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STAFF PAPER

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Project	**Goodwill and Impairment**
Paper topic	Subsequent accounting for goodwill

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This paper is unchanged from Agenda Paper 18F to the Board's April 2021 meeting except for some minor editorial changes in paragraphs 7, 26, 49, 81 and 118. These changes have been underlined.

Purpose and structure of this paper

1. This paper provides the International Accounting Standards Board (Board) with a summary of the feedback received on whether the Board should reintroduce amortisation of goodwill.
2. This paper does not ask the Board for any decisions.
3. The paper contains:
   - (a) Key messages (paragraph 4);
   - (b) Summary of the Board's preliminary views expressed in the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* (paragraphs 5–12);
   - (c) Questions asked (paragraphs 13–15);
   - (d) Feedback received (paragraphs 16–129), including:
     - (i) Overall summary (paragraphs 17–31);
     - (ii) Arguments provided by respondents in favour of reintroducing amortisation (paragraphs 32–74);
     - (iii) Arguments provided by respondents in favour of retaining the impairment-only model (paragraphs 75–97);

(iv) Other approaches suggested by respondents (paragraphs 98–107);

(v) User views (paragraphs 108–111);

(vi) New evidence provided to the Board (paragraphs 112–116);

(vii) Convergence (paragraphs 117–123); and

(viii) Other matters (paragraphs 124–129).

(e) Question for the Board.

Key messages

4. Key messages from the feedback on the Board's preliminary view to retain the impairment-only model were:

(a) stakeholders' views remain mixed. Many respondents agreed with the Board's preliminary view that it should retain the impairment-only approach but many other respondents disagreed, saying amortisation of goodwill should be reintroduced.

(b) respondents generally did not provide new conceptual arguments or evidence, although some respondents considered that there is new practical evidence since IFRS 3 *Business Combinations* was issued in 2004 being that the impairment test is not effective enough. Respondents referred to the evidence from applying the impairment-only model since 2004, and the problems encountered, as new evidence.

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

Summary of the Board's preliminary views

Background

5. The Board removed amortisation of goodwill and introduced a requirement for an entity to test cash-generating units containing goodwill for impairment annually when it issued IFRS 3 in 2004. Previously, IAS 22 *Business Combinations* had required companies to amortise goodwill over its useful life, presumed not to exceed 20 years, although companies could rebut that presumption. In addition, an impairment test was required:

   (a) when there was an indication that the goodwill may be impaired, if the useful life of the goodwill was 20 years or less; or

   (b) annually, if the useful life of the goodwill was more than 20 years, even if there was no indication that the goodwill may be impaired.

6. In the Post-implementation Review (PIR) of IFRS 3, many stakeholders said there was a time lag between an impairment occurring and recognition of an impairment loss in an entity's financial statements.

7. The Board investigated whether it could make the impairment test more effective at recognising impairment losses on goodwill on a timely basis at a reasonable cost, but concluded that significant improvements are not feasible (see Agenda Paper 18B). The Board considered whether to propose to reintroduce 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 cannot be tested for impairment directly.

Preliminary view

8. By a small majority (eight out of 14 Board members), the Board reached a preliminary view that the Board should retain the impairment-only model.

9. The Board accepted that both accounting models for goodwill—an impairment-only model and an amortisation model—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.

10. In reaching its preliminary view the Board considered arguments:

    (a) for reintroducing amortisation of goodwill (paragraph 11); and

    (b) for retaining the impairment-only model (paragraphs 12).

Reintroducing amortisation

11. Proponents of reintroducing amortisation had generally given one or more of the following arguments:

    (a) the PIR of IFRS 3 suggests that the impairment test is not working as the Board intended;

    (b) carrying amounts of goodwill are overstated and, as a result, a company's management is not held to account for its acquisition decisions;

    (c) goodwill is a wasting asset with a finite useful life, and amortisation would reflect the consumption of goodwill; and

    (d) amortisation would reduce the cost of accounting for goodwill.

Retaining the impairment-only model

12. Proponents of retaining the impairment-only model had generally given one or more of the following arguments:

    (a) the impairment-only model provides more useful information than amortisation.

    (b) if applied well, the impairment test achieves its purpose. The PIR of IFRS 3 and the Board's subsequent research have not found new evidence that the test is not sufficiently robust.

    (c) acquired goodwill is not a wasting asset with a finite useful life, nor is it separable from goodwill subsequently generated internally.

(d) reintroducing amortisation would not save significant cost.

Questions asked

13. The Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* (Discussion Paper) pointed out that the topic of accounting for goodwill has always been the subject of strongly held and divergent views. It explained that 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.

14. The Discussion Paper stressed that 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. It noted that 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.

15. In this context, question 7 of the Discussion Paper asked:

> Paragraphs 3.86–3.94 [of the Discussion Paper] summarise the reasons for the Board's preliminary view that it should not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill.
>
> (a) Do you agree that the Board should not reintroduce amortisation of goodwill? Why or why not? (If the Board were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.)
>
> (b) 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 had?
>
> (c) Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not?

