FASB FINANCIAL ACCOUNTING STANDARDS BOARD

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Memo

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Project	**Accounting for Goodwill for Public Business Entities and Not-for-Profit Entities**
Project Stage	**Initial Deliberations**
Issue(s)	**Project Update**

Purpose or Objective of This Memo

1. The purpose of this memo is to provide the Boards with a summary of the progress made to date by the FASB staff on the subsequent measurement of goodwill for public business entities (PBEs) and not-for-profits (NFPs) project. The project is currently in the initial deliberations stage. This is a non-decision-making meeting.

2. On November 25, 2013, the FASB added this project to the technical agenda and asked the staff to analyze potential alternatives for the subsequent measurement of goodwill for PBEs and NFPs. The project was added to the FASB's agenda at the same meeting the FASB endorsed the Private Company Council (PCC) recommendation for private companies for the subsequent measurement of goodwill. At its October 28, 2015 meeting, the FASB decided to divide the project into two phases. The first phase is to simplify the current impairment test by removing step 2 of the goodwill impairment test (see FASB Memo No. 7 on accounting for goodwill impairment) and the second phase, which is the focus of this memo, is to determine if additional changes to the subsequent accounting for goodwill are warranted.

3. This memo is organized as follows:

   (a) Summary of outreach activities and research

   (b) Summary of options considered to date

   (c) Appendix A: Summary of the FASB's past projects on the subsequent measurement of goodwill

   (d) Appendix B: Summary of feedback on amortization and direct writeoff approaches.

Summary of Outreach Activities and Research

PBEs

4. For PBEs, the FASB staff reviewed relevant comment letter responses and bases for conclusions from previous projects on the subsequent measurement of goodwill and performed outreach with PBE stakeholders, including 15 preparers, 10 users (including lenders, credit rating agencies, and equity analysts), the Investors Advisory Committee (IAC), 4 large accounting firms, and the Small Business Advisory Committee (SBAC).

5. The outreach activities conducted by the FASB staff indicated that some preparers struggle with the cost and complexity of the annual goodwill impairment test. Some assert that the qualitative test added in 2011 has not reduced cost or complexity, although recent research indicates that more preparers are embracing the qualitative assessment.

6. In 2015, Duff & Phelps and the Financial Executives Research Foundation (FERF) surveyed a sample of FEI members about their qualitative goodwill impairment.[1] The sample consisted of 219 entities, of which 37 percent were public entities and 63 percent were private entities. Twenty-six percent of the respondents have one reporting unit,[2] 47

[1] Duff & Phelps is a global valuation and corporate finance advisor. During the last seven years, Duff & Phelps performed a goodwill study in conjunction with the Financial Executives Research Foundation. Click here for the 2015 study: Duff & Phelps, 2015 U.S. Goodwill Impairment Study, November 2015.

[2] The Master Glossary of the Accounting Standards Codification defines a reporting unit as "the level of reporting at which goodwill is tested for impairment. A reporting unit is an operating segment or one level below an operating segment (also known as a component)."

percent have 2 to 5 reporting units, 15 percent have 6 to 10 reporting units, and 11 percent have more than 10 reporting units. Eighty-six percent of respondents indicated they did not recognize a goodwill impairment in 2014.

7. The results of the survey indicated that preference for the qualitative assessment has increased over the past few years and in the 2015 study, only 28 percent of entities indicated a preference for the quantitative impairment test. Similarly, use of the qualitative assessment has increased, with 54 percent of public entities and 40 percent of private entities stating that they applied the qualitative assessment to some or all of their reporting units in their most recent goodwill impairment analysis (up from 43 percent of public entities and 29 percent of private entities in the 2014 survey and 29 percent of public entities and 22 percent of private entities in the 2013 survey). Of the entities that applied the qualitative assessment, 86 percent reported not having to perform the quantitative goodwill impairment test after the qualitative screen. Furthermore, of the entities that have never applied the qualitative assessment, almost half indicated they are considering applying it in the future. Overall, the majority of respondents note that the qualitative assessment is meeting its stated objective as two-thirds of the respondents indicated that the qualitative assessment reduces costs.

