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STAFF PAPER

October 2015

IASB Meeting

Project	Goodwill and impairment project		
Paper topic	Subsequent accounting for goodwill		
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Objective of this paper

1. The purpose of this agenda paper is to help IASB members to:
   - (a) develop their views about approaches for subsequent accounting for goodwill following the joint meeting with the US Financial Accounting Standards Board (FASB) in September; and
   - (b) decide whether they need additional information before developing their views in (a).

Structure of this paper

2. This paper includes the following sections:
   - (a) Introduction to this agenda paper
   - (b) Staff analysis
     - (i) Overall objective of looking at subsequent accounting of goodwill
     - (ii) Four approaches for subsequent accounting for goodwill

       Approach 1: Amortisation of goodwill

       Approach 2: Accounting for the separate components of goodwill

       Approach 3: Direct write off of goodwill

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Approach 4: Only focusing on improving the impairment test for goodwill

(c) Staff recommendation and questions for the IASB

(d) Appendix A: Summary of what we've heard during the Post-implementation Review (PIR) of IFRS 3 *Business Combination*s on subsequent accounting for goodwill and impairment

(e) Appendix B: Extracts from the Basis for Conclusions accompanying IAS 36 *Impairment of Assets*

Introduction to this agenda paper

3. The IASB's report and feedback statement on the PIR of IFRS 3 provided the following possible next steps to address subsequent accounting for goodwill:

Area of focus	**Assessed significance**	**Possible next steps**
Subsequent accounting for goodwill (ie impairment-only approach compared with an amortisation and impairment approach).	High	Research will be undertaken. We could consider whether and how the costs of accounting for goodwill can be reduced without losing the information that is currently being provided by the impairment-only approach, and which our review of academic studies suggested was value-relevant. This could include considering: (a) how improvements to the impairment-only approach (in particular to the impairment test) could address some of the concerns that have been raised; and (b) whether a variation on an amortisation and impairment model could be developed with an amortisation method that does not undermine the information currently provided by the impairment-only approach.

4. The staff think there are four approaches to consider for subsequent accounting for goodwill:

   (a) Approach 1: Amortisation of goodwill

   (b) Approach 2: Accounting for the separate components of goodwill

   (c) Approach 3: Direct write off of goodwill

   (d) Approach 4: Only focusing on improving the impairment test

5. In this agenda paper the staff have listed the key arguments and advantages for and against each approach based on feedback during the PIR, the IASB's reasoning for its current accounting for goodwill, discussions with the FASB at the September 2015 meeting and the work of the FASB and the EFRAG/OIC/ASBJ Research Group[1] (see paragraphs 13-17 of Agenda Paper 18). The staff think that under all four approaches, improvements to the impairment test should be considered (addressed by Agenda Paper 18B).

6. The staff is not asking IASB members to make decisions on the four approaches at this meeting for the following reasons:

   (a) The staff think that the IASB should work with the FASB to avoid divergence between their converged Standards on business combinations and also to see if there is an opportunity to create further convergence for impairment testing. Consequently the staff recommend decisions about potential amendments to IFRS 3 are best taken jointly with the FASB at a later meeting. Nevertheless because the FASB has already discussed subsequent accounting for goodwill at several meetings, the staff think the IASB should have its own discussions initially before starting discussions with the FASB.

   (b) At the November 2015 meeting the staff plan to bring an agenda paper with proposals on recognising and measuring intangible assets acquired in a business combination. The staff recommendation in the November paper is likely to be that we should develop education material/guidance, rather than

[1] A research group consisting of individuals from the European Financial Reporting Advisory Group (EFRAG), the Organismo Italiano di Contabilità (OIC), and the Accounting Standards Board of Japan (ASBJ) (referred to as the EFRAG/OIC/ASBJ Research Group for the purpose of this agenda paper).

change the existing recognition requirements (and hence the composition of goodwill). However, staff have not had time to develop their analysis in time for this October meeting. The staff understand that IASB members need this analysis before making any decisions. The staff think that the views of IASB members on recognising and measuring intangible assets in a business combination may affect their views on the approaches being considered at this meeting because the topics are interrelated. For example, if IASB members were to support subsuming additional intangible assets, such as customer related intangibles, in goodwill this may influence their views about the four approaches in this agenda paper.

7. In September 2015 IASB Agenda Paper 13E the FASB staff identified four views for subsequent accounting for goodwill:

   (a) The Private Company Council (PCC alternative). Allows an entity to amortise goodwill over 10 years or less than 10 years if an entity demonstrates that another useful life is more appropriate. An entity would make an accounting policy election to test goodwill for impairment at the entity level or at the reporting unit level. It would test goodwill for impairment only when a triggering event occurs. An impairment loss would be measured as the difference between the carrying value of the entity and its fair value (if goodwill is tested for impairment at the entity level) or the carrying value of the reporting unit and its fair value (if goodwill is tested for impairment at the reporting unit level). This alternative is consistent with the alternative available for private companies.

