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STAFF PAPER

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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 assist Board members to:

   (a) continue their discussions from October and November 2015 and further develop their views about approaches for subsequent accounting for goodwill

   (b) discuss the sub-issues of an amortisation and impairment model for goodwill; and

   (c) decide whether they need additional information before developing their views in (a).

> This paper is an updated version of October IASB Agenda Paper 18A. Significant changes are:
>
> - Removal of the approach 'Accounting for the components of goodwill' (see paragraph 12).
> - Additional analysis of the sub-issues that would need to be addressed in an amortisation and impairment model (see paragraphs 44-90).

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2. The staff is not asking Board members to make any decisions on the possible approaches for subsequent accounting for goodwill at this meeting. The staff recommend decisions about potential amendments to IFRS 3 *Business Combinations* are best taken jointly with the US Financial Accounting Standards Board (FASB) at a later meeting to maintain convergence.

Structure of this paper

3. This paper includes the following sections:

   (a) Feedback from Post-implementation Review (PIR) of IFRS 3 *Business Combination*s

   (b) Overall objective

   (c) Part A: Approaches to consider

   Approach G1: Amortisation and impairment model

   Approach G2: Direct write off of goodwill

   Approach G3: Impairment only model

   (d) Part B: Analysis of sub-issues in Approach G1

   (e) Staff recommendation and questions for the Board

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

Summary of feedback in the PIR (see Appendix A of October IASB Agenda Paper 18A for the full comment letter analysis)

4. The Board'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.

5. Many participants in the PIR suggested reintroducing amortisation of goodwill because they assert it reflects consumption of the economic resource acquired in the business combination over time. Some noted this could be reintroduced with an indicator based impairment test rather than an annual test, reducing cost and complexity.

6. Some investors supported an impairment only approach because they think that the impairment only approach helps them to assess the stewardship of management and verify whether an acquisition is working as expected. Other investors support the amortisation of goodwill, because they think that goodwill acquired in a business combination is consumed and replaced by internally‑generated goodwill over time.

7. The staff note that the European Financial Reporting Advisory Group (EFRAG) secretariat has started analysing data on the impact of goodwill accounting in the financial statements of European entities applying IFRS, 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.

Overall objective of looking at subsequent accounting for goodwill

8. 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.

9. 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 or of any new conceptual arguments.

Approaches to consider

10. The staff think there are three approaches to consider for subsequent accounting for goodwill:
    (a) Approach G1: An amortisation and impairment model
    (b) Approach G2: Direct write off of goodwill
    (c) Approach G3: Impairment only model

11. 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 Board's reasoning for its current accounting for goodwill, discussions with the FASB at the September 2015 joint meeting and the work of the FASB and the EFRAG/OIC/ASBJ Research Group[1]. The staff think that under all three approaches, improvements to the impairment requirements should be considered (see Agenda Paper 18C for this meeting).

12. The staff has excluded the approach in IASB October 2015 Agenda Paper 18A that was referred to as 'accounting for the separate components of goodwill'. This is because the staff think it would increase complexity and subjectivity and would not be

[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 – see Appendix A of Agenda Paper 18 for this meeting).

consistent with the objective in paragraphs 8-9. The staff is also not aware of support for the Board to consider this approach. Furthermore, the staff note that if there are any components of goodwill that can be recognised and measured separately then one could argue that they would meet the criteria in IAS 38 for separate recognition.

13. 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 and it would test goodwill for impairment only when a triggering event occurs. This alternative is consistent with the alternative available for private companies in the US.

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

    (c) Direct write-off of goodwill.

    (d) Simplified impairment test.

14. The views in paragraph 13(b)-(d) are similar to Approaches G1-G3 in paragraph 10. 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).

Approach G1: Amortisation and impairment model

Description

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

Advantages of an amortisation and impairment model

16. The staff have identified the following as the key arguments for, and advantages of, considering an amortisation and impairment model:

(a) Some consider that over time acquired goodwill is consumed and replaced by internally generated goodwill. Consequently, some think that recognising acquired goodwill in profit or loss over time through amortisation 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 Board 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) Investors have told us that one of their main concerns about the impairment model is that 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 long).

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

amortisation method for goodwill are determined based on the pattern of recovery of benefits from the acquisition, rather than an arbitrary period, then it may provide some decision-useful information to users.

(f) On the basis of its work the EFRAG/OIC/ASBJ Research Group 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.

(g) During development of the *IFRS for SMEs*, the Board 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 Board'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.

(h) 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.

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

17. 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 Board's main reason for this change is that it concluded that

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

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 Board was 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. The staff think the Board 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 Board's reasoning for moving from an amortisation model to an impairment only model.

18. The staff think the following are the key arguments for, and advantages of, not reintroducing an amortisation and impairment 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. Also many investors said that amortisation does not provide useful information and they would disregard it in their analysis. If investors ignore information provided by an amortisation model then it would be very difficult to support reintroducing it.

