UK Endorsement Board

Research project

Subsequent Measurement of Goodwill: A Hybrid Model

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September 2022

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Delivery of UKEB's statutory remit to date

1. **Adopt new or amended IFRS for use within the UK when they meet statutory criteria**

→

Key achievements to date

- Adoption of IFRS 17 *Insurance Contracts*
- Adoption of 6 other Amendments

2. **Influence the development of global IFRS**

→

Key achievements to date

- 25 public consultations
- 17 final comment letters to IASB
- Established advisory groups
- Contributed to international debate
- Research projects underway
  - Intangibles
  - Subsequent measurement of goodwill

The UKEB's strategic plan is set out in its 2022/3 regulatory strategy and budget

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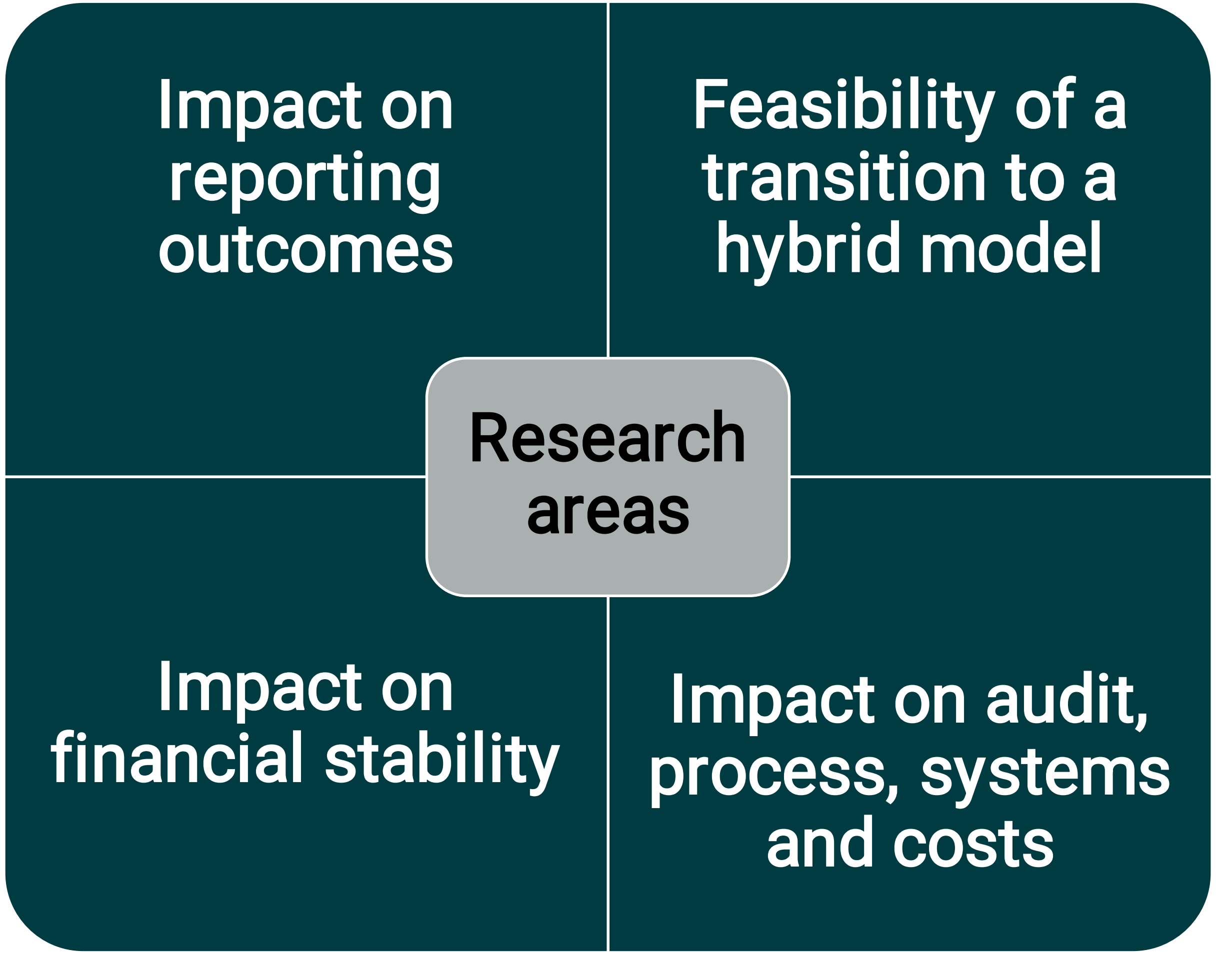
Research objective

The research objective is to contribute to the ongoing international debate on the subsequent measurement of goodwill by exploring the practical implications of a potential transition to a hybrid model*



* Hybrid model based on UK GAAP – annual amortisation charge combined with indicator-only impairment testing and supporting disclosures

UKEB's goodwill research project

Desk based research
Q4 2021

Investor outreach
Q1 2022

Field testing
Q1 – Q2 2022

Roundtables
Q2 2022

Investor outreach
Q2 2022

Publish research paper
September 2022

Evidence was gathered through:

Desk based research

Review of application of UK GAAP

UK IFRS preparer survey

Field testing

Roundtables

Investor outreach

Context: prevalence and size of goodwill in UK

228 FTSE 350 companies reported goodwill in 2021

£397 bn carrying amount of goodwill for the FTSE 350 in 2021

78% goodwill balance sheet growth since 2005 (from £223bn to £397bn)

18%: goodwill as a percentage of total assets for FTSE 350 entities reporting goodwill in 2021

63%: goodwill as a percentage of net assets for FTSE 350 entities reporting goodwill in 2021

On average goodwill impairments represented 2.85% of the opening carrying amount of goodwill each year over the 17 years since 2005

Decline in level of impairments from 5% to 2% of the carrying amount of goodwill between 2009 and 2021 (five year rolling average basis)

Age profile of goodwill – UK listed companies

Because of changes in UK financial reporting regimes from 1985 to 2005, UK IFRS reporters' current goodwill balances could include amounts recognised under:

FRS 10 Goodwill and Intangible Assets (1998 – 2004)

- Capitalised and amortised
- Capitalised and subject to annual impairment review

SSAP 22 Accounting for Goodwill (1985 – 1997)

- Capitalised and amortised
- Written off directly to reserves

…. and could be at least 17 years old.

