



cutting through complexity

IFRS

Who cares about goodwill impairment?

A collection of stakeholder views

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TIME TO ENGAGE

On 30 January 2014, the IASB launched the public phase of its post-implementation review of business combinations accounting when it released a Request for Information.¹ We believe that a key aspect of the review is the impairment-only accounting model for goodwill, which was introduced in 2004. Comments are due to the IASB by 30 May 2014, so now is the time for all stakeholders to provide their feedback on this emotive topic.

The Request for Information essentially asks three questions in relation to goodwill impairment testing.

- How useful have you found the information obtained from annually assessing goodwill for impairment?
- Do you think that improvements are needed regarding the information provided by the impairment test?
- What are the main implementation, auditing or enforcement challenges in testing goodwill for impairment?

With this in mind, we interviewed a sample of stakeholders to find out what they think about goodwill impairment testing – its relevance, its effectiveness, the difficulties and the disclosures.

This report is not, and was not designed to be, a statistical survey. Rather, we wanted to talk in depth with a group of key stakeholders from across the financial reporting spectrum. We were delighted that so many of these key stakeholders were keen to go on the record in this report to share their views, which reinforces our view that this is an important topic. I thank all of our interviewees for their participation and their candour.

Here we present our impressions from those interviews, which we hope will encourage and help you to gather your thoughts and respond to the IASB's Request for Information.



Mark Vaessen
Global IFRS Leader,
KPMG International
Standards Group

EXPLORING THE ISSUES

We've all heard a lot in recent years about the contribution of goodwill impairment testing in financial reporting to the efficient operation of capital markets. Against a backdrop of weakened economic conditions and their effects on the value underlying goodwill on the balance sheet, impairment testing is increasingly becoming a focus for regulators. But at the same time, we do not get the same sense of the importance of goodwill impairment testing from analysts and other market commentators, or even from preparers themselves.

Faced with these diverse views, we decided to seek a better understanding of the differing perspectives on the value of impairment testing in financial reporting for capital markets.

TODAY'S IFRS MODEL

Goodwill acquired in a business combination is capitalised as an asset. It is subject to mandatory annual impairment testing and is not amortised. Any impairment loss is measured with reference to the recoverable amount of the cash-generating unit(s) to which the goodwill has been allocated. 'Recoverable amount' is the higher of fair value less costs of disposal (a market-based measure) and value in use (largely an entity-specific measure).²

WHAT WE KNOW

Goodwill impairment testing is a complex area of financial reporting that requires careful judgement. In sector-based surveys, the impairment testing of goodwill is regularly cited as a critical judgement and a key area of estimation uncertainty in preparing financial statements.³

WHAT WE DID

We interviewed stakeholders from various backgrounds and geographies (see Appendix 1). We selected consistent areas of discussion and questions, but the interviews were free-form in nature, allowing interviewees to speak freely about their experiences and thoughts on goodwill impairment testing. We also looked at publicly available material, such as speeches and research findings.

HOW WE INTERPRETED INTERVIEWEE COMMENTS

We refer to this report as a collection of stakeholder views because it wasn't our intention to carry out a statistical analysis that could be extrapolated. Instead, the results of these interviews have allowed us to gain a first-hand insight into stakeholders' perceptions.

KEY THEMES

WHAT OUR INTERVIEWEES SAID

Although goodwill impairment testing is relevant in assessing how well an investment has performed, its relevance to the market is in confirming rather than predicting value.

The degree of subjectivity in goodwill impairment testing limits its effectiveness. And the high number of judgements and assumptions make goodwill impairment testing a complex and time-consuming exercise.

Many companies think that the level of impairment-related disclosures is excessive, but others do not share that view. Analysts, in particular, would be in favour of more disclosures.

There is considerable support for a return to an amortisation-based model of accounting for goodwill.

AFTER LISTENING TO OUR INTERVIEWEES, WE HAVE THESE QUESTIONS

If the cost of compliance is high and the value relevance of goodwill impairment testing is less significant, then could the model be simplified?

If a key benefit of goodwill impairment testing is accountability, then how could that still be achieved in a simplified model?

Why do users want enhanced disclosures – is it related to goodwill impairment or something else?

NOW IS THE TIME TO ENGAGE

Provide feedback on the IASB's post-implementation review of business combinations accounting. The deadline is 30 May 2014.

