STAFF PAPER

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IASB® Meeting

Project	Goodwill and Impairment
Paper topic	Presentation of total equity before goodwill subtotal

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Purpose of this paper

1. The purpose of this paper is to ask the Board whether they would like to include in the Discussion Paper a preliminary view that a subtotal of total equity before goodwill be presented in the statement of financial position.

Structure of the paper

2. The paper is structured as follows:

   (a) Background and introduction (paragraphs 3–10);

   (b) Rationale for considering presenting a subtotal of total equity before goodwill (paragraphs 11–17);

   (c) Approaches to presenting a subtotal of total equity before goodwill (paragraphs 18–26); and

   (d) Questions for the Board.

Background and introduction

3. During the Post-implementation review (PIR) of IFRS 3 *Business Combinations*, there were mixed views on the separate recognition of intangible assets from

goodwill. Some users of financial statements did not support identifying additional intangible assets (brands, customer relationships) beyond goodwill because the valuation of these assets is highly subjective.

4. In addition, some users stated that they wanted to remove amortisation of some intangible assets to remove the inconsistency between organically growing entities and entities growing by acquisitions, to help them better assess the performance of the acquired business.

5. The project had investigated whether any identifiable intangible assets acquired in a business combination should be included within goodwill and the Board tentatively decided in its April 2018 Board meeting not to explore this further.

6. As discussed in **Agenda Paper 18B Reintroduction of amortisation of goodwill**, some stakeholders are concerned with the effectiveness of the impairment test of goodwill and the feedback during the PIR of IFRS 3 that impairment losses are not recognised on a timely basis. Based on the work performed in this research project, the Board concluded that it is not possible to improve the impairment test to target the acquired goodwill in isolation. However, some stakeholders remain concerned that the carrying amounts of acquired goodwill could be overstated.

7. To respond to this feedback, the staff had initially considered requiring an entity to disclose:

   (a) the amount of equity the entity would have reported if it had not recognised goodwill and some intangible assets acquired in a business combination: those intangible assets that, based on circumstances at the acquisition date, would not have been recognised if they had been internally generated; and

   (b) the profit or loss an entity would have reported without amortisation and without any impairment losses, on goodwill and on those intangible assets identified in paragraph (a).

8. During the staff's outreach with the ASAF, the staff did not receive any strong support for this disclosure idea. Some ASAF members mentioned this information is readily available and users can make these adjustments themselves. One ASAF member also highlighted that the definition of which intangible assets to capture

in this disclosure can differ between users and the disclosure will suit some users but not all users, thus limiting the benefits of disclosing this information.

9. The staff had previously considered a similar idea (see **Agenda Paper 18A for the February 2016** Board meeting) whereby amortisation of intangible assets would be presented separately in the statement of profit or loss and had similarly not recommended the Board to pursue this idea because the views on which intangible assets would be subject to this presentation would vary by user and industry.

10. At the April 2019 Board meeting, some Board members agreed with a further suggestion that a subtotal in the statement of financial position highlighting tangible net worth should be investigated further for possible inclusion in a Discussion Paper to seek feedback from stakeholders on whether such a subtotal would be useful. Those Board members thought a tangible net worth subtotal would:

    (a) use a measure that is already used in, for example, bank covenants;

    (b) not add any costs for preparers; and

    (c) highlight those assets that on liquidation are harder to fully convert into cash.

Rationale for considering presenting a subtotal of total equity before goodwill

11. At various stages of the project, the Board has considered a number of alternatives that would have the aim of highlighting the impact on the statement of profit or loss and/or the statement of financial position of goodwill only or of goodwill and some or all intangible assets.

12. The staff think a subtotal of equity before goodwill and all intangible assets (tangible net worth), although it is a measure that is regularly used, could provide information that in some circumstances could be misleading, where, for example, entities operate in industries with large amounts of intangible assets with finite and well-defined lives.

13. As highlighted by the feedback from the ASAF, if only some intangible assets are excluded from the subtotal, views will vary by user and by industry on which intangible assets should be excluded. This variety of views would limit the usefulness of this subtotal.

14. Depending on whether the Board has agreed with the staff's recommendation in **Agenda Paper 18B Reintroduction of amortisation of goodwill** not to reintroduce amortisation as its preliminary view, the Board may want to highlight an entity's exposure to goodwill.

15. Goodwill is different from other assets. Although goodwill is an economic resource and has the potential to produce economic benefits, direct measurement of goodwill is not possible and therefore, goodwill can only be measured as a residual amount.[1] Goodwill does not generate cash flows independently of other assets or groups of assets, and often contributes to the cash flows of more than one cash-generating unit. It is an asset that on liquidation is harder to fully convert into cash than many other assets. This research project has also highlighted the inevitable limitations of the impairment test—it is not possible to target the acquired goodwill through the design of the impairment test.

