CL21

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

26 September 2014

Re: Discussion paper *Should goodwill still not be amortised? Accounting and disclosure for goodwill*

The Corporate Reporting Users' Forum welcomes the opportunity to respond to the Discussion Paper (DP) *Should goodwill still not be amortised? Accounting and disclosure for goodwill* issued in July 2014 by EFRAG, ASBJ and OIC.

CRUF participants think that while the arguments about purchased goodwill being replaced by internally generated goodwill are philosophically interesting, they are not really practically relevant to the task of getting the right accounting for purchased goodwill, the recognition of which is an exception to the accounting for internally generated goodwill. The point in the DP about goodwill on acquisition being consumed over time and replaced by organically derived goodwill is a fair observation. Conceptually, all goodwill and intangibles do decline in value over time to be replaced (in most cases) by organically generated intangibles. The DP points out that the recognition of organically derived intangibles is not allowed and therefore the accounting needs to converge to an organic equivalent over time. On this basis the DP argues that goodwill should have parallels to the other intangibles such as customer lists, brands etc.

However, many CRUF participants in Europe and other parts of the world think there are two key topics that are not addressed appropriately in the DP from the perspective of users of financial statements: (1) we need to measure the performance of management with reference to the stewardship over money they

spent and (2) we need to measure economic performance from one period to the next.

Measuring Economic Performance

- Ideally the P&L should be a measure of performance for the period, which should reflect current economic gains and losses. Although increases in organic goodwill and intangibles are not measured, this measure of performance is at least a proxy for stabilised cash flow by removing working capital and capex timing differences.
- Current acquisition accounting fails to reflect economic performance as there is no differentiation between genuinely wasting intangibles (e.g. patents), which should be seen as an expense in that year, and those intangibles which are organically replaced through the P&L (e.g. customer lists, brands etc.). Consequently, the P&L bears the cost of amortising historic spend to build the intangible and the current year cost of maintaining/replacing it – resulting in a double cost in the year. Similarly, management deploys resources to maintaining the value of goodwill, which is logical and a business choice that does not arise if the goodwill hasn't been purchased in the first place. If the goodwill is also being amortised, the entity will in essence be bearing a double charge in the P&L.
- The DP proposal to amortise goodwill would result in the same treatment as organically replaced intangibles. As users of accounts, we would add all the cost back – so goodwill amortisation (like other intangible amortisation) does not help in our assessment of performance. We did this when goodwill used to be amortised (over 20 years). Back then, most analysts and investors ignored the amortisation and added it back to profit to derive an "Earnings Before Goodwill" (EBG) figure. This practice was so common that EBG was a standard field used by the consensus collators such as Thomson Reuters. Given that background it would seem perverse to revert to a world in which goodwill was amortised again, although in some ways one might say that the

accounting does not matter as most users will ignore the amortisation – this is possibly true except for the next point on stewardship.

Stewardship

- Management need to be held accountable for the money they have spent – so by amortising goodwill and organically replaced intangibles we gradually lose a large part of the consideration management have paid to get the business in its current form.
- To assess management stewardship we need to be able to measure Return on Invested Capital (ROIC) (including acquisitions) as well as Return on Capital Employed (with intangibles removed to put all companies on a similar basis as if they all have grown organically). If goodwill is amortised all companies will converge to the same ROCE metrics and it will be difficult to assess which companies have managed their acquisitions well and which have not.
- For intangibles that are wasting in nature (such as a patent) then the current accounting is correct—we see both the amortisation charge in the year in the P&L (and not add it back as most management do for adjusted EPS) and the declining value of the asset on the balance sheet. For intangibles that are non-wasting (e.g. customer lists, brands etc.), we would prefer that they not to be amortised (i.e. they should be treated as goodwill is today). This would be different from today's accounting because the distinction between what is amortised and what is not would be based on different criteria (i.e. whether it is wasting in nature).

Lastly, while the life of purchased goodwill is unlikely to be infinite, it is in most cases certainly indefinite. It is not depleted in any objective sense and any loss in value will occur because of a change in the relevant business environment or a failure by the entity to exercise proper stewardship of what has been bought and the change in value when it comes is likely to be reasonably abrupt, hence recognising an impairment at that point should best reflect the economic reality. In contrast, any

amortisation period will be arbitrary and very likely wrong and conveys no useful information to users from either a decision-usefulness or stewardship perspective. Simply saying that users of financial statements can add back the intangible amortisation is not enough because we also need to be able to differentiate between wasting and organically replaced assets, which today's acquisition accounting does not allow us to do.

About the Corporate Reporting Users' Forum (CRUF)

The CRUF was set up in 2005 by users of financial reports to be an open forum for learning about and responding to the many accounting and regulatory changes that affect corporate reporting. In particular, participants are keen to have a fuller input into the deliberations of accounting standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers and corporate governance professionals. Participants focus on equity and fixed income markets. The Forum includes individuals with global or regional responsibilities and from around the world, including Australia, Canada, France, Germany, Hong Kong, Japan, New Zealand, South Africa, UK and USA.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations. Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organizations. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective organizations. The CRUF does not seek to achieve consensus views. However, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. The participants in the Forum that have specifically endorsed this response are listed below.

(Signatures)

Jed Wrigley
Portfolio Manager
Director Accounting and Valuations
Fidelity Worldwide Investments

Peter Elwin

Paul Lee
Head of Investment Affairs
National Association of Pension Funds

Norbert Barth
Independent Equity Analyst
Member of CMAC

Gunnar T. Miller
Managing Director
Global Co-Head of Research
Head of European Research
RCM

Marietta Miemietz,
Director of Pharmaceutical Advisory Services
Primavenue

Michael McKersie

Nick Anderson
Henderson Global Investors

Catherine Giordan
Exane BNP Paribas

Yoshihiro NOMURA
Senior Strategist
Nomura Securities co. LTD

Jun Goto
Rating & Investment Information Inc.(R&I)
Credit Rating Division
Chief Analyst

cc: Hans Hoogervorst, Chairman, International Accounting Standards Board