

STAFF PAPER

May 2016

IASB Meeting

Project	Goodwill and impairment project		
Paper topic	Cover Paper, includes feedback from the 2015 Agenda Consultation		
CONTACT(S)	Michelle Fisher	mfisher@ifrs.org	+44(0)20 7246 6918

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Objective of this meeting

1. The objective of this meeting is for Board members to consider:
 - (a) Quantitative data on goodwill and impairment: Staff from the Accounting Standards Board of Japan (ASBJ) and the European Financial Reporting Advisory Group (EFRAG) will present their data research, which includes quantitative information about the amount and trends of reported goodwill, impairment and intangible assets.
 - (b) Feedback in the 2015 Agenda Consultation: The IASB staff will present the feedback received both on this project and also on other issues relating to the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*.
 - (c) Progress report on the impairment phase of this project: The IASB staff will present a paper that provides an update on our progress on the impairment phase of the goodwill and impairment project and possible next steps.

This is not intended to be a decision making meeting.

Structure of this paper

2. This paper includes the following sections:

- (a) List of agenda papers for this meeting
- (b) Background to this meeting
- (c) Expected timetable for this project
- (d) Feedback from the 2015 Agenda Consultation
 - (i) Part I: On this project
 - (ii) Part II: On other issues relating to the IFRS 3 PIR
- (e) Appendix: Background to this project

List of agenda papers for this meeting

- 3. Agenda papers:
 - (a) Agenda Paper 18: Cover Paper (this agenda paper)
 - (b) Agenda Paper 18A: Progress report: Improving the impairment requirements
 - (c) Agenda Paper 18B: Quantitative study on goodwill and impairment prepared by the ASBJ/EFRAG staff
 - (d) Agenda Paper 18C: Appendices prepared by the ASBJ/EFRAG staff to accompany their quantitative study on goodwill and impairment

Background to this meeting

- 4. At its February 2016 meeting the Board asked the staff to provide certain quantitative information about the amount and trends of reported goodwill, impairment and intangible assets over recent years. The main reason the Board asked the staff to collect this data was to help it consider how to respond to concerns raised by interested parties during the IFRS 3 PIR that goodwill and intangible assets are growing significantly and could be overstated, and that impairment losses on goodwill are being recognised too late. The staff at the

ASBJ and the EFRAG have gathered this information and will present their research at this meeting.

5. Last year the Board issued a Request for Views (RFV) as part of its 2015 Agenda Consultation to solicit public input on its future work plan and priorities. In addition to the RFV, the Board solicited additional input from investors via outreach meetings and an online survey (described in paragraphs 4-9 of IASB April 2016 Agenda paper 24C). The staff have provided the feedback received, both on this project and also on other issues relating to the IFRS 3 PIR in paragraphs 9-35 of this paper. This feedback excludes feedback on the Board's definition of a business project, which will be considered as part of that separate project.
6. During its October 2015-April 2016 meetings the Board discussed a number of different approaches to improving the impairment requirements in IAS 36 *Impairment of Assets*. These approaches cover ways to simplify the impairment test and improve its application, ways to address investors' concerns that impairment losses are recognised 'too little, too late', and also ways to provide more effective disclosures about goodwill and impairment. For this meeting the staff have presented all of these approaches together in one paper to provide an overall picture of our considerations so far to help Board members to assess our progress in context with the quantitative data and feedback in the 2015 Agenda Consultation presented at this meeting.

Expected timetable for this project

7. The staff envisage the goodwill and impairment project continuing in two concurrent phases:
 - (a) Phase One: Considering the following two issues with the US Financial Accounting Standards Board (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 next step in this phase of this project will be having discussions with the FASB, expected next month.

- (b) Phase Two: Considering improvements to the impairment requirements in IAS 36 *Impairment of Assets*. The staff note that the FASB expect to issue an Exposure Draft this month which will propose 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. Agenda paper 18A for this meeting considers the next steps in this phase of this project.

8. The following is the expected timetable for the next couple of meetings.

Board meeting	Activity
May 2016	Education session with staff of the ASBJ and EFRAG to discuss their data research. Staff to provide feedback from the 2015 Agenda Consultation and present a progress report on improvements to the impairment requirements.
June 2016	Joint education session with the FASB. Board to continue discussions on this project, including considering the next steps in the light of the data research presented at the May meeting.

