IFRS

STAFF PAPER

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IASB® meeting

Project	**Goodwill and Impairment**
Paper topic	Subsequent accounting for goodwill—reintroducing amortisation

CONTACT(S) Tim Craig tcraig@ifrs.org +44 (0)20 7246 6410

Purpose and structure

1. The purpose of the paper is to initiate the International Accounting Standards Board's (Board) discussion on the subsequent accounting for goodwill and in particular, whether to reintroduce amortisation of goodwill. The paper provides an initial staff analysis of the feedback on this topic. It also outlines some options on how the Board could proceed. It does not ask for decisions.

2. The paper is structured as follows:
   (a) Background (paragraphs 3–11);
   (b) Staff analysis (paragraphs 12–61):
      (i) new arguments (paragraphs 13–27);
      (ii) trends (paragraphs 28–45);
      (iii) user views (paragraphs 46–48);
      (iv) views on whether amortisation can resolve concerns about timely recognition of impairment losses on goodwill (paragraphs 49–53); and
      (v) other factors (paragraphs 54–61);
   (c) Options on how to proceed (paragraphs 62–135):
      (i) retain impairment-only model (paragraphs 66–90);
      (ii) explore the reintroduction of amortisation (paragraphs 91–111);

(iii) explore the reintroduction of amortisation contingent upon (paragraphs 112–129):

1. requiring disclosures about the subsequent performance of business combinations (paragraphs 114–119);
2. not being able to improve the effectiveness of the impairment test of cash-generating units containing goodwill (paragraphs 120–125); and
3. the details of the amortisation model that is proposed (paragraphs 126–129);

(iv) Other approaches (paragraphs 130–135);

(d) Question for the Board; and

(e) Appendix—Other considerations if the reintroduction of amortisation is explored.

Background

3. The Board introduced the impairment-only model for the subsequent accounting for goodwill in 2004 when it issued IFRS 3 *Business Combinations*. Previously, IAS 22 *Business Combinations* had required entities to amortise goodwill over its useful life, presumed not to exceed 20 years, although companies could rebut that presumption.

4. When the Board introduced the impairment-only model in 2004, it concluded that:

(a) it is generally not possible to predict the useful life of goodwill and the pattern in which it diminishes. As a result, the amount of amortisation in any given period can be described as, at best, an arbitrary estimate of the consumption of goodwill during that period.

(b) straight-line amortisation of goodwill over an arbitrary period fails to provide useful information.

(c) the impairment test was rigorous and operational. Therefore, more useful information would be provided by not amortising goodwill, but instead testing it for impairment at least annually.

5. In the Post-implementation Review (PIR) of IFRS 3, many stakeholders said there was a time lag between an impairment occurring and the recognition of an impairment loss in an entity's financial statements. There were also many stakeholders that suggested reintroducing amortisation of goodwill.

6. The Board investigated whether it could make the impairment test significantly more effective at recognising impairment losses on goodwill on a timely basis at a reasonable cost, but concluded that doing so was not feasible (see Agenda Paper 18B to the Board's May 2021 meeting). The Board then considered whether to propose reintroducing amortisation of goodwill, with the aim of:

   (a) taking some pressure off the impairment test, which may make the impairment test easier and less costly to apply.

   (b) providing a simple mechanism that targets the acquired goodwill directly and reduces the possibility that the carrying amount of goodwill could be overstated because of management over-optimism or because goodwill is not tested for impairment directly.

7. By a small majority (eight out of 14 Board members), the Board reached a preliminary view of retaining the impairment-only model (preliminary view).

8. The Board accepted that both accounting models for goodwill—an impairment-only model and an amortisation model[1]—have limitations. No impairment test has been identified that can test goodwill directly, and for amortisation it is difficult to estimate the useful life of goodwill and the pattern in which it diminishes.

9. Paragraphs 3.86–3.87 of the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* (Discussion Paper) explain:

> 3.86 The topic of accounting for goodwill has always been the subject of strongly held and divergent views. To fulfil its role as a standard-setter, the Board needs to be satisfied that any decisions it makes now will not be reopened again in a few years—frequent changes back and forth between the different approaches would not help any stakeholders.

[1] For avoidance of doubt, an amortisation model refers to a model that includes amortisation of goodwill and an impairment test.

> 3.87 In the context of a PIR, the Board will propose changing IFRS requirements only if it has enough information to conclude that a change to the Standard is necessary. The Board will also need to decide that the benefits of such a change would outweigh the cost and disruption that would be caused by changing the requirements again.

10. The Board requested feedback that provides new practical or conceptual arguments, together with evidence for these arguments and highlighted that simply repeating the well-known arguments for the different views on this topic is unlikely to move the debate forward. In particular, the Board especially welcomed feedback that would help it understand:

    (a) why stakeholders have concerns that recognition of impairment losses on goodwill is not timely, and whether amortisation could and should resolve these concerns; and

    (b) what information best helps users of financial statements (users) hold entities' management accountable for business combination decisions at a reasonable cost.

Key messages from feedback

11. Key messages from feedback on this topic were:

    (a) stakeholders' views remain mixed. Many respondents agreed with the Board's preliminary view but many disagreed and suggested reintroducing amortisation of goodwill.

    (b) respondents generally did not provide new conceptual arguments or evidence, although some respondents considered that there is new practical evidence since the impairment-only model was introduced in 2004 that the impairment test is not working. These respondents referred to evidence from applying the impairment-only model, and the problems encountered, as new evidence.

(c) most respondents commenting on convergence with US generally accepted accounting principles (US GAAP)[2] said convergence on the subsequent accounting for goodwill was desirable. However, many respondents also said their view did not depend on convergence, or that the Board should make its decision on the basis of the evidence it has collected rather than solely to maintain convergence.

Staff analysis

12. This agenda paper does not repeat the details of feedback on the Board's preliminary view provided in Agenda Paper 18C to the May Board meeting. This section analyses some key aspects of the feedback that staff think will help the Board when it considers options on how to proceed. In particular, staff have analysed:

    (a) new arguments (paragraphs 13–27);

    (b) trends (paragraphs 28–45);

    (c) user views (paragraphs 46–48);

    (d) views on whether amortisation can resolve concerns about timely recognition of impairment losses on goodwill (paragraphs 49–53); and

    (e) other factors (paragraphs 54–61).

New arguments

13. Respondents that agreed with the Board's preliminary view and those that disagreed provided many arguments to support their views. Agenda Paper 18C to the May Board meeting documents these arguments. These arguments are not new—they were considered by the Board, either when issuing IFRS 3 or during the course of this project in developing the preliminary view (see, for example, Agenda Paper 18B to the June 2019 Board meeting). Hence, the staff have not identified any compelling

[2] The requirements for accounting for business combination under US GAAP and IFRS Standards are largely converged. Both adopt an impairment-only model for the subsequent accounting for goodwill (US private and not-for-profit entities can elect to amortise goodwill). However, the US Financial Accounting Standards Board (FASB) tentatively decided at its December 2020 meeting to require entities to amortise goodwill over a 10-year default period, unless an entity justifies another period, on a straight-line basis.

new conceptual or practical arguments either in favour of, or against the Board's preliminary view.