   (b) Amortisation of goodwill with impairment tests over its useful life.

   (c) Direct write-off of goodwill.

   (d) Simplified impairment test.

8. The FASB has not made a decision about which view or views it prefers. However, based on the September 2015 meeting and discussions with FASB staff, the staff think FASB members appear more focussed on view (b) or (d).

Staff analysis

Overall objective of looking at subsequent accounting for goodwill

9. The staff think the overall objective of looking at subsequent accounting for goodwill should be to consider whether and how the costs of the current accounting can be reduced without losing the information that is provided by the impairment-only approach.

10. The staff think there also needs to be a strong argument to support making further significant changes to IFRS 3. Stakeholders have always had opposing and strongly held views on subsequent accounting for goodwill (in particular amortisation versus non-amortisation) and the feedback during the PIR did not provide evidence that this diversity has decreased.

Approach 1: Amortisation of goodwill

Description

11. Amortise goodwill over its expected life with impairment testing, with guidance on determining an appropriate useful life and amortisation method.

Advantages of an amortisation approach

12. The staff have identified the following as the key arguments for, and advantages of, considering an amortisation approach:

    (a) Some consider that over time acquired goodwill is generally consumed and replaced by internally generated goodwill. It is argued that an impairment only approach allows entities to effectively recognise internally generated goodwill. Some think that recognising acquired goodwill in profit or loss over time under an amortisation model would be consistent with the prohibition in IAS 38 on the recognition of internally generated goodwill.

    (b) Conceptually, amortisation is sometimes considered to be a method of allocating the cost of acquired goodwill over the periods it is consumed and the benefits from the acquisition are realised. Some components of goodwill usually have a finite life, for example some expected synergies

and an assembled workforce. Amortisation would be consistent with the approach taken for other intangible and tangible assets that have finite useful lives. Some think that the useful life of goodwill is no more difficult to determine than it is for some other intangible assets.

(c) If goodwill is amortised this will reduce some of the pressures for the IASB to consider the need to:

(i) identify additional intangibles or analyse components of goodwill (because goodwill would be amortised as well as other intangibles), and/or

(ii) simplify impairment requirements which some assert are costly and complex to apply yet only provide limited benefits for investors (goodwill would reduce over time reducing the need to consider whether it is impaired).

(d) If the useful life and amortisation method for goodwill are determined based on the pattern of recovery of benefits from the acquisition then it may provide some decision-useful information to users.

(e) Investors have told us that one of their main concerns about the impairment model is impairment charges are often recognised too late. An amortisation approach would recognise the consumption of goodwill on a timelier basis (however, it would not completely eliminate the concern that impairment is recognised too late, particularly if the useful life is quite long).

(f) The FASB and the EFRAG/OIC/ASBJ Research Group have considered how to develop a more robust amortisation model, including on how to determine an appropriate useful life and amortisation method. The IASB could benefit from this research in considering an amortisation model.

(g) On the basis of its work the EFRAG/OIC/ASBJ Research Group stated that it concluded that an amortisation model is the most appropriate method for subsequent accounting for goodwill because it reasonably reflects the consumption of the economic resource acquired in the business combination over time, and can be applied with a sufficient level of verifiability and reliability. Also the ASBJ research paper on amortisation

of goodwill notes that the majority of Japanese financial statement users expressed support for the amortisation and impairment approach.

(h) During development of the *IFRS for SMEs*, the IASB concluded that for cost-benefit reasons, rather than conceptual reasons, goodwill and other indefinite life intangible assets should be considered to have finite lives and amortised.[2] The IASB's main cost benefit reasons for SMEs were:

(i) Smaller entities may find it difficult to assess impairment as accurately or as promptly as larger or listed entities, meaning the information could be less reliable.

(ii) Amortisation, particularly if coupled with a relatively short maximum amortisation period, would reduce the circumstances in which an impairment calculation would be triggered.

(i) During our PIR we have heard considerable support amongst preparers and others for a return to an amortisation model for goodwill with indicator-based impairment testing. Some think amortisation strikes a balance between faithful representation and reducing costs. The staff have included what we think are the main reasons supporting amortisation of goodwill above. Some additional reasons why respondents in the PIR support amortisation of goodwill are set out in paragraphs A3, A8 and A10-A11 of Appendix A of this agenda paper.