8. Many comment letter respondents to the PCC proposal, as well as others included in the FASB staff's outreach (including users), note that the subsequent measurement of goodwill is not an area that warrants a difference between public and private entities. Furthermore, the results of the Duff & Phelps and FERF survey indicated that 76 percent of respondents state that the PCC optionality adds complexity to GAAP.

9. However, preparers were split on whether they prefer the current model for the subsequent measurement of goodwill versus another model (such as amortization or a direct writeoff). Some of those who favor goodwill amortization were supportive primarily because it would reduce cost and complexity, not because they thought it would provide financial statement users with better information. Concerns expressed by preparers about the PCC alternative (or amortization in general) included the following:

(a) Whether there is a strong conceptual basis for moving to an amortization model or testing goodwill at the entity level. Some preparers pointed to the basis for conclusions in FASB Statement No. 142, *Goodwill and Other Intangible Assets*, and Accounting Standards Update No. 2011-08, *Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment*, in which the FASB concluded amortization does not reflect the economic reality of goodwill (as discussed above) and concluded that a reporting unit is the appropriate level to test goodwill because it best reflects the way an entity is managed.

(b) Whether the amortization period included in the PCC alternative is too short compared with the cash flows projected from an acquisition or whether any arbitrary maximum life for goodwill is appropriate.

(c) How analysts and investors may perceive the "drag" on earnings from goodwill amortization. Some noted that their goodwill was not a result of growing their operations through strategic acquisitions, but rather the result of the purchase of the entity by a financial investor (for example, a private equity firm). However, many of those preparers also said that investors and analysts of their entities today focus on measures other than net income or earnings per share (such as earnings before interest, tax, depreciation, and amortization [EBITDA]). Some preparers note that goodwill amortization would be ignored.

10. All users of PBE financial statements with whom the FASB staff spoke said goodwill amortization would not provide relevant information and indicated that they would adjust earnings to exclude goodwill amortization. The staff observes from its research that users ignored goodwill amortization when goodwill was amortized before Statement 142.

11. While some users were indifferent to which model (for example, amortization, impairment, and direct writeoff) is used for the subsequent measurement of goodwill (more often lenders), many users (more often credit rating agencies and equity analysts) note the following:

(a) Impairment charges do provide some relevant information from a qualitative perspective.

(b) Impairment charges are a lagging indicator of issues and often are anticipated (particularly if the issues that drive the impairment are industry-wide issues).

(c) The exact amount of the impairment may be less important and is not directly used in projecting cash flows, but the general magnitude of impairment, frequency of impairment, and acknowledgement by management that future cash flows might be lower than anticipated can provide useful information.

(d) The accumulation of impairment charges over time can inform an investor's view of management's business acumen and an entity's future prospects.

(e) Goodwill impairment is an area in which users can gain insights into changes in management's expectations of future cash flows.

12. The staff notes that the feedback from users that goodwill impairment is not used quantitatively, but can be helpful qualitatively, is consistent with the feedback the FASB received in connection with outreach performed when the qualitative screen was developed in 2011. An outreach summary from February 2011 on that project indicated that users were fairly indifferent about the manner in which goodwill is assessed for impairment, but they would support any change that reduces costs incurred by preparers if it achieves a similar result from applying current guidance. Overall, the staff believes that users have been more outspoken in current outreach about the qualitative benefits of goodwill impairment and that may be related to the fact that amortization or a direct writeoff would not achieve a result similar to current guidance.

13. Some users stated that they focus on tangible book value (or their focus also might include certain identifiable intangible assets) and do not see goodwill as an asset. Some of those users were open to a direct writeoff of goodwill, but some highlighted that disclosures would have to provide a history of the capital invested in acquisitions for investment return calculations. Other users were open to the idea of a direct writeoff over amortization primarily because it would not require an adjustment to an entity's reported results each reporting period.

NFPs

14. Many NFP stakeholders, including the members of the Not-for-Profit Advisory Committee (NAC) and the American Institute of Certified Public Accountants (AICPA) Not-For-Profit Entities Expert Panel, support the extension of the PCC alternative to NFPs because NFPs and private entities may face similar challenges (for example, they do not have an observable market price, they do not apply the segments guidance, which is the basis for reporting unit determination, and they have limited resources). At the March 10, 2014 NAC meeting, members were split on whether they preferred direct writeoff or amortization of goodwill. However, all of the NAC members that spoke at the meeting supported a change from the current impairment model.

