

## STAFF PAPER

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IASB<sup>®</sup> meeting

<b>Project</b>	<b>Goodwill and Impairment</b>	
<b>Paper topic</b>	Estimating the useful life of goodwill	
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**Purpose**

1. As explained in Agenda Paper 18, this paper summarises feedback from our research on 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.<sup>1</sup> We have also provided some initial observations on the feedback.

**Structure of this paper**

2. The paper is set out as follows:
  - (a) Key messages (paragraphs 3–8);
  - (b) Background (paragraphs 9–13);
  - (c) Process (paragraphs 14–16);
  - (d) Feedback (paragraphs 17–106), including:
    - (i) feasibility of estimating the useful life of goodwill and the pattern in which it diminishes (paragraphs 18–84);

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<sup>1</sup> For convenience, we refer to this as a 'reliable' estimate throughout the remainder of the paper.

- (ii)    auditability of the useful life of goodwill and its amortisation pattern (paragraphs 85–96); and
- (iii)    usefulness of information associated with managements’ estimates of the useful life of goodwill and its amortisation pattern (paragraphs 97–106);
- (e)    Appendix A—Process;
- (f)    Appendix B—Factors to estimate the useful life of goodwill from national GAAPs and other studies; and
- (g)    Appendix C—Extracts from IAS 38 *Intangible Assets*.

## **Key messages**

### ***Feasibility of estimating the useful life of goodwill and the pattern in which it diminishes***

3.    Outreach indicates that 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 when doing so.
4.    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.
5.    Many of the preparers we spoke with also commented on how to estimate the pattern in which goodwill diminishes. Of those who commented:
  - (a)    many said the pattern should not necessarily be straight-line with some suggesting linking the pattern to that used for the primary asset(s) acquired (for example, oil reserves); and
  - (b)    many said a straight-line approach should be adopted as a practical solution, but some suggested entities should be able to apply a different pattern if more appropriate.

6. Many stakeholders commented on whether the International Accounting Standards Board (IASB) should specify an upper limit for the useful life of goodwill (a cap). Many preparers we spoke with said a cap was needed either for practical reasons or to prevent excessively long useful lives being used. Also, many auditors said a cap is necessary to make an amortisation model operable and auditable. However, many auditors also said a cap may become an unintended default period.

### ***Auditability of the useful life of goodwill and its amortisation pattern***

7. Although auditors said it would be possible to audit managements' estimates of useful life, most auditors we spoke with said the IASB would need to provide application guidance, for example, on unit of account, when to use particular factors and so on.

### ***Usefulness of information associated with managements' estimates of the useful life of goodwill and its amortisation pattern***

8. Users of financial statements (users) had mixed views. Some Capital Markets Advisory Committee (CMAC) members 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 other CMAC members said amortisation would not provide useful information, for example because any amortisation charge would be arbitrary due to the difficulty of estimating the useful life of goodwill.

## **Background**

9. The IASB discussed the feasibility of estimating the useful life of goodwill and the pattern in which it diminishes<sup>2</sup> when it adopted an impairment-only model for the subsequent accounting for goodwill in 2004.

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<sup>2</sup> In the remainder of this paper, we'll discuss these two topics separately where it is clear stakeholders are referring to each topic separately. This paper uses the terms 'pattern in which goodwill diminishes' and 'amortisation pattern' interchangeably and with the same meaning.

10. Paragraph BC131D of the Basis for Conclusions on IAS 36 *Impairment of Assets* says stakeholders who expressed a clear view regarding an impairment-only or an amortisation-based model generally supported straight-line amortisation. One of the reasons was:

...

(c) the useful life of acquired goodwill cannot be predicted with a satisfactory level of reliability, nor can the pattern in which that goodwill diminishes be known. However, systematic amortisation over an albeit arbitrary period provides an appropriate balance between conceptual soundness and operationality at an acceptable cost: it is the only practical solution to an intractable problem.

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

...The Board observed that the useful life of acquired goodwill and the pattern in which it diminishes generally are not possible to predict, yet its amortisation depends on such predictions. As a result, the amount amortised in any given period can be described as at best an arbitrary estimate of the consumption of acquired goodwill during that period. The Board acknowledged that if goodwill is an asset, in some sense it must be true that goodwill acquired in a business combination is being consumed and replaced by internally generated goodwill, provided that an entity is able to maintain the overall value of goodwill (by, for example, expending resources on advertising and customer service). However, consistently with the view it reached in developing ED 3, the Board remained doubtful about the usefulness of an amortisation charge that reflects the consumption of acquired goodwill, when the internally generated goodwill replacing it is not recognised. Therefore, the Board reaffirmed the conclusion it reached in developing ED 3 that straight-line amortisation of goodwill over an arbitrary period fails to provide useful information. The Board noted that both anecdotal and research evidence supports this view.

### **Feedback to the Discussion Paper**

12. As discussed in [Agenda Paper 18D](#) to the IASB’s July 2021 meeting, feedback to the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* on whether it is feasible to reliably estimate the useful life of goodwill and the pattern in which it diminishes was mixed. Some respondents said a reliable estimate cannot be made, whereas some disagreed and said a reliable estimate can be made. This seems to indicate a possible shift in some stakeholders’ views compared to the feedback received in 2004 (see paragraphs 10–11). In particular, in response to a specific question<sup>3</sup> in the Discussion Paper, many respondents suggested basing the useful life of goodwill and amortisation pattern on managements’ estimates.
  
13. In its September 2021 meeting, the IASB asked us to investigate the feasibility of reliably estimating the useful life of goodwill and the pattern in which it diminishes. This would help the IASB better understand how entities would estimate the useful life of goodwill, the cost of making those estimates, the auditability of those estimates and the usefulness of the information resulting from those estimates were it to reintroduce amortisation of goodwill.

### **Process**

14. As part of our research, we reviewed, in more detail, comment letters to the IASB’s Discussion Paper from preparers, auditors, accounting bodies, regulators, users and academics who commented on estimating the useful life of goodwill. We discussed this topic at the November 2021 CMAC 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, via the International Forum of Accounting Standard-Setters (IFASS) and reviewed research papers and academic literature relevant to the topic. Appendix A provides more details of the process we followed.

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<sup>3</sup> Question 7(f) of the Discussion Paper asked ‘If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?’

15. Although our research focused on those who said it is possible to reliably estimate the useful life of goodwill, the feedback also includes contrary views offered by some stakeholders (including comments made by respondents to the Discussion Paper who said a reliable estimate of the useful life of goodwill cannot be made).
16. Appendix B summarises evidence gathered from the research of requirements and guidance in national generally accepted accounting principles (GAAP) on how to estimate the useful life of goodwill.

## Feedback

17. The feedback has been organised into the following sub-topics:
  - (a) feasibility of estimating the useful life of goodwill and the pattern in which it diminishes (paragraphs 18–84);
  - (b) auditability of the useful life of goodwill and its amortisation pattern (paragraphs 85–96); and
  - (c) usefulness of information associated with managements’ estimates of the useful life of goodwill and its amortisation pattern (paragraphs 97–106).

