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STAFF PAPER

September 2015

IASB Meeting

Project	**Goodwill and impairment research project**
Paper topic	Project plan —Approach to the project

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Objective of this paper

1. This agenda paper presents the staff's suggestions for approaches to consider during the goodwill and impairment research project and the staff's recommended output from the project.

2. The objective of this meeting and the questions the staff would like the IASB and the US Financial Accounting Standards Board (FASB) to respond to are in Agenda Paper 13.

Structure of this paper

3. This paper includes the following sections:
   - (a) Introduction
   - (b) Staff analysis
     - (i) Proposed project steps and approaches to consider
     - (ii) Proposed output from the project
   - (c) Summary of staff recommendations
   - (d) Appendix A: Summary of what we've heard during the PIR of IFRS 3
   - (e) Appendix B: Proposed timetable

Introduction

4. In February 2015, based on its findings during the Post-implementation Review (PIR) of IFRS 3 *Business Combinations* the IASB added to its research agenda the following areas of focus:

   (a) improving the impairment test in IAS 36 *Impairment of Assets*;

   (b) subsequent accounting for goodwill (including the relative merits of an impairment-only approach and an amortisation and impairment approach);

   (c) identification and measurement of intangible assets such as customer relationships and brand names; and

   (d) how to clarify the definition of a business.

5. The topics in paragraphs 4(a)-(c) relate to the composition of goodwill and so decisions made about one topic are likely to affect decisions made on the other topics. For example, if additional intangible assets are subsumed in goodwill this may influence any decisions about how to subsequently account for goodwill. Consequently the research project on goodwill and impairment will address these three topics together.

6. In the IASB's report and feedback statement on the PIR of IFRS 3, the IASB noted the following possible steps to address the three topics in paragraphs 4(a)-(c):

Area of focus	Assessed significance	Possible next steps listed in the report and feedback statement
Effectiveness and complexity of testing goodwill for impairment.	High	Research will be undertaken. We could review IAS 36 and we could consider improvements to the impairment model; particularly whether there is scope for simplification.
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.
Identification and fair value measurement of intangible assets such as customer relationships and brand names.	Medium/high	Research will be undertaken. We could consider whether particular intangible assets (for example, customer relationships) should be subsumed into goodwill. We could also consider what additional guidance could be given to assist in the identification of customer relationship intangibles and their associated measurement.

7. The research work on the definition of a business (paragraph 4(d)) will be addressed separately (see Agenda Papers 13 and 13B).

Staff analysis

Proposed project steps and approaches to consider

8. The staff think that the project should be approached using the following steps:

   (a) **Step 1:** Which intangible assets should be separately recognised and measured?

   Approaches for the IASB to consider:

   (i) Is our current principle in IFRS for separately recognising intangible assets acquired in a business combinations appropriate?

   (ii) Can additional guidance be developed to help preparers to identify and measure intangible assets acquired in a business combination and to ensure more consistent application of the requirements?

   Other considerations:

   (iii) Could disclosure requirements about the valuation of certain intangibles be improved to give investors more confidence by making the valuations more understandable?

   (iv) Performing a cost-benefit assessment of:

   1. separate recognition of different types of intangible assets, versus
   2. subsuming them in goodwill (or grouping them together —see step 2 below) together with additional disclosure to reduce loss of information.

   (v) Consider whether our initial views in Step 1 are consistent with our current proposals about recognition and measurement of assets in the Conceptual Framework project.

   (vi) Consider whether any differences between our initial views in Step 1 and the existing requirements for separate acquisition of intangible assets and internally generated intangibles are justified.

(vii) Consider whether there are other ways to help to address the difficulties preparers have with valuing some intangible assets, for example by developing separate education material on valuation of intangible assets.

Staff explanation: Addressing Step 1 first will enable the IASB to make an initial assessment of the composition of goodwill, ie what remains in goodwill after deciding which intangible assets are to be separately recognised. At their meeting in March 2015 members of the Accounting Standards Advisory Forum (ASAF) also suggested this step should be performed before considering subsequent accounting for goodwill.

(b) **Step 2:** How do we account for goodwill/the various 'components' of goodwill?

Approaches for the IASB to consider:

(i) Should we account for goodwill as a single asset, or are we able to break it down into components and account for the components separately? Some ideas:

1. Separating indefinite life components from any definite life components.
2. Relaxing the requirements in paragraph 37 of IAS 38 *Intangible Assets* for combining intangible assets together as a single asset. This might permit accounting for intangible assets that are difficult to value on an individual basis together with other intangible assets (as a 'portfolio' of intangibles) which could be accounted for separately from goodwill. For example, a portfolio of brand names.
3. Can other components of goodwill be identified, and accounted for separately from the residual amount of goodwill. For example this may include components representing synergies, control premium, assembled workforce, etc.

