IFRS Accounting

Staff paper

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IASB® meeting

Date	**October 2022**
Project	**Goodwill & Impairment**
Topic	**Subsequent accounting for goodwill – Overview of feedback and research**
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Purpose and Structure

1. The purpose of the paper is to remind the International Accounting Board (IASB) of feedback on the IASB's preliminary view to retain the impairment-only model for the subsequent accounting for goodwill. We also provide additional information or evidence and developments since the closure of the comment letter period for the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*.

2. The paper is structured as follows:

    (a) Background (paragraphs 3–10);

    (b) Overview of feedback to the Discussion Paper (paragraphs 11–16); and

    (c) Additional information and recent developments (paragraphs 17–65).

Background

3. The IASB introduced the impairment-only model for the subsequent accounting for goodwill in 2004 when it issued IFRS 3 *Business Combinations*. Previously, IAS 22 *Business Combinations* required entities to amortise goodwill over its useful life, presumed not to exceed 20 years, although entities could rebut that presumption.

4. When the IASB introduced the impairment-only model in 2004, it concluded that:

    (a) it is generally not possible to predict the useful life of goodwill and the pattern in which it diminishes. As a result, the amount of amortisation in any given period can be described as, at best, an arbitrary estimate of the consumption of goodwill during that period.

    (b) straight-line amortisation of goodwill over an arbitrary period fails to provide useful information.

    (c) the impairment test was rigorous and operational. Therefore, more useful information would be provided by not amortising goodwill, but instead testing it for impairment at least annually.

5. In the Post-implementation Review (PIR) of IFRS 3, many stakeholders said there was a time lag between an impairment occurring and the recognition of an impairment loss in an entity's financial statements. There were also many stakeholders that suggested reintroducing amortisation of goodwill.

6. The IASB investigated whether it could design a different impairment test that was significantly more effective at recognising impairment losses on goodwill on a timely basis at a reasonable cost than the impairment test of cash-generating units (CGUs) containing goodwill in IAS 36 *Impairment of Assets*.[1] However, the IASB concluded that doing so was not feasible (see Agenda Paper 18B to the IASB's May 2021 meeting). The IASB then considered whether to propose reintroducing amortisation of goodwill,[2] with the aim of:

   (a) taking some pressure off the impairment test, which may make the impairment test easier and less costly to apply; and

   (b) providing a simple mechanism that targets the acquired goodwill directly and reduces the possibility that the carrying amount of goodwill could be overstated because of management over-optimism or because goodwill is not tested for impairment directly.

7. By a small majority (eight out of 14 IASB members) the IASB reached a preliminary view of retaining the impairment-only model (preliminary view).

8. The IASB accepted that both accounting models for goodwill—an impairment-only model and an amortisation model—have limitations. No impairment test has been identified that can test goodwill directly, and for amortisation it is difficult to estimate the useful life of goodwill and the pattern in which it diminishes.

9. Paragraphs 3.86–3.87 of the Discussion Paper explain:

> 3.86 The topic of accounting for goodwill has always been the subject of strongly held and divergent views. To fulfil its role as a standard-setter, the Board needs to be satisfied that any decisions it makes now will not be reopened again in a few years—frequent changes back and forth between the different approaches would not help any stakeholders.
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> 3.87 In the context of a PIR, the Board will propose changing IFRS requirements only if it has enough information to conclude that a change to the Standard is necessary. The Board will also need to decide that the benefits of such a change would outweigh the cost and disruption that would be caused by changing the requirements again.

10. The IASB requested feedback that provides new practical or conceptual arguments, together with evidence for these arguments and highlighted that simply repeating the well-known arguments for the

[1] The IASB identified two broad reasons for concerns about the possible delay in recognising impairment losses on goodwill: (a) management over-optimism; and (b) shielding.
[2] The reintroduction of amortisation or an amortisation-based model refers to a model that includes amortisation of goodwill and an impairment test.

different views on this topic is unlikely to move the debate forward. In particular, the IASB especially welcomed feedback that would help it understand:

(a) why stakeholders have concerns that recognition of impairment losses on goodwill is not timely, and whether amortisation could and should resolve these concerns; and

(b) what information best helps users of financial statements (users) hold entities' management accountable for business combination decisions at a reasonable cost.