### ***Feasibility of estimating the useful life of goodwill and the pattern in which it diminishes***

18. Most respondents to the Discussion Paper who said it is feasible to reliably estimate the useful life of goodwill said doing so would be no more challenging than the judgements on useful life made for other tangible and intangible assets. A few respondents said that although subjective, estimating useful life would be no more and sometimes less subjective than estimating the assumptions for impairment tests. One preparer we spoke with said, in their view, things had changed in the last 20 years and the sophistication in how they do business combinations and review those business combinations has changed such that they can better estimate the useful life of goodwill.
19. Similarly, at the GPF meeting in November 2021, many members said it would be feasible to reliably estimate the useful life of goodwill. The rationale of some

members holding this view was that financial statements already contain many estimates and judgements that management have to make.

20. The remainder of this section discusses:
- (a) factors and methods to estimate useful life (paragraphs 21–47);
  - (b) capping the useful life (paragraphs 48–52);
  - (c) determining the amortisation pattern (paragraphs 53–57);
  - (d) comments suggesting it is not possible to reliably estimate the useful life of goodwill and amortisation pattern (paragraphs 58–61);
  - (e) information needed to estimate useful life and the associated cost (paragraphs 62–67);
  - (f) reassessing useful life in subsequent periods (paragraphs 68–74); and
  - (g) our initial observations (paragraphs 75–84).

*Factors and methods to estimate useful life*

21. Respondents to the Discussion Paper and preparers in follow-up discussions indicated a number of different factors that, depending on the applicable facts and circumstances, management could use to estimate the useful life of goodwill. For ease of analysis, we grouped those factors into different categories. Due to the nature of the factors, interrelationships between the categories, and differences in wording and level of detail provided by stakeholders, some factors might overlap between the different categories. These categories include:
- (a) factors that contribute to goodwill and the expected period over which benefits from goodwill are realised (paragraphs 23–26);
  - (b) expected period over which synergies are realised<sup>4</sup> from the business combination (paragraphs 27–30);
  - (c) expected period over which the business combination earns excess returns (paragraphs 31–33);

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<sup>4</sup> We think stakeholders who mentioned synergies as a factor to estimate useful life generally meant the period that the synergies, for example cost savings, were expected to benefit the entity rather than the period it is expected to take to achieve (implement) the cost savings.

- (d) expected period to achieve a business combination’s objectives (paragraphs 34–35);
  - (e) expected payback period (paragraphs 36–38);
  - (f) expected useful life of identified assets (paragraphs 39–44);
  - (g) expected period that would be required to create an equivalent business to that acquired (paragraph 45);
  - (h) expected period over which the business combination generates largely independent cash flows or increases cash flows (paragraph 46); and
  - (i) other factors (paragraph 47).
22. Factors suggested by other national standard-setters included in their national GAAPs, and by other studies, are similar to the factors set out within these categories. Appendix B summarises the factors from these other sources.

*Factors contributing to goodwill and expected period over which benefits from goodwill are realised*

23. Some respondents to the Discussion Paper suggested basing the useful life on factors contributing to goodwill and the period over which the benefits arising from that goodwill are expected to be realised. Entities would assess the reasons for the excess of consideration paid over the fair value of acquired net assets and estimate the useful life using that information. If goodwill is attributed to, for example, synergies (see also paragraphs 27–30) or an assembled workforce (see also paragraph 47(b)), entities would estimate the length of time over which those benefits are to be realised and use that information in assessing the useful life. These assessments would vary by business combination depending on the nature of, and reasons for, the business combination.
24. One preparer we spoke with explained how they would estimate the useful life of goodwill based on the factors contributing to goodwill. They said they would use the cash flow model that supported the price paid (and was also used as a basis for the valuation of the recognised assets). They would remove cash flows used to value the recognised assets—generally these would be the cash flows for the earlier periods in

the model—and then assess the useful life of goodwill by considering the remaining cash flows and the nature of goodwill.

25. Some preparers said if it were not possible to determine the factors that contribute to goodwill, they would use proxies. For example, they said they would use the average life of the recognised assets acquired (see paragraph 43) or would estimate the time it would take to build an equivalent business (see paragraph 45).
26. One preparer suggested amortising goodwill if, following an assessment of the nature of goodwill, it was concluded that goodwill predominantly had a finite useful life. However, if goodwill is assessed to have a predominantly indefinite useful life, then goodwill should, similar to other intangible assets with indefinite useful lives, be subject to an impairment-only model until such time it is concluded the life of the goodwill is finite. A few respondents to the Discussion Paper also suggested this as an alternative to an impairment-only model or an amortisation-based model.

#### *Expected synergies*

27. Most preparers we spoke with indicated synergies were a common factor contributing to goodwill. In their view (and in the view of many respondents to the Discussion Paper that commented on how to estimate the useful life) the estimate of the useful life of goodwill should be based on the period over which synergies are expected to be realised. A few respondents to the Discussion Paper said if at the acquisition date it is possible to provide information on the nature, timing and amount of synergies expected from the business combination,<sup>5</sup> it should also be possible to determine the period over which these synergies would be realised.
28. However, respondents to the Discussion Paper that said the amortisation period should be based on the period expected synergies are realised, generally offered no additional information about how to estimate that period. A few respondents said the estimates would depend on specific facts and circumstances and could be based on information from due diligence analysis.

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<sup>5</sup> One of the preliminary views in the Discussion Paper is to require entities to disclose, in the year of the acquisition, additional information about expected synergies from the business combination.

29. Preparers we spoke with provided more insight into how to estimate the period over which expected synergies would be realised. They said this estimate would depend on specific facts and circumstances and could be based on, for example:
- (a) the shorter of the life of the particular assets in the acquiring company's business that the synergies relate to, and the average lives of the assets acquired in the business combination. In their view, a longer period is not possible because this would require further investment which would result in internally-generated goodwill.
  - (b) the life cycle of products or services acquired which generate the synergies by complementing the entity's own products and services (see also paragraph 47(h)).
  - (c) contract terms, for example if the acquired business has a finite concession agreement.
30. Many preparers we interviewed said they would use proxies when synergies were considered to be indefinite. For example, of these preparers:
- (a) many said using present value techniques to measure these synergies means synergies expected to be realised in later years are less material due to the effect of discounting even though the synergies might extend over a long or indefinite period. These preparers would estimate the useful life based on the period over which a significant portion of the estimated synergies (for example, 90%) is expected to be realised.
  - (b) a few suggested setting a cap to address these situations.
  - (c) one said they would estimate useful life using other factors, for example, the period over which the entity expects to achieve the business combination's objectives (see also paragraphs 34–35).

### *Excess returns*

31. A few respondents to the Discussion Paper suggested basing the useful life of goodwill on the period over which the acquirer expects the acquired business to earn

excess returns.<sup>6</sup> In their view, this factor is conceptually sound because it would reflect the period which can reasonably be expected to elapse before a competitor could replicate or supersede the know-how, expertise or intellectual capital acquired that goodwill represents.

32. One preparer also said that even if a terminal value is used in the valuation model to determine the present value of an acquirer's ability to earn a higher rate of return this does not mean an entity should presume an indefinite useful life. This preparer also said that it was possible for them to isolate the period excess returns are earned because the preparer was regulated and the useful life would be based on the regulatory period over which the regulatory rate of return has been set.
33. One academic group responding to the Discussion Paper said there was academic evidence that the period of excess returns is finite and academic studies had estimated the period over which excess returns are earned. They also referred to academic studies that considered the factors that contribute to the persistence of excess returns (for example, the existence of barriers to entry, the retention of workforce skills, the market power of the combined entity and the dynamics of the market (see paragraphs 40–41 of [Agenda Paper 18F](#) to the IASB meeting in May 2021 for further details)).

