CRUF
CORPORATE REPORTING USERS' FORUM

11 December 2020

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD

Via email: commentletters@ifrs.org

Dear Sir/Madam,

Re: The IASB's Discussion Paper on Business Combinations—Disclosures, Goodwill and Impairment

The Corporate Reporting Users' Forum (hereinafter referred to as CRUF) are delighted to respond to the IASB's Discussion Paper (DP): '*Business Combinations — Disclosures, Goodwill and Impairment*'.

We only intend to answer the questions where we have a strong opinion. We have commented before on goodwill and intangibles (September 2014, December 2017 and May 2019) and this letter is broadly consistent with our previous views. As always, we do not seek to reach a consensus within the CRUF but to reflect a broad spectrum of users' views. This is a contentious topic and we have included differing views where relevant.

CRUF guiding principles

We have framed our response with the assistance of the CRUF's guiding principles and a focus on how information is used (or not used) in practice. We are not generally interested in arcane theoretical debates for their own sake but rather in the derivation of numbers that are robust and useful when disclosed. In accordance with our guiding principles, we are very interested in:

- The impact of acquisitions on cash flow
- Establishing the value of invested capital
- Stewardship
- Identifying the returns generated from the capital invested in the business

We have stated on previous occasions that we regard overall disclosure on acquisitions to be unsatisfactory. Acquisitions are often the single biggest category of investments made by companies and yet the disclosure requirements are much less comprehensive than, say, for example tangible fixed assets. For tangible fixed assets we get a detailed reconciliation from the opening to closing balance sheet entries. We can see cash cost of additions, depreciation, impairment and the effect of currencies. For acquisitions we often do not get all the information we are supposed to get and the information we do get is in multiple places. Goodwill is often the single biggest asset and yet we have limited information about where it came from and what benefits the company has derived from its creation. Worse, there is a growing category of quasi-goodwill intangibles with even poorer disclosure that are combined with internally generated intangibles.

Tangible and intangible assets are now often an impenetrable blend of historical cost, fair value adjustments and other assets created out of thin air during an acquisition. It is therefore frequently impossible to derive much useful information from the tangible and intangible asset notes of an acquisitive company without additional voluntary disclosure. The associated depreciation and amortisation charges are also now therefore a blend of '**operating'** (internally generated assets or acquired intangibles with fixed lives such as licences), '**written-up**' (existing assets written up to fair value during an acquisition) and '**created**' (quasi-goodwill intangibles created and then amortised over an arbitrary period). Deriving a meaningful measure of operating profit on an underlying or operating basis is getting steadily harder for acquisitive companies. As a general observation, the reported operating profit of a business unit should not change just because it has a new owner; under current rules the new owner will nearly always report lower profitability even though the business and its cash flow are unchanged. This does not strike us as either logical or desirable.

Debating the process of testing goodwill for impairment is in our view asking the wrong question. As the DP states, goodwill cannot be directly measured; it is simply the gap between the consideration paid and the measurable net assets received on consolidation. Testing goodwill for impairment will therefore never be anything other than a subjective exercise. We would challenge the board to produce a single example in history where a goodwill impairment produced new and useful information, rather than just a belated admission that an excessive premium had been paid. The debate on goodwill has been going on for decades. At its heart, goodwill exists because there is an inherent conflict between double-entry book-keeping and buying a business for a premium to asset value.

Before we get to the questions, we propose to start by considering what investors really want from acquisition disclosure, again with reference to our guiding principles.

For material acquisitions, we would like:

1. **Price.** The real acquisition price on an enterprise value basis, including non-cash transfers such as new shares in the acquirer issued to the vendor and assets injected by the acquirer into the new entity if the vendor retains a stake. In other words, the real economic value of what has been acquired and what the overall net cost has been. The cost should include acquired debts and liabilities (including quasi-debt such as underfunded pensions) and not just acquired cash. If management cannot derive the economic cost of the deal then they should explain why this is not possible. A lot of this information can be calculated from the notes but it can be challenging to locate and important pieces are often missing. The full economic cost should be visible in a single place. A date of first consolidation would be useful too. Asking companies to disclose what they bought, the true economic cost and when it was first consolidated does not strike us as unreasonable. Some of these items are already required but in our experience compliance is patchy at best. A narrative explaining the acquisition process would also be very informative. For example, who approached whom, whether it was a competitive auction, when the process started and so on.
2. **What is being bought.** Adequate pro forma information on what is being acquired, including pro forma annualised revenues, operating profit and any other subtotals already published in its existing financial statements and pro forma capital expenditure (if