(d) Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not?

(e) 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?

(f) 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?

Feedback received

16. Almost all (164) the comment letters received, and many of the outreach meetings held, provided the Board with feedback on its preliminary view that it should not reintroduce amortisation of goodwill.

Overall summary

17. Stakeholders continue to be split on the topic of whether to reintroduce amortisation of goodwill. Many respondents disagreed with the Board's preliminary view that it should retain the impairment-only model, but many other respondents agreed with the Board's preliminary view. Some respondents, when reporting their overall views on this topic, also reported that views within their own organisations were mixed.

Summary by type of stakeholder

18. Users of financial statements (users) were split in their views (see paragraphs 108–111 for more details on users' views).

19. Most preparers said they would prefer the Board to reintroduce amortisation, as did many national standard-setters. Accounting firms and accounting bodies were split in their views. Many academics favoured retaining the impairment-only approach. Two regulators preferred the reintroduction of amortisation but the remaining regulators provided no overall view, for example one said that their view depended on whether the Board could improve the effectiveness of the impairment test or not, and another had mixed views.

Geographical summary

20. There was noticeable support for reintroducing amortisation from respondents across different stakeholder groups in some countries, such as Brazil, Germany and Japan. Regionally, there was strong support for reintroducing amortisation in Europe and Latin America, whereas in Africa there was more support for retaining the impairment-only model. Asia Oceania and North American respondents were more split in their views.

Overview of arguments

21. Respondents favouring the reintroduction of amortisation provided numerous arguments, in two broad categories:

    (a) conceptual reasons (for example, that goodwill is a wasting asset with a finite useful life and amortisation of goodwill would reflect its consumption); and

    (b) practical reasons (for example, that the impairment test is not effective enough).

22. Respondents agreeing with the Board’s preliminary view also provided numerous arguments—in the same two broad categories:

    (a) conceptual reasons (for example, that impairment losses provide more useful information for users than amortisation would); and

    (b) practical reasons (for example, that there is no compelling evidence to support a change).

23. Paragraphs 32–97 discuss respondents’ reasons and arguments for these views in more detail.

24. Broadly, no new evidence or conceptual arguments were provided by respondents in either group. The Board had already considered most of the conceptual and practical arguments in reaching its preliminary view and when issuing IFRS 3 in 2004.

25. However, some respondents commented that studies and practice since 2004 have provided new evidence that impairment losses on goodwill are not being recognised on a timely basis.

26. Some respondents provided new evidence that they considered supports some of the arguments that the Board has considered before, for example new quantitative analyses of goodwill balances in their jurisdiction and new academic research[1].

27. A few respondents suggested approaches other than retaining the impairment-only model or reintroducing amortisation, for example, an accounting policy choice on a transaction-by-transaction basis or on an entity basis, a hybrid approach or direct write-off of goodwill on acquisition.

28. There were also a few respondents that did not offer a view, observing the merits and limitations of both models and because of mixed views in their organisations.

29. A few regulators and national standard-setters said the Board should explore further improvements to the impairment test first and then consider whether amortisation of goodwill should be reintroduced.

30. On convergence, most respondents said that convergence with US GAAP on the subsequent accounting for goodwill was desirable and that the Board and the US Financial Accounting Standards Board (FASB) should work collaboratively together. However many respondents said that their view did not depend on maintaining convergence, or said that the Board should base its decision on the evidence it has collected rather than solely on maintaining convergence.

31. The remainder of this paper discusses respondents' reasons and arguments for their views in more detail together with some of the evidence those respondents presented. The other parts of question 7 are also discussed. The remainder of the paper is organised as follows:

[1] An academic literature review summarising relevant evidence from academic papers is included in Agenda Paper 18F.

(a) Arguments (and supporting evidence) provided by respondents in favour of reintroducing amortisation (paragraphs 32–74);

(b) Arguments (and supporting evidence) provided by respondents in favour of retaining the impairment-only model (paragraphs 75–97);

(c) Other approaches suggested by respondents (paragraphs 98–107);

(d) User views (paragraphs 108–111);

(e) New evidence provided to the Board (paragraphs 112–116);

(f) Convergence (paragraphs 117–123); and

(g) Other matters (paragraphs 124–129).

Arguments provided by respondents in favour of reintroducing amortisation

32. Many respondents disagreed with the Board's preliminary view, and favoured reintroducing amortisation. They provided numerous arguments to support their views and these arguments can be grouped into two broad categories, with respondents often providing numerous reasons from both categories:

    (a) conceptual reasons: and

    (b) practical reasons.

