The period for which goodwill is expected to have an effect	20 years	・By amortising goodwill over the period for which goodwill is expected to have an effect, amortisation expenses can be matched against income as a result of the business combination. ・Consistent with the concept that the profit of the company represents the amount recovered in excess of the cost of the investment. ・The maximum period was carried over from predecessor guidance.
IFRS for SMEs (issued in 2009)	Useful life (paragraphs 19.23 and 18.21)	10 years	・For cost-benefit reasons, rather than conceptual reasons, goodwill should be considered to have finite lives and, therefore, goodwill should be amortised over their estimated useful lives, with a maximum amortisation period of ten years (paragraph BC112).
U.S. GAAP (Accounting Standards	Useful life (paragraph 350-20-15-4 of	10 years	・The useful life should be limited to 10 years on the basis that, generally, a significant portion of the assets and liabilities acquired in a business

Standard	Principle for Determination	Maximum Period	Rationale of Prescribing the Amortisation Period
Update No. 2014-02, optional for private companies, issued in 2014)	the Codification)		combination involving private companies would be fully used up or satisfied by the 10th year (paragraph BC17). ・Some stakeholders supported a 15-year period to align with amortisation of goodwill for U.S. federal tax purposes, but it was concluded that a period of 15 years was no less arbitrary than a period of 10 years and that a longer amortisation period would increase the risk of impairment (paragraph BC19).

34. In addition, in its Exposure Draft issued in 1999, the FASB proposed amortising over a uniform fixed period because the FASB concluded that that was the only practical solution to the intractable problem (paragraph B74 of Statement No. 142).

35. Regarding how accounting standard setters have prescribed the determination of the amortisation period in the past, the ASBJ observes the following:

    (a) as the principle for determining the amortisation period, some accounting standard setters have prescribed the principle more specifically, such as "the period estimated to be benefited" or "the period for which goodwill is expected to have an effect", instead of simply prescribing the amortisation period to be the "useful life";

    (b) all standards, including those that have prescribed a principle for determining the amortisation period, prescribe a maximum period; and

    (c) none of the standards contain a clear rationale regarding the specific number of years for the maximum period, but recently issued standards tend to have a shorter maximum period.

Needs of Users of Financial Statements

36. In past discussions, the IASB acknowledged that some users of financial statements think that information based on management's assessment of the useful life of goodwill may be useful[13]. Furthermore, the IASB indicated the importance of considering what information users of financial statements are asking for, focusing on the benefits for users of financial statements of

[13] Paragraph 7(b) of Agenda Paper 18B for discussion at the November 2015 IASB Board Meeting.

the current information versus the costs to preparers of applying the requirements[14] as ASAF members comments at the December 2015 ASAF meeting.

37. As described in ASBJ Research Paper No. 3, analysts have stated that information regarding the management's estimate of the amortisation period was useful. Analysts stated the following views:

    (a) Information regarding the management's estimate of the period for which future cash flows would increase due to the business combination was useful. These users also mentioned that, by amortising goodwill based on such period, profit or loss would be calculated by matching the increases in income due to the business combination with the amortisation expense determined based on the management's estimates and thus provides useful information.

    (b) The amortisation period should be determined based on the management's estimate of the period for which synergies would be realised and maintained. Goodwill may be amortised over a relatively long period when the synergies were expected to be realised over a long period of time.

    (c) The primary purpose of amortising goodwill is to ultimately reduce the carrying amount of goodwill to zero. The amortisation period should be based on the management's estimate of the period for which the amount of goodwill would be recouped by the increase in expected future cash flows due to the business combination.

Our Preliminary Views on the Amortisation period

Principle for the determination of the amortisation period

38. As mentioned earlier in this paper, one of the main reasons the IASB decided to abolish the amortisation of goodwill was that the amortisation period was determined arbitrarily. If the amortisation of goodwill were to be reintroduced, the ASBJ acknowledges that this would continue to be a concern.

39. If the amortisation of goodwill were to be reintroduced, the ASBJ thinks that it is important to clarify the principle for the determination of the amortisation period. In developing this principle, the ASBJ thinks the analysts' views regarding the amortisation period and the information provided by the amortisation of goodwill should be emphasised, in order to provide

[14] Appendix C paragraph C2(c) of Agenda Paper 18 for discussion at the February 2016 IASB Board Meeting.

relevant information through the amortisation of goodwill.

