STAFF PAPER

IASB Meeting

Project	Goodwill and impairment project		
Paper topic	Cover Paper		
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Objective of this meeting

1. The objective of this meeting is for Board members to continue their discussions about the three topics in its goodwill and impairment project and decide if they have any further information needs.

Structure of this paper

2. This paper includes the following sections:
   (a) February 2016 meeting papers
   (b) Proposed way forward and project timetable
   (c) Appendix A: Background to the project and work so far
   (d) Appendix B: Feedback from the Capital Markets Advisory Committee (CMAC) in November 2015
   (e) Appendix C: Feedback from the Accounting Standards Advisory Forum (ASAF) in December 2015.

February 2016 meeting papers

3. Agenda papers for this meeting:
   (a) Agenda Paper 18: Cover paper (this agenda paper)

(b) Agenda Paper 18A: Identifying and measuring intangible assets acquired in a business combination (updated from November 2015 IASB Agenda Paper 18A)

(c) Agenda Paper 18B: Subsequent accounting for goodwill (updated from October 2015 IASB Agenda Paper 18A)

(d) Agenda Paper 18C: Improving the impairment requirements for goodwill and other non-current, non-financial assets (updated from October 2015 IASB Agenda Paper 18B).

4. These papers are updated versions of the October and November 2015 IASB agenda papers. Significant changes have been highlighted in boxes at the start of the papers.

5. In the appendices for this paper the staff have included a summary of the main feedback on the goodwill and impairment project from CMAC members in November 2015 and ASAF members in December 2015. These meetings took place after the October and November 2015 papers were prepared and so have been included for consideration at this meeting.

Proposed way forward and timetable

6. The staff envisage the project continuing in two concurrent phases:

(a) <u>Phase One (joint decisions on joint papers with the US Financial Accounting Standards Board (FASB)):</u> Considering the following two issues with the FASB:

(i) whether to include any intangible assets in goodwill, rather than recognising them separately; and

(ii) subsequent accounting for goodwill, in particular whether to reconsider an amortisation approach for goodwill.

The issues are related and decisions on one may affect the other.

(b) <u>Phase Two (separate IASB papers and discussions, with co-operation with the FASB)</u>**:** Considering improvements to the impairment test and disclosures in IAS 36 *Impairment of Assets*. The staff note that the FASB is proceeding with an Exposure Draft to simplify the US GAAP impairment model. Consequently, the staff think that, at least initially, possible improvements to our impairment model should be discussed separately by the Board to understand the direction we wish to take.

Expected date	**Activity**
March 2016	IASB-only session (if required)
April 2016	Joint meeting with the FASB to discuss: - Whether to include any intangible assets in goodwill, rather than recognising them separately - Subsequent accounting for goodwill.

Appendix A: Background to the project and previous Board meetings

Background

A1. In February 2015, on the basis of its findings during the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*, the Board added to its research agenda the following areas of focus (collectively covered by the goodwill and impairment project):

(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); and

(c) identification and measurement of intangible assets acquired in a business combination.

September 2015 IASB/FASB meeting

A2. In September 2015 the Board had a joint meeting with the FASB to discuss the timing and overlap of their respective projects. The FASB has active projects on its agenda for public business entities and not-for-profit entities looking at subsequent accounting for goodwill, accounting for goodwill impairment, and accounting for identifiable intangibles in a business combination.

A3. At the September meeting the IASB staff highlighted the interrelationship of the three issues in paragraph A1 and provided a number of possible approaches that could be considered for addressing the issues. In the light of the interrelationships and possible new approaches that could be considered, the staff suggested that a Discussion Paper might need to be considered as the next due process step, rather than proceeding to an Exposure Draft.

A4. No decisions were made by the two Boards at the September meeting. However the staff think the following points came out of that meeting for the Board to consider going forward:

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

(b) The form of due process document (Exposure Draft versus Discussion Paper) should depend on the nature of any proposals being made by the Board. If we can proceed directly to an Exposure Draft we should do so in order to move more quickly.