#### *Business combination's objectives*

34. A few respondents to the Discussion Paper suggested estimating the useful life using the expected timeframe to achieve management's objectives for the business combination.
35. One respondent to the Discussion Paper said doing so would link the useful life with the metrics management uses to monitor the business combination's objectives and would be consistent with information about the subsequent performance of business combinations that would be disclosed applying the preliminary views expressed in the Discussion Paper.

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<sup>6</sup> We acknowledge that some stakeholders who suggested using excess returns might be saying the same thing as stakeholders who suggested using expected synergies but expressing it in a different way.

*Payback period*

36. A few respondents to the Discussion Paper and some preparers we spoke with suggested basing the useful life on the payback period. These stakeholders expressed different views on how to calculate a payback period. Many of them said the payback period is the period over which an acquirer expects to recover its total investment in the business combination, but some said it is the period over which the acquirer expects to recover the amount paid for goodwill. A few suggested calculating the payback period using discounted cash flows.
37. Some of those stakeholders who suggested using a payback period said, in their view, determining the payback period would be a good starting point, however, an entity should also consider other factors. For example, one respondent said the payback period itself would not faithfully represent the useful life of goodwill, and an entity would need to make appropriate adjustments. One preparer said they would also consider, for example, the nature of the business combination and what was acquired together with expected synergies and expectations of the industry's future growth. However, these stakeholders did not say how they would incorporate these other factors.
38. One preparer we spoke with said calculating the payback period is simple and accordingly, suggested using it in situations in which it may be difficult to estimate the useful life of goodwill because goodwill comprises different components.

*Useful life of identified assets*

39. A few respondents to the Discussion Paper and some preparers we spoke with suggested basing the useful life of goodwill on the useful life of other identified assets acquired in a business combination. Many of these stakeholders said this would be a good proxy of the useful life of goodwill. One respondent said this factor may be especially valid if an entity's operations significantly rely on a particular asset(s) and there is a reasonable correlation between the period of excess earnings from the business combination and the useful life of that asset(s).
40. One preparer said using this factor may be pragmatic if it is not easy to say what goodwill is and how it contributes to the cash flows.

41. Some of these stakeholders acknowledged that as a result of the business combination there might be wider benefits expected, such as synergies or future development of the business, but they said, in their view, these benefits will not go beyond the useful life of other identified assets acquired unless supported by additional investment which would result in internally generated goodwill.
42. Some respondents supporting this approach suggested looking at the useful life of the primary or major tangible and intangible assets acquired. However, they did not comment on how to identify those assets. One respondent suggested basing the useful life of goodwill on the useful life of the most important acquired intangible assets because the distinction between those intangible assets and goodwill is often arbitrary.
43. On the other hand, most stakeholders supporting this approach suggested using the weighted average useful life of other identified assets acquired or the weighted average useful life of the identified intangible assets acquired as a proxy of the useful life of goodwill. Those respondents provided different reasons to support their view and said using the weighted average life would:
- (a) be simple, objective, verifiable and would limit management’s judgement;
  - (b) reflect that goodwill is closely related to the acquired assets;
  - (c) reflect the consumption of benefits embodied in goodwill; and
  - (d) reflect their view that goodwill is a complimentary, rather than a residual, asset.
44. However, one respondent to the Discussion Paper and one auditor we spoke with disagreed and said using the useful lives of other identified assets acquired ignores that goodwill often represents unrecognised intangible assets to be developed in the future. Goodwill often represents cash flows generated after the useful life of the existing assets.

*Period to create an equivalent business*

45. Some preparers we spoke with suggested basing the useful life of goodwill on how long it would take to create a business similar to the one acquired. These stakeholders acknowledged this factor can be theoretical and may not work effectively for every business combination but, in their view, this factor can be useful especially for

business combinations aimed at acquiring a specific technology or know-how. They also said this factor would reflect that decisions to undertake a business combination are often assessed as ‘make or buy’ decisions. One of these preparers also explained they would use this factor to estimate the useful life of goodwill associated with synergies because, in their view, the period an entity benefits from synergies is the time saved by acquiring the business and generating those synergies, compared to how long it would take to generate those same synergies organically.

*Period over which the business combination generates largely independent cash flows*

46. A few respondents to the Discussion Paper, none of which were preparers, said that managements’ estimates of the useful life of goodwill could be based on the period the business combination generates largely independent cash flows or is expected to increase cash flows.

*Other factors*

47. Respondents to the Discussion Paper and preparers we spoke with also suggested other factors, including:
- (a) factors considered in determining the useful life of an intangible asset as listed in paragraph 90 of IAS 38 (see Appendix C);
  - (b) the historical turnover or the remaining term of employment of the assembled workforce;
  - (c) the period over which benefits from the business combination will be consumed, as implied by the price to earnings ratio of the business combination;
  - (d) the useful life of the cash generating unit (CGU) to which goodwill is allocated;
  - (e) the period over which the acquired entity is monitored and managed separately from the acquiring organisation, before its integration;
  - (f) the period before the terminal value assumption in the valuation model because the present value of assets in the terminal value tends to be close to zero;
  - (g) industry life cycles; and

- (h) the period of the expected life cycle of a specific product or technology acquired, with one preparer saying that most technology is finite because sooner or later it is replicated.

*Setting a cap*

- 48. Many respondents to the Discussion Paper suggesting the useful life should be based on managements' estimates also suggested specifying an upper limit for the amortisation period, with 10 or 20 years commonly mentioned. Some of those respondents said the cap could be rebuttable (that is, the cap can be rebutted if a longer useful life can be estimated).
- 49. Most members at the November 2021 GPF meeting also suggested specifying a cap. Some members said the cap would be a practical solution and some members said doing so would prevent entities from estimating excessively long useful lives.
- 50. During outreach, many preparers advocated a cap because, in their view:
  - (a) a cap would reduce the risk of entities using excessively long useful lives.
  - (b) it is difficult to justify that goodwill has not been replaced by internally generated goodwill beyond a particular point.
  - (c) a cap would improve comparability.
  - (d) a cap would be a practical solution particularly when:
    - (i) benefits from goodwill are expected to last for a long period; or
    - (ii) management cannot reliably estimate the useful life of goodwill. For example, for strategic acquisitions that give access to a new market, product or technology, it might be difficult to reliably estimate the useful life of goodwill.
- 51. Many auditors we spoke with said a cap may become an unintended default period. One auditor said a cap would break the link between accounting and economic reality and make the information obtained from the useful life of goodwill less meaningful. However, many auditors said a cap would be necessary to make the model operable and auditable, because it would be difficult to challenge entities that claim goodwill has an indefinite or an excessively long useful life. Auditor members of a Japanese accounting body also advocated a cap because, in their view:

- (a) it is difficult to differentiate between internally generated goodwill and acquired goodwill; and
  - (b) there is uncertainty about the nature of goodwill.
52. Some national standard-setters said when a rebuttable cap (or a default period) is specified in national GAAP, entities tend not to rebut that presumption and therefore do not deviate from that stated period.

