

22 September 2014

EFRAG - European Financial Reporting Advisory Group
35 Square de Meeûs
B-1000 Brussels
Commentletters@efrag.org

Response to discussion paper:
Should goodwill still not be amortised?

The Financial Reporting and Analysis Committee (FRAC) of the CFA Society of the UK (CFA UK) welcomes the opportunity to respond to the joint discussion paper by the European Financial Reporting Advisory Group (EFRAG), Accounting Standards Board of Japan (ASBJ) and Organismo Italiano di Contabilita (OIC) on accounting and disclosure for goodwill.

CFA UK represents more than 10,000 investment professionals working across the financial sector including asset managers, buy-side analysts, sell-side analysts and credit rating analysts, among others. For advocacy purposes in the field of financial reporting, these members are represented by the Financial Reporting and Analysis Committee.

Executive Summary

The consensus view of our committee is that we do not believe that reintroducing goodwill amortisation would be of benefit to users of accounts, specifically financial analysts and investors.

While the concept of amortising goodwill appears sensible, we believe it confuses investment with expense. When a company buys another company the purchase is treated partly as capital expenditure and partly as an investment. The capital expenditure reflects the plant, property and equipment that the acquirer inherits from the acquiree and which continues to be used and depreciated. However, a large part of the acquisition cost often reflects goodwill, which is treated as an investment. The value of investments does not necessarily erode over time but is reassessed periodically and, if necessary, written down (or up, goodwill excepting). To write down goodwill steadily over time, regardless of how the investment is performing, would lead to an excessively cautious measure of profitability in our view.

By way of analogy, if a company buys shares in another company these are held at cost on the balance sheet and marked to market periodically. The value of the investment in the shares is not depreciated or amortised over time regardless of its performance. Why then should goodwill be amortised if a company acquires all of the shares in another company?

Goodwill amortisation would not remove the need for impairments if expectations about acquired businesses changed, but the steady erosion of goodwill would diminish the potential size of impairments. Smaller impairments are less likely to attract the attention

of investors and hence any potentially useful information that impairments might normally convey about future prospects would be diminished. Write-downs as a result of impairment testing are useful for stewardship purposes so that management can be formally held to account for the investments they have made.

Please note that while the consensus view of our committee is that a return to goodwill amortisation would be a step back, a small minority of our committee members think it is a good idea and were never in favour of dropping it. They believe that, in practice, goodwill usually erodes over time and the best way to account for this is via a regular amortisation charge rather than irregular impairments. The more important issue they note is that there should be appropriate disclosure of the subsequent performance of acquisitions. On this point of stewardship the committee is unanimous.

Two “thought experiments” for considering goodwill amortisation

Below we consider the application of goodwill amortisation in two different scenarios. In the first we look at all share mergers. We then examine a cash shell company acquiring an operating business. We think automatic amortisation charges do not reflect economic reality and as such most analysts and investors would continue to look at earnings measures excluding goodwill amortisation if it were reintroduced into IFRS.

Share mergers

Consider the merger of two identical companies: A and B. Suppose both have the same amount of net income and the same number of shares. In a 50/50 merger, shareholders of both sides would still have the same economic stake post merger: their percentage holding has halved but the entity in which they hold shares has doubled in size. To reduce earnings by charging goodwill amortisation would suggest the combined entity was less profitable than the sum of its two constituents.

Acquisition of a business by a cash shell

Now consider the acquisition of company A by a shell company, C, whose only asset is a cash pile just sufficient to purchase A. Post acquisition, the profits generated by C would be identical to those of A, under current accounting rules. If instead we were to amortise the goodwill recognised on acquisition, C would report lower earnings than A. Why should the underlying business be any less profitable simply because its ownership has been transferred to C?

Related issues

Amortisation charges under existing IFRS

We believe the same arguments against goodwill amortisation also apply to the amortisation under current IFRS of certain intangibles, such as brands, trademarks and customer lists, which are only recognised when an acquisition takes place. These costs appear to be double counting as the maintenance of these assets is already expensed through the income statement as another cost, such as sales and marketing.

We would prefer that difficult-to-define assets (or those that are difficult to separate from the overall business) and intangibles with an indefinite life, such as brands and customer relationships, are subsumed into goodwill and subject to impairment testing rather than periodic amortisation.

Of course this is not the case for assets that are contractual, have a finite life and are separate from the overall business, such as licences for wireless spectrum or patent exploitation. Separate recognition for such assets is useful, as they are not organically replaced but instead require large capital expenditure after long intervals (i.e. will be renewed once the current licence expires). As such, the recognition and amortisation of these assets is appropriate, as it is a proxy for the replacement cost of the asset.

Timeliness of goodwill impairment charges

Currently we believe in most cases goodwill impairments are not predictive but merely confirm a deterioration in the outlook for a particular business that has already been anticipated by the market. To make goodwill impairment tests more useful to investors, companies should carry them out whenever there is a significant change in market conditions that would drive a change in profit forecasts. Although we recognise that IAS 36 Impairment of Assets already requires this, in practice this does not often happen. The outcome of the impairment test should be disclosed as soon as possible. At a minimum, results of the annual impairment test should be published with the preliminary full-year results and not wait till the annual report is published.

We look forward to discussing the issues raised in this response.

Yours sincerely,



Jane Fuller
Chair, Financial Reporting and Analysis Committee
CFA Society of the UK



Will Goodhart,
Chief Executive
CFA Society of the UK



James Crawshaw, CFA, ASIP
Financial Analysis and Accounting Adviser
CFA Society of the UK

About CFA UK and CFA Institute

The CFA Society of the UK (CFA UK) represents the interests of more than 10,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 100,000 members in 140 countries, of which more than 90,000 hold the Chartered Financial Analyst (CFA) designation.