STAFF PAPER

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IASB® meeting

Project	**Goodwill and Impairment**
Paper topic	Feedback summary—Other topics
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Purpose and structure of this paper

1. This paper provides the International Accounting Standards Board (Board) with a summary of the feedback received on:
   (a) the Board's preliminary view in its Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* to require an entity to present on its statement of financial position the amount of total equity excluding goodwill;
   (b) the Board's preliminary view that it should not develop a proposal to change the recognition criteria for identifiable intangible assets acquired in a business combination; and
   (c) other topics raised by respondents.
2. This paper does not ask the Board for any decisions.
3. This paper is structured as follows:
   (a) Key messages (paragraph 4–6);
   (b) Total equity excluding goodwill (paragraphs 7–15);
   (c) Intangible assets (paragraphs 16–33);
   (d) Other feedback received (paragraphs 34–45); and
   (e) Question for the Board.

Key messages

4. Almost all respondents disagreed with the Board's preliminary view that it should develop a proposal to require an entity to present on its statement of financial position the amount of total equity excluding goodwill.

5. Most respondents agreed with the Board's preliminary view that it should not develop a proposal to change the recognition criteria for identifiable intangible assets acquired in a business combination.

6. Some respondents also highlighted other issues which, in their view, the Board should consider. These issues relate to aspects of IFRS 3 *Business Combinations,* IAS 36 *Impairment of Assets,* IAS 38 *Intangible Assets* and other topics that the Board did not consider in this project.

Total equity excluding goodwill

7. In the Board's preliminary view, it should develop a proposal to require an entity to present on its statement of financial position the amount of total equity excluding goodwill. This amount would likely be presented as a free-standing item, and not as a subtotal, or line item, within the structure of the statement of financial position.

Arguments in favour of the Board's preliminary view

8. A few respondents agreed with the Board's preliminary view. These respondents commented that presenting the amount on the statement of financial position would help to bring greater transparency to the financial statements and help highlight risky businesses to users of financial statements (users), especially those who are relatively inexperienced. A few preparers also suggested that they are already presenting or disclosing similar amounts, such as net tangible assets, in their financial statements.

Arguments against the Board's preliminary view

9. Almost all respondents who commented on this issue disagreed with the Board's preliminary view. In their view:

(a) the presentation is unnecessary;

(b) the presentation lacks conceptual basis;

(c) the amount could cast doubt on whether goodwill is an asset;

(d) the Board should focus on addressing accounting for goodwill, and not use a presentation requirement as a substitute; and

(e) the preliminary view is not appropriate due to other reasons.

10. Most respondents who disagreed with the Board's preliminary view commented that the Board's preliminary view is unnecessary because users could easily compute total equity excluding goodwill based on information already included in financial statements. Many of those respondents also commented that the Board's Exposure Draft *General Presentation and Disclosures* already proposes to require an entity to present its goodwill balance on the statement of financial position. In their view, that requirement is sufficient to bring prominence to an entity's goodwill balance, and that introducing additional items could clutter the statement of financial position. A few respondents suggested the Board require entities to disclose the amount in the notes to financial statements, rather than to present it on the statement of financial position.

11. Many respondents who disagreed with the Board's preliminary view commented that the presentation of total equity excluding goodwill contradicts the Board's position that goodwill is an asset and that the presentation of this amount could confuse users. A few respondents suggested that the preliminary view could cast doubt on the reliability of the impairment test of cash-generating units (CGUs) containing goodwill and the reliability of financial statements in general. A few of these respondents further suggested that if the Board is of the opinion that goodwill is a questionable asset, it should amend IFRS Standards to prohibit the recognition of goodwill.

12. Some respondents commented that the amount of 'total equity excluding goodwill' has no conceptual basis. The *Conceptual Framework for Financial Reporting* identifies assets, liabilities, equity, income and expenses as the five elements of financial statements. In those respondents' view, 'total equity excluding goodwill' does not meet the definition of any of those elements and that it is unclear what the amount conceptually represents.

13. A few respondents commented that the amount could be misleading because of the accounting choice that an entity has in the initial accounting of non-controlling interests. IFRS 3 allows an entity to elect on initial recognition to measure non-controlling interests at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. If the non-controlling interest is measured at fair value, the goodwill initially recognised includes the non-controlling interest's share of goodwill; if the non-controlling interest is measured at its proportionate share of the acquiree's identifiable net assets, the goodwill initially recognised includes only the acquirer's share of goodwill. In addition, according to IFRS 10 *Consolidated Financial Statements*, regardless of the choice of measurement for non-controlling interests at initial recognition, any gains or losses from subsequent changes in the ownership interests in a subsidiary that do not result in loss of control shall be accounted for as equity transactions that do not impact goodwill. As a result, it is unclear whether, and if so, to what extent, is the non-controlling interest's share of goodwill included in the amount of 'total equity excluding goodwill'.

