Hong Kong Institute of Certified Public Accountants 香港會計師公會

Agenda paper 1B

ASBJ FASF

Goodwill: Improvements to Subsequent Accounting and an Update of the Quantitative Study

Joint Work of HKICPA Staff and ASBJ Staff

April 2020 ASAF meeting

Objective of the Research Paper

- To contribute relevant and timely analyses and arguments to the global research project on goodwill, and to present the views of the ASBJ Staff and the HKICPA Staff.

- The aims of this Research Paper are to:
  a. Share new findings from an updated quantitative study.
  b. Analyse the existing requirements for goodwill under IFRS.
  c. Explore alternative views on the subsequent accounting for goodwill.

Update on the Quantitative Study

Update on the quantitative study

Summary of the results

1. From 2014 to 2018, total goodwill and total goodwill per company tended to increase steadily in all stock market indices analysed.
   - Increase of **45%** for US, **26%** for Europe, **60%** for Hong Kong and **74%** for Japan.
2. Goodwill that exceeded 100% of net assets is not uncommon:
   - In 2018 this happened for **18.8%** of US and **10.1%** of EU indices companies.
3. Some companies had goodwill that exceeded 100% of their market capitalisation:
   - In 2018 this happened for **2.6%** of EU and **1.6%** of Japanese indices companies.
4. Implied time to fully expense goodwill was **122 years** for US, **78 years** for Europe, and **64 years** for Hong Kong and Japan.

Observations

- A notable **steady increase** in the amount of goodwill recognised by companies.
- Unlikely that the impairment-only model for goodwill is working as intended, leading to a “**too little, too late**” issue.

Number of companies that recognised goodwill exceeding 100% of net assets

In 2018, **<u>18.8%</u>** and **<u>10.1%</u>** of companies in the indices of US and Europe, respectively, recognised goodwill that exceeded **100%** of net assets.

Stock Market Index		The number of companies analysed	2014	share	2015	share	2016	share	2017	share	2018	share
US	50%+	489	169	34.6%	181	37.0%	192	39.3%	201	41.1%	201	41.1%
	100%+		(71)	(14.5%)	(73)	(14.9%)	(83)	(17.0%)	(82)	(16.8%)	(92)	(18.8%)
EUR	50%+	346	112	32.4%	119	34.4%	120	34.7%	119	34.4%	117	33.8%
	100%+		(39)	(11.3%)	(45)	(13.0%)	(41)	(11.8%)	(35)	(10.1%)	(35)	(10.1%)
HK	50%+	464	13	2.8%	11	2.4%	18	3.9%	18	3.9%	18	3.9%
	100%+		(7)	(1.5%)	(8)	(1.7%)	(8)	(1.7%)	(6)	(1.3%)	(8)	(1.7%)
JPN	50%+	62	4	6.5%	4	6.5%	6	9.7%	7	11.3%	5	8.1%
	100%+		(0)	(0.0%)	(1)	(1.6%)	(0)	(0.0%)	(0)	(0.0%)	(0)	(0.0%)

Improvements to Subsequent Accounting

Our thoughts – Common views for ASBJ Staff and HKICPA Staff

Support an amortisation plus impairment approach

- Acquired goodwill (AGW) is a **distinct unit of account** and independent from internally generated goodwill (IGGW).

- AGW should be amortised over time on a systematic basis, and the CGU(s) to which AGW is attributed should be tested for impairment <u>only</u> when there is an indication of impairment.

- AGW arising from each business combination should use a single amortisation period.

ASBJ Staff view

Why amortisation plus impairment?

- AGW is a "wasting asset" (that is, an asset that diminishes in value over time) and financial statements should reflect this nature.

  ⇨ The ASBJ Staff think that whether goodwill is of a wasting nature is not an old issue as there continues to be no consensus.

- Impairment serves to signal the lack of recoverability of the carrying amount of AGW and amortisation signals the consumption of AGW. Both impairment and amortisation are necessary.

How to determine the amortisation period?

- The amortisation period should be based on the period that management expects to generate incremental cash inflows arising from the acquisition.
- Should establish a maximum number of years.

HKICPA Staff view

Nature of goodwill

Economic goodwill = **fair value** of an entity – identifiable net assets recognised (**book value**)

- Economic goodwill - dynamic amount that changes over time
- Acquired goodwill - static “snapshot” of economic goodwill as of the acquisition date

HKICPA Staff view

Why amortisation plus impairment?

1) Improve financial reporting and better reflect the nature of AGW.
    a) Demonstrate AGW becomes increasingly less representative of entity.
    b) Provide better opportunity to show how an acquisition is utilised.
    c) Improve comparability between organic and acquisitive growth.
2) Increasingly large AGW balances may contribute negatively to management incentives and misrepresent risks.
    a) Amortisation ensures allocation to expense on a timely basis.

How to determine the amortisation period?

- Determine in terms of the expected utilisation of an acquisition.
    - ➢ E.g. What is the integration plan and how long will it last?
- Rebuttable presumption on length (e.g. 10 years).

Questions for ASAF members

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- **What do you think about the significant amounts of goodwill on entities' balance sheets?**
  - Is "too little, too late" a problem?
  - Does this affect management incentives and/or misrepresent risks?
- **Does amortisation better reflect the nature of AGW and/or improve financial reporting?**
  - If yes, do you agree in particular with any of arguments presented in the Research Paper?
- **If AGW were to be amortised, how should the amortisation period be determined? What about the amortisation pattern?**
  - Should there be a maximum number of years or a rebuttable presumption?

Appendix

Appendix
Quantitative study - background

Scope

- Results based on the data from 2014 to 2018, update of:
  - 2016 ASBJ research paper No. 2 “Quantitative Study on Goodwill and Impairment” which was:
    - based on the data from 2005 to 2014
    - conducted jointly with the European Financial Reporting Advisory Group (EFRAG) secretariat
- Scope of companies:
  - The stock market indices of:
    - the United States (the S&P 500 index)
    - Europe (the S&P Europe 350 index)
    - Hong Kong (the Hang Seng Composite index)
    - Japan (the Nikkei 225 index, for companies applying IFRS)

Thank you!

Please keep in touch with us and share your views!

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