4. Can the residual amount of acquired goodwill be estimated after identifying these other components (ie an estimated amount of overpayment or overvaluation)?

(ii) If we account for different components of acquired goodwill separately, how do we measure those components on initial recognition?

(iii) How do we subsequently account for goodwill/components of goodwill (for example amortisation with impairment versus impairment only)?

(iv) Should the residual amount of acquired goodwill be recognised as an asset or written off on acquisition?

Other considerations:

(v) If the residual amount of goodwill is written off on acquisition:

1. Should the expense be taken to profit or loss (or other comprehensive income or directly in equity— with or without 'recycling' on subsequent disposal or impairment)?
2. Is there a risk of losing information, particularly in the early years, for example about impairments or capital investment?

(vi) If we make significant changes to the existing requirements, how would this interact with segment reporting, which may be performed on a different basis because it uses information reported internally.

Staff explanation: Step 2 will enable the IASB to consider whether to explore other approaches for accounting for goodwill. For example, rather than the question of whether to amortise goodwill or not, should we be considering whether information provided would be improved if subsequent accounting depends on the factors that comprise goodwill (for example amortisation could be applied to some components, but not others)?

(c) **Step 3:** Can we improve the current impairment model?

Approaches for the IASB to consider:

(i) Recoverable amount is determined as the higher of two methods of measurement—an asset's fair value less costs of disposal and its value in use (VIU). Is this objective appropriate? For example:

1. Should recoverable amount be determined by reference to a single method, rather than two methods?
2. Should recoverable amount depend on how the entity expects to recover the asset?
3. Should different valuation models be considered?

(ii) If the determination of recoverable amount is based on one method, are additional disclosures necessary about the other method? For example if we eliminate VIU should we add disclosures about entity-specific assumptions?

(iii) Can we simplify the impairment calculations or provide further guidance? For example:

1. Removing the requirement to use pre-tax rates because post-tax rates are often used in practice.
2. Reconsideration the current limitations on what can be included in VIU cash flows, for example enhancement cash flows? If so, do we need additional disclosures about assumptions used and the consequences of those assumptions, ie a greater granularity in the disclosures required.
3. Providing guidance on the difference between the market perspective (fair value) and the entity perspective (VIU)?
4. Simplifying requirements, or improving guidance, for allocating goodwill to cash-generating units (CGUs) and also reallocating goodwill if an entity later reorganises its reporting structure?

(iv) For CGUs with goodwill/indefinite life intangible assets, an explicit annual impairment test is required, even if there is no indication that the CGU may be impaired. Should we explore an indicator approach instead (ie an explicit impairment test would be required only if there is some indication of a possible impairment)?

Other considerations:

(v) In addition to focusing on simplifying and improving the existing impairment model, how can we address investors' concerns that impairment losses of non-financial assets, including goodwill, are being recognised too late under the requirements in IAS 36?

1. Can we develop a more rigorous impairment model that may result in more timely recognition of impairment (this may include similar considerations as for impairment of financial assets).
2. Considering if there are ways to differentiate purchased goodwill from internally generated goodwill going forward.
3. Improving disclosures, particularly in the first few periods following the acquisition, for example about the actual performance of the acquiree and whether it is in line with initial expectations.

(vi) Investors express concerns that information about impairment of goodwill is subjective. Are these concerns caused primarily by deficiencies in IAS 36 or because some entities are not complying with the disclosure requirements or are using boilerplate disclosures? If so, how could we encourage improved disclosures?

Staff explanation: Once the IASB has considered the composition of goodwill (step 1) and the subsequent accounting for goodwill (step 2), it will be better placed to discuss the concerns relating to the current impairment testing requirements for CGUs with goodwill. For example, depending on the composition and accounting for goodwill, the need for the IASB to revisit the impairment requirements for goodwill may become more or less important. Many of the concerns about the existing impairment test for goodwill are also general concerns about the impairment model in IAS 36 and how it applies to other non-current, non-financial assets. Consequently, considering whether changes should be made to the existing impairment test for goodwill can be done in parallel with considering changes to the overall impairment model.

9. During the project steps we will need to carefully consider the outreach and work performed by organisations such as the FASB, Accounting Standards Board of Japan (ASBJ), European Financial Reporting Advisory Group (EFRAG) and the Organismo Italiano di Contabilità (OIC) on their projects in this area. The staff plans to make reference to this outreach and work in future IASB agenda papers as relevant to the IASB's discussions. The staff note that the papers prepared by the FASB for this September meeting contain a helpful summary of this outreach.

Proposed output from the project

Introduction

10. The Due Process Handbook notes:

    (a) Publishing a Discussion Paper (or research paper) before adding a standards-level project to the IASB's agenda is not a requirement, but the IASB must be satisfied that it has sufficient information and understands the problem and potential solutions well enough to proceed.

    (b) The IASB might conclude that a Discussion Paper is not necessary because it has sufficient input from a Request for Information or other research to proceed directly to an Exposure Draft.