    (b) Some investors have concerns about the current impairment test, for example that 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. 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) 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.

(g) 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 analysis

19. As noted in paragraph 9, the staff think there needs to be a strong argument for the Board to reconsider amortisation of goodwill. 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 impairment requirements to ensure that impairments of goodwill are being properly recognised.

20. The Board 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 Board heard strong support for reintroducing an

amortisation model but no new conceptual arguments were identified. Consequently the staff do not think that a sufficient argument has yet been made for the Board to reintroduce amortisation.

21. The EFRAG/OIC/ASBJ Research Group has performed work to consider how to apply annual amortisation to goodwill, including considering how the useful life and amortisation pattern should be determined. However, no conclusions on a single model have so far been made. Some of the group's suggestions are included in our analysis of the sub-issues in Part B of this paper.

Staff view

22. The FASB is considering two amortisation approaches as part of its work (the PCC model and developing a separate amortisation model). Consequently, in the light of the support for reintroducing an amortisation model the staff think the Board should join the FASB in discussing the merits of an amortisation model to avoid any potential for divergence between the boards' converged Standards. Views on whether an amortisation model is appropriate may be affected if the Board support subsuming additional intangible assets in goodwill.

23. To prepare for discussions with the FASB about an amortisation and impairment model, the staff think the Board should consider the following sub issues (these types of issues have been considered by the FASB and also the EFRAG/OIC/ASBJ Research Group). These have been analysed in more detail in Part B of this paper:

    (a) how the useful life of goodwill should be determined;

    (b) whether there should be an upper limit on that useful life;

    (c) how the amortisation method should be determined;

    (d) whether annual reassessment of the amortisation method and useful life should be required;

    (e) whether all intangible assets should be amortised;

    (f) allocation of impairment to amortisable units of goodwill (ie allocation to the goodwill amounts arising from different acquisitions); and

    (g) allocation of goodwill to amortisable units of goodwill on a disposal or reorganisation.

24. In Agenda Paper 18C for this meeting, the staff have recommended that the Board consider introducing a requirement for companies to disclose the key performance assumptions or targets supporting the purchase price and hence those assumptions/targets supporting the goodwill figure (for example these might be revenue targets, operating margins, cost savings etc). The staff observe that the key performance assumptions or targets would also be the kind of factors that would need to be considered if an entity made an assessment of the useful life of goodwill and the amortisation pattern. For example the key performance assumptions may include specific synergies expected over a five year period. The staff have considered this further in Agenda Paper 18C for this meeting.

Approach G2: Direct write off of goodwill

Description

25. 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).

26. 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.

Advantages of a direct write off approach

27. 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 (including 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

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

[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.

Framework as well as the proposal in the Board'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. If goodwill is written off immediately, information about impairment and accountability of management 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) Immediate write off would give the impression that there has been a decrease in value of the acquiree. If goodwill had value initially (evidenced by the purchase price) no event other than a catastrophe could render it immediately worthless. Furthermore if part or all of the acquired business was sold on, one might expect that a similar amount of goodwill would be included in the selling price. Consequently writing off the goodwill on acquisition and then later recognising a significant gain on disposal would not faithfully represent the economic reality.

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

(g) Writing off goodwill would make companies that grow by acquisition seem more profitable than those that grow organically because acquired goodwill

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

would be written off immediately whereas expenses related to internally generated goodwill affect profit or loss over time.

(h) In developing FRS 10 *Goodwill and Intangible Assets* in 1997, the UK Accounting Standards Board (ASB) removed the option to write off goodwill directly against reserves at the acquisition date. This option was removed primarily because the ASB took the view that there should only be a single method for accounting for goodwill, and because the option attracted criticism and was becoming less accepted internationally. The ASB was also influenced in particular by arguments that[6]:

(i) A method requiring elimination against reserves would treat goodwill very differently from brands and similar intangibles assets. Given that such assets are similar in nature to goodwill and that the allocation of a purchase cost between the two can be subjective, it would be possible for a reporting entity's results to be shown in a more favourable light merely by classifying expenditure as an intangible asset rather than goodwill or vice versa.

(ii) Immediate elimination of goodwill against reserves fails to demonstrate management's accountability for goodwill as part of the investment in an acquired business. The goodwill is not included in the assets on which a return must be earned and no charge would be made in profit or loss if the value of the goodwill were not maintained.

Staff analysis

29. As noted in paragraph 9, the staff think there needs to be a strong argument to support making further significant changes to IFRS 3. Approach G2 would result in significant changes.

30. Based on the discussion at the September 2015 joint meeting with the Board 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 Board to consider

[6] See paragraphs 2 and 16 of Appendix III to FRS 10(1997) *Goodwill and Intangible Assets*

Approach G2. Furthermore, if the Board considers subsuming additional intangible assets in goodwill, Approach G2 is likely to be very difficult to support.

