Update on IASB Research project Goodwill and Impairment

Issues Paper

Objective

1 The purpose of this paper is to provide an update on the IASB Research project Goodwill and Impairment (the research project) and seek views from EFRAG TEG and EFRAG CFSS members on disclosure proposals being developed by the IASB staff and whether amortisation of goodwill should be reintroduced.

Agenda papers

2 In addition to this paper, agenda paper 09-02 – *IASB's ASAF paper on Goodwill and Impairment* – has been provided for the session for background only.

Background

3 In response to the feedback from the IASB's Post-implementation Review (PIR) of IFRS 3 *Business Combinations*, the IASB initiated a research project on goodwill and impairment that aimed to improve the effectiveness of goodwill impairment testing under IAS 36 *Impairment of Assets* as well as simply it.

4 In developing the research project, the IASB examined ways to make the impairment test more effective in terms of timely recognition of goodwill impairment. The IASB staff developed the headroom approach with the objective of removing the shielding effect created by internally generated goodwill. The IASB discussed the approach with some of the IASB's consultative groups[1], and become aware that it was not supported by many stakeholders as they did not consider the approach feasible in terms of cost-benefit considerations. Consequently, the IASB decided not to consider the headroom approach further.

5 Some ASAF members asked the IASB to make clear what the intended objective of improving the goodwill impairment test was, and whether the objective was that goodwill should not remain on the entity's statement of financial position indefinitely. They added that reintroducing amortisation of goodwill would be a less costly way of achieving that objective than introducing the headroom approach.

IASB meeting in October 2018

6 In the October 2018 meeting, the IASB discussed various aspects of the project including the timing for publication of the discussion paper. Several IASB members cautioned against delaying publication to H1 2020 as this might create 'wait fatigue' for stakeholders and asked the IASB staff to bring forward the publication date.

[1] The headroom approach was discussed with the Advisory Standards Advisory Forum, Capital Markets Advisory Panel and the Global Preparers Forum.

7 The IASB noted that they had collected sufficient feedback to develop a discussion paper. The extensive research conducted by the IASB staff, including the development of the headroom approach, which although had not been supported by stakeholders, had demonstrated that the goodwill impairment testing was not working as intended. The IASB also noted that the FASB had decided to add a project to its agenda on subsequent accounting for goodwill and accounting for some intangible assets in a business combination.

Revised project objectives

8 In light of the feedback, the IASB decided to focus on developing improved disclosures and simplifications to the impairment test. In its July 2018 meeting, the IASB tentatively decided to pursue the following three objectives:

(a) Objective A - Identifying disclosures to enable investors to assess management's rationale for the business combination, and whether the post-acquisition performance of the business combination meets expectations set at the acquisition date;

(b) Objective B - Simplifying the accounting for goodwill by exploring whether to permit an indicator-only approach to determine when an impairment test is required; and/or reintroduce amortisation of goodwill;

(c) Objective C - Improving the calculation of value in use by exploring whether to remove the prohibition on the inclusion in cash flow projections of future enhancements to the asset and permit the use of post-tax inputs in the calculation of value in use.

9 Objectives A and B are discussed below. Objective C was discussed by ASAF members in a previous meeting.

Objective A – targeted improvements to existing disclosures

10 Based on user feedback received, the IASB staff are proposing improved disclosures that would enable investors to assess whether a business combination was a good investment decision and whether, after the acquisition, the acquired business is performing as was expected at the time of the acquisition.

11 The IASB tentatively decided that the staff should not perform a complete review of all the disclosure requirements in IFRS 3 and IAS 36. In November 2018, the IASB staff presented the proposals to the Capital Markets Advisory Forum (CMAC) and the Global Preparers Forum (GPF).

Feedback from the CMAC

12 CMAC members highlighted that the fundamental problem is the lack of information about the reasons for undertaking the acquisition and assessing whether it has been successful. Some members said that they ignore goodwill in their analysis.

13 CMAC members explained that the disclosures in IFRS 3 do not currently provide them with sufficient information for their analysis. It was difficult to assess how successful an acquisition has been, especially once it was integrated. Members said that they would like information about the performance and long-term value generation of the acquired company to assess stewardship and the allocation of capital in terms of consideration paid. This would enable them to better understand both the performance of the acquiring company and the acquired company before and after the acquisition and help with management accountability. Some members thought that such information should be provided on a segmental basis.

14 CMAC members generally supported the IASB staff proposals for **acquisition date** information. In particular they noted that:

(a) Quantitative information on synergies was particularly useful including timing that informs when synergies are achieved and cost;

(b) Pro-forma pre-acquisition information should be provided to permit comparability;

(c) Disclosure of debt and pension obligations acquired was useful information.

15 CMAC members would like quantitative information to be able to track the acquisition in **subsequent periods**, rather than qualitative information. There were mixed views on the number of years the information should be provided for. Post-acquisition information is needed for stewardship purposes, and some members added that it was also useful for valuation purposes. In particular:

(a) Some members noted that post-acquisition information was particularly important for major acquisitions involving significant investment;

(b) Members did not think that segment information under IFRS 8 *Operating Segments* was sufficient to assess the success of an acquisition;

(c) Members generally agreed that post-acquisition performance information could be based on how management assess the achievement of the key objectives for internal reporting performances, as it will be hard to develop a 'fit-for-all' set of requirements.

