IASB Research project Goodwill and Impairment Project Update

Objective

1 The objective of this paper is to provide an update on the IASB research project *Goodwill and Impairment* ('the Project').

Project objectives and background

2 The Project responds to concerns reported during the IASB's post-implementation review (PIR) of IFRS 3 *Business Combinations*. During the course of the project, the IASB considered a number of ways to address the 'too little too late' goodwill impairment issue, and how it could improve the disclosures for business combinations.

3 EFRAG has already contributed to the PIR and to the debate:

(a) In July 2014, EFRAG together with the Accounting Standard Board of Japan (ASBJ) and the Italian Standard Setter (OIC), published a Discussion Series Paper *Should Goodwill still not be amortised? – Accounting and Disclosure for Goodwill* ('July 2014 DP'). It was concluded by the Research Group that the reintroduction of goodwill amortisation would be appropriate, because it reasonably reflects the consumption of the economic resource acquired in the business combination over time, and can be applied in a way that achieves an adequate level of verifiability and reliability. In addition, the Research Group concluded that there was a room for improvement in the disclosure requirements for the impairment test.

(b) EFRAG's Discussion Paper *Goodwill Impairment Test: Can It Be Improved?* issued in June 2017 ('June 2017 EFRAG DP') suggested a "Step Zero", similar to US GAAP requirements, that would allow an entity to perform a qualitative assessment of the likelihood of an impairment loss. An entity would not be required to determine the recoverable amount when, and only when, the likelihood of an impairment is assessed to be remote. In addition, EFRAG suggested to allow the inclusion of cash flows from future restructurings or future enhancements in the calculation of value in use. Finally, EFRAG suggested that the requirements should be changed to allow entities to choose between a pre-tax or post-tax calculation of value in use.

4 According with the feedback received in the PIR, the IASB has tentatively decided to clarify the project objectives as follows:

(a) Objective A - Exploring whether to simplify the accounting for goodwill by permitting an indicator-only approach to determine when an impairment test is required; and/or reintroducing amortisation of goodwill;

(b) Objective B - Exploring whether to improve the calculation of value in use by permitting cash flow projections to include future restructurings and future enhancements to an asset; and the use of post-tax inputs in the calculation of value in use; and

(c) Objective C - Identifying disclosures to enable investors to assess management's rationale for the business combination; and whether the subsequent performance of the acquired business, or combined business, meets expectations set at the acquisition date.

5 Appendix 1 provides a summary of the IASB staff recommendations and the IASB's preliminary views on these recommendations.

6 The IASB's discussion paper is expected by February 2020 with a proposed comment period of 180 days.

7 The following sections describe the IASB's tentative decisions on the topics related to the three objectives mentioned in paragraph 3 and the input received from EFRAG TEG and its working groups.

8 The last section includes a short summary of the activities of the FASB in the area.

Indicator only approach

9 In relation to Objective A, the IASB has tentatively decided to propose to:

(a) remove the requirement to carry out an annual quantitative impairment test for goodwill when no indicator indicates the existence of an impairment; and

(b) apply the same relief as for goodwill for intangible assets with indefinite useful lives and for intangible assets not yet available for use.

10 Although this could result in a limited loss of information and a less robust impairment test, the IASB considered that this would be outweighed by the cost-savings for preparers and result in a uniform impairment model in IAS 36. This would in the IASB's view help to achieve the objective of simplifying the accounting for goodwill.

11 For similar reasons the IASB decided to extend this relief to intangible assets with indefinite useful lives and intangible assets not yet available for use. In the IASB's view this approach will:

(a) remove the difference in frequency of impairment tests between identifiable and unidentifiable intangible assets (including goodwill);

(b) reduce scope for accounting arbitrage when different impairment models applied to goodwill and other types of intangible assets; and

(c) ensure the consistent accounting treatment between intangible assets not yet available for use and tangible fixed assets under development (indication based only impairment test for both categories).

12 Possible indicators, in addition to those already included in IAS 36[1] could be introduced. These include:

(a) a failure to meet the key objectives of the acquisition;

[1] Paragraph 12 requires an entity to consider, as a minimum, the following indications that an asset may be impaired: external sources of information (observable indications; significant changes with an adverse effect on the entity that have taken place or will take place in the near future, in the technological market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated; changes in interest rates and similar that are likely to affect the discount rate used in calculating an asset's value in use and decrease the recoverable amount materially; or the carrying amount of the net assets of the entity is more than its market capitalization), internal sources of information (obsolescence or physical damage; changes with an adverse effect in the manner an asset is used or will be used in the near future; or evidence from internal reporting that the economic performance of an asset is, or will be worse than expected) and dividend from a subsidiary, joint venture or associate (the carrying amount of the investment exceeds the carrying amounts in the consolidated financial statements of the investee's net asset; or the dividend exceeds the total comprehensive income of the subsidiary, joint venture or associate in the period the dividend is declared).