*Amortisation pattern*

53. Many respondents to the Discussion Paper that suggested amortising goodwill based on management's estimate of its useful life also suggested basing the amortisation pattern on managements' estimates. In their view, the manner in which goodwill is consumed differs for each business combination and a straight-line amortisation pattern would be arbitrary. Some of those respondents said the amortisation pattern should reflect the realisation of expected synergies or should be aligned with the amortisation pattern of other acquired assets.
54. Many of the preparers we spoke with did not specifically comment on amortisation pattern. It is possible that comments on how entities would estimate the useful life of goodwill would also apply to determining the pattern (for example, basing the pattern on the period over which synergies are expected to be realised). However, many other preparers did specifically comment on amortisation pattern. Of those that commented:
- (a) many said the pattern should not necessarily be straight-line with some operating in the energy industry suggesting linking the pattern to that used for the primary asset(s) acquired (for example, oil reserves); and
  - (b) many said a straight-line approach should be adopted as a practical solution, but some suggested entities should be able to apply a different pattern if more appropriate.
55. A few respondents and preparers we spoke with said beginning amortisation when the acquired business starts delivering benefits rather than from the acquisition date might better reflect goodwill consumption. However, one academic respondent, although agreeing that goodwill consumption may not start from the acquisition date, said allowing this to be reflected would increase the risk of earnings manipulation.

56. Many other respondents to the Discussion Paper that suggested amortising goodwill based on management estimates suggested using a straight-line amortisation pattern because it is simple. For example, one user group said ideally the amortisation pattern should be consistent with the payback pattern, but considering complexity they said straight-line amortisation would be appropriate.
57. One respondent suggested using the ‘reverse sum of the years digits method’,<sup>7</sup> which some Australian companies used before adopting IFRS Accounting Standards. Using this method, although arbitrary, the amortisation rate increases over time and, in their view, this would better match the amortisation charge with increasing returns from the business combination.

*Comments from stakeholders that questioned some of the suggestions made*

58. As discussed in paragraph 15, although our outreach was aimed to gather information from respondents to the Discussion Paper who said it is possible to reliably estimate the useful life of goodwill, feedback to the Discussion Paper was mixed and some respondents said a reliable estimate cannot be made. A few stakeholders we spoke with, also questioned some of the suggestions made by stakeholders for estimating the useful life of goodwill.
59. For example, these respondents and stakeholders said:
- (a) because of difficulties of estimating the useful life of goodwill, any amortisation charge would be arbitrary;
  - (b) estimating the useful life of goodwill is different to estimating other assets’ useful lives because the useful life of goodwill cannot be benchmarked;
  - (c) goodwill has, in their view, an indefinite life, and accordingly, there is no conceptual basis for determining an amortisation period;
  - (d) they would question whether the useful life of goodwill would reflect the economic reality of post-acquisition performance;

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<sup>7</sup> Applying this method, the amortisation rate is calculated as the number of years after acquiring the asset divided by the sum of every year through the asset's life. For example, assuming a useful life of 20 years, in the first year 1/210 of asset’s value would be amortised, in the second year 2/210 and in the last year 20/210 (210 is the sum of every year through the asset’s life, that is 1+2+3+...+19+20).

- (e) goodwill contains wasting and non-wasting elements and it is difficult to separate these; and
- (f) entities suggest using proxies such as the useful lives of other identified assets or the payback period to estimate the useful life of goodwill because they are simple solutions.
60. Our review of academic literature highlighted that several studies provide evidence that entities made use of the maximum allowed period for goodwill amortisation (up to 40 years under US GAAP of the time), documenting amortisation periods of over 30 years on average under US GAAP. The useful lives may not always have reflected goodwill's useful life but may instead have been influenced by capital-markets related, contracting or political motives. For example, Skinner (1993)<sup>8</sup> finds extended amortisation periods for firms with accounting-based bonus plans and high leverage. Hall (1993)<sup>9</sup> investigated whether managers are influenced by economic consequences when selecting amortisation periods. Results indicate that the choice is affected by proxies for political costs and the nearness of the entity to its debt covenant constraints.
61. Duvall, et al (1992)<sup>10</sup> comments on some criticism of the US GAAP accounting standard of the time<sup>11</sup> because it allowed 'such wide latitude in the selection of amortization periods that provisions for goodwill expense may be unduly optimistic'. Henning And Shaw (2003)<sup>12</sup> refer to a December 1997 letter to the International Accounting Standards Committee from the Association of Investment Management and Research (AIMR) Financial Accounting Policy Committee (FAPC) that stated the majority view that goodwill amortisation is unrelated to the assessment of future cash flows. They said amortisation encourages income statement and balance sheet

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<sup>8</sup> Skinner, D.J. (1993), 'The Investment Opportunity Set and Accounting Procedure Choice', *Journal of Accounting and Economics*, Vol. 16, No. 4, pp. 407–445.

<sup>9</sup> Hall, S.C. (1993), 'Determinants of Goodwill Amortization Period', *Journal of Business Finance & Accounting*, Vol. 20, No. 4, pp. 613–621.

<sup>10</sup> Duvall, L., R. Jennings, J. Robinson and R. B. Thompson II (1992), 'Can Investors Unravel the Effects of Goodwill Accounting?', *Accounting Horizons*, Vol. 6, No. 2, pp. 1–14.

<sup>11</sup> American Institute of Certified Public Accountants, Accounting Principles Board Opinion No. 17—*Intangible Assets (1970)* required amortisation of goodwill over a period not exceeding 40 years.

<sup>12</sup> Henning, S. L. and W. H. Shaw (2003), 'Is the Selection of the Amortization Period for Goodwill a Strategic Choice?', *Review of Quantitative Finance and Accounting*, Vol. 20, No. 4, pp. 315–333.

manipulation that may not be easily undone by investment professionals because of insufficient disclosure related to the amortisation charge and/or the selected useful lives. In addition, Henning and Shaw (2003) also refer to an October 1998 letter to Lynn Turner, Chief Accountant at the U.S. Securities and Exchange Commission in which AIMR FAPC expressed concern about earnings management in six areas of financial reporting, including discretion surrounding the estimation of useful lives.

*Information needed and the associated cost*

62. Feedback from respondents to the Discussion Paper on the cost of estimating the useful life of goodwill was mixed, although not many respondents commented on this. A few respondents said there would not be significant incremental costs because the information needed is generally available and entities already make similar estimates for other assets. However, a few said the cost of estimating the useful life of goodwill would be significant because of:
  - (a) the subjectivity of the estimate;
  - (b) the documentation and analysis needed to support the estimate; and
  - (c) the cost of auditing the estimate.
  
63. Almost all preparers we spoke with did not express concerns about the cost. One said removing the requirement for an annual impairment test would help offset the costs of estimating the useful life. Others said there would be an incremental, one-off cost for each business combination but that this cost would not be significant.
  
64. Those preparers said, at the time of a business combination, management has information needed to estimate the useful life of goodwill or can easily access that information. They said this would include information from:
  - (a) due diligence materials;
  - (b) documents used to make the investment decision or justify the price paid (for example, valuation models and analysis of products and services or of markets); or
  - (c) other reports prepared by external parties.
  
65. A few national standard-setters commented on the information needed and the associated costs of estimating the useful life of goodwill under national GAAP. One

national standard-setter from Asia provided feedback similar to that discussed in paragraph 64 and said, in their jurisdiction, entities use information in documents presented to the body that makes investment decisions, including reports prepared by external experts, such as due diligence or pricing reports.

