Opportunities for Enhancing the Goodwill Impairment Framework

Article 3 of 3

International Valuation Standards Council

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The IVSC issues Perspectives Papers from time to time, which focus on pertinent valuation topics and emerging issues. Perspectives Papers serve a number of purposes: they initiate and foster debate on valuation topics as they relate to the International Valuation Standards (IVS); they provide contextual information on a topic from the perspective of the standard setter; and they support the valuation community in their application of IVS through guidance and case studies.

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By: Kevin Prall, Business Valuation Technical Director, in consultation with the IVSC Business Valuation Board

Amortisation of Goodwill Revisited

Accounting standard setters have begun projects to consider potential changes to goodwill accounting. In the context of these projects, the IVSC received a number of questions from constituents and stakeholders asking whether the principles underlying business valuations are compatible with certain concepts being considered, principally the amortisation of goodwill. The IVSC Boards concluded that the best way to aid public discussion was to publish a three-part article series to explore the fundamental issues with the goal of aiding capital markets by informing financial statement preparers, reviewers, and users.

In the first article, *Is Goodwill a Wasting Asset?*, the IVSC examined whether goodwill is economically a wasting asset, and if so, if the life and implicit decline in value can be reasonably estimated and supported. The IVSC examined this question through (1) a functional

assessment of the nature of goodwill, and (2) an analysis of the assumptions underlying deal models and the implicit assumptions regarding goodwill. The evidence indicated that goodwill is clearly not a wasting asset. This conclusion is supported by both the functional analysis of the components of goodwill and consideration of how businesses are valued and priced for transactions.

In the second article, *Information Value of the Current Impairment Test: Leading or Lagging Indicator?*, the IVSC explored the information content of the goodwill impairment test and highlighted reasons for its perceived limitations as a leading indicator. For this purpose, the IVSC analysed the accounting framework to better understand why goodwill impairments in certain situations fail to be a leading indicator. In doing so, we identified four primary reasons for why goodwill impairments may lag market sentiment.

The identification of the shortcomings provides a clear roadmap to explore how the current goodwill framework could be improved to provide investors with more timely and relevant information. As the previous article demonstrated, the current goodwill impairment framework provides inconsistent results as a leading indicator. This is of course not the sole measure of the usefulness of the impairment exercise. Nonetheless, it is an important shortcoming, thus, many of our suggestions focus on solutions to enable the timelier identification of potential impairments to goodwill. However, we also more broadly explore ways in which the current framework can provide investors with more decision useful information.

We previously examined the primary reasons for the potential timing lag in the disclosure of goodwill impairments. To identify opportunities for improvements to the current model, we explore potential options to mitigate or eliminate each limitation:

1. Impairment Shielding – Internally generated headroom
2. Artificial Headroom – Amortisation of acquired intangible assets
3. Impairment Triggers – Overly broad and outward looking
4. Behavioural Considerations – A reluctance to take impairment

We believe the following suggestions represent viable options that not only significantly improve the information content of the goodwill impairment framework, but also simultaneously reduce cost and complexity as compared to the current framework. Such options

also do not require significant changes to the current framework, and as such represent practicable options that deserve further examination by stakeholders.

Potential Solutions for Impairment Shielding

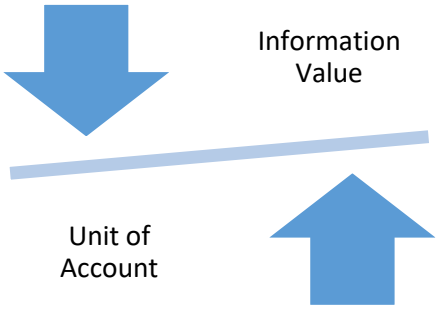
The current accounting model attempts to balance the desire of investors to understand the performance of acquisitions subsequent to the transaction, with the reality for preparers of tracking the acquired operations separately from its normal course of business. The result is the Tested Unit[1] concept, which allows for the combination of an acquired business with legacy operations.

As the impairment framework relies on the comparison of Value[2] to a Tested Unit's carrying amount[3], acquired goodwill can be shielded from impairment by unrecognised headroom of the legacy business that becomes part of the Tested Unit post acquisition. Internally generated headroom primarily consists of self-generated and unrecognised intangible assets and goodwill of the legacy business of the Tested Unit. As a result of the internally generated headroom, the purchased goodwill will only be impaired once the decline in Tested Unit Value exceeds the internally created goodwill and intangibles.