Overview of feedback to the Discussion Paper

11. A detailed analysis of feedback to the Discussion Paper on this topic is provided in Agenda Paper 18C to the IASB's May 2021 meeting and in Agenda Paper 18D to the IASB's July 2021 meeting.

12. Key messages from that feedback were:

(a) stakeholders' views remain mixed. Many respondents agreed with the IASB's preliminary view but many disagreed and suggested reintroducing amortisation of goodwill.

(b) respondents generally did not provide new conceptual arguments or evidence—the arguments and evidence provided were considered by the IASB either when issuing IFRS 3 or during the course of this project in developing the preliminary view (for example, see Agenda Paper 18B to the IASB's June 2019 meeting). However, some respondents said there is new practical evidence since the impairment-only model was introduced in 2004 that the impairment test is not working. These respondents referred to evidence from applying the impairment-only model, and the problems encountered, as new evidence.

(c) most respondents commenting on convergence with US generally accepted accounting principles (US GAAP)[3] said convergence on the subsequent accounting for goodwill was desirable. However, many respondents did not provide a response to the question. Of those respondents that did answer the question,[4] many said, although convergence was preferable, their view did not depend on convergence, or that the IASB should make its decision on the basis of the evidence it has collected rather than solely to maintain convergence.

13. The reasons respondents provided to support their views can be grouped into two broad categories:

(a) Conceptual reasons; and

(b) Practical reasons.

[3] The requirements for accounting for business combination under US GAAP and IFRS Accounting Standards are largely converged. Both adopt an impairment-only model for the subsequent accounting for goodwill (US private and not-for-profit entities can elect to amortise goodwill).

[4] Question 13 of the Discussion Paper asked: 'Do your answers to any of the questions in this Discussion Paper depend on whether the outcome is consistent with US GAAP as it exists today, or as it may be after the FASB's current work? If so, which answers would change and why?

14. The reasons provided by respondents in favour of reintroducing amortisation of goodwill were:

    (a) Conceptual reasons:

        (i) Goodwill is a wasting asset and amortisation would reflect its consumption;

        (ii) Amortisation would prevent the recognition of internally generated goodwill;

        (iii) Entities can reliably estimate the useful life of goodwill;

        (iv) Amortisation would help hold management accountable better than an impairment-only model, by for example, requiring profit to be generated to recover the cost related to goodwill recognised by the amortisation expense; and

        (v) Amortisation would be consistent with the accounting for other tangible and intangible assets which are amortised.

    (b) Practical reasons:

        (i) The impairment test is not working;

        (ii) Goodwill balances are too high;

        (iii) Reintroducing amortisation would resolve concerns that entities do not recognise impairment losses on a timely basis;

        (iv) Amortisation is a simple method that would reduce costs;

        (v) Earnings would be less volatile, helping financial stability, and amortisation would reduce the possibility of procyclical consequences;

        (vi) Amortisation would take pressure off the impairment test because, for example, of the reduced size of potential impairment losses;

        (vii) The limitations of the impairment test mean that it produces information of limited use; and

        (viii) Amortisation removes goodwill from the statement of financial position when the balance is no longer relevant or meaningful.

15. The reasons provided by respondents in favour of retaining the impairment-only model were:

    (a) Conceptual reasons:

        (i) Goodwill is not a wasting asset with a determinable useful life;

        (ii) Impairment losses provide users with more useful information than amortisation would;

        (iii) The useful life of goodwill cannot be estimated reliably; and

        (iv) The impairment-only model helps hold management accountable better than amortisation would.

(b) Practical reasons:

  (i) Reintroducing amortisation would not resolve concerns that entities do not recognise impairment losses on a timely basis;

  (ii) Compelling evidence for a change has not been identified; and

  (iii) Reintroducing amortisation would not significantly reduce cost.

16. There continues to be evidence of divergent and strongly held views. The arguments respondents provided to support either retaining the impairment-only model or reintroducing amortisation are often diametrically opposed—for example, whether goodwill is a wasting asset or not, whether amortisation provides useful information and holds management to account or not.

