

STAFF PAPER

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Project	Goodwill and Impairment research project		
Paper topic	Background and objectives of the research project		
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Purpose

1. The purpose of this paper is to provide the Board with background on the research project. This paper is for information only.
2. This paper sets out (a) a summary of the feedback that the Board received from the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*; and (b) the objectives that the Board set when it added the research project to its agenda.

Structure of the paper

3. This paper is structured as follows:
 - (a) objectives and scope of the research project (paragraphs 4–11);
 - (b) [Appendix A](#)—feedback received during and after the PIR of IFRS 3; and
 - (c) [Appendix B](#)—the Financial Accounting Standards Board’s (FASB) projects on goodwill and impairment.

Objectives and scope of the research project

4. The Board added the Goodwill and Impairment research project (the research project) to its agenda to consider how to address the following three areas of focus identified in the [Post-Implementation Review \(PIR\) of IFRS 3 Business Combinations](#):
 - (a) whether changes should be made to the existing impairment testing requirements in IAS 36 *Impairment of Assets*;
 - (b) subsequent accounting for goodwill (including the relative merits of an impairment-only approach and an amortisation and impairment approach); and
 - (c) the extent to which other intangible assets should be separated from goodwill.
5. [Appendix A](#) summarises the feedback from stakeholders during and after the PIR of IFRS 3.
6. The objective of considering changes to the impairment testing model is to identify:
 - (a) possible simplifications to the impairment testing model that help reduce the cost of testing without making the test less robust ('simplification objective'); and
 - (b) improvements that make the impairment testing model more effective in capturing impairment losses at the appropriate time and in the appropriate amounts ('effectiveness objective').
7. The objective of considering changes to subsequent accounting for goodwill is to identify the merits, if any, in introducing other approaches, such as amortisation of goodwill. However, during and after the PIR of IFRS 3, the Board observed that there needs to be a strong argument to support making fundamental changes to the accounting for goodwill. Stakeholders have always had opposing and strongly held views on subsequent accounting for goodwill, in particular amortisation versus non-amortisation. The feedback from the PIR of IFRS 3 did not provide evidence of (a) decrease in diversity of views; (b) new conceptual arguments; or (c) goodwill amortisation being considered as providing useful information to

investors. Consequently, the Board concluded that the focus of the research project should be to first explore improvements to the impairment testing model in IAS 36. If the concerns heard during the PIR of IFRS 3 could be sufficiently addressed through improvements to the impairment testing model, there may not be a need to reconsider accounting for goodwill.

8. The objective of considering identification of intangible assets separately from goodwill in a business combination is to determine whether there are cost benefit reasons to subsume within goodwill any intangible assets for which IFRS 3 currently requires separate recognition.
9. Another area of focus identified from the PIR of IFRS 3 was information about the subsequent performance of the acquiree. The Board determined this to be of medium significance in preparing the Report and Feedback Statement on the PIR of IFRS 3. The Board noted that this topic is related to the subsequent accounting for goodwill. The Board did not add this topic to its agenda and decided that it could further investigate whether it would be practical for entities to prepare this information. However, on the basis of subsequent outreach with investors, the Board learnt that investors would like entities to disclose information about (a) the key drivers that justified the valuation of an acquisition (and hence the amount of goodwill); and (b) whether the acquisition has been successful. Investors indicated that this information would enable them to assess the performance of the acquirer's management. Consequently, the Board directed the staff to consider this topic in the context of the overall objective of the research project and assess whether better and more timely information about goodwill and impairment can be provided to users of financial statements without imposing costs on preparers that exceed the benefits.
10. Accordingly, the research project has the following strands:
 - (a) simplifying the impairment testing model in IAS 36;
 - (b) improving effectiveness of impairment testing;
 - (c) improving the disclosures about goodwill and impairment; and
 - (d) identifying intangible assets in a business combination.