14. As noted earlier, the Board concluded in 2004 that the impairment test was sufficiently rigorous and operational and an approach in which goodwill is not amortised, but instead tested for impairment annually, would provide more useful information. However, some respondents said the impairment-only model is not working as intended and practical evidence of the impairment test not working is new evidence the Board should consider. One of those respondents said the impairment test is the cornerstone of treating goodwill differently to other assets (that is as an asset that is not amortised) and another respondent said the test is not rigorous or operational. These respondents consider this to be evidence that the Standard(s) are not working as the Board intended.

15. However, as paragraphs 3.75–3.79 of the Discussion Paper explain, the Board was already aware of the issue of shielding when issuing IFRS 3 and concluded then that no impairment test can discern whether pre-existing internally generated goodwill, rather than the acquired goodwill, has been impaired and replaced by goodwill generated after an acquisition. The Board, at that time, accepted that shielding is inevitable in an impairment test of cash-generating units containing goodwill. Management judgement in cash flow forecasts is also necessary. The staff think the Board will need to consider whether there is compelling evidence that its previous conclusion is no longer appropriate and the reintroduction of amortisation is necessary.

16. The paragraphs below discuss some of the evidence some respondents provided in support of their view that the impairment test was not working.

High goodwill balances and implied useful lives

17. Some respondents, favouring the reintroduction of amortisation, said goodwill balances are too high. Many of these respondents provided quantitative evidence from their jurisdictions to illustrate the increase in goodwill balances and implied useful lives under the impairment-only model.

18. One national standard-setter observed that goodwill balances in its jurisdiction increased by 69% for their sample of current-listed entities between 2005 and 2019.

They said their research (which compared changes in the goodwill balances with changes in the market capitalisation of the entities) also showed that goodwill balances had not fluctuated as much as they had expected despite significant changes in market conditions since 2005 (for example, as a result of the 2007 subprime mortgage crisis, 2008 global financial crisis, 2015 Greek debt crisis and 2016 UK Brexit vote). This national standard-setter said this might indicate impairment losses are not recognised on a timely basis and said the continual build-up of goodwill balances would not provide useful information because it does not reflect the nature of goodwill—that is, a wasting asset whose benefits are consumed over time.

19. A few respondents also referred to the high ‘implied useful life’ of goodwill in various studies as further evidence of the impairment test not working. For example, one national-standard setter referred to a study they carried out in 2020 which demonstrated that the average implied time to fully expense goodwill far exceeded 20 years, the previous presumed maximum useful life of goodwill in IFRS Standards. For entities on the stock exchanges of the United States (S&P 500 index), Europe (S&P Europe 350 index), Hong Kong (Hang Seng Composite index) and Japan (Nikkei 225 index—for companies that applied IFRS Standards in 2019), the average implied lives of goodwill for the period 2014–2018 were 122 years, 78 years, 64 years and 64 years respectively.

20. However, the staff think it is difficult to draw definitive conclusions from this evidence. To claim that goodwill balances are ‘too’ high requires developing an expectation of the ‘correct’ goodwill balance. Although it might be possible to develop such an expectation (and some respondents have tried to do so), the staff think it is difficult to determine whether those expectations are correct because goodwill is not directly observable. Therefore it is difficult to determine how significant an issue high goodwill balances are and what conclusions to draw from the quantitative evidence provided.

21. The staff think there are various reasons why goodwill balances might be high, for example:

    (a) low interest rates stimulating M&A activity;

    (b) general growth in global economies;

(c) an extended period of consolidation amongst global entities; and

(d) acquisitions involving increasingly intangible-based entities.

22. One preparer provided quantitative information that illustrated a significant increase in the carrying amount of its goodwill balance between 2005 and 2019. However, that preparer said the increase in its goodwill balance would have been significant even if goodwill was being amortised over 20 years. Therefore the increase must be driven by other, more important factors than the lack of amortisation.

23. One consultant said that, compared to other European countries, UK companies within the STOXX® Europe 600 had the highest aggregate amount of goodwill impairment in 2019 (€19.3 billion), nearly triple the 2018 impairment (€7.1 billion). They went on to say this has been the highest level of impairment losses for the UK in any year since 2012, in part underpinned by the uncertainty of Brexit. Based on a review of the total goodwill impairment losses recorded by European listed companies in the STOXX® Europe 600, the consultant concluded that major macroeconomic events consistently impact goodwill impairment trends demonstrating that the current goodwill impairment test works as anticipated.

24. Although the population of listed entities considered by the consultant differs to those considered by the national-standard setter referred to in paragraph 18, both considered entities from the UK and came to different conclusions about whether the level of impairment losses recognised indicated that the impairment test was working and reflected significant changes in market conditions. In the staff's view this indicates at least some of the difference in interpretation of the results of these quantitative studies could be down to the expectations of the authors, which illustrates the difficulty in determining what the right amount of goodwill balances and impairment losses is.

25. The evidence on the implied useful life of goodwill is also mixed. One accounting body respondent referred to a research study that determined an implied useful life of goodwill of 15 years for listed companies in Australia, New Zealand and the World (using the Standard and Poor's Compustat Global Database excluding the United States) based on the frequency and magnitude of impairment losses.

26. This result differs from other implied useful life studies respondents referred to and this might be partly due to how entities included in the studies are selected. For

example, if entities are included by reference to only those listed entities that were part of a stock exchange index at the end of a particular period, this would mean that entities that were removed from the index during that period (and these might be entities that are more likely to recognise an impairment) would not be included (survivorship bias). The study in paragraph 25 used all companies that were part of the relevant indexes for the entire period in question and is therefore not subject to survivorship bias.

27. Overall the staff think the trend of increasing goodwill balances and the evidence regarding implied useful lives of goodwill are not compelling evidence that the impairment test is not working as intended.

Trends

28. Although the staff have identified no new compelling arguments, the staff have identified a few trends in support for particular arguments that might be relevant to the Board's considerations:

(a) divergent and strongly held views (paragraphs 29–33);

(b) support for reintroducing amortisation (paragraphs 34–38); and

(c) estimating the useful life of goodwill (paragraphs 39–45).

Divergent and strongly held views

29. Firstly, there continues to be evidence of divergent and strongly held views. The arguments respondents provided to support either retaining the impairment-only model or reintroducing amortisation are often diametrically opposed—for example, whether goodwill is a wasting asset or not, whether amortisation provides useful information and holds management to account or not. A few respondents doubted whether discussing the merits of the two models would be productive.

30. At the heart of the conceptual debate is whether goodwill is a wasting asset with a determinable life. In the recent feedback (see Agenda Papers 18C and 18F to the May Board meeting) a group of academics reviewed arguments from the economic, management and accounting literature and concluded that goodwill is a wasting asset. On the other hand a few respondents referred to the International Valuation Standards

Council's article *Is Goodwill a Wasting Asset?* which concluded that the majority of components in goodwill are not wasting.

31. Stakeholders' views may also depend on the unit of account, for example whether acquired goodwill is distinct from internally generated goodwill, or whether acquired and internally generated goodwill are a single unit of account that is maintained over time. Most respondents said in their view acquired and internally generated goodwill are different. However, some respondents disagreed and a few said it was impractical to distinguish between acquired and internally generated goodwill.

32. Stakeholders also have different views about whether the useful life of goodwill is determinable—paragraphs 39–45 discuss this further.