material). This should be as contemporary as possible so investors can compare current operating performance with the economic acquisition cost. Such information would reduce uncertainty for analysts and investors. As with point 1 above, we would expect a competent management team to have all this information readily available. We would prefer a principles-based definition of pro forma operating performance rather than a precise definition that might prove too narrow. As with acquisition price, management should be required to provide this information or explain why it is not possible.

3. **Expected synergies and the timescale and cost to achieve them, ideally split between 'hard' (e.g. reduced overhead costs) and 'aspirational' (e.g. revenue synergies)**. Disclosure on this varies widely and some consistency and external oversight would be very welcome. As with pro forma trading, we would prefer a principles-based approach with a "provide or explain" requirement.
4. **Information on whether the synergies have been achieved**, **while recognising that full integration may hinder measurement.** Post-acquisition operating profit performance should not include the depreciation or amortisation of assets artificially created during the consolidation process as these charges are not economically meaningful. They are in effect all just disguised goodwill amortisation.
5. **Adequate information to assess stewardship.** One of the best ways to look at a company's track record is to follow the operating profit or cash return on invested capital. Current accounting disclosure frequently makes this impossible or at least very difficult. For example, if the goodwill is subsequently impaired, the notes should always include the total cumulative impairment so investors can derive a meaningful value for invested capital. Quasi-goodwill intangibles should also include all historical amortisation or impairment so that investors can derive the important invested capital number.
6. **Better stub period disclosure.** Finally, we note that most acquired companies have a stub period, i.e. after the last audited balance sheet but before the date of first consolidation by the new owner. This period is usually not visible and investors should be informed if any unusual accounting events have occurred in this period, such as asset impairments, changed creditor terms, debt drawdown, altered contract provisions etc. In our experience, stub periods are sometimes used for creative accounting.

Incidentally, a very similar list can also be applied to divestments.

To summarise our overall views:

1. We support the Board's overall objective of enhancing disclosure on acquisitions and their subsequent performance. Current disclosure is extremely unsatisfactory.

2. We do not regard testing goodwill for impairment as either robust or desirable. Some CRUF participants favour a broader annual test of the market value of an acquisition, with goodwill being lowered if necessary.

3. Most CRUF participants do not support the reintroduction of goodwill amortisation. This is not a universal view; CRUF Japan does support the reintroduction of goodwill amortisation. CRUF Japan also thinks that all intangible assets should have a finite lifespan and that the current impairment test should not be simplified. One CRUF participant views goodwill as a heterogeneous mixture and that each element should be treated differently: expected synergies should be amortised, customer lists should be tested for impairment and the amount overpaid should be written-off immediately.

4. We do not see any need to require companies to report total equity excluding goodwill as this number is easy to derive if required.

5. Views on quasi-goodwill intangibles (customer lists, brands etc) are mixed. Some participants regard these separate classifications as useful and some do not. However, none of the signatories regard current disclosure as satisfactory and none regard the associated amortisation charge as economically meaningful. As a minimum we would like to see separate disclosure of internally generated intangible assets and those created during the acquisition consolidation process.

Please see below for more detailed responses to the questions in the DP.

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APPENDIX – CRUF's responses to the questions raised in the DP

Question 1 – Paragraph 1.7 summarises the objective of the Board's research project. Paragraph IN9 summarises the Board's preliminary views. Paragraphs IN50–IN53 explain that these preliminary views are a package and those paragraphs identify some of the links between the individual preliminary views. The Board has concluded that this package of preliminary views would, if implemented, meet the objective of the project. Companies would be required to provide investors with more useful information about the businesses those companies acquire. The aim is to help investors to assess performance and more effectively hold management to account for its decisions to acquire those businesses. The Board is of the view that the benefits of providing that information would exceed the costs of providing it.

(a) Do you agree with the Board's conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project's objective?

(b) Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on whether the Board reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?

Broadly speaking, we agree that acquisition disclosure is unsatisfactory and needs improving. Our detailed comments above and below set out our views in more detail. We strongly welcome the board's decision to address this topic. We also note that this project may overlap with the IASB's upcoming management commentary project.

