IFRS™

STAFF PAPER

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IASB Meeting

Project	**Goodwill and impairment project**		
Paper topic	Appendices accompanying Agenda Papers 18A and 18B (for reference only)		
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Accounting Standards Advisory Forum, December 2015, Agenda paper 5F

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Agenda paper 18A appendices

1. The staff have provided the following four appendices for IASB member's reference when reading Agenda Paper 18A: Identification and measurement of intangible assets acquired in a business combination:

   (a) Appendix A: Relevant extracts from the comment letter analysis on the Post-implementation Review (PIR) of IFRS 3 *Business Combinations* **(pages 2-8)**.

   (b) Appendix B: Summary of FASB meetings on their related project on accounting for identifiable intangible assets in a business combination **(pages 9-10)**.

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   (d) Appendix D: Relevant extracts from Basis for Conclusions accompanying IFRS 3(2004) and (2008) **(pages 11-17)**.

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit www.ifrs.org

Agenda paper 18B appendices

2. The staff have provided the following four appendices for IASB member's reference when reading Agenda Paper 18B: Feedback from users of financial statements about information on goodwill and impairment

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Appendix A: Relevant extracts from the comment letter analysis presented at the September 2014 IASB meeting on identification and measurement of intangible assets

What have been the most significant valuation challenges in measuring fair value within the context of business combination accounting? What have been the most significant challenges when auditing or enforcing those fair value measurements? Has fair value measurement been more challenging for particular elements?

A1. Many preparers[1] think that the calculations are often difficult to prepare, taking a significant amount of time and often require the engagement of independent valuation specialists, which makes the exercise costly.

A2. Many participants[2] think that the biggest valuation challenge is the identification and measurement of intangible assets that are separable from goodwill. This is primarily due to the lack of sufficient reliable and observable data. Intangible assets that are

[1] See, for example, The 100 Group's comment letter.

[2] See, for example, American Appraisal's comment letter.

particularly challenging to measure are: non-contractual intangible assets; intangible assets for which there is no active market; and intangible assets in the 'early stage' of development. In addition, where there are multiple intangible assets, such as brand names, customer relationships and customer lists, judgement is needed not only to value them individually but also to determine interrelationships.

A3. Some preparers[3] think that the most significant challenge is the application of the different types of asset valuation methods and the determination of the respective input parameters. In their view, the underlying problem is that the Standards refer to a valuation model ('stand-alone fair values' defined as price paid in an arm's length transaction) that are hardly applicable in practice, because it does not exist for most assets being too specific for having observable transaction or market prices.

A4. Some advisory firms[4] think that practical problems include isolating reliable revenue streams on which to base the valuation model; attributing costs; assessing value in the context of the new owner's strategies; and assessing contingent outcomes.

A5. The most significant valuation and auditing[5] challenges in fair value measurement of separate intangible assets identified by respondents are due to the number of valuation approaches and the level of judgement required. In most cases, these assets do not derive separate cash flows and determining their fair value requires a number of difficult assumptions to be made.

A6. Many participants think that fair value measurement is more challenging for the following intangible assets:

(a) non-contractual intangible assets;

(b) intangible assets for which there is no active market;

(c) intangible assets in the 'early stage' of development.

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[3] See, for example, Linde Group's comment letter.

[4] See, for example, Westworth Kemp Consultants' comment letter.

[5] See, for example, EY's comment letter.

Do you find the separate recognition of intangible assets useful? If so, why? How does it contribute to your understanding and analysis? Do you think changes are needed and, if so, what are they and why?

A7. Some users[6] do not support the current practice of identifying additional intangible assets (brands, customer relations, etc) beyond goodwill, because the valuation of these assets is highly subjective and, in fact, open to significant arbitrage opportunities for companies during business combinations. They think that these intangible assets should be recognised only if there is a market for them.

A8. Some users[7] think that:

(a) the separate recognition of intangible assets is of limited (if any) utility to investors.

(b) investors are interested in understanding the return on the capital (cash and cash equivalents) that has been deployed.

(c) investors give little credence to the valuations placed on acquired intangible assets, such as customer lists and brands.

(d) the subsequent accounting treatment of intangible assets acquired in business combinations is an unhelpful element of IFRS based accounting that investors face today. They think that it causes confusion, limits comparability and potentially distorts the efficient operation of capital markets.

(e) in most circumstances, the amortisation of acquired intangibles conveys no useful information about the economics of a business. It is normally added back by preparers and investors to derive an underlying earnings number. The number added back is sometimes referred to as purchase price allocation (PPA) amortisation. However, it is not always easy for investors to differentiate between PPA amortisation and the amortisation of other internally generated assets, such as capitalised software. The latter is more

[6] See, for example, SFAS's comment letter.

[7] See, for example, Enderson Global Investors's comment letter.

akin to depreciation and should not be added back to derive an underlying earnings number.

A9. Similarly, some users[8] think that the amortisation charge arising from intangible assets, such as brands and customer lists, appears to be double counting, because the maintenance of these assets is already expensed through the income statement as another cost, such as sales and marketing. As such, many analysts add back these amortisation charges in their measures of underlying earnings. They would prefer that difficult-to-define (or difficult-to-separate from the overall business) and 'indefinite-lived' intangible assets, such as brands and customer relationships, should be subsumed into goodwill because they are more akin to goodwill. They think that only intangible assets that are contractual have a finite life and that are separate from the overall business (such as licences) should be recognised and measured separately. Separate recognition for such assets is useful, because they require large capital expenditure to be replaced. In their view, the recognition and amortisation of these assets is appropriate, because it is a proxy for the replacement cost of the asset.

A10. The research published by the UK's Financial Reporting Council in March ('Investor Views on Intangible Assets and their Amortisation') identifies a distinction between 'wasting' intangible assets and 'organically replaced' intangible assets. Wasting assets have finite economic lives and would include licences, patents and software. Organically replaced assets are likely to be difficult to separate from the business or to reliably determine a useful life. Such intangible assets, including customer lists and brands, are replenished through marketing and promotional investment that is expensed through the profit and loss.

A11. Some users[9] think that estimating fair values for intangible assets acquired in business combinations is a costly exercise for preparers and its advantage can be questioned. In their experience as analysts they rarely look at the values accounted for. An exception would be for those intangible assets for which a reliable measure of fair value can be attained.

[8] See, for example, CFA UK's comment letter.

[9] See, for example, EFFAS's comment letter.

A12. Some users think that intangible assets that are tax deductible should be separated, because they are useful to estimate future tax expenses.

A13. However, other users think that the separate recognition of intangible assets from goodwill is useful, because

(a) it provides an insight on why a company purchased another company and provides information on the future cash flows arising from the acquired business.

(b) it helps in understanding the components of the acquired business, including its primary assets (ie the value-drivers).

(c) it permits comparison between different accounting policies that management choose to make (for example, one entity may amortise customer lists over 10 years, whereas another entity may decide to amortise customer lists over 20 years). They think that information provided by intangible assets is more useful than information provided by goodwill.

(d) all intangible assets wear out and the amortisation reflects the need for future investment to replace them, in addition to the expensed 'maintenance' costs of marketing, research etc.

What are the main implementation, auditing or enforcement challenges in the separate recognition of intangible assets from goodwill?

A14. Many participants[10] think that some intangible assets, such as internally generated brands and customer lists, are difficult to distinguish from the business as a whole and could require subjective and arbitrary allocation of future cash flows among these intangible assets and other assets.

A15. The main causes of the challenges in recognising and measuring intangible assets described by participants are:

(a) many intangible assets are not frequently traded on a stand-alone basis and therefore very often there is no active market for them;

[10] See, for example, ASC's comment letter.

(b) many intangible assets are unique and therefore not easy to identify and assess their value;

(c) valuation methods are complex and subjective;

(d) values may be attributed to the wrong asset due to confusion on the source of profit generation;

(e) the measurement is more complex/subjective when the intangible assets are not based on legally enforceable rights;

(f) the lack of any thresholds in terms of control or measurement reliability means that some respondents assert that this requires a search for intangible assets to recognise separately at a very granular level—these respondents also say that the measurement of these intangibles are also highly judgemental;

(g) the acquirer already owns the intangible assets (for example, customer relationships when there is an overlap in the customer base of the acquirer and the acquiree);

(h) the acquirer does not intend to use the intangible assets (for example, a brand acquired and held for defensive reasons); and

(i) the useful life of some intangible assets is subjective.

