Project update: subsequent measurement of goodwill

Executive Summary

Project Type	Research
Project Scope	Limited scope

Purpose of the paper

This paper seeks the Board's approval to: publish and submit our response to the IASB staff questions on potential changes to the subsequent measurement of goodwill, and to undertake further work to develop and field test illustrative examples of transitional arrangements.

Summary of the Issue

This paper summarises the conclusions from our research project on subsequent measurement of goodwill, namely:

1. A potential transition to a hybrid model for subsequent measurement of goodwill
   a) Would have a material impact on the financial position of UK IFRS reporters, although this is not of itself a compelling reason to defer a transition;
   b) Would increase the risk of non-compliance with IFRS-based measures in financial covenants, although in practice re-negotiation of covenants would be the most likely outcome in the event of non-compliance due to changes in IFRS Standards;
   c) Is unlikely to have a material impact on distributable profits; and
   d) Does not increase the risk of non-compliance with market regulation.

2. Under UK GAAP, management is required to determine the useful life of goodwill, and financial statement disclosures of larger UK GAAP goodwill reporters show cases where specific and relevant factors for each acquisition are considered in this determination.

Decisions for the Board

The Board is asked:

1. To approve the draft response to the IASB for publication and for submission to IASB staff.
2. To approve further work to develop and field-test illustrative examples of transitional arrangements.

Recommendation

Board gives approval as requested above

Appendices

Appendix 1 Project update: subsequent measurement of goodwill

Background

1. The UK Endorsement Board (UKEB) approved the Project Initiation Plan for a limited scope research project on the subsequent measurement of goodwill at its October 2021 board meeting.

2. The project responds to and expands on a request from IASB staff to national standard setters to undertake research on the subsequent measurement of goodwill. The research will inform the IASB's redeliberations on its Discussion Paper DP 2020/1 *Business Combinations: Disclosures, Goodwill and Impairment* (the DP). IASB staff identified two specific areas of analysis for input from national standard setters. These are:

   a) How the useful life of goodwill is determined for amortisation purposes under national GAAP; and

   b) The potential impacts of reintroducing amortisation, including on financial position, financial stability, and legal and regulatory compliance.

3. In addition, UKEB staff identified two further areas for analysis that it anticipated would be useful to the IASB in its ongoing redeliberations. These areas are:

   a) How a hybrid model[1] can provide information that is useful for users of financial statements.

   b) Cost implications of a hybrid model.

4. At the November 2021 UKEB meeting, a paper including an interim update on research provided the Board with the opportunity to share feedback and consider the proposed direction of subsequent work on the project.

5. This paper provides a summary of research undertaken, conclusions reached and the proposed next steps.

International developments

6. The Accounting Standards Committee of Germany has published its response to the IASB staff's questions on the subsequent measurement of goodwill.[2] The response highlighted that goodwill balances are a growing and significant component of IFRS balance sheets. It also identified the factors considered when determining the useful life of goodwill under German GAAP and concluded that German GAAP provided a well-established

[1] The UKEB Secretariat's response to the IASB's DP 2020/1 *Business Combinations: Disclosures, Goodwill and Impairment* advocated a hybrid model for the subsequent measurement of goodwill. In the hybrid model, an annual amortisation charge would be made over the useful economic life of goodwill and would be supported by indicator-only impairment testing.

[2] https://www.drsc.de/app/uploads/2021/11/211123_ASCG_Information_Request_subsequent_accounting_for-goodwill.pdf

methodology which is well-suited to determining the useful life of goodwill in a comprehensive and verifiable manner.

7. The FRC, as the UK's domestic GAAP standard setter, responded to the IASB's staff's questions on whether a default period is provided for the amortisation of goodwill in local GAAP, whether the useful life of goodwill is established on the basis of management's best estimate, and, if so, whether a list of indicators / factors to be considered is provided. The FRC's response confirmed that under UK GAAP:

    a) There is not a default period for determining the useful life of gooodwill for amortisation purposes in UK GAAP.

    b) The useful life of goodwill is established on the basis of management's best estimate.

    c) If management cannot determine the useful life of goodwill reliably, then goodwill should be amortised over a period not exceeding ten years.

    d) A list of indicators / factors to be considered in the determination of the useful life of goodwill for amortisation purposes is not provided.