About the related FASB projects

11. The research project is not a joint project with the Financial Accounting Standards Board of the US (FASB). However, the FASB has two projects on its research agenda with objectives similar to those of the research project and both Boards have decided to monitor each other's work because of converged requirements on accounting for business combinations. The current requirements in IFRS Standards and US GAAP on impairment of non-financial assets are not converged. See [Appendix B](#) for (a) a brief background on the FASB's projects; and (b) a high-level comparison of IFRS Standards and US GAAP in respect of impairment of non-financial assets.

Appendix A

Feedback from stakeholders during and after the PIR of IFRS 3

Impairment testing

A1. The Board’s Report and Feedback Statement on the PIR of IFRS 3 set out the following next steps:

Area of focus	Assessed significance	Possible next steps
Effectiveness and complexity of testing goodwill for impairment	High	Research will be undertaken. We could review IAS 36 and we could consider improvements to the impairment model; particularly whether there is scope for simplification.

A2. Many participants in the PIR think that the impairment test is complex, time-consuming and expensive and involves significant judgements.

A3. The main concerns about applying the current impairment testing requirements are as follows:

- (a) the overall costs involved in performing the impairment test, including the requirement to perform it annually and the need to determine both value in use (VIU) and fair value less costs of disposal (FVLCD) in some situations.
- (b) limitations of the VIU calculation, including the prohibition on including expansion capital expenditure in cash flow projections and the requirement to use a pre-tax discount rate. These limitations are seen as artificial by participants citing these problems.
- (c) the high degree of subjectivity in the assumptions used in the impairment test, including allocating goodwill to cash-generating units (CGUs) for impairment testing purposes, and reallocating that goodwill if a restructuring occurs.

A4. Investors think that there appears to be a ‘lag’ in the time between the impairment occurring and the impairment charge being recognised in the financial statements. Some stakeholders think that managers use their discretion in recognising impairment charge in ways that are potentially favourable to themselves. There is

some academic evidence to support that thought. Consequently, they think that the current impairment model is not effective.

Subsequent accounting for goodwill

A5. The Board’s Report and Feedback Statement on the PIR of IFRS 3 set out the following next steps:

Area of focus	Assessed significance	Possible next steps
Subsequent accounting for goodwill (ie impairment-only approach compared with an amortisation and impairment approach)	High	<p>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:</p> <ul style="list-style-type: none"> (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.

A6. Many participants in the PIR suggested reintroducing amortisation of goodwill together with an indicator-based impairment test because they think that:

- (a) goodwill acquired in a business combination is supported and replaced by internally generated goodwill over time;
- (b) estimating the useful life of goodwill is possible and is no more difficult than estimating the useful life of other intangible assets;
- (c) goodwill has been paid for and so, sooner or later, it should have an impact on profit or loss;

- (d) amortising goodwill would decrease volatility in profit or loss when compared to an impairment model; and
- (e) amortising goodwill would reduce pressure on the identification of intangible assets, because both goodwill and intangible assets would be amortised.

A7. Some participants, especially investors, supported the current requirements because they think that the impairment-only approach has confirmatory value because it:

- (a) is useful for relating the price paid to what was acquired and for calculating the return on invested capital;
- (b) helps them to assess the stewardship of the management; and
- (c) helps them to verify whether an acquisition is working as expected.

A8. At the March 2017 meeting of the Global Preparers Forum (GPF), the staff did not ask GPF members for their views on subsequent accounting for goodwill, but a few GPF members said that the Board should consider alternative approaches, such as amortisation or direct write-off of goodwill, because they think that:

- (a) the high level of subjectivity in the value in use methodology:
 - (i) makes it difficult to obtain accurate inputs, for example, because of difficulty in segregating cash flows attributed to regular maintenance of an asset from cash flows attributed to improving or enhancing an asset's performance; and
 - (ii) causes unproductive debates with auditors;
- (b) the measurement of recoverable amount is often highly sensitive to unverifiable assumptions about the terminal growth rate;
- (c) the impairment testing methodology could be 'gamed' by manipulating the recoverable amount, and consequently the timing of recognition of impairment loss;
- (d) because internally generated goodwill gradually replaces purchased goodwill, at some point the carrying amount of goodwill will no longer represent only synergies that arose from the past business combination that gave rise to the recognition of the purchased goodwill; and

- (e) amortisation of goodwill would better reflect the economics in some situations, for example, if the acquired business has a finite life.