Conceptual reasons

33. The conceptual reasons provided by respondents were as follows:

    (a) goodwill is a wasting asset and amortisation of goodwill would reflect its consumption (paragraphs 34–35);

    (b) amortisation prevents the recognition of internally generated goodwill (paragraphs 36–42);

    (c) a reliable estimate of useful life can be made (paragraphs 43–51);

    (d) amortisation helps hold management accountable (paragraphs 52–53); and

    (e) other reasons (paragraph 54).

Goodwill is a wasting asset

34. Many of those respondents, and most preparers, favouring reintroducing amortisation said goodwill is a wasting asset. The value of goodwill in their view diminishes over time due to competition, technological factors or, as one accounting firm said, because the benefits of synergies are realised as businesses are combined, or an acquiree's skilled workforce leave or retire. In their view amortisation allocates the cost of acquired goodwill over the periods in which it is consumed, and some respondents said this matches the cost with the benefits it relates to. A few respondents also said the impairment-only model cannot distinguish between this consumption and other losses, and an impairment is therefore often incorrectly interpreted as a failure of an acquisition.

35. One respondent supported its view that goodwill was a wasting asset by referring to an academic study that suggested the value relevance of acquired goodwill declines as it ages. A group of academics also provided a summary of the academic literature in economic disciplines. The academic studies highlighted suggested that:

    (a) in the absence of barriers to entry, competitive advantage will erode over time;

    (b) sustained competitive advantage is based on intangible assets and people-dependent capabilities rather than on tangible assets, and durable sustainable competitive advantage is only possible under very specific circumstances; and

    (c) persistence of abnormal earnings, earnings that exceed the expected return, is limited to a period of 3 to 20 years and competitive forces reduce the persistence of abnormal earnings.

Prevents recognition of internally generated goodwill

36. Many of those respondents favouring reintroducing amortisation said in their view acquired goodwill is replaced by internally generated goodwill over time and amortisation prevents that internally generated goodwill being recognised in the statement of financial position implicitly by being offset against unrecognised amortisation of the acquired goodwill.

37. A few respondents said that reintroducing amortisation would improve comparability between those entities growing organically and those entities growing by acquisition, and many of these respondents said that this would prevent a bias against organic growth. A few respondents gave the implicit recognition of internally generated goodwill under the impairment-only model as the reason for the lack of comparability today.

38. The responses to question 7(d) in the Discussion Paper—whether respondents viewed acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units—are related to this view.

39. Most respondents answering question 7(d) viewed acquired and internally generated goodwill as distinct and many of those respondents said that in their view acquired goodwill was different from internally generated goodwill in nature and in how it is measured.

40. For example, because acquired goodwill is measured indirectly as a residual it contains elements (for example, overpayments and the effects of recognising deferred taxes) that would not be present if internally generated goodwill were to be measured. Respondents also said acquired goodwill is recognised and measured in an arms-length transaction with a third party and is static, whereas internally generated goodwill is generated by ongoing business activities, is dynamic and is challenging to measure.

41. One user said that internally generated goodwill represents an entity's ability to develop a profitable strategy whereas acquired goodwill represents the premium paid by an entity to be able to generate those same profits.

42. Some respondents disagreed that acquired and internally generated goodwill are distinct and a few respondents said it was not practical to distinguish between acquired and internally generated goodwill in cash generating units—they become indistinguishable after acquisition.

Reliable estimates of useful life can be made

43. Some of those respondents favouring reintroducing amortisation said that a reliable estimate of the useful life of goodwill could be made. Although most acknowledged the challenges, respondents said that this is no more challenging than the judgements

on useful life made for other tangible and intangible assets. For example, estimates of the effect of technological or commercial obsolescence would apply to those other assets as well. Many of these respondents, a few of which were users, said that management's judgements about the useful life of goodwill could provide useful information about management's expectations of the period the benefits associated with goodwill will be realised.

44. Some respondents said that entities would have information from the acquisition process (for example, estimates of synergies and payback periods) that could permit a reasonable estimate of the useful life to be made. One user said that amortising goodwill would help management and investors evaluate performance because amortisation of goodwill is an expense that is incurred in generating the revenue from the business combination.

45. A few respondents said that although subjective, estimating useful life is no more and sometimes less subjective than making the assumptions used for impairment tests. One respondent said that it is not possible to predict the useful life of goodwill precisely, but that amortisation was a practical expedient based on a reasonable estimate of the useful life.

46. Comments on whether it is possible to estimate the useful life of goodwill reliably should be considered in the context of responses to question 7(f) of the Discussion Paper, which asked how the useful life of goodwill and its amortisation pattern should be determined if amortisation was reintroduced. In line with the feedback on whether a reliable estimate of the useful life could be made, many respondents in response to question 7(f) said that the useful life should be based on managements' estimates. Estimates of synergies or benefits expected from the acquisition when agreeing the price were some suggestions from respondents for what those estimates should be based upon.

47. Many of those suggesting the useful life should be based on managements' estimates also suggested that a cap should be put in place, with 10 or 20 years commonly mentioned. Some respondents suggested this could be a rebuttable cap.