Feedback from the 2015 Agenda Consultation

Part I: Goodwill and impairment project

Current project scope and objectives

Scope

9. The following three topics are covered by the goodwill and impairment project:
- (a) identification and measurement of intangible assets acquired in a business combination;
 - (b) subsequent accounting for goodwill (including the relative merits of an impairment-only approach and an amortisation and impairment approach); and
 - (c) improving the impairment requirements in IAS 36.

Objective of looking at identification and measurement of intangibles¹

10. The staff think the main objective is whether subsuming any identifiable intangible assets acquired in a business combination in goodwill is supported by cost benefit reasons. This includes considering whether guidance or education material would help mitigate cost benefit concerns rather than change the requirements.

Objective of looking at subsequent accounting for goodwill²

11. The staff think the main objective is to consider whether and how the costs of the current accounting can be reduced without losing the information provided by the impairment-only approach.

¹ Objective taken from paragraphs 13 of IASB February 2016 Agenda Paper 18A

² Objective taken from paragraphs 8 of IASB February 2016 Agenda Paper 18B

Objective of looking at improving the impairment test³

12. The staff think there are two main objectives:
- (a) consider whether the impairment test could be simplified and its application improved without loss of information for investors. This includes considering ways to simplify the mechanics of the impairment test for preparers.
 - (b) consider whether information can be improved for investors without imposing costs that would exceed the benefits provided by the improvements. This includes considering investors' concerns that the current requirements result in impairment losses being recognised too slowly and in too small amounts ('too little, too late').

Feedback from 2015 Agenda Consultation RFV

Main feedback received

13. Nearly half of the 119 comment letters on the Board's Request for Views (RFV) ranked the goodwill and impairment project as of high importance/urgency. Over ten percent of comment letters ranked this project as of medium importance/urgency. Therefore, over half of the respondents to the RFV ranked the goodwill and impairment project as of high or medium importance/urgency.
14. Some respondents referred to their individual comments on the IFRS 3 PIR and/or referred to the conclusions in the Board's Report and Feedback Statement on the IFRS 3 PIR as their basis for ranking the goodwill and impairment project as high or medium importance/urgency without providing further comments. The following were the main other issues raised about this project:

³ Objective taken from paragraphs 7 of IASB February 2016 Agenda Paper 18C

Issue raised	By whom	Reason given
1) Reallocate project from research phase to either development stage or Standards level stage, and accelerate the project.	Range of respondents - mainly from Europe and Japan.	Confusion about this project being in the research phase when they assert there is sufficient evidence to include this project in the development stage or Standards level stage from the IFRS 3 PIR and work done by others.
2) Main focus of project and highest priority should be on improving impairment requirements.	Range of respondents in Europe, Asia and Canada.	<p>Some had concerns that impairment requirements are poorly applied, overly complex and subjective.</p> <p>Some had concerns about the low level of impairments being recorded and possible overstatement of goodwill. Some noted there was a need to improve communication to users.</p> <p>Some noted that subsequent measurement of goodwill is an old issue where no satisfactory solution exists and so it is preferable to concentrate on improving the impairment requirements.</p>
3) Reintroduce amortisation of goodwill.	Range of respondents in Europe and Japan.	For cost-benefit and/or conceptual reasons (eg goodwill is consumed over time).
4) Consider the accounting for intangibles in a business combination, and also the accounting for other intangibles (outside business combination).	Accounting bodies and users in Europe.	<p>Some say the costs of separating intangibles from goodwill in a business combination do not justify the benefits of the information, particularly for those types of intangibles that are not recognised if internally generated.</p> <p>Some say it is important to address the inconsistency of treatment between acquired and internally generated intangibles.</p>

15. Very few comment letters to the RFV listed the project as of low importance/urgency. The reasons provided by these respondents were either limited issues in practice (a preparer and accounting body in South Africa) or because the project touches on conceptual issues, such as asset definitions, and so

should wait until conclusion of the Conceptual Framework project (Australian accounting body).

Staff analysis

16. Staff analysis of the issues in the table in paragraph 14:
- (a) Issue 1) This project was added to the research agenda because, although we had a good understanding of the main problems from the IFRS 3 PIR and work performed by others, it was not sufficiently clear which issue, or package of issues, needed to be solved. This is primarily because of the interrelationships between the three topics covered by the project (listed in paragraph 9) and because it was not clear what the most promising way forward would be.
 - (b) Issues 2 and 3) These issues have been highlighted in recent agenda papers for this project as issues that will need to be considered. The staff do not think the comments on these issues provide new information or would affect the direction of the project.
 - (c) Comment 4) One of the issues being considered in this project is the cost benefit trade-off of separating intangibles from goodwill in a business combination. However, the accounting requirements for internally generated and other intangibles are not currently within the scope of this project. The staff think that whilst there would be some benefit in considering all intangible asset issues together, the main focus of this project is accounting for goodwill, and in particular improving the impairment test for goodwill. Widening the scope of the project would delay any improvements we make to the impairment requirements for goodwill. The specific comments in the 2015 Agenda Consultation about accounting for intangible assets will be considered separately by the Board.