CRUF Japan notes that the expansion of disclosure alone will not be sufficient to resolve the delayed recognition of goodwill impairment losses that investors are concerned about, and that discussions on the reintroduction of goodwill amortisation should be included in the package.

Question 2 – Paragraphs 2.4–2.44 discuss the Board's preliminary view that it should add new disclosure requirements about the subsequent performance of an acquisition.

(a) Do you think those disclosure requirements would resolve the issue identified in paragraph 2.4—investors' need for better information on the subsequent performance of an acquisition? Why or why not?

(b) Do you agree with the disclosure proposals set out in (i)–(vi) below? Why or why not?

(i) A company should be required to disclose information about the strategic rationale and management's (the chief operating decision maker's (CODM's)) objectives for an acquisition as at the acquisition date (see paragraphs 2.8–2.12). Paragraph 7 of IFRS 8 Operating Segments discusses the term 'chief operating decision maker'.

(ii) A company should be required to disclose information about whether it is meeting those objectives. That information should be based on how management (CODM) monitors and

measures whether the acquisition is meeting its objectives (see paragraphs 2.13–2.40), rather than on metrics prescribed by the Board.

(iii) If management (CODM) does not monitor an acquisition, the company should be required to disclose that fact and explain why it does not do so. The Board should not require a company to disclose any metrics in such cases (see paragraphs 2.19–2.20).

(iv) A company should be required to disclose the information in (ii) for as long as its management (CODM) continues to monitor the acquisition to see whether it is meeting its objectives (see paragraphs 2.41–2.44).

(v) If management (CODM) stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition, the company should be required to disclose that fact and the reasons why it has done so (see paragraphs 2.41–2.44). (vi) If management (CODM) changes the metrics it uses to monitor whether the objectives of the acquisition are being met, the company should be required to disclose the new metrics and the reasons for the change (see paragraph 2.21).

2 (c) Do you agree that the information provided should be based on the information and the acquisitions a company's CODM reviews (see paragraphs 2.33–2.40)? Why or why not? Are you concerned that companies may not provide material information about acquisitions to investors if their disclosures are based on what the CODM reviews? Are you concerned that the volume of disclosures would be onerous if companies' disclosures are not based on the acquisitions the CODM reviews?

(d) Could concerns about commercial sensitivity (see paragraphs 2.27–2.28) inhibit companies from disclosing information about management's (CODM's) objectives for an acquisition and about the metrics used to monitor whether those objectives are being met? Why or why not? Could commercial sensitivity be a valid reason for companies not to disclose some of that information when investors need it? Why or why not?

(e) Paragraphs 2.29–2.32 explain the Board's view that the information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information. Instead, the Board considers the information would reflect management's (CODM's) targets at the time of the acquisition. Are there any constraints in your jurisdiction that could affect a company's ability to disclose this information? What are those constraints and what effect could they have?

There are 10 sub-questions in question 2 and we propose to give a higher-level response.

We broadly agree that there should be much better disclosure of how material acquisitions have performed against expectations and that such reporting should come from the Chief Operating Decision Maker (CODM). We like the "disclose or explain" principle; we would expect most companies to happily comply with what we consider to be reasonable requests. We note that not all acquisitions are expected to produce synergies.

We would also add that commercial sensitivity is seldom a valid excuse for non-compliance. We can think of no example where a business has been genuinely harmed by complying with IFRS. We do not think that the proposed new disclosures are likely to cause damage. High-level business objectives are almost never commercially sensitive, unless they relate to secret and therefore unexecuted plans.

CRUF Japan note that they do not agree with (b) as they believe that the two-year period for monitoring achievement of the objectives of an acquisition is too short. In many cases, acquisitions are expected to enhance corporate value over long-term horizons of five years, 10 years, or even longer. Accordingly, CRUF Japan believe disclosure should be required for as long as management continues to monitor the acquisition, as proposed in (b-iv). Some participants also argue that it is also necessary to consider the treatment of cases where companies implement numerous small-scale acquisitions over a single or multiple years, that are material when taken together.

Question 3 – Paragraphs 2.53–2.60 explain the Board's preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand:

- **the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and**
- **the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition.**

Do you agree with the Board's preliminary view? Why or why not?