31. The Board has not previously had a formal discussion on the possibility of writing off goodwill and so Approach G2 may necessitate issuance of a Discussion Paper. The analysis in the Discussion Paper would need to consider 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 components of goodwill (for example representing a genuine overpayment or overvaluation) could be separated from the rest of goodwill and written off.

32. The Board could draw on the work and research performed by the FASB and the EFRAG/OIC/ASBJ Research Group if Board members support considering Approach G2. Furthermore the Board could consider evidence from jurisdictions that have applied a write off method for goodwill under their local GAAP. For example pre 1997 UK GAAP included an option to write off goodwill directly against reserves at the acquisition date (see paragraph 28(h)).

Staff view

33. The staff do not support Approach G2. Nevertheless, this is also one of the approaches being considered by the FASB and so the staff think it could be further discussed with the FASB.

Approach G3: Impairment only model

Description

34. No changes to the current accounting for goodwill. However, identify improvements to the impairment requirements in IAS 36.

35. The staff note that improvements to the impairment requirements should also be considered under Approaches G1 and G2. Although under approach G2 goodwill would be written off, some of the concerns about impairment testing of goodwill also apply to impairment testing of other non-financial assets.

36. Agenda Paper 18C for this meeting explores the different ways we could improve the impairment requirements in IAS 36.

Advantages of focusing only on improving impairment requirements

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

    (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 Board 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 Board could learn from this research. 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 changes to their impairment test, for example the qualitative screen that we can consider and benefit from (see Agenda Paper 18C).

    (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 G1) or goodwill was written off immediately (Approach G2).

Disadvantages of focusing only on improving impairment requirements

38. 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 improving the impairment requirements would not address conceptual concerns that goodwill is consumed over time and should be amortised over its useful life.

Staff analysis

39. As noted in paragraph 9, the staff think there needs to be a strong argument to support making further significant changes to IFRS 3. Approach G3 would focus on improving the impairment requirements in IAS 36 and so have no or a limited effect on IFRS 3.

40. 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 G3 because they think the Board should focus on improving the impairment requirements in IAS 36 rather than making other changes to the accounting for goodwill.

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

42. 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 requirements. If adequate improvements are made to the impairment requirements, the staff think this may result in sufficient improvement without the need to consider other changes for accounting for goodwill.

Staff view

43. The staff support Approach G3. Details of our proposals for improving the impairment requirements are provided in Agenda Paper 18C for this meeting.

Part B: Sub-issues to consider in an amortisation and impairment model (Approach G1)

44. As noted in paragraph 23, the staff think the Board should consider the following sub-issues of an amortisation and impairment model:

    (a) how goodwill differs from other intangible assets;

    (b) how the useful life of goodwill should be determined;

    (c) whether there should be an upper limit on that useful life;

    (d) how the amortisation method should be determined;

    (e) whether annual reassessment of the amortisation method and useful life should be required;

    (f) whether all intangible assets should be amortised;

    (g) other effects of an amortisation and impairment model that may require consideration:

        (i) allocation of impairment to amortisable units of goodwill (ie allocation of impairment to the goodwill amounts arising from different acquisitions); and

        (ii) allocation of goodwill to amortisable units of goodwill on a disposal or reorganisation.

45. The staff have provided an analysis of these sub-issues below to assist the Board discussion. The staff is not asking the Board to make decisions on these sub-issues, but rather prepare for a discussion on these sub-issues with the FASB in April 2016.

How goodwill differs from other intangible assets

46. When moving from an amortisation and impairment model to an impairment only approach for goodwill in 2004, the Board 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).

47. The staff note that determining a useful life and amortisation pattern would be more complex for goodwill than other assets because goodwill is recognised at a residual

value and is not comprised of a single type of asset. For example goodwill may include the following components (based on considering paragraph BC313 of IFRS 3):

(a) The fair value of the expected synergies and other benefits from combining the acquirer’s and acquiree’s net assets and businesses.

(b) The fair value of the going concern element of the acquiree’s existing business, ie the ability of the established business to earn a higher rate of return on an assembled collection of net assets and employees than would be expected if those net assets had to be acquired separately.

(c) Assets that are not recognised separately, because they are not identifiable.

(d) Differences that arise because some assets and liabilities acquired in a business combination are not measure at fair value, for example income taxes and employee benefits.

(e) Overvaluation of the consideration paid by the acquirer, particularly when estimates are made in valuing any non-monetary consideration—for example when equity instruments are used as consideration.

(f) Overpayment or underpayment by the acquirer.

48. If the Board decides to subsume additional intangible assets within goodwill (see analysis in Agenda Paper 18A for this meeting), this will further increase the different types of components within the amount assigned to goodwill.