Feedback from investors during 2015 Agenda Consultation

Main feedback received

17. The Board received 12 comment letters on the RFI from financial statement users/user representative bodies of which 4 ranked the goodwill and impairment project as of high importance/urgency. None of the other letters provided a ranking. In addition to those comment letters, the Board received input via investor outreach meetings and the online survey. The following were the main comments about the goodwill and impairment project⁴:
- (a) many investors still requested the Board to consider this project;
 - (b) some investors stated that because the non-amortisation of goodwill, together with the current impairment requirements, allow entities the flexibility to record losses when they wish, they may manage losses and avoid variability in earnings. Some other investors commented that goodwill should be capitalised and amortised in a systematic fashion and that the goodwill impairment test was inconsistent and subjective;
 - (c) a few other investors stated that the separation between goodwill and other intangibles is arbitrary and decreases comparability between companies. Other investors commented that there was no merit in distinguishing acquisition related intangible assets from goodwill; and
 - (d) many members of the Capital Markets Advisory Committee (CMAC) thought that the Board should designate goodwill as a priority. 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. A few CMAC members thought that amortisation of goodwill should be considered.

⁴ This summary was taken from paragraph 47(h) in IASB April 2016 Agenda Paper 24C.

Online survey

18. Approximately one third of the 86 users of financial statements who participated in the online survey ranked the goodwill and impairment project as of high importance/urgency. A further one third of those users ranked the project as of medium importance/urgency. Most of the other users did not provide a ranking and only a few users ranked the project as of low importance/urgency.
19. The main comments by users responding to the online survey were in the following areas (list is provided in order of frequency of the comments):
- (a) Concerns about separation of intangibles from goodwill being arbitrary and amortisation resulting in double counting of expenses.
 - (b) Concerns about overstatement of goodwill and late recognition of impairments.
 - (c) Concerns about subjectivity of the impairment calculations and diversity in how they are applied.
 - (d) Concerns about the Board reconsidering an amortisation approach for goodwill because they do not support amortisation.
20. 67 non-users also responded to the survey. Nearly half of these non-users ranked the goodwill and impairment project as of high importance/urgency and one third ranked it as medium importance/urgency. Where comments were provided, the feedback received was similar to the feedback in the comment letters on the RFI (see paragraphs 13-15).

Staff analysis

21. All of the comments in paragraphs 17 and 19 have been highlighted in recent agenda papers for this project as issues that should be considered. The staff do not think these comments provide new information or would affect the direction of the project.

Staff recommendation on next steps for goodwill and impairment project

22. Based on the staff analysis in paragraphs 16 and 21 the staff do not think the feedback from the 2015 Agenda Consultation provides any significant new information about this project that has not already been considered, or that should lead to a change to the current scope of this project. However, the comments reinforce the importance of continuing to consider these issues.
23. However, the staff think it would be appropriate to clarify that the objective in paragraph 12(b) is a general objective that applies to all three topics covered by this project “Consider whether information can be improved for investors without imposing costs that would exceed the benefits provided by the improvements” to highlight that users’ concerns are being considered (see also paragraph 33(c)).

Part II: Other issues related to the IFRS 3 PIR (excluding definition of a business which is part of a separate project)**Feedback from 2015 Agenda Consultation RFV***Main feedback received*

24. Only a few respondents to the RFV had comments on other issues relating to the PIR of IFRS 3.
25. These respondents noted that the Board should address the following areas of concern:
- (a) the relevance of the profit and loss impact resulting from step acquisitions and partial disposals;
 - (b) subsequent accounting of contingent consideration, or recognition of contingent consideration as compensation for post-acquisition services;
 - (c) guidance on reverse acquisitions;
 - (d) grossing up the acquirer’s goodwill for non-controlling interest (NCI) using the full-goodwill approach; and

- (e) difficulties in aligning the requirements of IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 36.