We broadly agree with the board's proposals on this point. However, the usefulness of such disclosure may be limited. We cannot envisage many companies stating that an acquisition will produce minimal benefits and does not meet the CODM's objectives.

Question 4 - Paragraphs 2.62–2.68 and paragraphs 2.69–2.71 explain the Board's preliminary view that it should develop proposals:

- **to require a company to disclose:**
    - **a description of the synergies expected from combining the operations of the acquired business with the company's business;**
    - **when the synergies are expected to be realised;**
    - **the estimated amount or range of amounts of the synergies; and**
    - **the expected cost or range of costs to achieve those synergies; and**
- **to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.**

Do you agree with the Board's preliminary view? Why or why not?

We broadly agree with the board's proposals on this point. We would add that expected tax synergies, where material, should also be disclosed. We would add though that synergies are seldom hard numbers and an excessive focus on short-term savings can cause long-term damage.

Badly drafted standards can lead to undesirable management behaviour. It is important that the board does not unintentionally create an environment where management will focus on hitting short-term synergy targets at the expense of longer-term stewardship.

Question 5 – IFRS 3 Business Combinations requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period. Paragraphs 2.82–2.87 explain the Board's preliminary view that it should retain the requirement for companies to prepare this pro forma information.

(a) Do you agree with the Board's preliminary view? Why or why not?

(b) Should the Board develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the Board require companies to disclose how they prepared the pro forma information? Why or why not?

IFRS 3 also requires companies to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period. Paragraphs 2.78–2.81 explain the Board's preliminary view that it should develop proposals:

- **to replace the term 'profit or loss' with the term 'operating profit before acquisition-related transaction and integration costs' for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss would be defined as in the Exposure Draft General Presentation and Disclosures.**
- **to add a requirement that companies should disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.**

(c) Do you agree with the Board's preliminary view? Why or why not?

Disclosure on pro forma acquisition performance is almost universally unsatisfactory at present and we welcome the board's decision to address this. The success or failure of this initiative will be dependent on how well the standard is written. The standard should focus on providing companies with robust guidance rather being overly prescriptive.

Pro forma operating profit numbers for an acquisition should be as clean and comparable as possible, i.e. before the depreciation and amortisation of assets marked up or created during the consolidation process. The cost of these notional charges will not affect cash flow or in our experience the management rationale for acquiring the business.

Current IFRS 3 disclosure requirements are inadequate. Disclosing the impact of an acquisition in the current year sounds appealing but there are two main problems. First, acquisitions made later in the financial year will contribute a lot less than a full 12-month share, often exacerbated by undisclosed seasonality. Second, the definition of profit or loss bears no relation to the operating number investors would like to see and there is no reconciliation between the two.

Ideally the CRUF would like to see pro forma revenue and meaningful operating profit numbers for a 12-month period for all material acquisitions. The choice of the 12-month period can be left to management discretion but it should be as recent as possible. By 'meaningful', we mean before non-recurring items (e.g. integration expenses, the impact of inventory write-ups, amortisation of quasi-goodwill intangibles, asset write-downs etc) so that users can compare the price paid to a relevant measure of profitability. This should also address our wish to see better stub period disclosure.

Question 6 – As discussed in paragraphs 3.2–3.52, the Board investigated whether it is feasible to make the impairment test for cash-generating units containing goodwill significantly more effective at recognising impairment losses on goodwill on a timely basis than the impairment test set out in IAS 36 Impairment of Assets. The Board's preliminary view is that this is not feasible.

(a) Do you agree that it is not feasible to design an impairment test that is significantly more effective at the timely recognition of impairment losses on goodwill at a reasonable cost? Why or why not?

(b) If you do not agree, how should the Board change the impairment test? How would those changes make the test significantly more effective? What cost would be required to implement those changes?

(c) Paragraph 3.20 discusses two reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis: estimates that are too optimistic; and shielding. In your view, are these the main reasons for those concerns? Are there other main reasons for those concerns?

(d) Should the Board consider any other aspects of IAS 36 in this project as a result of concerns raised in the Post-implementation Review (PIR) of IFRS 3?

We regard this as the wrong question. As the DP states, goodwill cannot be measured directly so any subsequent attempt to test it for impairment is inherently unreliable. We can give examples from personal experience where the timing of an impairment that everyone knew was coming was decided by management for presentational purposes.