49. With the passage of time acquired goodwill will diminish, often replaced by internally generated goodwill. Nevertheless, considering the components in paragraph 47, the staff think that conceptually some goodwill could have an indefinite life. For example, an indefinite life component may exist if a business to which goodwill relates can be maintained over a long period with no foreseeable limit. The term 'indefinite' does not mean 'infinite'. An asset is considered to have an indefinite life when there is no foreseeable limit to the period of time over which the asset is expected to generate net

cash inflows for the entity. Nevertheless, difficulties in accurately determining useful life would not provide a basis for regarding that useful life as indefinite.[7]

How the useful life of goodwill should be determined

Methods to consider

50. The staff think the following methods could be considered for determining the useful life of goodwill:

    (a) Rebuttable presumption of a fixed period, for example 10 years.

    (b) Selected based on facts and circumstances, unless the useful life cannot be established reliably and then a fixed period would be used.

    (c) Selected purely based on facts and circumstances

Past and current IFRS requirements

51. IAS 22 *Business Combinations*, the Standard superseded by IFRS 3 (2004) *Business Combinations*, required goodwill to be amortised over its useful life and provided the following guidance for determining the useful life of goodwill:

    (a) The amortisation period should reflect the best estimate of the period during which future economic benefits are expected to flow to the enterprise.

    (b) Many factors need to be considered in estimating the useful life of goodwill including:

        (i) the nature and foreseeable life of the acquired business;

        (ii) the stability and foreseeable life of the industry to which the goodwill relates;

        (iii) public information on the characteristics of goodwill in similar businesses or industries and typical lifecycles of similar businesses;

        (iv) the effects of product obsolescence, changes in demand and other economic factors on the acquired business;

[7] See paragraph BC65 of IAS 38

(v) the service life expectancies of key individuals or groups of employees and whether the acquired business could be efficiently managed by another management team;

(vi) the level of maintenance expenditure or of funding required to obtain the expected future economic benefits from the acquired business and the company's ability and intent to reach such a level;

(vii) expected actions by competitors or potential competitors; and

(viii) the period of control over the acquired business and legal, regulatory or contractual provisions affecting its useful life

52. IAS 38 *Intangible Assets* (and IAS 16 *Property, Plant and Equipment*) defines the useful life of an asset as:

(a) the period over which an asset is expected to be available for use by an entity; or

(b) the number of production or similar units expected to be obtained from the asset by an entity.

53. Paragraph 90 of IAS 38 *Intangible Assets* also gives the following examples of factors to consider in determining the useful life for intangible assets:

(a) the expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;

(b) typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;

(c) technical, technological, commercial or other types of obsolescence;

(d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;

(e) expected actions by competitors or potential competitors (same as paragraph 51(b)(vii));

(f) the level of maintenance expenditure or of funding required to obtain the expected future economic benefits from the acquired business and the

company's ability and intent to reach such a level (same as paragraph 51(b)(vi));

(g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases (same as paragraph 51(b)(viii)); and

(h) whether the useful life of the asset is dependent on the useful life of other assets of the entity.

Work of others

54. In 2014 the EFRAG/OIC/ASBJ Research Group published its work and research so far on goodwill amortisation and impairment in a form of a Discussion Paper[8]. In its 2014 Discussion Paper the EFRAG/OIC/ASBJ Research Group concluded that the following requirements would enable entities to estimate the amortisation period of acquired goodwill in a reasonable way[9]:

(a) establishing an overall principle that the goodwill should be amortised over the period in which the goodwill recognised from a business combination is expected to give rise to its effect;

(b) requiring that the entity base its assessment on relevant information that is available including information about current conditions and reasonable and supportable forecasts, but give greater weight to objective evidence of conditions that affect the period in which the goodwill recognised from a business combination is expected to give rise to its effect;

(c) providing guidance that an entity would normally consider the following factors in determining the amortisation period:

(i) the expected period in which the acquirer expects the acquired business to earn a higher rate of return as a standalone business. In addition, depending on the situations, the period over which synergies and other benefits from combining the acquirer's and acquiree's net assets and businesses will be realised may also be

[8] The work of the EFRAG/OIC/ASBJ Research Group can be accessed on their project page here: http://www.efrag.org/Front/p261-1-272/Proactive---Goodwill-impairment-and-amortisation.aspx.

[9] Paragraph 84 of the 2014 EFRAG/OIC/ASBJ Research Group Discussion Paper

considered. Consideration of this factor does not mean that an entity should presume an indefinite amortisation period, if it uses terminal value in calculating the present value of an acquirer's ability to earn a higher rate of return;

(ii) the expected payback period of the investment on a business combination, which is normally estimated at the time when the business combination takes place. However, the payback period itself would not meet the definition of an amortisation period, and an entity would need to make the appropriate adjustments in determining the amortisation period; and

(iii) the useful life of the primary asset (or the weighted-average useful life of group of assets) which is the primary identifiable long-lived asset, including intangibles, from the use of which the entity is expected to derive its future cash flows. This may be especially valid when an entity's operation significantly relies on a particular asset (or a group of assets) and there is a reasonable correlation between the period over which the excess earning power diminishes and the useful life of the particular asset (or a group of assets); and

(d) requiring that the entity reviews the amortisation period when necessary by considering whether there have been significant changes in technology, commercial innovation, or market demand for products or services (both already occurred or reasonably expected in the future) since the business combination.

