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FASB Eliminates Step 2 From the Goodwill Impairment Test

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On January 26, 2017, the FASB issued [ASU 2017-04](#),¹ which simplifies the accounting for goodwill impairments by eliminating step 2 from the goodwill impairment test. Instead, if “the carrying amount of a reporting unit exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit.”

Background and Key Provisions of the ASU

In November 2013, the FASB issued a Private Company Council (PCC) accounting alternative that allows nonpublic business entities to amortize goodwill and perform a simplified impairment test.² As noted in the Summary of ASU 2017-04, feedback received by the Board on that PCC accounting alternative indicated 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 to the feedback, the FASB added to its agenda a two-phase goodwill simplification project. ASU 2017-04 was issued in conjunction with phase 1 of the project; however, on October 10, 2016, the Board [decided](#) to suspend deliberations of phase 2 and move that portion of the project to its research agenda. Before evaluating whether to make any

¹ FASB Accounting Standards Update No. 2017-04, *Simplifying the Test for Goodwill Impairment*.

² See Deloitte's January 27, 2014, [Heads Up](#) for more information about the FASB's simplified approaches to goodwill and hedge accounting for private companies.

additional changes to the model for the subsequent accounting for goodwill, the Board will evaluate the effectiveness of ASU 2017-04 and continue to monitor the IASB's projects on goodwill and impairment.

Under the current guidance in 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 must "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." Accordingly, performing 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." In the Financial Accounting Foundation's (FAF's) [report](#) on its post-implementation review of FASB Statement 141 (revised 2007),⁴ the FAF discussed the cost and complexity associated with performing step 2.



Editor's Note

The ASU requires goodwill impairments to be measured on the basis of the fair value of a reporting unit relative to the reporting unit's carrying amount rather than on the basis of the implied amount of goodwill relative to the goodwill balance of the reporting unit. Thus, the ASU permits an entity to record a goodwill impairment that is entirely or partly due to a decline in the fair value of other assets that, under existing GAAP, would not be impaired or have a reduced carrying amount.

The ASU does not change the qualitative assessment;⁵ however, it removes "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 will apply the same impairment test. Therefore, as the FASB notes in the ASU's Basis for Conclusions, the goodwill of reporting units with zero or negative carrying values will not be impaired, even when conditions underlying the reporting unit indicate that goodwill is impaired. Entities will, however, be required to disclose any reporting units with zero or negative carrying amounts and the respective amounts of goodwill allocated to those reporting units.



Editor's Note

U.S. GAAP does not prescribe whether an entity should use an enterprise premise or an equity premise in assigning assets and liabilities to a reporting unit to determine its carrying amount. Under an enterprise premise, debt is excluded from the liabilities available for assignment to a reporting unit; under an equity premise, debt is included in those liabilities. A reporting unit that uses an equity premise sometimes may have a zero or negative carrying amount because of the assignment of debt, which may not have resulted if the entity used an enterprise premise.

³ For titles of *FASB Accounting Standards Codification* (ASC or the "Codification") references, see Deloitte's "[Titles of Topics and Subtopics in the FASB Accounting Standards Codification](#)."

⁴ FASB Statement No. 141(R), *Business Combinations* (superseded).

⁵ The optional assessment described in ASC 350-20-35-3A through 35-3G to determine whether it is more likely than not that the carrying amount of a reporting unit exceeds its fair value is commonly referred to as the qualitative assessment or step 0.

Under current guidance, if the carrying amount of a reporting unit is zero or negative, an entity must perform a qualitative assessment of goodwill to determine whether step 2 of the goodwill impairment test is warranted. The qualitative assessment has the effect of reducing the impact of the entity's judgment related to assigning debt to a reporting unit when such assignment causes the reporting unit to have a zero or negative carrying amount. Since the ASU significantly changes the accounting for goodwill for reporting units with zero or negative carrying amounts, an entity's judgment in choosing a valuation premise may affect its conclusions regarding the recoverability of goodwill when it applies the new guidance.