One user representative body responding to the RFV said there is a need to improve disclosures about mergers and acquisitions, including the need to mandate and improve preparation of pro-forma information (this is included in the summary in paragraphs 29-34).

26. The concerns in paragraph 25(a)-(e) were only raised by one or two comment letters. The concerns in paragraph 25(a)-(d) were also raised by respondents during in the IFRS 3 PIR and so were considered when determining the significance of the issues identified during the PIR. The staff have asked the respondent for more information about the concern in paragraph 25(e).

Outcome of the IFRS 3 PIR

27. The following related areas of focus were specifically highlighted in the report and feedback statement on the IFRS 3 PIR:

Area of focus	Assessed significance	Possible next steps
Usefulness of the subsequent accounting for contingent consideration.	Medium	Depending on the feedback received from the 2015 Agenda Consultation, we could start working on this issue. Some participants suggested investigating whether, in some circumstances, changes in the fair value of contingent consideration should be recognised by adjusting the carrying value of the assets acquired.
Fair value measurement of contingent consideration and contingent liabilities.	Medium	Depending on the feedback received from the 2015 Agenda Consultation, we could start working on this issue. Some participants suggested investigating whether the accounting for contingent consideration and contingent liabilities could be reconsidered in order to enhance relevance and faithful representation.

Usefulness of the accounting for step acquisitions and loss of control.	Medium	Depending on the feedback received from the 2015 Agenda Consultation, we could start working on this issue. Some participants suggested investigating whether remeasurement gains resulting from step acquisitions and loss of control should be recognised in other comprehensive income (OCI).
Measurement of NCIs.	Low	Depending on the feedback received from the 2015 Agenda Consultation, we could start working on this issue. Some participants suggested investigating whether the measurement of NCIs should be a one-time accounting policy choice for all business combinations (ie it should not be a transaction-by-transaction choice).

Staff analysis

28. Only one or two respondents raised the concerns in paragraph 25. The staff does not think such a low level of support would change the level of significance assigned to these issues in the Report and Feedback Statement on the IFRS 3 PIR. Therefore, the staff do not think there is sufficient support to increase the level of significance assigned to the concerns in paragraph 25 or add these concerns to the Board's agenda at the current time.

Feedback from investors during 2015 Agenda Consultation

Main feedback received

29. The following were the main comments from users/user representative bodies in their comment letters, investor outreach meetings and the online survey on issues relating to the IFRS 3 PIR⁵:
- (a) the IFRS 3 PIR did not sufficiently address issues relating to goodwill amortisation, disclosure of pro-forma information and information needs pertaining to mergers and acquisitions. One investor

⁵ This summary was taken from paragraph 23(a) in IASB April 2016 Agenda Paper 24C.

representative group noted that investors are heavily dependent on the availability and quality of pro-forma information. Even though the Standards suggest providing this information, it is often not provided or is not of sufficient granularity and the key assumptions used are not disclosed;

- (b) provision of prior year comparative pro-forma information would also be useful although the priority is not as high; and
- (c) some investors called for clear disclosures of the total consideration paid for an acquisition (including the debt acquired or any pension liabilities assumed), the dilutive effects of the transaction, a clear description of intangibles acquired, distinguishing between those acquired assets that have a finite life (e.g. a patent) and those that are sustained through expenditure that goes through the income statement (eg customer lists and brands), and clear disclosures of the financial returns (or expected returns) from the acquired assets or businesses if possible.

Online survey

- 30. Only 3 of the 86 users of financial statements who participated in the online survey noted that other IFRS 3 issues should be added to the Board's agenda. Only one of these provided supporting comments. The comments were about pro-forma information on mergers and acquisitions. The user noted it is very time consuming for analysts to compute pro-forma information on mergers and acquisitions themselves and even when entities provide pro-forma information, not all entities provide it in the same way.
- 31. Some non-users also responded to the survey. However none of these mentioned any other IFRS 3 issues.

Outcome of the IFRS 3 PIR

- 32. The following related areas of focus were specifically highlighted in the report and feedback statement on the IFRS 3 PIR:

Area of focus	Assessed significance	Possible next steps
Information about the subsequent performance of the acquiree.	Medium	This topic is related to the subsequent accounting for goodwill. Depending on the feedback received from the 2015 Agenda Consultation, we could investigate whether it would be practical to prepare this information, and for how many reporting periods post-acquisition this information would be cost-beneficial.
Pro-forma prior year comparative information.	Low	Depending on the feedback received from the 2015 Agenda Consultation, we could start working on this issue. Some participants suggested investigating whether it would be practical to prepare this information.