55. Japanese GAAP has an amortisation and impairment model for goodwill. It currently requires that "goodwill shall be recognised as an asset and be amortised on a systematic basis, using the straight line method or other reasonable method, over the period for which goodwill is expected to have an effect, which shall not exceed 20 years"[10]. A research paper published by the Accounting Standards Board of Japan (ASBJ) in 2015[11], included the following observations (amongst others – see paragraph 46 of that research paper) based on work which included sending a survey

[10] paragraph 32 of ASBJ Statement 21 Accounting Standard for Business Combinations

[11] 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.

to major Japanese companies and a review of the accounting policy disclosures in annual reports of listed companies included in the JPX Nikkei Index 400:

(a) Some companies interpreted that determination of the amortisation period "…means only the periods over which an acquiree, on a stand-alone basis, is expected to maintain higher future cash flows, while others seemed to interpret that it should also include time periods over which synergies resulting from both an acquirer and an acquiree are expected to be realised." The ASBJ noted this may be one of the areas on which we should seek to have consistent understanding.

(b) "In addition to the two factors mentioned above, the expected payback period was commonly referred to as a factor in estimating the amortisation period." The ASBJ noted that although the concept of expected payback period is not fully aligned with the period over which goodwill is expected to have an effect, in many cases the notion of the expected payback period would at least be a good starting point to consider the appropriate amortisation period.

Additional staff analysis

56. A rebuttable presumption of a fixed period would be the most practical solution for many entities. However, the staff think that some entities will simply use the presumed useful life to avoid the complexities estimating the useful life. The staff is concerned this may be the case under both methods in paragraphs 50(a) and 50(b).

57. The Board has consistently received feedback that amortisation of goodwill over an arbitrary period does not provide decision useful information for investors. Consequently, the staff think that better information would be provided to users if an entity determines the useful life of goodwill based on its facts and circumstances, rather requiring than using a default useful life, provided that an appropriate basis can be determined. The staff think that if the useful life was determined based on facts and circumstances and an entity was required to provide detailed disclosures about the basis of determining useful life, and any revisions to it, this might go some way towards compensating for the loss of information provided by an impairment-only approach.

58. In line with this in the recent 2015 amendments to the *IFRS for SMEs* the Board decided to require that if the useful life of goodwill or another intangible asset cannot be established reliably then the useful life shall be estimated by management (but shall not exceed 10 years). Previously, the *IFRS for SMEs* required that if a reliable estimate could not be made, the useful life would be presumed to be 10 years. The Board concluded that although a default useful life of 10 years is simple, it does not provide users of financial statements with any information about the period over which goodwill or another intangible asset is expected to be available for use.[12] The staff note that if the Board reached this conclusion in the *IFRS for SMEs*, it would be difficult to justify using a default life in IFRS.

59. The staff note that even though goodwill was required to be amortised over its useful life under IAS 22, there were concerns that amortisation did not provide useful information to investors. Consequently the staff think that if we move back to an amortisation and impairment model, we need to consider what additional guidance we could add to help an entity determine the useful life of goodwill and to prevent the use of an arbitrary life.

60. For example rather than just providing a list of factors to consider in determining useful life, the staff think some factors should be given more emphasis. For example the Board could distinguish between primary factors and other factors and provide more guidance on those primary factors. The staff would suggest the primary factors include:

    (a) the period in which the acquirer expects the acquired business to earn a higher rate of return as a standalone business.

    (b) if goodwill is comprised primarily of synergies, the expected period over which those synergies are expected to arise.

Staff view

61. The staff think if an amortisation and impairment model is developed then the useful life of goodwill should be determined based on facts and circumstances, rather than prescribing or presuming a default useful life in some circumstances. This would

[12] See Paragraph BC247 of the Basis for Conclusions accompanying the IFRS for SMEs.

provide better information for users, particularly if coupled with detailed disclosures about the basis of determining useful life, and any revisions to it. Furthermore, the staff think that rather than just providing a list of factors to consider in determining useful life, the staff think some factors should be given more emphasis.

<u>Points for the Board to consider:</u>

- Should the useful life be determined based on facts and circumstances or should a default useful life be considered under any circumstances?
- What should be the primary factors in determining the useful life of goodwill?

Whether there should be an upper limit on that useful life

Limits to consider

62. The staff think the following limits could be considered:

    (a) Prescribed upper limit, for example 10 years, 20 years etc.