Identification and measurement of intangible assets in a business combination

A9. The Board’s Report and Feedback Statement on the PIR of IFRS 3 set out the following next steps:

Area of focus	Assessed significance	Possible next steps
Identification and fair value measurement of intangible assets such as customer relationships and brand names	Medium/high	<p>Research will be undertaken. We could consider whether particular intangible assets (for example, customer relationships) should be subsumed into goodwill.</p> <p>We could also consider what additional guidance could be given to assist in the identification of customer relationship intangible assets and their associated measurement.</p>

A10. Some participants in the PIR raised concerns about measuring, and in some cases, identifying the following intangible assets:

- (a) non-contractual intangible assets;
- (b) intangible assets that are not capable of being sold or licensed separately;
- (c) intangible assets for which there is no active market; and
- (d) intangible assets in the early stages of development.

A11. Their main concern is that the assumptions made, including the useful life, in valuing those assets are highly subjective. The fair values are sometimes sensitive to small changes in those assumptions. Furthermore, there is diversity in the valuation methods used in determining the fair value of those assets.

A12. Specifically in relation to customer relationships and brands, some participants think that measuring fair value of those intangible assets is costly, complex and time-consuming. Complexity arises when an acquired brand derives its value mainly from customer relationships of an acquired entity. In such situations, a

high level of judgement may have to be used by the acquirer in valuing the acquired brand and customer relationship intangible assets separately. Those participants think that the benefit to investors of the information provided about these intangible assets does not justify the costs of separately recognising them.

- A13. Feedback from investors in relation to customer relationships and brands is mixed. Some investors think that valuation of those intangible assets is subjective and that separate recognition does not provide useful information. Other investors support separate recognition of those intangible assets because it provides an insight into the value drivers of the business combination.
- A14. In relation to the presentation and disclosure of intangible assets in a business combination, investors raised two main concerns:
- (a) *presentation of amortisation expense*—some investors raised concerns that amortising intangible assets that they consider to be continually replaced, such as brands and customer-related intangible assets, results in double counting of expenses. For this reason they adjust the earnings of an entity by adding back the amortisation expense on these intangible assets. However, they say they are often unable to identify the amortisation expense that they want to add back, especially in an entity's interim financial statements. This information should be available from the reconciliation of intangible assets (see paragraph 118(e) of IAS 38) in an entity's annual financial statements. The reconciliation may not be provided by the entity in its interim financial statements. Consequently, for intangible assets that are continually replaced, those investors prefer that the amortisation expense should be presented separately on the face of the statement of comprehensive income.
 - (b) *additional disclosures*—some investors said that there is insufficient information about the assumptions made in valuing intangible assets acquired in a business combination. Some noted that it would be useful to extend to these intangible assets the disclosure requirements in IFRS 13 *Fair Value Measurement*.

Improving disclosures on goodwill and impairment

A15. The Board’s Report and Feedback Statement on the PIR of IFRS 3 set out the following next steps:

Area of focus	Assessed significance	Possible next steps
Information about the subsequent performance of the acquiree	Medium	<p>This topic is related to the subsequent accounting for goodwill.</p> <p>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.</p>

A16. Investors gave a mixed feedback about the current information provided on goodwill and impairment.

- (a) Some said the current information is useful because it provides confirmatory value about the performance of the acquisition and about the stewardship of management.
- (b) However some say the current information has limitations for the following main reasons:
 - (i) impairment calculations are inherently very judgemental and the assumptions used in the calculations are subjective.
 - (ii) disclosures are not sufficient to assess whether the main inputs/assumptions are reasonable. However some investors said that some of the current disclosures are useful; these included discount rates used, long-term growth rates, profit and capital expenditure assumptions and sensitivities.
 - (iii) insufficient information to help them understand the subsequent performance of the acquired business and whether main targets/synergies of the acquisition are achieved.