Disadvantages of an amortisation approach **(and so also advantages of an impairment-only approach)**

13. A key change introduced by IFRS 3 when it was first issued in 2004 was to eliminate amortisation of goodwill and instead require goodwill to be tested annually for impairment. The IASB's main reason for this change is that it concluded that assessing goodwill annually for impairment provides better information than an allocation of the cost via an amortisation charge, which depends on factors that are generally not possible to predict, such as the useful life of the acquired goodwill and the pattern in which it diminishes. Furthermore, the IASB was doubtful about the usefulness of an amortisation charge that reflects the consumption of acquired

[2] Paragraphs BC108-BC112 in the 2009 Basis for Conclusions accompanying the *IFRS for SMEs*.

goodwill, when the internally generated goodwill replacing it is not recognised. The staff think the IASB would need a strong argument to support moving back to an amortisation model. Appendix B provides the extracts in the Basis for Conclusions accompanying IAS 36 *Impairment of Assets* on the IASB's full reasoning for moving from an amortisation model to an impairment only model.

14. The staff think the following are the key arguments for, and advantages of, not reintroducing an amortisation approach:

    (a) The useful life of acquired goodwill and the pattern in which it diminishes generally are not possible to predict with a satisfactory level of reliability. As a result, many do not think there is a good conceptual basis for amortisation of goodwill and do not think it would provide useful information to investors.

    (b) Some investors have concerns about the current impairment test, for example that the impairment is recognised too late and the assumptions used in the calculations are subjective. Nevertheless feedback during the PIR indicated that information provided by the current impairment test is useful to many investors. Also some investors said that amortisation does not provide useful information and they would disregard it in their analysis (see paragraphs A2, A6-A7 and A9 of Appendix A for more information on this feedback). Over time amortisation would reduce the likelihood of impairment of goodwill and the amount of any impairment loss, meaning that some of the current information about impairment would be lost.

    (c) Interested parties generally support amortisation of goodwill for cost-benefit reasons rather than conceptual reasons. However, an amortisation approach would still require impairment testing. Consequently, particularly during the years following an acquisition, it would be unlikely to reduce costs of accounting for goodwill and impairment testing. Furthermore if a more robust amortisation model is developed it could increase complexity in accounting for goodwill, for example determining the useful life would likely be very judgemental.

(d) There is a risk that reintroducing amortisation would divert attention from the problems relating to poor impairment testing, ie it would help to avoid overstatement of goodwill, but would not focus on the underlying problem which is the need to improve the way the impairment test is being applied to ensure that impairments of goodwill are properly recognised.

(e) By its nature, goodwill, or some components of goodwill, is often considered to have an indefinite life and is not consumed over time. If there is no foreseeable limit on the period during which an entity expects to consume future economic benefits embodied in goodwill, amortisation over an arbitrarily determined period would not faithfully represent the economic reality.

(f) When the IASB was developing IFRS 3 most investors said they found little, if any, information content in the amortisation of goodwill over an arbitrary period. All users of public benefit entity financial statements that the FASB staff spoke to during their recent outreach said goodwill amortisation would not provide relevant information and that they would make an adjustment to earnings for goodwill amortisation. The IASB has generally agreed in the past that straight line amortisation over an arbitrary period does not reflect economic reality and thus does not provide useful information. If investors ignore information provided by an amortisation model then it would be very difficult to support reintroducing it.

(g) Some think amortisation of goodwill is unfair to entities whose growth comes largely from acquisitions rather than internally, because of what they perceive to be a "doubling-up" of expenses within a reporting period as a result of expensing current outgoings that generate goodwill (such as advertising and research) and at the same time amortising goodwill.

(h) Whist there appears to be support from some stakeholders to return to an amortisation model of accounting for goodwill, a proposal to introduce an amortisation model may uncover equally strong opposition.

Staff view

15. As noted in paragraph 10, the staff think there needs to be a strong argument for the IASB to reconsider an amortisation model for goodwill. The IASB has consistently received feedback that amortisation of goodwill over an arbitrary period does not provide decision useful information for investors. Nevertheless during the PIR the IASB heard strong support for reintroducing an amortisation model.

16. When developing the current requirements for goodwill, the IASB observed that the useful life of acquired goodwill and the pattern in which it diminishes are generally not possible to predict with a satisfactory level of reliability (paragraph BC131E of IAS 36 – see Appendix B). The EFRAG/OIC/ASBJ Research Group is currently focussing on assessing how to apply annual amortisation to goodwill, including considering how the useful life and amortisation pattern should be determined. This work is still ongoing and no conclusions on a single model have so far been made.