Imagine trying to explain goodwill impairment to an intelligent and numerate non-accountant. "We have an 'asset' that we cannot measure and is really just a balancing item. We are then going to test the robustness of this 'asset' by doing a very subjective, long-term cash-flow based assessment on a business unit that may well be different to the unit that the goodwill belongs to. We will have to make lots of subjective judgments in this process and any resulting impairment will not result in new and useful information for investors. And we have to pay experts to do this every year."

In practice, the only useful information is the disclosure of the assumptions underpinning the impairment test, such as long-term growth rates and cash flows. Having this information would allow users to determine if management is being too optimistic or not. The better way to address this issue is to improve disclosure on the expected benefits of an acquisition as proposed elsewhere. See also the answer to question 11.

Some participants suggested that it would be more meaningful for the acquirer to assess the market value of the acquired business on an annual basis and compare it to the original transaction. Any loss in value would result in the goodwill being adjusted downward.

Finally, we note that it is very difficult for investors to know how to interpret an impairment. Investors own a stake in the whole entity, not just the cash generating unit, and do not have full visibility of the underlying calculation. The impairment will almost certainly have been anticipated but investors will be unable the answer the crucial question: are things better or worse than they already thought?

Question 7 – Paragraphs 3.86–3.94 summarise the reasons for the Board's preliminary view that it should not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill.

(a) Do you agree that the Board should not reintroduce amortisation of goodwill? Why or why not? (If the Board were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.)

(b) Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had?

(c) Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not?

(d) Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not?

(e) If amortisation were to be reintroduced, do you think companies would adjust or create new management performance measures to add back the amortisation expense? (Management performance measures are defined in the Exposure Draft General Presentation and Disclosures.) Why or why not? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not?

(f) If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?

Many CRUF participants support the board's view that goodwill should not be amortised. Any goodwill amortisation charge is the result of spreading the cost of something that you cannot directly measure over a highly subjective period of time with no cash flow implications.

This view is not universally held and CRUF Japan in particular would like goodwill amortisation to be reintroduced. If amortisation is not reintroduced, then CRUF Japan would like the annual impairment test to be retained in its current form. CRUF Japan is particularly concerned that some companies are too slow to recognise when goodwill has been impaired, which reduces the usefulness of the financial statements. CRUF Japan regards this concern as the new evidence on the reintroduction of goodwill amortisation, and that amortisation over a fixed period as being a better alternative. CRUF Japan regards that amortisation should be implemented in a straight line over a fixed amortisation period, with the amortisation period set as the period for recouping the investment estimated by management at the time of the acquisition. If management expects to recoup goodwill—a past expenditure—within a certain period through operating revenue, it should be expensed in conjunction with recognition of operating revenue under the principle of matching costs and revenues, so we think the most rational solution would be to set the amortisation period as the period for recouping the investment estimated by management at the time of acquisition. We believe management's decision regarding how many years it expects to take to recoup goodwill is material and useful information for users of financial statements, and we also believe it would be rational for a company to recognise impairment losses at the point where it becomes unable to recoup the investment as initially estimated at the time of acquisition.

One non-Japanese CRUF participant supports the amortisation of goodwill on the basis of matching. Current accounting rules arguably overstate post-acquisition operating profit as it includes all of the benefits from synergies, but not all of the costs as it excludes what was paid for goodwill.

See also the answer to question 11.

Question 8 – Paragraphs 3.107–3.114 explain the Board's preliminary view that it should develop a proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill. The Board would be likely to require companies to present this amount as a free-standing item, not as a subtotal within the structure of the balance sheet (see the Appendix to this Discussion Paper).

(a) Should the Board develop such a proposal? Why or why not?

(b) Do you have any comments on how a company should present such an amount?

It is not obvious to us that a requirement to present this specific number as a free-standing item would be of any benefit to investors, especially as some goodwill is in effect re-classified as artificially created intangible assets. It is also very easy to generate the number, simply being one number taken away from another and we therefore see little value in doing it.