A16. According to the report[11] published by ESMA in June 2014:

(a) 77 per cent of the issuers included in the sample recognised intangible assets other than goodwill as part of the business combination.

(b) 54 per cent of the total amount of intangibles (including goodwill) related to separable intangible assets.

(c) intangible assets for which usually there is no observable market, such as customer-related and marketing-related intangibles, were the most common assets recognised in the review. The customer- related intangibles included customer relationships, customer lists, customer contracts and order

[11] ESMA Report: *Review on the application of accounting requirements for business combinations in IFRS financial statements*.

backlogs. Marketing-related intangibles mainly related to brand names and internet domains.

(d) techniques used to measure fair values in a business combination vary significantly and often external experts are engaged.

(e) ESMA noted that the most prevalent intangible asset recognised separately from goodwill related to customer relationships. Customer relationships stem from both contractual and non-contractual relationships. In its *Update* from March 2009, the IFRS Interpretations Committee (the 'Interpretations Committee') dealt with a question on the circumstances in which a non-contractual customer relationship arises in a business combination and concluded that the way that a relationship was established helps to identify whether a customer relationship exists but should not be the primary basis for determining whether the acquirer recognises an intangible asset. Due to the widespread diversity observed by the Interpretations Committee, it decided to refer this question to the IASB. ESMA's experience and the review results confirm that customer relationships play a significant role in business combinations, thus ESMA encourages the IASB to work on this topic as part of the PIR and, in particular, to deal with the recommendation from the March 2009 Interpretations Committee decision.

A17. Some users think that it would be useful also to have more information about the inputs and methodologies used to measure the fair value of the acquired assets and liabilities, such as the disclosures in IFRS 13.

A18. Some users would like more information about the nature of the intangible assets that are recognised as a result of a business combination; and the underlying criteria and rationale used by management when identifying and separating intangibles from goodwill

A19. According to the ACCA Research Report *Worldwide application of IFRS 3, IAS 38 and IAS 36, related disclosures, and determinants of non-compliance* on average, 38.9 per cent of the total purchase price is allocated to 'other intangible assets'. Companies are not explicit on what is recognised in this 'class' of assets so there is a need for supportive disclosures on what these assets constitute.

Appendix B: Summary of FASB meetings on their project *Accounting for Identifiable Intangible Assets in a Business Combination for Public Business Entities and Not-For-Profit Entities*

B1. At the September 2015 meeting the FASB staff presented a paper summarising their progress to date on their project looking at accounting for identifiable intangible assets in a business combination for public business entities and not-for-profit entities (See IASB Agenda Reference 13D for that meeting).

B2. The following are the meetings held to date by the FASB on this topic with brief summaries based on the minutes on their website.

Date	Summary
November 2014	The FASB added the project to its agenda (see paragraph B3). The project will evaluate whether certain intangible assets should be subsumed into goodwill, with a focus on customer relationships and noncompete agreements. The FASB asked the staff to consider the implications of potentially subsuming intangible assets into goodwill in conjunction with its additional research and to consider IASB activities on goodwill and intangible assets in response to the IASB's PIR.
April 2015	The staff updated the FASB on research and outreach performed since the project was added to the technical agenda in November 2014. The FASB made no technical decisions.
September 2015	The FASB and the IASB met and discussed the progress on their respective projects. No decisions were made.
October 2015	The FASB discussed whether to change the initial recognition of customer-related intangible assets or noncompetition agreements acquired in a business combination for public business entities in light of the totality of the staff's research and outreach conducted to date. The FASB decided to continue this project by continuing to engage with the international community on this matter. In particular, the FASB directed the staff to research whether the usefulness of information provided by the recognition of acquired intangible assets is different for US and international investors and if so, why that difference exists.

B3. In September 2014 the Private Company Council (PCC) reached a consensus to change US GAAP for private companies on the accounting for identifiable intangible assets in a business combination. The PCC consensus allows private companies to subsume into goodwill customer-related intangible assets (unless they are capable of being sold or licensed independently from the other assets of the

business) and noncompetition agreements. In December 2014, the FASB endorsed the PCC consensus. As a result of some feedback indicating that certain public business entities and not-for-profit entities experience the same issues as private companies, the FASB added this project to its agenda for public business entities and not-for-profit entities.

Appendix C: IFRIC agenda decision in March 2009 IFRIC update newsletter

C1. The following IFRIC agenda decision[12] has been extracted from the March 2009 edition of IFRIC update.

IFRS 3 Business Combinations—Customer-related intangible assets

The IFRIC[13] received a request to add an item to its agenda to provide guidance on the circumstances in which a non-contractual customer relationship arises in a business combination. IFRS 3 (as revised in 2008) requires an acquirer to recognise the identifiable intangible assets of the acquiree separately from goodwill. An intangible asset is identifiable if it meets either the contractual-legal criterion or the separable criterion in IAS 38 s. Contractual customer relationships are always recognised separately from goodwill because they meet the contractual-legal criterion. However, non-contractual customer relationships are recognised separately from goodwill only if they meet the separable criterion.

The IFRIC noted that the IFRS Glossary defines the term ‘contract’. Paragraphs B31─B40 of IFRS 3 provide application guidance on the recognition of intangible assets and the different criteria related to whether they are established on the basis of a contract. The IFRIC also noted that paragraph IE28 in the illustrative examples accompanying IFRS 3 provides indicators for identifying the existence of a customer relationship between an entity and its customer and states that a customer relationship ‘may also arise through means other than contracts, such as through regular contact by sales or service representatives.’

The IFRIC concluded that how the relationship is established helps to identify whether a customer relationship exists but should not be the primary basis for determining whether the acquirer recognises an intangible asset. The IFRIC noted that the criteria in paragraph IE28 might be more relevant. The existence of contractual relationships and information about a customer’s prior purchases would be important inputs in valuing a customer relationship intangible asset but should not determine whether it is recognised.

In the light of the explicit guidance in IFRS 3, the IFRIC decided that developing an Interpretation reflecting its conclusion is not possible. Noting widespread confusion in

[12] IFRIC agenda decisions are not Interpretations.

[13] The IFRS Interpretation Committee was previously called the IFRIC.

practice on this issue, the IFRIC decided that it could be best resolved by referring it to the IASB and the FASB with a recommendation to review and amend IFRS 3 by:

- removing the distinction between 'contractual' and 'non-contractual' customer-related intangible assets recognised in a business combination; and
- reviewing the indicators that identify the existence of a customer relationship in paragraph IE28 of IFRS 3 and including them in the standard.

Appendix D: Extracts from the Basis for Conclusions accompanying IFRS 3 (2008) and (2004)

D1. The staff have included the extracts from the Basis for Conclusions supporting IFRS 3(2008) and IFRS 3(2004) that we think are most relevant to our discussions on identifying and measuring intangible assets in a business combination:

IFRS 3(2008)

D2. Paragraphs BC157-BC174 of IFRS 3(2008) summarises the main considerations of the IASB and the FASB in reaching the conclusions in their revised standards, IFRS 3 *Business Combinations* (2008) and FASB Statement No. 141 (2007) *Business Combinations* (SFAS 141(R)), on distinguishing intangible assets from goodwill.

Distinguishing identifiable intangible assets from goodwill

BC157 Early in their respective projects on accounting for business combinations, the IASB and the FASB both observed that intangible assets make up an increasing proportion of the assets of many (if not most) entities. The boards also observed that intangible assets acquired in a business combination were often included in the amount recognised as goodwill.

BC158 Both the IASB and the FASB decided that they needed to provide explicit criteria for determining whether an acquired intangible asset should be recognised separately from goodwill. The FASB provided such criteria in SFAS 141 and the IASB provided similar, although not identical, criteria in IAS 38.[8] One reason for providing such criteria was the boards' conclusion that the decision-usefulness of financial statements would be enhanced if intangible assets acquired in a business combination were distinguished from goodwill. For example, the FASB's Concepts Statement No. 5 *Recognition and Measurement in Financial Statements of Business Enterprises* says that classification in financial statements facilitates analysis by grouping items with essentially similar characteristics and separating items with essentially different characteristics. Analysis aimed at objectives such as predicting amounts, timing and uncertainty of future cash flows requires financial information segregated into reasonably homogeneous groups.

