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Heads Up

FASB Proposes Amendments to Simplify the Accounting for Goodwill Impairment

by Denise Lucas and Andrew Winters, Deloitte & Touche LLP

On May 12, 2016, the FASB issued a proposed ASU[1] that would remove step 2 from the goodwill impairment test. The proposed amendments, which are intended to simplify the accounting for goodwill impairment, would instead require an entity to "recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. However, that amount should not exceed the carrying amount of goodwill allocated to that reporting unit."

Background and Key Provisions of the Proposed ASU

In November 2013, the FASB endorsed (and later issued guidance on[2]) a decision by the Private Company Council (PCC) to give nonpublic business entities an accounting alternative under which they can elect to amortize goodwill and perform a simplified impairment test. The Board received feedback on the PCC accounting alternative indicating that many public business entities and not-for-profit entities had similar concerns about the cost and complexity of the annual goodwill impairment test. In response, the Board added a goodwill simplification project to its agenda in 2014, which will be completed in two phases.

In phase 1, step 2 would be removed from the current goodwill impairment test; in phase 2, the Board will explore other alternatives related to the accounting for goodwill, including the amortization of goodwill.

Under ASC 350,[3] impairment of goodwill "is the condition that exists when the carrying amount of goodwill exceeds its implied fair value." The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. The process of measuring the implied fair value of goodwill is currently referred to as step 2 of the goodwill impairment test.

To perform step 2, an entity is required to "assign the fair value of a reporting unit to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination." Therefore, the performance of step 2 can sometimes result in significant cost and complexity since "the fair value of goodwill can be measured only as a residual and cannot be measured directly." Likewise, cost and complexity related to step 2 were also identified in the post-implementation review of FASB Statement No. 141 (revised 2007), *Business Combinations*.

[1] FASB Proposed Accounting Standards Update, *Simplifying the Accounting for Goodwill Impairment*.
[2] For more information, see Deloitte's January 27, 2014, *Heads Up*.
[3] FASB Accounting Standards Codification (ASC) Subtopic 350, *Intangibles — Goodwill and Other*.

As noted above, the proposed ASU would eliminate step 2 of the goodwill impairment test. Instead, goodwill impairments would be measured by the amount by which the carrying amount exceeds the reporting unit's fair value, but that amount should not exceed the reporting unit's allocation of the carrying amount of goodwill.

Editor's Note: The proposed ASU's Basis for Conclusions notes that during deliberations of the proposed guidance, one FASB board member supported the introduction of an optional step 2 assessment because an entity may fail to meet the step 1 requirements, but satisfy those in step 2 in the current guidance. Under the proposed ASU as drafted, an entity would no longer determine impairment of goodwill on the basis of the fair value of all identifiable assets and liabilities. Instead, the entity would compare the fair value of a reporting unit with the carrying amount of the reporting unit, which would not always be identical. The goodwill impairment test under the proposal would therefore not be as precise at that under current guidance. Accordingly, under the proposed guidance, an entity could record a goodwill impairment even though the decline in the fair value of amortizing intangible assets and other long-lived assets caused the decline in the fair value of the reporting unit but not a decline in the fair value of goodwill.

The qualitative assessment of goodwill would be unchanged under the proposed ASU. However, the proposed amendments would remove "the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test." Instead, all reporting units, even those with a zero or negative carrying amount, would apply the same impairment test. As noted in the proposal's Basis for Conclusions, goodwill of reporting units with a zero or negative carrying amount would not be impaired even when conditions underlying the reporting unit indicate that it was impaired. However, entities would be required to disclose any reporting units with a zero or negative carrying amount and the respective amounts of goodwill allocated to those reporting units.

Editor's Note: Under the proposed ASU, reporting units with a zero or negative carrying amount would essentially never be impaired. Accordingly, judgments related to the assignment of assets and liabilities to a reporting unit may become more relevant. The Board considered, but rejected, prescribing further guidance for allocating assets and liabilities to reporting units. The proposed ASU's Basis for Conclusions notes that "the amendments included in this proposed Update should not trigger changes to the composition of a reporting unit and that preparers, auditors, and regulators should pay close attention to any change to a reporting unit that results in a zero or negative carrying amount. The Board emphasized that the allocation of assets and liabilities to reporting units should not be viewed as an opportunity to avoid impairment charges."

The proposed amendments would also make minor changes to the Overview and Background sections of certain ASC Topics and Subtopics as part of the Board's initiative to unify and improve those sections throughout the Codification.

Next Steps

Comments on the proposed ASU are due by July 11, 2016. An entity would apply the final guidance prospectively from the date of adoption. The proposal notes that the FASB "will determine the effective date and whether early adoption should be permitted after it considers stakeholder feedback on the proposed Update." A nonpublic business entity that has already elected the PCC's accounting alternative for goodwill and would like to apply the final guidance would need to perform an assessment of preferability in accordance with ASC 250.[4]

In phase 2 of its project, the Board expects to consider whether to make additional changes to the subsequent accounting for goodwill, including whether to permit or require amortization of goodwill or make further changes to impairment testing methods.

Convergence With IFRSs

The removal of step 2 from the goodwill impairment test would more closely align ASC 350 with IAS 36,[5] under which the impairment test is performed in one step. However, the IAS 36 impairment test is performed at the level of the cash-generating unit or group of cash-generating units, whereas under U.S. GAAP it is performed at the reporting-unit level. Further, IAS 36 requires an entity to compare the carrying amount of that cash-generating unit or units with its recoverable amount, whereas the proposed guidance would require an entity to compare the carrying amount of a reporting unit with its fair value.

[4] FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*.
[5] IAS 36, *Impairment of Assets*.

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