17. The staff do not think that a sufficient argument has yet been made for the IASB to reconsider an amortisation model. Furthermore, the staff are concerned that an amortisation model would be addressing some of the problems arising from poor impairment testing, without focussing on the underlying problem. The staff think the underlying problem is the need to improve the way the impairment test is applied to ensure that impairments of goodwill are being properly recognised.

18. In the light of the support for reintroducing an amortisation model and the ongoing research by the EFRAG/OIC/ASBJ Research Group the staff recognise that some IASB members may not want to dismiss Approach 1 at this stage. Consequently the staff suggest the IASB continues to monitor the work being performed by the EFRAG/OIC/ASBJ Research Group. Furthermore, views on whether an amortisation model is appropriate may be affected if the IASB support subsuming additional intangible assets in goodwill.

19. The FASB is considering two amortisation approaches as part of its work (the PCC model and developing a separate amortisation model). Consequently, the staff think the IASB should join the FASB in discussing the merits of an amortisation model to avoid any potential for divergence between the Board's converged Standards.

20. If the IASB explores an amortisation model further with the FASB the staff think it should consider the following issues (these types of issues have been considered by the FASB and also the EFRAG/OIC/ASBJ Research Group).

    (a) How should the useful life be determined? For example rather than a default fixed useful life should an entity always be required to consider its facts and circumstances? This may include considering factors such as:

        (i) the expected period in which the acquiree will lead to increased earnings/cash flow.

        (ii) the period over which synergies and other benefits from combining the acquirer's and acquiree's net assets will be realised.

        (iii) the expected payback period of the investment.

        (iv) the useful life of the primary assets of the acquiree.

        (v) consideration of the type of industry.

    (b) Is there a need to set an upper limit for the useful life?

    (c) How should the amortisation method be determined? Prohibiting a default straight line basis may provide better information. The factors in (a)(i)-(v) could be considered. Other considerations:

        (i) A declining balance amortisation approach may be appropriate if most benefits are expected to be realised in earlier years.

        (ii) An increasing balance amortisation approach might better reflect the consumption if it takes time to utilise the synergies. This would also leave more room for recognition of impairment losses in the early years (that some investors consider to be more relevant to help them assess the success of the acquisition).

        (iii) Are any other approaches supportable?

    (d) Should annual reassessment of the amortisation method and useful life be required or would this risk incorporating internally generated goodwill?

    (e) Should all indefinite life intangible assets be amortised?

Approach 2: Accounting for the separate components of goodwill

Description

21. Goodwill comprises different components. If these components are separated out different accounting treatments could be applied to each component. We could consider whether information provided would be improved if subsequent accounting of each goodwill component depended on the factors that constitute it (for example amortisation might be more appropriate for some components, than others, or it may be appropriate to write off some components immediately).

22. Possible suggestions when identifying components:

    (a) Identifying the different types of components of goodwill. This may include some of the following components — synergies, control premium, assembled workforce, going concern element of the acquiree's existing business, overvaluation of the consideration paid, overpayment or underpayment by the acquirer, etc. Paragraphs BC313-BC318 of the Basis for Conclusions accompanying IFRS 3 discuss these components in more detail.

    (b) Separating indefinite life components from finite life components.

    (c) Separating any component of goodwill that a represents a genuine overpayment or overvaluation from the rest of goodwill.

Advantages of looking at the separate components of goodwill

23. The staff have identified the following as the key arguments for, and advantages of, considering this approach:

    (a) It would provide more information for investors about the different components of goodwill.

    (b) If we look at goodwill at a more granular level, it would enable us to determine a more refined conceptual basis for the subsequent accounting for goodwill. For example the amortisation method and period may be easier to determine for a component of goodwill than goodwill as a single asset.

Disadvantages of looking at the separate components of goodwill

24. The staff think the following are the key arguments for, and advantages of, not considering this approach:

    (a) Identifying and measuring separate components of goodwill would be a significant change to the existing requirements.

    (b) Determination of the components could be subjective and could increase costs and complexity.

    (c) If there are any components of goodwill that can be recognised and measured separately then one could argue that IAS 38 would already require them to be measured separately if they are assets. Also in paragraph BC382 of the Basis for Conclusions accompanying IFRS 3 the IASB stated that they thought that in practice any overpayment is unlikely to be detectable or known at the acquisition date. The IASB noted it was not aware of instances in which a buyer knowingly overpays or is compelled to overpay a seller to acquire a business. Even if an acquirer thinks it might have overpaid in some sense, the amount of overpayment would be difficult, if not impossible, to quantify. Thus, the IASB concluded that in practice it is not possible to identify and reliably measure an overpayment at the acquisition date.