BC159 In developing its 1999 Exposure Draft, the FASB considered various characteristics that might distinguish other intangible assets from goodwill. Because the FASB concluded that identifiability is the characteristic that conceptually distinguishes other intangible assets from goodwill, the 1999 Exposure Draft proposed that intangible assets that are identifiable and reliably measurable should be recognised as assets separately from goodwill. Most respondents to the 1999 Exposure Draft agreed that many intangible assets are identifiable and that various intangible assets are reliably measurable. However, respondents' views on the proposed recognition criteria varied. Many of those respondents

suggested alternative recognition criteria and many urged the FASB to clarify the term *reliably measurable*.

Reasons for the contractual-legal criterion

BC163 In developing IFRS 3 and SFAS 141, the IASB and the FASB observed that many intangible assets arise from rights conveyed legally by contract, statute or similar means. For example, franchises are granted to car dealers, fast food outlets and professional sports teams. Trademarks and service marks may be registered with the government. Contracts are often negotiated with customers or suppliers. Technological innovations are often protected by patents. In contrast, goodwill arises from the collection of assembled assets that make up an acquiree or the value created by assembling a collection of assets through a business combination, such as the synergies that are expected to result from combining two or more businesses. Therefore, both boards concluded that the fact that an intangible asset arises from contractual or other legal rights is an important characteristic that distinguishes many intangible assets from goodwill and an acquired intangible asset with that characteristic should be recognised separately from goodwill.

Reasons for the separability criterion

BC164 As already noted (paragraph BC161), the original version of IAS 38 included separability as a characteristic that helps to distinguish intangible assets from goodwill. In developing IFRS 3, the IASB affirmed that conclusion for the reasons discussed in the following paragraphs.

BC165 In developing IFRS 3 and SFAS 141, the IASB and the FASB observed that some intangible assets that do not arise from rights conveyed by contract or other legal means are nonetheless capable of being separated from the acquiree and exchanged for something else of value. Others, like goodwill, cannot be separated from an entity and sold or otherwise transferred. Both boards thus concluded that separability is another important characteristic that distinguishes many intangible assets from goodwill. An acquired intangible asset with that characteristic should be recognised separately from goodwill.

BC166 The FASB's 2001 Exposure Draft proposed that an intangible asset that was not separable individually would meet the separability criterion if it could be sold, transferred, licensed, rented or exchanged along with a group of related assets or liabilities. Some respondents suggested that the FASB should eliminate that requirement, arguing that unless the asset is separable individually it should be included in the amount recognised as goodwill. Others asked the FASB to clarify the meaning of the term *group of related assets*, noting that even goodwill can be separated from the acquiree if the asset group sold constitutes a business.

BC167 The FASB noted that some intangible assets are so closely related to another asset or liability that they are usually sold as a 'package' (eg deposit liabilities and the related depositor relationship intangible asset). If those intangible assets were subsumed into goodwill, gains might be inappropriately recognised if the intangible asset was later sold along with the related asset or obligation. However, the FASB agreed that the proposed requirement to recognise an intangible asset separately from goodwill if it could be sold or transferred as part of an asset group was a broader criterion than it had intended. For those reasons, SFAS 141 provided, as do the revised standards, that an intangible asset that is not separable individually meets the separability criterion if it can be separated from the entity and sold, transferred, licensed, rented or exchanged in combination with a related contract, other identifiable asset or other liability.

BC168 Some respondents to the 2001 Exposure Draft suggested limiting the separability criterion to intangible assets that are separable and are traded in observable exchange transactions. Although the FASB agreed that exchange transactions provide evidence of an asset's separability, it concluded that those transactions were not necessarily the only evidence of separability and it did not adopt that suggestion.

BC169 Other respondents suggested that the separability criterion should be modified to require recognition of an intangible asset separately from goodwill only if management of the entity intends to sell, lease or otherwise exchange the asset. The FASB rejected that suggestion because it concluded that the asset's capability of being separated from the entity and exchanged for something else of value is the pertinent characteristic of an intangible asset that distinguishes it from goodwill. In contrast, management's intentions are not a characteristic of an asset.

The FASB's reasons for rejecting other recognition criteria suggested for SFAS 141

BC170 Some respondents suggested that the FASB should eliminate the requirement to recognise intangible assets separately from goodwill. Others suggested that all intangible assets with characteristics similar to goodwill should be included in the amount recorded as goodwill. The FASB rejected those suggestions because they would diminish rather than improve the decision-usefulness of reported financial information.

BC171 Some respondents doubted their ability to measure reliably the fair values of many intangible assets. They suggested that the only intangible assets that should be recognised separately from goodwill are those that have direct cash flows and those that are bought and sold in observable exchange transactions. The FASB rejected that suggestion. Although the fair value measures of some identifiable intangible assets might lack the precision of the measures for other assets, the FASB concluded that the information that will be provided by recognising intangible assets at their estimated fair values is a more faithful representation than that which would be provided if those intangible assets were subsumed into goodwill. Moreover, including finite-lived intangible assets in goodwill that is not being amortised would further diminish the representational faithfulness of financial statements.

Convergence of criteria in SFAS 141 and IFRS 3

BC172 The criteria in IFRS 3 for determining if an intangible asset is identifiable and thus should be recognised separately from goodwill included the same contractual or legal and separability conditions as SFAS 141. However, IFRS 3 also included a requirement that the fair value of an identifiable intangible asset should be reliably measurable to be recognised separately. In developing the 2005 Exposure Draft, the boards considered how best to achieve convergence of their respective recognition criteria for intangible assets.

BC173 In developing IFRS 3, the IASB noted that the fair value of identifiable intangible assets acquired in a business combination is normally measurable with sufficient reliability to be recognised separately from goodwill. The effects of uncertainty because of a range of possible outcomes with different probabilities are reflected in measuring the asset's fair value; the existence of such a range does not demonstrate an inability to measure fair value reliably. IAS 38 (before amendment by the revised IFRS 3) included a rebuttable presumption that the fair value of an intangible asset with a finite useful life acquired in a business combination can be measured reliably. The IASB had concluded that it might not always be possible to measure reliably the fair value of an asset that has an underlying contractual or legal basis. However, IAS 38 provided that the only circumstances in which it might not be possible to measure reliably the fair value of an intangible asset that arises from legal or other contractual rights acquired in a business combination were if it either:

(a) is not separable; or

(b) is separable, but there is no history or evidence of exchange transactions for the same or similar assets, and otherwise estimating fair value would depend on immeasurable variables.

BC174 In developing the 2005 Exposure Draft, the IASB concluded that separate recognition of intangible assets, on the basis of an estimate of fair value, rather than subsuming them in goodwill, provides better information to the users of financial statements even if a significant degree of judgement is required to estimate fair value. For that reason, the IASB decided to propose consequential amendments to IAS 38 to remove the reliability of measurement criterion for intangible assets acquired in a business combination. In redeliberating the proposals in the 2005 Exposure Draft, the IASB affirmed those amendments to IAS 38.

IFRS 3(2004)

D3. Paragraphs BC88-BC106 of the Basis for Conclusions accompanying IFRS 3(2004) summarises the main considerations of the IASB in reaching its main conclusions in IFRS 3(2004) on distinguishing intangible assets from goodwill.

Intangible assets

BC88 The IFRS requires an acquirer to recognise separately at the acquisition date an intangible asset of the acquiree, but only when it meets the definition of an intangible asset in IAS 38 *Intangible Assets* and its fair value can be measured reliably. A non-monetary asset without physical substance must be identifiable to meet the definition of an intangible asset. In accordance with IAS 38, an asset meets the identifiability criterion in the definition of an intangible asset only if it arises from contractual or other legal rights or is separable. Previously IAS 22 required an acquirer to recognise any identifiable asset of the acquiree separately from goodwill at the acquisition date if it was probable that any associated future economic benefits would flow to the acquirer and the asset could be measured reliably. The previous version of IAS 38 clarified the definition of an intangible asset required an intangible asset to be identifiable to distinguish it from goodwill. However, it did not define 'identifiability', but stated that an intangible asset could be distinguished from goodwill if the asset was separable, though separability was not a necessary condition for identifiability. Therefore, previously under international standards, to be recognised separately from goodwill an intangible asset would have to be identifiable and reliably measurable, and it would have to be probable that any associated future economic benefits would flow to the acquirer.

