Goodwill and Impairment

Agenda ref: WSS9

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World Standard-setters Conference 2018

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Agenda

1. **Background and introduction**
2. **Key findings from the Board's research project so far**
3. **Objectives for follow-up work for the research project *(July Board Meeting)***
   a) **identifying better disclosures**
   b) **simplifying accounting for goodwill**
   c) **improving the calculation of value in use**

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Background and introduction

Background and introduction

2009

Entities started implementing revised version of IFRS 3 *Business Combinations.*

Background and introduction

2009 2013

The Board sought stakeholder feedback on specified matters as part of the Post-implementation Review of IFRS 3.

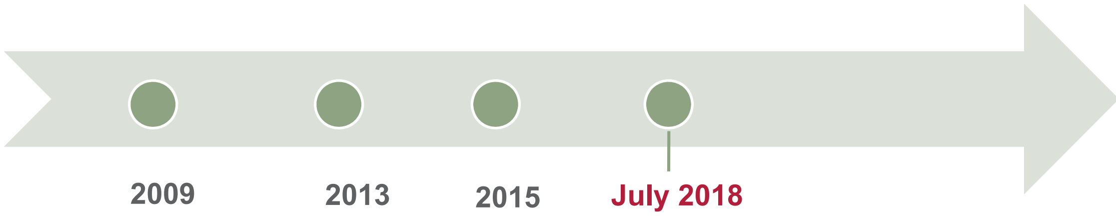
Background and introduction

2009 2013 2015

The Board, after examining stakeholder views, set as research objectives:

- whether to change the subsequent accounting for goodwill;
- whether to allow identifiable intangible assets acquired in a business combination to be included within goodwill;
- whether to provide better information about goodwill and impairment through disclosures; and
- whether to change the impairment test in IAS 36 by:
  - ✓ simplifying the test without making it less robust; or
  - ✓ improving the effectiveness of the test.

Background and introduction



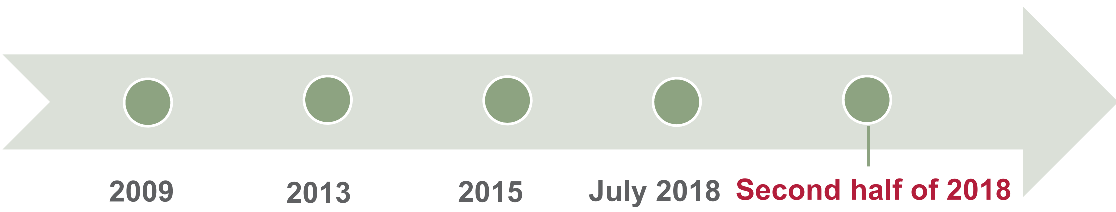
The Board tentatively decided to pursue the following objectives for follow-up:

a) **identifying better disclosures about business combinations;**

b) **simplifying the accounting for goodwill; and**

c) **improving the calculation of value in use**

Background and introduction



The Board will continue its discussions on how to achieve the objectives the Board is pursuing for the project and work towards issuing a Discussion Paper.

Key findings from the Board's research project so far

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Key findings—accounting for goodwill

Whether goodwill is an asset	Whether goodwill should be amortised
• goodwill mainly consists of 'core goodwill': ▪ going concern element of acquired business; and ▪ expected synergies from acquisition; • no new developments question whether core goodwill meets the definition of an asset (eg revisions to the *Conceptual Framework for Financial Reporting*); • goodwill is measured as a residual, but this does not prevent goodwill from being an asset; and • immediate write-off of goodwill on initial recognition would undermine the conclusion that goodwill is an asset (Board did not pursue)	• no significant new evidence or strong new arguments to support amortisation of goodwill; • amortisation would be pragmatic solution that might help in resolving concerns about the amount of goodwill on the balance sheet; • amortisation would reduce costs to preparers in accounting for goodwill; • amortisation would not provide useful information for users; and • amortisation reduces the information usefulness (even if limited) provided by current impairment test

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Key findings—identifiable intangible assets

✓ **Investors' mixed views about the information usefulness provided by separate recognition of identifiable intangibles:**

Some supported current IFRS 3 requirements

Some questioned certain intangibles (brands and customer relationships) because of concerns about:
- credibility of fair value measurement;
- usefulness of information provided by amortisation of those intangibles; and
- accounting differences (internally generated intangibles vs intangibles acquired in a business combination).