(b) indicators of impairment suggested or used by other bodies, such as EFRAG and the FASB. They include, but are not limited, to macroeconomic and entity specific conditions, such as observable prices for CGU, evolution of entity actual earnings versus budget, cost factors and changes in management.

EFRAG discussions

13 The EFRAG User Panel has expressed mixed views on the indicator-only approach.

(a) Some members supported the indicator-only impairment model with a robust list of indicators. One member noted that whether acquisitions were living up to expectations could be determined from other available information. However, another member thought that this relied on the disclosures required by the IASB to obtain the right information to reveal impairments.

(b) Other members highlighted that goodwill impairment had been recognised too little and too late. Without annual impairments, they did not think the problem would be solved.

14 Similarly, EFRAG TEG members have expressed mixed views. Nevertheless, many EFRAG TEG members support an indicator approach if it would be combined with amortisation. However, some of these EFRAG TEG members were not convinced that in practice companies would no longer need to perform an impairment calculation to justify that there would be no indications of goodwill impairment. Auditors would ask for justification; and one member indicated that users would lose information on governance and stewardship of capital employed with no mandatory annual impairment test.

Amortisation of goodwill

15 In relation to the reintroduction of goodwill impairment in Objective A, the IASB staff has concluded (in an analysis for the June 2019 IASB meeting) that neither the impairment-only model nor the amortisation approach produces a perfect answer and stakeholder preferences will depend on which arguments they give more weight to. For instance, some will argue that the impairment-only model risks mislabelling consumption as impairment losses; while others will argue that amortisation risks pre-empting impairment losses and mislabelling them as consumption. Overall, the IASB staff concluded that a desire to reduce the carrying amount of goodwill is not strong enough to reintroduce amortisation.

16 There were mixed views from IASB members on this point, with only a slight majority (8/14) not supporting the reintroduction of amortisation of goodwill. Given the mixed views, the forthcoming IASB discussion paper is likely to discuss whether goodwill should be amortised.

EFRAG discussions

17 The EFRAG User Panel has expressed mixed views on whether goodwill should be amortised.

18 Also, EFRAG Academic Panel members discussed this matter. Some of the arguments presented in favour of amortisation combined with impairment were:

(a) Studies showed that impairments happen too late and often in relation to a management change. The latter indicates that it was used opportunistically.

(b) Amortisation over an arbitrary period (5-10 years) would be relatively uncostly and information about goodwill is anyway not particularly useful and it is complicated to allocate goodwill to CGU.

(c) Although amortisation of goodwill would not reflect a decline in value of goodwill, it could match the cost of the acquisition with the related benefits.

(d) If users do not like the amortisation expense reported in financial statements, the expenses can easily be removed just for doing their estimations.

Some of the arguments presented in favour of an impairment only model were:

(a) Amortisation is arbitrary and information about goodwill amortisation is not value relevant.

(b) Goodwill impairments are followed by significant stock market reactions. This indicate that the information is useful.

(c) Literature shows that there is a strong association between equity value and goodwill.

19 EFRAG TEG members expressed sympathy for amortisation from a practical point of view but recognises that it has no strong conceptual basis. In their view, goodwill 'does not last forever'. One member has indicated that amortisation would be useful in case goodwill was considered a wasting asset and thus did not have a perpetual life.

Future restructuring and future enhancements in the calculation of value in use

20 In relation to Objective B, the IASB's preliminary view (reached at its June 2019 meeting) is that it should be allowed to take into consideration future enhancements in the estimation of future cash flows in the calculation of value in use. Consultations with preparers has shown that they do not support the existing restriction on doing so, as it causes cost and complexity. Another argument in favour of removing the restriction is that it could eliminate an inconsistency in IAS 36 in the sense that it would capture within the value in use the cash flows that will arise from any existing potential to restructure or enhance an existing asset (or CGU) rather than ignoring this potential, and align with the way restructuring cash flows are considered when determining fair value.

EFRAG discussions

21 EFRAG User Panel members have generally supported allowing future restructuring and future enhancement in the estimation of future cash flows in the calculation of value in use. This is also the case for EFRAG TEG members. However, some EFRAG TEG members are of the view that this could increase the use of unjustifiable optimistic inputs and therefore create a potential for earnings management. If it should be possible to include cash flows arising from a future restructuring, it would therefore be necessary to develop guidance on when to include restructuring cash flows in the calculation.

Post-tax inputs in the calculation of value in use

22 The IASB has (at its June 2019 meeting), tentatively decided to:

(a) remove the explicit requirement to use pre-tax inputs and pre-tax discount rate to calculate value in use;

(b) require entities to use internally consistent assumptions for cash flows and discount rates; and

(c) disclose the discount rates used in the estimation of value in use.