8. The FASB discussed its tentative decision to require amortisation of goodwill at its 17 November 2021 board meeting. Topics explored included: whether a cap or a floor on useful life should be set; and whether a list of factors to be used in determining useful life should be provided. No decisions were made.

9. The IASB is currently redeliberating the DP proposals and plans to vote on those proposals in Q1 2022. At its November 2021 meeting, the IASB discussed the DP's proposals to enhance the disclosure requirements in IFRS 3 *Business Combinations*, and in particular the proposed disclosures on expected synergies arising from a business combination and pro-forma information. The IASB:

    a) approved the staff's proposals to field-test illustrative examples of proposed disclosures on synergies. We are supporting IASB staff in this field-testing;

    b) tentatively decided to retain the requirement for pro-forma profit and loss information; and

    c) tentatively decided not to add a requirement to disclose pro-forma operating cash flows.

Research to date and proposed next steps

10. Our draft response to the IASB is in Appendix A to this paper. A summary of our research objectives, sources and conclusions is in Appendix B to this paper.

11. We would like to continue to provide relevant evidence and examples to the IASB as it continues its redeliberations. We are seeking the Board's approval to develop and field-test illustrative examples of different potential approaches to a transition to a hybrid model for subsequent measurement of goodwill.

12. We have already identified stakeholders with an interest in taking part in the field-testing. We envisage sharing the results of the field-testing with the IASB. There may also be potential to publish a short research paper including the results from the proposed field tests and other parts of the project.

13. On the proviso that the Board approves the further research we propose, we have not included a feedback statement in this paper. We will provide a feedback statement when the project is completed.

Questions for the Board

14. Do Board Members approve the draft response for submission to the IASB staff and for publication?

15. Do Board Members approve continued work on the development and field-testing of illustrative examples of transitional arrangements?

Next steps

16. Subject to the Board's approval, we will continue development and field-testing of illustrative examples of transitional arrangements and report to the Board at its February 2022 meeting.

Appendix A: Draft response

Dr Andreas Barckow
International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London
E14 4HD

13 December 2021

Dear Andreas,

Subsequent accounting for goodwill

The UK Endorsement Board (UKEB) is responsible for endorsement and adoption of IFRS for use in the UK and therefore is the UK's National Standard Setter for IFRS. The UKEB also leads the UK's engagement with the IFRS Foundation (Foundation) on the development of new standards, amendments and interpretations. This letter forms part of those influencing activities and is intended to contribute to the International Accounting Standards Board's (IASB) due process. The views expressed by the UKEB in this letter are separate from, and will not necessarily affect the conclusions in, any endorsement and adoption assessment on new or amended International Accounting Standards undertaken by the UKEB.

There are currently approximately 1,500 entities with equity listed on London Stock Exchange using IFRS Standards[3]. In addition, unlisted companies have the option to use IFRS and a significant number take up this option.

We are pleased to support the IASB's further research on the subsequent accounting for goodwill. We welcome the opportunity to contribute to the ongoing exploration of this significant area in international financial reporting, and to provide relevant information to support the IASB as it redeliberates the feedback received on its Discussion Paper 2020/01 *Business Combinations: Disclosures, Goodwill and Impairment.*

In developing our responses, we conducted desk-based research and outreach to UK IFRS reporters. Outreach to UK IFRS reporters included a public survey which received 23 responses from entities, representing 17% of the FTSE 350 by market capitalisation and 17% of the combined goodwill of FTSE 350 entities for 2020. 96% of responding organisations had made acquisitions in the last 5 years. Respondents were from a range of sectors including: fast-moving consumer goods, banking, energy, utilities, construction, technology, retail, pharmaceutical, medical technology, insurance, airlines, B2B, and manufacturing.

[3] UKEB calculations based on LSEG and Eikon data.

We also conducted desk-based research and outreach to ascertain how the useful life of goodwill is determined for amortisation purposes under UK GAAP.