(c) IFRS 3 *Business Combinations* and Statement 141R *Business Combinations* (codified in Topic 805 of the Accounting Standards Codification) of the FASB are converged standards. There is strong support for the Board to stay converged with the FASB where possible. The best approach to achieve this would be for both Boards to work together and make any decisions about potential amendments to Standards jointly.

(d) The Board should have its own discussion initially on the three topics before further discussing the topics with the FASB.

October 2015 Board meeting

A5. At the October meeting the Board started its discussions on two of the three topics: These were:

(a) subsequent accounting for goodwill; and

(b) improving the impairment test.

A6. This was not intended to be a decision-making meeting and so no decisions were made. The Board asked the staff to perform additional work to understand better what information investors want to receive about goodwill and impairment, to inform the Board’s future discussions.

November 2015 Board meeting

A7. At the November meeting the Board had initial discussions on the third topic, identification and measurement of intangible assets in a business combination. The Board also discussed a summary of the feedback received in the PIR of IFRS 3 about what information users of financial statements want to receive about goodwill and impairment. The staff also gave an oral update of feedback from the CMAC November 2015 meeting. A summary of this meeting has now been prepared and is included in Appendix C.

A8. This was not intended to be a decision-making meeting and no decisions were made.

October 2015 and January 2016 FASB meetings

A9. At its meeting in October 2015 the FASB discussed issues on the accounting for identifiable intangible assets in a business combination:

(a) 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 the light of the totality of the staff's research and outreach conducted to date.

(b) 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.

A10. In October 2015, the FASB also discussed whether and how to change the subsequent measurement of goodwill and made the following decisions:

(a) The FASB decided to proceed with the project under a phased approach. The first phase is to simplify the impairment test by removing the requirement to perform a hypothetical purchase price allocation when the carrying value of a reporting unit exceeds its fair value (ie the FASB has proposed to remove Step 2 of the impairment model in US GAAP). The FASB considered allowing entities an option to perform Step 2 but decided not to do so.

(b) In the second phase of the project, the FASB plans to work concurrently with the IASB to address any additional concerns about the subsequent accounting for goodwill.

A11. At its January 2016 meeting the FASB directed the staff to draft a proposed Accounting Standards Update for vote by written ballot that would simplify the impairment test in US GAAP, with a comment period of 60 days.

Work performed by others

A12. During this project the Board can benefit from the research and work performed by others, including the FASB and 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 these agenda papers).

A13. At the September 2015 meeting the FASB staff presented a paper that provided a summary of their outreach and work to date on accounting for goodwill for public business entities and not-for-profits project (see IASB Agenda Paper 13E/FASB Memo No 6 for the September meeting).

A14. In September 2015 IASB Agenda Paper 13E the FASB also included a summary of the work performed by the EFRAG/OIC/ASBJ Research Group on accounting for goodwill and impairment (see paragraphs 21-40 of that agenda paper). Further details of the work of the EFRAG/OIC/ASBJ Research Group can be accessed on their project page here: http://www.efrag.org/Front/p261-2-272/Proactive---Goodwill-impairment-and-amortisation.aspx. The ASBJ's research paper on amortisation of goodwill is available on the ASBJ website: https://www.asb.or.jp/asb/asb_e/international_activities/discussion_research/20150519.jsp. The staff have referred to the work and conclusions of the FASB and the EFRAG/OIC/ASBJ Research Group in Agenda Papers 18A-18C for this meeting when analysing the approaches for the Board to consider.

A15. The EFRAG secretariat has started analysing data on the impact of goodwill accounting in the financial statements of European entities applying IFRS Standards, including considering the amounts of goodwill recognised between 2007 and 2011 and the extent to which goodwill impairments were recognised across the different industries. The staff are monitoring this work.

Appendix B: Summary of November 2015 CMAC meeting—goodwill and impairment discussion

B1. At the October 2015 Board meeting, the Board asked the staff to perform additional work to identify what investors want to know about goodwill and impairment. At this CMAC meeting the staff asked for CMAC members' views on goodwill amortisation and how they currently use the information provided by entities about goodwill and impairment, eg whether they currently make any adjustments to the information provided by companies. The following is a summary of the main points from the meeting:

(a) A common thread among all CMAC members was that they want to understand what had been the key drivers for management that justified the valuation of the acquisition and hence the additional amount of goodwill.