BC89 Changes during 2001 to the requirements in Canadian and United States standards on the separate recognition of intangible assets acquired in a business combination prompted the Board to consider whether it also should explore this issue as part of the first phase of its Business Combinations project. The Board observed that intangible assets comprise an increasing proportion of the assets of many entities, and that intangible assets acquired in a business combination were often included in the amount recognised as goodwill, despite the previous requirements in IAS 22 and the previous version of IAS 38 that they should be recognised separately from goodwill. The Board also agreed with the conclusion reached in IAS 22 and by the Canadian and US standard-setters that the usefulness of financial statements would be enhanced if intangible assets acquired in a business combination were distinguished from goodwill. Therefore, the Board concluded that IAS 38 and the IFRS arising from the first phase of the project should provide a definitive basis for identifying and recognising intangible assets acquired in a business combination separately from goodwill.

BC90 The Board focused its deliberations first on intangible assets, other than in-process research and development projects, acquired in a business combination. Paragraphs BC91–BC103 outline those deliberations. The Board then considered whether the criteria for recognising those intangible assets separately from goodwill should also be applied to in-process research and development projects acquired in a business combination, and concluded that they should. The Board's reasons for reaching this conclusion are outlined in paragraphs BC104–BC106.

BC91 In revising IAS 38 and developing the IFRS, the Board affirmed the view contained in the previous version of IAS 38 that identifiability is the characteristic that conceptually distinguishes other intangible assets from goodwill. The Board concluded that to provide a definitive basis for identifying and recognising intangible assets separately from goodwill, the concept of identifiability needed to be articulated more clearly.

BC92 Consistently with the guidance in the previous version of IAS 38, the Board concluded that an intangible asset can be distinguished from goodwill if it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged. Therefore, in the context of intangible assets, separability signifies identifiability, and intangible assets with that characteristic that are acquired in a business combination should be recognised as assets separately from goodwill.

BC93 However, again consistently with the guidance in the previous version of IAS 38, the Board concluded that separability is not the only indication of identifiability. The Board observed that, in contrast to goodwill, the values of many intangible assets arise from rights conveyed legally by contract or statute. In the case of acquired goodwill, its value arises from the collection of assembled assets that make up an acquired entity or the value created by assembling a collection of assets through a business combination, such as the synergies that are expected to result from combining two or more entities or businesses. The Board also observed that, although many intangible assets are both separable and arise from contractual-legal rights, some contractual-legal rights establish property interests that are not readily separable from the entity as a whole. For example, under the laws of some jurisdictions some licences granted to an entity are not transferable except by sale of the entity as a whole. The Board concluded that the fact that an intangible asset arises from contractual or other legal rights is a characteristic that distinguishes it

from goodwill. Therefore, intangible assets with that characteristic that are acquired in a business combination should be recognised as assets separately from goodwill.

BC94 As outlined in paragraph BC88, the previous Standards required an intangible asset acquired in a business combination and determined to be identifiable also to satisfy the following recognition criteria to be recognised as an asset separately from goodwill:

(a) it must be probable that any associated future economic benefits will flow to the acquirer; and

(b) it must be reliably measurable.

BC95 ED 3 and the Exposure Draft of Proposed Amendments to IAS 38 proposed that the above recognition criteria would, with the exception of an assembled workforce, always be satisfied for an intangible asset acquired in a business combination. Therefore, those criteria were not included in ED 3. ED 3 proposed requiring an acquirer to recognise separately at the acquisition date all of the acquiree's intangible assets as defined in IAS 38, other than an assembled workforce. After considering respondents' comments, the Board decided:

(a) to proceed with the proposal that the probability recognition criterion is always considered to be satisfied for intangible assets acquired in a business combination.

(b) not to proceed with the proposal that, with the exception of an assembled workforce, sufficient information should always exist to measure reliably the fair value of an intangible asset acquired in a business combination.

BC96 In developing ED 3 and the IFRS, the Board observed that the fair value of an intangible asset reflects market expectations about the probability that the future economic benefits associated with the intangible asset will flow to the acquirer. In other words, the effect of probability is reflected in the fair value measurement of an intangible asset. The Board concluded that, given its decision to require the acquirer to recognise the acquiree's intangible assets satisfying the relevant criteria at their fair values as part of allocating the cost of a business combination, the probability recognition criterion need not be included in the IFRS. The Board observed that this highlights a general inconsistency between the recognition criteria for assets and liabilities in the *Framework* (which states that an item meeting the definition of an element should be recognised only if it is probable that any future economic benefits associated with the item will flow to or from the entity, and the item can be measured reliably) and the fair value measurements required in, for example, a business combination. However, the Board concluded that the role of probability as a criterion for recognition in the *Framework* should be considered more generally as part of a forthcoming Concepts project.

BC97 In developing ED 3 and the IAS 38 Exposure Draft, the Board had concluded that, except for an assembled workforce, sufficient information could reasonably be expected to exist to measure reliably the fair value of an asset that has an underlying contractual or legal basis or is capable of being separated from the entity. Respondents generally disagreed with this conclusion, arguing that:

(a) it might not always be possible to measure reliably the fair value of an asset that has an underlying contractual or legal basis or is capable of being separated from the entity.

(b) a similar presumption does not exist in IFRSs for identifiable tangible assets acquired in a business combination. Indeed, the Board decided when developing the IFRS to carry forward from IAS 22 the general principle that an acquirer should recognise separately from goodwill the acquiree's identifiable tangible assets, but only provided they can be measured reliably.

BC98 Additionally, as part of its consultative process, the Board conducted field visits and round-table discussions during the comment period for the Exposure Draft. 2 Field visit and round-table participants were asked a series of questions aimed at improving the Board's understanding of whether there might exist non-monetary assets without physical substance that are separable or arise from legal or other contractual rights, but for which there may *not* be sufficient information to measure fair value reliably.

BC99 The field visit and round-table participants provided numerous examples of intangible assets they had acquired in recent business combinations whose fair values might not be reliably measurable. For example, one participant acquired water acquisition rights as part of a business combination. The rights are extremely valuable to many manufacturers operating in the same jurisdiction as the participant—the manufacturers cannot acquire water and, in many cases, cannot operate their plants without them. Local authorities grant the rights at little or no cost, but in limited numbers, for fixed periods (normally 10 years), and renewal is certain at little or no cost. The rights cannot be sold other than as part of the sale of a business as a whole, therefore there exists no secondary market in the rights. If a manufacturer hands

the rights back to the local authority, it is prohibited from reapplying. The participant argued that it could not value these rights separately from its businesses (and therefore from the goodwill), because the businesses would cease to exist without the rights.

BC100 After considering respondents' comments and the experiences of field visit and round-table participants, the Board concluded that, in some instances, there might not be sufficient information to measure reliably the fair value of an intangible asset separately from goodwill, notwithstanding that the asset is 'identifiable'. The Board observed that the intangible assets whose fair values respondents and field visit and round-table participants could not measure reliably arose either:

(a) from legal or other contractual rights and are not separable (ie could be transferred only as part of the sale of a business as a whole); or

(b) from legal or other contractual rights and are separable (ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability), but there is no history or evidence of exchange transactions for the same or similar assets, and otherwise estimating fair value would be dependent on variables whose effect is not measurable.

BC101 Nevertheless, the Board remained of the view that the usefulness of financial statements would be enhanced if intangible assets acquired in a business combination were distinguished from goodwill, particularly given the Board's decision to regard goodwill as an indefinite-lived asset that is not amortised. The Board also remained concerned that failing the reliability of measurement recognition criterion might be inappropriately used by entities as a basis for not recognising intangible assets separately from goodwill. For example, IAS 22 and the previous version of IAS 38 required an acquirer to recognise an intangible asset of the acquiree separately from goodwill at the acquisition date if it was probable that any associated future economic benefits would flow to the acquirer and the asset's fair value could be measured reliably. The Board observed when developing ED 3 that although intangible assets constitute an increasing proportion of the assets of many entities, those acquired in business combinations were often included in the amount recognised as goodwill, despite the requirements in IAS 22 and the previous version of IAS 38 that they should be recognised separately from goodwill.