48. Some respondents said a cap would reduce the risk of over-optimistic useful lives being assumed for goodwill. A few other respondents said that a cap would ensure the carrying amount of goodwill is reduced in this maximum period and was, in their

view, necessary because amortisation is being reintroduced to resolve the issue of impairments not being recognised on a timely basis under the impairment-only model.

49. One respondent referred to an academic study that suggested goodwill balances under an amortisation and impairment model (with a maximum amortisation period of twenty or forty years, as required previously under IFRS and US GAAP) better explained equity prices than goodwill balances as reported under an impairment-only model. Further, the study suggested that equity prices were better explained by decreasing the maximum amortisation period to ten years or less[2].

50. Many respondents said that goodwill should be amortised over a default period set by the Board, with 10 and 20 years being the most common suggestions. Many of these respondents said that entities should have the option to deviate from the default period with justification.

51. With respect to the amortisation pattern, many of those respondents that suggested the useful life should be based on managements' estimates also said that the amortisation pattern should be based on managements' estimates. Most of those respondents that suggested a default useful life and also suggested how the pattern of amortisation should be determined, said this should be on a straight-line basis.

Helps hold management accountable

52. Some of those respondents, and some users, favouring reintroducing amortisation said that in their view amortisation would hold management to account for acquisition decisions better than an impairment-only model. For example, management would be held accountable by the amortisation expense to generate profits to recover the cost related to the goodwill.

53. A few respondents said that reintroducing amortisation would improve the corporate governance for acquisition decisions, and would help deter overpayments. One preparer group said in their view amortisation would provide more discipline over acquisition decisions because most variable management compensation was earnings based which would be affected by the amortisation expense. A few respondents said

[2] The study also found that a 'pre-acquisition headroom' impairment-only approach better explained equity prices than the amortisation and impairment approaches studied and the respondent recommended the Board reconsider this approach (see Agenda Paper 18B).

that this lack of an amortisation expense in the income statement provides an incentive that favours acquisitive growth over organic growth (see also paragraph 37).

Other reasons

54. A few respondents favouring reintroducing amortisation of goodwill said that this would be consistent with the accounting for other tangible and intangible assets.

Practical reasons

55. Respondents provided several practical reasons for why they favoured the reintroduction of amortisation and some of these reasons are linked to one another:

(a) the impairment test is not working (paragraphs 56–58);

(b) goodwill balances are too high (paragraphs 59–65);

(c) reintroduction of amortisation would resolve the concerns that entities do not recognise impairment losses on a timely basis (paragraphs 66–68);

(d) amortisation is a simple method that would reduce costs (paragraphs 69–71);

(e) earnings would be less volatile, helping financial stability, and amortisation would reduce the possibility of procyclical consequences (paragraphs 72–73); and

(f) other reasons (paragraph 74).

Impairment test is not working

56. Many of those respondents in favour of reintroducing amortisation said that the impairment test for goodwill was not working, because of the limitations of the impairment test, and the Board had not been able to make the test more effective. Some respondents also said that the impairment test was too subjective and could permit earnings management.

57. Respondents made a variety of comments in providing these views saying:

(a) the test is not meeting user needs or expectations;

(b) the test is not trusted;

(c) a structural deficiency has been highlighted, causing not only overstatement of goodwill, but also harming the relevance of financial information;

(d) there is an urgent need to change the accounting regime to ensure proper accounting outcomes;

(e) the shortcomings in the test reduce the usefulness of financial statements;

(f) the test is the cornerstone of treating goodwill differently to other assets; and

(g) the test can no longer be seen as advantageous regardless of its theoretical or conceptual superiority.

58. Many of these respondents said that evidence the impairment test is not working is new evidence. A few respondents said the lack of impairments recognised in extreme circumstances such as the covid-19 pandemic provided such evidence. A few respondents also provided references to various academic studies that suggested the impairment test permitted earnings management.

Goodwill balances are too high

59. Some respondents said that goodwill balances are too high, often linking their comments to views that the impairment test is not working.

60. Some of these respondents said that this increase was due to shielding in the impairment test. A few of these respondents said the increase was due to low-interest-rate conditions, an increase in mergers and acquisitions (M&A) activity since 2004 and increasing deal prices.

61. Many respondents who said goodwill balances are too high provided quantitative evidence from their jurisdictions to illustrate the increase in goodwill balances.

62. One national standard-setter referenced an academic study that studied entities listed on European stock exchanges and found an increase in the implicit lifetime of goodwill from 38 years in 2010 to 103 years in 2018. They referenced another academic study that reported a 60% increase in goodwill balances in their sample from 2008 to 2016.

63. One national standard-setter had performed their own quantitative analysis and said although increased goodwill balances may partly be due to an increase in the number of acquisitions, in its view the shielding effect was the main cause for this trend.