    (d) Some investors do not think goodwill has relevance and they ignore goodwill and amortisation of goodwill in their analysis. It would be difficult to justify the cost of asking preparers to spend time disaggregating goodwill down into its components if investors ignore the information provided.

    (e) The FASB are not considering this approach. If the IASB decide to develop this approach it could result in divergence in the converged Standards and may mean that the two Boards will not be able to work together.

    (f) In its 2014 Discussion Paper, the EFRAG/OIC/ASBJ Research Group explored a 'discernible elements approach' (ie separating goodwill into different components). The EFRAG/OIC/ASBJ Research Group concluded that it would be impracticable to implement, although it has conceptual merits. In particular such an approach was considered difficult to apply in

practice because it requires numerous subjective judgements to identify the discernible elements, and it would likely not result in reduced costs or complexity in subsequent accounting for goodwill.

Staff view

25. As noted in paragraph 10, the staff think there needs to be a strong argument to support making significant changes to IFRS 3. Approach 2 would result in significant changes and has the potential to increase complexity and subjectivity. The staff think the overall objective of looking at subsequent accounting for goodwill is to consider how the costs of the current accounting treatment can be reduced without losing the information that is currently being provided (see paragraph 9). The staff does not think Approach 2 is consistent with this objective.

26. Based on the discussion at the September 2015 meeting with the IASB and the FASB, feedback from the PIR and the work performed by the EFRAG/OIC/ASBJ Research Group, the staff has not identified much support for the IASB to consider Approach 2. Developing the approach would take time because it is a new approach that has not been explored by the IASB and so it would likely necessitate issuance of a Discussion Paper. The FASB are not considering Approach 2 and so it would create divergence between the converged Standards unless both Boards decided to pursue this approach.

27. Consequently the staff do not recommend that the IASB consider Approach 2 further.

Approach 3: Direct write off of goodwill

Description

28. Write off goodwill on acquisition. Options for recognising the write off are:

    (a) a charge to profit or loss; and.

    (b) a charge to other comprehensive income (OCI) or direct recognition in equity (with or without ‘recycling’ on subsequent disposal or impairment).

29. We could also consider variants of this method:

    (a) if there should be a rebuttable presumption that goodwill should be written off unless an entity can demonstrate that the goodwill is an asset.

(b) if some component of goodwill (for example representing a genuine overpayment or overvaluation) could be separated from the rest of goodwill and written off (included in Approach 2 in paragraph 22(c)).

Advantages of a direct write off approach

30. The staff think the following are the key arguments for, and advantages of, considering this approach:

  (a) It would reduce many of the concerns about the cost, complexity and subjectivity of accounting for goodwill.

  (b) Some investors do not think goodwill has relevance and they ignore goodwill and amortisation of goodwill in their analysis.

  (c) If goodwill is a genuine residual amount (ie is a genuine overpayment or overvaluation) it could be argued that it is not an asset.

  (d) This approach would be consistent with the fact that entities do not recognise internally generated goodwill.

Disadvantages of a direct write off approach

31. The staff think the following are the key arguments for, and advantages of, not considering this approach:

  (a) If goodwill is a genuine residual amount (ie is a genuine overpayment or overvaluation) it could be argued that it is not an asset. However, without considering the components of goodwill it is difficult to argue that goodwill does not meet the definition of an asset both in the current Conceptual Framework[3] and the Exposure Draft *Conceptual Framework for Financial Reporting*.[4] Goodwill often contains components such as the going concern element of the acquiree's business and expected synergies. The staff think that these meet the definition of an asset because they are controlled by the acquirer and are expected/have the potential to produce future economic benefits. Furthermore, the staff think that goodwill can be measured with

[3] An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity

[4] An asset is a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.

sufficient reliability as a residual amount to meet the recognition requirements for assets and some investors think it provides relevant information (see paragraph (d) below).

(b) In its 2014 Discussion Paper, the EFRAG/OIC/ASBJ Research Group stated that it had concluded that the direct write-off approach (immediate charge of the goodwill to profit or loss) implies that acquired goodwill is not an asset. The EFRAG/OIC/ASBJ Research Group noted that whilst it can be debated whether goodwill is or is not an asset, it concluded that it would meet the recognition criteria both under the existing Conceptual Framework as well as the proposal in the IASB's Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*[5]. The EFRAG/OIC/ASBJ Research Group reached a similar conclusion in relation to the direct write-off to equity and also identified additional conceptual problems with this method.

(c) Writing off goodwill immediately, particularly if the write off is taken to profit or loss, would have a significant effect on an entity's financial position and performance, distributable profits, key ratios and its ability to meet debt covenants. Furthermore, it would be difficult to support recognising writing off goodwill to equity on a conceptual basis, for example because it is not a transaction with owners.