Feedback from the GPF

16 GPF members did not support the IASB staff proposals for the following reasons:

(a) It would not be feasible to provide quantitative information relating to goodwill because the acquisition price is influenced by a number of factors and the success of an acquisition is not generally monitored using quantitative factors;

(b) It was difficult to quantify the expected synergies especially for strategic acquisitions;

(c) Some of the information being requested is commercially sensitive;

(d) Where integration of the acquired business occurs, it is difficult to track the subsequent performance of the acquisition on a stand-alone basis; monitoring focuses on the updated target for the combined business rather than on the acquired business;

(e) As the business strategy may change over time, continuing to hold management accountable for its acquisition date strategy may not be meaningful.

Question for EFRAG TEG/CFSS members

17 Do you have any advice on the issues discussed by CMAC and GPF?

Objective B – Amortisation of goodwill

18 The IASB had decided not to pursue the headroom approach for cost-benefits reasons. This meant that the issue with the goodwill number would remain when it did not reflect a failed acquisition or did not reflect impairment because it was shielded by internally generated goodwill. Consequently, an impairment loss of goodwill might be recognised too late; or the carrying amount of goodwill might remain on the statement of financial position indefinitely.

19 There was a question about whether the objective of subsequent accounting for goodwill was to 'reduce the carrying amount of goodwill to zero' as the benefits from the business combination are consumed. If so, amortisation could be a pragmatic

and easy solution because it is the most simple and cost-effective way to try to achieve this objective.

20 Other arguments for amortisation of goodwill noted by the IASB staff are:

(a) Over time, the original acquired goodwill may be replaced by the creation of internally generated goodwill;

(b) Allocating the cost of the acquired goodwill over the time periods in which it is consumed.

21 The IASB staff noted that if the amortisation of goodwill were to be reintroduced, a company would need to determine the useful life and pattern of consumption for goodwill in a manner that reflects the economics of a business combination, which could be difficult. There is also a question of whether indefinite-lived intangible assets should be amortised.

EFRAG Secretariat observations

22 The EFRAG Secretariat agree that it is important to develop clear disclosure objectives before adding more disclosures to IFRS 3 to avoid duplication and ensure the disclosures have a clear purpose. This could mean that some of the current disclosures might need to be replaced or made clearer.

23 In July 2014, a Research Group from the European Financial Reporting Advisory Group (EFRAG), the Organismo Italiano di Contabilità (OIC), and the Accounting Standards Board of Japan (ASBJ) (collectively, the EFRAG/OIC/ASBJ Research Group) published a discussion paper (the DP): "*Should goodwill still not be amortised? – Accounting and Disclosure for goodwill'*.

24 The DP, among the other things, suggested a number of possible new disclosures about impairment testing for goodwill that focused on user needs and would provide information to assist users to:

(a) Understand the robustness of the modelling and the entity's assumptions;

(b) Confirm the reasonableness of the entity's past assumptions;

(c) Predict future goodwill impairment.

25 Respondents provided mixed views on the proposed disclosures. Some considered that there was room for improvement, while others did not. Nonetheless, respondents emphasised that any additional disclosure requirements should be considered in the context of overall amount of disclosure requirements, which are already considered extensive.

26 The DP also suggested the reintroduction of amortisation of goodwill. Most respondents to the DP agreed that the impairment-only model for acquired goodwill did not provide the most appropriate solution for subsequent measurement of goodwill. These respondents agreed that amortisation of goodwill should be reintroduced if it could reasonably reflect the consumption of the economic resources acquired in the business combination and allocate the costs of acquired goodwill to the periods it was consumed.

27 Nonetheless, these respondents provided mixed views on whether the IASB should indicate a maximum amortisation period. Some acknowledged the subjectivity and high level of judgement in determining the useful life of goodwill. However, they believed that the level of subjectivity and judgement was not higher than that in the impairment test. In general, respondents who supported the amortisation of goodwill considered that the IASB should develop guidance to help preparers determine the useful life of the acquired goodwill.

28 In contrast, a minority of respondents, mostly users, were supportive of the current impairment-only approach. These respondents explained that the amortisation

model did not provide relevant information and would not be beneficial to users of financial statements.

Questions for EFRAG TEG/CFSS members

29 Do you agree that the objective of subsequent accounting for acquired goodwill should be to reduce the carrying amount of acquired goodwill to zero as the benefits from the business combination are consumed? Why or why not?

30 Do you think that the carrying amount of goodwill becomes less decision-useful if it reflects some internally generated goodwill rather than only the original acquired goodwill?

31 Do you think amortisation of goodwill is the best way to achieve an objective of reducing the carrying amount of goodwill to zero?

32 Do you think it is possible to determine the useful life of goodwill and consumption pattern of goodwill in a way that reflects the economics of the business combination?

33 What do you think the useful life of the goodwill is? (eg pay-back period, the period over which the intangible assets are consumed, etc).

Other IASB staff disclosure ideas

34 To help investors remove the effects of goodwill and specified amortisation charges from a company's results, the IASB staff are considering the following further disclosure ideas:

(a) Disclose the amount of equity an entity would report if it did not recognise:

(i) Goodwill;

(ii) Those acquired intangible assets that would not have been recognised if they had been internally generated.

(b) Disclose the profit or loss an entity would report without amortisation and without any impairment losses on those intangible assets and goodwill.

35 The IASB staff noted the following pros and cons to the disclosures above. The pros include:

(a) Provides information for users to better compare between entities growing organically and those growing through acquisitions;

(b) Provides disclosure of the amount of a company's equity resulting from recognising goodwill;

(c) Does not add significant costs to preparers.

36 However, this information might already be available to investors through other means and could be perceived as being excessive.

Question for EFRAG TEG/CFSS members

37 Do you have any other comments on the other disclosure ideas or alternative suggestions you would like the IASB to consider?