THE ACADEMIC RESEARCH⁴

HOW THE CURRENT MODEL CAME ABOUT

Today's impairment-only accounting model for goodwill was introduced in 2004 to replace the previous amortisation-based model. The introduction of the current model followed the lead taken by the US Financial Accounting Standards Board (FASB) three years earlier.⁵

Over the years there has been much academic research to support the notion that impairment charges better reflect the underlying economic attributes of goodwill than systematic amortisation charges, and that such annual charges generally have very little information value to users. This was a key reason why both Boards replaced the straight-line amortisation of goodwill with a model based solely on impairment testing.^{6, 7, 8}

IFRS COMPARED TO US GAAP

Much of the academic research focuses on companies applying US GAAP, rather than IFRS. Although the two accounting models are not identical, they are both impairment-only models. Therefore, research that in effect compares systematic amortisation to impairment has general relevance.⁹

COMPLEX RELATIONSHIP WITH THE MARKET

Subsequent research finds that goodwill impairment charges under the current impairment-only model are associated with economically significant reductions in market value. This indicates that impairment charges better reflect changes to the underlying economic goodwill than do amortisation charges.

Some studies have shown that goodwill impairments convey value-relevant information¹⁰, and that there is a negative relationship between reported charges and share price.^{11, 12}

Research has also considered whether the information content of impairment charges varies depending on an entity's specific circumstances. Such research suggests that market reaction to an announcement of an impairment charge may be muted for firms with greater levels of broker coverage or institutional shareholding, perhaps because investors anticipate impairment charges before they are recognised. Market reaction also appears to be lower for smaller firms, perhaps because of investor concerns about the credibility of such charges.¹³

A recent study has also shown that it is currently more common for companies in Europe (applying IFRS) to have a market value below book value than for companies in the US (applying US GAAP), and that US companies generally have larger, less frequent impairment charges.¹⁴

“The Board [concluded that] if a rigorous and operational impairment test could be devised, more useful information would be provided to users of an entity's financial statements under an approach in which goodwill is not amortised, but is instead tested for impairment annually or more frequently if events or changes in circumstances indicate that the goodwill might be impaired.”

IASB's Basis for Conclusions to the 2004 impairment standard²

IMPAIRMENT TRAILS THE MARKET

Some studies have shown that goodwill impairments generally lag behind true economic impairment. This seems to imply that the market, at least partially, anticipates impairments before their announcement. Two separate studies have shown that the announcement of goodwill impairments lags deteriorating operating performance and share returns by at least two years.^{15, 16}

Other studies have considered the extent to which the timing and magnitude of impairment charges may reflect management/agency issues. For example, management may have incentives to delay (or accelerate) or to minimise (or maximise) an impairment charge for reputational, compensation or financing covenant reasons. Such studies would appear to indicate that agency issues may play a role in the timing and magnitude of goodwill impairment recognition.^{17, 18}

KPMG observations

An efficient market implies that investors will incorporate price-sensitive information into share prices before they are recorded in financial statements. As such, one would usually expect a limited reaction to any specific item in the financial statements, which would usually be seen as confirming prior judgements.

Typically, it is the change in expectations signalled by the impairment loss that drives any market reaction – and not the asset itself.

Goodwill as an asset on the balance sheet has limited direct relevance to the valuation of a business, because in many industries valuations are based on market multiples and discounted cash flow analyses that do not directly incorporate goodwill balances.

However, an impairment loss related to goodwill may have an indirect effect on value to the extent that it leads analysts or investors to revise their expectations of the future prospects of a business.

“But in practice, entities might be hesitant to impair goodwill, so as to avoid giving the impression that they made a bad investment decision. Newly appointed CEOs, on the other hand, have a strong incentive to recognize hefty impairments on their predecessor’s acquisitions. Starting with a clean slate, they can more or less ensure a steady flow of earnings in the future. The question is if our current rules provide sufficient rigor to these decisions.”

Hans Hoogervorst, Chairman, IASB¹⁹

IS GOODWILL IMPAIRMENT TESTING RELEVANT?

Interviewees commented that the value relevance of goodwill impairment testing to the markets is in confirming rather than in predicting value. However, there is relevance in assessing how well an investment has performed.

CONFIRMING RATHER THAN PREDICTING VALUE

There was little support among interviewees for the notion that goodwill impairment is a predictor of future value. In particular, analysts emphasised that value is assessed based on discounted cash flows, earnings multiples (before impairment) or residual income, depending on the valuation method used, but is not based on a balance sheet number for goodwill or related impairment charges. However, there was an interest among some analysts in the disclosures as an input to a user's own valuation model (see pages 12–13).

Most interviewees focused on the value of goodwill impairment testing in confirming or calibrating the market's previous assessment of value.

Academics noted that the relevance of impairment testing is not solely derived from reporting an impairment charge as such, but from the process of identifying potential impairment losses; and the disclosure of specific assumptions helps the market to calibrate the level of impairment.