(d) It is clear from the PIR that information provided by the current impairment test is relevant to some investors (see paragraphs A2, A6-A7 and A9 of Appendix A). If goodwill is written off immediately, information about impairment would be lost. Furthermore, information about the history of the capital invested in acquisitions, for example used by investors in investment return calculations, could also be lost.

(e) If goodwill had value initially (evidenced by the purchase price) no event other than a catastrophe could render it immediately worthless.

[5] The EFRAG/OIC/ASBJ Research Group Discussion Paper was issued before the Exposure Draft *Conceptual Framework for Financial Reporting* was issued.

(f) Writing off goodwill immediately would be inconsistent with the way other non-financial assets are measured on initial recognition, usually historical cost.

Staff view

32. As noted in paragraph 10, the staff think there needs to be a strong argument to support making further significant changes to IFRS 3. Approach 3 would result in significant changes.

33. Based on the discussion at the September 2015 meeting with the IASB and the FASB, feedback from the PIR and the work performed by the EFRAG/OIC/ASBJ Research Group, the staff has not identified much support for the IASB to consider Approach 3. Furthermore, if the IASB considers subsuming additional intangible assets in goodwill, Approach 3 is likely to be very difficult to support.

34. The IASB has not previously had a formal discussion on the possibility of writing off goodwill and so Approach 3 may necessitate issuance of a Discussion Paper. Although Approach 3 may be a less complex approach to develop than Approach 2, it would still take time to develop because of the need to answer questions such as whether the write off would be taken to profit or loss, OCI or equity. We might also consider other variants to this method, for example whether some component of goodwill (for example representing a genuine overpayment or overvaluation) could be separated from the rest of goodwill and written off (the staff explain why this was not previously considered and supported by the IASB in paragraph 24(c) above).

35. However, the IASB could draw on the work and research performed by the FASB and the EFRAG/OIC/ASBJ Research Group if IASB members support considering Approach 3. Furthermore the IASB could consider evidence from jurisdictions that have applied a write off method for goodwill under their local GAAP. For example pre 1997 UK GAAP used to include an option to write off goodwill directly against equity at the acquisition date.

36. The staff do not support Approach 3. Nevertheless, as this is one of the approaches being considered by the FASB, the staff think that it could be further discussed with the FASB if we move forward with them.

Approach 4: Focus only on improving the impairment test

Description

37. No changes to the current accounting for goodwill, except with regards to the impairment test in IAS 36.

38. The staff note that improvements to the impairment test should also be considered under Approaches 1-3. Consequently Approach 4 is effectively the view that we should not make any of the changes under Approaches 1-3.

39. Agenda Paper 18B explores the different ways we could improve the impairment test in IAS 36.

Advantages of focusing only on the impairment test

40. The staff think the following are the key arguments for, and advantages of, focusing only on improving the impairment test:

    (a) Most of the concerns about complexity in accounting for goodwill relate to the impairment test. If the impairment test is simplified and improved, this may mitigate the main underlying concerns that led to calls for the IASB to make changes to the accounting for goodwill

    (b) The EFRAG/OIC/ASBJ Research Group has performed research on improving the impairment requirements and is currently discussing possible improvements in some aspects of the impairment model. The IASB could learn from this research. (e) On the basis of their work the EFRAG/OIC/ASBJ Research Group concluded that there are a number of areas for possible improvements in IAS 36 in order to reduce the operational challenges. The FASB has also considered improvements to their impairment test that we can consider and benefit from (although US GAAP impairment requirements differ from ours).

    (c) Feedback during the PIR indicated that information provided by the current impairment test is useful to many investors. During their outreach with users of public benefit entities, the FASB staff found that many of those users are more interested in the existence of impairment than the precise

amount. This feedback supports keeping, but improving, the impairment only approach.

(d) Focussing only on improving the impairment requirements also avoids the risk of losing the information provided by the impairment test that might occur if amortisation of goodwill was reintroduced (Approach 1) or goodwill was written off immediately (Approach 3).

Disadvantages of focusing only on the impairment test

41. The staff think the following are the key arguments for, and advantages of, considering other approaches to address accounting for goodwill:

(a) Some argue that the challenges with the impairment test are only part of the challenges with accounting for goodwill and business combinations. They think focussing only on the impairment test would ignore these other challenges.

Staff view

42. As noted in paragraph 10, the staff think there needs to be a strong argument to support making further significant changes to IFRS 3. Approach 4 would focus on improving the impairment test in IAS 36 and so have no or a limited effect on IFRS 3.