14. Some respondents cited other reasons for disagreeing with the Board's preliminary view. These reasons included:

    (a) the presentation could lead to unintended consequences, such as possible legal disputes that may arise from existing financial covenants or in bankruptcy proceedings.

    (b) the amount might give users a false impression that the business combination is financed by the acquirer through issuance of equity rather than through debt.

15. A few respondents suggested the Board require entities present or disclose other items instead of the amount of total equity excluding goodwill, for example:

    (a) net tangible assets;

    (b) working capital; and

    (c) net debt.

Intangible assets

16. The Board's preliminary view is that it should not change the recognition criteria for identifiable intangible assets that are acquired in a business combination.

17. Most respondents who commented on the question, including many users, agreed with the Board's preliminary view not to develop such a proposal. In their view, goodwill and other intangible assets acquired in a business combination are different in nature and that recognising these assets separately provides users with better and more useful information.

18. On the other hand, some respondents, including some users, disagreed with the Board's preliminary view for various reasons. In their view, separately recognising acquired intangible assets does not provide useful information and the costs of doing so outweigh the benefits.

Arguments in favour of the Board's preliminary view

19. Many respondents who agreed with the Board's preliminary view commented that recognising acquired intangible assets separately from goodwill provides users with better information. In their view, separate information about intangible assets would result in more transparent financial reporting and enables users to better understand what the acquirer paid for in a business combination.

20. Some respondents suggested that intangible assets have become increasingly important in the modern economy and have become a key asset for many entities. Therefore, in their view, it would be counterintuitive to provide less information about those intangible assets by including them in goodwill.

21. Some respondents pointed out that including some intangible assets in goodwill will result in entities recognising more goodwill. In their view, the larger balance could put further pressure on the impairment test to recognise accurate and timely impairment losses on goodwill.

22. A few respondents said that acquired intangible assets are tested for impairment separately and that, in their view, those impairment tests tend to be more robust than impairment tests for CGUs containing goodwill. In their view, including some

intangible assets in goodwill would put greater pressure on the impairment test by allowing 'headroom' in CGUs containing goodwill to shield those acquired intangible assets that could otherwise be tested for impairment separately. This would, in their view, reduce the robustness of the impairment test in IAS 36, resulting in late and inadequate recognition of impairment losses.

23. A few respondents commented that most intangible assets acquired in a business combination have fixed or determinable useful lives, which is different from goodwill that has an indefinite useful life. In those respondents' view, including some intangible assets in goodwill would prevent those intangible assets from being amortised over their useful lives and does not accurately depict how the asset is consumed post-acquisition. A few respondents also pointed out that even if goodwill amortisation is reintroduced, including some intangible assets in goodwill will commingle assets with different useful lives, making it difficult to determine the useful life of this commingled asset.

24. A few respondents suggested that entities have established methods for valuing intangible assets acquired in business combinations and developed procedures for performing purchase price allocations. In their view, it is therefore neither costly nor complex for entities to recognise separately intangible assets that entities acquired in business combinations.

25. One respondent commented that goodwill is treated differently from other intangible assets for prudential regulatory purposes. Therefore, changing the recognition criteria for goodwill could have unintended consequences on financial institutions that are subject to those regulatory requirements.

26. Many respondents who agreed with the Board's preliminary view commented that their view on intangible assets will not change even if the Board decided to reintroduce amortisation of goodwill. On the other hand, a few respondents commented that their view could change if the Board were to reintroduce amortisation of goodwill, which would align the subsequent accounting treatment of goodwill with some identifiable intangible assets.

Arguments against the Board's preliminary view

27. Many of the respondents who disagreed with the Board's preliminary view commented that it is costly and complex to perform purchase price allocations to identify, separately from goodwill, intangible assets acquired in a business combination. A few of those respondents further commented that information about separately recognised intangible assets is not used by users. Given the cost and complexity of separately recognising intangible assets, in those respondents' view, the costs of separately recognising these intangible assets outweigh the benefits.

28. A few respondents commented that performing a purchase price allocation to determine the amount of intangible assets an entity acquired in a business combination is often complex and requires management to exercise significant judgement. As a result, in their view, the amount of intangible assets recognised could be highly subjective and are not comparable across entities.

29. A few user representative groups suggested that management has significant discretion in the recognition and measurement of acquired intangible assets, giving rise to opportunities for accounting arbitrage. One user group mentioned that, in its view, entities' earnings could be managed upwards by management allocating a higher proportion of consideration to goodwill that is not subject to amortisation.