66. However, one national standard-setter from Europe said their national GAAP presumes that goodwill has an indefinite useful life but allows entities to rebut this presumption if physical, technical, legal or economic factors indicate the useful life is finite. The standard-setter said goodwill is not generally amortised and this is because of the undue cost and effort involved in estimating its useful life.
67. Another national standard-setter from Europe surveyed IFRS reporters in their jurisdiction about the cost of estimating the useful life of goodwill if the IASB were to reintroduce amortisation of goodwill. Thirty-nine per cent of respondents said reintroducing amortisation would result in either a substantial reduction, a minor reduction, or minimal or no impact on costs. Forty-eight per cent of respondents anticipated a minor increase in costs as a result of reintroducing amortisation and 13% of respondents anticipated a significant increase in costs. Increases were anticipated in implementation costs (for example, developing a model for estimating the useful life of goodwill) and ongoing costs (for example, costs needed to reassess the useful life of goodwill).

*Reassessing useful life in subsequent periods*

68. During interviews with preparers and auditors, we asked whether an entity would be able to reassess the useful life of goodwill in subsequent periods and whether the useful life should be reassessed. Almost all responding to these questions said entities should be able to reassess the useful life. They said reassessing the useful life of goodwill would be consistent with the requirement to reassess the useful life of other assets such as property, plant and equipment and the information to do this would be available. One auditor said an amortisation model without a reassessment requirement would provide less useful information because it would break the link between the accounting and economic reality.
69. One preparer, although agreeing that the useful life should be reassessed, said doing so could be difficult if, for example, goodwill mainly consists of synergies. It may be

difficult for an entity to determine whether synergies have been realised as expected when the acquired business has been integrated.

70. A member of a preparer group also said entities may find reassessment difficult if goodwill has been allocated to different CGUs or if the composition of these CGUs has changed after the business combination.
71. Many stakeholders favouring reassessment suggested that it should take place when there is an indication that the expected useful life differs from previous estimates (an indicator approach). Most of these stakeholders said the useful life should only be reduced and not increased as a result of the reassessment because, in their view, a reassessment performs a similar function to an impairment test. One auditor cautioned linking any reassessment to the impairment test because the impairment test applies to a different unit of account—CGUs containing goodwill rather than goodwill itself. Some auditors said the useful life should not be increased because it would risk including internally generated goodwill in the reassessment. One preparer said being able to extend the amortisation period could lead to earnings manipulation.
72. Some stakeholders said subsequently extending the useful life could be justified only in some circumstances. However, one auditor suggested prescribing the circumstances when this could happen.
73. A few preparers said if it is possible to link the useful life of goodwill to a particular asset, the reassessment would not be significantly costly. For example, a preparer operating in the energy industry said a review of the useful life and the amortisation pattern would be based on its annual assessment of oil and gas reserves.
74. However, one preparer disagreed that the useful life should be reassessed and said that, although a reduction of the useful life is conceptually possible, the impairment test should deal with any reductions in the useful life.

*Our initial observations*

75. Our outreach with preparers highlighted several factors entities could use to estimate the useful life of goodwill (see paragraphs 21–47). Feedback from national standard-setters identified further factors entities might use (see Appendix B).
76. We think this diversity in factors is likely to be influenced by:

- (a) different facts and circumstances of each business combination;
  - (b) different judgements of what goodwill is and whether it has an indefinite life; and
  - (c) different preferences in the factors selected—for example, selecting a simple, observable factor.
77. Some preparers we spoke with said estimating the useful life of goodwill would be relatively easy because of the nature of the businesses they acquire. Most of these preparers were from the energy industry and said the businesses they acquire are associated with finite natural resources and therefore the useful lives of the associated assets or reserves could be used to estimate the useful life of goodwill. A few preparers gave examples of businesses with regulated assets or businesses subject to a finite term concession agreement, and for these businesses the useful life of goodwill would be linked to those regulated assets or concession agreements.
78. However, feedback suggests estimating the useful life of goodwill would be less straightforward when goodwill does not have an observable finite life. When discussing how entities would estimate the useful life of goodwill in these circumstances some preparers said they would consider several factors and weigh these up in estimating the useful life.
79. If the IASB were to reintroduce amortisation, we think the IASB will need to consider whether diversity arising from different entities using different factors would result in reliable estimates of the useful life of goodwill being made or whether application guidance would be needed.
80. Many preparers also suggested that if the benefits included in goodwill are considered to be indefinite, or if entities are unable to determine the nature of goodwill, management could use proxies, such as:
- (a) the useful life of another acquired asset(s);
  - (b) the payback period;
  - (c) the cap if specified; or
  - (d) their own maximum period (see paragraph 30(a)).

81. Although these proxies provide an easier means of estimating the useful life of goodwill, there could be some doubts whether these would result in a reliable estimate of the useful life of goodwill and the pattern in which it diminishes. In particular:
- (a) using the useful life of another asset(s) as a proxy might not faithfully represent the useful life of goodwill if the benefits represented by goodwill relate to future products or developments in technology, or future developments as a consequence of new relationships in new markets or jurisdictions. In addition, as one preparer explained (see paragraph 24), the cash flows in the valuation model in the early years tend to relate to the identified assets and liabilities rather than the acquired goodwill.
  - (b) using a payback period could be counterintuitive: a good business combination (that generates significant benefits quickly) would have a short payback period and a short useful life for goodwill resulting in a higher amortisation charge per period. It is possible users could, when comparing to an entity with goodwill with a longer useful life, assess the first business combination less favourably because the use of a shorter useful life implies the benefits represented by goodwill are expected to last for a much shorter period. In addition, if the payback period is determined based on the period to recoup the entire investment in the business combination, this may not always reflect the period the entity realises the benefits represented by goodwill. Similar to (a), the cash flows in the short-term are more likely to relate to the identified assets and liabilities rather than to the goodwill.
  - (c) using a cap could break the link between accounting and economic reality and is more likely to result in an arbitrary amortisation period. Although we acknowledge that setting a cap could help avoid excessively long amortisation periods, we think that it could be difficult to prevent entities using it as a default period.
82. Many respondents to the Discussion Paper suggesting the useful life should be based on managements' estimates said a cap should be put in place. Many members in the November 2021 GPF meeting and many of the preparers we spoke with also suggested a cap was needed either for practical reasons or to prevent excessively long useful lives being selected. We think this might cast some doubt on whether a reliable

estimate of the useful life of goodwill can be made if a cap is needed to make the amortisation model operable.

- 83. Academic research (see paragraphs 60–61) highlights stakeholder concerns about the reliability of managements’ estimates of the useful life of goodwill made under the previous US GAAP amortisation model.
- 84. Feedback on whether entities can reliably estimate the useful life of goodwill is mixed. We have not found clear evidence that the IASB’s conclusion in 2004, that a reliable estimate of the useful life of goodwill cannot be made, no longer holds true.