However, the analysts that we interviewed were less confident that the outcome of goodwill impairment testing has a real impact on the market's view of value, based on their experience.

In general, companies were the most negative about goodwill impairment testing's relevance to external markets. Reasons varied, but included the timeliness of the information – a point raised by most interviewees across all categories – and the flaws in the impairment model (see pages 8–9). Over a third of companies said that they regarded goodwill impairment testing as a compliance exercise.

“I do not want my money to be spent on appraising goodwill because I do not need the company's management to tell me what the goodwill is currently worth – that's what the market does every day by valuing the shares.”

David M. Webb, investor, Founder of Webb-site.com

“The large number of assumptions, significant judgements required and room for interpretation means that the results are not particularly relevant in the market.”

Michael Fahey, Head of Group Finance,
AGL Energy

KPMG observations

Although some academic research tends to indicate a degree of correlation between impairment announcements and movement in share prices (see pages 4–5), this was not a message that came through strongly in our interviews. However, this might reflect the fact that some markets are better at anticipating impairments – causing the actual announcement to be less important – than others.

The outcome raises an interesting question about whether companies and

analysts share the same view of what is ‘significant’, although our interviews did not explore this in depth.

For example, perhaps companies focus on the magnitude of a change in share price, whereas analysts focus on the consistency of reactions. Alternatively, companies may believe that certain changes are not as significant as others might believe, or may attribute the share price movement to other factors – e.g. a change in outlook following an impairment charge.

HOW WELL DID WE DO?

A stronger theme from interviewees was the idea that goodwill impairment is relevant in assessing the performance of an investment, and consequentially in assessing the performance of management. However, few companies indicated that they use the results of goodwill impairment testing internally to ensure that management is held accountable for the investments made and their ability to realise synergies post-acquisition. Most companies indicated that they do not use the results of impairment tests for internal purposes. In general, this was on the basis that management uses other measures of management performance – e.g. EBITDA.

“The true importance is that goodwill impairment testing and related disclosure is sometimes the only way in which the shareholder can understand or evaluate whether the company could recover its investment.”

Professor Mauro Bini, Bocconi University

“Goodwill is relevant to assess the financial outcome of the original decision made and to hold the Board and senior management accountable for capital allocation decisions.”

Keith Nichols, CFO, Akzo Nobel

IS GOODWILL IMPAIRMENT TESTING EFFECTIVE ?

Interviewees commented that goodwill impairment charges are less effective in the sense that they do not act as a signalling event for the market. Additionally, the degree of subjectivity limits the effectiveness of the testing. But, although it is less subjective, a price-to-book ratio of less than one does not warrant an automatic impairment loss.

THE LATER THE CHARGE, THE LESS ITS EFFECTIVENESS

Recent academic research indicates that impairment charges can lag behind share performance by up to two years (see pages 4–5). Most interviewees agreed that impairment charges do generally lag behind actual business developments. However, a number pointed out that this delay in recognition is not surprising, because commercial developments occur first and accounting is not designed to be quicker than the market. This is one of the reasons why interviewees thought that impairment tends only to confirm rather than to predict value (see pages 6–7).

Some interviewees used the argument of impairment charges being late to support their preference for straight-line amortisation (see pages 14–15).

KPMG observations

The interview results seem to support the academic research conclusions that goodwill impairment charges generally lag behind true economic impairment.

However, it is not entirely clear if this can be attributed to an inherent flaw in the model or to efficiencies in those markets being considered.

A GREAT DEAL OF SUBJECTIVITY

The degree of estimation required in goodwill impairment testing was raised by companies as one of the difficulties in applying the model (see pages 10–11), and was largely seen by all categories of interviewees as reducing its effectiveness. A number of interviewees pointed out that this difficulty can be attributed to human nature, rather than a problem specific to the model itself. However, there was general acknowledgement that this level of estimation means that there is a degree of discretion in deciding exactly when an impairment charge is recognised.

Although there is less subjectivity when an impairment loss is measured with reference to fair value, surveys in some sectors have shown that most companies use value in use, which is largely an entity-specific measure.³

“Often, share prices reflect the impairment before the company records it on the balance sheet. In other words, the impairment test comes too late.”

Hans Hoogervorst, Chairman, IASB²⁰

“It is impossible for management to have an unbiased view.”