Potential consequences of transitioning to a hybrid model

1. Goodwill is a significant balance for UK IFRS reporters and potential changes to the subsequent measurement of goodwill are likely to have material impacts if adjustment of existing balances is required. In 2020, goodwill for FTSE 350 and AIM entities totalled £391.3bn, representing 15.2% of total assets and 50.9% of net assets. Goodwill exceeded net assets for 57, or 5%, of FTSE 350 and AIM entities.[4] However, if changes to the subsequent accounting for goodwill are to be made, material impacts on transition are not a compelling argument for deferral, because if the growth trend in goodwill continues[5], transitional impacts will only increase in future.

2. According to our survey results, potential changes to the subsequent measurement of goodwill are associated with an increased risk of breach of covenants if adjustment of existing goodwill balances is required on transition. The impact cannot be quantified without further information on current headroom and more comprehensive data on specific covenant terms. 47%[6] of respondents to our survey questions on covenants stated that IFRS-based measures in financial loan covenants are not based on frozen GAAP[7] and 80% stated that covenant terms do not specify a renegotiation right should financial reporting standards change. Follow-up discussions with survey respondents, however, suggested that although covenant terms typically do not specify a renegotiation right, , in practice the most likely outcome would be a renegotiation if there were changes to IFRS and if the covenant were not based on frozen GAAP.

3. Our desk-based research and survey results suggest that potential changes to the subsequent measurement of goodwill would not have a significant impact on distributable profits for UK IFRS reporters. Distributable profits are not affected by amortisation or impairment of goodwill arising on consolidation in the UK, because distributions are made by individual companies and not by groups under UK law. In contrast, goodwill arising on the acquisition of an unincorporated business is recognised in the acquiring entity's separate financial statements and therefore its amortisation reduces that entity's distributable profits. Since 39% of our survey respondents acquired at least one unincorporated entity in the last five years, their distributable profits are likely to be affected by potential changes to the subsequent measurement of goodwill. However, a review of their financial statements suggested that acquisitions of unincorporated entities did not typically result in material goodwill balances.

4. Under current UK tax legislation, tax payable by UK IFRS reporters and their UK-based subsidiaries would not be directly impacted by changes to the subsequent measurement

[4] Source: UKEB calculations based on Eikon data.
[5] Goodwill increased by 69% from £227bn to £383bn for the FTSE 350 between 2005 and 2020.
[6] We note that in a 2015 EFRAG survey prior to the introduction of IFRS 16, a similar percentage of respondents stated that IFRS-based measures in covenants are not based on frozen GAAP.
[7] Covenants based on frozen GAAP apply the accounting treatment in place when the loan was agreed.

of goodwill under IFRS. This is because UK companies' corporation tax payable is determined by applying UK tax legislation not IFRS Standards. For non-UK-based subsidiaries, different tax regimes may apply.

5. Our outreach and review of the FCA handbook have not identified an increased risk of failing to meet market regulations if there were changes to the subsequent measurement of goodwill.

6. The majority (71%) of respondents to our public survey said that they would not anticipate significant operational changes if there were a transition to a hybrid model[8] for the subsequent measurement of goodwill. Anticipated operational changes seemed not to depend on the number of acquisitions or on the value of the goodwill balance.

Determining the useful life of goodwill for amortisation purposes

7. We understand that the FRC, as the UK's domestic GAAP standard setter, has responded to you separately on the questions of whether a default period is provided for the amortisation of goodwill in local GAAP, whether the useful life of goodwill is established on the basis of management's best estimate, and, if so, whether a list of indicators / factors to be considered is provided. To provide additional evidence, we have analysed the financial statements of the largest UK GAAP reporters and conducted outreach with their auditors to understand how the useful life of goodwill is determined and verified in practice.

8. The evidence we collected through desk-based research and outreach suggests that in many cases specific and appropriate considerations are applied by entities when determining the useful life of goodwill. Auditors gain sufficient and appropriate audit evidence on the useful life of goodwill by applying ISA 540 *Auditing Accounting Estimates and Related Disclosures,* which was revised for accounting periods beginning on or after 15 December 2019 in order to provide more extensive guidance on the audit of accounting estimates. Audit firms highlighted to us that since the revision of the ISA and increased audit challenge in this area, there has been increased use of input from independent business valuation specialists as audit evidence on the useful life of goodwill.