BC102 Therefore, although the Board decided not to proceed with the proposal that, with the exception of an assembled workforce, sufficient information should always exist to measure reliably the fair value of an intangible asset acquired in a business combination, the Board also decided to clarify in IAS 38 that the fair value of an intangible asset acquired in a business combination can normally be measured with sufficient reliability for it to be recognised separately from goodwill. When, for the estimates used to measure an intangible asset's fair value, there is a range of possible outcomes with different probabilities, that uncertainty enters into the measurement of the asset's fair value, rather than demonstrates an inability to measure fair value reliably.

(b) to include in IAS 38 a rebuttable presumption that the fair value of a finite-lived intangible asset acquired in a business combination can be measured reliably.

(c) to clarify in IAS 38 that the only circumstances in which it might not be possible to measure reliably the fair value of an intangible asset acquired in a business combination are when the intangible asset arises from legal or other contractual rights and it either (i) is not separable or (ii) is separable but there is no history or evidence of exchange transactions for the same or similar assets and otherwise estimating fair value would be dependent on variables whose effect is not measurable.

(d) to include in the IFRS a requirement for entities to disclose a description of each asset that meets the definition of an intangible asset and was acquired in a business combination during the period but was not recognised separately from goodwill, and an explanation of why its fair value could not be measured reliably.

BC103 Some respondents and field visit participants suggested that it might also not be possible to measure reliably the fair value of an intangible asset when it is separable, but only together with a related contract, asset or liability (ie it is not individually separable), there is no history of exchange transactions for the same or similar assets on a stand-alone basis, and, because the related items produce jointly the same cash flows, the fair value of each could be estimated only by arbitrarily allocating those cash flows between the two items. The Board disagreed that such circumstances provide a basis for subsuming the value of the intangible asset within the carrying amount of goodwill. Although some intangible assets are so closely related to other identifiable assets or liabilities that they are usually sold as a 'package', it

would still be possible to measure reliably the fair value of that 'package'. Therefore, the Board decided to include the following clarifications in IAS 38:

(a) when an intangible asset acquired in a business combination is separable but only together with a related tangible or intangible asset, the acquirer recognises the group of assets as a single asset separately from goodwill if the individual fair values of the assets in the group are not reliably measurable.

(b) similarly, an acquirer recognises as a single asset a group of complementary intangible assets constituting a brand if the individual fair values of the complementary assets are not reliably measurable. If the individual fair values of the complementary assets are reliably measurable, the acquirer may recognise them as a single asset separately from goodwill, provided the individual assets have similar useful lives.

BC104 As noted in paragraph BC90, the Board also considered whether the criteria for recognising intangible assets separately from goodwill should also be applied to in-process research and development projects acquired in a business combination, and concluded that they should. In reaching this conclusion, the Board observed that the criteria in IAS 22 and the previous version of IAS 38 for recognising an intangible asset acquired in a business combination separately from goodwill applied to all intangible assets, including in-process research and development projects. Therefore, the effect of those Standards was that any intangible item acquired in a business combination was recognised as an asset separately from goodwill when it was identifiable and could be measured reliably, and it was probable that any associated future economic benefits would flow to the acquirer. If those criteria were not satisfied, the expenditure on that item, which was included in the cost of the combination, was attributed to goodwill.

BC105 The Board could see no conceptual justification for changing the approach in IAS 22 and the previous version of IAS 38 of using the same criteria for all intangible assets acquired in a business combination when assessing whether those assets should be recognised separately from goodwill. The Board concluded that adopting different criteria would impair the usefulness of the information provided to users about the assets acquired in a combination, because both comparability and reliability would be diminished.

BC106 Some respondents to ED 3 and the IAS 38 Exposure Draft expressed concern that applying the same criteria to all intangible assets acquired in a business combination to assess whether they should be recognised separately from goodwill results in treating some in-process research and development projects acquired in business combinations differently from similar projects started internally. The Board acknowledged this point. However, it concluded that this does not provide a basis for subsuming those acquired intangible assets within goodwill. Rather, it highlights a need to reconsider the view taken in IAS 38 that an intangible asset can never exist in respect of an in--process research project and can exist in respect of an in-process development project only once all of the criteria for deferral in IAS 38 have been satisfied. The Board concluded that such a reconsideration is outside the scope of its Business Combinations project.

Appendix E: Extract from the comment letter analysis presented at the September 2014 IASB meeting on accounting for goodwill and impairment

How useful have you found the information obtained from annually assessing goodwill and intangible assets with indefinite useful lives for impairment, and why?

E1. Some users supported the current requirements on subsequent measurement of goodwill and indefinite-lived intangible assets, because they think that the non-amortisation of goodwill:

(a) is useful for relating the price paid to what was acquired and for calculating the Return on Invested capital (ie ROI).

(b) helps them to assess the stewardship of the management. It gives them a better understanding of whether the management has overpaid or whether the acquisition was successful.

(c) helps them to verify whether an acquisition is working as expected and whether the acquirer is still expecting future economic benefits, such as synergies, from the business combination.

(d) impairment test of goodwill can act as a clearing event, which demonstrates to investors that management has recognised previous mistakes and can 'move on'.

They consider the amortisation of goodwill to be only an arbitrary allocation exercise (ie it does not provide useful information). Consequently, they would disregard the amortisation of goodwill in their analysis.

E2. They think that the information provided by the impairment test of goodwill is useful, because it has a confirmative value. However, they admit that impairment losses are often recognised too late (ie it has not predictive value).

E3. Other users supported the amortisation of goodwill and indefinite-lived intangible assets, because they think that:

(a) assumptions used in the impairment test are too optimistic and difficult to analyse.

(b) impairment losses are recognised when the investors have already reached a view that the company over paid for the acquisition and, therefore, the market ignores the impairment test results (ie the impairment loss is already included in the share price).

(c) estimating the useful life of goodwill is possible and is no more difficult than estimating the useful life of other intangible assets.

(d) goodwill has been paid for and so, sooner or later, it should have an impact on profit or loss.

(e) goodwill represents future profits, thus should be allocated over time.

(f) amortising goodwill reflects that the acquirer need to 'maintain' the profitability of the acquired company. The amortisation reflects the costs incurred by acquirer to maintain such profitability.

(g) amortising goodwill would decrease volatility in profit or loss when compared to an impairment model.

(h) amortising goodwill would improve comparability between companies that grow organically (ie without acquisitions) and companies that grow through acquisitions, because the non-amortisation of goodwill discriminates companies that grow organically.

(i) goodwill acquired in a business combination is supported and replaced by internally generated goodwill over time.

(j) amortising goodwill would reduce pressure on the identification of intangible assets, because both goodwill and intangible assets would be amortised.

E4. Many users think that information required by IAS 36 *Impairment of Assets* is useful. Useful disclosures include discount rates used, long-term growth rates, profit and capital expenditure assumptions and sensitivities. However, some users think that the disclosed information is boilerplate and insufficient for them to assess whether or not the main inputs/assumptions are reasonable.

E5. Some users[14] think that to make impairment tests more useful, companies should carry them out whenever there is a significant change in market conditions that would drive a change in profit forecasts. In their view, the need to conduct a test in response to value-threatening events should be reinforced. They also think that more information about the assumptions fed into valuation models would be useful. Such granular disclosure should come out as soon as possible (ie with the preliminary full-year results, instead of just in the notes of the annual report).

Is other information needed to properly understand the effect of the acquisition on a group? If so, what information is needed and why?

(Not strictly related to feedback on accounting for goodwill and impairment but the staff think this section of the comment letter analysis helps us understand what information users want about goodwill and impairment)

E6. Many users think that once an acquisition has been completed it is often hard to track the subsequent performance of the acquired business. Consequently, they think that better disclosure is needed to allow them to do so. For example, it is important for them to know how much of the business has grown organically versus how much it has grown through acquisitions. Up to the end of the first full year after the acquisition, it would be helpful for them to know the contribution of the acquiree to revenue, gross profit and/or operating profit.