    (a) Prescribed upper limit only if the useful life of goodwill cannot be established reliably (based on requirement in the *IFRS for SMEs*)

    (b) Rebuttable presumption that the useful life is less than an upper limit

    (c) No upper limit

Past IFRS requirements

63. In 1993, during revisions to IAS 22, the IASC Board introduced a statement that the amortisation period should not exceed five years unless a longer period, not exceeding twenty years from the date of acquisition, can be justified. Previously IAS 22 did not have an upper limit on the useful life for goodwill. Paragraph 45 of IAS 22 (1993) clarified:

> 45 Because goodwill represents future economic benefits from synergy or assets for which separate recognition is not possible, it is frequently difficult to estimate its useful life. Therefore, for accounting purposes, this Standard specifies an arbitrary limit on the amortisation period. The presumption in this Standard is that goodwill does not normally have a useful life in excess of five years. However, there may be circumstances when the goodwill is so clearly related to an identifiable asset that it can reasonably be expected to benefit the acquirer over the useful life of the identifiable asset. This may be the case, for example, when the principal identifiable asset in the acquisition is a broadcasting licence with a term longer than five years. After recording the fair value of the broadcasting licence as an asset, any goodwill arising on the acquisition is amortised over the period of the

broadcasting licence. Nevertheless, since an enterprise's planning horizon with respect to its operations as a whole is unlikely to exceed twenty years, projections as to the life of goodwill beyond this period are not sufficiently reliable to permit an amortisation period of longer than twenty years.

64. In 1998 the IASC Board removed the reference to five years and changed the requirement to be a rebuttable presumption that the useful life of goodwill will not exceed twenty years from initial recognition. The IASC Board concluded that that[13]:

    (a) in most cases, it will not be possible to determine reliably that the useful life of an intangible asset or goodwill will exceed 20 years from initial recognition. However, there are some specific cases where this general presumption is not true, and not just in the circumstances described in 1995 Exposure Draft E50 *Intangible Assets*. To impose an arbitrary limit in such cases would be contradictory to the objective of fair presentation;

    (b) detailed requirements for testing the recoverability of an asset are now in IAS 36. These reduce the need for an arbitrary ceiling on the amortisation period

65. 1995 Exposure Draft E50 *Intangible Assets* identified two cases where the useful life of an intangible asset could be measured reliably beyond 20 years. These were if there was a legal right to use the asset over more than 20 years and:

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

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

66. Some argue that there should be an arbitrary ceiling on the amortisation period for intangible assets and goodwill for one or more of the following reasons:[14]

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[13] From paragraph 52 of the Basis for Conclusions to IAS 22 (1998) which was derived from the Basis for Conclusions published in August 1997 with Exposure Draft E60 *Intangible Assets*. It was prepared by the IASC staff and was not reviewed by the IASC Board

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

(b) future economic benefits embodied in intangible assets and goodwill do not last forever;

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

(d) no impairment test can be robust enough to ensure that carrying amounts will not be overstated.

Work of others

67. The EFRAG/OIC/ASBJ Research Group favoured establishing a rebuttable presumption that the amortisation period should not exceed a maximum amount of years (for example, ten or twenty years). The group noted that some may argue that setting ten or twenty years seems too long, given the results of academic literature on the consumption of the excess earning power (the group noted that several studies found that excess earning power diminished over time with the period varying from 3 to 10 years, although the findings were not uniform). However, in the EFRAG/OIC/ASBJ Research Group's view, the presumption should capture a maximum period, while the academic literature focused on an average period of consumption of the excess earning power.[15]

68. The ASBJ Research Paper published in 2015, noted that based on the ASBJ review of public disclosures of listed entities included in the JPX Nikkei Index 400 "it was found that for many business combinations, 5 years was often estimated as the

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[14] From paragraph 47 of the Basis for Conclusions to IAS 22 (1998) which was derived from the Basis for Conclusions published in August 1997 with Exposure Draft E60 *Intangible Assets*. It was prepared by the IASC staff and was not reviewed by the IASC Board

[15] Paragraph 80 and 85 of the 2014 EFRAG/OIC/ASBJ Research Group Discussion Paper

appropriate amortisation period. However, for goodwill arising from larger scale business combinations, many companies estimated a longer-year [longer period] (up to and including 20 years) to be the appropriate period." The ASBJ noted "this is primarily because for larger scale business combinations, companies often make investment decisions based on a much longer-term horizon with the expectation of longstanding synergy effects."[16]

Staff view

69. The staff think if an amortisation and impairment model is developed there should be a rebuttable presumption that the useful life of goodwill will not exceed twenty years from initial recognition for the IASC Board's reasoning in paragraph 62(a). However, the staff does not think there should be a prescribed limit because the staff think that conceptually some goodwill could have a much longer life or an indefinite life (as explained in paragraph 49).

Points for the Board to consider:
- Should an upper limit on the useful life of goodwill be presumed or prescribed?
- Are there any other types of limits to consider in paragraph 62?