Additional information and recent developments

17. This section summarises additional information or evidence and recent developments since the feedback on the Discussion Paper on this topic:

(a) Feedback on convergence and developments on FASB project (paragraphs 18–27);

(b) Additional staff research (paragraphs 28–46):

  (i) Estimating the useful life of goodwill (paragraphs 30–41); and

  (ii) Transitioning to an amortisation-based model (paragraphs 42–46); and

(c) Other developments (paragraphs 47–65):

  (i) UK Endorsement Board research report (paragraphs 47–56);

  (ii) Disclosures about business combinations (paragraphs 57–61); and

  (iii) Other (paragraphs 62–65).

Feedback on convergence and developments on FASB project

Feedback on convergence

18. In addition to feedback to the Discussion Paper (see paragraph 12(c)), the importance of maintaining convergence between IFRS Accounting Standards and US GAAP was highlighted by the International Organization of Securities Commissions (IOSCO)'s public statement in February 2021 encouraging the IASB and US Financial Accounting Standards Board (FASB) to work collaboratively together.

19. The topic of convergence was discussed at the June 2021 Accounting Standards Advisory Forum (ASAF) and the November 2021 Capital Markets Advisory Committee (CMAC) meetings.

20. ASAF members that commented said it is important that the standards are converged in respect of whether goodwill is amortised, however, the details of the amortisation model do not need to be identical. In respect of the potential costs of divergence, a few ASAF members said:

(a) entities could incur additional costs when raising capital in different jurisdictions and in explaining differences in the subsequent accounting for goodwill to users; and

(b) users would incur additional costs in adjusting performance measures reported by entities and some users might not be familiar with the detailed accounting requirements.

21. Many CMAC members said divergence was not ideal and they would prefer if the accounting models could remain aligned. However, many CMAC members said they could cope with different accounting models for the subsequent accounting for goodwill. Many CMAC members said they would need additional information to enable them to compare entities using different accounting models for goodwill.

Developments on FASB project

22. The FASB had on their agenda a project—*Identifiable Intangible Assets and Subsequent Accounting for Goodwill*—that covered some similar topics to the IASB's project. The FASB had provided leanings that an entity should amortise goodwill on a straight-line basis over a 10-year default period, although an entity would be able to elect another amortisation period if that could be justified based on facts and circumstances subject to a cap of 25 years.

23. In June 2022, the FASB reviewed the package of leanings provided to date, considered their holistic effect on benefits and costs, and decided to deprioritise and remove the project from its technical agenda.

24. Most FASB members expressed that a need to improve US GAAP will continue to exist.

25. However, the FASB concluded that the amortisation with impairment approach tentatively developed did not sufficiently rebalance the benefits and costs in a way that created a compelling case for change at this time. Most FASB members believed the information derived from the proposed approach would not significantly change the decision usefulness of reported information and several FASB members questioned the magnitude of cost savings for preparers from the proposed model. Several FASB members observed the potential benefits of the proposed approach may not overcome the costs associated with potential divergence from IFRS Accounting Standards.

26. Revisions to the proposed approach that a majority of the FASB would support could not be identified at this time. Further information on the leanings and the reasons for the FASB's decision in June 2022 can be found in Agenda Paper 18A to the September 2022 Joint IASB–FASB education meeting.

27. At the September 2022 Joint IASB–FASB meeting, one FASB member said, in their view, it is important the IASB—if it decides to explore reintroducing amortisation of goodwill—agree on the objective of doing so—that is, whether the objective is to improve the usefulness of information or to reduce cost.

Additional staff research

28. As part of the IASB's plan to redeliberate the preliminary views in the Discussion Paper the IASB, at its meeting in September 2021, asked us to further analyse specific aspects of feedback on the subsequent accounting for goodwill including:

 (a) whether it is feasible to estimate a useful life of goodwill, and the pattern in which it diminishes, that faithfully represents its decline in value;[5] and

 (b) the potential consequences of transitioning to an amortisation-based model were the IASB to reintroduce amortisation of goodwill.

29. Agenda Papers 18A and 18B of the IASB's May 2022 meeting presented our research and findings on these topics. We present below a summary of that research and feedback.

Estimating the useful life of goodwill

30. Not being able to reliably estimate the useful life of goodwill and the pattern in which it diminishes was central to the IASB's conclusions to adopt the impairment-only model in 2004 (see paragraph 4).

31. Feedback to the Discussion Paper on whether a reliable estimate of the useful life of goodwill can be made was mixed. Some respondents said a reliable estimate cannot be made, whereas some disagreed and said a reliable estimate can be made.

