

CL 27 – AIAF

Discussion Paper ‘Should goodwill still not be amortised?’

Question 1

Do you agree that there should be a requirement to recognise goodwill as an asset and amortise it over subsequent periods? If so, do you support amortisation because:

- (a) goodwill existing at acquisition date is consumed and replaced with internally generated goodwill over time, thus it should be allocated to subsequent periods as part of the cost of acquiring an entity;*
- (b) an impairment-only model is not sufficiently reliable due to the large use of assumptions in the impairment test (future cash flows, terminal growth rate and discount rate); or*
- (c) amortisation of goodwill, in addition to the impairment test, achieves an appropriate cost-benefit balance.*

We agree that goodwill should be recognised as an asset with a definite useful life and therefore should be depreciated, because it represents the extra-earning granted by the competitive advantage expected in the medium-long term in the market of activity, in relation to technological innovation and competitive environment.

At the same time, since it is medium-long term investment, it is necessary to have an assessment (impairment test) to ensure that the carrying amount is consistent with the economic reality.

From an economical perspective, goodwill is an investment that should be recovered in a reasonable period. Shareholders have the right to ascertain that the investment can generate a current, future and certain usefulness. Amortisation expresses the return on investment within a limited time period that can be measured with an amortisation plan. The practice used by financial analysts is based on experience in similar markets and it is believed that the management can make a reasonable estimate, considering a return proportioned to the industry segment. If we look at the arguments about large international groups of consumer goods, we could conclude that ‘trademarks’ should not be amortised because its useful life is correlated to the internally generated goodwill whose value is defined only in case of disposal. This scenario occurs when goodwill is continuously regenerated with investments and the trademark maintains its value (i.e., the Coca Cola trademark). But it should be verified that the entity can really maintain the value with continuous investments. These, in the analysis of the AIAF working group on intangibles, can be correlated to two types of investments:

- Research and developments to innovate the product (for Coca Cola, an example is packaging);
- Marketing and advertising (in the Coca Cola case, these investments are recurring and significant).

Trademark and goodwill cannot be always equated, because goodwill is a residual while trademark is an identified asset. In relation to the trademark, it should be noted that not all expenses that internally are considered to increment value can be recognised as an asset with the current Standards. Moreover, the value of a trademark can be assessed with models such as the ‘relief of royalty’ model, while since goodwill is a residual its value is linked only to the generation of extra-earnings and is only generated from business combinations, since internally generated goodwill cannot be recognised as an asset.

As noted above, investments to maintain the trademark cannot always be recognised as assets, but this creates differences in the financial statements of entities that operate in different business, which damages comparability. Finally, in relation to trademarks, while it is true that the ‘relief of royalty’ method is commonly used, what about trademark of entities that are not allowed to license it (such as banks)? Therefore, trademark is part of the cost incurred to acquire a business or costs incurred by the entity that have been recognised as assets only for accounting purposes. In both cases, the carrying amount is unlikely to represent the economic value. In conclusion, we believe that all intangibles should be amortised and subject to impairment.

Question 2

Assuming that there was a requirement to amortise goodwill, do you think that the IASB should:

- (a) indicate what the amortisation period should be?*
- (b) indicate a maximum amortisation period?*
- (c) provide guidance on how entities should assess the amortisation period (for instance, by referring to the expected payback period or the useful life of the primary asset)?*

(d) allow entities to elect the amortisation period that they consider appropriate?

It is reasonable to identify classes of segments with similar characteristics and define the useful life in relation to the life cycle of the reference good, to reduce judgment and ensure a closer relation to the economic reality – for instance hi-tech segments have a short life cycles of 3/5 years, while pharma has a longer 10/15 year period.

It is difficult to allocate entities in different business and assess for each an average useful life for the goodwill, even if based on the work of the AIAF working group on intangibles it seems reasonable to assume that for different segments the amortisation period should differ.

It is proposed to include a presumption of a maximum amortisation period within the Standard. The definition should be linked to the characteristics of the segment with a clear disclosure of the assumptions for each segment. If the amortisation period was too long, the fair value of the goodwill would become lower than its residual value and the carrying amount would have to be impaired to fair value.

Question 3

The DP suggests the need for improved guidance in a number of areas in IAS 36. Do you think that the IASB should improve and/or provide additional guidance in relation to:

- (a) the methods to determine the recoverable amount of the goodwill;*
- (b) the application of the value-in-use method;*
- (c) the identification of cash-generating units and allocation of goodwill to each unit; and*
- (d) the choice of the discount rate.*

If not, please indicate why. Please state any specific suggestions for improvements if you have.

About the CGU, while we agree conceptually on the definition, the application is difficult and leaves room to judgment. It would be appropriate to clarify for instance, by identifying CGU with the reporting unit monitored internally.

About the measurement of the terminal value, we suggest that the use of a perpetual growth method is more appropriate for those entities whose business model and reference market support the assumption that cash flows can grow for longer periods (15 – 20 years). However, it is a more appropriate method than the use of multiples, because this latter requires more judgment and less reliable, apart from the difficulty to identify peers that are really comparable for growth rates, financial structure, risk exposure and other variables.

To ensure the application of a rigorous DCF model, the Standard could indicate what are the reliable sources for the terminal growth rate.

Also, the Standard could set a simplified approach for assessing permanent losses in value as is the case in the Italian Standard OIC 9.

The terminal growth rate should be linked to observable input and/or to reliable studies from entities that are not involved in the transaction and therefore have no potential conflict of interest. We need reliable accounting standards that are not subject to the assessment of third parties that could have a conflicting interest in the assessment.

Question 4

The DP suggests a number of possible new disclosures about impairment testing for goodwill. Do you think that the IASB

should consider improving requirements to:

- (a) assist users in understanding the robustness of the modelling and the entity's current assumptions;*
- (b) provide confirmation of the 'reasonableness' of the entity's past assumptions; and*
- (c) assist users in predicting future impairment.*

Please refer to our reply to question 3.

Question 5

IAS 38 requires that intangible assets with indefinite useful lives are not amortised but tested for impairment at least annually.

Assuming that there was a requirement to amortise the goodwill, do you think that the same requirement should be extended to other intangible assets with indefinite useful lives? In addition, assuming that there was a requirement to amortise goodwill, do you think that the current requirements of identifying intangible assets separately from goodwill should be reconsidered? If so, how?

We believe that all intangible assets should be amortised and subject to impairment. From an user's perspective, there could inconsistent reporting between two groups that have made the same investment in an intangible. Assume that the first group has made the investment and expensed it in the parent company; while the second has made the investment in a subsidiary and then merged it into the parent. In the first entity the investment would be fully expensed, while in the second the merger would give rise to a goodwill. With the current Standard that does not allow amortisation, the difference would remain over time, while with an annual amortisation the difference would progressively disappear over time

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