How the amortisation method should be determined

Bases to consider

70. The staff think the following bases could be considered:

    (a) Prescribed straight line basis.

    (b) Straight line method used unless there is persuasive evidence that another method is more appropriate.

    (c) Determined based on facts and circumstances, but straight line basis used if the pattern in which the benefits are expected to be consumed cannot be determined reliably.

    (d) Determined purely based on facts and circumstances.

[16] Taken from paragraph 46(g) of the 2015 ASBJ research paper.

Past and current IFRS requirements

71. Paragraph 97 of IAS 38 requires that the depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. It also requires that the amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method is used. IAS 22 had a similar requirement for amortisation of goodwill except it noted that the straight line method should be adopted unless there is persuasive evidence that another method is more appropriate in the circumstances.

Work of others

72. The EFRAG/OIC/ASBJ Research Group concluded that systematic amortisation on a straight-line basis would meet an appropriate balance between faithful representation and cost. The 2015 ASBJ research paper noted that "although Japanese GAAP does not prohibit the use of amortisation methods other than the straight-line method, virtually no company used other methods."[17] The staff think this was also the common practice under IAS 22.

Additional staff analysis

73. The staff note that amortising goodwill on a straight line basis would be the most practical solution. However, the staff think that in some cases amortisation on a different basis may provide better information than a default straight line basis. Nevertheless the staff think in many cases the costs of requiring an entity to determine and apply a different amortisation basis may exceed the benefits.

74. In assessing whether a different basis than straight line should be used the staff think similar factors used in determining the useful life should be considered. Other considerations:

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

[17] Taken from paragraph 46(e) of the 2015 ASBJ research paper.

(b) An increasing balance amortisation approach might better reflect the consumption if it takes time to realise 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).

(c) Are any other approaches supportable, for example units of production method?

Staff view

75. Consistent with the current requirements in IAS 38, the staff think if an amortisation and impairment model is developed for goodwill, then the amortisation method should reflect the pattern in which the benefits are expected to be consumed. Similarly consistent with IAS 38 the staff think for practical reasons if that pattern cannot be determined reliably, the straight-line method should be used.

<u>Points for the Board to consider</u>:

- Should a straight line basis be presumed or prescribed?
- Are there any other bases to consider in paragraph 70?

Whether annual reassessment of the amortisation method and useful life should be required

Methods to consider

76. The staff think the following should be considered:

(a) Annual reassessment

(b) No reassessment

Current IFRS requirements

77. IAS 38 (and IAS 16) require the useful life and amortisation period for intangible assets (and property, plant and equipment) to be reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly. If there has been a change in the

expected pattern of consumption of the future economic benefits embodied in the asset, the amortisation method shall be changed to reflect the changed pattern. Such changes are accounted for as changes in accounting estimates in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (paragraph 104 of IAS 38). IAS 22 similarly used to require the useful life and amortisation period for goodwill to be reviewed at least at each financial year-end.

Additional staff analysis

78. The staff note that it would be more complex to perform a reassessment of the estimates used for goodwill than other assets and making changes would be very subjective in some cases. For example, it may become difficult to distinguish the synergies of one acquisition from the synergies arising from other acquisitions and exclude the effects of internally generated goodwill, particularly if the useful life of goodwill is long and the acquiree is integrated into the entity's business. Nevertheless the staff do not think that a clear change in the useful life or amortisation method of goodwill should be ignored.

Staff view

79. The staff note that making changes would be very subjective in some cases. Consequently the staff think if an amortisation and impairment model is developed for goodwill, there should be a requirement that changes to the useful life or amortisation method should only be made if they can be justified. The staff think we should also consider whether more detailed disclosures than those in IAS 8 should be required.

Points for the Board to consider:

- Should annual reassessment of the useful life and amortised period of goodwill be required? If so, should additional safeguards be put in place?
- Are there any other methods we should consider in paragraph 76?

Whether all indefinite life intangible assets should be amortised

Possibilities to consider

80. If the Board decides to require the amortisation of goodwill, it will also need to consider whether to require amortisation of all intangible assets. The staff think the following approaches should be considered:

    (a) Allow goodwill and intangible assets to be classified as indefinite.

    (b) Restrict those assets that can be classified as indefinite, for example only intangible assets not goodwill.

    (c) No indefinite life classification.

Current IFRS requirements

81. In developing IAS 38 the Board concluded that tangible assets (other than land) could not be regarded as having indefinite useful lives because there is always a foreseeable limit to the expected physical utility of the asset to the entity. However it concluded that it is possible for management to have the intention and the ability to maintain an intangible asset in such a way that there is no foreseeable limit on the period over which that particular asset is expected to generate net cash inflows for the entity. In other words, it is conceivable that an analysis of all the relevant factors (ie legal, regulatory, contractual, competitive, economic and other) could lead to a conclusion that there is no foreseeable limit to the period over which a particular intangible asset is expected to generate net cash inflows for the entity.