Andrew Cuffe, Former Head of Equity Research – South Africa, JP Morgan

Potential behavioural biases

Anchoring	Failing to depart sufficiently from an 'anchor', such as an initial estimate.
Confirmation bias	Placing more weight on evidence that is consistent with a person's views and less weight on evidence that contradicts such views.
Overconfidence	Placing too much confidence in a person's opinions and underestimating risks.
Aversion to loss	Being more willing to accept risk to avoid a definite loss than a person might accept in pursuit of a profit.
Excessive optimism	Placing disproportionately more weight on the likelihood and magnitude of possible positive outcomes than the likelihood and magnitude of possible negative outcomes.
Extrapolation bias	Assuming that current conditions or trends will continue.
Groupthink	When acting in a group, valuing conformity over quality in making decisions.

“You can use the best model in the world to measure the impairment loss, but the result of the analysis will only be as good as the inputs used in the model.”

Professor Louise Martel, HEC Montreal

PRICE-TO-BOOK IS NOT THE MAGIC ANSWER

Measuring an impairment loss with reference to market capitalisation could remove much of the subjectivity inherent in goodwill impairment testing. However, there was almost unanimous agreement among interviewees that a price-to-book ratio of less than one does not warrant an automatic impairment loss. Rather, it is simply an indicator that requires assessment. See also pages 14–15.

“Although a price-to-book ratio below one is a strong indicator, an impairment charge is not warranted solely on this basis, as management may be utilising different information in its value in use calculation.”

Laurent Degabriel,
Head of Investment and Reporting Division,
European Securities and Markets Authority

WHAT ARE THE DIFFICULTIES ?

Interviewees commented that a high number of judgements and assumptions are needed in goodwill impairment testing, making it a complex and time-consuming exercise. In addition, it is not clear whether the disconnect between the unit of account (cash-generating units) and how management runs the business is warranted.

JUDGEMENTS AND ASSUMPTIONS – AND A TIME-CONSUMING EXERCISE

The discussion on pages 8–9 highlights the degree of subjectivity involved in goodwill impairment testing. Consistent with that discussion, the most difficult areas raised by companies related to judgements and assumptions – e.g. the discount rate. However, in addition to that general concern, a number of companies separately highlighted issues with cash-generating units (see below) and forecasts and terminal values.

A few companies acknowledged that the incremental effort of goodwill impairment testing was not significant because much of the data was already collected for management purposes. However, over a third of companies indicated that they spend a significant amount of time on this area relative to other areas of external financial reporting.

A few companies specifically noted the challenge of explaining the complex accounting model to non-specialists in their organisation. In particular, they noted that an impairment loss might arise from the technical requirements of the impairment model (e.g. the discount rate), although the investment is otherwise performing well.

“I have the perception that we spend too much time on the goodwill impairment testing relative to other aspects of external financial reporting – for something for which the potential benefit is questionable.”

Aaron Holzinger, Director Financial Reporting,
Samsonite International

“It is a challenge to explain the concept of impairment testing within the organisation given the many different functions affected by the process. This is however inevitable in order to safeguard the quality of the results, which have to be based on realistic assumptions for business cases and valuation parameters.”

Anonymous, CFO

THE PROBLEM WITH CASH-GENERATING UNITS

Over a third of companies raised the concept of a cash-generating unit as a key area of difficulty in applying the goodwill impairment model – from identifying cash-generating units and allocating goodwill following a business combination, through to reallocating goodwill following a restructuring or disposal. A number of companies struggled to understand why the allocation of goodwill to cash-generating units does not mirror how management runs the business at a high level, which causes a disconnect between goodwill impairment and the operating segments that form the basis of segment reporting.

The definition of a cash-generating unit²

A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Goodwill is allocated to cash-generating units or groups of cash-generating units that are expected

to benefit from the business combination in which the goodwill arose. This allocation should represent the lowest level within the organisation at which goodwill is monitored by management.

This should not be larger than an operating segment (used in segment reporting), but may well be lower.

“The concept of testing for impairment at a CGU level (based on cash inflows) is particularly cumbersome, and can be very rigid to determining a CGU to a particularly low level – and is being viewed at a level that is significantly lower than how the chief operating decision maker reviews the business.”

Paulina Molnar, Vice President Corporate Controller,
Rogers Communications

A FOCUS FOR THE REGULATORS

Regulators indicated that they are spending a significant amount of time looking at companies' disclosures and analysis in respect of goodwill impairment testing. However, most companies that we interviewed had not received questions from their regulator(s). For those that had received enquiries, the questions were typically about the disclosures (see pages 12–13), with only two being questioned about the assumptions used.

“High quality standards are (only) those which are enforceable. This is the remit for the IASB. Due to the very subjective nature of the assumptions chosen by issuers, it is often impossible for enforcers to enforce aggressive accounting. This means that certain standards simply cannot be assessed as being of high quality.”

Axel Berger, Former Vice President,
German Financial Reporting Enforcement Panel

DO WE NEED ALL OF THESE DISCLOSURES?