A comprehensive solution to eliminate the effect of internally generated headroom would be for the recognition of internally developed intangible assets and goodwill. The current accounting models do not account for internally generated intangible assets, which has ramifications well beyond goodwill impairment testing. The effect to the goodwill impairment framework is just one of multiple consequences that results from the absence of a more systematic approach to costs and asset generation related to intangible assets. However, fundamental changes to intangible asset accounting is beyond the scope of this current discussion.

[1] The term "Tested Unit" is used throughout the article for simplicity. Tested Unit should be considered synonymous with a Reporting Unit for US GAAP or Cash Generating Unit under IFRS.
[2] "Value" will necessarily include recoverable amount (the higher of fair value less costs of disposal and value in use) for IFRS, or fair value for US GAAP.
[3] Carrying amount, carrying value, and book value are all commonly used in practice, and are considered equivalent for purposes of this article.

Another option to mitigate, or eliminate, the impact of internally generated headroom is to test at a lower level.



To completely eliminate the effect, it would require that each acquisition becomes its own Tested Unit and be tracked and tested on a like for like basis to the operations acquired. However, doing such would be cumbersome to administer and impractical in the longer term, as most often acquired businesses are merged with legacy operations after acquisition in an attempt to materialise aspired synergies and separate financial results are often only tracked for a certain period of time after the acquisition. Alternatively, there may exist a lower unit of account, than the current Tested Unit criteria, that provides an attractive cost benefit proposition. While reassessment of the current Tested Unit regime is also beyond the scope of the current discussion, investors have expressed confusion regarding how Tested Units are defined for impairment testing purposes. As such, later in this article we consider how additional insights could be conveyed to investors through more detailed disclosures.

Instead of expanding the scope to assess the cost benefit of the additional recognition of some or all internally generated intangible assets or considering how any changes to reduce the unit of account for the Tested Unit may benefit investors, we explore more direct solutions to account for the internally generated headroom.

Step-Up Approach

The calculation of internally generated headroom at the time of acquisition, and its inclusion in the carrying value of the Tested Unit in subsequent testing periods, would more appropriately account for the internally generated intangibles and goodwill. This would enable a more direct test of acquired goodwill in subsequent periods and negate much of the problems resulting from internally generated headroom.

This concept is far from being new or innovative. FRS 11 Impairment of Fixed Assets and Goodwill, was issued in July 1998 by the UK Accounting Standards Board. Paragraph 50 from FRS 11 stated that "*Where an acquired business is merged with an existing business and*

results in an income-generating unit that contains both purchased and (unrecognised) internally generated goodwill: (a) the value of the internally generated goodwill of the existing business at the date of merging the businesses should be estimated and added to the carrying amount of the income-generating unit for the purposes of performing impairment reviews;"

Additionally, a 2017 IASB Staff Paper outlined what was termed the "headroom approach" as a proposed methodology to negate the unit of account impact without adding significant cost to the impairment process.[4] The approach captures the internally generated headroom at the time of acquisition. At subsequent dates, the internal headroom amount is netted against the Value of the CGU (or equivalently added to the carrying amount) so as to mitigate the impact of aggregation within a Tested Unit and its propensity to shield impairment from an underperforming acquired business. However, as noted below, the headroom approach suggested additional complicating procedures not contained in FRS 11.

In practice, calculating the amount of internally generated headroom of the Tested Unit legacy business at the time of acquisition could be done by (1) determining the Value of the Tested Unit legacy business and subtracting its carrying amount, or (2) determining the entire Tested Unit Value, then subtracting off the legacy operations carrying amount and the purchase price. The determination of the Value of the Tested Unit in aggregate, or the Value of the legacy business, would be an incremental requirement at the time of acquisition as compared to the current framework. However, the additional effort would be minimal considering the pre-deal efforts of the acquirer when determining the relevant price of the target company and the role of synergies, and likely more than offset by additional benefits. For instance, the various exercises already done to price the transaction would create significant synergies for determining the Value of the entire Tested Unit (e.g., reliance on discount rate assumptions,