Recommended next steps

9. Our research has identified that a potential transition to a different model for subsequent measurement of goodwill may impact financial position and covenants for UK IFRS reporters. Our research has also provided insight into the determination of the useful life of goodwill under UK GAAP and identified that a significant proportion of UK IFRS reporters responding to our survey do not anticipate major operational changes as a result of transition.

[8] The UKEB Secretariat's response to the IASB's DP recommended a hybrid model for the subsequent measurement of goodwill. Under a hybrid model, an annual amortisation charge would be supported by indicator-based impairment testing.

10. We intend to conduct field-testing to explore how different options for transitional arrangements could mitigate the potential impacts to financial position and covenants. In particular, field-testing will focus on:

    a) Retrospective and prospective options for transition;
    b) Presentation and disclosure, focusing on the user perspective;
    c) Whether the useful life of goodwill should be assessed at acquisition level or CGU level;
    d) Whether application guidance for determination of useful life of goodwill should be provided; and
    e) Whether practical expedients are needed for very old and/or immaterial balances.

We would be happy to share the output from our field-testing with you if you would find it of interest.

If you would like to discuss these comments, please contact the project team at contact@endorsement-board.uk .

Yours sincerely

Pauline Wallace
Chair
UK Endorsement Board

Appendix 1 Response to IASB staff questions

Appendix 1: Responses to IASB staff questions

Question 1: Determination of the useful life of goodwill for amortisation purposes under UK GAAP
Based on your experience: (A) If the applicable local accounting framework in your jurisdiction requires goodwill to be subsequently amortised, how is the useful life determined and, in particular whether: (i) a default period is provided in local GAAP (for example: 10 or 20 years) and the reasons for setting a default period and how that default period was determined; (ii) entities can deviate from a default period based on specific facts and circumstances (rebuttable presumption) and, if so, whether in practice entities tend to rebut that presumption and deviate from the default period, and what evidence is provided to support any deviation; (iii) useful life is established on the basis of management's best estimate and, if so, whether a list of indicators/factors to be considered is provided (for example: cash flow streams, synergies, payback period), how entities are making these estimates and whether auditors and regulators can, and do, challenge these assumptions.

A1 We understand that the FRC, as the UK's domestic GAAP standard setter, has responded to you on questions A i and A ii and the first part of A iii. We share below the insights we gained from additional desk-based research and stakeholder outreach to understand how the useful life of goodwill amortisation is determined for UK GAAP purposes, and whether auditors and regulators can and do challenge these assumptions.

A2 To understand how the useful life of goodwill is determined under FRS 102, we analysed the financial statements of the UK's 100 largest private companies[9]. 48 of those companies report under FRS 102, and of those 48 companies, 34 reported goodwill in their most recent financial statements. The highest reported goodwill was £628m and the average was £48m.[10] As a comparator, the average goodwill reported by FTSE 350 and AIM entities combined in 2020 was £366m. Therefore, the larger private company goodwill balances are comparable in size to those reported at the smaller end of the listed market.

A3 Analysis of goodwill balances and related disclosures in those annual reports showed:

a) Of the 34 companies whose disclosures on goodwill we reviewed:

[9] Sunday Times Top Track League Table of UK private companies, ranked by turnover, published July 2020. Such companies have a similar financial profile to some IFRS reporters at the lower end of the listed market.