***Auditability***

- 85. A few respondents to the Discussion Paper indicated auditability of managements’ estimates of the useful life of goodwill as a possible area of concern. For example, the global auditing standard-setter cautioned against reintroducing amortisation because of auditability issues related to determining the amortisation period and the substantial judgement involved.
- 86. However, during subsequent outreach, most preparers said auditing managements’ estimates of the useful life of goodwill would be no more difficult and costly than auditing other estimates and judgements, such as those used in the impairment test.
- 87. We also heard other views and some cautionary remarks from some preparers. For example:
  - (a) one preparer said the judgements required would be more subjective than those required to perform the impairment test because it is difficult to know what goodwill is whereas the impairment test is supported by cash flow forecasts;
  - (b) one preparer said estimates of the useful life of goodwill would be auditable if the requirements were not too prescriptive; and
  - (c) one preparer said it may be harder to audit managements’ estimates of the useful life of goodwill if there is no cap (see also paragraphs 48–52).
- 88. We also spoke with auditors. All of these auditors said they would be able to audit managements’ estimates of the useful life of goodwill. They said doing so would not

be much different to auditing the impairment test or the identification of acquired intangible assets in a business combination—they audit judgements all the time. One auditor said evidence from jurisdictions which require or permit amortisation in national GAAP, for example Japan and Germany, confirms auditors can audit managements' estimates about the useful life of goodwill.

89. However, most of these auditors said application guidance or illustrative examples would be needed to help them enforce the requirements. One auditor said people have different views of what goodwill is and without application guidance diversity in practice will occur, it will be difficult to challenge managements' judgements and entities might be able to manage earnings. In particular, they suggested:
- (a) providing a list of factors, additional to those in IAS 38 (see Appendix C), to be considered in estimating the useful life of goodwill and application guidance or examples illustrating when to use different factors. For example, one auditor said because their national GAAP refers to a reasonable payback period as one of the factors entities can consider when estimating the useful life of goodwill, in their view, there are no auditability issues.
  - (b) clarifying the unit of account entities should consider when estimating useful life of goodwill because goodwill may consist of more than one component.
  - (c) providing guidance on whether to reflect future maintenance expenditure in estimates of the useful life of goodwill and what differences there are between how the useful life is assessed for acquired goodwill and other intangible assets. In their view, judgements required to distinguish if these cash outflows relate to acquired goodwill or internally generated goodwill would be more subjective than those required in IAS 38 in assessing the useful life of other intangible assets.<sup>13</sup>

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<sup>13</sup> Paragraph 91 of IAS 38 states that the useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset's useful life, and the entity's ability and intention to reach such a level.

90. On the other hand, one auditor said existing requirements in IAS 38 about estimating the useful life of intangible assets other than goodwill would be sufficient to audit managements' estimates of the useful life of goodwill.
91. Many auditors said a cap would make the useful life estimate auditable. A cap would help challenge entities claiming goodwill has an indefinite or an excessively long useful life. However, another auditor said a cap would seldom be challenged by auditors when entities use the cap.
92. One auditor also questioned whether it was worth investing the time and effort in estimating the useful life of goodwill if analysts remove amortisation from their valuations.
93. Some national standard-setters and regulators commented on whether auditors can, and do, challenge managements' estimates of the useful life of goodwill in jurisdictions where their national GAAP includes an amortisation model:
- (a) one regulator from Europe said the challenge of management's assumptions is a theme that has been raised a number of times in the quality review of audits in that jurisdiction;
  - (b) one national standard-setter from Europe said an estimated useful life exceeding 20 years is usually subject to additional audit scrutiny; and
  - (c) a few national standard-setters said auditors obtain sufficient evidence by applying *ISA 540 Auditing Accounting Estimates and Related Disclosures*.

#### *Our initial observations*

94. Feedback from auditors suggests that auditing managements' estimates of the useful life of goodwill would not be significantly more difficult than auditing other estimates and judgements. However, most auditors said application guidance and a cap would be necessary to audit and enforce the requirements.
95. We think if the IASB were to develop requirements or provide application guidance on some of the matters suggested—for example, unit of account, assumptions about maintenance expenditure, what factors to use and when—this may require the IASB to make conceptual decisions about the nature of goodwill which it might not otherwise need to.

96. We also think if a cap is needed to audit and enforce the requirements, this might cast some doubt on how effectively auditors would be able to challenge judgements entities make.

***Usefulness of information associated with managements' estimates of the useful life of goodwill***

97. Many respondents to the Discussion Paper who said the useful life of goodwill can be reliably estimated said managements' judgements about useful life could provide useful information. For example, those judgements could provide useful information about managements' expectations of the period over which an entity expects to realise benefits associated with goodwill, the nature of goodwill and managements' expectations of the period to recover the investment. An amortisation model could provide useful information by allocating the cost attributed to goodwill to periods in which goodwill's benefits are realised providing useful information on the business combination's performance.
98. However, as discussed in [Agenda Paper 18C](#) to the May 2021 IASB meeting, some respondents who agreed with the IASB's preliminary view to retain the impairment-only model said an amortisation charge would be arbitrary and would not provide useful information for users because of the difficulty of estimating the amortisation period and pattern of goodwill consumption.
99. Whether information about the useful life of goodwill and the pattern in which goodwill diminishes would be useful was discussed at the November 2021 CMAC meeting.
100. Some CMAC members said a useful life and amortisation pattern based on management's estimate would provide useful information. In particular:
- (a) one CMAC member said an amortisation charge would provide insights into what to expect from goodwill. That CMAC member also said the amortisation charge in the income statement, together with the revenue generated by the business combination would better reflect the performance of the entity.

- (b) another CMAC member, although uncertain as to whether the amortisation charge itself would be useful, said management's estimate of the useful life would provide insight into management's thinking regarding the recovery period for the investment. That CMAC member also said, if an impairment loss were to be recognised during the useful life, it would be possible to infer that the acquisition had not progressed according to management's expectations.
  - (c) one other CMAC member said the amortisation charge itself would not be useful, but information about management's thought process when determining the useful life would help explain the rationale for the purchase price.
101. However, many other CMAC members said they generally favour an impairment-only model because amortisation would not provide useful information. They said:
- (a) an amortisation model had been tried before and analysts ignored the amortisation charge.
  - (b) the useful life of goodwill will always be arbitrary and entities will use the maximum period allowed.
  - (c) the impairment-only model better reflects whether a business combination is accretive. An amortisation model would treat all business combinations similarly and would not provide real insight into management performance.
  - (d) from a credit perspective, it is important to be able to determine future cash flows and amortisation would not provide information that would help make that determination. Impairment information helps make that determination because the impairment test is based on future cash flows.
102. We also discussed the usefulness of the information associated with managements' estimates of the useful life of goodwill with a Japanese user group. In their view, an amortisation period based on management's estimates would:
- (a) provide insight into management's expectations on the period to recoup the investment;

- (b) make the impairment test more meaningful, because an impairment loss would convey that the business combination is not meeting expectations; and
  - (c) help compare entities that grow organically with entities that grow through acquisitions.
103. As detailed in [Agenda Paper 18F](#) to the IASB’s May 2021 meeting, the conclusion from Amel-Zadeh et al’s literature review<sup>14</sup> on the decision usefulness of goodwill is that the value relevance of goodwill—its association with share prices and returns—and the predictive ability of goodwill for future cash flows, increased after the introduction of the impairment-only model relative to when entities reported using amortisation-based approaches. The evidence on whether decision usefulness of impairment losses on goodwill changed as a result of the impairment-only model is mixed. However, academics note that comparing the quality of financial reporting using the impairment-only model and the amortisation model is difficult due to variation in reporting practices for goodwill across jurisdictions before the introduction of the impairment-only model.
104. Although most academic studies we found suggest amortisation is not value relevant, some academic studies support a different view. For example, Amel Zadeh et al (2020)<sup>15</sup> provides evidence that an amortisation with impairment model provides value relevant information— based on a sample of 414 UK entities applying UK GAAP in the period 1998–2004 both impairment losses on goodwill and amortisation expenses were negatively associated with share prices and returns.