- (c) Some investors focus more on the timing of the impairment write-down and its overall magnitude rather than the specific amount of impairment recognised.

- A17. Investors appear to be particularly interested in understanding (a) the key drivers that justified the valuation of an acquisition (and hence the amount of goodwill); and (b) whether the acquisition has been successful. This information would enable them to assess the performance of the acquirer's management. They think that the current disclosures in financial statements about the primary reasons for the business combinations and the factors that make up the goodwill (paragraph B64 of IFRS 3) are either insufficient or boilerplate repetition of the Standard).
- A18. Although this topic was not added to the Board's agenda, on the basis of feedback from investors during and after the PIR, the Board directed the staff to consider various ways in which information about subsequent performance of the acquiree could be provided. The form of the disclosure could range from detailed financial information about the acquiree to the key financial performance indicators. The staff has limited its considerations to the latter.
- A19. Preparers generally think that the current disclosure requirements about goodwill and impairment are already excessive. The feedback from the PIR of IFRS 3 and subsequent outreach provided some evidence that the current disclosure requirements in IAS 36 are not being properly applied in practice.

Appendix B The FASB's projects on goodwill and impairment

About the FASB's projects

- B1. The FASB has the following two projects.
- (a) Goodwill impairment, divided into:
 - (i) Phase 1—Accounting for Goodwill Impairment¹; and
 - (ii) Phase 2—Subsequent Accounting for Goodwill for Public Business Entities and Not-for-Profit Entities.²
 - (b) Accounting for Identifiable Intangible Assets in a Business Combination for Public Business Entities and Not-For-Profit Entities.³
- B2. The objective of Phase 1, Accounting for Goodwill Impairment, was to reduce the cost and complexity of the subsequent accounting for goodwill by simplifying the impairment test.
- B3. The FASB completed Phase 1 in January 2017 when it issued [Accounting Standards Update \(ASU\) 2017-04, *Simplifying the Test for Goodwill Impairment*](#). Before the ASU, the impairment test in US GAAP was a two-step process. The first step was to compare the carrying amount of a reporting unit with its fair value. If the carrying amount was higher than the fair value, the second step was to calculate the implied fair value of goodwill and recognise an impairment loss if the carrying value of goodwill exceeded its implied fair value. In computing the implied fair value of goodwill, an entity had to determine the fair value of all identifiable assets and liabilities of the reporting unit in a manner similar to determining fair value of assets acquired and liabilities assumed in a business

¹ Link to the project webpage
http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176163679475

² Link to the project webpage
http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176167307243

³ Link to the project webpage
http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176165910709

combination. IAS 36 does not require an entity to determine the implied fair value of goodwill when measuring a goodwill impairment loss.

- B4. The ASU eliminated the second step of determining the implied fair value of goodwill. The objective was to reduce the cost and complexity of the impairment test. With this simplification, one difference between IFRS Standards and US GAAP was eliminated. However, the respective impairment models remain unconverged.

- B5. The objective of Phase 2, Subsequent Accounting for Goodwill for Public Business Entities and Not-for-Profit Entities, is to evaluate whether additional changes need to be made to the subsequent accounting for goodwill beyond any changes to the impairment test resulting from Phase 1.

- B6. The FASB’s identifiable intangible assets project is intended to evaluate whether certain identifiable intangible assets acquired in a business combination should be subsumed into goodwill.

Current status of the FASB’s projects

- B7. The FASB has moved Phase 2 of its goodwill impairment project and the intangible assets in a business combination project from its standard-setting agenda to its research agenda. The FASB decided to evaluate the effectiveness of its simplification amendments described above and monitor the IASB Board’s research project before considering whether there is a need for additional changes to the subsequent accounting for goodwill, including consideration of permitting or requiring amortisation of goodwill and/or additional changes to the impairment testing methodology.