CRUF Japan however agree that the board should develop such a proposal. The proposed presentation would clearly display the balance of goodwill and the relationship with the quality of capital for all users of financial statements and would also likely act as a bulwark against delayed recognition of impairment by compilers. CRUF Japan participants also think this presentation would be of high utility in highlighting financial risks to users of financial statements, since goodwill inherently carries risk of impairment in times of worsening business conditions, which can also significantly impact net assets. Of note, some CRUF Japan participants argued that the proposed presentation would have little utility, and others argued that intangible assets with indefinite useful life should be included as well as goodwill.

Question 9 - Paragraphs 4.32–4.34 summarise the Board's preliminary view that it should develop proposals to remove the requirement to perform a quantitative impairment test every year. A quantitative impairment test would not be required unless there is an indication of impairment. The same proposal would also be developed for intangible assets with indefinite useful lives and intangible assets not yet available for use.

(a) Should the Board develop such proposals? Why or why not?

(b) Would such proposals reduce costs significantly (see paragraphs 4.14–4.21)? If so, please provide examples of the nature and extent of any cost reduction. If the proposals would not reduce costs significantly, please explain why not.

(c) In your view, would the proposals make the impairment test significantly less robust (see paragraphs 4.22–4.23)? Why or why not?

See answer to question 11.

Question 10 – The Board's preliminary view is that it should develop proposals:

· to remove the restriction in IAS 36 that prohibits companies from including some cash flows in estimating value in use—cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance (see paragraphs 4.35–4.42); and

· to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use (see paragraphs 4.46–4.52).

The Board expects that these changes would reduce the cost and complexity of impairment tests and provide more useful and understandable information.

(a) Should the Board develop such proposals? Why or why not?

(b) Should the Board propose requiring discipline, in addition to the discipline already required by IAS 36, in estimating the cash flows that are the subject of this question? Why or why not? If so, please describe how this should be done and state whether this should apply to all cash flows included in estimates of value in use, and why.

CRUF Japan opposes any simplification of the current impairment test. They also oppose the inclusion of cash flow from uncommitted restructuring as they already regard the current regime as being too optimistic in practice.

See also answer to question 11.

Question 11 – Paragraph 4.56 summarises the Board's preliminary view that it should not further simplify the impairment test.

(a) Should the Board develop any of the simplifications summarised in paragraph 4.55? If so, which simplifications and why? If not, why not?

(b) Can you suggest other ways of reducing the cost and complexity of performing the impairment test for goodwill, without making the information provided less useful to investors?

Yes, we can suggest a way to reduce "the cost and complexity of performing the impairment test for goodwill, without making the information provided less useful to investors". As we discussed above, a goodwill impairment has little or no practical value to equity investors as it will almost always be obvious long before the impairment that the premium paid was excessive.

We have a very simple suggestion: leave goodwill on the balance sheet in perpetuity unless the business unit is subsequently closed or sold. This would help investors derive invested capital, might discourage management from over-paying for assets and would eliminate the arcane debate about how to measure something that doesn't exist.

The suggestion that goodwill stay on the balance sheet until the relevant unit is sold or closed is not universally supported. Some CRUF participants (notably CRUF Japan) would prefer that goodwill is amortised as it does not last forever, and impairment testing tends to be over-optimistic. They regard amortisation over an appropriate period as a better alternative.

Question 12 – Paragraphs 5.4–5.27 explain the Board's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill.

(a) Do you agree that the Board should not develop such a proposal? Why or why not?

(b) If you do not agree, which of the approaches discussed in paragraph 5.18 should the Board pursue, and why? Would such a change mean that investors would no longer receive useful information? Why or why not? How would this reduce complexity and reduce costs? Which costs would be reduced?

(c) Would your view change if amortisation of goodwill were to be reintroduced? Why or why not?

We have never supported the creation of quasi-goodwill intangible assets as part of the acquisition integration process. Our rationale is that:

1. The requirement to create and capitalise intangible assets on acquisition is intellectually inconsistent with the ban on capitalising most internally generated intangibles.
2. The measurement of such assets is highly subjective. We make an exception here for fixed-term wasting assets such as licences which are operational in nature and can be valued more readily.