43. Based on the feedback from the PIR and the work performed by others, views on the most appropriate accounting for goodwill are mixed. Consequently, the staff think it may be challenging to develop a different approach that leads to an improvement in the accounting for goodwill. For this reason the staff prefer Approach 4 because they think the IASB should focus on improving the impairment requirements in IAS 36 rather than making other changes to the accounting for goodwill.

44. Feedback during the PIR indicated that information provided by the current impairment test is useful to many investors. This feedback supports keeping, but improving, the impairment only approach.

45. The PIR identified concerns that the current impairment requirements are costly and complex to apply and there are some short comings in the information that they provide to investors. The staff think that most of the concerns about complexity in accounting for goodwill relate to the impairment test. If adequate improvements are

made to the impairment test, the staff think this may result in sufficient relief without the need to consider other changes for accounting for goodwill.

46. The staff think that improvements to the impairment test should also be considered under Approaches 1-3. Details of our proposals for improving the impairment test are provided in Agenda Paper 18B.

Staff recommendation on subsequent accounting for goodwill and questions

47. The staff think that Approaches 1 and 4 are the only two realistic approaches to consider even if the IASB later decides to make changes to the recognition and measurement requirements for intangible assets. Approaches 2 and 3 would result in significant changes to the accounting for goodwill and the staff do not think that sufficient arguments have been made in favour of considering these approaches. The staff also note that Approach 2 is not consistent with our objective of looking at subsequent accounting for goodwill (paragraph 9). The staff think further research would be needed before considering Approaches 2 and 3 to determine if they would meet the needs of investors and that the costs to preparers under those approaches would not exceed any benefits to investors.

48. The staff recommend Approach 4 because we think if we can sufficiently improve the impairment test, this would mitigate the need to make other changes.

49. Nevertheless the staff think that the IASB should discuss Approaches 1, 3 and 4 at a joint meeting with the FASB before making any decisions because these are all approaches that FASB are considering. The staff do not recommend pursuing Approach 2 further.

50. As noted above the staff only ask the IASB to discuss their views on the four approaches at this meeting and to identify what additional information they require to be able to develop views on these approaches.

Questions
1) Do IASB members need any further information before developing views on which of the four approaches they would like to consider further? 2) Do IASB members think they have enough information about these approaches, and have had sufficient discussion, to be ready for a discussion with the FASB?

Appendix A: Summary of what we've heard during the IFRS 3 PIR on subsequent accounting for goodwill and impairment

The IASB's report and feedback statement on the PIR of IFRS 3

A1. **Investors.** There are mixed views on the impairment−only approach (ie non−amortisation) for goodwill.

A2. Some support the current requirements, because they think that the impairment-only approach

(a) is useful for relating the price paid to what was acquired and for calculating the return on invested capital;

(b) helps them to assess the stewardship of the management; and

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

They think that the information provided by the impairment test of goodwill is useful, because it has confirmatory value.

A3. Others would prefer the re-introduction of the amortisation of goodwill because they think that:

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

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

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

(d) amortising goodwill would decrease volatility in profit or loss when compared to an impairment model; and

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

A4. **Other participants.** Many suggested having an amortisation and impairment approach. Under this model, an impairment test would be performed only if impairment indicators are present.

A5. Many think that the impairment test is complex, time-consuming and expensive and involves significant judgements. The main challenges identified are the following:

(a) difficulties in determining a pre-tax discount rate for the VIU calculation.

(b) some of the limitations of the VIU calculation, for example the prohibition on including expansion capital expenditures in cash flow projections. Some participants regard these limitations as artificial.

(c) many participants think that there appears to be a 'lag' in the time between the impairment occurring and the impairment charge being recognised in the financial statements.

(d) the costs involved in performing the impairment test, including the requirement to perform it annually even if there are no impairment indicators.

(e) the high degree of subjectivity in the assumptions used in the VIU calculation.

(f) difficulties (and subjectivity involved) in allocating goodwill to CGUs for impairment testing purposes, and reallocating that goodwill when restructuring occurs.

Extract from the comment letter analysis presented at the September 2014 IASB meeting

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

A6. 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.

A7. 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).

A8. 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.

A9. 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.

A10. Some participants[6] suggest an amortisation and impairment approach. They think that the reintroduction of amortisation of goodwill:

(a) would be appropriate, because it reasonably reflects the consumption of the economic resource acquired in the business combination over time, and can be applied in a way that achieves an adequate level of verifiability and reliability; and

(b) does not replace the need for a robust impairment model.