32. In its September 2021 meeting, the IASB asked us to perform additional analysis on whether the useful life of goodwill can be estimated reliably, in particular to understand from preparers who said they could estimate the useful life of goodwill how they would make those estimates. Some IASB members said information on this topic would help them decide whether to retain the impairment-only model for the subsequent accounting for goodwill.

33. Our research considered:

 (a) feasibility of estimating the useful life of goodwill and the pattern in which it diminishes (paragraphs 34–39);

 (b) auditability of the useful life of goodwill and its amortisation pattern (paragraph 40); and

 (c) usefulness of information associated with managements' estimates of the useful life of goodwill and its amortisation pattern (paragraph 41).

Feasibility of estimating the useful life of goodwill and the pattern in which it diminishes

34. Outreach indicated that there are several factors and methods entities would use to estimate the useful life of goodwill. For some entities, making this estimate would be relatively straightforward given the

[5] For convenience, we will refer to this as a 'reliable' estimate throughout the remainder of the papers for this meeting.

finite nature of the businesses they acquire. For other entities, making this estimate would be more subjective and entities may need to consider several factors or use proxies when doing so.

35. This diversity of factors and methods might be a result of different facts and circumstances of each business combination, different judgements of what goodwill is or different preferences in the method(s) selected.

36. Many stakeholders commented on whether the IASB should specify an upper limit for the useful life of goodwill (a cap). Many preparers we spoke with said a cap was needed either for practical reasons or to prevent excessively long useful lives being used. Also, many auditors said a cap is necessary to make an amortisation-based model operable and auditable. However, many auditors also said a cap may become an unintended default period.

37. Almost all the preparers we spoke with did not express concerns about the cost of estimating the useful life of goodwill. However, in our research we spoke with preparers who said they could estimate the useful life of goodwill and the pattern in which it diminishes. Feedback to the Discussion Paper on that cost was more mixed.

38. We found academic literature that highlighted stakeholder concerns about the reliability of managements' estimates of the useful life of goodwill under the US GAAP accounting standard of the time.[6]

39. Many of the preparers we spoke with also commented on how to estimate the pattern in which goodwill diminishes. Of those who commented:

    (a) many said the pattern should not necessarily be straight-line with some suggesting linking the pattern to that used for the primary asset(s) acquired (for example, oil reserves); and

    (b) many said a straight-line approach should be adopted as a practical solution, but some suggested entities should be able to apply a different pattern if more appropriate.

Auditability of the useful life of goodwill and its amortisation pattern

40. Auditors we spoke to said it would be possible to audit managements' estimates of useful life. However, most of those auditors suggested providing application guidance, for example, on unit of account because goodwill may consist of more than one component, and when to use particular factors.

Usefulness of information associated with managements' estimates of the useful life of goodwill and its amortisation pattern

41. Users had mixed views. Some CMAC members said a useful life and amortisation pattern based on management's estimate would provide useful information, for example it would provide insight into management's assessment of the recovery period for the investment and the rationale for the purchase

[6] American Institute of Certified Public Accountants, Accounting Principles Board Opinion No. 17—*Intangible Assets (1970)* required amortisation of goodwill over a period not exceeding 40 years.

price. However, many other CMAC members said amortisation would not provide useful information, for example because any amortisation charge would be arbitrary due to the difficulty of estimating the useful life of goodwill.

Transitioning to an amortisation-based model

42. In its September 2021 meeting, the IASB asked us to perform additional analysis on the legal and regulatory consequences of transitioning to an amortisation-based model. Information on this topic would also help IASB members decide whether to retain the impairment-only model.

43. We did not specifically research the practicality of applying different transition approaches (for example, retrospective or prospective). However, a few stakeholders commented on practicality.

44. Potential legal and regulatory consequences of transition considered were effects on:

    (a) entities' financial positions and performance;

    (b) access to capital markets and economic development;

    (c) capital maintenance;

    (d) dividend distribution;

    (e) debt covenants and credit ratings; and

    (f) taxation.