30. A few respondents commented that some of the intangible assets recognised separately from goodwill, such as brand and customer lists, represent excess earnings acquired and are similar in nature to goodwill. In their view, these intangible assets should be included in goodwill due to their similar nature. For example, a few user groups said that assets such as customer lists are, in their view, non-wasting but are often recognised separately from goodwill and are amortised over a short period of time. Those user groups said that amortising intangibles they view as being similar in nature to goodwill distorts an entity's profit and doesn't help users hold management to account.

31. A few respondents who supported reintroducing amortisation of goodwill suggested that acquired intangible assets are currently recognised separately from goodwill because their subsequent accounting treatment is different. In their view, if

amortisation is reintroduced for goodwill, there will no longer be a need for those intangible assets to be recognised separately.

Recognition criteria for intangible assets acquired in a business combination

32. A few respondents who disagreed with the Board's preliminary view suggested the Board include in goodwill those intangible assets that are unable to generate cash inflows that are largely independent from other assets. A few other respondents who disagreed with the Board's preliminary view suggested that if an intangible asset acquired in a business combination cannot be sold by the entity (because it is not separable) or if the intangible asset does not have an active market, then that intangible asset should not be recognised separately from goodwill.

33. One respondent suggested the Board require entities to separately recognise 'principal intangible assets' that are closely related to the rationale for the entity's acquisition, and, subject to the Board's decision to reintroduce amortisation of goodwill, include some intangible assets with finite useful lives in goodwill. In its view, this approach helps to achieve an appropriate balance between the information needs of users and the costs for preparers.

Other feedback received

34. Some respondents made additional comments on other topics not discussed in the Discussion Paper which, in their view, the Board should consider. These topics include issues relating to:

(a) IFRS 3 (paragraphs 35–40);

(b) IAS 36 (paragraph 41);

(c) IAS 38 (paragraphs 42–44); and

(d) other topics (paragraph 45).

Feedback on issues relating to IFRS 3

Issues relating to non-controlling interests

35. A few respondents commented that requirements in IFRS Standards relating to the accounting of non-controlling interests are unclear or require improvement. A few of those respondents highlighted issues relating to the accounting of non-controlling interests when initially measured at its proportionate share of acquiree's net assets. In those respondents' view:

    (a) It is unclear whether paragraph 19 of IFRS 3 was intended to limit the application of the 'proportionate share of net assets' approach in measuring non-controlling interests, or was intended as a requirement on how that approach should be applied.

    (b) There is a lack of guidance on how to account for equity transactions with non-controlling interests that do not result in a loss of control, especially when the non-controlling interest was initially measured using the 'proportionate share of net assets' approach. A few respondents commented that, in their view, those transactions may overstate goodwill or could result in greater headroom that 'shields' goodwill from impairment losses.

    (c) It is unclear how entities should account for settlement of pre-existing relationships with non-controlling interests if those entities have initially measured the non-controlling interests using the 'proportionate share of net assets' approach.

    (d) The financial results of entities initially measuring their non-controlling interests using the 'proportionate share of net assets' approach are not comparable with the financial results of entities using the fair value approach.

    (e) Goodwill attributable to non-controlling interests is not an asset of the reporting entity, and entities should therefore not be allowed to recognise such an asset when measuring non-controlling interests under the fair value approach.

36. A few respondents also commented on other issues relating to the accounting of non-controlling interests. Specifically:

(a) It is unclear how to allocate impairment losses between non-controlling interests and owners of the parent entity if the CGU giving rise to the impairment loss includes both subsidiaries with non-controlling interests and subsidiaries without non-controlling interests.

(b) One respondent suggested that an entity's goodwill balance should be adjusted for subsequent changes in the ownership interests in a subsidiary that do not result in loss of control. In its view, this would better depict changes to future economic benefits of the reporting entity because of that transaction.

Other issues relating to IFRS 3

37. Some respondents made additional comments on other topics not discussed in the Discussion Paper which, in their view, the Board should consider. Many of these topics relate to aspects of IFRS 3 that the Board did not consider in this project. Specifically:

(a) A few respondents commented that the fair value adjustments made to assets acquired and liabilities assumed in a business combination impact the financial performance of the reporting entity in future periods. For example, if the inventory that an entity acquired in a business combination received an upward fair value adjustment during purchase price allocation, the inventory will have a higher cost basis in the consolidated financial statements. When the acquired inventory is eventually sold to an external party, the reporting entity would recognise a higher cost of goods sold, and correspondingly, a lower gross profit. In those respondents' view, the financial impact caused by the fair value adjustment distorts the operating margin reported by the entity post-acquisition.