[10] Source: UKEB staff calculations on financial statements.

i. 16 amortised goodwill on the same straight-line basis for all acquisitions. The periods over which goodwill was amortised were 10 years (9 companies), 20 years (5 companies) and 5 years (2 companies).

ii. 10 determined the useful life of goodwill for each acquisition within an overall range. The ranges were: 4 – 20 years (1 company), 5 – 20 years (5 companies), 10 - 20 years (2 companies), and up to 20 years (2 companies).

iii. 4 disclosed the specific useful life of goodwill determined for individual acquisitions. These specific useful lives were 1 year, 7 years, 19 years, and 50 years. This implies that specific factors are, in at least some cases, considered in the determination of the useful life of goodwill.

iv. 4 did not disclose the period over which goodwill was amortised.

v. Where the useful life was determined for individual acquisitions, disclosures indicated that a range of relevant factors was considered in that determination.

b) 17 companies (50%) determined a useful life of goodwill that exceeded ten years for at least some of their acquisitions. Under UK GAAP, if management cannot reliably estimate the useful life of goodwill, goodwill must be amortised over a period of ten years or less. Only where management can estimate the useful life of goodwill reliably and auditors can obtain sufficient and appropriate audit evidence in relation to that estimate can a useful life exceeding ten years be used for goodwill amortisation. The evidence therefore suggests that, although estimating the useful life of goodwill includes an element of judgement in the same way as estimating the useful life of intangible and tangible assets includes an element of judgement, in half of the cases we reviewed, management can reliably estimate the useful life of goodwill.

c) Disclosures indicated that a broad range of factors is used to determine the useful life of goodwill. These included: strength of brand, products and services provided, competition and expected future performance, expected use of acquired assets, any legal, regulatory, or contractual provisions that may limit the useful life, strategic plans and expected life of the operating unit or line of business to which the goodwill relates.

d) The useful life was typically longer for the food retail and motor services sectors, while the entities in the construction, retail, leisure, and hospitality sectors had shorter useful lives. The useful life was typically longer in the luxury goods sector and where acquisitions had delivered technological capability or online presence. Whilst not conclusive, this evidence suggests that specific and appropriate considerations are applied by each entity when determining the useful life of goodwill.

A4 From our financial statement analysis, we identified 14 entities with goodwill disclosures which suggested that particular rigour had been applied to the determination of the useful life of goodwill. We have approached these entities to gain further insight into their approach to determining the useful life of goodwill. At the time of writing, we are awaiting their responses.

A5 Our outreach to the relevant team at the FRC indicated that it does not generally receive queries on how to determine the useful life of goodwill under FRS 102. It appears, therefore, that the application of FRS 102 on goodwill is not generally problematic.

A6 We conducted structured interviews with auditors of FRS 102 reporters to ascertain the types of audit evidence they seek on management's estimate of the useful life of goodwill, and how that evidence is challenged. Auditors gain sufficient and appropriate audit evidence on the useful life of goodwill by applying ISA 540 *Auditing Accounting Estimates and Related Disclosures,* which was revised for accounting periods beginning on or after 15 December 2019 to provide more extensive guidance on the audit of accounting estimates. Audit firms highlighted to us that since the revision of the ISA and consequent increased audit challenge in this area, there has been increased use of expert input from business valuation specialists as audit evidence on the useful life of goodwill.

Question 2: Potential changes to subsequent measurement of goodwill
(B) If the Board decides to reintroduce goodwill amortisation and transition to an amortisation model requires adjusting historical goodwill balances, what are the potential effects of writing-off significant amounts of historic goodwill on transition and amortising the remaining historic goodwill balances, in terms of: (i) financial position, financial loan covenants, distributable reserves and dividend distribution, capital maintenance and other similar measures; (ii) capital markets and economic development, and whether entities would run the risk of failing to meet any market regulations (for example, listing requirements); (iii) tax implications and whether the amortisation charge would be tax deductible; and (iv) any other local jurisdictional requirements that might be relevant.

I. Financial position

A7 Goodwill is a significant balance for UK IFRS reporters and potential changes to the subsequent accounting for goodwill are likely to have material impacts. In 2020, goodwill for FTSE 350 and AIM entities totalled £391.3bn, representing 15.2% of total assets and 50.9% of net assets. Goodwill exceeded net assets for 57, or 5%, of FTSE 350 and AIM entities.[11]

A8 The growth in goodwill balances in absolute and relative terms since the introduction of the impairment-only model in 2005 was highlighted in the UK Endorsement Board Secretariat's response to the IASB's Discussion Paper 2020/1 *Business Combinations: Disclosures, Goodwill and Impairment*. We support the IASB's current exploration of different approaches to the subsequent measurement of goodwill given the continued

[11] Source: UKEB calculations based on Eikon data.

significance of goodwill balances for UK IFRS reporters, in both absolute and relative terms.