15. Furthermore, the users of NFP financial statements (which included three lenders and underwriters, two credit-rating agencies, and users that are part of NAC) indicated that they rarely see goodwill. However, the users that do see goodwill indicated that goodwill balances and impairment generally are not relevant to their analyses of NFPs. One user on the NAC indicated that goodwill is irrelevant because it cannot be used to fulfill an NFP's mission.

16. NFPs that rely predominantly on contributions are required to write off goodwill at the acquisition date and, therefore, those NFPs would not be affected by the PCC's alternative (unless the FASB changed the writeoff requirements for those entities). In addition, some combinations of NFPs can qualify as mergers and the carryover basis is applied. Thus, a change to the subsequent accounting for goodwill would be limited to NFPs that are more "business-like," which includes, for example, health care entities, universities, and museums. Business-like NFPs are more likely to issue or be an obligor (conduit bonds) for publicly traded debt because their operations are capital intensive. Of those more business-like entities, health care entities (that are often conduit bond obligors) historically are the entities that are most likely to have goodwill because they are the most active in completing business combinations. The split between business-like and traditional NFPs was made in FASB Statement No. 164, *Not-for-Profit Entities: Mergers and Acquisitions,* based on feedback that indicated that the business-like NFPs wanted financial statements that were

more comparable to their for-profit counterparts (however, at that time, there was no distinction for PBEs and private entities).

17. One of the analysts in the staff's outreach that specifically focuses on bond ratings for health care NFPs noted that for a substantial majority of the time, the health care NFPs he follows do not have goodwill or the goodwill balance is immaterial. This analyst indicated that he does not compare health care NFPs to health care PBEs. Based on discussions with this analyst and based on prior outreach by the GASB staff, credit-rating agencies and buy-side analysts do not typically compare NFPs and PBEs. However, one NAC member, who is a user, challenged whether this is always the case. He asserted some users compared NFP health care entities to PBE health care entities. Although the analyst in the staff's outreach did not feel strongly about the accounting for goodwill (as it is so rarely relevant), he did prefer a consistent accounting treatment among those NFPs he follows versus the ability for them to account for goodwill in two different ways (that is, he preferred a requirement versus an alternative).

18. Many comment letter respondents to the PCC alternative for goodwill indicated that the alternative developed by the PCC for private entities should be extended to NFPs.

Staff Analysis and Options Considered to Date

19. Many models have been considered for the subsequent measurement of goodwill. Throughout the staff's outreach and review of comment letter responses and outreach on prior projects, the feedback on the accounting for goodwill has consistently been mixed. There does not appear to be a clear answer about what the accounting for goodwill should be and it may be challenging to identify a model that satisfies the needs of all stakeholders.

20. It also is possible that all of the potential benefits from the optional qualitative test for goodwill impairment have not been realized because the guidance is relatively new and the global economy has been recovering to some extent from a recession (which should begin to decrease the risk of impairment for many entities). The staff observes that feedback about the complexity of asset impairment testing during or immediately following an economic recession is to be expected and is not necessarily a sufficient reason to

immediately change the accounting model. Furthermore, the 2015 Duff & Phelps study referenced above indicates that the use of the qualitative screen has increased significantly in recent years.

21. The current accounting guidance for business combinations is predominantly converged under GAAP and International Financial Reporting Standards (IFRS). The main differences are related to the impairment test. IFRS guidance has one test for most nonfinancial assets, while GAAP has different tests for long-lived assets, indefinite lived intangible assets, and goodwill. The tests also are performed at a different level (cash-generating units under IFRS and reporting units under GAAP). Current GAAP has a two-step test and IFRS has a one-step test; however, the Exposure Draft of the proposed Accounting Standards Update, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment*, proposes changing the GAAP requirement to a one-step test. Both Boards have expressed their strong desire that the accounting remain converged.