Company interviewees commented that they are suffering from disclosure overload in respect of impairment, but others do not share that view. Analysts, in particular, would be in favour of more impairment-related disclosures. And although regulators are satisfied with the current impairment disclosures required by the standard, they would like to see the quality improved.

CONTRASTING VIEWS ON DISCLOSURE

In general, companies indicated that they believe current impairment disclosure requirements are sufficient, and they are wary of disclosing competitive information.

Analysts, however, indicated that they would like to see enhanced disclosures about goodwill impairment. They also appear to be frustrated by the lack of consistency in impairment-related disclosures, which makes it difficult to compare companies. One analyst indicated that it would be more useful to have disclosure at the higher level of the segment, rather than based on cash-generating units, to provide a better link with other data by segment; this links to one of the difficulties noted on pages 10–11.

KPMG observations

The call for more and/or better impairment-related disclosures does not necessarily make sense when compared with interviewee comments on the relevance of goodwill impairment testing (see pages 6–7).

However, this may be because the disclosures help users to calibrate

their own valuation models, rather than being useful in terms of goodwill impairment itself.

These different perspectives on the role of the disclosures need to be kept in mind in considering potential alternatives to an impairment-only model (see pages 14–15).

“It would be helpful to have more information at the segment level, or even the CGU level, if goodwill is material and helps in analysing the success of an acquisition and in estimating its future performance.”

Dennis Jullens, Rotterdam School of Management

“The required disclosures, not only for impairment but in general, are very extensive and the company’s financial statement is a ‘compliance document’. Therefore, we also prepare and publish a synthetic document that comprises an extract of the description of the business, management’s discussion and analysis of the financial condition and results of operations, and certain other company information from the Annual Report in order to provide a useful summary of the most relevant figures.”

Luca Cencioni, VP Group Accounting Policy, ENI Group

REGULATORS CONCERNED ABOUT COMPLIANCE

Regulators indicated that their focus is not on increasing the quantity of disclosures, but on improving the quality of the existing disclosures. They expressed concern about boilerplate and overly aggregated disclosures, indicating that they spend considerable time reviewing the impairment disclosures made by companies.

The ESMA report²¹

In January 2013, ESMA published a report on impairment testing, based on its review of the accounting and disclosure practices of 235 European listed companies. It highlighted the following main concerns about goodwill impairment disclosures:

- inadequate disclosures on management's key assumptions;
- inadequate disclosures, and a lack of consistency, on sensitivity analyses; and
- the disclosure of discount rates was too aggregated, with many companies disclosing a single average rate.

It also highlighted the following concerns relevant to the assumptions made by management (see also pages 10–11):

- insufficient weighting given to external evidence when impairment was measured with reference to fair value less costs of disposal; and
- high growth rates used in impairment calculations.

“In light of the economic conditions over the last five years and reflecting the growing importance of the topic, the number of enforcement actions taken in relation to impairment testing of goodwill and related disclosures rose significantly.”

Laurent Degabriel,
Head of Investment and Reporting Division,
European Securities and Markets Authority (ESMA)

“With regard to the disclosure of key assumptions and sensitivities as highlighted by ESMA, we believe that investors have other sources of information for forecasts (such as public information on government budgets, analysts' reports, etc) and do not rely on the annual financial statements to calibrate their expectations.”

Peter Lynas, Group Finance Director, BAE Systems

WHAT ARE SOME OF THE ALTERNATIVES ?

We asked if there is a better way to account for goodwill that would provide information that is more relevant to financial statement users. The overwhelming response from interviewees was a preference for a return to an amortisation-based model.

AMORTISATION – A RETURN TO THE OLD WAYS

The most popular suggestion, supported by most companies and two of the three regulators, was the straight-line amortisation of goodwill. Some would combine this with a trigger-based impairment test of goodwill, whereas others would not. A number of reasons were expressed, including simplicity, prudence and reducing reliance on forecasting subjectivity.

One of the two academics supported the systematic amortisation of goodwill on the basis that it would lead to more consistent application and would relieve pressure on the use of significant estimates and judgement. From a theoretical standpoint, the academic noted that such a method would be appropriate because acquired goodwill is replaced over time by other unrecognised intangible assets.

Some supporters of an amortisation-based model argued that amortisation would still provide a level of accountability of management decisions, because a charge would be recognised in profit or loss. However, others did not support amortisation, because they felt that it provides fairly meaningless information.

MOVE AWAY FROM MANDATORY TESTING

Another suggestion was to consider trigger-based impairment testing, with some suggesting the 'Step 0' test under US GAAP.²² Under both approaches, there would be a qualitative hurdle that would have to be satisfied first before an impairment calculation is required. This would help to alleviate some of the burden of performing an annual impairment test when an entity is performing well. However, it would do little to eliminate the level of judgement required or the complexity involved when a triggering event does occur.