64. On the other hand, one national-standard setter said that while there has been an increase in goodwill balances in absolute terms there was no evidence that goodwill had increased significantly in relative terms, for example in comparison to total assets, total equity or market capitalisation. One accounting body referred to a research study that observed that across time (2005–2020) the level of investment in goodwill, as a percentage of total assets, had remained remarkably constant in its jurisdiction and globally. This study also observed that the impairment frequency and magnitude implied a useful life of 15 years. One preparer provided quantitative information that illustrated a significant increase in the carrying amount of its goodwill from 2005 compared to 2019. However, that preparer said the increase in goodwill would still have been significant even if goodwill were being amortised over 20 years and therefore the increase must be driven by other, more important factors than the lack of amortisation.

65. One national standard-setter observed that goodwill balances increased by 69% for their sample of listed entities between 2005 and 2019 in their jurisdiction. They said their research also showed that goodwill balances had not fluctuated as much as they expected given changing economic conditions in that period. They also observed that goodwill as a portion of total assets remained broadly constant and said that greater fluctuation in goodwill as a proportion of total assets over the 14-year period could, in their view, be reasonably expected given the changing economic conditions. They suggested further research could be performed, for example to understand the effect of increased M&A activity on goodwill balances.

Amortisation would resolve concerns that entities do not recognise impairment losses on goodwill on a timely basis

66. Many of those respondents in favour of reintroducing amortisation said that this would resolve, or at least reduce, the main reasons for the concerns that entities do not recognise impairment losses on goodwill on a timely basis. Many of those respondents had also said that the impairment test is not working or that goodwill balances are too high and said reintroducing amortisation of goodwill would be an

appropriate solution to these concerns. Some respondents not in favour of reintroducing amortisation of goodwill, also said that reintroducing amortisation could resolve, or at least reduce, the effect of the main reasons for the concerns that entities do not recognise impairment losses on goodwill on a timely basis in their responses to question 7(c) of the Discussion Paper (see paragraph 15).

67. Many of the respondents said that amortisation would resolve the concerns that entities do not recognise impairment losses on goodwill on a timely basis. However, some of these respondents are concerned with the timely recognition of an expense in the income statement rather than the timeliness of impairments. A few respondents said it would improve the timeliness of impairments, for example one respondent said that it would hold management to account for acquisitions and the prices paid and therefore reduce the incidence of impairments that are not recognised on a timely basis.

68. Many of the respondents said that amortisation would only reduce but not eliminate the concerns that entities do not recognise impairment losses on goodwill on a timely basis. Many of these respondents said that amortisation would reduce carrying amounts of goodwill therefore reducing the risk of overstatement and some respondents said that amortisation would reduce the subjectivity in the test.

Simple method that would reduce costs

69. Some of those respondents in favour of reintroducing amortisation (mostly preparers, accounting firms and national standard-setters) said that amortisation is a simple method that would reduce the cost and subjectivity of the impairment test. One preparer said that the impairment test requires significant resources to prepare internal forecasts and document the assumptions, and requires entities to spend significant hours on annual impairment tests together with the cost to audit the tests.

70. Some of these respondents said the cost of the impairment test did not justify the benefits from the test.

71. One respondent said that reintroducing amortisation would permit the simplifications of the impairment test the Board is proposing because amortisation would hold management to account for acquisition decisions and therefore ensure there was sufficient discipline to permit these simplifications.

Reduces procyclicality, helps financial stability

72. Some of those respondents in favour of reintroducing amortisation said that unexpected impairment losses make the income statement more volatile and can have procyclical effects and affect the financial stability of markets. Those respondents said that amortisation would reduce the number of unexpected impairment losses, reducing volatility in the income statement and so reduce procyclical effects.

73. However, one national standard-setter, while acknowledging that reintroducing amortisation could reduce procyclicality and help financial stability, said the Board should not change accounting standards to produce less useful information. Encouraging better capital allocation by providing more useful information is, in their view, a better way to achieve financial stability.

Other reasons

74. Other practical reasons that respondents gave in support of reintroducing amortisation of goodwill included:

    (a) amortisation would take pressure off the impairment test because, for example, of the reduced size of unrecognised impairment losses;

    (b) the limitations of the impairment test mean that it produces information of limited use; and

    (c) amortisation removes goodwill from the statement of financial position when the balance is no longer relevant or meaningful.

Arguments provided by respondents in favour of retaining the impairment-only model

75. Many respondents agreed with the Board's preliminary view to retain the impairment-only model, providing numerous arguments in two broad categories:

    (a) conceptual reasons: and

    (b) practical reasons.

Conceptual reasons

76. The conceptual reasons provided by respondents were as follows:

    (a) goodwill is not a wasting asset with a determinable useful life (paragraphs 77–80);

    (b) impairment losses provide users with more useful information than amortisation does (paragraphs 81–83);

    (c) the useful life of goodwill cannot be estimated reliably (paragraphs 84–85); and

    (d) the impairment-only model helps hold management accountable better than amortisation would (paragraphs 86–88).