In paragraph BC51 of the ASU, the FASB cautioned that "the allocation of assets and liabilities to reporting units should not be viewed as an opportunity to avoid impairment charges and should only be changed if there is a change in facts and circumstances for a reporting unit." Further, the Board reiterated in paragraph BC52 that "the allocation of assets and liabilities to reporting units should not be viewed as an opportunity to achieve a desired impairment result."

The ASU also:

- Clarifies the requirements for excluding and allocating foreign currency translation adjustments to reporting units related to an entity's testing of reporting units for goodwill impairment.
- Clarifies that "an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable."
- Makes minor changes to the Overview and Background sections of certain ASC Subtopics and Topics as part of the Board's initiative to unify and improve those sections throughout the Codification.

Convergence With IFRSs

Removing step 2 from the goodwill impairment test under ASC 350 more closely aligns U.S. GAAP with IFRSs because there is only one step in the goodwill impairment test under IFRSs. However, the impairment test required under IAS 36⁶ is performed at the cash-generating-unit or group-of-cash-generating-units level rather than the reporting-unit level as required by U.S. GAAP. Further, IAS 36 requires an entity to compare the carrying amount of the cash-generating unit with its recoverable amount, whereas the ASU requires an entity to compare the carrying amount of a reporting unit with its fair value.

Effective Date and Transition

For public business entities that are SEC filers,⁷ the ASU is effective for annual and any interim impairment tests for periods beginning after December 15, 2019.

⁶ IAS 36, *Impairment of Assets*.

⁷ The ASC master glossary defines an "SEC filer" as follows:

"An entity that is required to file or furnish its financial statements with either of the following:

a. The Securities and Exchange Commission (SEC)

b. With respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.

Financial statements for other entities that are not otherwise SEC filers whose financial statements are included in a submission by another SEC filer are not included within this definition."

An SEC filer does not include an entity's financial statements or financial information that is required to be or is included in a filing with the SEC (see, e.g., Regulation S-X, Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons," or Regulation S-X, Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired," and Regulation S-X, Rule 4-08(g), "Summarized Financial Information").



Editor's Note

SAB Topic 11.M⁸ requires SEC registrants to disclose the effect of new accounting standards that have been issued but are not yet effective. In addition, in a manner consistent with the views expressed by the SEC staff at the [March 2001](#) and [March 2002](#) AICPA SEC Regulations Committee joint meetings with the SEC staff, if a registrant adopts a new standard in an interim period, the registrant must comply with all of the standard's disclosure requirements (including annual disclosures that are not duplicative of interim disclosures) as well as required transitional disclosures and any disclosures required by ASC 250 and ASC 270. Such disclosures should be provided in all interim periods until year-end rather than only in the first interim period the standard was adopted.

Public business entities that are not SEC filers should apply the new guidance to annual and any interim impairment tests for periods beginning after December 15, 2020. For all other entities, the ASU is effective for annual and any interim impairment tests for periods beginning after December 15, 2021. Early adoption is allowed for all entities as of January 1, 2017, for annual and any interim impairment tests occurring on or after January 1, 2017.



Editor's Note

Early adoption of the ASU is allowed for all entities beginning with any goodwill impairment test occurring and performed on or after January 1, 2017, as noted above. An entity would not be able to early adopt the ASU for goodwill impairment tests with testing dates during 2016, even if financial statements have not yet been issued in 2017. For example, an entity with an annual goodwill impairment test date of December 31, 2016, whose test is being completed in early 2017 would not be able to apply the ASU's guidance to its December 31, 2016, test.

An entity must also provide the transition disclosures described in ASC 250-10-50-1(a) and ASC 250-10-50-2. The ASU clarifies that the guidance may be adopted regardless of whether an entity evaluates goodwill for impairment by using the quantitative assessment in the period of adoption.

The ASU also notes that private companies that switch from the PCC accounting alternative should apply the ASU's guidance prospectively on or before its effective date. Private companies that switch from the PCC accounting alternative to the ASU's guidance on or before the effective date would **not** need to justify preferability for the accounting change. Paragraph BC67 states that the "issuance of this Update should be sufficient to justify the change."

⁸ SEC Staff Accounting Bulletin Topic 11.M, "Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period."

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