“ I am clearly in favour of the straight-line amortisation of goodwill. The argument that the goodwill impairment only approach would support the decision usefulness criteria much better might be theoretically reasonable, but the practical problems outweigh the intended benefits. The barrier for management to come to an impairment combined with huge possibilities of influencing the assumptions of the respective impairment test must lead to a rather limited information value of this model. ”

Dr. Jochen Schmitz, Head of Reporting and Controlling, Siemens

IMPROVE THE STATUS QUO

A number of suggestions from interviewees involved tweaking the current model

Align with operating segments	Fully aligning the unit of account for goodwill impairment testing (cash-generating units) with operating segments (used in segment reporting) could provide more relevant information by better reflecting how management views the business. It might also improve disclosures, because instead of trying to provide enough detail for each cash-generating unit, management could provide disclosures specific to the particular operating segment.
Provide application guidance	Additional application guidance could help improve consistency in the application of goodwill impairment testing.
Increase disclosures	As noted on pages 12–13, some users would recommend additional impairment-related disclosures.

“I do not think that the answer lies only in disclosures, because there is no real accounting pressure in that case. The act of trying to quantify is a necessary step in transparency.”

Ian Mackintosh, Vice-Chairman, IASB

GET RID OF IT

A few interviewees suggested that goodwill be written off immediately, although their reasons varied from the more conceptual (to improve comparability or because it's not really an asset) to the practical (significantly reduce the work required).

THE BEST SOLUTION MAY BE TO DO NOTHING

Some interviewees made the point that although the model may have its limitations, it does work and one should not be hasty to get rid of it.

KPMG observations

Although most interviewees supported a return to an amortisation-based model of accounting for goodwill, this is somewhat at odds with the academic research.

As noted on pages 4–5, an impairment-only model has its limitations, but it does generally provide more

relevant market information than an amortisation-based model.

The reason for this apparent disconnect may be that interviewees are considering the wider cost-benefit trade-off in the current model, and not simply its relevance.

“Goodwill should not appear on the balance sheet because it distorts the comparison between otherwise identical companies – one of which reflects a pile of goodwill but has the same net tangible assets, and another that achieved it by organic growth and has no goodwill.”

David M. Webb, investor, Founder of Webb-site.com


“I think that the current model does work.”

David Cleasby, CFO, Bidvest

WE HAVE THREE UNANSWERED QUESTIONS

Our interviews have enabled us to form some initial impressions, and as a result we have questions related to the relevance of the goodwill impairment test, the cost of such testing and the purpose of the disclosures.


1. If the cost of compliance is high and the value relevance of goodwill impairment testing is less significant, then could the model be simplified?



Company interviewees indicated that goodwill impairment testing is a costly and time-consuming exercise. At the same time, as general observations, interviewees noted that any value relevance is in confirming rather than predicting value, and goodwill impairment charges do not appear to act as a major signalling event for the market.

These appear to be strong arguments for simplifying the accounting model. As an extreme, goodwill could be written off immediately, which some believe would enhance the comparability of financial statements. A less drastic change would be a return to amortisation over a capped period.

2. If a key benefit of goodwill impairment testing is accountability, then how could that still be achieved in a simplified model?



A theme coming through from interviewees, although not from most company interviewees, was that goodwill impairment testing does have value in assessing management's performance. In that case, a reasonable compromise might be indicator-based impairment testing, instead of an annual test, with or without a return to amortisation over a capped period.

3. Why do users want enhanced impairment disclosures – is it related to goodwill impairment or something else?



Typically, users of financial statements support the impairment-related disclosure requirements and in some cases believe that the disclosures should be even more extensive. However, we are not clear about the reasons for supporting or enhancing the disclosures – is it because they contain valuable information about impairment testing, or are they simply useful in helping to value a company?

In general, we think that there are valid concerns about increased complexity and disclosure overload in current financial reporting, which supports the need to think carefully about whether the current level of impairment disclosures is indeed warranted.

A CALL TO ACTION

There are three projects currently under way by standard-setters that we believe are of key importance to the debate on accounting for goodwill: two are IASB projects; the third is a FASB project. Now is the time to engage.

FEEDBACK NOW: IASB's post-implementation review of business combinations accounting

On 30 January 2014, the IASB launched the public phase of its post-implementation review of IFRS 3 *Business Combinations* when it released a Request for Information.¹ A key aspect of the review is the impairment-only accounting model for goodwill, which was introduced in 2004. The Request for Information essentially asks three questions in relation to goodwill impairment testing.