✓ no compelling evidence that including some intangible assets in goodwill would save costs; and

✓ aligning internally generated and acquired intangible asset accounting would be a fundamental change to intangible asset accounting.

Key findings—impairment testing of goodwill

Costs and complexity of performing the impairment test of goodwill

- mainly in relation to determining the recoverable amount of the unit for the test.

Benefits from the impairment testing of goodwill

- does not always provide information about the performance of the acquired business; and
- depending on facts and circumstances, often the information is only confirmatory.

Ineffectiveness of the impairment testing model for goodwill

- acquired goodwill:
  - is tested for impairment as part of a cash-generating unit(s); and
  - can be shielded from impairment by unrecognised headroom* of the existing business of the acquirer (so called shielding effect: see **slide 13 and 14**).
- investigated the 'headroom approach' to improving the effectiveness of the impairment test; and
  - feedback indicated this would add to the cost and complexity of the impairment test.

- Unrecognised headroom: Difference between the recoverable amount of a unit and its carrying amount. This difference mainly comprises internally generated goodwill, unrecognised intangible assets, and book value to fair value differences of existing assets.

Key findings—impairment testing of goodwill

✓ **Shielding effect arising from current impairment testing of goodwill**

Goodwill is allocated to cash-generating units (CGUs) expected to benefit from the acquisition

Compare recoverable amount (RA) of the CGUs with their carrying amount (CA) at the current impairment testing date T1 (tested annually)

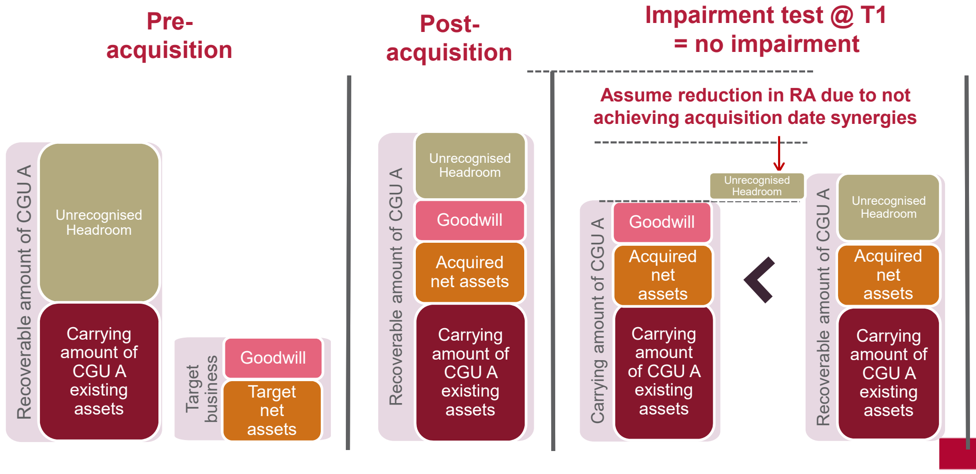
Goodwill is impaired only if recoverable amount of the CGUs is less than its carrying amount (ie $RA_{T1} < CA_{T1}$)

Shielding of acquired goodwill from impairment can occur particularly where allocated to CGUs with existing assets

Key findings—impairment testing of goodwill

✓ **Shielding effect arising from current impairment testing of goodwill**

Shielding of acquired goodwill from impairment can occur particularly where allocated to CGUs with existing assets



Key findings—improving disclosures

✓ **Investors view following information as useful information for business combinations, goodwill and impairment:**