23 Various stakeholders, including users, have said that a pre-tax discount rate is hard to understand and does not provide useful information because that rate is not observable and is generally not used for valuation purposes. The current value of an asset is regarded and understood as a post-tax measure which is a more directly observable measure. The IASB's tentative decisions thus address this concern. The IASB also assesses that the proposals would reduce the cost of the goodwill impairment test; would provide more useful information; and would make the test

more understandable. In addition, using post-tax discount rate and post inputs would be more consistent with other IFRS Standards.

24 When developing IAS 36 and requiring a pre-tax rate, the IASB observed that using post-tax input without specifying the tax attribute could double-count future tax consequences. However, the IASB Staff considers that the double counting issue can also exist with a pre-tax calculation.

EFRAG discussions

25 The EFRAG User Panel members have generally supported to use a post-tax discount rate and the use of pre-tax inputs in the calculation of value in use. This is also the general view of EFRAG TEG members. However, some TEG members recommends that the IASB develops further guidance to avoid double counting of tax cash flows in estimates of value in use, where the tax cash flows included in the measurement of deferred tax assets or deferred tax liabilities are also included in the recoverable amount of an asset.

Better disclosures for business combinations

26 Users have reported that the disclosures on business combinations are generally boilerplate and insufficient to provide a proper understanding of the rationale of the business combination and its overall success. Accordingly, the IASB has decided (at its June 2019 meeting) that it should develop a proposal:

(a) To improve the disclosure objectives of IFRS 3 with the aim of helping users of financial statements assess the performance of an acquired business after a business combination;

(b) To require entities to disclose information intended to indicate whether the objectives of a business combination are being achieved; and

(c) To require entities to disclose:

(i) the amount, or range of amounts, of expected synergies;

(ii) any liabilities arising from financing activities and pension obligations assumed; and

(iii) an acquiree's revenue, operating profit or loss before acquisition-related transaction and integration costs, and cash flow from operating activities, after the acquisition date.

(d) To require disclosure of the information the chief operating decision maker (as defined by IFRS 8 *Operating Segments*) uses to assess the extent to which the objectives of a business combination are being achieved;

27 Some of this information might require that an entity track an acquisition's performance against management-designated targets for several years and could create additional cost.

EFRAG discussions

28 EFRAG User Panel members have expressed mixed views on the usefulness of the proposed disclosures, confidentiality of the information about the expected synergies and the reliability of the quantitative information required to be provided. The members of the EFRAG Academic Panel have generally supported enhancing the existing disclosures. More information is necessary about how the value of goodwill and how it is preserved. EFRAG TEG has not yet discussed disclosures.

IFASS meeting roundtable discussion

29 IFASS members discussed this topic in the meeting in September. The discussion focused on two core questions:

(a) whether acquired goodwill is a diminishing asset; and

(b) whether a relevant amortisation period can be determined.

30 The views from the IFASS participants were mixed. However, most participants seemed to agree that goodwill, or some components of goodwill, meet the definition of an asset. Some participants considered acquired goodwill should be amortised because it is gradually replaced by internally generated goodwill. On the other hand, some participants questioned whether goodwill is consumed in its entirety and loses value over time. They also highlighted the difficulties in distinguishing between acquired goodwill and internally generated goodwill, and hence determining whether acquired goodwill is a diminishing asset.

31 As to a relevant amortisation period, some participants noted that a cost allocation method, similar to fixed assets, should be applied to acquired goodwill, and amortisation provides useful information about future cash flows when re-investment is required. Participants made the following suggestions for determining the amortisation period:

(a) useful life of the identifiable underlying assets acquired, for example on a relative basis;

(b) industry and business/product life cycles for the reporting entity, and

(c) mandating a uniform amortisation period for simplicity.

32 Suggestions also included introducing amortisation as an option or applying an impairment-only approach for goodwill in the first few years after the acquisition (e.g. 5 years) when the impairment information is most useful for the users, then moving to an amortisation model to reflect the difficulties in conducting a robust impairment test as time passes. Some participants also suggested progressive or increasing amortisation over time to reflect the sharp decline in value after acquisition.

FASB invitation to comment (ITC) - Identifiable Intangible Assets and Subsequent Accounting for Goodwill

33 In July 2019, the FASB published the Invitation to Comment (ITC) *Identifiable Intangible Assets and Subsequent Accounting for Goodwill* with comments requested by 7 October 2019. The FASB seeks feedback on amortising goodwill and modifying the goodwill impairment test.

34 The FASB split its ITC into 4 main sections:

(a) Section 1: Whether to change the subsequent accounting for goodwill;

(b) Section 2: Whether to modify the recognition of intangible assets in a business combination;

(c) Section 3: Whether to add or change disclosures about goodwill and intangible assets; and

(d) Section 4: Comparability and scope.