Staff analysis

11. At the ASAF meeting in March 2015, ASAF members stated there may be no need for the IASB to issue a Discussion Paper. This is because they think that the PIR acts as a Discussion Paper and that issuing a Discussion Paper is unlikely to produce additional information.

12. The staff acknowledge that we have a good understanding of the main problems relating to the three topics in paragraphs 4(a)-(c) from the PIR. However, the staff think the decision on whether to go down an Exposure Draft route or a Discussion Paper route depends on whether the IASB intends to:

    (a) propose significant changes and/or consider new approaches—the staff think this would require a Discussion Paper route in order to solicit broader feedback from respondents.

    (b) refine existing requirements to address application problems—the staff think this could be addressed through an Exposure Draft because the IASB would primarily be seeking narrower feedback on the redrafting of existing requirements or additional guidance, and any perceived implementation issues.

13. In paragraph 8 the staff have listed a number of ideas for possible approaches to addressing the three topics that the IASB could consider. We think there are a range of possible approaches and that we would obtain more detailed feedback on these and possible other approaches if we issue a Discussion Paper.

14. The staff also note some of the possible approaches in paragraph 8 have not yet been discussed in detail by the IASB, for example considering expensing the amount of residual acquired goodwill. The staff would expect the IASB to issue a Discussion Paper as a first step to get feedback if we consider any of these new approaches.

15. The staff further note that if the IASB proposes an approach based on methods it previously considered and discussed, moving straight to an Exposure Draft may not be appropriate. For example, reintroducing amortisation of goodwill or eliminating the notion of value in use (VIU) would be considered significant changes to the current requirements. Respondents could respond very differently on proposals to introduce these alternative requirements than they have on earlier consultation documents that have not contained similar proposals. For example, whilst some respondents may have voiced concerns about the impairment only model for goodwill, those respondents may have even greater concerns about a proposal to

reintroduce amortisation or have different views about how a requirement to amortise goodwill should be incorporated.

16. The staff note that any changes proposed by the IASB to address one of the three topics in paragraphs 4(a)-(c) may affect the views of respondents about other topics. Therefore, the staff do not think that the IASB should issue proposals on one topic before it considers all three topics. This interrelation in the topics adds complexity to the consultation process, making it very difficult to develop a proposal for one issue without understanding how this would affect the views of respondents on other issues. This understanding would best be developed through a Discussion Paper that outlines the different approaches and their interrelations.

Staff recommendation

17. The staff recommend that the IASB approaches the project in the following order

    (a) Step 1: Which intangible assets should be separately recognised and measured?

    (b) Step 2: How do we account for goodwill/the different 'components' of goodwill?

    (c) Step 3: How can we improve the current impairment model?

18. The staff recommend that the IASB works towards issuing a Discussion Paper as the output from the research project because of the interrelation of the three issues and the number of different approaches that could be considered. The Discussion Paper would cover all three topics in paragraph 4(a)-(c) because they are interrelated.

19. The staff propose to present their detailed analysis and recommendation for steps 1-3 at IASB meetings from October 2015 onwards.

Questions

20. See Agenda Paper 13.

Appendix A: Summary of what we've heard during the IFRS 3 PIR

Topic 1: Identification and measurement of intangible assets

A1. **Investors.** There are mixed views:

(a) Some do not support the current practice of identifying additional intangible assets (for example, brands, customer relationships, etc) beyond goodwill, because, in their opinion, it is highly subjective and 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.

(b) Others support the current practice, because it provides an insight on why a company purchased another company and it helps in understanding the components of the acquired business, including its primary assets (ie the value-drivers).

A2. **Other participants.** Many think that some intangible assets are difficult to measure at fair value, primarily due to the lack of sufficient reliable and observable data. They assert the following are particularly challenging: customer relationships, non-contractual intangible assets; intangible assets for which there is no active market; and intangible assets in the 'early stage' of development. The main causes of the challenges described are:

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

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

(c) valuation methods are complex and subjective;

(d) the measurement is more complex when the intangible assets are not based on legally enforceable rights; and

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

Topic 2: Subsequent accounting for goodwill

A3. **Investors.** Some support the current requirements, because they think that the current approach (non-amortisation of goodwill and impairment) only helps them to verify whether an acquisition is working as expected. 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.

Topic 3: Improving the impairment test

A5. **Investors.** There are mixed views on the impairment-only approach (ie non-amortisation) for goodwill.

(a) Some support the current requirements, because they think that the impairment-only approach:

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

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

(iii) 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.

(b) Other investors would prefer the re-introduction of the amortisation of goodwill (see paragraph A3).

A6. **Other participants**. 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.

Appendix B – Proposed timetable

Expected date	**Activity**
4Q 2015-2Q 2016	IASB discussions
Mid-late 2016	Publication of a Discussion Paper