Simplifying goodwill impairment testing

Many preparers viewed the current two-step goodwill impairment testing as costly and onerous. To reduce the level of effort, the FASB eliminated Step 2 of the goodwill impairment test. The new goodwill impairment test requires only a single-step quantitative test for all reporting units. The qualitative assessment remains optional and is unchanged.

- The goodwill impairment test has been simplified, reducing cost and effort
- The new test may be less precise than the current goodwill impairment test
- The date of adoption may impact the timing and amount of goodwill impairment

What you need to know

Simplified test for goodwill impairment

Optional qualitative assessment

Step 1 – Quantitative assessment: Carrying value vs. fair value of reporting units

Step 2 – Quantitative calculation: Carrying value vs. implied fair value of goodwill

This simplification is not without controversy. While simpler, the new single step may be less precise. As a result, it may give rise to a goodwill impairment that is largely driven by other assets in the reporting unit that are underwater but are not otherwise impaired under the accounting literature.

A reporting unit is the level of an entity at which goodwill is tested for impairment.
What’s the difference?
Prior to the new guidance, companies first evaluated whether the carrying value of a reporting unit was greater than its fair value. If it was, then in the second step, companies calculated the implied fair value of goodwill. If the carrying value of goodwill was more than the implied fair value, an impairment charge for the difference was recorded.

Under the new test, if the carrying value of a reporting unit is greater than its fair value, a goodwill impairment charge will be recorded for the difference (up to the carrying value of goodwill). This impairment charge may be less precise because it is calculated at the reporting unit level rather than specifically for goodwill. For example, when the fair value of the reporting unit is less than its carrying value, there will be a goodwill impairment charge under the new test, even if the difference is attributable to the fair value of other assets in the reporting unit (such as loan receivables or fixed assets) being less than their respective carrying values. Of course, on the other side, when there is unrecognized appreciation in the fair value of other assets in the reporting unit, the amount of the impairment charge would be less than under the prior test.

A vast majority of preparers will find the new single-step test easier and less costly. The fair value calculated in Step 2 under the previous guidance was similar to the analysis performed when recording an acquisition of a business. That fair value exercise could be costly, generally requiring the use of independent valuation resources. The determination that a reporting unit is underwater and the corresponding need to perform Step 2 may have come late in the process, causing potential delays in financial reporting. The increased efficiency may result in a reduction in precision, but many users have indicated that the more useful information is knowing whether an impairment charge is warranted, not necessarily the precise amount. The reduction of time and resources needed to perform the new goodwill impairment test will be a recurring benefit for preparers because goodwill must be tested at least annually for impairment.

So when should you adopt?
Public companies must adopt the new goodwill impairment test by January 1, 2020. The FASB aligned the effective date with the new standard on measuring credit losses on financial instruments, but the two standards do not have to be adopted together. We expect many companies will take advantage of the cost savings and will elect to adopt the goodwill guidance early.

Today, there may be situations when companies fail Step 1, but determine that the carrying amount of goodwill in Step 2 is not impaired. However, under the new guidance, the failure of Step 1 will always result in a goodwill impairment. Companies in this position may decide not to early adopt to defer an impairment charge.

How PwC can help
To have a deeper discussion about goodwill impairment, please contact:

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