Goodwill is not a wasting asset with a determinable life

77. Many respondents (mostly academics, national standard-setters and consultants) agreeing with the Board's preliminary view to retain the impairment-only model said goodwill generates economic benefits over an indefinite period. The pattern of these cash flows is one of continuous growth and amortising goodwill on a straight-line basis over an arbitrary number of years would undervalue the asset, with one respondent saying that amortising goodwill would further disconnect the accounting from the reality of the transaction and the economic premise of the acquisition.

78. A few respondents referred to the International Valuation Standards Council's article *Is Goodwill a Wasting Asset?* which concluded that the majority of components included in goodwill are not wasting. One respondent said the notion that goodwill has an indefinite life can be conceptually illustrated by looking at equity investments. After purchase, an equity instrument may appreciate or may depreciate in value—but never due to a systematic amortisation of goodwill. All else equal, the value of the investment does not become less simply because of the passage of time.

79. A few respondents said that it is not clear goodwill is consumed over time, goodwill does not lose its value like other assets, and reduces in value due to events that do not usually occur consistently over time, and therefore goodwill is better measured by an impairment test.

80. Linked to these assertions, a few respondents said that carrying amounts of goodwill should not be reduced if the acquisition has been successful.

More useful information

81. Many respondents agreeing with the Board's preliminary view to retain the impairment-only model said it provides better information than amortisation of goodwill would, and amortisation did not provide any useful information. Most users in favour of retaining the impairment-only model provided this reason for their view.

82. A few of those respondents that said recognising impairment losses provides useful information, said impairment losses have predictive value and might result in users revising their cash flow forecasts. However, some respondents said the information would only be confirmatory but they also said that this would be better information than that provided by amortisation. Many respondents who said amortisation did not provide useful information said this was because the information it provides is arbitrary.

83. One respondent referred to an academic study that suggested the impairment-only model reflects the economic value that the goodwill balance represents better than an amortisation model would, and referred to academic studies suggesting that the results of the impairment test had predictive value. Another respondent referred to academic studies that suggested impairment losses are relevant information for users.

Useful life of goodwill cannot be estimated reliably

84. Many respondents agreeing with the Board's preliminary view to retain the impairment-only model said that it is not possible to estimate reliably the useful life of goodwill. Many of these respondents said that because of difficulties of estimating the amortisation period and pattern of goodwill reliably, any amortisation expense would be arbitrary. Some respondents said this would not provide useful information for users.

85. The global auditing standard-setter cautioned against reintroducing amortisation of goodwill because of the auditability issues related to determining the amortisation period.

Help hold management accountable

86. Some respondents agreeing with the Board's preliminary view to retain the impairment-only model said the impairment-only model holds management to account for the acquisition decisions it makes and amortisation of goodwill does not do so.

87. For example, these respondents said amortisation reports an expense for all acquisitions regardless of subsequent performance, and therefore does not distinguish between high performing entities and underperforming entities, preventing users from distinguishing between good and bad managers.

88. One respondent referred to an academic study which suggested that the root cause of many goodwill impairment losses was overpricing of the buyer's shares at the acquisition date. That respondent said amortisation of goodwill would enable management to spread that overpricing in the income statement and management might never be held accountable for the excess payment.

Practical reasons

89. The practical reasons provided by respondents were as follows:

    (a) reintroduction of amortisation would not resolve the concerns that entities do not recognise impairment losses on a timely basis (paragraphs 90–93);

    (b) compelling evidence for a change has not been identified (paragraphs 94–96); and

    (c) other reasons (paragraph 97).

Amortisation would not resolve concerns that entities do not recognise impairment losses on goodwill on a timely basis

90. Some respondents, responding to question 7(c) of the Discussion Paper (see paragraph 15), said that reintroducing amortisation would not resolve the main reasons for the concerns that entities do not recognise impairment losses on goodwill on a timely basis.

91. Respondents said that impairment losses would not be recognised on a more timely basis if amortisation of goodwill was reintroduced. Rather, amortisation would reduce

the potential size of impairments and result in fewer and smaller impairments. One user group said that all amortisation can accomplish is to provide a mechanical convention for poor impairment testing.

92. A few of these respondents said they were not convinced there was a failure to recognise impairment losses on a timely basis. One national standard-setter said that the Board should not overstate the case of a lack of timeliness—in its view there are no grounds to believe in a widespread timeliness issue or that management over-optimism is significantly undermining the effectiveness of the impairment test.

93. Some of the respondents who said that amortisation would not resolve the timeliness of recognition of impairment losses were however in favour of reintroducing amortisation of goodwill, and some of these said that amortisation is not intended to solve the timeliness of recognition of impairment losses but to depict consumption.

No compelling evidence for a change

94. Some respondents agreeing with the Board's preliminary view to retain the impairment-only model said that there was no compelling evidence of any need to make such a major change to IFRS Standards.