33. The staff think it is unlikely that these views (and other views on the topic) are ever likely to be resolved.

Support for reintroducing amortisation

34. As explained in Agenda Paper 18C to the May Board meeting, respondents' views on whether to reintroduce amortisation of goodwill remain mixed. Nonetheless, the staff have identified some shifts in stakeholder support.

Responses to question 7(b)

35. A few respondents to question 7(b) of the Discussion Paper[3] said their position on whether to reintroduce amortisation had changed in recent years. Most of these respondents said they now favoured reintroducing amortisation generally because of the limitations of the impairment-only model and most also said this was new evidence (see paragraphs 13–27).

European stakeholders

36. The European Financial Reporting Advisory Group (EFRAG) said:

> Some constituents have always been in favour of the impairment-only approach for conceptual reasons and some others in favour of amortisation. From the first group a shift can

[3] Question 7(b) of the Discussion Paper asked: 'Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already held?'

> be observed. Because of this shift for practical reasons now the amortisation approach seems to have a majority in Europe.

37. However, the staff observe paragraph BC131D of the Basis for Conclusions on IAS 36 *Impairment of Assets* notes that respondents to ED 3 *Business Combinations* that expressed a clear view regarding an impairment-only or an amortisation model generally supported an amortisation model and therefore this might not be as significant a change as it sounds.

Users

38. There has also been a shift in the balance of user views with more users that responded to the Discussion Paper supporting the reintroduction of amortisation of goodwill compared to the views of users that responded to the PIR of IFRS 3. However, despite this shift, staff observe that overall user views continue to be mixed. Paragraphs 46–48 provide further analysis of user views.

Estimating useful life of goodwill

39. Not being able to reliably estimate the useful life of goodwill and the pattern in which it diminishes was central to the Board's conclusions to adopt the impairment-only model. Paragraph BC131D of the Basis for Conclusions on IAS 36 says respondents to ED 3 who expressed a clear view regarding an impairment-only or an amortisation model generally supported straight-line amortisation. One of the reasons was that:

> …
>
> (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.

40. Paragraph BC131E of the Basis for Conclusions on IAS 36 goes on to say:

> …
>
> 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.

41. The feedback on whether a reliable estimate of the useful life of goodwill can be made was more mixed this time. Some respondents said a reliable estimate cannot be made, whereas some disagreed and said a reliable estimate can be made, which seems to indicate a possible shift in some stakeholders' views.

42. In response to question 7(f)[4] in the Discussion Paper, many respondents suggested basing the useful life of goodwill and amortisation pattern on managements' estimates, for example basing the useful life and amortisation pattern on a business combinations' expected payback period, synergies or other benefits.

43. Some respondents said the impairment-only model provides better information than an amortisation model, and some respondents said an amortisation model would not provide useful information because the information it provides is arbitrary. As highlighted in paragraph 4 the Board's conclusions in 2004 were based on a

[4] Question 7(f) of the Discussion Paper asked 'If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?'

conclusion that the useful life cannot be reliably estimated and amortisation would only be an arbitrary estimate. However, some respondents said an amortisation model could provide useful information. For example, managements' judgements about the useful life of goodwill could provide useful information about managements' expectations of the period over which an entity expects to realise benefits associated with goodwill and an amortisation model could provide useful information by allocating the cost to periods in which the benefits are realised.

44. Although academic evidence generally supports the view that impairment losses provide useful information, one academic respondent provided evidence[5] that an amortisation model provides value relevant (its association with share prices and returns) information (see Agenda Paper 18F to the May Board meeting for further information).

45. The shift in views on whether the useful life of goodwill can be estimated reliably may indicate that the Board should reconsider the arguments it found most convincing when it adopted the impairment-only model (see paragraph 4).

User views

46. As discussed in paragraph 38, there has been a shift in the balance of user views since the PIR of IFRS 3 with more users supporting the reintroduction of amortisation, although the staff observe that user views remain mixed. Only one of the respondents to the PIR of IFRS 3 that also responded to the Board's Discussion Paper reported a change in users' views on this topic. In response to that PIR of IFRS 3, this national standard-setter said users they consulted did not support amortising goodwill because it would provide no informational value. In its comment letter to the Board's Discussion Paper, this national standard-setter said most users they consulted supported amortising goodwill, provided entities present the amortisation of goodwill separately from amortisation of other long-lived assets. The respondent did not provide further information about the reasons for this change.

[5] Amel-Zadeh, A., Faasse, J., Li, K., and Meeks, G. (2020), 'Stewardship and Value-Relevance in Accounting for the Depletion of Purchased Goodwill', in A. Amel-Zadeh and G. Meeks (eds.), *Accounting for M&A: Uses and Abuses of Accounting in Monitoring and Promoting Merger* (London: Routledge), 79-112.

47. The reasons provided by user respondents to the Discussion Paper who favoured retaining the impairment-only model remain the same, compared to those provided by user respondents to the PIR of IFRS 3, with most saying the impairment-only model provides better information and/or amortisation does not provide any useful information.

48. User respondents who favoured reintroducing amortisation of goodwill provided numerous reasons when responding to the PIR of IFRS 3 and to the Discussion Paper, with the impairment test not working and goodwill is a wasting asset being common reasons provided to both consultations. However, many user respondents to the Discussion Paper that were in favour of reintroducing amortisation said amortisation could provide useful information whereas this was not a reason provided in the PIR to IFRS 3—however, it is not clear whether these respondents' support for reintroducing amortisation is contingent on, for example, how an entity would determine the useful life of goodwill.

Views on whether amortisation can resolve concerns about timely recognition of impairment losses on goodwill

49. Question 7(c) in the Discussion Paper asked whether reintroducing amortisation would resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis. The Board had identified two main reasons for why impairment losses on goodwill were not recognised on a timely basis—management over-optimism and shielding. The staff think this is a key question the Board should consider when redeliberating its preliminary view.

50. Some respondents said reintroducing amortisation would not resolve the main reasons for the concerns. Many of these respondents said that amortisation would not ensure more timely recognition of impairment losses. In particular:

    (a) some of these respondents said amortisation would worsen shielding and consequently reduce the number and magnitude of recognised impairment losses.

    (b) some of these respondents said amortisation would not solve the problem of untimely impairment losses but would instead reflect the consumption of goodwill. These respondents think showing the consumption of goodwill is a reason to reintroduce amortisation.

51. Many respondents who answered this question said although amortisation might not fully resolve the main reasons for the concerns, reintroducing amortisation would help reduce these concerns. In particular:

(a) many of these respondents said reintroducing amortisation would reduce carrying amounts of goodwill thereby reducing the risk of overstatement.

(b) some of these respondents said it would reduce pressure on the impairment test, reducing the reliance on subjective estimates over time as the carrying amount reduces.

52. Some respondents who answered this question said amortisation would resolve the main reasons for the concerns. In particular:

(a) some of these respondents said impairment losses would be recognised on a more timely basis—only one of these respondents explained their view further and said amortisation would reduce the incidence of overpayments because it would help hold management to account for business combinations and the prices paid which in turn would reduce the incidence of impairments that are not being recognised on a timely basis.