*Our initial observations*

105. As discussed in paragraphs 97–104, managements’ estimates of the useful life of goodwill could provide useful information. However, whether useful information is provided depends on the estimate of the useful life of goodwill being reliable and, as

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<sup>14</sup> Amel-Zadeh, A., Glaum, M., and Sellhorn, T. (2021), 'Empirical Goodwill Research: Insights, Issues and Implications for Standard Setting and Future Research' *European Accounting Review*.

<sup>15</sup> Amel-Zadeh, A., Faasse, J., Li, K., and Meeks, G. (2020), 'Stewardship and Value-Relevance in Accounting for the Depletion of Purchased Goodwill', in A. Amel-Zadeh and G. Meeks (eds.), *Accounting for M&A: Uses and Abuses of Accounting in Monitoring and Promoting Merger* (London: Routledge), 79-112.

discussed in paragraphs 75–84, it is questionable whether that estimate would always be reliable.

106. In order for the requirements to result in reliable estimates of the useful life of goodwill, those requirements need to be enforceable. As discussed in paragraph 89, the IASB would need to consider whether to provide application guidance to assist the enforcement of any requirements for entities to estimate the useful life of goodwill.

**Question for the IASB**

Do IASB members have any questions or comments on the feedback discussed in this paper? Specifically:

(a) is any feedback unclear?

(b) are there any points you would like us to research further prior to deciding whether to reintroduce amortisation of goodwill?

## Appendix A—Process

A1. This section summarises the process we followed to gather information on whether it is feasible to estimate a useful life of goodwill and the pattern in which it diminishes.

### Preparers

A2. We spoke with preparers and preparer groups to gather information on whether it is feasible to reliably estimate the useful life of goodwill, the pattern in which goodwill diminishes, and what information preparers would use to make these estimates:

- (a) we had 12 one-to-one meetings with preparers and preparer groups who indicated in their comment letters to the Discussion Paper that it is possible to reliably estimate the useful life of goodwill.
- (b) we discussed this topic at the November 2021 GPF meeting and had further one-to-one meetings with five members who indicated that, in their view, it would be possible to reliably estimate the useful life of goodwill.
- (c) we received feedback on this topic from two preparers who took part in our research on the practical concerns raised by respondents to the Discussion Paper on some additional disclosure requirements considered by the IASB (discussed at the IASB’s April 2022 meeting).

A3. In total, this outreach involved 19 preparers. The following table summarises the regions and industry sectors of the preparers involved:

Industry	Region						Total
	Africa	Asia	Europe	Latin America	North America	Oceania	
Automotive			2				2
Conglomerate		1					1
Energy			2	1	1	1	5
Financial services	1		4		1		6
Logistics		1					1
Retail			1				1
Technology		1	2				3
<b>Total</b>	<b>1</b>	<b>3</b>	<b>11</b>	<b>1</b>	<b>2</b>	<b>1</b>	<b>19</b>

- A4. During those meetings we discussed:
- (a) how to estimate the useful life of goodwill, and the pattern in which it diminishes:
    - (i) in the year of the business combination; and
    - (ii) subsequently (if the entity was required to reassess its estimates in future periods);
  - (b) what factors would be used and what information would be needed to make these estimates and whether such information is readily available; and
  - (c) the costs entities would face if the IASB required them to estimate the useful life of goodwill and pattern in which it diminishes.

### **Users**

- A5. We spoke with users to understand whether an amortisation-based model using managements' estimates of the useful life of goodwill could provide useful information and what information, if any, users would lose.<sup>16</sup> In particular, we:
- (a) discussed this topic at the November 2021 CMAC meeting; and
  - (b) met with a user group from Japan—because entities in Japan can apply an impairment-only approach required by either IFRS Accounting Standards or US GAAP, or an amortisation-based model required by national GAAP.

### **Auditors**

- A6. Auditors' views were obtained in five one-to-one meetings and, for reasons discussed in paragraph A5, with members of a Japanese accounting body. At these meetings we discussed whether managements' estimates of useful life could be audited.

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<sup>16</sup> In commenting on the Discussion Paper, some users said if the IASB were to reintroduce amortisation they would lose information they currently receive when impairment losses are recognised. This is because amortisation would reduce the likelihood of an entity recognising an impairment loss, and therefore would reduce the information value of the impairment test.

### **National Standard-setters**

- A7. We sent an information request to national standard-setters, via the IFASS, to gather information on how goodwill amortisation periods were determined in national GAAPs which require the use of an amortisation model. Specifically, we asked whether:
- (a) national GAAP provides a default period, the reasons for setting a default period and how that default period was determined;
  - (b) national GAAP allows entities to deviate from a default period based on specific facts and circumstances (rebuttable presumption) and, if so, whether in practice entities tend to deviate from the default period, and what evidence entities provide to support any deviation; and
  - (c) applying national GAAP, useful life is determined on the basis of management’s best estimate and, if so, whether national GAAP provides a list of indicators or factors to consider, how entities make these estimates and whether auditors and regulators can, and do, challenge these estimates.
- A8. In total we received feedback from 15 national standard-setters and one regional group of national standard-setters. Of the 16 responses, seven were from Europe, five from Asia-Oceania, three from Latin America and one from North America.
- A9. In July 2019, the US national standard-setter, the Financial Accounting Standard Board (FASB), published an Invitation to Comment *Identifiable Intangible Assets and Subsequent Accounting for Goodwill* (ITC) in which it asked for stakeholders’ inputs on the subsequent accounting of goodwill and considered, together with other topics, whether to reintroduce amortisation of goodwill. Our analysis considers feedback to the ITC and further tentative decisions made by the FASB.

### **Academic literature**

- A10. We reviewed research papers and academic literature relevant to this topic. This review was based on:

- (a) published and working papers identified from relevant academic literature reviews, including the academic evidence presented in [Agenda Paper 18F](#) to the May 2021 meeting of the IASB; and
- (b) relevant research papers published since 2013 by national standard-setters.

## **Appendix B—Factors to estimate the useful life of goodwill from other national GAAPs, other studies and discussions**

B1. We considered factors to estimate the useful life of goodwill from national GAAPs and other studies and discussions. This section summarises this evidence.

### ***Recent FASB discussions***

B2. During its November 2021 meeting, the FASB discussed the FASB staff’s research and analysis on the elements of an estimated goodwill amortisation model as part of its project *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*. Although the FASB made no decisions, they discussed a possible list of factors entities could consider when estimating the goodwill amortisation period. The factors were:

- (a) the expected useful life of the underlying assets:
  - (i) the useful life of the primary asset acquired; and
  - (ii) weighted average of the useful lives of the acquired assets.
- (b) discounted payback method—the period over which a specified percentage of the purchase price is recovered using the cash flows on which the business combination was based, on a discounted basis.
- (c) the legal, regulatory, or contractual provisions that may affect the useful life of the acquisition.
- (d) value creation—effect of synergies on the consolidated entity’s future cash flows.
- (e) diversification—effect of the diversified business operations on consolidated cash flows.
- (f) effect of acquiring an entity in a defensive acquisition.
- (g) placeholder for other factors as appropriate to the specific facts and circumstances of the business combination if there is an open list.
- (h) undiscounted payback period—the period over which a specified percentage of the purchase price is recovered using the cash flows on which the business combination was based, on an undiscounted basis.