95. Respondents said that it is not clear that reintroducing amortisation would lead to an overall improvement in the accounting for goodwill and in the information that is provided to users.

96. Some regulators said that lack of compliance in the application of the impairment test was not compelling evidence to reintroduce amortisation.

Other reasons

97. Other practical reasons that a few respondents provided in support of retaining the impairment-only model included that reintroducing amortisation would not significantly reduce cost.

Other approaches suggested by respondents

98. A few respondents, mostly preparers and individuals, disagreed with the Board's preliminary view to retain the impairment-only model but favoured a different approach than reintroducing amortisation (with an impairment test).

99. Many of these respondents suggested that entities should have the option either to amortise goodwill over its useful life or for goodwill to be subject to an impairment-only model. Most of these respondents suggested an approach that treated goodwill consistently with intangible assets in accordance with IAS 38 *Intangible Assets*, with additional guidance to determine whether goodwill is classified as an asset with a finite or indefinite useful life on the basis of the facts and circumstances. Respondents suggested this could be on a transaction-by-transaction basis or an entity accounting policy election.

100. A few respondents suggested a hybrid approach with impairment-only for an initial period of time, followed by amortisation with an impairment test for the remaining life of the goodwill.

101. A few respondents suggested that goodwill should be directly written-off on acquisition.

102. A few respondents said views on an amortisation model and the impairment-only model are strongly held and doubted whether a discussion on the merits of the two models would be fruitful. One of these respondents, a national standard-setter, said that in their view the difficulties were due to the residual nature of goodwill, giving rise to conceptual and practical challenges.

103. This national standard-setter also said that in their view many of the issues surrounding the subsequent accounting for goodwill arose from the fundamentally different accounting for acquired goodwill and internally generated goodwill. For example, because internally generated goodwill is not recognised on the statement of financial position, internally generated goodwill shields acquired goodwill from impairment (see also paragraphs 36–42).

104. These respondents suggested the Board explore the accounting for internally generated goodwill and other intangible assets.

105. One user group said the majority of its members did not support reintroducing amortisation of goodwill. This user group also suggested another approach—leaving the goodwill balance on the statement of financial position in perpetuity unless the business unit is subsequently closed or sold. This would help users derive invested capital and might discourage management from overpaying for assets. In their view

this would remove the cost and complexity of performing the impairment test for goodwill, without making the information provided less useful to investors.

106. A few respondents (for example, some accounting firms, accounting bodies and national standard-setters, and many regulators) discussed the Board's preliminary view to retain the impairment-only model but did not express a view. Many of these respondents observed the merits and limitations of both models and reported mixed views within their organisations.

107. A few respondents (regulators and national standard-setters) said the Board should try to improve the effectiveness of the impairment test first and then decide whether to reintroduce amortisation. For example, one national standard-setter said the Board should conduct a full review of IAS 36 *Impairment of Assets* and reconsider whether to reintroduce amortisation after that full review.

User views

108. Users were split on whether to reintroduce amortisation of goodwill, with many users favouring reintroducing amortisation of goodwill and many other users favouring retaining the impairment-only model. Two global user groups were not in favour of reintroducing amortisation of goodwill. Although a European analyst organisation's membership were in favour of reintroducing amortisation, their membership was not unanimous and that was also reflected in the views of other users in Europe. Other notable geographical trends were that most users based in the UK and the US were in favour of retaining the impairment-only model and most users in Japan were in favour of reintroducing amortisation.

109. The reasons provided by both sets of users were similar to those provided by other respondents to the Discussion Paper. Many that favour reintroducing amortisation said that goodwill is a wasting asset, that management can make a reliable estimate of the useful life of goodwill and that this estimate could provide useful information and that the impairment test is not working. Some of these users said that if amortisation is reintroduced it should be disclosed separately in the financial statements.

110. Most of those that favoured retaining the impairment-only model said that amortisation provides no useful information and recognition of impairment losses

provides information that is more useful for users. A few also said that goodwill is not a wasting asset and that the impairment-only model better holds management to account—amortisation does not distinguish between good and bad managers.

111. A few users suggested other approaches, with one user group suggesting that goodwill could be left on the balance sheet without amortisation and without being subject to an impairment test to help users derive invested capital and to deter overpayment. One user was in favour of direct write-off of goodwill on acquisition. One user said they did not feel strongly about amortisation or the impairment-only approach, as long as there is convergence between IFRS Standards and US GAAP.

New evidence provided to the Board

112. The arguments that respondents provided for favouring reintroducing amortisation (see paragraphs 33 and 55) and for retaining the impairment-only model (see paragraphs 76 and 89) are generally arguments that the Board has considered already, either when deciding to issue IFRS 3 or during this project in developing the Discussion Paper. A few respondents provided additional evidence to support these previous arguments.