(b) many of these respondents explained that in their view amortisation would resolve the concerns because entities would recognise sufficient expenses in the income statement on a timely basis. The staff think this view is generally held by those that consider goodwill to be a wasting asset and consider that amortisation would solve a problem of not recognising the consumption of goodwill rather than the problem of not recognising an impairment loss on goodwill on a timely basis. The view could also be held by those that are concerned that the impairment test is not working and that carrying amounts of goodwill are potentially overstated—in their view, a more timely expense (through amortisation) would resolve the lack of an expense from not recognising impairment losses on a timely basis.

53. The different views of respondents that answered this question and the basis for those views illustrates that different stakeholders may have different views as to what the so

called 'too little, too late' problem refers to and consequently whether reintroducing amortisation of goodwill would solve that problem (see Agenda Paper 18A to the June meeting for more discussion on this topic). In addition, views that reintroducing amortisation can help reduce the risk that carrying amounts of goodwill are overstated are linked to the discussion in paragraphs 17–27 on goodwill balances being too high—however, as discussed in that section of the paper, the extent of that risk and how persuasive these views are debatable.

Other factors

54. As discussed in paragraphs 29–33, stakeholders continue to have strongly held and divergent views on the topic of the subsequent accounting for goodwill and, as discussed in paragraphs 13–27, no new conceptual arguments have been provided by respondents. Because it is unlikely that these different views can be resolved, other factors may have to be considered by the Board when deciding whether to reconfirm its preliminary view. Paragraphs 28–45 highlight some potential trends in the feedback that might differ from previous feedback. The staff think this is one factor the Board could take into consideration during its redeliberations.

55. Other factors that may be relevant are:

    (a) the stability of the accounting framework (hence why the Board is exploring whether there is compelling evidence for a change to the subsequent accounting for goodwill);

    (b) transition to an amortisation model (if applicable), and the effect this could have on entities' financial positions and stability, and on capital markets;

    (c) whether the Board is considered to have responded to the limitations of the impairment test identified in the PIR of IFRS 3; and

    (d) convergence with US GAAP—the following paragraphs discuss this in more detail.

Convergence with US GAAP

56. The importance of convergence for stakeholders has been highlighted by IOSCO's recent public statement encouraging the Board and the US Financial Accounting Standards Board (FASB) to work collaboratively together.

57. As reported in Agenda Paper 18C to the May Board meeting, most respondents answering the question in the Discussion Paper about convergence[6] said convergence was desirable, and that the Board and the FASB should work collaboratively together. However many respondents did not provide a response to the question. Of those respondents that did answer the question:

    (a) many respondents that had definitive views on whether to reintroduce amortisation said although convergence was preferable, their views would not change or the Board should make its own decision and not change IFRS Standards solely to maintain convergence, so it is an important, but not necessarily determinative factor.

    (b) some respondents said maintaining convergence was more important than determining what the converged approach should be and indicated that they would change or at least reconsider their views on the subsequent accounting for goodwill in order to encourage the Board and the FASB to maintain convergence. Many of these respondents expressed no overall view on reintroducing amortisation or reported mixed views within their organisations and convergence was the factor that tipped the balance.

    (c) for some respondents it was not clear from their feedback whether they would reconsider their view in order to encourage the Board to maintain convergence.

58. Most respondents who provided reasons why convergence was preferable cited comparability and a few of these respondents specifically referred to comparable performance metrics. A few mentioned potential increased costs of dual reporting in

[6] Question 13 of the Discussion Paper asked: 'Do your answers to any of the questions in this Discussion Paper depend on whether the outcome is consistent with US GAAP as it exists today, or as it may be after the FASB's current work? If so, which answers would change and why?'

the event of non-convergence and some respondents mentioned the importance of maintaining a level playing field for mergers & acquisitions (M&A).

59. However, on the subject of a level playing field for M&A, one national standard-setter said that they had heard arguments that entities applying an amortisation model would be favoured in M&A bids and also that entities applying an impairment-only model would be favoured in M&A bids—in both cases they heard views that the respective accounting models would allow the entities to bid higher.

60. The staff think the potential costs of divergence could include:

    (a) the cost to users of adjusting performance metrics to be able compare entities—although business combinations themselves are not necessarily comparable, it is likely that particular performance metrics could be further distorted by different accounting regimes;

    (b) the cost to IFRS preparers where dual listed or where overseas subsidiaries report under US GAAP; and

    (c) potential costs and confusion when users, particularly less sophisticated users, are unaware of the accounting differences—although there are other differences between IFRS Standards and US GAAP, business combinations are often material transactions and hence differences in accounting could also be material.

61. The project and the topic of convergence was discussed at the June 2021 Accounting Standards Advisory Forum (ASAF) meeting. On the extent of convergence that is important, ASAF members that commented said the details of the amortisation model did not need to be identical and it is more important that the standards are converged in respect of whether goodwill is amortised. However, one ASAF member said, although it may not be feasible to have identical standards, both boards should seek to converge the accounting requirements as much as possible. In respect of the potential costs of divergence, a few ASAF members said:

    (a) entities could incur additional costs when raising capital in different jurisdictions, in explaining differences to users and in preparing common measures to compare performance of operations within the consolidated group when there are some subsidiaries that report under US GAAP.

(b) users would incur additional costs in adjusting the performance measures reported by entities and some users might not be familiar with the detailed accounting requirements.

Outline of options for the subsequent accounting for goodwill

62. This section sets out the staff's initial view on the possible options the Board could consider with respect to the subsequent accounting for goodwill and what feedback/arguments might support each option. At this stage the staff are not recommending any one of these options.

63. The options considered are as follows:

(a) retain the impairment-only model; (paragraphs 66–90);

(b) explore the reintroduction of amortisation of goodwill (paragraphs 91–111); and

(c) explore the reintroduction of amortisation contingent upon (paragraphs 112–129):

(i) providing disclosures about the subsequent performance of business combinations (paragraphs 114–119);

(ii) not being able to improve the effectiveness of the impairment test of cash-generating units containing goodwill (paragraphs 120–125); and

(iii) the details of the amortisation model that is proposed (paragraphs 126–129).

64. The staff have placed weight on particular arguments or interpreted feedback in a particular way so as to outline the support for the different options. At this stage this is for illustrative purposes only. In particular, the staff have not analysed the relative merits of the different arguments with a view to arriving at a staff recommendation. The staff intend to perform this analysis and develop a recommendation for the Board to consider at a future meeting.

65. In addition to these options, the staff have included analysis of other approaches that some respondents suggested the Board consider instead of an impairment-only or amortisation model (paragraphs 130–135).

Option 1–retain the impairment-only model

66. Under this option, the Board would confirm its preliminary view to retain the impairment-only model and would not reintroduce amortisation.

67. The staff think the Board could cite the following reasons as the basis:

    (a) lack of compelling new evidence (paragraphs 68–71);

    (b) the impairment test meets its objective (paragraphs 72–78);

    (c) amortisation does not resolve concerns about impairment losses not being recognised on a timely basis (paragraphs 79–82);

    (d) amortisation does not represent a significant improvement in financial reporting (paragraphs 83–89); and

    (e) convergence, although important, is not sufficient to warrant a change (paragraph 90).

Lack of compelling new evidence

68. In the Discussion Paper, the Board encouraged stakeholders to provide feedback that provides new practical or conceptual arguments. This is because, in the context of a post-implementation review, the Board will propose changing requirements in IFRS Standards only if it has enough information to conclude that a change to a Standard is necessary. In addition, frequent changes back and forth between the different approaches would not help stakeholders.