- (i) estimated useful life of material intangible assets not separately identified from goodwill. A useful life may parallel the service life expectancies of individuals or groups of employees.
- (j) product life cycle—time period over which a product is expected to be viable in a market.
- (k) time periods over which an acquiree, on a standalone basis, is expected to maintain higher future cash flows (or excess earnings power) compared with competitors in the industry.
- (l) increase in financial capacity.
- (m) industry-specific indicators, such as tangible book-value earn back.
- (n) make versus buy—the amount of time it would have taken to develop the technology, customer base, or other value gained in the acquisition.
- (o) historical performance of the acquiree.
- (p) period over which deferred tax assets arising from the business combination will be recovered.

B3. During the meeting, the FASB indicated its leanings to including factors (a) through (g) plus (j) and (k) as examples that entities may refer to when estimating the amortisation period for goodwill.

***Other studies and discussions***

B4. The Feedback Statement on the Discussion Paper *Should Goodwill still not be Amortised?* jointly published in July 2014 by European Financial Reporting Advisory Group (EFRAG), Organismo Italiano di Contabilità (OIC) and the Accounting Standards Board of Japan (ASBJ), listed the following factors suggested by respondents:

- (a) the period over which the acquirer expects to earn excess return over the theoretical case of a standalone business;
- (b) the expected payback period;
- (c) useful life of a primary identifiable long-lived asset;

- (d) economic assumptions that were used to price the transaction; and
- (e) type of industry (for example, hi-tech segments have a short life cycle of 3 to 5 years, while pharma has a longer cycle of 10 to 15 years).

B5. The ASBJ's Research Paper 1 *Amortisation of Goodwill* published in May 2015 surveyed Japanese entities applying Japanese GAAP<sup>17</sup> and asked about factors considered when determining the useful life for goodwill.<sup>18</sup> Respondents to this survey indicated they consider:

- (a) the time period over which an acquiree, on a stand-alone basis, is expected to maintain higher future cash flows;
- (b) the time period over which synergies resulting from acquirer and an acquiree are expected to be realised;
- (c) the expected payback period of the business combination;
- (d) the useful lives of related identifiable primary assets;
- (e) uncertainty about the estimate of the period over which goodwill is expected to have an effect;
- (f) average number of periods over which unrecognised intangible assets are expected to have an effect;
- (g) risks of overstating assets in balance sheets (including risks pertinent to start-up companies and macro-economic risks);
- (h) an entity's financial capacity; and
- (i) size of goodwill.

### **National GAAPs**

B6. In response to our request to IFASS (see paragraph A7), many national standard-setters provided information about the factors to use in estimating the useful life of

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<sup>17</sup> Japanese GAAP requires goodwill to be amortised over the period for which goodwill is expected to have an effect, which shall not exceed 20 years.

<sup>18</sup> The research carried out by the ASBJ in this paper followed on from the joint research carried out by the ASBJ, EFRAG and the OIC on subsequent accounting of goodwill in paragraph B4.

goodwill included in their respective national GAAPs or, in some cases, their national GAAPs prior to adoption of IFRS Accounting Standards.

B7. For example, the old Australian Accounting Standard (AAS) 18 *Accounting for Goodwill* included the following factors:<sup>19</sup>

- (a) effects of obsolescence, demand and other economic factors;
- (b) the service life expectancies of individual employees or groups of employees;
- (c) expected actions by competitors or potential competitors;
- (d) relevant legal, regulatory or contractual provisions; and
- (e) foreseeable life of the entity or industry.

B8. The German Accounting Standard (GAS) 23 *Accounting for Subsidiaries in Consolidated Financial Statements* lists the following factors:<sup>20</sup>

- (a) the expected life and development of the acquired entity, including legal or contractual requirements;
- (b) the life cycle of the products of the acquired entity;
- (c) the effects of expected changes in sales and procurement markets as well as in the economic, legal and political environment affecting the acquired entity;
- (d) the level and timing of maintenance expenditures required to realise the expected economic benefits from the acquired entity, and the ability of the entity to finance those expenditures;
- (e) the term of material sales and procurement agreements of the acquired entity;

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<sup>19</sup> The estimated useful life must not exceed 20 years. The Standard also states that in order to amortise goodwill over the period during which the associated benefits are expected to arise, separate assessments may need to be made in respect of different goodwill components (such as those relating to the purchase of different businesses) to the extent that such components can be separately identified.

<sup>20</sup> If the useful life cannot be reliably estimated a default period of 10 years is used.

- (f) the expected duration of employment of key personnel of the acquired entity;
  - (g) the expected behaviour of (potential) competitors of the acquired entity; and
  - (h) the sector and expected trends in that sector.
- B9. Portuguese accounting standards require goodwill to be amortised and the useful life of goodwill takes into consideration:<sup>21</sup>
- (a) the expected use of the asset by the acquiring entity;
  - (b) the typical life cycles for the asset and public information on useful life of similar assets;
  - (c) technological or technical obsolescence;
  - (d) control period and possible legal restraints; and
  - (e) other related assets useful lives, from the entity.
- B10. The Italian accounting standard OIC 24 *Intangible Assets* lists the following factors that may be used:<sup>22</sup>
- (a) the expected period in which the acquirer expects to receive additional economic benefits from the acquired business or from the synergies generated by the business combination;
  - (b) the period in which the acquirer expects to recover its investment (so called payback period); and
  - (c) the weighted-average useful lives of the main assets acquired in the business combination (including intangible assets).
- B11. Paragraph 382 of the Implementation Guidance on the *Accounting Standard for Business Combinations and Accounting Standard for Business Divestures* in Japanese GAAP says in practice, an entity may consider a reasonable expected payback period of the investment when determining the amortisation period of goodwill.

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<sup>21</sup> If the useful life cannot be reliably estimated a default period of 10 years is used.

<sup>22</sup> If the useful life cannot be reliably estimated, goodwill is amortised over a period not exceeding 10 years.

- B12. As part of their response to our request to IFASS, the ASBJ interviewed preparers in their jurisdiction to understand the factors entities consider important in estimating the useful life of goodwill. The factors provided were:
- (a) the payback period;
  - (b) the period during which synergies are expected to have effect;
  - (c) the useful lives of key operating resources (for example, major facilities of the acquiree); and
  - (d) the useful lives of related intangible assets.
- B13. The UK Endorsement Board reviewed financial statements of the largest entities applying FRS 102 *The Financial Reporting Standard Applicable in the UK and Republic of Ireland*. Disclosures indicated the use of a broad range of factors to determine the useful life of goodwill. These included:
- (a) strength of brand;
  - (b) products and services provided;
  - (c) competition and expected future performance;
  - (d) expected use of acquired assets;
  - (e) any legal, regulatory, or contractual provisions that may limit the useful life;
  - (f) strategic plans; and
  - (g) expected life of the operating unit or line of business to which the goodwill relates.

## Appendix C—Extracts from IAS 38 *Intangible Assets*

C1. Paragraph 90 of IAS 38 says:

Many factors are considered in determining the useful life of an intangible asset, including:

(a) the expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;

(b) typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;

(c) technical, technological, commercial or other types of obsolescence;

(d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;

(e) expected actions by competitors or potential competitors;

(f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intention to reach such a level;

(g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and

(h) whether the useful life of the asset is dependent on the useful life of other assets of the entity.