BPM

Goodwill Impairment Testing: Is a Qualitative Assessment Right for Your Company?

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According to a recent survey by Duff & Phelps (2013 U.S. Goodwill Impairment Study), most businesses aren't using the optional qualitative assessment to evaluate goodwill for impairment. The Financial Accounting Standards Board (FASB) introduced this option in 2011 to ease the often complex and costly burden of quantitative testing. Nevertheless, many company leaders have opted to stick with the quantitative approach.

Step Zero

Under U.S. Generally Accepted Accounting Principles (GAAP), determining whether goodwill is impaired is a two-step process. In step one, a company calculates the fair value of each reporting unit and compares it to its carrying amount, including goodwill. If a unit's fair value equals or exceeds its carrying amount, goodwill isn't considered impaired and, thus, step two isn't necessary. But if a unit's fair value is less than its carrying amount, the business must proceed to step two and measure the amount of the impairment loss.

In Accounting Standards Update (ASU) No. 2011-08 — which took effect for fiscal years beginning after Dec. 15, 2011 — FASB created a "step zero," giving companies an opportunity to avoid steps one and two. Under this approach, a business first analyzes qualitative factors, such as industry conditions and company-specific factors, to determine the likelihood that goodwill is impaired. The company isn't required to proceed to step one unless the qualitative assessment shows that it's more likely than not that a unit's fair value is less than its carrying amount.

Survey Statistics

Despite the availability of step zero, companies continue to use older methods of determining goodwill impairment. The Duff & Phelps study indicates that 71% of public companies bypass step zero and move directly to step one. Nearly half of public companies (45%) simply prefer quantitative testing, and 13% cite a "lack of practical guidance." Another 13% considered step zero but concluded that it wouldn't be cost-effective.

Despite FASB's goal of reducing cost and complexity, qualitative testing often requires substantial effort and extensive documentation. This is particularly true for businesses with multiple reporting units and narrow margins between fair value and carrying amount.

New Guidance

A lack of practical guidance may no longer be a justification for avoiding step zero. In November 2013, the American Institute of Certified Public Accountants published its Accounting and Valuation Guide, Testing Goodwill for Impairment. The guide offers practical advice on a number of impairment-testing issues, including identifying reporting units, allocating assets and liabilities (such as goodwill and shared assets and liabilities) among reporting units, and evaluating market participant assumptions.

The guide also offers a framework for performing the optional qualitative assessment. And it provides specific examples of qualitative factors to consider in determining whether a quantitative assessment is necessary. These include:

- Market reaction to new products or services,
- Technological obsolescence,
- Significant legal developments, and
- Contemplation of bankruptcy proceedings.

Companies also should review expected changes in risk factors that influence fair value assumptions, such as discount rates or market multiples.

Consult A Professional

Under the right circumstances, a qualitative assessment can be a cost-effective solution for goodwill impairment testing. Your auditors and an experienced valuation professional can help you determine whether a qualitative assessment is appropriate.