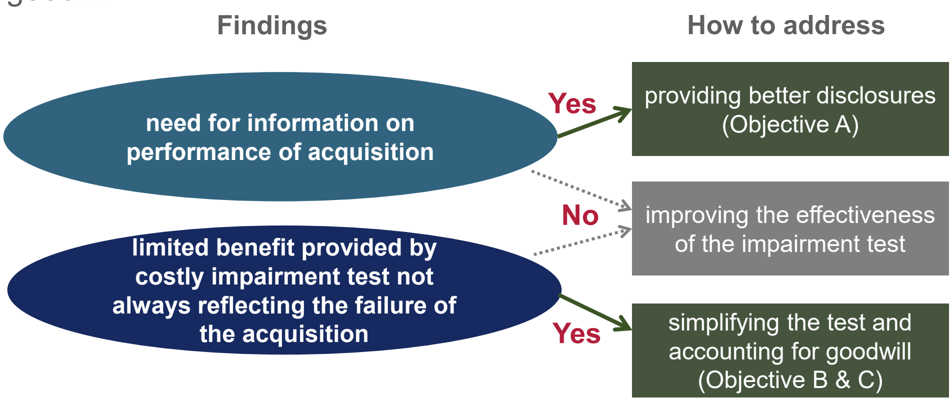
Business combination	Goodwill and impairment
• information to help users assess whether an acquisition is a good investment decision; and • information to help users assess whether the acquired business has been performing after acquisition as expected at the acquisition date.	• information to help users understand the reasons for any premium paid for a business; but • the impairment test provides limited information regarding the performance of the acquired business post-acquisition.

Objectives for follow-up work for the research project

(July 2018 Board Meeting)

Objectives for follow-up work for the project

✓ The rationale for the Board's tentative decision to pursue better disclosures; and to simplify the impairment test and the accounting for goodwill



Objectives for follow-up work for the project

✓ **At the July 2018 Board meeting, the Board tentatively decided to pursue the following three objectives for addressing the interrelated problems identified in the research project:**

Objective A	Identifying disclosures to enable investors to assess: • management's rationale for the business combination; and • whether the post-acquisition performance of the business combination meets expectations set at the acquisition date.
Objective B	Simplifying the accounting for goodwill by: • permitting an indicator-only approach as to whether an impairment test is required; and • exploring whether to reintroduce amortisation of goodwill.
Objective C	Improving the calculation of value in use by permitting: • cash flow projections that may include future enhancements to the asset; and • the use of post-tax inputs in the calculation of value in use.

Objective A—identifying better disclosures

- ✓ The staff are considering possible disclosures to provide better information for users about business combinations and goodwill and impairment.
- ✓ Those disclosures can be split into three parts:
  a. disclosures about whether the acquisition is a good investment decision;
  b. disclosures about subsequent performance of the acquisition; and
  c. specific disclosures arising from research that may provide better information for users about goodwill and impairment.
- ✓ The Board could also consider whether to perform a full IFRS 3 disclosure review.

Objective A—identifying better disclosures

- ✓ Considering additional **disclosure objectives** about the acquired business:

A.1 for business combinations that occur in the current reporting period,

an entity shall disclose information that helps users to understand:

a. the strategic rationale and key drivers of the value of a business combination; and

b. the factors identified at the date of acquisition that an entity will use to assess the success of a business combination.

A.2 for business combinations that occurred in prior reporting periods,

an entity shall disclose information that helps users to assess the extent to which past business combinations have been successful, as measured by the success factors identified at the date of acquisition.

Objective A—identifying better disclosures

✓**Objective A.1a largely met by existing IFRS 3 disclosure requirements with some proposed additional disclosures:**

- primary reasons for paying any premium and the value of those elements that support the goodwill recognised on acquisition:
  - not only a qualitative description, but also a quantitative assessment of synergies, etc. together with an assessment of the costs to achieve these synergies;
- separate disclosure of debt and pension obligations assumed on acquisition;
- description of types and classes of intangible assets recognised; and
- valuation techniques and significant inputs to measure the values of the assets acquired and liabilities assumed.

Objective A—identifying better disclosures

✓ **Objective A.1b and A.2 will require flexibility. Staff are considering:**

- requiring disclosure of information on the performance of a business combination in the manner that the entity's management determine the success of that business combination; and
- disclose the approach(es) used by management to determine the success of a business combination and measurement against the approach(es) in subsequent reporting periods.

Objective A—identifying better disclosures

- ✓ **Possible approaches could include:**
  - ▪achievement of acquisition date synergies;
  - ▪achievement of acquisition date financial/operating KPIs;
  - ▪comparison of actual vs forecast cash flows;
  - ▪contribution of the acquisition to annual changes in segment/CGU return on assets; or
  - ▪progress of the acquisition in achieving acquisition date payback period.
- ✓ **Period for which disclosures are provided for will be determined by the entity and the period required to assess the success of the business combination**

Objective A—identifying better disclosures

Other disclosures to provide better information about goodwill and impairment

- reasons why an entity has chosen a particular assumption for calculating recoverable amount;
- breakdown of carrying amount of goodwill by past acquisition and rationale why recoverable;
- time period analysis of value in use;
- headroom of CGUs with goodwill allocated;
- indicators that triggered the quantitative impairment test; and
- total net assets, less goodwill.