2. Covenants

A9 Our public survey[12] included questions on financial loan covenants. The objective of these questions was to establish whether potential changes to the subsequent measurement of goodwill could lead to breaches of such covenants.

A10 15 respondents completed the covenants section of our public survey for UK IFRS preparers, compared to 23 respondents overall. Several respondents stated that they did not complete the covenants section because the information requested was confidential. Respondents who completed the covenants section of the survey have a combined market capitalisation of £290bn, representing 11% of FTSE 350 market capitalisation. Their combined goodwill totals £49bn, representing 13% of FTSE 350 combined goodwill.[13]

A11 Of the respondents to the covenants section, 87% (13 respondents) affirmed that covenants use IFRS-based measures.

A12 Of these 13 respondents: eight stated that the IFRS-based measures in covenants include goodwill and are taken directly from the financial statements, one stated that the IFRS-based measures in covenants are derived from the financial statements but adjusted to exclude goodwill, and four stated that covenants used both types of IFRS-based measure.

A13 We asked whether IFRS-based measures in covenants were based on frozen GAAP. Of the respondents to the covenants section, 47% (seven respondents) stated that IFRS-based measures in covenants were based on frozen GAAP. Another 47% (seven respondents) stated that IFRS-based measures in covenants were not based on frozen GAAP. 6% (one respondent) did not answer this question.

A14 We further asked whether covenants allow for re-negotiation when there are changes to financial reporting standards. Of the respondents to the covenants section of our survey, 80% (12 respondents) stated that covenants do not allow for renegotiation when there are changes to financial reporting standards. 20% (three respondents) stated that covenants allow for re-negotiation when there are changes to financial reporting standards. These 3 respondents were not a subset of those respondents who stated that IFRS-based measures in covenants were not based on frozen GAAP.

A15 Based on our survey results, potential changes to the subsequent measurement of goodwill are associated with an increased risk of breach of covenants. The impact cannot be quantified without further information on current headroom and more comprehensive data on specific covenant terms. However, follow-up discussion with respondents identified that in practice, covenants which did not use frozen GAAP would be likely to be renegotiated in the event of changes to IFRS.

[12] Our public survey was open from 15 November 2021 to 26 November 2021
[13] Source: UKEB calculations based on Eikon data

A16 Some respondents noted that changes to credit ratings may impact loan covenants. Since ratings agencies typically exclude goodwill in their rating methodologies, we do not anticipate that this would typically impact loan covenants.

A17 Several respondents from the banking and insurance sectors noted that loan covenants are typically based on their Solvency II position rather than on IFRS-based measures. There were no other discernable trends by sector, size of entity, reported goodwill or number of acquisitions in the responses to our survey questions on covenants.

3. Management compensation schemes

A18 Some survey respondents highlighted that potential changes to the subsequent measurement of goodwill could impact management compensation schemes. Through follow up discussion with survey respondents, we identified that remuneration committees will typically discuss and agree on any necessary adjustments to IFRS-based performance measures in management compensation schemes if there are changes to IFRS Standards. Given lead-times for the implementation of new Standards, there is sufficient time for adjustments to be made. We do not foresee significant impact on management compensation schemes arising from potential changes to the subsequent measurement of goodwill.

4. Distributable profits

A19 Under the UK Companies Act 2006 and UK common law, distributions are made by individual companies and not by groups. The group accounts are therefore not relevant for the purpose of determining a company's profits available for distribution, dividend payments or capital maintenance. Amortisation or impairment of goodwill arising on consolidation has no direct impact on distributable profits, dividend payments or capital maintenance. However, goodwill arising on the acquisition of an unincorporated business is reported in the acquiring entity's separate financial statements and therefore its amortisation would directly impact distributable profits and dividend payments for that entity.