[4] https://www.ifrs.org/-/media/feature/meetings/2017/october/iasb/goodwill-and-impairment/ap18b-impairment-revised.pdf
See also:
https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F1801080908338930%2F08-02%20-%20Issues%20paper%20on%20Updated%20Headroom%20Approach%20-%20Goodwill%20and%20Impairment%20-%20EFRAG%20TEG%20%2018-03-07.pdf&AspxAutoDetectCookieSupport=1

market multiples, PFI assumptions, etc.). Additionally, often the legacy business of the Tested Unit is the subject of significant analysis during the transaction as companies assess synergies, benchmark the target to current operations, and plan for future integration. Determination of the entire Tested Unit Value would also simplify synergy allocation determinations. And finally, the Value of the Tested Unit would provide the baseline for any necessary analysis in subsequent periods (i.e. the incremental effort to value the entire Tested Unit is brought forward to the transaction date, rather than be incurred in the first testing period after the transaction). [5]

Table 1 below displays the first of these two options. The internally generated headroom is calculated as the difference between the legacy business of the Tested Unit's Value and its carrying amount as of the transaction date. This amount is then added to the carrying amount and the transaction amount for the acquired business to derive the stepped-up Tested Unit carrying amount.[6] At acquisition, this approach would result in zero headroom, equivalent to if the acquisition became a standalone Tested Unit. In this example, an impairment is taken in year 3, in the amount equivalent to the value reduction of the acquired business.[7] However, without the step-up, the table below shows that no impairment would be taken under the status quo.

[5] For consistency, we believe that such procedures would also be necessary upon a reorganisation of the Tested Unit structure that involves any Tested Units that contain goodwill. For example, if the reorganisation resulted in additional assets being placed into an existing Tested Unit that has goodwill, failure to reset the carrying value for goodwill testing purposes would create artificial headroom. Additionally, if goodwill was moved from a Tested Unit to a legacy Tested Unit without goodwill, failure to reset the carrying value for goodwill testing purposes would completely circumvent the effort to negate the impact of internally generated headroom.

[6] The "stepped-up Tested Unit carrying amount" is only for purposes of performing the goodwill impairment test. The step-up would not be recorded on the company's balance sheet.

[7] Unlike the IASB's headroom approach, we propose that any impairment is taken only and fully to the acquired goodwill. The IASB's headroom approach envisioned an allocation process of the decline in Tested Unit Value between internally generated goodwill and acquired goodwill. In our opinion, the allocation process would be exceedingly difficult to apply in practice with negligible benefits. Additionally, the unit of account dictates that acquired goodwill becomes an asset of the entire Tested Unit subsequent to acquisition, thus an allocation of impairments to legacy and acquired goodwill is inconsistent with the current accounting framework.

Table 1		With Step-Up Approach			Without Step-Up Approach		
Ref		2019	2020	2021	2019	2020	2021
[A]	**Legacy Business of Tested Unit Value**	100	100	100	100	100	100
[B]	**Legacy Business of Tested Unit Carrying Amount**	60			60		
[C]	**Internally Generated Headroom** *[A] less [B]*	40			0		
[D]	**Value of Acquired Business**	100	100	80	100	100	80
[E]	**Tested Unit Value** *[A] + [D]*	200	200	180	200	200	180
[F]	**Stepped-up Tested Unit Carrying Amount** *[B] + [C] + Purchase Price of 100*	200	200	200	160	160	160
[G]	**Net Tested Unit Headroom for Impairment Test** *[E] - [F]*	0	0	-20	40	40	20
	Financial Reporting Impairment	No	No	Yes	No	No	No

There are multiple advantages of the step-up approach as compared to the current framework. Most significantly is that the step-up approach more appropriately accounts for the internally generated intangibles and goodwill, thus enabling a more direct test of acquired goodwill which would lead to more timely goodwill impairments.

Potential Solutions for Impairment Shielding and Artificial Headroom

While the Step-Up approach accounts for intangibles created before the acquisition date when performing the impairment test, it does not account for intangibles created after the acquisition date when performing the impairment test. As newly developed intangible assets are not recognised on the balance sheet, the amortisation of acquired intangibles creates artificial headroom as time passes. Artificial headroom is created regardless of whether an acquired company is combined with legacy business operations within the Tested Unit or set up as a stand-alone Tested Unit.