(b) A few respondents suggested the Board explore how to better account for 'technical goodwill' that results from deferred tax liabilities arising from fair value adjustments made to assets acquired and liabilities assumed in a business combination. A few of these respondents suggested the Board require entities to derecognise such goodwill when the corresponding deferred tax liabilities are derecognised. If the Board decides not to do so, one of these respondents said that the Board should make it clear that a component of goodwill that resulted from the recognition of a deferred tax liability should be tested for impairment at the same level as the deferred tax liability is recognised. A few respondents also suggested the Board should reconsider separating goodwill into components and accounting for the different components separately.

(c) A few respondents commented that there is misalignment between the accounting for business combinations and the accounting for the acquisition of assets that are similar in nature to business combinations.

38. A few respondents highlighted that if the consideration for the business combination included equity financial instruments, there is often a difference between the goodwill measured on acquisition date and the goodwill if it were measured at the date of the acquisition agreement due to changes in fair value of those instruments. In their view, the amount of goodwill recognised in financial statements is misstated because it does not represent the amount management intended to pay to acquire the business and therefore does not help to hold management to account for their acquisition decisions. One respondent suggested the Board require entities to disclose this difference.

39. A few respondents suggested the Board review the definition of goodwill and clarify that goodwill includes both the value of going concern as well as expected synergies.

40. One respondent highlighted that there is a conflict between the measurement principles in IFRS 3 (which is based on fair value) and in IFRS 15 (which measures the consideration an entity is entitled to in a contract with a customer) that needs to be addressed.

Feedback on issues relating to IAS 36

41. A few respondents highlighted difficulties in determining cash outflows when applying IAS 36 to CGUs containing right-of-use assets recognised applying IFRS 16 *Leases*. These issues included:

(a) The definition of a CGU in paragraph 6 of IAS 36 does not include liabilities, and paragraph 50(a) of IAS 36 states that estimates of future cash flows should not include cash inflows or outflows from financing activities. A few respondents commented that preparers find it difficult to adjust management budgets to separate the cash flows relating to leases that are included in the lease liability applying IFRS 16 from those that are not included in the lease liability. Some of those respondents suggested the Board simplify the accounting requirement and allow entities to include lease liabilities relating to right-of-use assets in the carrying value of a CGU and include cash flows related to financing liabilities when estimating value in use. See also Agenda Paper 18D to this meeting.

(b) Paragraph 33 of IAS 36 states that when an entity estimates value in use, cash flow projections and forecasts based on budgets shall cover a maximum period of five years, unless a longer period can be justified. A few respondents suggested the Board provide guidance for cash flows relating to right-of-use assets beyond the forecast period, including guidance for cash flows from reinvesting these assets at the end of the lease term.

Feedback on issues relating to IAS 38

42. Some respondents suggested ways to improve the accounting for intangible assets. Some of these respondents suggested the Board undertake a broad scope project to review IAS 38 in general due to the increasing importance of intangible assets in a knowledge-based economy.

43. A few respondents suggested that the Board should allow entities recognise more intangible assets, including internally generated intangible assets. In their view, this would allow users to more easily compare the financial performance of entities that grow organically with entities that grow mainly through acquisitions.

44. Some respondents also made other suggestions for the accounting of intangible assets. These suggestions included:

(a) providing better guidance on how entities should recognise intangible assets acquired in a business combination; and

(b) requiring entities to provide better disclosures about intangible assets, such as:

(i) details about intangible assets generated internally by the entity that were not recognised;

(ii) disclosing intangible assets generated internally by the entity separately from intangible assets acquired in a business combination; and

(iii) how the entity values its acquired intangible assets.

Feedback on other topics

45. A few respondents provided feedback on other topics not explored in the Discussion Paper. These included suggestions that the Board should:

(a) consider whether, and if so how, its preliminary views would apply to investments accounted for using the equity method;

(b) review how the requirements in IAS 21 *The Effects of Changes in Foreign Exchange Rates* relating to the level goodwill balances are translated interacts with the level at which goodwill is tested for impairment under IAS 36;

(c) require entities to incorporate Environmental, Social, and Corporate Governance (ESG) considerations when forecasting future cash flows for impairment tests;

(d) require entities to disclose the breakdown of goodwill by acquisition, the allocation of goodwill to different segments as well as the age of goodwill; and

(e) prevent entities from being able to window dress their financial results by prohibiting entities from classifying impairment losses recognised on goodwill as an unusual expense as proposed by the Board's *Primary Financial Statements* project.

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