A20 Our survey revealed that 39% of respondents (nine respondents) had acquired at least one unincorporated entity in the last five years. 26% (six respondents) had acquired between one and five unincorporated entities during the last five years. 9% (two respondents) had acquired between six and 10 unincorporated entities during the last five years and 4% (one respondent) had acquired more than 10 unincorporated entities during the last five years. Acquisitions of unincorporated businesses took place in the technology, information services, banking and FMCG sectors. However, an initial review of their financial statements revealed that acquisitions of unincorporated entities did not typically result in material goodwill balances.

5. Tax implications

A21 Transitioning to a hybrid model for the subsequent measurement of goodwill under IFRS would not directly impact tax payable by UK IFRS reporters and their UK-based subsidiaries.

A22 This is because for UK companies corporation tax payable is computed under tax legislation and is not directly derived from accounting profits. For non-UK based subsidiaries, different tax regimes may apply.

6. Market regulations

A23 Our outreach and desk-based research have not identified an increased risk of failing to meet market regulations if there were changes to the subsequent measurement of goodwill.

A24 Where market regulations include tests of gross assets, capital and profits to determine whether additional disclosure is required [for example, Listing Rules Class tests for transactions Listing Rules 13.5.33b; Disclosure Guidance and Transparency Rules Related Party tests] retrospective application of potential changes to the subsequent measurement of goodwill would not increase the risk of compliance failure because these tests are applied to asset and profit values at the time the test was required to take place. Prospective application may lead to increased disclosures relating to these types of transaction in future.

A25 Several respondents to our public survey for IFRS preparers from the banking and insurance sectors noted that changes to the subsequent measurement of goodwill would not impact Solvency II compliance, since goodwill is already excluded from Solvency II ratios.

7. Operational implications

A26 The majority (71% / 16 responses) of responding organisations said that they would not anticipate significant operational changes if there were a transition to a hybrid model for the subsequent measurement of goodwill. These respondents identified that they would expect some change in the following operational areas if the potential transition to a hybrid model were to go ahead: processes and procedures, audit, staff training, and investor relations. One respondent commented that, 'There would also be a need to train / educate investors and users of our financial reports on the change in our reporting, given the non-cash nature of the charge.'

A27 The remaining 39% (seven responses) said that they anticipated significant operational changes if there were a transition to a hybrid model. These respondents identified that significant changes would be needed to the following areas: processes and procedures, audit, data, staff training, and systems and technology.

A28 Respondents anticipating significant operational changes if there were a transition to a hybrid model did not report higher numbers of acquisitions in the last five years or higher goodwill.

8. Cost implications

A29 When asked about the anticipated cost impact of a potential transition to a hybrid model, 39% of respondents anticipated either a substantial reduction, a minor reduction, or minimal or no impact on costs. The respondent who anticipated a substantial reduction in costs cited ongoing cost reductions in processes and procedures as the underlying reason.

A30 48% of respondents anticipated a minor increase in costs and 13% of respondents anticipated a significant increase in costs. Approximately one third of the respondents anticipating a minor increase in costs attributed this to implementation costs rather than ongoing costs. Respondents anticipating a significant increase in costs cited audit, staff training and additional expert resource as underlying reasons. Two thirds of these respondents anticipated increases in implementation costs and ongoing costs. The implementation costs related to developing a model for estimating useful life of goodwill and a methodology for revising it for future acquisitions.

A31 Respondents anticipating cost increases did not report higher numbers of acquisitions in the last five years or higher goodwill.

