Insights

by Capital Markets & Accounting Advisory Services (CMAAS)

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Goodwill - to amortise or not to amortise? Have your say.

Discussion paper	Business Combinations - Disclosures, Goodwill and Impairment
Comments end date	31 December 2020

Highlights of IASB's preliminary views

- Additional disclosures on management's objectives for the acquisition and how the acquisition has performed against those objectives
- Goodwill should continue to be tested for impairment but only when there is an impairment indicator
- Future restructuring and enhancement expenditures to be included in value in use ("VIU") cash flows
- Allow the use of post-tax cash flows and post-tax discount rate in VIU model
- Presenting total equity excluding goodwill on the face of the statement of financial position

This insights provides an overview of the International Accounting Standards Board ("IASB")'s preliminary views on enhancing disclosures on business combinations, retaining impairment testing of goodwill and simplifying the impairment test. The IASB is seeking comments to determine the way forward.

Objective of the Discussion Paper

The IASB is carrying out a research project on goodwill and impairment in response to the feedback received from stakeholders in the post-implementation review ("PIR") of IFRS 3 *Business Combinations* conducted from 2013 to 2015. The research project's aim is primarily to explore whether companies, can at a reasonable cost, provide investors with more useful information about acquisitions made, including improving the accounting for goodwill.

The Discussion paper sets out the IASB's preliminary views which the IASB is seeking comments on before deciding on whether and how to move forward with the project, and whether to change any of its preliminary views.

PIR feedback from stakeholders* & the IASB's responses

1. Not getting enough information about acquisitions and their subsequent performance

Business combinations generally are material transactions that involve significant outlay with impact to future periods earnings. Investors want to understand how an acquisition is performing relative to management expectations and whether management's objectives for the acquisition are met. Better information would help investors assess performance and more effectively hold management accountable for acquisition decisions.

The IASB's responses to improving disclosures about acquisitions

To provide information that investors need, companies should be required to disclose the following:

- Management's objectives for the acquisition and how the acquisition has performed against those objectives.The metrics used to monitor performance should be based on information the chief operating decision maker ("CODM") uses to monitor the acquisition internally. Hence, companies should not be creating information solely to meet external reporting requirements.

  How long would management be required to report on how the acquisition is performing? Information about the subsequent performance of an acquisition becomes less relevant after a relatively short time, as the acquired business could be integrated with the rest of the acquirer's businesses. The IASB proposes that companies should be required to disclose the information for as long as the CODM continues to monitor the performance of the acquisitions internally. If the CODM does not monitor an acquisition or stops monitoring within two years after the acquisition occurred, the company would be required to disclose this fact and explain why.

- A description of the synergies management expects from the acquisition and the estimated amount of synergies. This information would help investors to better understand the factors that contributed to the acquisition price.

- Amount of defined benefit pension and debt liabilities taken over in the acquired business, separately from other classes of liabilities, in order to enable investors to assess companies' return on capital employed.

* Stakeholders comprise mainly of investors, preparers, auditors and regulators.

PIR feedback from stakeholders & the IASB’s responses

2. Impairment losses on goodwill are often recognised too late, long after the events that cause those losses.

Impairment losses often lag market’s assessment of an acquisition’s performance. Stakeholders urged the IASB to make the impairment test of goodwill more effective at recognising losses on a timely basis.

The IASB’s responses to improving accounting for goodwill

Can impairment testing for goodwill be made more effective to enable timely recognition of impairment losses?

As goodwill is not capable of generating cash inflows independent of other assets, it is tested for impairment as part of a cash generating unit (“CGU”) or group of CGUs. The larger headroom from the other assets or CGUs to which goodwill is allocated provides a shielding effect on the goodwill attributed to the acquisition, resulting in the delay in recognition of impairment of goodwill.

The IASB’s preliminary view is that it is not possible to eliminate shielding from the impairment test because goodwill has to be tested for impairment together with other assets and these groups of assets could contain internally generated goodwill that is not recognised. Therefore, the impairment test, even if performed annually, cannot always signal how well the acquired business is performing due to the shielding effect. Consequently, the IASB felt that it is not feasible to significantly improve the effectiveness of the impairment test for goodwill at a reasonable cost to companies.