22. The following views on potential changes to the subsequent measurement of goodwill have been discussed at prior FASB meetings:

    (a) View A—No changes to GAAP

    (b) View B—Amortization

    (c) View C—Direct writeoff

    (d) View D—Additional changes to the impairment test.

View A—No changes to GAAP

23. As noted through the staff's outreach and research, there is no one answer about the appropriate treatment of goodwill that has a preponderance of support. Some of the alternatives discussed represent fundamental changes to the current accounting model.

24. Although feedback on the various alternatives proposed for the subsequent accounting for goodwill is decidedly mixed, there is support for simplifying the model that is currently prescribed. Given the feedback received throughout the life of this project, many

stakeholders would not be satisfied with leaving the accounting "as is" for an indefinite period of time.

25. However, to address concerns about the cost and complexity of the current model, the FASB issued the Exposure Draft on simplifying the accounting for goodwill impairment on May 12, 2016. The amendments in this proposed Update would remove step 2 of the impairment test. It is possible that these proposed changes will simplify the current impairment test and alleviate the concerns about cost and complexity such that additional changes to the subsequent accounting for goodwill are considered unnecessary. The Exposure Draft includes a question for respondents asking whether additional changes should be made to the accounting model to meet this objective.

View B—Amortization

26. View B is to amortize goodwill. In addition to the fundamental question of whether or not goodwill should be amortized, there are several amortization sub-issues that will need to be addressed, as follows:

    (a) Useful life:

        (i) Selected based on facts and circumstances

        (ii) Prescribed or no longer than:

            (1) Ten years (PCC alternative)

            (2) Fifteen years (useful life of goodwill for tax)

            (3) Twenty years (1999 ED)

            (4) Forty years (APB Opinion 17).

    (b) Pattern of recognition:

        (i) Straight line

        (ii) Systematic and rational.

    (c) Allocation of impairment within a reporting unit among amortizable units of goodwill:

(i) Reasonable and rational approach

(ii) Pro rata.

(d) Allocation of goodwill on disposal (amount disposed and reallocation of remaining amount):

(i) Reasonable and rational approach

(ii) Current GAAP (relative fair value approach).

(e) Reorganization of reporting units (that is, how to allocate amortizable units of goodwill upon reorganization of reporting structure resulting in changes to reporting units):

(i) Reasonable and rational approach

(ii) Current GAAP (relative fair value approach).

27. The FASB also will need to consider the challenges of determining the appropriate transition approach if amortization is required.

28. In a separate project, the FASB is considering changes in the recognition criteria for acquired intangible assets for PBEs and NFPs. The options being considered in that project include subsuming certain intangible assets into goodwill. See FASB Memo No. 5 on identifiable intangible assets for additional information. The staff notes that if the Board decides to include these intangible assets in goodwill, it may influence the FASB's decisions related to the amortization of goodwill.

View C—Direct writeoff

29. View C entails a direct writeoff of goodwill. Key elements include the following:

(a) Write off goodwill at transition

(b) Write off any new goodwill at the acquisition date as any of the following:

(i) A charge to net income

(ii) A charge to other comprehensive income

(iii) An adjustment directly to equity.

30. Recognition in other comprehensive income or equity also has additional issues that would need to be addressed:

    (a) Allocation of goodwill (from other comprehensive income or equity to gain or loss on disposal) upon a disposal

    (b) Classification of bargain purchase gains.

View D—Additional changes to the impairment test

31. Depending on feedback the FASB receives on the Exposure Draft, the FASB could pursue other ways to simplify the impairment test. Potential simplifications for the impairment test identified by the staff include any of the following:

    (a) Testing for impairment at the entity, operating segment, or reportable segment level rather than the reporting unit level

    (b) Testing for impairment only on the occurrence of a triggering event rather than annually

    (c) The ability to change the date the impairment test is performed rather than a requirement to test at the same time every year.

Appendix A: Summary of the FASB's Past Projects on the Subsequent Measurement of Goodwill

32. The FASB has considered and changed the accounting for the subsequent measurement of goodwill multiple times in recent years.