The impact of amortising intangibles is shown in Table 2 below. In the Step-Up approach, the amount of the impairment is now distorted by the amortisation of acquired intangible assets and the lack of recognition of new intangibles. In the without Step-Up approach, the amortisation creates even more cushion to shield a greater downturn.

Table 2		With Step-Up Approach			Without Step-Up Approach		
Ref		2019	2020	2021	2019	2020	2021
[A]	Legacy Business of Tested Unit Value	100	100	100	100	100	100
[B]	Legacy Business of Tested Unit Carrying Amount	60			60		
[C]	Internally Generated Headroom *[A] less [B]*	40			0		
[D]	Value of Acquired Business	100	100	80	100	100	80
[E]	Carrying Amount of the Acquired Business	100	95	90	100	95	90
[F]	Tested Unit Value *[A] + [D]*	200	200	180	200	200	180
[G]	Tested Unit Carrying Amount *[B] + [C] + [E]*	200	195	190	160	155	150
[H]	Net Tested Unit Headroom for Impairment Test *[F] - [G]*	0	5	-10	40	45	30
	Financial Reporting Impairment	No	No	Yes	No	No	No

Similar to the Step-Up approach which accounts for internally generated goodwill of the legacy business prior to the acquisition, a possible solution could include an adjustment to the carrying amount, or value, that considers the cumulative amortisation of the acquired assets subsequent to the acquisition as well as impacts to related accounts such as deferred taxes.

We note that combining an add-back of the amortised intangible assets, with an approach that accounts for internally generated headroom from legacy operations, effectively results in a calculation of Value at the time of acquisition. While a combination of both adjustments does remedy the impacts of internal headroom and the amortisation without replenishment of intangibles, it would be more intuitive and less costly to apply a direct Value comparison approach.

Direct Value Comparison

A direct comparison of the Value of the Tested Unit at acquisition to the Value of the Tested Unit as of subsequent test dates provides an intuitive and direct test of the value creation ability of the business, while also eliminating the need for many elements of the current framework that increase confusion and cost. [8]

[8] As with the Step-Up Approach, for consistency, we believe that such procedures would also be necessary upon a reorganisation of the Tested Unit structure that involves any Tested Units that contain goodwill.

Table 3 below shows the simple derivation of the total Tested Unit Value at acquisition, and the direct comparison of the Tested Unit Value at subsequent testing periods to this initial amount.[9]

Table 3					
Ref		2019	2020	2021	2022
[A]	**Legacy Business of Tested Unit Value at Acquisition**	100			
[B]	**Value of Acquired Business at Acquisition**	100			
[C]	**Total Value of Tested Unit at Acquisition** (Adjusted for Impairments*)	200	200	200	180*
[D]	**Tested Unit Value** *[A] + [D]*	200	200	180	180
[E]	**Net Tested Unit Headroom for Impairment Test** *[C] - [D]*	0	0	-20	0
	Financial Reporting Impairment	No	No	Yes	No

As with the step-up approach, a direct Value comparison more appropriately accounts for the internally generated intangibles and goodwill and enables a more direct test of acquired goodwill, leading to timely goodwill impairments.

Unlike the headroom approach, a direct Value comparison approach would circumvent the impact of amortisation of acquired intangible assets. The Value of the Tested Unit at each test date would be compared to the static Value of the Tested Unit at acquisition, rather than to an adjusted carrying amount distorted by the amortisation of intangible assets without the offsetting recognition of new intangibles.[10]

While a direct Value comparison approach recognises an impairment upon diminution in value of the Tested Unit, it

[9] The Total Value of the Tested Unit at Acquisition is only for purposes of performing the goodwill impairment test. No step-up would be recorded on the company's balance sheet.

[10] We note that certain events would require an adjustment to the static Value of the Tested Unit at acquisition. For example, an impairment of long-lived assets held within the Tested Unit would require the same amount be subtracted from the static Value of the Tested Unit at acquisition to prevent a double count of impairments. Similarly, a significant cash infusion (dividend) into (out of) the Tested Unit would require a corresponding increase (decrease) to the static Value of the Tested Unit at acquisition.

does not require any (value) growth in the acquired business. Some investors note that Management (of the acquirer) should be assessed on its ability to grow the value of the business consistent with the premise for the acquisition, not simply be tested on its ability to not lose value.[11] While we appreciate the sentiment, we do not believe such a threshold is consistent with the impairment principle as it is currently referenced throughout accounting standards. Value creation would allow Management to create extra headroom going forward.