45. Many respondents said transition would significantly affect entities' financial positions and performance because of the size of historic goodwill balances. Some of these effects could be significant and more prevalent for entities in particular jurisdictions. We note that:

    (a) respondents from Asia-Oceania said entities in their jurisdictions risk failing to meet listing requirements and, eventually, being suspended from trading or delisted if they report negative equity and/or profit; and

    (b) respondents from Latin America said the amounts of dividends that entities in their jurisdictions could distribute would be affected.

46. However, many other respondents said the consequences of transition would be limited and manageable. Some respondents said the effects are not compelling enough to prevent the IASB from reintroducing amortisation of goodwill.

Other developments

UK Endorsement Board research report

47. The UK Endorsement Board (UKEB) presented its research report *Subsequent Measurement of Goodwill: A Hybrid Model* at the September 2022 meeting of ASAF. Aspects of this research had been provided to us by the UKEB as part of their response to our research on the topics in paragraphs 28–

46. However, the research report contains findings from further research on the use of an amortisation-based model (referred to in the report as a 'hybrid model') for the subsequent accounting for goodwill including, for example, the results of field testing and user feedback.

48. The objective of the UKEB's research was to contribute to the ongoing international debate on the subsequent measurement of goodwill by exploring the practical implications of a potential transition to an amortisation-based model. The report notes that since 2005, the carrying amount of goodwill for the FTSE 350[7] has increased by 78% to £397 billion. The carrying amount of goodwill has remained broadly constant as a proportion of total assets for those entities reporting goodwill, at approximately 18%.

49. The research considered the:

    (a) effect of reintroducing amortisation of goodwill on reporting outcomes, financial stability and audit processes, systems and costs; and

    (b) practical feasibility of transition to an amortisation-based model, including the feasibility of estimating a useful life of goodwill.

50. Overall, the report concluded that transition to an amortisation-based model would be practically feasible.

51. Some of the feedback to the UKEB was similar to feedback from our research (see paragraphs 28–46), for example:

    (a) the factors entities would use to estimate the useful life of goodwill were consistent with the factors we heard in our research, although there were a few additional factors stakeholders provided us, such as a payback period.

    (b) several preparers and auditors said they would welcome application guidance including examples of factors to consider when determining the useful life of goodwill which is consistent with the feedback we received from auditors (see paragraph 40).

    (c) user views on the usefulness of information from an amortisation-based model were mixed which is consistent with feedback we received from users (see paragraph 41). For example, some users were sceptical about the relevance of information about the useful life of goodwill because in their view goodwill is an indefinite-life intangible asset, however some users said disclosures on the rationale underpinning management's estimate of useful life would be useful and would help discussions with management about accountability for business combinations.

    (d) the UKEB's research indicates that transition to an amortisation-based model described in the UKEB report would be unlikely to have significant adverse consequences on processes,

[7] The Financial Times-Stock Exchange 350 share index is a weighted average index of the top 350 companies by free float market capitalisation on the London Stock Exchange.

operations and costs. This is consistent with what preparers said in our research however, as discussed in paragraph 37, the feedback on cost from respondents to the Discussion Paper (which included feedback from preparers who said it would not be possible to estimate the useful life of goodwill) was more mixed.

52. On the other hand, some of the feedback to the UKEB differed to our findings, for example:

(a) a majority of preparers in the UKEB research considered it would either be easy, or challenging but possible, to estimate a useful life of goodwill for amortisation purposes, and a minority of preparers identified significant challenges in estimating a useful life. The feedback to the IASB's Discussion Paper appears to be more mixed, some respondents said a reliable estimate can be made, however some disagreed and said a reliable estimate cannot be made.

(b) a majority of preparers from the UKEB's field testing considered a maximum or minimum useful life for goodwill would partially negate anticipated improved financial reporting outcomes, whereas many preparers we spoke with said a cap was needed either for practical reasons or to prevent excessively long useful lives being used (see paragraph 36).

(c) the UKEB's research indicates that transitioning to an amortisation-based model would be unlikely to have a significant adverse impact on financial stability. Feedback to our research was more mixed—many stakeholders said the consequences of transition would be limited (see paragraph 46), however many said transition would significantly affect entities' financial positions and performance (see paragraph 45).

53. As explained in paragraph 43, we did not specifically research the practicality of applying different transition approaches (for example, retrospective or prospective). The UKEB's research included some feedback on the practicality of applying different transition approaches.