33. Before 2002, all entities following generally accepted accounting principles (GAAP) amortized goodwill over its useful life, not to exceed 40 years, based on the requirements in APB Opinion No. 17, *Intangible Assets*.

34. In the 1999 Exposure Draft, *Business Combinations and Intangible Assets* (the 1999 ED), the FASB proposed a reduction in the maximum life of goodwill from 40 years to 20 years as a part of a complete overhaul of accounting for business combinations, goodwill, and intangible assets. In the 1999 ED, the FASB concluded that the life of goodwill cannot be predicted with a satisfactory level of reliability and the pattern in which goodwill diminishes cannot be known. Thus, amortization over an arbitrary period was the only practical solution.

35. Some respondents supported this amortization model. However, others challenged the use of an amortization model and the use of an arbitrary maximum period for amortization. The FASB ultimately agreed with those respondents that "…straight-line amortization of goodwill over an arbitrary period does not reflect economic reality and thus does not provide useful information…" (paragraph B79 of Statement No.142).

36. The FASB also considered a "discernible elements" approach to goodwill early in that project, which would have necessitated identifying the reasons for any premium paid for an acquisition, allocating goodwill to those elements, and determining the appropriate useful life for each. Paragraph B73 of Statement 142 acknowledges that this approach was highly subjective and that the results of a 1998 field test led the Board to conclude that, while potentially a conceptually sound approach, it was not practical in operation.

37. In response to the feedback received, the FASB then developed a model that required an annual impairment test and did not permit amortization. The model was finalized in 2001 as a part of Statement 142. While many stakeholders supported the concept of an impairment model, feedback on the impairment model was mixed on whether it would work

in practice and whether the previous proposal or another method for accounting for goodwill (such as a direct writeoff of goodwill) was more appropriate.

38. The requirements of Statement 142 (and FASB Statement No. 141, *Business Combinations*) were deferred for NFPs. The accounting for mergers and acquisitions of NFPs was addressed separately as a part of Statement 164. Statement 164 requires NFPs that rely predominantly on contributions to write off goodwill at the acquisition date. Other more business-like entities (such as health care entities) account for goodwill in accordance with Statement 142. In addition, the combination of two NFPs can qualify as a merger under certain circumstances and the carryover basis of accounting would be applied (that is, no goodwill would be recognized). The acquisition guidance in Statement 164 was effective in 2010 for calendar-year entities and effective for fiscal years ending in June 30, 2011 for many NFPs.

39. In Update 2010-28, the Emerging Issues Task Force (EITF) concluded that if the carrying value of a reporting unit was zero or negative, certain factors should be used to determine if it is more likely than not that goodwill is impaired and, if so, step 2 must be performed. These factors include, for example, consideration of declines in actual or planned revenue or earnings compared with relevant prior periods, changes in customers, a deterioration in the environment in which the entity operates, and increases in costs that have a negative effect on earnings and cash flows. Before this guidance, some entities always concluded that because the fair value of the reporting unit was higher than the carrying value (that was zero or negative), step 1 was passed (and, thus, goodwill was not impaired).

40. In 2011, due to concerns about the cost and complexity of the annual goodwill impairment test, the FASB developed an optional qualitative impairment test as a screen for companies to assess whether it is more likely than not that goodwill is impaired before performing the quantitative impairment test (originally in the amendments in Update 2011-08, now included in Subtopic 350-20, Intangibles—Goodwill and Other—Goodwill). As part of the deliberations on that project, the FASB considered goodwill amortization and a direct writeoff of goodwill. In the basis for conclusions in Update 2011-08, the FASB affirmed the decisions reached in connection with Statement 142 that (a) amortization was inappropriate because the pattern of expense recognition for goodwill often does not align

with the economics of the goodwill recognized because not all goodwill declines in value and it is difficult to estimate a useful life and an appropriate pattern of amortization for any portion of goodwill that is wasting (paragraph BC15 of Update 2011-08) and (b) direct writeoff is inappropriate because goodwill meets the definition of an asset; thus, goodwill should not be written off unless it is deemed impaired (paragraph BC16 of Update 2011-08).