- How useful have you found the information obtained from annually assessing goodwill for impairment?
- Do you think that improvements are needed regarding the information provided by the impairment test?
- What are the main implementation, auditing or enforcement challenges in testing goodwill for impairment?

Comments are due to the IASB by 30 May 2014. The Request for Information emphasises that the IASB will assess the responses received based on the merits of the information, rather than on the absolute number of responses on a particular point.

For these reasons, it is important that responses focus on providing the reasoning behind comments being made, highlighting practical issues in terms of usefulness and challenges. In preparing a response, it may also be worth considering the work done by the European Financial Reporting Advisory Group (EFRAG) and the Organismo Italiano di Contabilita (OIC) on stakeholder views related to the subsequent measurement of goodwill.²³

MONITOR: FASB's project on accounting for goodwill

In November 2013, the FASB voted to add a project to its agenda to consider changes to the accounting for goodwill by public companies.²⁴ There are four alternatives that will be considered.

- Amortise goodwill and test for impairment only when there is an indicator of impairment.
- Amortise goodwill over its useful life, not to exceed a specified number of years.
- Immediately write off goodwill at acquisition.
- Simplify the goodwill impairment test while retaining the non-amortisation of goodwill.

There is currently no committed timeline for the project, with staff first conducting additional outreach and research.

We would expect the IASB to watch the progression of this project carefully, and it is likely to be influential in any future IASB deliberations in respect of goodwill impairment testing.

MONITOR: IASB's disclosure initiative

In January 2013, the IASB hosted a *Discussion Forum on Disclosure in Financial Reporting*, which invited participants to give their input on the issue of disclosure overload.²⁵ As a result, the IASB committed to undertake a research project on the broader challenges associated with disclosure effectiveness.

One of the medium-term projects that makes up the disclosure initiative is a standards-level review aimed at identifying and assessing conflicts, duplication and overlaps in disclosures; the first exposure draft was issued in March 2014.²⁶ We expect this project to consider the more general issue of disclosure overload, which will be relevant in the context of goodwill impairment disclosures.

APPENDIX 1: THE INTERVIEWEES

We would like to thank everyone who participated in this report.

Name and title	Organisation	Region
Companies		
Michael Fahey, Head of Group Finance	AGL Energy	Australia
Keith Nichols, CFO	Akzo Nobel	Europe
Kevin Davies, VP Group Accounting Policy	Anglo Gold Ashanti	Africa
Peter Lynas, Group Finance Director	BAE Systems	Europe
Karyn Brooks, Senior Vice-President and Controller	BCE and Bell Canada	North America
David Cleasby, CFO	Bidvest	Africa
Luca Cencioni, VP Group Accounting Policy	ENI Group	Europe
Susan Callahan, Director, Americas Accounting	Ford Motor Company	North America
Eouzan Christophe, Group Chief Accounting Officer	Orange	Europe
Lisa M. Halper, Vice President and Assistant Controller, Technical Accounting and Policy	PepsiCo	North America
Paulina Molnar, Vice President Corporate Controller	Rogers Communications	North America
Aaron Holzinger, Director Financial Reporting	Samsonite International	North America
Brenda Baijnath, General Manager Finance: Group Finance Technical and Advisory	Sasol Group Services	Africa
Dr. Jochen Schmitz, Head of Reporting and Controlling	Siemens	Europe
Thomas Buess, Group CFO	Swiss Life	Europe
Vera Last, Head of Financial Accounting		
Richard Olav Aa, CFO	Telenor	Europe
Arcangelo M. Vassallo, Head of Accounting	UniCredit	Europe
Anonymous CFO	Anonymous	Europe

Name and title	Organisation	Region
Academics		
Professor Mauro Bini	Bocconi University	Europe
Professor Louise Martel	HEC Montreal	North America
Analysts		
David M. Webb, investor, Founder of Webb-site.com	N/A	Asia
Andrew Cuffe, Former Head of Equity Research – South Africa	JP Morgan	Africa
Peter D. Routledge, Director, Equity Research – Financial Services	National Bank Financial	North America
Dennis Jullens (Former European Head of Valuation and Accounting Research at UBS Investment)	Rotterdam School of Management	Europe
Regulators		
Laurent Degabriel, Head of Investment and Reporting Division Tomas Borovsky, Officer – Investment and Reporting Division	European Securities and Markets Authority (ESMA)	Europe
Axel Berger, Former Vice President	German Financial Reporting Enforcement Panel	Europe
Steve Ong, Senior Vice President, Head of Accounting Affairs	Hong Kong Exchanges and Clearing Limited	Asia
Standard setter		
Prof. Dr. Klaus-Peter Naumann, Chairman of the Board	German Institute of Public Auditors (IDW)*	Europe
Ian Mackintosh, Vice-Chairman	IASB	Global

* The IDW is not a standard setter in the traditional sense, but issues IFRS interpretations and other accounting regulations that are mandatory for German Public Accountants. The IDW has been classified as a standard setter in this report.