3. The amortisation period is also highly subjective. Things like customer lists have indefinite lives as they evolve over time to reflect the departure of old and the arrival of new customers. One can further argue that a prime aim of the marketing budget is to ensure that the customer list remains up to date. It is illogical to treat the customer list as a wasting asset as virtually every company will strive to ensure that the list evolves and remains valid. These types of acquired intangible are often referred to as ones which are "organically replaced through the P&L" such that the value does not erode over time. The income statement, if it is to be a measure of economic performance, should not show both the cost of maintaining the asset as well as the amortisation charge.
4. The resulting amortisation charge therefore has little economic meaning. In our experience, most investors simply strip out such charges.
5. The derivation of a useful operating profit number is made more complicated. Many companies are moving to a version of EBITA to get around this. Analysts typically accept this as a better measure of profit as they see the non-wasting nature of many of these assets. When companies adopt a new reporting metric, it can be an indication that the standards are not working effectively.
6. The sudden increase in profit when the amortisation period ends is another sign that this process is flawed.
7. As discussed elsewhere, it makes the balance sheet less informative.

We have expressed these opinions before so we thought it would be helpful to add another viewpoint and ask the Board to consider the following questions:

- What useful information does the Board think that investors can derive from these artificially created assets?
- Does it give a better number for profitability?
- Does it help with deriving invested capital?
- Does it make the notes on tangible and intangible fixed assets more useful?
- Does the mixing of amortisation of the organically replaced intangibles (e.g. customer lists, etc.) with genuinely wasting acquired intangibles (e.g. licences, patents, etc.) create distortions in reporting as management will often add back all amortisation of acquired intangibles for APMs despite some representing a true economic cost?

As a point of principle, the Board should not be requiring companies to derive and present information that has no practical value. However, if non-goodwill intangibles are created during the acquisition process, then we believe they should be separately disclosed.

Question 13 – IFRS 3 is converged in many respects with US generally accepted accounting principles (US GAAP). For example, in accordance with both IFRS 3 and US GAAP for public companies, companies do not amortise goodwill. Paragraphs 6.2–6.13 summarise an Invitation to Comment issued by the US Financial Accounting Standards Board (FASB). Do your answers to any of the questions in this Discussion Paper depend on whether the outcome is consistent with US GAAP as it exists today, or as it may be after the FASB's current work? If so, which answers would change and why?

We regard convergence as desirable but only if it does not dilute the quality of IFRS. We do not want to see convergence to an inferior position. We welcome regular dialogue between the IASB and FASB as new standards are developed.

Question 14 – Do you have any other comments on the Board's preliminary views presented in this Discussion Paper? Should the Board consider any other topics in response to the PIR of IFRS 3?

As mentioned in our opening remarks, we would like to see separate disclosure of internally generated assets and those created or marked up to fair value during an acquisition. Some companies are already doing this voluntarily and we would highlight Swedish company Atlas Copco as an example of good practice on this point. This information is by definition already available as it would not be possible to calculate the net asset total without it.

Separate disclosure of internally generated intangible assets would also enable users to get a better view of overall operating performance. We also note that some acquired intangibles, such as fixed-term licences, are actually operational in nature.

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 and auditing standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers, investors and corporate governance and ESG 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, India, 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. In our meetings around the world, we seek to explore and understand the differences in opinions of participants. The CRUF does not seek to achieve consensus views, but instead we focus on why reasonable participants can have different positions. Furthermore, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. This response is a summary of the range of opinions discussed at the CRUF meetings held globally. Local country differences of opinion are noted where applicable.

Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organisations. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective organisations. The participants in the Forum that have specifically endorsed this response are listed below.

Signatures:

Peter Reilly
The Bailey Network

Greg Collett
Pictet Asset Management

Jane Fuller, FSIP
Co-director, Centre for the Study of Financial Innovation

Jed Wrigley
Investment Advisor

Jeremy Stuber

Charles Henderson
UKSA

Sue Milton
UKSA

Andrew Burton

Anna Czarniecka
Financial reporting consultant

Scott A. Nammacher, ASA, CFA
Empire Valuation Consultants, Inc.

Naoki Hirai
Senior Officer, Nomura Securities Co., Ltd

Keiko Mizuguchi
Council, Japan Credit Rating Agency.Ltd.

Yosuke Mitsusada, Ph.D, CFA
Director, Founding Partner, Asuka Corporate Advisor Co., Ltd.

Masayuki Kubota, CFA
Chief Strategist, Rakuten Securities, Inc.

Koei Otaki, CPA, CMA
Senior equity analyst, SMBC Nikko securities, Inc.