Significant challenges in attempting to obtain indicative information on age of goodwill carried in 2021 balance sheets.

Disclosures insufficient to allow an aged analysis or to allocate impairments to acquisitions.

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Subsequent measurement – a hybrid model

Under the hybrid model tested in the research:

Annual amortisation based on an estimate of goodwill's useful life determined by management

combined with

Impairment testing only when impairment is indicated

and

Disclosures to increase management accountability for acquisitions

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Research areas and methods

The research on the subsequent measurement of goodwill was undertaken in two phases and focused on four areas, to which various research methodologies were applied

Research areas	Research methods applied
Effect on financial reporting outcomes	Field testing and outreach events
Feasibility of amortising goodwill under a hybrid model	Review of application of a hybrid model under UK GAAP, field testing and outreach events
Effect on financial stability	Preparer survey and desk-based research
Effect on audit, processes, systems and costs	Preparer survey, field testing and outreach

Effect on financial reporting outcomes

Stakeholder views were mixed, but the following financial reporting outcomes were anticipated:

UK IFRS preparer views

- More **faithful representation** of consumption of benefits anticipated by preparers who viewed goodwill as a wasting asset
- **Lower impact** from shielding
- **Relevant** information for investors
- Improved **comparability** with entities which grow organically

UK investor views

- Disclosures would support **accountability for acquisitions**
- **Mixed views** on whether **faithful representation** would be improved, depending on view on whether goodwill is a wasting asset

Practical feasibility of a transition to a hybrid model

Our research indicated that transition to a hybrid model would be practically feasible

Feasibility of estimating useful life

- A range of relevant and specific factors could be used in estimating the useful life.
- UK GAAP review and field test demonstrated that it is feasible to estimate useful life.

Default periods for useful life

- Default periods would partially negate the usefulness of the disclosures.
- Where management cannot reliably determine the useful life, a backstop* may be necessary.

Approach to legacy goodwill

- It would be possible to analyse legacy goodwill by business combination.
- Retrospective application would be preferable on transition as it would provide a more faithful representation.

* A model where, if management is unable to estimate the useful life of goodwill reliably, there is a cap on the period over which goodwill is amortised.

Impact on financial stability

The research did not identify significant impacts on financial stability from a transition to a hybrid model

Compliance with debt covenants	Compliance with market regulations	Tax payments	Management compensation schemes
• Transition would be unlikely to result in non-compliance with debt covenants – most entities able to renegotiate in the event of changes to IFRS.	• No increased risk of non-compliance identified. • Prospective application may lead to increased disclosures about future acquisitions under the Listing Rules.	• Transition would not generally significantly impact tax payable by UK entities – tax liabilities are calculated at individual company level.	• There is generally sufficient time to plan changes to management compensation schemes to allow for any impact from a transition to a hybrid model.

Impact on audit, processes, systems and costs

Research did not identify significant potential impact on audit, processes, systems or costs.

Audit and operational areas

- No significant operational changes anticipated if there were a transition to a hybrid model.
- Minor changes were anticipated for processes and procedures, audit, staff training and investor relations.

Costs

- No significant adverse impacts on costs from a transition to a hybrid model were identified.
- Further work would need to be undertaken to conclude definitively.

Stakeholder feedback on anticipated benefits of a hybrid model

Some of the stakeholders who took part in our research told us they anticipated the following benefits from a hybrid model:

1. More **faithful representation** by reflecting the consumption of benefits (although **not all stakeholders agree** that goodwill is a wasting asset).

2. **Reduced impact of the shielding effect** because the hybrid model would require management tracking and amortisation of goodwill on an acquisition-by-acquisition basis.

3. Improved **comparability** between entities that grow organically and those that grow through acquisition.

4. Disclosure of management assumptions underpinning the estimate of useful life would increase **management accountability for acquisitions.**

5. **Potential cost savings** as impairment testing will be done on an indicator-only basis (**potentially offset** by cost of monitoring useful life of goodwill).

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Conclusions

Context	Stakeholder views from research
1. The debate on goodwill subsequent measurement is ongoing 2. Goodwill is prevalent and significant for UK IFRS reporters today and likely to remain so in future 3. Current disclosures do not provide an analysis of goodwill by age or acquisition	Transition to a hybrid model would be feasible because: 1. A similar model works under UK GAAP 2. Range of relevant factors can be considered in estimating goodwill useful life 3. Legacy goodwill can be accounted for retrospectively on transition 4. Significant impacts on financial stability are not anticipated on transition 5. Significant operational or cost impacts are not anticipated on transition

Some stakeholders who took part in the research anticipate improvements in financial reporting outcomes from a hybrid model, including more faithful representation, improved accountability and better comparability.

Additional resources

1. UKEB website

2. UKEB goodwill research project page

3. Subscribe to our newsletters and alerts by emailing contact@endorsement-board.uk with 'SUBSCRIBE' in the subject line.

Questions?

Thank You

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