Goodwill Impairment Testing Simplified

On January 26, 2017, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.* The amendments eliminate Step 2 of the goodwill impairment test. Instead, under the new ASU, goodwill impairment will be measured by comparing a reporting unit's carrying amount, including goodwill, to its fair value (FV) and recognizing an impairment charge for the difference—limited to the total carrying amount of that reporting unit's allocated goodwill. When goodwill impairment exists, entities will also need to consider the deferred tax effect from any tax-deductible goodwill on a reporting unit's carrying amount when measuring the goodwill impairment loss. If a reporting unit's FV exceeds its carrying amount, there is no goodwill impairment.

Entities will be required to apply the one-step impairment test to all reporting units, including those with zero or negative carrying amounts. The requirement in today's guidance to perform a qualitative assessment and—if it fails—Step 2 of the goodwill impairment test for reporting units with zero or negative carrying amounts will no longer be required. However, entities will have to disclose the amount of goodwill allocated to each reporting unit with a zero or negative carrying amount.

Removing Step 2 equates to removing the requirement for entities to determine the FV of individual assets and liabilities—including unrecognized assets and liabilities—of a reporting unit following the same hypothetical purchase price allocation required in determining the FV of assets acquired and liabilities assumed in a business combination. Performing Step 2 was challenging for many entities, and eliminating it from the goodwill impairment test should reduce the cost and complexity of evaluating goodwill for impairment.

Entities will still have the option to first assess qualitative factors to determine whether the quantitative impairment test is necessary, *i.e.*, whether it is more likely than not (a likelihood of more than 50 percent) that a reporting unit's FV is less than its carrying amount, including goodwill, or directly proceed to the simplified one-step quantitative goodwill impairment test.

The concept of goodwill impairment is changed from the condition that exists when the goodwill's carrying amount exceeds its implied FV to the condition that exists when a reporting unit's carrying amount that includes goodwill exceeds its FV. Entities considering early adoption for the simplification benefits may want to first evaluate whether the new impairment guidance results in more (or less) impairment than recognized under today's guidance.

Effective Date & Transition

The ASU's amendments should be applied prospectively and are effective for annual and any interim impairment tests performed in periods beginning after:

- December 15, 2019, for public business entities that are U.S. Securities and Exchange Commission (SEC) filers
- December 15, 2020, for public business entities that are not SEC filers
- December 15, 2021, for all other entities, including not-for-profits

Early adoption is permitted for any impairment tests performed after January 1, 2017.

Next Steps

FASB will evaluate the effectiveness of ASU 2017-04 and monitor the International Accounting Standards Board's projects on goodwill and impairment before considering whether additional changes to the subsequent accounting for goodwill—including consideration of permitting or requiring amortization of goodwill and/or additional changes to the impairment testing methodology—are warranted. For further information, contact your BKD advisor.

Contributor

Connie Spinelli, CPA