E7. Many users also require clear information on the operating performance of the acquired business, specifically, revenue and operating profit over preceding periods and pro-forma prior year comparative information for the combined entity for purposes of their trend analysis.

E8. Users often seek to assess the return on the capital (cash or cash equivalent) that has been deployed in an acquisition. However, they think that it is often difficult to ascertain what consideration has been paid for an acquisition. For them it is critical to calculate the total consideration including cash paid, cash acquired, debts and pensions liabilities assumed, fees and restructuring costs, shares and notes issued to the vendor together with any deferred consideration. They told us that:

(a) beyond the cash paid and cash acquired, disclosure is often incomplete; and

[14] See, for example, CFA UK's comment letter.

(b) entities are required to provide information on the major categories of assets and liabilities acquired but short term debt, for instance, can be ‘hidden’ within current liabilities.

E9. They also think that it would be useful also to have more information about the inputs and methodologies used to measure the fair value of the acquired assets and liabilities, such as the disclosures in IFRS 13.

E10. When there are anticipated restructuring costs in order to realise the synergies that justify an acquisition, some users would like the company to disclose subsequent progress (amounts and timing) on achieving the cost savings and on the related spending on restructuring. They also think that, since tax arbitrage is increasingly being cited as a potential ‘benefit’ of an acquisition, the acquirer should set out its targets for tax rate reduction and the potential gains to net income. Post-acquisition, progress on achieving these gains should be reported on along with the gains from restructuring etc.

E11. Some users would like to see a requirement to disclose the acquiree's carrying amount of the assets acquired and the liabilities assumed by the acquirer at the acquisition date and any fair value adjustments to these amounts. They think that knowing which types of assets had significant increases in fair value over the carrying amount in the acquiree's financial statements would be useful to them in evaluating the post-acquisition statement of financial position.

E12. Many users expressed concerns about the quality of the information disclosed about the primary reasons for business combinations. In their view, entities often provide very general ‘boiler plate’ explanations that lacked insight on the real economic reasons for the acquisition.

E13. Some users ask the IASB to improve IAS 34 with regards to information on business combinations. They think that this information is less comprehensive than information reported in annual financial statements and that the timing of disclosures is crucial, given stock prices sensitiveness to companies’ business combinations announcements. In addition, in their view, the interim financial statements do not sufficiently explain the developments in business combinations that are still within the measurement period under IFRS 3.

E14. Some that:

(a) the requirement to provide disclosure about the impact of acquisitions made after the reporting date, but before the financial statements are authorised, can be difficult, because the information is not often known and so the disclosures are not always meaningful; and

(b) the disclosures made regarding the qualitative description of goodwill are often generic and tend not to provide useful information.

Appendix F: Capital Markets Advisory Committee (CMAC) meeting summaries

F1. The staff discussed the PIR of IFRS 3 with CMAC members during October 2013, February 2014 and June 2014. The staff have included the extracts on goodwill and impairment from the CMAC meeting summaries on our website (http://www.ifrs.org/About-us/IASB/Advisory-bodies/CMAC/past-meetings/Pages/past-meetings.aspx).

October 2013 CMAC meeting

F2. There were different views on whether amortising goodwill could be better than impairment.

(a) The majority supported more timely impairment testing, and enhanced disclosures to increase transparency. Some believe that while impairment is often delayed, amortisation is not the right answer because it will hide bad investment decisions and subsequent decreases in value of the purchase. In the end the market will make the correction even if the impairment is not recognised in the appropriate period. These members would add back any amortisation costs because they would otherwise distort their calculation of return on invested capital.

(b) However, one member supported bringing back the amortisation of goodwill. This member believes that management is too optimistic and will therefore pay more for a company but may not take the impairment at the appropriate time

February 2014 CMAC meeting

F3. Some members supported the non-amortisation of goodwill and indefinite-lived intangible assets because:

(a) they find it useful for calculating the Return on Investment (ROI);

(b) it gives them a better understanding of whether the management has overpaid and/or whether the acquisition was successful;

(c) it enables them to assess management (eg whether the acquisition was a good business decision); and

(d) it helps them to verify whether an acquisition is working as expected.

F4. Other members supported the amortisation of goodwill and indefinite-lived intangible assets, because:

(a) they believe that the impairment test is unrealistic; goodwill is always recoverable even if the market capitalisation is low and the value of goodwill is significant;

(b) they believe that the impairment test is not effective, so the market ignores the impairment test results;

(c) they believe that estimating the useful life of goodwill is possible and is no more difficult than estimating the useful life of other intangible assets;

(d) that goodwill has been paid for and so, sooner or later, it should have an impact on profit or loss.

F5. Many members also think that the impairment test disclosures are useful (even though some of them think that goodwill should be amortised).

June 2014 CMAC meeting (Joint meeting with GPF)

F6. GPF and CMAC members discussed:

(a) whether goodwill should be amortised, or simply be subject to an impairment test; and

(b) the implementation issues arising from the requirement in IFRS 3 to assess test goodwill for impairment, without amortising it.

F7. Their comments include:

(a) Some GPF and CMAC members thought that goodwill should be amortised, because it represents future profits, and thus should be allocated over time. Some also thought that this method was more straightforward to explain and would be less subjective to implement.

(b) Some GPF members stated that amortising goodwill reflected the fact that the parent needed to 'maintain' the revenue-generating capability of the acquiree.

(c) Some CMAC members disagreed with the requirements in IFRS 3 not to amortise goodwill, because they thought that goodwill acquired in a business combination is subsequently replaced progressively by internally generated goodwill.

(d) Other CMAC members supported the impairment test for goodwill because they thought that it helps them to assess the stewardship of the management of the company and helps them to monitor the synergies from the acquisition. They did not support amortisation of goodwill, because they thought that the goodwill has an indefinite life and they considered amortisation to be merely an arbitrary allocation exercise.

(e) Some GPF members thought that testing goodwill for impairment is difficult, because it is difficult to allocate the cash flows relating to the goodwill acquired separately from other cash flows. They stated that the judgements required for this disclosure were not only complex, but could also result in inconsistent application.

(f) Some GPF and CMAC members suggested that the IASB should reconsider this decision, because they were of the view that existing impairment requirements did not provide investors and analysts with timely information.

(g) Many GPF and CMAC members stated that if the IASB were to reconsider this requirement, it should do so jointly with the FASB.

Appendix G: FASB outreach outlined in their September paper

G1. At the September 2015 meeting the FASB staff presented a paper that provided summary of their outreach and work to date on accounting for goodwill for public business entities (PBE) and not for profits project (see IASB Agenda Paper 13E/FASB Memo No 6 for the September meeting). In that paper the FASB staff noted the following from their outreach with users of PBE financial statements:

(a) All users of PBE financial statements that the staff spoke to said goodwill amortization would not provide relevant information and indicated that they would make an adjustment to earnings for goodwill amortisation. The staff observes from its research that users ignored goodwill amortisation when goodwill was amortized prior to Statement 147 *Goodwill and Other Intangible Assets*.

(b) While some users were indifferent to which model is used for the subsequent measurement of goodwill (more often lenders), many users (more often credit rating agencies and equity analysts) noted the following

(i) Impairment charges do provide some relevant information from a qualitative perspective.

(ii) Impairment charges are a lagging indicator of issues and are often anticipated (particularly if the issues that drive the impairment are industry-wide issues).

(iii) The exact amount of the impairment may not be important and is not directly used in projecting cash flows, but the general magnitude of impairment, frequency of impairment, and acknowledgement by management that future cash flows might be lower than anticipated can provide useful information.

(iv) The accumulation of impairment charges over time can inform an investor's view of management's business acumen and future prospects of the company.

(v) Goodwill impairment is an area where users can gain insights into changes in management's cash flow projections

(c) Some users stated that they focus on tangible book value (or their focus also might include certain identifiable intangible assets) and do not see goodwill as an asset. Some of those users were open to a direct write-off of goodwill, but some highlighted that disclosures would have to provide a history of the capital invested in acquisitions for investment return calculations. Some users were open to the idea of a direct write-off over amortization primarily because it would not require an adjustment to an entity's reported results each reporting period.