High-level comparison of IFRS Standards and US GAAP (impairment of non-financial assets)

- B8. The following table summarises the main differences between the current requirements in IFRS Standards and US GAAP for impairment of non-financial assets that are relevant to the research project.

IFRS Standards	US GAAP
Impairment testing is required when there is an indication of impairment.	Similar requirement.
Annual impairment testing is required for goodwill, indefinite life intangible assets and intangible assets not yet available for use. The annual test may be performed at any time during the year provided it is performed at the same time each year.	Similar requirement except that intangible assets not yet available for use are tested only if there is an indicator of impairment.
Depending on the circumstances, assets are tested for impairment as an individual asset, as part of a CGU or as part of a group of CGUs. When possible, an impairment test is performed for an individual asset. Otherwise, assets are tested in CGUs.	Depending on the circumstances, assets are tested for impairment as an individual asset, as part of an asset group or at the reporting unit level. Depreciable assets are tested for impairment in asset groups unless an individual asset generates identifiable cash flows largely independent of the cash flows from other asset groups.
A CGU is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or groups of assets.	An asset group is the lowest level for which there are identifiable cash flows that are largely independent of the net cash flows of other groups of assets. A reporting unit is an operating segment or one level below an operating segment if specified conditions are met. (Both may differ from a CGU under IFRS Standards.)
Goodwill is allocated to CGUs or groups of CGUs that are expected to benefit from the synergies of the business combination from which it arose. Each unit or group of units is required to reflect the lowest level at which goodwill is monitored for internal management purposes and shall not be larger than an operating segment.	Goodwill is allocated to reporting units that are expected to benefit from the synergies of the business combination from which it arose.
An impairment loss for a CGU is allocated first to any goodwill and then pro rata to other assets in the CGU that are within the scope of IAS 36.	An impairment loss for an asset group is allocated pro rata to assets in the asset group, excluding working capital, goodwill, corporate assets and indefinite-lived intangible assets.

IFRS Standards	US GAAP
Reversals of impairment are required, but are prohibited for goodwill.	Reversals of impairments are prohibited.
<p>Impairment testing model</p> <p>One-step impairment test for all assets within the scope of IAS 36</p> <p>The carrying amount of an asset or CGU is compared with its recoverable amount.</p> <p>Recoverable amount is the higher of fair value less costs of disposal and value in use.</p> <p>The impairment loss is measured as the difference between carrying amount and recoverable amount.</p>	<p>Impairment testing model: Different models for goodwill, indefinite-lived intangible assets and long-lived assets</p> <p><i>Goodwill</i></p> <p>One-step impairment test.</p> <p>The carrying amount of a reporting unit is compared with its fair value.</p> <p>The impairment loss is measured as the excess of the carrying amount over the fair value of the reporting unit. The loss recognised cannot exceed the carrying amount of goodwill.</p> <p>Optional qualitative assessment:</p> <p>An entity may first assess qualitative factors to determine whether the quantitative goodwill impairment test is necessary. If the entity determines, based on the qualitative assessment, that it is more likely than not that the fair value of a reporting unit is below its carrying amount, the quantitative impairment test is performed. Examples of events and circumstances that an entity would need to consider in doing qualitative impairment test are provided.</p> <p>An entity can bypass the qualitative assessment for any reporting unit in any period and proceed to the quantitative test.</p>

IFRS Standards	US GAAP
	<p><i>Indefinite-lived intangible assets</i></p> <p>One-step impairment test.</p> <p>The carrying amount of an asset is compared with its fair value.</p> <p>The impairment loss is recognised as the excess of the carrying amount over the fair value of the asset.</p> <p>An entity could perform an optional qualitative assessment, similar to the one used for goodwill.</p> <p><i>Long-lived assets</i></p> <p>Two-step impairment test.</p> <p>Step One—The carrying amount is first compared with undiscounted cash flows. If the carrying amount is lower than the undiscounted cash flows, no impairment loss is recognised.</p> <p>Step Two—If the carrying amount is higher than the undiscounted cash flows, an impairment loss is measured as the difference between the carrying amount and fair value.</p>