41. In 2013, the PCC developed an alternative that was endorsed by the FASB and included in Update 2014-02 that permits private companies to elect to amortize goodwill and perform a simplified impairment test on the occurrence of a triggering event. This alternative was based on feedback from private company stakeholders that the benefits of the subsequent measurement of goodwill before the alternative did not justify the costs for private companies. Users indicated that the existing goodwill impairment test provided limited decision-useful information and preparers and auditors of private company financial statements indicated concerns about the cost and complexity involved in performing the impairment test.

Appendix B – Summary of Feedback on Amortization and Direct Writeoff

View B – Amortization of Goodwill	
Proponent views	Opponent views
• Goodwill is acquired to generate future cash flows and should be recognized as those cash flows are realized. • Users often disregard goodwill impairment charges in their quantitative analyses of operating performance. • The benefits of the current impairment model do not justify its costs. • Goodwill is a wasting asset and the internally generated goodwill that is replacing it is not recorded.	• At least part of goodwill is a nonwasting asset and can have an indefinite useful life. • The useful life and the pattern in which any wasting portion of goodwill diminishes are difficult to estimate, are highly subjective, and may not be comparable among entities. • Amortization of goodwill decreases the relevance of financial statements. • Amortization of goodwill is unfair to entities whose growth comes largely from acquisitions rather than from internal sources. • Goodwill does not necessarily represent an asset that benefits future operations. • Amortization is conceptually inferior to an impairment model.

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<tr><th colspan="2">View C – Direct Writeoff of Goodwill</th></tr>
<tr><th>Proponent views</th><th>Opponent views</th></tr>
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Users ignore goodwill and its subsequent measurement (impairment or amortization).
Direct writeoff could eliminate all costs associated with the subsequent measurement of goodwill.
Any model for amortizing goodwill would result in an amortization period that is arbitrary and would require ongoing impairment tests.
Some have concerns about how reliably goodwill can be measured after acquisition and/or uncertainties about what the asset and subsequent measurement represents.
Lack of comparability arises today between similar entities as a result of recognizing goodwill as an asset in a business combination versus internally generated goodwill.
Others assert that goodwill is not an asset because:

It cannot be used to settle liabilities.
There is no observable market for it.
It cannot be transferred separately from the entity.
Its useful life is unclear.
It is a residual.

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Goodwill has the characteristics of an asset in FASB Concepts Statement No. 6, Elements of Financial Statements.
Goodwill is controlled by the acquirer and it contributes to the generation of future cash flows much like other intangible assets or long-lived assets. In connection with the development of FASB Statement No. 141(R), the FASB also concluded that goodwill is an asset and, therefore, should not be written off at the date of acquisition.
If goodwill had value initially (which opponents believe is evident from the purchase price a buyer is willing to pay in a business combination), no event other than a catastrophe could render goodwill immediately worthless.
A business as a whole is an asset; thus, the value of that asset should be recorded, in total, on the acquirer's balance sheet when it is purchased. It is inappropriate to treat the purchase of a business differently in a business combination versus an investment in a smaller portion of the business.
There are difficulties that arise in determining the decline in the value of goodwill in subsequent periods, but such estimation difficulties are not unique to goodwill and are not used as a justification for the immediate writeoff of other assets.

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• The fact that a buyer is willing to pay for goodwill (or pay more than the fair value of the net assets separately recognized in a business combination) in an arms-length transaction does not necessarily mean that it is an asset or that it provides relevant information about an acquisition. • While entities make some expenditures with an expectation of generating cash inflows (such as advertising and research and development costs), they do not give the entity a present right to such cash inflows and are generally expensed as incurred.	• Goodwill should continue to be tested for impairment, at least annually, because impairment is a relevant indicator of the success or failure of an acquisition and/or management. • Writing off goodwill could negatively affect some entities' net assets/equity, which could cause a perception that a business is not being managed appropriately or could affect an entity's ability to declare and pay dividends and (amortization over a short period could have a similar effect). • Ratios or debt covenants that include measures based on total assets or equity could be affected by the direct writeoff of goodwill, and the potential need to amend debt agreements could add costs to the system. • Preparers and NAC members generally did not support any disclosures associated with the performance of an acquisition that could be required under the direct writeoff approach.