40. In this respect, the ASBJ thinks that it would be inappropriate for an accounting standard setter to prescribe a uniform fixed period. Information based on a uniform fixed period prescribed by an accounting standard setter will not be useful to users of financial statements who think information based on the management's estimates are useful. In addition, assuming that all goodwill acquired by the reporting entities have the same useful life does not necessarily result in faithful representation.

41. There are mixed views regarding the principle for the determination of the amortisation period. For example, a feedback statement of the joint research by the EFRAG, the Organismo Italiano di Contabilità (OIC) and the ASBJ[15] stated there were factors that could help determining the length of the amortisation period, including:

    (a) the period over which the acquirer expects to earn excess return over the theoretical case of a standalone business;

    (b) the expected payback period; and

    (c) economic assumptions that were used to price the transaction.

42. Furthermore, as mentioned earlier in this paper, users of financial statements interviewed by the ASBJ supported estimating the amortisation period based on the period for which expected future cash flows would increase due to the business combination.

43. Regarding the preceding two paragraphs, the ASBJ observes that, although the views were expressed differently (especially for the concept of "the expected payback period"), there were many points in common. The ASBJ thinks the principle that most appropriately describes the essence of the common nature would be "estimating the amortisation period based on the management's estimate of the period for which the future net cash inflows would increase due to the business combination".

44. The ASBJ acknowledges that there may be concerns about the arbitrariness involved because the amortisation period would be determined based on management's estimates. However, the ASBJ is of the view that this is requiring judgment of the management in order to provide relevant information to users of financial statements and, accordingly, its advantages would outweigh the concerns about the arbitrariness.

[15] https://www.asb.or.jp/en/discussions/papers/2014-0722/feedback.html.

Whether to prescribe a maximum period for the amortisation period

45. As stated in paragraph 33 of this paper, all standards, including those that have prescribed a principle for determining the amortisation period, prescribe a maximum period for the amortisation period.

46. As discussed earlier in this paper, the ASBJ supports adopting a principles-based approach to determining the amortisation period. Following this principle, prescribing a maximum period for the amortisation period may impair the relevance of the information provided.

    On the other hand, generally speaking, predictions are less reliable when they are more out in the future. Some think that it is necessary to prescribe a maximum period in order to ensure a certain level of relevance, and the ASBJ thinks it is worth exploring this issue.

    As long as management can justify the amortisation period it adopts, even if that period becomes very long period, using that period for amortisation would be consistent with the principle discussed earlier. Accordingly, if a maximum period were to be prescribed, the ASBJ thinks that it is appropriate to make it rebuttable.

47. The maximum period for the amortisation period, under the assumption that it would be rebuttable, would be difficult to determine objectively. Nevertheless, considering the fact that accounting standards issued recently prescribe a maximum period for the amortisation period of 10 years and based on the research results of some academic papers[16], the ASBJ thinks 10 years is most likely to be accepted by constituents.

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[16] The ASBJ reviewed academic papers including the following:
Healy, P., Serafeim, G., Srinivasan, S. and Yu, G. (2011). Market competition, government efficiency, and profitability around the world. Working paper, Harvard Business School. Available at SSRN 1865878.
Nissim, D. and Penman, S. H. (2001). Ratio analysis and equity valuation. Review of Accounting Studies, 6, 109–154.
Obinata, T. (2013). Sustainability and mean reversion of profitability. Chuokeizai-sha, Inc.
Palepu, K. G. and Healy, P. M. (2012). Business analysis and valuation 5th edition - International edition, Cengage learning.

Palepu and Healy showed the empirical research results that excess operating returns on equity diminished within 5 to 10 years. Nissim and Penman explored the period of the mean reversion for decile portfolios formed on excess operating profit and found that excess operating profit for the highest decile remained over 10 years.

Discussion Points

- Do you agree with the determining the amortisation period based on the management's estimate of the period for which the future net cash inflows would increase due to the business combination?
- Do you support providing a rebuttable presumption regarding the maximum period for the amortisation period? If so, how should that maximum period be prescribed?