113. A few respondents, some supporting impairment-only and some supporting amortisation, specifically commented that there were, in their view, no new conceptual arguments or new evidence. Some respondents however said that there was new practical evidence that the impairment test was not working. A few respondents also highlighted increasing goodwill balances and one group of academics highlighted new evidence since 2004 of earnings management in the impairment-only model.

114. One respondent said that in their view the impairment-only model was inferior to an amortisation model at ensuring accountability, and that there was new evidence of an increased need for accountability—because of the growth in M&A activity, entities were entering into more ‘intangible-heavy’ acquisitions and a greater incidence of earnings-related executive pay models.

115. A few respondents, responding to question 7(b) (see paragraph 15), said that their position on whether to reintroduce amortisation of goodwill or not had changed in

recent years and most of these respondents said they had changed their view to favour reintroducing amortisation—generally due to the limitations of the impairment test.

116. One regional national standard-setting body observed that more stakeholders in their region now favour reintroducing amortisation mainly for practical reasons.

Convergence

117. IFRS 3 was issued, and subsequently revised, as a result of a joint project between the Board and the FASB. Consequently, IFRS 3 is largely converged with the US GAAP equivalent standard for business combinations[3]. Entities are not permitted to amortise goodwill and instead are required to test goodwill annually for impairment in accordance with IFRS Standards and US GAAP, although the standards for the impairment test of goodwill are not converged.

118. On convergence, most respondents (most accounting firms, national standard-setters and regulators) said that convergence with US GAAP on the subsequent accounting for goodwill was desirable and that the Board and the FASB should work collaboratively together, however many (most academics and, many preparers and <u>some</u> users) did not provide a response to the question.

119. IOSCO recently issued a public statement, similar to their comments on this topic included in their comment letter, which supported maintaining and enhancing convergence in this area and encouraged the Board and the FASB to work collaboratively together. They supported the objective of a single set of high-quality accounting standards and said that this view is also shared by the leaders of the G20 and other international organisations.

120. 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 in order to encourage the Board and the FASB to maintain convergence. Many of these respondents had expressed no overall view on whether to reintroduce amortisation of goodwill or had reported mixed views in their organisations.

[3] FASB Accounting Standards Codification® Topic 805 *Business Combinations*.

121. Some respondents said convergence was important but it was unclear whether they would change their views on whether to reintroduce amortisation in order to achieve or maintain convergence. Most of these respondents favoured reintroducing amortisation of goodwill.

122. Many respondents said convergence was preferable but that their views on whether to reintroduce amortisation would not change or that the Board should make its own decision rather than changing IFRS Standards solely to maintain convergence if that would not improve IFRS Standards.

123. Finally, some respondents (including many accounting bodies) did not express a particular preference for convergence and said that their views on whether to reintroduce amortisation would not depend on whether these were consistent with US GAAP or that the Board should make its own decision rather than changing IFRS Standards solely to maintain convergence.

Other matters

Add back of amortisation expenses

124. In response to question 7(e) of the Discussion Paper (see paragraph 15), most respondents said they expect entities would adjust management performance measures (or create new ones) to add back amortisation expenses because, for example, it is a non-cash item. However, many of these respondents said that the possibility of adjusted (or new) performance measures was not a reason not to reintroduce amortisation.

125. One user group said that, although an amortisation expense and an impairment loss are both non-cash items and would be added back to provide a proxy of cash flow, they do not have equivalent information content. The add back of amortisation would be done each period, highlighting that it is not an unusual item, just an un-useful item.

126. Some of the respondents who said they expect entities would adjust management performance measures (or create new ones) to add back amortisation expenses, also said they thought amortisation of goodwill should be reintroduced because it could provide users with useful information. One of these respondents did however say that

adding back amortisation expenses does not indicate the information from amortisation expenses is less useful.

Intangible assets

127. Some respondents commented on the implications of reintroducing amortisation of goodwill for the separate recognition of intangible assets in a business combination. Many of these respondents, mostly favouring reintroducing amortisation, said that reintroduction would allow the Board to revisit the recognition of intangible assets and reduce costs and complexity.

128. A few respondents said that reintroducing amortisation might reduce the incentive to recognise intangible assets with finite lives, reducing information for users and also might incentivise entities to allocate more of the purchase price to intangible assets with indefinite lives. On the other hand, a few respondents said that reintroducing amortisation would remove the incentive to include more of the purchase price in goodwill rather than recognise separate intangible assets subject to amortisation, resulting in better information.

Transition

129. A few respondents made comments on transition if amortisation is reintroduced, with many of these (national standard-setters and accounting bodies) concerned with the potential impact of reintroducing amortisation on entities' reported financial positions. One national standard-setter said that in the absence of absolute evidence to support reintroducing amortisation, they favoured retaining the impairment-only model because of this potential effect on entities' reported financial positions and capital markets.

Question for the Board
Does the Board have any comments or questions on the feedback discussed in this paper?