Ancillary Benefits of a Direct Value Comparison Approach:

While providing a better comparison of goodwill, which would facilitate timely impairments, the direct Value comparison approach would also provide an opportunity to reduce overall cost and complexity. A direct Value comparison approach would eliminate the need to derive carrying amounts for the Tested Units at each testing date. Depending on a company's complexity, procedures, and systems, the derivation of carrying amounts typically requires significant internal company effort as well as many judgements. For example, judgements must often be made about how to appropriately allocate certain assets between multiple Tested Units, such as a manufacturing facility that is utilised in the production of product lines from different Tested Units. The same complexities arise in the allocation of liabilities. As just one example, the allocation of debt to Tested Units often requires numerous assumptions. Finally, judgement is also required not only to determine which Tested Unit assets and liabilities should be allocated to, but if certain assets and liabilities should be allocated to Tested Units at all or if they should be maintained at a de facto corporate unit. For this item in particular, the existing guidance is lacking and often results in wide divergence in practice. While the complex derivation and subjective judgments result in significant efforts by management, they in turn also can necessitate significant audit procedures. As with management, any opportunity to shift audit time and resources to more value-added areas, should be welcomed.

Additionally, under current US GAAP, a Step-0 qualitative analysis typically still requires the derivation of carrying values for the reporting units. Under a direct Value comparison approach, this arduous process would be avoided all together.

[11] The European Financial Reporting Advisory Group has recently discussed a similar idea it termed 'goodwill accretion' in the EFRAG discussion paper "Goodwill impairment test: can it be improved?" of June 2017.

Similarly, as both the IASB and FASB consider trigger-based tests, a direct Value comparison approach may reduce the effort associated with compliance in such instances.

Further, as noted in our second article, under the current framework there is not a direct correlation to the amount of impairment and overall diminution in value of the Tested Unit. The current framework can even indicate an increasing rate of decline for the Tested Unit, when actual performance has improved as compared to a prior year in which impairment was taken. By comparing Value over time, any goodwill impairment would be equal to the reduction in Value of the Tested Unit.

Finally, a direct Value comparison approach would help simplify other complex aspects of the goodwill framework. For instance, this approach would help in the initial allocation of goodwill when there are multiple Tested Units, as the Value determination of each of the Tested Units will help understand and reconcile where synergies are expected to be realised. Similarly, the approach would also facilitate exercises required for the restructuring of Tested Units and any dispositions from Tested Units.

Potential Solutions for Impairment Triggers

A review of the example triggers cited in accounting standards, and those noted by companies upon an impairment disclosure, shows them to be overly broad and strongly focused on external market and industry conditions. Additional examination finds the same to be true for acquisition disclosures of the recognition and valuation of goodwill and intangible assets. The CFA Institute has noted that such disclosures, and subsequent disclosures for impairment tests, are "generally sparse, qualitative and boilerplate".[12] CFA Institute goes on to say that financial statement users have consistently and clearly articulated that "Investors want more, not less, information regarding intangibles and long-term value creating activities of the business"[13] and "Improved disclosures on value creation."[14]

[12] Invitation to Comment (ITC) Identifiable Intangible Assets and Subsequent Accounting for Goodwill - CFA Institute Response, pages 4 and 5.

[13] Invitation to Comment (ITC) Identifiable Intangible Assets and Subsequent Accounting for Goodwill - CFA Institute Response, page 27.

[14] Invitation to Comment (ITC) Identifiable Intangible Assets and Subsequent Accounting for Goodwill - CFA Institute Response, page 28.

Such comments indicate that initial recognition and valuation of goodwill and intangible assets disclosures should be enhanced, and Impairment triggers should be more directly tied to those same KPIs, criteria, and disclosures made at the acquisition regarding the expected performance of the acquisition. The below discussion:

- Explores the information and data produced in normal course of the acquisition process;
- Assesses the relevance of such information and data to investors; and
- Considers how the disclosure of such information may aid in the subsequent goodwill impairment process.