(d) The staff notes that the feedback from users that goodwill impairment is not used quantitatively, but can be helpful qualitatively, is consistent with the feedback the FASB received in connection with outreach performed when the qualitative screen was developed in 2011. An outreach summary from February 2011 on that project indicated that users were fairly indifferent about the manner in which goodwill is assessed for impairment but they would support any change that reduces costs incurred by preparers if it achieves a similar result from applying current guidance. Overall, the staff believes that users have been more outspoken in current outreach about the qualitative benefits of goodwill impairment and that may be due to the fact that amortization or a direct write-off would not achieve a result similar to current guidance.

Appendix H: History behind the development of the requirements for accounting for goodwill

H1. The staff have included extracts from the 1998 Basis for Conclusions accompanying IAS 22 *Business Combinations* and extracts from the 2004 Basis for Conclusions accompanying IFRS 3(2004) *Business Combinations* to enable IASB members to see how the reasoning of the IASB/IASC has developed over time.

1998 Extracts from the Basis for Conclusions to IAS 22 (revised 1998) Business Combinations[15]

H2. The following extracts discuss changes made in July 1998 to IAS 22 for the amortisation of goodwill[16].

Amortisation of Intangible Assets and Goodwill

41. The requirements for the amortisation of intangible assets and goodwill raised the most significant controversy in the development of IAS 38 *Intangible Assets* and in the revisions to IAS 22 *Business Combinations*. The issues are the following:
    (a) whether amortisation is appropriate for all intangible assets and goodwill; and
    (b) if so, what the amortisation period should be.

42. As explained in paragraph 2, the Board supported adopting the same requirements for the amortisation of intangible assets and goodwill. This is to avoid creating opportunities for accounting arbitrage. The spectrum of intangible assets is broad and some consider certain intangible assets to be similar to goodwill (for example a brand name, a masthead, etc.). Therefore, the reasons for supporting or rejecting certain alternative solutions expressed in this document apply to the treatment of both intangible assets (in IAS 38) and goodwill (in IAS 22, Business Combinations).

Background on the Requirements for the Amortisation of Intangible Assets and Goodwill

43. Proposed and approved requirements for the amortisation of intangible assets and goodwill include:
    (a) in 1993, during revisions to IAS 22, Accounting for Business Combinations, the Board introduced a 20 year ceiling on the amortisation period for goodwill;
    (b) in 1995, the Board proposed in Exposure Draft E50, Intangible Assets, requirements for the amortisation of intangible assets that reflected the requirements for goodwill in IAS 22, Business Combinations, approved in 1993. However, because some intangible assets are different from goodwill, the Board proposed limited exceptions to the general requirements. The proposed amortisation requirements for intangible assets were opposed by many commentators on E50; and
    (c) in 1997, the Board proposed in Exposure Drafts E60, Intangible Assets, and E61, Business Combinations:
        (i) to require that intangible assets and goodwill should be amortised over the best estimate of their useful life;
        (ii) to convert the 20 year ceiling on the amortisation of intangible assets and goodwill into a rebuttable presumption that the useful life of these assets will not exceed 20 years;
        (iii) to require the application of an annual impairment test whenever the amortisation period for intangible assets or goodwill exceeds 20 years; and

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[15] The Basis for Conclusions to IAS 22 was derived from the Basis for Conclusions published in August 1997 with Exposure Draft E60 *Intangible Assets*. It was prepared by the IASC staff and has not been reviewed by the IASC Board

[16] This document uses the term 'goodwill' with the meaning of IAS 22 *Business Combinations* that is, it refers to 'purchased' goodwill rather than 'internally generated' goodwill. Also, references to 'intangible assets' in this document refer solely to intangible assets that are covered by IAS 38 *Intangible Assets* and, therefore, do not refer to goodwill.

(iv) to require disclosure of the reasons why the 20 year presumption on the useful life of intangible assets and goodwill is rebutted.

44. The majority of commentators on E60 and E61 supported the Board's proposals. A minority of commentators on E60 strongly supported no amortisation of intangible assets with long estimated useful lives. Another minority of commentators on E61 strongly supported amortising goodwill over 20 years or less. Some commentators mentioned that the proposals were not their preferred choice but did not object to them as a compromise.

Impairment Tests Instead of Amortisation

45. Some favour applying a regular impairment test to some intangible assets and goodwill instead of amortising them, on one or more of the following grounds:

(a) intangible assets and goodwill may have an infinite (or very long) useful life. Proponents of this view argue that:

(i) the value of some intangible assets and goodwill does not decrease over time. They claim that, for example, where history demonstrates that an intangible asset, or a business to which goodwill relates, can be maintained over a long period, amortisation is inappropriate. They explain that the objective of amortisation is to reflect the consumption of service potential and argue that certain intangible assets and goodwill are not consumed. They quote examples of brand names which have existed for more than 150 years and whose value has increased; and/or

(ii) it is virtually impossible to determine a meaningful useful life;

(b) companies incur expenditure to maintain the value of intangible assets or goodwill. This expenditure is recognised as an expense. Therefore, amortisation would, in effect, be a double charge if the value of an intangible asset or goodwill does not decrease;

(c) goodwill is a portion of a larger asset, the underlying investment. They argue that since investments are not amortised, goodwill should not be amortised; and

(d) since amortisation of intangible assets or goodwill can be determined only on an arbitrary basis, applying an impairment test:

(i) better reflects any consumption of intangible assets or goodwill; and

(ii) gives more relevant information on whether the value of an intangible asset or goodwill has been maintained.

46. The Board's view – consistently reflected in IAS 38, Intangible Assets, in IAS 22, Business Combinations, and in previous exposure drafts – is that intangible assets and goodwill should always be amortised and that impairment tests should not be used as a replacement for a systematic allocation of cost. The Board believes that:

(a) the depreciable amount (cost less residual value, if any) of all assets (other than assets held as investments) should be allocated on a systematic basis to reflect the consumption of these assets over their useful lives, even if they are long. The future economic benefits embodied in an intangible asset and goodwill are always consumed. Although there may be no physical limit to the useful life of some intangible assets and goodwill, infinite lives do not exist;

(b) if the value of an intangible asset or goodwill does not decrease over time, it is because the potential for economic benefits that was purchased initially has been progressively replaced by the potential for economic benefits resulting from subsequent enhancements to the asset. Unless the expenditure on these

enhancements meets the requirements under IAS 38 to be added to the cost of the intangible asset, it contributes to the internally generated goodwill of the enterprise. The Board does not support the recognition of internally generated goodwill as an asset; and

(c) an impairment approach is a valuation concept rather than one of allocation of cost. The purpose of an impairment test is to ensure that the carrying amount of an asset will be recovered through use or sale of the asset. It is not to reflect the consumption of the economic benefits embodied in an asset.

Amortisation Period

47. Some argue that there should be an arbitrary ceiling on the amortisation period for intangible assets and goodwill for one or more of the following reasons:

   (a) it is often not possible to determine the useful life of intangible assets and goodwill reliably. Therefore, individual preparers should not be permitted to select their own amortisation period. Comparability of financial statements is enhanced if preparers and auditors are required to respond in the same manner to the same uncertainties;

   (b) future economic benefits embodied in intangible assets and goodwill do not last forever. History tends to support this view. For example, certain brand names and newspaper mastheads were effective in generating significant economic benefits for long periods in the past but no longer exist. In recent times, changing economic circumstances and consumer preferences and attitudes, together with technological advances and aggressive marketing campaigns by competitors, have undermined the economic value of a number of prominent long-lived brand names;

   (c) as an enterprise's planning horizon for its operations as a whole is unlikely to exceed 20 years, projections of the life of intangible assets and goodwill beyond this period are not sufficiently reliable to permit an amortisation period of longer than 20 years; and

   (d) no impairment test can be robust enough to ensure that carrying amounts will not be overstated. In addition, certain features of the IASC's impairment test, as set out in IAS 36, Impairment of Assets, (such as how recoverable amount should be estimated and the use of cash-generating units) will make it impossible to avoid the recognition of some internally generated goodwill.

48. E50, Intangible Assets, identified two cases where the useful life of an intangible asset could be measured reliably beyond 20 years. These were if there was a legal right to use the asset over more than 20 years and:

   (a) the intangible asset was not separable from a specific tangible asset whose useful life could be reliably determined to exceed 20 years. This case applied to industries where the planning horizon exceeds 20 years and the useful life of intangible assets is limited only by the physical deterioration of associated tangible assets. For example, some held the view that a licence to supply water is not separable from the physical distribution network. Therefore, they would amortise the licence over the shorter of the term of the licence and the useful life of the distribution network; or

   (b) there was an active (secondary) market for the asset.