69. As paragraphs 13–27 and the relevant section of Agenda Paper 18C to the May Board meeting highlight, respondents have not provided compelling new evidence. The arguments that have been presented in support of both models continue to be strongly-held, divergent and have already been previously considered by the Board. Although respondents have provided some new evidence to support particular arguments, the evidence remains mixed.

70. As discussed in paragraphs 14–27, many respondents supporting amortisation said the impairment test is not working and some respondents said that practical evidence that the impairment test was not working was new evidence that suggests a change is needed. However, as discussed in that section, the evidence provided is not compelling. The staff also note:

(a) some respondents remained unconvinced there is a significant problem. In their view optimism is natural and oversight from auditors and safeguards in IAS 36 (for example, the requirement to use reasonable and supportable assumptions) helps counter any over-optimism. They also said shielding is inevitable, and is inappropriate only when goodwill is not allocated properly to cash-generating units.

(b) one of the academic studies[7] provided by respondents to the Discussion Paper, concluded for listed companies in Australia, New Zealand and the World (based on the Standard and Poor's Compustat Global Database excluding the United States) that the impairment frequency and magnitude implies a useful life of goodwill of 15 years. The previous presumed maximum useful life of goodwill in IFRS Standards was 20 years and this evidence further questions how much the impairment-only model is contributing to the concern raised by some respondents (that favour reintroducing amortisation of goodwill) that goodwill balances are too high (see paragraphs 17–27) for further discussion).

(c) there is academic evidence[8] that the relationship between impairment decisions and economic fundamentals is stronger in the presence of strong enforcement. This supports the Board's view in the Discussion Paper that management over-optimism is an application matter and therefore better dealt with by auditors and regulators.

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[7] Pinnuck, M. and Ghandar, A. (2020), 'How Long Is the Piece of String? Intangibles and Goodwill on Balance Sheets Worldwide, in Australia and New Zealand', *Chartered Accountants Australia and New Zealand and University of Melbourne Report*.

[8] Glaum, M., Landsman, W. R., and Wyrwa, S. (2018), 'Goodwill Impairment: The Effects of Public Enforcement and Monitoring by Institutional Investors', *The Accounting Review*, 93 (6), 149-80.

(d) As discussed in paragraphs 14–15, the limitations of the impairment test of cash-generating units containing goodwill is not new evidence. The Board was aware of the shielding effect when it issued IFRS 3 and still concluded that the test was rigorous and operational.

71. As discussed in paragraphs 39–45, many respondents suggested basing the useful life of goodwill on management's estimates, which might suggest a shift in views about whether a reliable estimate of the useful life of goodwill can be made which was one of the key factors in the Board's decision in 2004 to adopt an impairment-only model. However, many respondents agreeing with the Board's preliminary view to retain the impairment-only model said the useful life of goodwill is subjective and cannot be reliably estimated. Hence, this evidence is mixed.

Impairment test meets its objective

72. The objective of the impairment test in IAS 36 is to ensure that an entity's assets are carried at no more than their recoverable amounts.

73. Goodwill does not generate cash inflows independently. Thus, the impairment test focuses on the cash-generating unit, rather than the individual asset—the appropriate approach when an asset does not generate largely independent cash inflows but jointly contributes to the generation of future cash flows with other assets. The use of a cash-generating unit is a core principle of impairment testing in IAS 36.

74. The Board explored the possibility of designing a different impairment test to resolve the shielding issue but its preliminary view was that it was not feasible to do this at a reasonable cost, and most respondents agreed with this view.

75. Therefore, without performing a fundamental review of IAS 36 and of the cash-generating unit concept, which is not in the scope of this project, testing goodwill—an asset that does not generate cash inflows independently and that cannot be directly measured—as part of a group of cash-generating units remains the best test available.

76. The test ensures that the combined carrying amount of the assets within cash-generating units is not higher than their combined recoverable amount, and that the combined carrying amount of these assets (including goodwill) is therefore not overstated. The Board concluded in 2004 when issuing IFRS 3 and the revisions to IAS 36 that such a test is sufficiently rigorous and operational for goodwill.

77. Expectations that the impairment test can directly test goodwill, which cannot be directly measured, are misplaced and arguments that the impairment test is not working may be based on a misunderstanding or an unrealistic expectation of what the impairment test is designed to achieve. As discussed in paragraph 70(a), shielding and the application of judgement in the test is inevitable.

78. Clarifying the objective of the impairment test may help respond to stakeholders who have different expectations of what the impairment test of cash-generating units containing goodwill can do.

Amortisation does not resolve concerns about untimely recognition of impairment losses

79. Arguments that amortisation resolves concerns that impairment losses are not recognised on a timely basis are unconvincing. Only a few respondents explicitly said reintroducing amortisation of goodwill would result in impairment losses being recognised on a more timely basis—this being the problem identified in the PIR of IFRS 3—while a few respondents said reintroducing amortisation would increase shielding and therefore make the situation worse. More respondents said amortisation would resolve these concerns because it would result in a more timely expense in the income statement, however, as discussed in paragraphs 49–53, this generally results from a concern of not recognising the consumption of goodwill rather than a concern about not recognising impairment losses on goodwill on a timely basis.

80. Amortisation would reduce carrying amounts of goodwill, and a few respondents said this would at least reduce concerns about the timely recognition of impairment losses because it reduces the risk of overstatement. However, as discussed in paragraphs 17–27, the extent of that risk is difficult to assess and, as discussed in paragraph 76, the impairment test is designed to ensure that the combined carrying amount of all the assets in the cash-generating units (including goodwill) are not overstated.

81. Hence reintroducing amortisation of goodwill would not resolve timeliness concerns. At best it may reduce the size of potentially unrecognised impairment losses on goodwill but that is not compelling evidence to justify a change.

82. The impairment test should ensure the carrying amount of all the assets in the cash-generating units combined (including the goodwill) are not overstated. However, if

impairment losses are not recognised on a timely basis when an impairment event occurs because of, for example, unavoidable shielding in the impairment test, the disclosures on the subsequent performance of business combinations that the Board is proposing will help highlight this and are a more appropriate response than the reintroduction of amortisation of goodwill.

Significant improvement in financial reporting

83. It is debatable whether reintroducing amortisation of goodwill would significantly improve financial reporting.

84. Some respondents said amortisation could provide useful information about the period over which management expects to realise the benefits associated with goodwill and because amortisation allocates the cost in the income statement to the period of that benefit the income statement is more meaningful. Many users that favour reintroducing amortisation said management can make a reliable estimate of the useful life of goodwill. However, some respondents, including many users, said the impairment-only model provides better information and/or that amortisation provides no or only arbitrary information.

85. The ability of an amortisation model to provide useful information appears, for some, to be contingent on determining a reliable estimate of the useful life of goodwill and the pattern in which goodwill diminishes. As discussed in paragraphs 39–45, there continues to be a debate whether that is possible.

86. Academic evidence (see Agenda Paper 18F to the May Board meeting) on whether amortisation would be a significant improvement is also mixed. In particular:

   (a) some studies (see Agenda Paper 18F to the May Board meeting) concluded that amortisation was not value relevant and some that amortisation was value relevant. It is therefore possible that reintroducing amortisation would not improve the information provided to users.