(b) Some CMAC members would like to see the Standards require the disclosure of a breakdown of goodwill by acquisition.

(c) Some CMAC members observed that analysts often add back amortisation of goodwill and other intangible assets and impairment charges because these are non-cash items. However, some noted that these adjustments are made for the purpose of deriving cash flow information and do not imply that analysts do not think these items should be recognised in determining earnings.

(d) Some CMAC members supported reintroducing amortisation of goodwill. Some thought that amortisation provides useful information about the number of years over which management expects to benefit from the investment. Some noted that acquired goodwill is consumed and replaced by internally generated goodwill over time and this is best reflected by an amortisation model.

(e) Some CMAC members did not support reintroducing amortisation and supported an impairment-only approach for goodwill. Some considered goodwill to be a long-life asset that does not have a determinable finite life. They thought that amortisation would be only an arbitrary allocation exercise (ie it would not provide useful information). Some members were concerned that amortisation could hide impairment losses, meaning that useful information would be lost, eg about an assessment that management had overpaid.

(f) Some CMAC members said that conceptually the impairment test was the right approach, even though in practice impairment losses are often recognised too late. They noted that this indicates the need for a more robust impairment test rather than a different approach, such as amortisation. Some thought that the current impairment test provided useful information for the calculation of return on invested capital, about whether management had overpaid and if the acquisition was a good business decision, and about the value of the organisation and expected future cash flows.

(g) Some members expressed concerns about the difficulties of comparing organically grown companies with acquisitive companies. However, members generally agreed that it would be difficult to resolve these concerns without a radical change, eg either capitalising more internally generated companies or writing off goodwill immediately.

(h) Some CMAC members thought that disclosures about goodwill impairment testing should be developed to provide more information about the assumptions made and the success of previous acquisitions. One CMAC member thought that impairment should be based on an assessment of whether pre-acquisition projections had been achieved

(i) Many CMAC members thought that goodwill was an area that the Board should designate as a priority.

Appendix C: Summary of December 2015 ASAF meeting—goodwill and impairment discussion

C1. The objective of the session was to:

(a) provide ASAF members with an update on the Board's initial discussions in the project; and

(b) ask ASAF members for feedback on the Board's initial discussions and for any advice on the way forward with the project.

C2. The following is a summary of the main feedback from ASAF members:

(a) Some support an impairment-only approach for goodwill, because feedback from users indicates that it provides better information than an amortisation with impairment approach. However other ASAF members supported amortisation of goodwill and noted that it does provide some useful information for users, for example about the payback period.

(b) The Board should be careful about changing the requirements for accounting for goodwill, because there is no ideal approach. 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 Post-implementation Review of IFRS 3 *Business Combinations* has not provided evidence of any new arguments.

(c) It is important to consider what information users want; it was said that we should focus on the benefits for users of the current information versus the costs to preparers of applying the requirements. For example, if users are only getting confirmatory information, and this is at a significant cost to preparers, this may support a more aggressive approach to trying to reduce the costs of applying the requirements.

(d) The Board should focus primarily on improving the impairment test, because such an improvement would be required regardless of the approach for accounting for goodwill. However some ASAF members were concerned that simplifying the impairment test, for example by removing the annual impairment test, might increase concerns expressed by investors about impairments being recognised too late.

(e) In addition, some ASAF members thought it necessary to retain a robust impairment test if the impairment-only approach is maintained. This reflects the fact that the Board decided 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.

(f) One ASAF member stated that accounting requirements for identification and measurement of intangible assets is closely related to subsequent accounting requirements for goodwill. This member thought that if amortisation of goodwill is reintroduced, the Board should consider whether, and if so, how to maintain a classification of intangible assets that are not subject to amortisation (that is, intangible assets with indefinite useful lives under the existing Standard).

(g) Maintaining convergence with US GAAP was important and the ASAF members supported the Board and the FASB working together.