APPENDIX 2: REFERENCES AND NOTES

- 1 Request for Information [Post-implementation Review: IFRS 3 Business Combinations](#). See also KPMG's [In the Headlines: Review of Business Combinations Accounting – Focus on usefulness and challenges](#).
- 2 IFRS 3 *Business Combinations* and IAS 36 *Impairment of Assets*.
- 3 KPMG's series [The Application of IFRS](#), which has looked at the following sectors over the past five years: food, drink and consumer goods; chemicals and performance technologies companies; media; mining; oil and gas; power and utilities; retail; telecoms; technology companies.
- 4 The references to academic research given in this section are examples and are not intended to be an exhaustive list.
- 5 The FASB published FAS 142 *Goodwill and Other Intangible Assets* in 2001 (now incorporated in ASC Topic 350 *Goodwill and Other Intangible Assets*).
- 6 *How Informative are Earnings Numbers That Excluded Goodwill Amortization?* Stephen R. Moehrle, James S. Wallace, Jennifer A. Reynolds-Moehrle; 2001.
- 7 *Does a goodwill impairment regime better reflect the underlying economic attributes of goodwill?* Keryn G Chalmers, Jayne M Godfrey, John C Webster; 2011.
- 8 *Reporting goodwill: are the new accounting standards consistent with market valuations?* Natalie Tatiana Churyk; 2005.
- 9 For an analysis of the differences between IFRS and US GAAP in respect of goodwill impairment testing, see KPMG's publication [IFRS compared to US GAAP](#).
- 10 *The Value Relevance of Goodwill Impairments: UK Evidence*; Naser M. Abughazaleh, Osama M. Al-Hares, Ayman E. Haddad; 2012.
- 11 *The impairment of purchased goodwill: effects on market value*; Kevin Li, Amir Amel-Zadeh, Geoff Meeks; 2010.
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- 13 *The Information Content of Goodwill Impairment and the Adoption of SFAS 142*; Daniel A. Bens, Wendy Heltzer, Benjamin Segal; 2011.
- 14 *Companies with market value below book value are more common in Europe than in the US: evidence, explanations and implications*; Mauro Bini, Stephen Penman, sponsored by KPMG's Global Valuation Institute; 2013.
- 15 *Has goodwill accounting gone bad?* Kevin K. Li, Richard G. Sloan; 2009.
- 16 *Goodwill Impairment Loss: Cases and Consequences*; Zining Li, Pervin K. Shroff, Ramgopal Venkataraman; 2006.
- 17 *Do Managers Benefit from Delayed Goodwill Impairments?* Karl A. Muller, III, Monica Neamtiu and Edward J. Riedl; 2012.
- 18 *The case of goodwill non-impairments: A study on the current situation with evidence from the European market*; Master Thesis of Claes Christiansen, Master of Science in Strategic Management; submitted to Prof. Yann le Fur; HEC Paris; May 2013.
- 19 Speech to the Federation of European Accountants (FEE) Conference on Corporate Reporting of the Future in Brussels; 8 September 2012; [The Concept of Prudence: dead or alive?](#)
- 20 Speech to the International Association for Accounting Education & Research conference; Amsterdam, 20 June 2012; [The imprecise world of accounting](#).
- 21 [European enforcers review of impairment of goodwill and other intangible assets in the IFRS financial statements](#).
- 22 Under US GAAP, a company is permitted, but not required, to evaluate qualitative factors to determine whether it is more likely than not that the fair value of the reporting unit is below its carrying amount; if it is not, then no further work is required. [ASC Subtopic 350-20-35]
- 23 [Questionnaire on the Subsequent Measurement of Goodwill – Feedback Statement](#).
- 24 FASB project: [Accounting for Goodwill for Public Business Entities and Not-for-Profits](#).
- 25 IASB project: [Disclosure Initiative](#).
- 26 Exposure Draft [Disclosure Initiative – Proposed Amendments to IAS 1](#). See also KPMG's [In the Headlines: Making financial statements more relevant – Short-term clarifications to IAS 1](#).

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This report was authored by the following on behalf of the KPMG International Standards Group (part of KPMG IFRG Limited).

Jim Calvert

Glenn D'souza

Egbert Eeftink

Brandon Gardner

Seung Im (Celine) Hyun

Julie Santoro



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