Acquisition Disclosures

The current acquisition accounting requirements generate an abundance of decision useful information, yet public disclosures related to transactions are but a small fraction of that relied on by the preparers and reviewers of the financial statements. Below represents some of such information:

- Financial Metrics – Financial metrics are pervasive within the M&A process. The below highlights some of such metrics at various levels of detail: (1) Deal Metrics (transaction level), (2) PFI (forecast outputs), (3) KPIs (forecast inputs):
    - Deal Metrics – Deal models are used to help price transactions as well as throughout the business combination process. The price paid and the assumed cash flows, result in an expected internal rate of return (IRR). The IRR can be compared to the company's cost of capital to determine if the transaction is expected to be accretive to overall value. In addition to the IRR, deal metrics are often assessed through implied multiples of a subject metric(s), such as EBITDA. Similar to the IRR, the implied multiples from the transaction can be compared to that of the acquirer, and in this case also to multiples of public companies that operate in the same industry. The systematic disclosure of such deal economics would provide invaluable information to investors to assess the relative valuation creation prospects of the transaction.

- Projected Financial Information (PFI) – Deal models rely on key assumptions on revenue growth, expected margin expansion, capital expenditures, synergies and long-term growth and margin assumptions. Preparers and reviewers spend significant time developing and reviewing the PFI, which is ultimately used to derive fair value measurements for tangible and intangible assets. However, few if any of the PFI assumptions are communicated to investors. While full disclosure of the PFI would reveal proprietary competitive information, the consistent disclosure of certain key assumptions of the PFI would also provide invaluable information to investors to assess the relative valuation creation prospects of the transaction.

- Key Performance Indicators (KPIs) – With all acquisitions, management relies on certain metrics that they use internally to justify the purchase and later to assess whether a transaction is successful. Such KPIs will include certain deal economics or PFI considerations as referenced above but may also include more target or industry specific metrics such as customer retention rates. More disclosure of these KPIs that were used to assess the deal would provide investors with key insights with which to independently prepare financial models to assess intrinsic value. Additionally, as discussed below, they also provide an objective framework for the assessment of future performance, impairment triggers, and possible impairment charges.

- Tested Unit Structure – The current Tested Unit structure is not always that informative to investors. There is no information provided on whether the acquisition will be combined with an existing Tested Unit or will be standalone. If combined with legacy operations, there are no disclosures on what other assets and operations are included in the Tested Unit, the relative size or value of the existing Tested Unit, the amount of internal headroom contained in the tested Unit, and whether the Tested Unit contains other prior acquisitions. All

such information is reviewed by the preparers and reviewers as part of acquisition accounting requirements. Required disclosures of key Tested Unit insights would provide decision useful information to assess various aspects of the transaction, such as claims on the level of expected synergies that will be generated through combination with legacy operations.

- Goodwill Disclosures – While the amount of goodwill is disclosed and recorded on the balance sheet, little additional information is conveyed to investors. For example, the first article in this series discussed the various components of goodwill, including: reputation, future intangible value, workforce, synergies, and assemblage value. These categories of goodwill may provide a framework for the disclosure of meaningful information to investors on how a company plans to create and maintain its value creation advantages beyond the life of the identified tangible and intangible assets. For example, although not separately recognised, the value of the acquired assembled workforce is valued as part of the acquisition accounting fair value process. While the other components of goodwill are not computed, synergies and assemblage value could be reasonably estimated at a high level for directional disclosure. Finally, the remaining portions of goodwill could appropriately be addressed through management disclosures and analysis as value emanating from the maintenance of corporate reputation, or value to be realised by future technology that will be dependent on successful completion of future research activities.

Goodwill Test Triggers

At subsequent goodwill test dates, those KPIs identified and disclosed by management at acquisition, should form the basis for effective trigger-based test criteria. For example, in the periods immediately following the acquisition, actual performance should be compared to the PFI at the time of the acquisition to see if expectations have been met. Additionally, deal metrics such as relevant discount rates and implied multiples should also be calibrated from the acquisition. For the IRR, market inputs to discount rate derivation can easily be compared to those at the acquisition to determine if there have been significant changes in the required rate of return since the acquisition. Whereas, implied multiples of comparable public companies can be compared to those at acquisition to determine if there has been

a deterioration in the prospects of the broader industry. Finally, objective KPIs as identified at acquisition can also be measured and compared to the assumptions made at the time of the acquisition.

