Business Combinations: Disclosures, Goodwill and Impairment Update on FASB project *Identifiable Intangible Assets and the Subsequent Accounting for Goodwill*

Objective

1 The objective of this agenda paper is to provide EFRAG Board an update on the latest developments on the FASB project *Identifiable Intangible Assets and the Subsequent Accounting for Goodwill*.

2 The IASB and the FASB have been monitoring each other's work and having regular joint meetings to discuss project summaries and progress reports. The FASB's project is in an active project phase while the IASB's project is in a research phase.

Background

3 In the Post-Implementation Review of FASB Statement No. 141, *Business Combinations* issued in 2013, the FASB described the concerns of its stakeholders on the cost to perform the goodwill impairment test.

4 To date, the FASB has issued two Updates that aim to reduce cost for public business entities (PBEs) by simplifying the goodwill impairment test.

(a) **Update 2011-08** offers an optional screen (referred to as "Step 0") that allows an entity to first assess qualitative factors to determine whether it is necessary to perform the quantitative impairment test. The amendments in Update 2011-08 are intended to reduce cost by lessening the need to perform a quantitative goodwill impairment test when it is clear that an impairment loss is unlikely.

(b) **Update 2017-04** removes Step 2 of the goodwill impairment test. Step 2 involves estimating the implied fair value of goodwill, which requires that an entity allocate the estimated fair value of a reporting unit to individual assets and liabilities within the reporting unit.

5 Despite the issuance of Updates 2011-08 and 2017-04, the FASB continues to receive feedback from stakeholders that the cost of the impairment model is not justified by its perceived benefits.

6 In October 2018, the FASB decided to add to its technical agenda a broad project to revisit the subsequent accounting for goodwill and the accounting for certain identifiable intangible assets, in order to address stakeholder concerns on the costs and benefits of the subsequent accounting for goodwill.

FASB project *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*

7 On 9 July 2019, the FASB issued an Invitation to Comment *Identifiable Intangible Assets and Subsequent Accounting for Goodwill* with a 90-days comment period

ending on 7 October 2019, to obtain formal input from stakeholders (focusing on public business entities) on:

(a) the subsequent accounting for goodwill;

(b) the accounting for certain identifiable intangible assets; and

(c) the scope of the project on those topics.

8 The FASB has received 101 comment letters, from numerous industries represented by mostly preparers, practitioners, valuation professionals, auditors, academics, etc. A summary of the comment letters received by the FASB can be found here. The FASB also received feedback in outreach events, interviews, surveys and public roundtables.

9 The FASB staff provided a summary of the feedback received from their respondents (a summary of the feedback received can be found here). The feedback received was often contingent on other changes and many commented on consequential considerations beyond goodwill and intangible assets. The FASB summarised the responses as follows:

	Impairment	**Amortisation**
Conceptual	Many valuation professionals expressed that goodwill is not a wasting asset but represents the going-concern assertion and projected into perpetuity.	Amortising goodwill better reflects an entity's profit or loss after a business combination, net of the cost of investment. Other stakeholders state that goodwill is largely a wasting asset being carried on the books when cash flows may have already been realised. No new conceptual evidence has been received.
Practical	Some respondents stated benefits outweigh the costs because processes and controls are currently working effectively. GWI informational utility is lost after the first few years post-acquisition.	Some respondents stated that significant costs remain even after the recent simplification efforts of Updates 2011-08 and 2017-04. The current impairment model has limited information utility because GWI is more often lagging and confirmatory. Old goodwill is hung up on the balance sheet and is not representative of the acquired goodwill.

10 Some users favour the goodwill impairment test as it is considered useful to assess management stewardship and the performance of an acquisition. Some users agree with the previous statement, but are open to change since the information necessary to assess management stewardship and the performance of an acquisition can also be assessed through the margins and the cash flows. Other users are indifferent as both impairment expenses as well as amortisation expenses are adjusted in non-GAAP measures. Nevertheless, the consistent view amongst users is that information from the impairment test becomes significantly less useful over time.

11 Most respondents did not agree with any optionality to choose between impairment only and amortisation as comparability is considered important. Some stated that comparability is not an issue unless an entity has a public company exit strategy. Others stated that lack of comparability increases costs for certain users and those entities who may be required to unwind private company alternatives.

12 Many respondents did not comment on the topic relating to the convergence between the USGAAP and IFRS. Others support maintaining convergence because a difference in rules increases costs to users in adjusting for comparability and to preparers in complying with two sets of standards.

FASB latest directions

13 In the 15 July 2020 meeting, the FASB Board asked the staff to explore adding amortisation to the goodwill impairment model, including the amortisation method and period, amongst other requests (refer to slide 7, linked in paragraph **Error! Reference source not found.**). The FASB is considering the following four methods to determine the amortisation period (expressing from a) till d) an increasing information value and increasing cost):

(a) **Default only**: Entities would use the default period provided in the guidance.

(b) **Default with option to deviate**: Entities would follow the default period provided but would be able to deviate with justification based on the facts and circumstances of the acquisition.

(c) **Management judgment then default**: Entities would first attempt to determine the amortisation period. If the amortisation period cannot be reliably determined, then the entity would use the default.

(d) **Management judgment only**: Management would determine the amortisation period based on the facts or circumstances of the acquisition.

14 The FASB Board meeting planned for 18 November 2020 was postponed as the staff needs more time to process the information received. It is expected to be planned in December 2020.