   (b) academic evidence shows that entities experience negative share price returns up to 12 quarters before an impairment loss announcement which implies that impairment losses may not be timely. However, there is also academic evidence showing that announcements of impairment losses on goodwill are associated with negative stock market reaction, indicating that such announcements help resolve uncertainty and thus provide new information to users. The evidence is consistent with users who said recognition of an impairment loss provides useful confirmatory information.

87. There are also mixed views about whether an amortisation model would better hold management to account than an impairment-only model. A few respondents said management would be held accountable to recover the cost related to the amortisation expense and that this would improve the corporate governance over acquisition decisions and help deter overpayments. However, a few respondents said an amortisation model would report an expense for all business combinations regardless of subsequent performance, and therefore would not distinguish between high performing and underperforming business combinations, preventing users from distinguishing between good and bad managers. Amortisation would enable management to spread any overpayment in the income statement and management might never be held accountable for any overpayment.

88. Most respondents answering question 7(e)[9] of the Discussion Paper said they expect entities would adjust management performance measures (or create new ones) to add back amortisation expense because, for example, it is a non-cash item. If an amortisation expense is adjusted for in entities' management performance measures, it is questionable whether reintroducing amortisation would significantly improve financial reporting.

89. There is therefore no compelling evidence to suggest that reintroducing amortisation of goodwill would significantly improve financial reporting. In fact, it is possible that doing so could reduce the information provided to users and hinder users in holding management to account. Therefore reintroducing amortisation might not meet the project's objective of providing users with better information about business combinations at a reasonable cost thereby helping users more effectively hold management to account for their decisions to acquire those businesses.

[9] Question 7(e) of the Discussion Paper asked 'If amortisation were to be reintroduced, do you think companies would adjust or create new management performance measures to add back the amortisation expense? (Management performance measures are defined in the Exposure Draft *General Presentation and Disclosures*.) Why or why not? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not?'

Convergence

90. As discussed in paragraphs 56–61, although convergence with US GAAP could be beneficial, many respondents said their views would not change or that the Board should make its own decisions rather than changing IFRS Standards solely to maintain convergence if that would not improve IFRS Standards. Although important, since it is not clear whether reintroducing amortisation would significantly improve financial reporting, convergence itself is not a sufficient reason for the Board to reintroduce amortisation.

Option 2 – explore reintroducing amortisation

91. Under this option, the Board would decide to explore the reintroduction of amortisation with a view to proposing this in an exposure draft. The staff think the Board could cite the following reasons as the basis:

   (a) the impairment test is not working (paragraphs 93–98);

   (b) the benefits of the impairment test do not outweigh its cost (paragraphs 99–102);

   (c) shifts in stakeholder views (paragraph 103);

   (d) reintroducing amortisation of goodwill appropriately responds to the limitations of the impairment test (paragraphs 104–109); and

   (e) convergence with US GAAP (paragraphs 110–111).

92. If the Board decides to propose reintroducing amortisation of goodwill, the Board would also need to consider other more detailed follow up matters. The appendix to this paper lists some of these matters.

Impairment test is not working

93. There is evidence from the PIR of IFRS 3 and from many respondents who favour the reintroduction of amortisation of goodwill, that the impairment test is not working. In particular:

(a) an academic study[10] documented negative share price returns up to 12 quarters before the impairment loss announcement implying that impairment losses on goodwill may not be timely. In the researcher's view, comparing the results before and after the adoption of Statement of Financial Accounting Standards (SFAS) No. 142 *Goodwill and Other Intangible Assets*[11] indicated impairment losses on goodwill were larger and less timely in the post-SFAS 142 period.

(b) respondents said goodwill balances are high and although there may be many reasons for this as discussed in paragraphs 17–27, respondents said the adoption of the impairment-only model is part of the reason.

94. The disclosures on the subsequent performance of business combinations and other proposals in the Discussion Paper are not a sufficient response to concerns that the impairment test is not working. One user organisation said the test is not trusted and another said shortcomings in the test reduce the usefulness of financial statements. One accounting body said a structural deficiency has been highlighted, causing not only overstatement of goodwill, but also harming the relevance of financial information.

95. Some respondents said that this practical evidence that the impairment test is not working is new evidence that the Board should consider when assessing whether there is compelling evidence to warrant a change. Although the Board may have been aware of the shielding issue when issuing IFRS 3, it may not have been aware of the extent of the effect of shielding. In addition, given increasing M&A activity and increasing goodwill balances, there is an increased risk of overstating goodwill balances because of the limitations of the impairment test. One respondent said there is also an increased need for accountability because of this growth in M&A activity, entities entering into more ‘intangible-heavy’ acquisitions and a greater incidence of earnings-related executive pay models. In this respondents’ view, the impairment-only model was inferior to an amortisation model at ensuring accountability.

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[10] Li, K. K. and Sloan, R. G. (2017), 'Has Goodwill Accounting Gone Bad?', *Review of Accounting Studies*, 22 (2), 964-1003.

[11] SFAS No. 142 eliminated the periodic amortisation of goodwill and replaced it with an impairment-only model whereby goodwill is tested at least annually for impairment.

96. Paragraph BC197 of the Basis for Conclusions on IAS 36, in considering a subsequent cash flow test when amending IAS 36, says:

> …
>
> The Board observed that, given current trends in 'big bath' restructuring charges, the greater risk to the quality of financial reporting might be from entities trying to write off goodwill without adequate justification in an attempt to 'manage' the balance sheet.
>
> …

97. This paragraph indicates that the Board was less concerned about impairment losses being recognised too late. Feedback from the PIR of IFRS 3 and the Discussion Paper about impairment losses on goodwill not being recognised on a timely basis provides new evidence suggesting that this is now a bigger concern.

98. The Board's decision to adopt the impairment-only model was dependent on devising a rigorous and operational impairment test and the Board, in revising IAS 36 and issuing IFRS 3, concluded that a sufficiently rigorous and operational impairment test could be devised. The evidence suggests the test is not working as intended and, therefore, in the context of a post-implementation review, a change to IFRS Standards is justified.

The benefits of the impairment test do not outweigh its costs

99. It is questionable whether the impairment test of cash-generating units containing goodwill meets a cost-benefit assessment. The feedback and evidence gathered in the project highlights that the information provided by the impairment-only model is limited. Feedback from the PIR of IFRS 3 also highlighted the cost and complexity of the impairment test.

100. Although there is some academic evidence suggesting that the value relevance of goodwill and the ability of goodwill to predict future cash flows increased after the introduction of the impairment-only model, two studies[12] suggest that the introduction

[12] Li, Z., Shroff, P. K., Venkataraman, R., and Zhang, I. X. (2011), 'Causes and Consequences of Goodwill Impairment Losses', *Review of Accounting Studies*, 16 (4), 745-78 and Bens, D. A., Heltzer, W., and Segal, B.

of the impairment-only model neither increased nor decreased the information content of impairment losses on goodwill This therefore questions whether the high cost of the impairment test is justified.