82. For example, the Board observed that some intangible assets are based on legal rights that are conveyed in perpetuity rather than for finite terms. As such, those assets may have cash flows associated with them that may be expected to continue for many years or even indefinitely. The Board concluded that if the cash flows are expected to

continue for a finite period, the useful life of the asset is limited to that finite period. However, if the cash flows are expected to continue indefinitely, the useful life is indefinite.[18]

Additional staff analysis

83. Rapid changes in technology, economic circumstances and consumer preferences, are likely to mean that no intangible asset will last forever. However, as noted in paragraph 49, indefinite does not mean infinite. There are examples of brand names which have existed for more than 100 years, for which there is no foreseeable limit to the period of time over which the brands are expected to generate net cash inflows and whose value has increased over this time. This lends support for allowing an indefinite life to be used for certain intangible assets.

Staff view

84. The staff think that conceptually some goodwill and some intangibles could have an indefinite life (as explained in paragraphs 49, 65 and 83). Amortisation of these assets over an arbitrary short life would not result in a faithful representation. Consequently the staff think that the indefinite life classification should be retained for goodwill and intangibles.

<u>Questions for the Board to consider</u>:

- Should indefinite life intangible assets/ goodwill exist in IFRS?
- Are there any other options to consider in paragraph 80?

Other effects of an amortisation model that may require consideration:

85. The staff think the following issues would require consideration under an amortisation and impairment model:

    (a) allocation of impairment to amortisable units of goodwill (ie allocation to the goodwill amounts arising from different acquisitions); and

[18] paragraphs BC61, BC62 and BC65 of IAS 38

(b) allocation of goodwill to amortisable units of goodwill on a disposal or reorganisation.

86. The staff have provided a brief explanation below but do not propose spending much time discussing these issues at this meeting. However, the staff think it is worth considering these issues.

Allocation of impairment to amortisable units of goodwill

87. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to cash-generating units (CGUs), or groups of CGUs, expected to benefit from the synergies of the combination. Consequently if goodwill is amortised, the Board would need to consider how impairments should be allocated to amortisable units of goodwill (ie allocation to the goodwill amounts arising from different acquisitions). Goodwill allocated to a CGU cannot be considered to be a single asset for the purposes of impairment testing because it consists of goodwill that is being amortised on different bases.

88. For example, goodwill arising from several different acquisitions may have been allocated to a particular CGU for the purposes of impairment testing. The goodwill will have arisen at different times and may be being amortised over different useful lives and possibly using different amortisation methods. If the CGU is impaired, the impairment would need to be allocated to goodwill from each acquisition in order to determine amortisation of goodwill going forward. Considerations for allocation bases may include:

(a) Pro rata on the basis of the carrying amount of goodwill allocated from each acquisition (consistent with requirement for other assets in IAS 36)

(b) Taking into account whether the impairment has resulted from one particular under-performing acquisition. If so it may be appropriate to allocate the impairment to the goodwill from that acquisition first.

(c) Giving an entity flexibility to determine the most appropriate allocation bases based on its own facts and circumstances.

89. An inappropriate allocation to goodwill arising from different acquisitions could affect the potential for future impairment. However, the staff note that it may be

appropriate to follow (a), consistent with the requirements for other assets in IAS 36, because the added complexity from a more detailed analysis and may not be justified for cost-benefits reasons. Agenda Paper 18C considers the cost-benefits balance of the current impairment requirements.

Allocation of goodwill to amortisable units of goodwill on disposal or reorganisation

90. Similarly on a disposal of part of a CGU, or group of CGUs, containing goodwill, the Board will need to consider how the disposal of goodwill is allocated between the different amortisable units of goodwill because this will affect the amortisation going forward. Similar considerations would apply for a reorganisation of operations affecting CGUs to which goodwill has been allocated, as described above for impairment of goodwill.

Staff recommendation on subsequent accounting for goodwill and questions

91. The staff support Approach G3, an impairment only approach for goodwill. However, the staff think that the Board should discuss the three approaches at a joint meeting with the FASB before making any decisions.

92. As noted above the staff only ask the Board to discuss their views on the three approaches at this meeting, including the sub-issues under Approach G1, and to identify what additional information they require to be able to develop views on these approaches.

Questions
1) Do Board members agree with the sub-issues identified in part B of this paper and the points to consider for these sub-issues? 2) Do Board members think any other sub issues should be considered? 3) Do Board members need any further information before developing preliminary views on the three approaches G1- G3? 4) Do Board members think they have enough information about these three approaches, and have had sufficient discussion, to be ready for a discussion with the FASB?

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

A1. The following extracts from the Basis for Conclusions in IAS 36 (that also appeared in IFRS 3(2004)) explain the Board 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.