16. The Board has tentatively decided in the *Primary Financial Statements* project to require goodwill to be presented as a separate line item in the statement of financial position. This would make the carrying amount of goodwill more visible. The Board may decide it would like to create additional prominence by requiring the presentation of a subtotal of total equity before goodwill in the statement of financial position as an additional response to the 'too late' issue.

17. Paragraph 55 of IAS 1 *Presentation of Financial Statements* requires that an entity should present additional line items (including by disaggregating listed line items), headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position and this may justify the presentation of this subtotal in the statement of financial position.

[1] The *Conceptual Framework* defines an asset as a present economic resource controlled by the entity as a result of past events. It defines an economic resource as a right that has the potential to produce economic benefits.

Approaches to presenting a subtotal of total equity before goodwill

18. The staff think that the following approaches to providing this information in the statement of financial position could be considered:

    (a) Alternative 1: presenting a subtotal of total assets before goodwill, less total liabilities.

    (b) Alternative 2: presenting a subtotal of total equity before goodwill.

    (c) Alternative 3(a): presenting a subtotal of total assets before goodwill, less total liabilities, as a footnote, or free-standing disclosure, on the face of the statement of financial position.

    (d) Alternative 3(b): presenting a subtotal of total equity before goodwill as a footnote, or free-standing disclosure, on the face of the statement of financial position.

19. Alternative 1 presents a subtotal of total assets before goodwill, less total liabilities as follows[2]:

	31 Dec 20X0
ASSETS	
Non-current assets, other than goodwill	CU 300
Current assets	CU 200
Total assets, other than goodwill	CU 500
LIABILITIES	
Non-current liabilities	CU 400
Current liabilities	CU 200
Total liabilities	CU 600
Total assets other than goodwill, less total liabilities	**CU (100)**
Goodwill	CU 300
Total assets, less total liabilities	CU 200
EQUITY	
Total equity	CU 200

[2] For the purposes of illustration, only a summary statement of financial position has been presented.

20. The *Guidance on Implementing* IAS 1 sets out an illustrative example of the structure of the statement of financial position. A structure of the statement of financial position where total assets equal total equity plus total liabilities is a common presentation structure of the statement of financial position in many jurisdictions and is the basis of the example in the implementation guidance.

21. Alternative 1 would prevent the use of the statement of financial position illustrated in the implementation guidance. This could lead to additional costs and/or problems with local filing requirements.

22. Alternative 2 presents a subtotal of equity, less goodwill as follows:

	31 Dec 20X0
ASSETS	
Non-current assets	
Property, plant and equipment	CU 300
Goodwill	CU 300
Current assets	CU 200
Total assets	CU 800
EQUITY AND LIABILITES	
EQUITY	
Equity, before goodwill	**CU (100)**
Equity attributable to goodwill	**CU 300**
Total equity	CU 200
LIABILITIES	
Non-current liabilities	CU 400
Current liabilities	CU 200
Total liabilities	CU 600
Total equity and liabilities	CU 800

23. Alternative 2 follows the structure of the statement of financial position in the implementation guidance for IAS 1 and therefore does not cause the same problem as alternative 1, as explained in paragraph 21.

24. This approach would not permit total equity to be split into its component parts on the face of the statement of financial position. That split would have to be presented in the statement of changes in equity or disclosed in the notes. However, this may contravene local company law requirements in certain jurisdictions and

also may not comply with paragraph 54(q) and 54(r) of IAS 1[3] (or at best make compliance difficult). In addition, it may also not be clear and understandable what the equity attributable to goodwill means.

25. Alternative 3(a) presents a subtotal of total assets before goodwill, less total liabilities as a footnote below the statement of financial position or as a free-standing disclosure after, for example, total assets. This is the simplest way to provide a subtotal in the statement of financial position since it is not constrained by the structure of the statement of financial position. However, the nature of the information provided by the subtotal and its prominence may be reduced if it is not integrated into the structure of the statement of financial position.

26. Alternative 3(b) would present a subtotal of equity, before goodwill and equity attributable to goodwill as a footnote to the statement of financial position or as a free-standing disclosure after total equity. This may address some of the issues associated with alternative 2 and, as with alternative 3(a), is a simpler approach which is not constrained by the structure of the statement of financial position.

Questions for the Board

Questions for the Board
1. Does the Board want to include a preliminary view in the Discussion Paper that a subtotal of total equity before goodwill be presented in the statement of financial position? If not: 2. Does the Board want to include in the Discussion Paper a brief discussion of the various presentations considered in this paper to obtain feedback from stakeholders with no preliminary view expressed?

[3] Paragraph 54(q) and 54(r) of IAS 1 requires that the statement of financial position shall include line items that present the amounts of non-controlling interests presented within equity and issued capital and reserves attributable to owners of the parent.