101. In addition, there are academic studies that suggest the reintroduction of amortisation would not reduce the information provided by the impairment-only model and is therefore not contrary to the project's objective. Because an impairment test would continue to be required and because information associated with impairment losses on goodwill reduces over time (according to some respondents and one academic study[13]), it is likely that an amortisation model would still provide the most useful information from the impairment test (since an impairment test would still be required) in the initial years following an acquisition. This further questions whether the benefits of the impairment-only model justify the cost of the model.

102. On the other hand reintroducing amortisation of goodwill could hold management to account better for the reasons given in paragraph 106 and would also result in cost reduction because:

(a) amortisation would take pressure off the impairment test and, at the end of the useful life of goodwill, an impairment test is no longer required.

(b) reintroducing amortisation could allow further simplifications to the impairment test. For example, although most respondents commenting on the Board's preliminary view to remove from IAS 36 the requirement for an entity to perform a mandatory annual quantitative impairment test of cash-generating units containing goodwill disagreed, many of these respondents said an indicator-only approach could be introduced if amortisation of goodwill is reintroduced. This would also mean the impairment testing for cash-generating units containing goodwill would be consistent with that for other tangible and intangible assets that are subject to depreciation or amortisation.

(2011), 'The Information Content of Goodwill Impairments and SFAS142', *Journal of Accounting, Auditing & Finance*, 26 (3), 527-55.

[13] Bugeja, M. and Gallery, N. (2006), 'Is Older Goodwill Value Relevant?', *Accounting & Finance*, 46 (4), 519-35.

Shifts in stakeholder views

103. As discussed further in paragraphs 34–38, although there were many respondents that agreed with the Board's preliminary view to retain the impairment-only model, there has been a shift in the numbers of those that support the reintroduction of amortisation. This is largely driven by concerns with the impairment test, and this adds to the weight of evidence suggesting that the Board reintroduce amortisation.

Reintroducing amortisation appropriately responds to the limitations of the impairment test

104. Reintroducing amortisation of goodwill would appropriately respond to the limitations of the impairment test that have been identified. These limitations mean that there is an insufficient amount of expense being recognised in the income statement on a timely basis. This is particularly a concern for those stakeholders who consider goodwill to be a wasting asset with a determinable life. However, even for other stakeholders, the lack of timely impairment losses on goodwill means that an insufficient amount of expense has been recognised in the income statement.

105. There is academic evidence suggesting that managements' decisions to allocate smaller or larger portions of the purchase price to goodwill are influenced by contracting and compensation incentives, such as a desire to maximise post-acquisition earnings or bonuses. There is also academic evidence that the recognition of impairment losses on goodwill vary with management incentives (see Agenda Paper 18F to the May Board meeting).

106. As discussed in paragraphs 39–45, many respondents answering question 7(f) in the Discussion Paper said the useful life of goodwill should be based on management's estimates, suggesting that they consider a reliable estimate of the useful life of goodwill can be made. This would mean that the resulting amortisation expense would not be arbitrary and could provide useful information. The resulting expense would hold management to account better than an impairment-only model—management would need to demonstrate that the business combination is generating sufficient earnings to cover this expense, an expense that should match the benefits being generated by the goodwill. Academic evidence in paragraph 105 demonstrates that an impairment-only model could help management avoid being held to account.

107. In deciding to adopt an impairment-only model, the Board observed that the useful life of acquired goodwill and the pattern in which it diminishes are not generally possible to predict. As a result, the amortisation expense in any given period can be described, at best, as an arbitrary estimate of the consumption of acquired goodwill during that period. However, the feedback from many respondents suggesting a reliable estimate of the useful life of goodwill can be made and feedback from some respondents suggesting that amortisation could provide useful information (see paragraph 43) challenges those conclusions.

108. The reintroduction of amortisation can, in addition to addressing concerns about the insufficient amount of expense being recognised in the income statement, result in the recognition of an expense (amortisation) that can provide useful information and better hold management to account thereby meeting the project’s objective.

109. Even if the amortisation charge is based on a default period determined by the Board, this could still be considered to be a reasonable estimate of the useful life of goodwill, and this could therefore still result in a more appropriate amount of expense being recognised in the income statement compared with the potential lack of expense under an impairment-only model. Any limitations of basing the amortisation charge on a default period would be more than offset by the risks posed by the limitations of the impairment test that would be mitigated. For example, such an approach would reduce the risk that carrying amounts of goodwill are overstated.

Convergence

110. As discussed in paragraphs 56–61, although not definitive for many respondents, convergence is an important factor in improving the comparability of financial statements and avoiding the costs mentioned in paragraph 60. Some respondents also said maintaining convergence was more important than determining what the converged approach should be (see paragraph 57).

111. If the FASB reintroduces amortisation and the Board concludes it is not possible to resolve different views on how to account for goodwill with both models having their limitations, then convergence could become an increasingly important factor in the Board’s decision on whether to reintroduce amortisation.

Option 3 –explore reintroducing amortisation contingent on other topics

112. The Board's decision to explore reintroducing amortisation may be contingent on one or more of the following topics:

 (a) disclosures about the subsequent performance of business combinations (paragraphs 114–119);

 (b) improvements to the effectiveness of the impairment test of cash-generating units containing goodwill (paragraphs 120–125); and

 (c) details about how an amortisation model would work (paragraphs 126–129).

113. If the Board's decision is contingent on one or more of these topics, the staff will take this into consideration when planning the timing of the Board's discussions and decisions on these other topics.

Disclosures about the subsequent performance of business combinations

114. The Board's decision to reintroduce amortisation of goodwill might be contingent on the Board's decisions regarding disclosures about the subsequent performance of business combinations.

115. The feedback from users is that information about the subsequent performance of business combinations would be useful and is needed for stewardship purposes, and they do not get this information at the moment.

116. Users may be using the impairment test to provide them with some information about the performance and success of a business combination. However, the impairment test of cash-generating units containing goodwill was not designed to provide this information and the disclosures proposed in the Discussion Paper will more directly provide the relevant information.

117. The disclosure proposals might be a better way to provide the information users need about the subsequent performance of business combinations, and help users hold management to account for their acquisition decisions, than attempting to improve the effectiveness of the impairment test.

118. If the proposed disclosures provide the relevant information, the Board could reintroduce amortisation for more practical reasons such as for simplifying and

reducing costs associated with the subsequent accounting for goodwill or for maintaining convergence with US GAAP (if the FASB confirm their tentative decision to reintroduce amortisation of goodwill). Any potential loss of information currently provided by the impairment test would be more than offset by the improved information provided by the proposed disclosures.

119. The Board would then assess whether the best overall package that provides useful information to users at a reasonable cost and therefore meets the project objective, is a package that provides:

(a) information about the subsequent performance of business combinations and information from an impairment test in the first few years after a business combination that is useful in holding an entity's management to account; and

(b) a reduction in cost for preparers resulting from an amortisation model that eventually removes goodwill from the balance sheet when it provides less useful information to users.

Improving the effectiveness of the impairment test

120. A few respondents said the Board should reintroduce amortisation only if the Board fails to improve the effectiveness of the impairment test of cash-generating units containing goodwill.

121. Although a full review of IAS 36 and the concept of a cash-generating unit is beyond the scope of this project, some respondents proposed different impairment tests the Board could develop, for example a form of 'headroom approach' (see Agenda Paper 18B to the May Board meeting for further details). The Board could choose to pursue one of these suggestions and see if it can develop a more effective impairment test. These are discussed further in Agenda Paper 18B to this meeting.