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PIR feedback from stakeholders & the IASB's responses

3. Testing goodwill for impairment is complex, time-consuming, costly and involve significant judgments

Stakeholders highlighted that the need to perform impairment test annually even if there is clearly no evidence of impairment under the current IAS 36 *Impairment of Assets* increases cost with no benefits.

This is further compounded by the need to adjust management's financial budgets to exclude future restructuring and enhancement costs when the recoverable amount is determined using the VIU model. Distinguishing maintenance capital expenditures from expansionary types can pose challenges.

In addition, the use of pre-tax discount rate in a VIU model is hard to understand and does not provide useful information.

The IASB's responses to improving accounting for goodwill

Should amortisation of goodwill be reintroduced?

There have always been strongly held and divergent views on whether goodwill should be amortised or should only be tested for impairment. Each approach has its limitations. In the IASB's preliminary view, the impairment only model should be retained given that there is no compelling evidence that amortising goodwill would result in a significant improvement in financial reporting. The majority of the IASB's Board members who supported this decision, however, was small.

The table below summarises the arguments for the amortisation vs impairment only model.

Amortisation model	Impairment only model
• Impairment model often results in goodwill being overstated. Hence, not holding management accountable • Amortisation target goodwill directly, reflects the consumption of the economic benefits embedded in goodwill • Easier and less costly to apply	• Useful life of goodwill and accordingly, amortisation is arbitrary. Hence, cannot be used to hold management accountable • Goodwill is not a wasting asset

PIR feedback from stakeholders & the IASB's responses

3. Testing goodwill for impairment is complex, time-consuming, costly and involve significant judgments (continued)

Simplifying impairment testing for goodwill

To reduce the cost and complexity of performing impairment tests, the IASB's preliminary view is to align cash flow estimates used for impairment testing with companies' internal forecasts and industry practice.

- Companies are not required to carry out an annual quantitative impairment test of CGUs containing goodwill if there is no indication that an impairment has occurred. A company would still be required to assess whether any such indication exists.
- Allow companies to include cash flows from uncommitted future restructuring and enhancement capital expenditures in the VIU cash flows which are prohibited under the existing IAS 36 on the basis that the assets are tested for impairment in their current condition.
- Allow the use of post-tax cash flows and post-tax discount rate in the VIU model. The existing IAS 36 only allows a post-tax discount rate to be applied to the post-tax cash flows provided the post-tax discount rate is adjusted to reflect the specific amounts and timing of the future tax cash flows.

4. Whether recognising intangible assets acquired in a business combination separately from goodwill provides useful information

Investors have mixed views on whether separate recognition of intangible assets such as customers' relationships and brands would provide useful information. Some felt that valuing these intangibles is complex, subjective and costly.

PIR feedback from stakeholders* & the IASB's responses

4. Whether recognising intangible assets acquired in a business combination separately from goodwill provides useful information (continued)

The IASB's responses to recognising acquired intangible assets separately from goodwill

In accordance with IFRS 3, acquired intangible assets such as brand shall be recognised separately from goodwill. In view of the differing views of the stakeholders on how useful and costly this information is, the IASB has no compelling evidence that it should change the range of intangible assets recognised in a business combination.

In addition, the IASB also felt that goodwill can only be measured indirectly as part of a business, it cannot be sold separately. In the IASB's view, presenting the amount of total equity excluding goodwill on the balance sheet would make the amount more prominent and draw investors' attention to companies whose goodwill constitutes a significant portion of their net assets.

What you should do

The IASB's preliminary views on enhancing disclosures of business combinations and the impairment testing of goodwill are expected to have significant impact to the financial statements of acquirer entities beyond the period in which the acquisitions are completed. It would be in the interests of preparers to have their say on the IASB's preliminary views, whether in support of the IASB's views or to offer counter-arguments.

You may submit your comments directly to the IASB before 31 December 2020 or through the MASB before 30 November 2020.

Do you need further information on this topic?	Contact Chew Lam Koon | Director Email: lam.koon.chew@pwc.com | Tel: +60(3) 2173 0779
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