Impairment Disclosures

While the above acquisition disclosures and related impairment triggers provide a more transparent and objective framework with which to assess for impairment triggers, attention should also be given to the disclosures made when an impairment charge is taken.

As referenced in the second article of this series, the study "*Trigger Warnings: When is Goodwill Impairment Disclosure Informative?*" examines the information content of financial statement disclosures related to goodwill impairment testing. The paper contends that impairment reasons can be grouped into three categories: firm, industry, or economy related. The study finds significant price and volume market reactions to a firm's decision to impair goodwill, but only if a firm discloses firm-specific triggering events. The author concludes that these results indicate that financial statement users require more detailed firm-specific disclosures related to goodwill impairment testing. In addition to categorising the cause of the impairment, it would be helpful to disclose the KPI(s) that triggered the test and specifics on how the KPI(s) missed expectations.

Potential Solutions for Behavioural Considerations

The current goodwill framework seems too opaque, creates confusion for companies and investors alike, and ultimately may incentivise behaviours that lead to delayed impairments. This section examines how ideas set forth in this article may help to change certain behavioural circumstances that can lead to delayed impairments.

Direct Value Comparison Approach

The current framework's utilisation of carrying amount is somewhat of a black box for investors.[15] As shown throughout the article series, the carrying amount of a Tested Unit may have little relation to the Value of the Tested Unit. While the derivation of such carrying amounts is completely hidden from investor view, providing details on its derivation would

[15] Invitation to Comment (ITC) Identifiable Intangible Assets and Subsequent Accounting for Goodwill - CFA Institute Response, page 35

do little to enhance relevance or clarity. Alternatively, investors would fully appreciate a like for like comparison of the Tested Unit at the measurement date back to the Value of the Tested Unit at the acquisition date, as it would create a mutually agreed definition of what constitutes impairment. A clear understanding what impairment means, will foster a more transparent and objective process for preparers and reviewers.

Additionally, as discussed in the second article of this series, the current mechanics of the goodwill framework creates artificial headroom through the amortisation of intangible assets. This may have an impact on management's reluctance to take goodwill impairments. For example, rather than recognise an impairment, management may desire to delay the impairment charge in hope that the additional cushion created by intangible amortisation in the following year will take pressure off the calculation. The introduction of goodwill amortisation would further exacerbate the reluctance to take goodwill impairment charges, if and when needed. Alternatively, a direct Value comparison test would not encourage management to delay impairments in hope of generating sufficient artificial headroom in subsequent periods.

Finally, standard setters and regulators have noted how the current framework encourages management to allocate goodwill to Tested Units with the most internally generated headroom, both at the time of acquisition and at subsequent internal restructurings. A direct Value comparison test eliminates the effect of internally generated headroom, and thus eliminates any motivation to allocate acquisition goodwill to particular Tested Units. Additionally, as such procedures would also be necessary upon a reorganisation of the Tested Unit structure that involves any Tested Units that contain goodwill, there would be no opportunity to restructure Tested Units at subsequent dates to move goodwill to Tested Units with relatively more headroom.

Enhanced Disclosures and Objective Triggers

Enhanced KPIs and disclosures at acquisition would help set the guidelines for future impairment testing. The criteria for acquisition success, and alternatively impairment, should be defined and articulated to investors at the time of acquisition to the greatest extent possible. By defining the criteria for success and failure at the time of the acquisition, it will foster an impairment process that is more objective and transparent. As a result,

impairment testing would require less judgment, and thus reduce the potential moral hazard.

Conclusions

We believe the above suggestions represent viable options that not only significantly improve the information content of the goodwill impairment framework, but also simultaneously reduce cost and complexity as compared to the current framework. In particular, the direct Value comparison approach fixes a key criticism of the current goodwill framework of being a lagging indicator, while simultaneously providing an opportunity for simplification and cost reduction. Additionally, while the above does not make recommendations on exactly what information should be disclosed at acquisition, more decision useful information for investors is readily available. Whatever is disclosed, it should form the basis for the future impairment triggers and assessments. Finally, we believe that such changes will have a significant positive affect on the inherent behavioural elements that exist within this and other impairment processes.

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