122. Most respondents agreed with the Board's preliminary view that it is not feasible to design a different impairment test that is significantly more effective at recognising impairment losses on goodwill at a reasonable cost. If the Board confirmed this preliminary view, the Board could still choose to implement some of the improvements that many respondents, despite agreeing with the Board's preliminary

view, suggested the Board could make to improve the application of the impairment test in IAS 36.

123. Although these improvements would not fully resolve concerns about impairment losses on goodwill not being recognised on a timely basis, these improvements could reduce the effect of shielding and management over-optimism.

124. Although, as acknowledged by the Board, shielding will always occur, these suggested improvements could reduce the incidence of inappropriate shielding. These improvements could also help reduce management over-optimism by making the requirements easier to enforce by, for example, clarifying the meaning of some of the requirements in IAS 36. Further details of these improvements are provided in Agenda Paper 18C to this meeting. Implementing some of these suggestions should improve the effectiveness of the impairment test, allowing the Board to conclude that it has responded to feedback in the PIR of IFRS 3.

125. However, if these improvements do not sufficiently improve the effectiveness of the impairment test or are found to be not feasible, then the Board could at that point pursue the reintroduction of amortisation of goodwill as a response to the feedback in the PIR of IFRS 3 and the conclusion that it is not feasible to sufficiently improve the effectiveness of the impairment test.

Details about the amortisation model

126. The Board's decision to reintroduce amortisation of goodwill may be contingent on the amortisation model that the Board is able to develop (see the appendix to this paper for some of the matters the Board would have to consider in developing an amortisation model). For example the Board's decision could be contingent on (a) the extent to which the useful life of goodwill and the pattern in which it diminishes is based on management's estimate or on a default period specified by the Board, or (b) whether transition to an amortisation model would be retrospective or prospective.

127. The Board's decision to reintroduce amortisation might be contingent on whether an entity can reliably estimate the useful life of goodwill and consequently, whether an amortisation expense can provide useful information and help hold management to account. The Board may therefore want to first explore whether it is possible to reliably estimate the useful life of goodwill (particularly given that the Board

previously reached a different conclusion when issuing IFRS 3) before deciding whether to reintroduce amortisation.

128. A few respondents commented on transition to an amortisation model, with many of these respondents concerned with the potential impact of retrospectively reintroducing amortisation of goodwill on entities' financial positions on transition. The Board may want to first determine whether the reintroduction of amortisation would risk negatively affecting the stability of entities and of capital markets before deciding to reintroduce amortisation.

129. Prospectively reintroducing amortisation of goodwill might resolve the negative effects on entities' financial positions on transition, but could delay the benefits of reintroducing amortisation. If the usefulness of an amortisation model and its ability to hold management to account were a key part of the Board's rationale for reintroducing amortisation, this could result in the Board deciding to retain the impairment-only model.

Other approaches

130. A few respondents disagreed with the Board's preliminary view to retain the impairment-only model but suggested a different approach to reintroducing amortisation (with an impairment test). Suggestions included:

(a) providing entities an option to either amortise goodwill over its useful life or apply an impairment-only model;

(b) adopting a hybrid approach with an impairment-only model for an initial period of time, followed by amortisation model;

(c) direct write-off of goodwill;

(d) separating goodwill into components and accounting for the components separately based on the nature of the components;

(e) exploring the accounting for internally generated goodwill and other intangible assets; and

(f) leaving goodwill on the statement of financial position in perpetuity unless the related business unit is subsequently closed or sold.

131. The majority of these suggestions have been considered and rejected by the Board previously and the staff think respondents have not provided any convincing arguments to change the Board's views on these alternatives. For example:

(a) a hybrid approach (paragraph 130(b)) was mentioned in the Discussion Paper and may have the advantage that an annual impairment test is performed when the information is most useful. However, the time period selected for the initial impairment-only model may not be appropriate for all entities and additional complexity may arise where goodwill arising from different acquisitions are allocated to the same cash-generating unit.

(b) the Discussion Paper rejects a direct write-off of goodwill (paragraph 130(c)) primarily because this would be inconsistent with the Board's conclusion that goodwill is an asset.

(c) the Discussion Paper rejects separating goodwill into components (paragraph 130(d)) because it would increase the complexity and subjectivity of the subsequent accounting for goodwill. In addition, because goodwill itself cannot be measured directly, the different components of goodwill would probably not be reliably measurable.

132. Although some respondents suggested allowing entities an option to either amortise or follow an impairment-only model (paragraph 130(a)), most respondents favouring such an option suggested an approach that would treat goodwill consistently with other intangible assets with additional guidance to determine whether goodwill should be classified as an asset with a finite or indefinite useful life based on facts and circumstances. In considering the appropriate accounting for acquired goodwill after its initial recognition when amending IAS 36 in 2004 the Board examined three approaches, one of which was permitting entities a choice between straight-line amortisation with an indicator-based impairment test or an impairment-only approach with an annual impairment test. The Board decided not to provide such an option on the basis that it would impair the usefulness of information because both comparability and reliability would be diminished (see paragraphs BC131B–BC131C of the Basis for Conclusions on IAS 36). In addition, given the continuing debate on whether goodwill is a wasting asset with a determinable finite life or with an indefinite useful life, there could be differences of opinion of how goodwill should be

classified and the Board might find it hard to provide guidance on how to make judgements on whether goodwill is classified as an asset with a finite or indefinite useful life.

133. In relation to separating goodwill into components and accounting for these separately (paragraph 130(d)), a few respondents suggested exploring how to better account for 'technical goodwill' resulting from recognising deferred tax liabilities in a business combination. A few of these respondents suggested requiring entities to derecognise such goodwill when the corresponding deferred tax liabilities are derecognised. It is unclear how significant an issue this is and how easy it would be to track the corresponding deferred tax liabilities.

134. Exploring the accounting for internally generated goodwill and other intangible assets (paragraph 130(e)) is beyond the scope of this project and, as mentioned in the Discussion Paper, stakeholders who want the Board to consider adding to its work plan a broader project on intangible assets should respond to the Board's Third Agenda Consultation.

135. The suggestion of leaving goodwill on the statement of financial position in perpetuity unless the business unit is subsequently closed or sold (paragraph 130(f)) would result in a long-term non-financial asset being retained on the statement of financial position without being subject to any form of impairment. This would be unusual and could bring into question the reliability of financial statements.

Question for the Board
Does the Board have any comments or questions on the analysis presented in this paper?

Appendix—Other considerations if the reintroduction of amortisation is explored

A1. If the Board decides to reintroduce amortisation of goodwill, the Board would also need to consider other more detailed follow up matters, including:

(a) how to determine the useful life of goodwill;

(b) whether that useful life should have an upper limit, a lower limit or both;

(c) how to determine the amortisation method;

(d) whether to require an annual reassessment of the amortisation method and useful life;

(e) whether to also require amortisation of intangible assets with indefinite useful lives;

(f) how to allocate impairment losses to carrying amounts of goodwill arising from different acquisitions included in the same group of cash-generating units;

(g) how to allocate goodwill arising from different acquisitions on disposal or reorganisation;

(h) related presentation and disclosure requirements—for example, for the amortisation expense; and

(i) applicable transitional arrangements.