49. A large proportion of commentators on E50 disagreed that the amortisation requirements for intangible assets should be different from those for property, plant and equipment in IAS 16, Property, Plant and Equipment – i.e. they disagreed that

there should be an arbitrary ceiling on the amortisation period of intangible assets. They argued that the cases proposed in E50 where an intangible asset could be amortised over more than 20 years were too limited and that there were other cases where the useful life of an intangible asset could be determined reliably beyond 20 years.

50. Commentators on E50 also pointed out that the limit of 20 years from the date of initial recognition could lead to odd results when the allowed alternative treatment for subsequent measurement was applied. For example, if an asset was revalued up until the nineteenth year, E50 proposed that the twentieth year would bear amortisation of the full carrying amount.

51. Finally, since 1993, the IASC had received many complaints that the requirements for the amortisation of goodwill, in some cases, did not reflect business reality. Some argued that the useful life of an acquired business could sometimes be reliably estimated to be longer than 20 years and, therefore, the amortisation period for goodwill should not always be limited to 20 years.

52. In the light of the comments received on E50, the Board concluded that:

    (a) in most cases, it will not be possible to determine reliably that the useful life of an intangible asset or goodwill will exceed 20 years from initial recognition. However, there are some specific cases where this general presumption is not true, and not just in the circumstances described in E50. To impose an arbitrary limit in such cases would be contradictory to the objective of fair presentation;

    (b) detailed requirements for testing the recoverability of an asset are now available (see IAS 36, Impairment of Assets). These reduce the need for an arbitrary ceiling on the amortisation period;

    (c) the amortisation requirements for goodwill and intangible assets should remain the same; and

    (d) an acceptable solution to the issue of the amortisation of intangible assets and goodwill should be found, even if this solution is not the preferred choice of those who favour an arbitrary ceiling or of those who favour no amortisation at all.

53. As a result, IAS 38 and IAS 22 (revised 1998) reflect the Board's view – supported by the majority of commentators on E60 and E61 – that intangible assets and goodwill should be amortised over the best estimate of their useful life (without any specified arbitrary upper limit) with a rebuttable presumption that the useful life of intangible assets and goodwill is 20 years or less. If an enterprise amortises an intangible asset or goodwill over more than 20 years:

    (a) the intangible asset or the goodwill should be tested for impairment at least annually (even if there is no indication that the asset may be impaired); and

    (b) the enterprise should disclose the reasons why the 20 year presumption on the useful life of an intangible asset or goodwill is rebutted, and also the factor(s) that played a significant role in determining the useful life of the asset.

54. E60 included an additional proposal to test for impairment, at least annually, internally generated intangible assets that are amortised over more than 5 years. Commentators on E60 opposed the proposal to introduce different requirements for different types of intangible assets. Therefore, the Board withdrew the proposal and added guidance on determining the useful life of the intangible assets that were targeted by E60's proposal (i.e. computer software and other intangible assets that are susceptible to technological obsolescence).

55. Some commentators on E60 and E61 supported reducing the period for the rebuttable presumption on the useful life of intangible assets and goodwill. Particularly, proposals were made to reduce the period to 5 or 10 years for goodwill. These commentators believe that it is unlikely that the future economic benefits embodied in goodwill can last longer than this. A few commentators proposed extending the period to, say, 40 years.

56. Although IAS 22 (revised 1993) included a 5 year rebuttable presumption for the useful life of goodwill, the Board believes that 20 years is a reasonable period that is applicable to both intangible assets and goodwill.

2004 Extracts from the Basis for Conclusions in IAS 36 (and IFRS 3(2004))

H3. The following extracts from the Basis for Conclusions in IAS 36 *Impairment of Assets* (these were also in IFRS 3(2004)) explain the IASB reasoning for choosing an impairment only model over an amortisation with impairment model in 2004:

BC131A The Board concluded that goodwill should not be amortised and instead should be tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired. IAS 22 Business Combinations required acquired goodwill to be amortised on a systematic basis over the best estimate of its useful life. There was a rebuttable presumption that its useful life did not exceed twenty years from initial recognition. If that presumption was rebutted, acquired goodwill was required to be tested for impairment in accordance with the previous version of IAS 36 at least at each financial year-end, even if there was no indication that it was impaired.

BC131B In considering the appropriate accounting for acquired goodwill after its initial recognition, the Board examined the following three approaches:

(a) straight-line amortisation but with an impairment test whenever there is an indication that the goodwill might be impaired;

(b) non-amortisation but with an impairment test annually or more frequently if events or changes in circumstances indicate that the goodwill might be impaired; and

(c) permitting entities a choice between approaches (a) and (b).

BC131C The Board concluded, and the respondents to ED 3 Business Combinations that expressed a clear view on this issue generally agreed, that entities should not be allowed a choice between approaches (a) and (b). Permitting such choices impairs the usefulness of the information provided to users of financial statements because both comparability and reliability are diminished.

BC131D The respondents to ED 3 who expressed a clear view on this issue generally supported approach (a). They put forward the following arguments in support of that approach:

(a) acquired goodwill is an asset that is consumed and replaced by internally generated goodwill. Therefore, amortisation ensures that the acquired goodwill is recognised in profit or loss and no internally generated goodwill is recognised as an asset in its place, consistently with the general prohibition in IAS 38 on the recognition of internally generated goodwill.

(b) conceptually, amortisation is a method of allocating the cost of acquired goodwill over the periods it is consumed, and is consistent with the approach taken to other

intangible and tangible fixed assets that do not have indefinite useful lives. Indeed, entities are required to determine the useful lives of items of property, plant and equipment, and allocate their depreciable amounts on a systematic basis over those useful lives. There is no conceptual reason for treating acquired goodwill differently.

(c) the useful life of acquired goodwill cannot be predicted with a satisfactory level of reliability, nor can the pattern in which that goodwill diminishes be known. However, systematic amortisation over an albeit arbitrary period provides an appropriate balance between conceptual soundness and operationality at an acceptable cost: it is the only practical solution to an intractable problem.

BC131E In considering these comments, the Board agreed that achieving an acceptable level of reliability in the form of representational faithfulness while striking some balance with what is practicable was the primary challenge it faced in deliberating the subsequent accounting for goodwill. The Board observed that the useful life of acquired goodwill and the pattern in which it diminishes generally are not possible to predict, yet its amortisation depends on such predictions. As a result, the amount amortised in any given period can be described as at best an arbitrary estimate of the consumption of acquired goodwill during that period. The Board acknowledged that if goodwill is an asset, in some sense it must be true that goodwill acquired in a business combination is being consumed and replaced by internally generated goodwill, provided that an entity is able to maintain the overall value of goodwill (by, for example, expending resources on advertising and customer service). However, consistently with the view it reached in developing ED 3, the Board remained doubtful about the usefulness of an amortisation charge that reflects the consumption of acquired goodwill, when the internally generated goodwill replacing it is not recognised. Therefore, the Board reaffirmed the conclusion it reached in developing ED 3 that straight-line amortisation of goodwill over an arbitrary period fails to provide useful information. The Board noted that both anecdotal and research evidence supports this view.

BC131F In considering respondents' comments summarised in paragraph BC131D(b), the Board noted that although the useful lives of both goodwill and tangible fixed assets are directly related to the period over which they are expected to generate net cash inflows for the entity, the expected physical utility to the entity of a tangible fixed asset places an upper limit on the asset's useful life. In other words, unlike goodwill, the useful life of a tangible fixed asset could never extend beyond the asset's expected physical utility to the entity.

BC131G The Board reaffirmed the view it reached in developing ED 3 that if a rigorous and operational impairment test could be devised, more useful information would be provided to users of an entity's financial statements under an approach in which goodwill is not amortised, but instead tested for impairment annually or more frequently if events or changes in circumstances indicate that the goodwill might be impaired. After considering respondents' comments to the exposure draft of proposed amendments to IAS 36 on the form that such an impairment test should take, the Board concluded that a sufficiently rigorous and operational impairment test could be devised.