FASB - IASB Joint Education Meeting on 19 November 2020

Subsequent accounting for goodwill

15 The FASB Board members asked whether the IASB expected any differences in practice between the outcome of the value in use (‘VIU’) calculation and the fair value less costs of disposal (‘FVLCD’). The IASB staff explained that the current VIU calculation and the FVLCD have theoretical differences, but when the restrictions on cash flows relating to uncommitted future restructurings and asset enhancements are removed, the two methods will be aligned in practice. This is confirmed by feedback received from stakeholders to consider only one method to determine the recoverable amount.

16 The IASB Board members were interested in and asked questions on the conceptual basis for the amortisation approach on goodwill and the method for determining the amortisation period. The IASB Board members were also interested if convergence between the USGAAP and IFRS Standards was considered important amongst stakeholders of the FASB.

17 The FASB staff responded that an amortisation approach would not be based on a strong conceptual view as there is no conclusion whether goodwill is a wasting asset or not. However, at the same time the goodwill amount on the balance sheets of companies is increasing, is aged and the information value of impairment tests becomes significantly lower on the longer term. Additionally, the cost-benefit and current shortcomings of the impairment test are taken into account.

18 The FASB staff explained that the following is considered in order to determine a default period for amortisation:

(a) Historical data on the average life cycle of businesses;

(b) The current principles around amortisation of intangible assets and compared to the developments of goodwill;

(c) A maximum number for the default amortisation period, but not developed further as it limits the information utility only below the default period.

19 The FASB staff noted that the unit of account for amortisation is the acquisition level while the unit of account for the impairment is at a higher level, for example the CGU or reporting entity level.

20 The FASB Board members further noted that the accounting for and presentation of any amortisation expense in the income statement or through other comprehensive income (OCI) still needs to be considered; although the accounting through OCI is not expected to get much support. It was explained that both the current impairment expense as well as any amortisation expense are both judgmental and arguably both distort the income statement. The only difference is the timing of the amortisation expense versus the impairment expense. The fact that investors would take-out these expenses from the income statement is not an issue as the expenses are non-cash. The FASB Board members argued that conceptually, since the company paid for the goodwill, at some point it should be impacting the income statement, as the payment relates to future earnings.

21 The IASB Board members emphasised that amortising based on an arbitrary period will result in expensing the premium paid during an acquisition without holding the management to account for their decisions.

22 Furthermore, both the IASB and the FASB received feedback from some stakeholders that the amortisation approach would be preferred only if there is convergence between the USGAAP and IFRS Standards.

Disclosures on acquisitions

23 The FASB Board members were interested in the preliminary views of the IASB relating to the requirement to disclose the metrics that management (the Chief Operating Decision Maker) will use to monitor whether the objectives of the acquisition are met. The FASB Board members asked whether:

(a) the scope of the disclosure requirements should be extended (e.g. all significant events);

(b) companies would encounter difficulties tracking an acquisition when it is subsequently integrated or would need to disclose the metrics in perpetuity when the acquired business is not integrated at all;

(c) the Chief Operating Decision Maker ('CODM')-level is the right level; and

(d) the impairment test could be used to monitor subsequent performance of an acquisition.

24 The IASB staff responded that the scope of the IASB's proposed disclosures included in its DP only considered business combinations because it was based on the feedback received from stakeholders on the post-implementation review of IFRS 3 *Business Combinations*. Some stakeholders commented that the scope could also include asset acquisitions.

25 The IASB staff noted that, in accordance with their proposals, companies would need to disclose the information about business combinations as long as management continued to monitor the metrics against the objectives determined at acquisition date when the acquired business was not integrated. This is because it is easier to track an acquired business that is not fully integrated in the acquirer's business. Nevertheless, in the DP it is assumed that companies that acquire a

business with the intention to integrate will set their metrics based on the combined business instead of the acquired business as such.

26 The IASB Board members also noted that the decision for the CODM-level is a concept that stakeholders understand. Using the materiality threshold could lead to an overload of information, in particular at companies with many acquisitions.

27 The IASB Board members further noted that the impairment test is often not useful to assess management stewardship and monitor the performance of an acquisition because of, for example, pre-acquisition headroom that may shield the goodwill from impairment. The IASB Board members concluded that it is difficult to improve the impairment test, therefore it is more efficient and effective to provide information through disclosures. It was noted that the majority of investors agree that providing the IASB's proposed disclosures will help them to hold management to account for its decisions and will actually lead to better decisions by management.

28 Nonetheless, the IASB Board members acknowledged that preparers have concerns regarding the practicability of tracking the information, both operational and financial, and the reliability of the information relating to acquisitions in fast moving business environments. The IASB Board members also pointed out that some stakeholders did not agree at all with the proposed disclosure requirements as they considered that the proposals lacked a conceptual basis or they should be included in the management report.

Recognition of identifiable intangible assets

29 The FASB Board members confirmed that their current research project on intangible assets focusses on the disclosure on intangibles but might be expanded to also the accounting for intangibles. However, this research project is separate from the project on accounting for goodwill.

30 The IASB Board members noted that nowadays the largest companies have more important intangible assets and the investor analysis focusses on income and cash flows compared to companies with a focus on tangible assets where investors have a main focus on the balance sheet. Most investors believe that it is not possible to recognise and measure these intangibles reliably and request more disclosures instead. However, it is not simple to design a Standard that can be applied to all different kinds of intangibles.

Next Steps of the FASB project

31 The next steps of the project are:

(a) Next FASB meeting (December 2020)

(b) Monitor IASB's discussion paper (2020)

(c) Monitor CFA Institute's Survey (2020)

Questions for EFRAG Board

32 Does EFRAG Board have any questions?