54. The majority view from field test participants to the UKEB's research was that retrospective application was preferable to prospective application:[8]

(a) Prospective application would not necessarily provide a faithful representation, because the benefits of legacy goodwill may already have been consumed; and

(b) Retrospective application would allow for improved comparability between entities from the effective date forward.

55. However, most participants said practical expedients would be necessary for retrospective application because:

[8] If applied prospectively, the model would be applied to legacy goodwill from the effective date forwards. Retrospective application would not require all legacy goodwill to be written off at the effective date. Rather, it would require adjustment for the amount of legacy goodwill which would have been amortised under a model between the date of the business combination and the effective date. The amount of the adjustment would therefore be determined by the estimated useful life of goodwill and the time elapsed between the date of the business combination and the effective date.

(a) the information required to determine a useful life of goodwill may not be available for historic acquisitions; and

(b) management may have limited ability to determine the useful life of goodwill without hindsight.

56. The most frequently recommended practical expedient was a default amortisation period for legacy goodwill.

Disclosures about business combinations

57. In its September 2021 meeting the IASB decided to prioritise performing further work to make decisions on the package of disclosure requirements about business combinations. Many IASB members said more information about the package of disclosure requirements after the IASB's redeliberations would help them decide on the subsequent accounting for goodwill.

58. At its September 2022 meeting the IASB made tentative decisions on its preliminary views related to disclosing information about business combinations, in particular:

(a) information about the subsequent performance of business combinations, based on objectives, metrics and targets set by the entity in the year of acquisition; and

(b) quantitative information about expected synergies.

59. Users providing feedback in the PIR of IFRS 3 and subsequently said they need better information about business combinations. In particular, users said they need information to help them assess:

(a) whether the price paid for a business combination is reasonable; and

(b) the subsequent performance of a business combination.

60. However, preparers raised a number of practical concerns about providing this information.

61. The IASB considered the benefits of amending its preliminary views compared to the cost of disclosing that information, and in September 2022 tentatively decided to proceed with an amended version of its preliminary views. In particular, the IASB tentatively decided to propose:

(a) including an exemption from disclosing some information in specific circumstances.

(b) requiring some of the information about the subsequent performance of business combinations only for 'strategically important' business combinations.

Other

62. At the IASB's May 2022 meeting, one IASB member said they wanted to better understand feedback from users on the usefulness of existing disclosure requirements of IFRS 3 and IAS 36 and whether useful information could be lost if amortisation was reintroduced.

63. As noted in paragraph 7 of Agenda Paper 18B to the IASB's November 2015 meeting, feedback during the PIR of IFRS 3 indicated that:

(a) users seem to find information about goodwill and the impairment test of CGUs containing goodwill helpful in assessing the accountability of management (for example, whether management overpaid and if the acquisition was a good business decision); and

(b) many users said there are limitations to the information provided by entities applying existing requirements for various reasons, including that:

(i) impairment calculations are inherently very judgemental and the assumptions used in the calculations are subjective.

(ii) disclosures are not sufficient to assess whether the main inputs/assumptions are reasonable. However, some users said some disclosures are useful, these included discount rates, long-term growth rates, profit and capital expenditure assumptions and sensitivities.

64. Other users have also said they find information about assumptions used in the impairment test of CGUs containing goodwill (as required by IAS 36) useful. For example, most users responding to the Discussion Paper disagreed with removing the requirement to perform a quantitative impairment test annually because they would lose useful information about assumptions (such as discount rates) entities use in their impairment tests (see Agenda Paper 18B to the IASB's April 2021 meeting). Some users said information about year-on-year changes in the assumptions can help assess the subsequent performance of business combinations. For example, declining growth rates might indicate the acquired business is not performing as well as expected.

65. Based on this feedback, we note:

(a) information about assumptions used in the impairment test of CGUs containing goodwill would not be lost if amortisation of goodwill is reintroduced as long as the requirement for the annual impairment test of CGUs containing goodwill is retained.

(b) information about the impairment loss itself could be reduced if amortisation is reintroduced if, as respondents to the Discussion Paper in favour of retaining the impairment-only model suggested, amortisation would reduce the potential size of impairments and result in fewer and smaller impairments. Most users in favour of retaining the impairment-only model said the recognition of impairment losses provides information that is more useful than amortisation.