Questions for WSS members

1. Do you have any comments or feedback on the disclosure objectives for business combinations set out on slide 20?
2. Do you have any comments or feedback on the suggestions for how an entity may meet these disclosure objectives as set out on slides 21 to 23?
3. Do you support that the Board should consider reviewing the full IFRS 3 disclosure requirements?

Objective B—simplifying accounting for goodwill

✓ **Possible relief from the mandatory annual quantitative impairment test**

- **Requiring impairment testing of goodwill only when there are indicators of possible impairment (Indicator-only approach).**

Current requirements:	Basis of the simplification
• for a unit that contains goodwill, the impairment test must be performed annually; and • for a unit that does not include goodwill, the test is performed only when there is an indication that the unit may be impaired.	• focus of the current test is to assess whether the carrying amount of the unit is recoverable; • if test does not need to provide information on the performance of the acquisition, simplification is possible; and • frequency of quantitative impairment test no longer needs to depend on whether the unit contains goodwill – it should not make test less robust.

Objective B—simplifying accounting for goodwill

✓ **Permitting an indicator-only approach as to whether an impairment test is required:**

Pros	Cons
• is consistent with impairment testing for other assets, other than indefinite life intangibles;	• increases concerns about timely recognition of impairments of goodwill;
• reduces the cost and complexity of current test without any information loss; and	• furthers management (and auditors) judgement in impairment testing; and
• reduces disclosure burden (eg disclosing inputs to the quantitative test each year).	• risks loss of good governance mechanism.

Objective B—simplifying accounting for goodwill

✓ **Exploring whether to reintroduce amortisation of goodwill**

- **The Board could explore reintroducing amortisation of goodwill to simplify the accounting for goodwill.**

Amortisation with Impairment model | Impairment only model

- stakeholder views were polarised, and perhaps will always remain polarised;
- amortisation model arguably does not provide useful information for users, but this could be offset by improved disclosures;
- determining the amortisation period is difficult;
- amortisation model is a less-costly way to reduce the carrying value of goodwill on the statement of financial position; and
- impairment test provides limited information about the performance of the acquisition, the principal rationale for moving to an impairment only model.

Objective B—simplifying accounting for goodwill

✓ **Exploring whether to reintroduce amortisation of goodwill**

- **the following potential mechanics involved in amortisation of goodwill would need to be determined:**

  - **how should the useful life of goodwill be determined and should there be an upper limit on that useful life?**
  - **how should the amortisation method be determined?**

- **in addition, whether goodwill should be treated differently to indefinite life intangible assets would need to be addressed**

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Objective C—improving the calculation of VIU

✓ **Pursuing targeted changes to the value in use calculation**

- **the Board could consider proposing amendments to IAS 36:**
  - ➢ by removing the requirement to exclude from the calculation of value in use those cash flows arising from a future restructuring or from a future enhancement; and
  - ➢ by removing the explicit requirement to use pre-tax inputs in calculating value in use, and to disclose pre-tax discount rates used;
- **these changes are relatively straight forward improvements; and**
- **the changes would reduce the costs and complexity of the impairment test in IAS 36.**

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Questions for WSS members

4. Would providing relief from the mandatory annual impairment test (slides 26 and 27) combined with the improvements to the VIU calculation (slide 30) result in a significant reduction in costs of impairment testing?
5. In what circumstances should these changes be considered:
   a) to support the continuation of an impairment-only approach?
   b) only if the Board reintroduces amortisation of goodwill?
   c) in all circumstances, irrespective of whether the Board decides to retain the impairment-only approach or reintroduce amortisation?

Questions for WSS members

6. If amortisation of goodwill was reintroduced:
   a) how should the useful life of goodwill be determined?
   b) what amortisation method should be used for goodwill?
   c) should indefinite-lived intangible assets also be amortised?

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