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Staff paper

FASB | IASB Joint Education Meeting

Date	**September 2022**
Project	**Goodwill and Impairment**
Topic	**Subsequent accounting for goodwill**
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Background

Discussion Paper—the preliminary view

Reintroducing amortisation

- Retain the impairment-only approach (small majority).
- The IASB welcomed feedback that provides new practical or conceptual arguments, together with evidence for these arguments.

Convergence with US GAAP

- The IASB asked stakeholders whether their views depend on whether the outcome would be consistent with US Generally Accepted Accounting Principles (US GAAP).

The preliminary view was expressed in the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*.

Feedback

Overall message

Respondents' views remain mixed. Many respondents agreed with the preliminary view to retain the impairment-only model but many disagreed, saying amortisation of goodwill should be reintroduced.

Summary of feedback

- 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.
- Most respondents who commented said **convergence with US GAAP** was desirable. However, many respondents also said their view did not depend on whether the outcome would maintain convergence, or that the IASB should make its decision based on evidence it has collected rather than solely to maintain convergence.

Feedback

Reasons for reintroducing amortisation

Conceptual reasons

- Goodwill is a wasting asset and amortisation of goodwill would reflect its consumption.
- Amortisation prevents the recognition of internally generated goodwill.
- A reliable estimate of useful life can be made.
- Amortisation helps hold management accountable.

Practical reasons

- The impairment test is not working.
- Goodwill balances are too high.
- Reintroducing amortisation would resolve concerns that entities do not recognise impairment losses on a timely basis.
- Amortisation is a simple method that would reduce costs.
- Earnings would be less volatile, helping financial stability.

Reasons for retaining impairment-only approach

Conceptual reasons

- Goodwill is not a wasting asset with a determinable useful life.
- Impairment losses provide users with more useful information than amortisation.
- The useful life of goodwill cannot be estimated reliably.
- The impairment-only model helps hold management accountable better than an amortisation model.

Practical reasons

- Reintroducing amortisation would not resolve concerns that entities do not recognise impairment losses on a timely basis.
- Compelling evidence for change has not been identified.

Staff observations

Impairment-only vs amortisation	• There remain **divergent and strongly** held views on whether to retain the impairment-only model or reintroduce an amortisation model. The arguments provided to support either approach are often **diametrically opposed** (see slide 6). In addition many of the arguments provided had been made during the development of IFRS 3 or during the course of this project. • There appears to have been a **shift** in the balance of user views since the PIR of IFRS 3 with more users supporting the reintroduction of amortisation. However user views remain **mixed**.
Amortisation model	• When the IASB decided to adopt the impairment-only model, not being able to reliably estimate the useful life of goodwill was central to its conclusions. Some respondents to the Discussion Paper however said a reliable estimate can be made. • A few respondents were concerned about the consequences of transitioning to an amortisation-based model, for example on entities' financial positions and stability.
Convergence with US GAAP	• The importance of convergence (and maintaining convergence) is evident from the feedback. Additionally, IOSCO made a public statement shortly after the comment letter period had closed **encouraging the IASB and the FASB to work collaboratively** on this matter.

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Developments since the last joint meeting

Further research

In September 2021 the IASB asked us to further analyse two specific aspects of feedback on whether the IASB should reintroduce amortisation of goodwill including:

	Useful life of goodwill	Transition
Focus of the research	• Whether it is feasible to estimate a useful life of goodwill and the pattern in which it diminishes, that faithfully represents its decline in value.	• The potential consequences of transitioning to an amortisation based model were the IASB to reintroduce amortisation of goodwill.
Process	• Discussed this topic at the November 2021 Capital Markets Advisory Committee and Global Preparers Forum (GPF) meetings. We held one-to-one meetings with preparers, preparer groups, auditors and users. We also sent an information request to national standard-setters.	• Discussed the issue at the November 2021 GPF meeting. We sent an information request to national standard-setters and regulators.

The IASB has not decided whether to retain the impairment-only model or whether to explore reintroducing amortisation of goodwill, but further information on these two topics will help the IASB in making that decision, planned for Q4 2022.

Research—estimating the useful life of goodwill (1)

Feasibility

- There are several factors and methods entities would use to estimate the useful life of goodwill. For some entities, making this estimate would be relatively straightforward given the finite nature of the businesses they acquire. For other entities, making this estimate would be more subjective and entities may need to consider several factors or use proxies.
- Examples of factors management would use to estimate the useful life of goodwill were:
  - factors that contribute to goodwill and the expected period over which benefits from goodwill are realised;
  - expected period over which synergies are realised from the business combination;
  - expected period to achieve a business combination's objectives;
  - expected payback period;
  - expected useful life of identified assets acquired;
  - expected period that would be required to create an equivalent business to that acquired;
  - expected period over which the business combination generates largely independent cash flows or increases cash flows; and
  - product or industry life cycles.
- This diversity of factors and methods might be a result of different facts and circumstances of each business combination, different judgements of what goodwill is or different preferences in the method(s) selected.

Research—estimating the useful life of goodwill (2)

Feasibility (contd.)	• Many preparers suggested specifying an upper limit:
	  • for practical reasons, when the benefits from goodwill are expected to last for a long period or management cannot reliably estimate the useful life of goodwill; or
	  • to prevent excessively long useful lives being used.
	• Many preparers expressing a view said the pattern goodwill diminishes should not necessarily be straight-line but many said a straight-line approach should be adopted as a practical solution.
	• Almost all preparers we spoke with did not express concerns about the cost of making these estimates.* The feedback from respondents to the Discussion Paper was more mixed.

Auditability	• Auditors said it would be possible to audit managements' estimates of useful life, but most of them suggested providing application guidance, for example, on unit of account, when to use particular factors and so on. • Many auditors also said specifying an upper limit would make the useful life auditable by helping challenge entities claiming goodwill has an indefinite or excessively long useful life.
Usefulness	• Users had mixed views. Many said a useful life and amortisation pattern based on management's estimate would provide useful information, for example it would provide insight into management's assessment of the recovery period for the investment and the rationale for the purchase price. • However, many said an amortisation charge would be arbitrary due to the difficulty of estimating the useful life of goodwill and would not provide useful information.

* Our research focused on those who said it is possible to reliably estimate the useful life of goodwill.

Research—potential consequences of transition

Feedback

- We researched the legal and regulatory consequences of transitioning to an amortisation-based model rather than the practical consequences (for example, whether the useful life of goodwill could be estimated retrospectively without the use of hindsight).
- Potential legal and regulatory consequences of transition discussed by respondents were effects on:
  - entities’ financial positions and performance;
  - access to capital markets and economic development;
  - capital maintenance;
  - dividend distribution;
  - debt covenants and credit ratings; and
  - taxation.
- Many respondents said transition would significantly affect entities’ financial positions and performance because of the size of historic goodwill balances.
- Some of these effects could be significant and more prevalent for entities in particular jurisdictions:
  a) respondents from Asia-Oceania said entities in their jurisdictions risk failing to meet listing requirements and, eventually, being suspended from trading or delisted if they report negative equity and/or profit; and
  b) respondents from Latin America said the amounts of dividends entities in their jurisdictions could distribute would be affected.
- However, many other respondents said the consequences of transition would be limited. Some said the consequences are not compelling enough to prevent reintroducing amortisation of goodwill.

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