Staff analysis

33. Staff analysis of how the issues in paragraphs 29-30 affect the goodwill and impairment project:
- (a) This project is already further considering issues relating to goodwill amortisation.
 - (b) The staff have been considering ways to make the disclosure requirements about goodwill and impairment more effective for financial statement users. For example at the February 2016 CMAC meeting the staff asked CMAC members what users what to know about goodwill and impairment. Furthermore, at the March 2016 Board meeting⁶ the staff proposals included considering disclosure of the key performance targets supporting the purchase price paid in an acquisition, comparison of actual performance of the acquisition against the key performance targets and a breakdown of goodwill by acquisition. The staff think these kinds of disclosures would be useful

⁶ IASB March 2016 Agenda Paper 18B.

in helping users to assess the subsequent performance of the acquisition and its ongoing effect on the business. The staff also think if these kinds of proposals are introduced, users would be less reliant on other pro-forma information about the acquiree and the combined group which is used for assessing the performance of the acquisition.

- (c) At the February 2016 Board meeting the staff presented a paper⁷ that considered how to address users' concerns about presentation and disclosure of intangible assets in a business combination. The staff proposals included disclosures about the nature and valuations of the intangibles, together with further disaggregation of the amounts relating to intangible assets (eg distinguishing between intangible assets that investors consider to be organically replaced, such as brands and customer relationships, and wasting intangibles, eg software and patents). In paragraph 23 of this paper the staff recommends clarifying in the objectives that we are considering these presentation and disclosure concerns in this project.

34. When developing our proposals on disclosures for goodwill and impairment at future meetings, we will be considering the existing disclosures in IFRS 3. Hence, the staff think we could consider some of the other suggestions in paragraph 29 as part of this project. Nevertheless, the main disclosure need highlighted by investors in paragraph 29 is better pro-forma information relating to acquisitions, including the need to mandate and improve the quality of pro-forma information in paragraph B64(q) of IFRS 3. As noted in paragraph 33(b), the staff think that the disclosures currently being considered in the goodwill and impairment project would already lead to a significant improvement in the information provided to users about the performance of acquisitions. The staff think it is important for the goodwill and impairment project to continue to prioritise ways of making the disclosure requirements about goodwill and impairment more effective for

⁷ IASB February 2016 Agenda Paper 18A

investors to alleviate some of the disclosure concerns identified during the 2015 Agenda Consultation.

Staff recommendation on next steps for other issues related to IFRS 3 PIR

35. Based on the staff analysis in paragraphs 29 and 33-34 the staff think do not think the feedback from the 2015 Agenda Consultation provides sufficient persuasive argument for adding further items from the IFRS 3 PIR to the Board's agenda at the current time. The staff think it also supports the current scope and objectives of the goodwill and impairment project in paragraphs 9-12.

Appendix: Background to the project

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 the following three topics to the assessment phase of its research agenda (collectively covered by the goodwill and impairment project):
- (a) identification and measurement of intangible assets acquired in a business combination;
 - (b) subsequent accounting for goodwill (including the relative merits of an impairment-only approach and an amortisation and impairment approach); and
 - (c) improving the impairment requirements in IAS 36.

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. The following points came out of that meeting 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 proposals made by the Board.
- (c) IFRS 3 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.

October 2015 and January 2016 FASB meetings

- A5. In October 2015 the FASB discussed issues on the accounting for identifiable intangible assets in a business combination. 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.
- A6. 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.

A7. At its January 2016 meeting the FASB directed its 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. This exposure document is expected to be issued in the second quarter of 2016.

October 2015, November 2015 and February 2016 Board meetings

A8. The Board started its discussions on the three topics in paragraph A1(a)-(c). The meetings were not decision-making meetings.

March 2016 Board meeting

A9. The Board discussed the following areas:

- (c) a possible modification to the impairment test to address concerns about late recognition of impairment losses and overstatement of goodwill;
- (d) improving the disclosure requirements for goodwill and impairment;
- (e) a possible improvement to the definition and guidance for customer relationships acquired in a business combination.

A10. The Board provided feedback and encouraged the staff to develop their proposals further in these areas. No decisions were made.

April 2016 Board meeting

A11. The Board continued its discussion from its March meeting about a possible modification to the impairment test to address concerns about the late recognition of impairment losses and the overstatement of goodwill. No decisions were made.