35 In its ITC, the FASB discusses the possibility to remove the requirement to assess goodwill at least annually and only require that an entity assesses goodwill for impairment following an event or change in circumstances that indicates that goodwill may be impaired (that is, following a “triggering event”). However, it notes that some stakeholders suggested that removing the requirement to assess goodwill for impairment at least annually would be appropriate only if coupled with goodwill amortisation because amortisation likely would reduce the need to impair goodwill. The FASB is seeking stakeholders’ views on the extent to which they support (or oppose) removing the requirement to assess goodwill (qualitatively or quantitatively) for impairment at least annually.

36 In addition, in its ITC, the FASB discusses several approaches to determining the goodwill amortisation period.

37 A summary of the FASB's ITC was provided for the November 2019 TEG meeting and is attached as background paper for this meeting.

38 The FASB has received mixed views on its ITC. Some users have stated that although amortising goodwill is practical, it may eliminate decision-useful information, lead to complexity and/or inconsistency in application, or not properly capture the time period in which synergies related to the acquisition have been realised, depending on the amortisation period allowed and how that is determined.

39 However, other stakeholders have commented that if testing goodwill for impairment is burdensome and costly, an accounting change may be warranted. Some stakeholders support amortisation of goodwill over a default period of 10 years. Some users appear indifferent as they disregard the information on impairments (and amortisation if adopted) in their analyses (see FASB paper 19-11-15).

Next steps

40 In January EFRAG TEG will complete the first round of discussions on the tentative decisions, covering the topic of the disclosure about business combinations and will discuss the EFRAG outreach approach.

Questions for EFRAG Board members

41 Does the EFRAG Board have any comments on this update?

Agenda Papers

42 In addition to this paper the following agenda papers have been provided for the session:

(a) Agenda paper 09-02 *Project update – Presentation on Goodwill and Impairment – EFRAG Board 19.12.18* (for background only); and

(b) Agenda paper 09-03 *Summary of FASB's Invitation to Comment – EFRAG Board 19.12.18 (*for background only).

Appendix 1: IASB staff's recommendations and IASB's tentative decisions

Introduction

43 The following table summarises the IASB staff's recommendation for the IASB's preliminary views to be included in the forthcoming discussion paper against the overall aims of the project objectives. The table also includes the IASB tentative/indicative decisions.

Idea being explored	IASB staff's recommendation	Aims achieved	Aims hindered	IASB's indicative decision
Reintroduction of amortisation	Retain an impairment-only model and not reintroduce amortisation of goodwill.	• Better information from impairment test retained. • Purpose of impairment test clarified for stakeholders. • Avoids disruption when there is, at best, a marginal case for change.	• It is not possible to amend the impairment test to target acquired goodwill in isolation. • Consumption may be mislabelled as impairment loss.	A close majority of the IASB members (8/14) agreed to retain impairment-only approach. However, they agreed to explore in the discussion paper both approaches providing arguments in favour and against.
Relief from the mandatory annual impairment test	Remove the requirement for a mandatory annual quantitative test of goodwill and some intangible assets.	• Reduces the costs associated with the impairment test (performing test/providing disclosures).	• Change in frequency of performing test should result in limited reduction in robustness of test. • Loss of disclosures generated by goodwill impairment tests.	IASB agreed moving to an indictor-only approach requiring impairment testing of goodwill only when there are indicators of possible impairment.

Idea being explored	IASB staff's recommendation	Aims achieved	Aims hindered	IASB's indicative decision
Removing restrictions on cash flow projection used in calculating value in use	Permit the inclusion of cash flows from future restructurings or future enhancements in estimates of value in use.	• Reduces cost and complexity of performing test. • Improves effectiveness as cash flow forecasts used are not just produced for financial reporting purposes.	Might impact robustness of test by permitting inclusion of unjustifiably optimistic cash flows.	IASB agreed to allow the inclusion of cash flows from future restructurings or future enhancements in the calculation of value in use.
Removing requirement to use pre-tax inputs in calculating value in use	Permit the use of post-tax inputs and a post-tax discount rate to estimate value in use.	• Permits disclosure of post-tax discount rates, which are likely to be more useful information. • Makes test more understandable.	None identified by the IASB staff.	IASB agreed to remove the explicit requirement to use pre-tax inputs to estimate value in use.
Better disclosures for a business combination	Require disclosures of subsequent performance of the acquired business, and targeted improvements to existing requirements.	• Provides better information for users. • Addresses feedback from PIR of IFRS 3 that users need information on subsequent performance of acquired business.	• Additional costs for preparers. • Additional costs limited by use of chief operating decision maker threshold and removing pro forma information requirement, but less information provided as a consequence. • Further deletions could offset the additional costs.	IASB supported the disclosures recommended by the IASB staff.