Appendix B: Research Objectives, Sources and Conclusions

Objectives	Sources	Conclusions
Gain evidence of the impact of the potential transition on: - Financial loan covenants - Regulatory compliance - Operations - Costs	UKEB public survey for IFRS preparers (23 responses from IFRS preparers representing 17% of the FTSE 350 by market capitalisation)	The potential transition increases the risk of non-compliance with financial loan covenants. The risk cannot be quantified without further information on headroom and more extensive quantitative data on covenants. The potential transition is not generally expected to impact regulatory compliance. A majority of respondents do not anticipate significant operational or cost impacts as the result of the potential transition. Acquisitions of unincorporated businesses occur with some frequency but their impact on distributable profits is unlikely to be significant because the goodwill arising on acquisition is not usually material.
Gain further insight on survey responses	Structured interviews with 5 UKEB public survey respondents	Whilst a potential transition to amortisation of goodwill could lead to an increased risk of non-compliance with the current terms of financial loan covenants because those covenants do not include a right to renegotiate in the event of non-compliance , respondents' experience in practice is that such covenants are likely to be renegotiated in the event of non-compliance due to changes in IFRS Standards.
Assess whether potential transition to hybrid model would have material impacts	Market capitalisation and financial statement data for FTSE 350 and AIM entities	Transitional arrangements are likely to have a material impact on financial position because goodwill represents 15.2% of total assets for the FTSE 350 (2020 figures). However, given the growth trend in goodwill balances for UK IFRS reporters from 2005 – 2020, this is not a compelling argument for deferral, if changes to the subsequent accounting for goodwill are to be made.

Establish the range of useful lives determined for goodwill under UK GAAP and identify factors considered in its determination Establish whether the useful life of goodwill is typically determined on an acquisition-by-acquisition basis Establish the frequency with which useful life of goodwill exceeds 10 years, since under FRS 102 a useful life greater than 10 years is permitted only when the estimate can be made reliably	Analysis of financial statements of the UK's 100 largest private companies Of the UK's 100 largest private companies, 34 report goodwill under FRS 102 Targeted questionnaires sent to those 14 companies whose disclosures indicate that they determine the useful life of goodwill by considering specific factors relevant to individual acquisitions (currently awaiting responses).	Of the 34 companies whose disclosures on goodwill we reviewed: - 16 amortised goodwill on the same straight-line basis for all acquisitions. The periods over which goodwill was amortised were 10 years (9 companies), 20 years (5 companies) and 5 years (2 companies). - 10 determined the useful life of goodwill for each acquisition within an overall range. The ranges were: 4 – 20 years (1 company), 5 – 20 years (5 companies), 10 - 20 years (2 companies), and up to 20 years (2 companies). - 4 disclosed the specific useful life of goodwill determined for individual acquisitions. These specific useful lives were 1 year, 7 years, 19 years, and 50 years. - 4 did not disclose the period over which goodwill was amortised. Where the useful life was determined for individual acquisitions, disclosures indicated that a range of relevant factors was considered in that determination.
Understand how estimates of the useful life of goodwill are derived by management and how auditors gain audit evidence on those estimates	Structured interviews with six audit firms (three Big 4 firms and three challenger firms). At the time of writing, three interviews have taken place and the additional three are scheduled.	Management considers a range of relevant factors in determining the useful life of goodwill. Auditors gain evidence by following ISA 540 *Auditing Accounting Estimates and Related Disclosures,* which was revised for accounting periods beginning on or after 15 December 2019 to provide more extensive guidance on the audit of accounting estimates. Input from independent business valuation specialists is becoming more common as a source of audit evidence in this area. Some valuation models componentise accounting goodwill, which facilitates consideration of the different elements of goodwill in determining its overall useful life.

Ascertain impact of potential transition on distributable profits	Review of Companies Act requirements and ICAEW distributable profits guidance	Since profit distributions are determined for individual companies rather than groups under UK law, amortisation of goodwill arising on consolidation would not directly impact distributable profits. Goodwill arising on the acquisition of unincorporated businesses impacts distributable profits of the acquiring entity. A significant minority of survey respondents identified that they had acquired unincorporated businesses during the last five years. However, an initial review of their most recent financial statements suggested that amortisation of goodwill on these acquisitions is unlikely to have a material impact on distributable profits.
Ascertain impact of potential transition on tax payable	HMRC (HM Revenue and Customs) website	Tax payable is not impacted by accounting amortisation charges for UK companies under current UK tax legislation.
Ascertain impact of potential transition on compliance with market regulations	FCA (Financial Conduct Authority) handbook	We do not anticipate an increased risk of non-compliance with market regulations resulting from the potential transition.