A11. Similarly, some participants[7] suggest that goodwill should be amortised over the period and to the extent that the profits were expected to arise from the business

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[6] See, for example, the Discussion Paper *Should goodwill still not be amortised?*, which was published by ASBJ, EFRAG and OIC in July 2014.

combination at the acquisition date. Subsequent changes to the original business plan should not be reflected in the amortisation pattern. Due to the time value of money and the uncertainty inherent in the estimation of future profits, they would expect that the amortisation charge of goodwill would decline over time. Under this model, an impairment test would only need to be performed if specific impairment indicators would arise. They think that such a treatment would better reflect the economic substance of a business combination in the following years as well as eliminate the current accounting discrepancy between internally generated and acquired goodwill. As an additional benefit, this model would be less complex and less costly, as no annual impairment test would need to be performed unless there are specific impairment indicators.

A12. Similarly, according to a report[8] published by KPMG in April 2014:

(a) the high number of judgements and assumptions make the goodwill impairment testing a complex and time-consuming exercise;

(b) it is not clear that the benefits of mandatory annual impairment testing outweigh the related costs;

(c) the value relevance of impairment testing is in confirming instead of predicting value, and goodwill impairment charges do not act as a major signalling event for the market; and

(d) there is considerable support for a return to an amortisation-based model of accounting for goodwill with indicator-based impairment testing.

Do you think that improvements are needed regarding the information provided by the impairment test? If so, what are they?

A13. Many participants think that the information provided by the impairment test as well as the related disclosures requirements is comprehensive.

A14. Some users[9] think that to make impairment tests more useful, companies should carry them out whenever there is a significant change in market conditions that

[7] See, for example, SIX Swiss Exchange's comment letter.

[8] See the report *Who cares about goodwill impairment?*

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

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).

A15. Some participants[10] suggest the following possible improvements:

(a) requiring mandatory disclosure of the sensitivity analysis.

(b) clarify that when a sensitivity analysis needs to be provided, the requirement does not only apply to the growth rate and the discount rate but also to other key assumptions.

(c) in the light of the fact that post-tax rate is used when calculating fair value according to IFRS 13 *Fair Value Measurement*, the requirement to disclose only the pre-tax rate when measuring the recoverable amount based on the value in use calculation should be reconsidered. Use and disclosure of the pre-tax rate for the goodwill impairment test can be confusing to users of financial statements, because observable market information is available only for post-tax rates.

What are the main implementation, auditing or enforcement challenges in testing goodwill or intangible assets with indefinite useful lives for impairment, and why?

A16. Many participants think that the impairment test is complex, time-consuming and expensive and involves significant judgements. The main challenges identified are the following:

(a) determining the cash flows from the cash generating unit to which the goodwill has been allocated, the discount factor to be applied and the terminal value (growth rate) of the cash flows can be very judgemental. Cash flows projections must be prepared specifically for the purpose of impairment testing, as management projections are not based on an 'as is'

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

status, but also include management best estimates of future cash flows derived from new investments and products.

(b) the allocation of goodwill to cash generating units (CGUs) for impairment testing. Goodwill is allocated to the CGUs that are expected to benefit from the synergies of the combination, which can be judgemental and difficult to apply in practice. After the initial allocation, the carrying value of the goodwill is tested for impairment as part of the respective GCUs, which might be merged or restructured in subsequent years to a degree that they have little or no similarities to the originally acquired business. Furthermore, the impairment test is performed based on the most recent approved budgets, which over time can be substantially different from the business plans at the acquisition date.

(c) it is not clear what represents 'the lowest level within the entity at which the goodwill is monitored for internal management purposes', as set out in paragraph 80 of IAS 36.

(d) practical difficulties related to the testing of a CGU for impairment when part of the recoverable amount is attributable to non-controlling interest (NCI). If an entity is measuring NCI at its proportionate share of net assets, this needs to be reflected in the impairment calculation. This becomes more complicated when there have been transactions with NCI holders after the business acquisition date, or if there is a group of CGUs to which goodwill is attributed that is partly measured at fair value and partly on a proportionate basis.

(e) the requirement to use a pre-tax discount rate when equity returns are always post-tax (meaning there are not observable market inputs for a pre-tax cost of equity). Practically, this means that the test is usually conducted on a post-tax basis with an additional iteration performed simply to derive a pre-tax discount rate.

(f) separating forecast capital expenditures between maintenance capital expenditures and expansionary capital expenditures; particularly, how this

separation impacts subsequent cash flows, not just the exclusion of expansionary capital expenditures itself.

Appendix B: Extracts from the Basis for Conclusions in IAS 36

B1. The following extracts from the Basis for Conclusions in IAS 36 (that also appeared in IFRS 3(2004) explain the IASB reasoning for choosing an impairment only model over an amortisation with impairment model:

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.