Subject: Response to BCDGI invitation to comment

Dear Ms Wallace,

Thank you for the *Invitation to Comment on Business Combinations* which accompanied the FRC email of 15 December 2020. Having watched the outreach event of 26 November, basically I agree with the comments of the UKEB to the IASB expressed in you Draft Comments for 29 January 2021; i.e. to use both amortisation and impairment as appropriate to valuing Goodwill's varied constituent elements.

I have attempted to address in outline, below, a few of the topics related to specific concerns of mine from Part B, along with trying to explain possibilities for further related progressive/developmental work on them.

The subject of Business Combinations is of interest to me, as a private investor and as an engineer interested in corporate value: Its creation through innovation and/or its acquisition through combination; particularly those elements of value based on science/engineering/technology, etc; how it is perceived, preserved, evaluated and measured; along with its recording and publication in companies' annual report and accounts. It is an interesting subject and a good point of departure for considering some of the wider aspects of the Standards, particularly Goodwill and intangibles; though, please accept my apologies for ignorance of accounting Standards' details with resulting errors and simplistic views as I am and engineer, not an accountant.

So, having contributed to work on intangibles in the FRC's 2019 project, I am delighted to see work continuing in an associated area of this important, interesting and complex subject. Therefore, I would very much like to take part in progressive work on intangibles and Goodwill - for the sake of their clarification, and to arrive at practicable conclusions, incorporated into Standards.

One effect of a Combination is the need to manage the outcomes, technically and financially; indeed, the current study focusses on the post-combination challenges of disclosure and its effects, with the value-reducing impairment and amortisation of goodwill on the balance sheet, and mainly on management of the downside risks.

However, good engineering practice should give rise to an interest in the *causes* of Combinations, as well as the challenges in managing the positive *effects*.

Therefore, to achieve a more complete, useful, and broad understanding, with considerations for anticipating practicable management of a combination's challenges, it may be beneficial to address Combinations also in terms of their *causes*; considering initially the perceived rationale behind combinations in terms of opportunities and synergies with upward revaluation - which one supposes were their original objectives.

The value of Goodwill as recorded in the Assets of a company's Financial Statements may be clear, but possibly overvalued.

Whereas the *potential goodwill* of a Combination target's entity – its detail, magnitude, and estimated value - may not be generally clear nor broadly well understood, though it may be the root *cause* and attraction to investing in an under-valued business by astute acquisitive companies and/or aspiring retail investors seeking 'value'.

Alternatively however, the *causes* of some Combinations may be the result of inaccurate perception, understanding and/or inappropriate interpretation of Standards, either by the acquirer and/or the target entity: Eg, the bases of corporate Asset estimated value, including goodwill, and/or its other 'intangibles'; changes in Standards or the

Conceptual Framework, such as to an Asset being an economic resource having the *potential to produce economic benefit*; the value/worth of separate constituent elements and dimensions, to the shareholders (current and prospective acquirers), general stakeholders, and inhabitants of its business macro- and micro-environment, as well as the commercial community in general.

The valuation of Goodwill, with its individual elements – eg, brand, lists, incorporated science, knowledge of technology/engineering, etc - should take into consideration the constituents elements' characteristics, they being different and arguably calling for different/alternative treatments in their annual appraisal of value. Whilst there is a need to improve goodwill accounting, there is often not enough reliable information.

So it is useful to have both amortisation and impairment available: For example, the value, nature and life of brands - being unclear, unstable and a function of volatile market sentiment/perceptions - are probably more suited to annual (linear) amortisation after a brief impairment test/review, whereas science/technology may have a more predictable life and changeable (up or down) *potential* to produce economic benefit, so more suited to quantitative analysis, such as NPV of estimated future earnings.

In the outreach event of 26 November, there were several references to over-valued or unmeasurable Assets carried under Goodwill in some companies' balance sheets, resulting from insufficient impairment/amortisation of the combination's sourced Intangible Assets. This may be the case, but conversely in alternative circumstances there may be under-valued business's intangibles (see above), perhaps resulting from (inappropriate) allocation of innovation's Research and Development costs; between being expensed as Research in P&L, which in some cases should have been more appropriately capitalised instead as Development IA in the balance sheet. Arguably, the root cause of this may be insufficiently clear Standard/s, allowing too much scope for management 'judgement' (manipulation/obfuscation/etc), such as in interpreting and applying some of the Standards, the clarity of which could benefit from review and eventual rewriting.

Associated with this value and nature of intangibles, there has been significant discussion, and changes in attituded on many sides, in relation to 'predator' acquisitions – be they private equity, cross-border (with the potential for a threat to the economy/security of the target company's country), or more recently 'pacs', etc. This identification by acquirers of possible suspected asset undervaluation (invisible, hidden, obscured/concealed intangibles' value in a company's accounts) has been evidenced in many cases by the rapid increase in share price of the target when market 'interest' becomes known. So to reduce opacity, with its resultant opportunities for 'judgement', and so improve transparency to, and perception by, the market or potential investor, the root cause of, and hence scope for, such under-valuations – increasingly related to intangibles, often of a science/technology nature – deserves further attention to clarifying Standards.

Alternative perceptions are expressed from the different perspectives of preparers, auditors and users, demonstrably not all sharing precisely the same opinions in this area; this is evidenced by several participants and slides at the event, as well as in the work on intangibles during the FRC's 2019 project. Hopefully, differences can be reconciled, and intangibles will be taken into consideration in a study paper in the near future.

The challenges of goodwill, intangibles, impairment, amortisation, etc, may also be worth examining as a possible cause of Combinations, not only in view of the overall context of UK's exit from EU: The bigger picture could be addressed to explore and exploit the arising potential opportunities for independent thinking by the UK on the related Standards. This could benefit, eventually, from a much broader, more all-embracing and holistic, examination of Standards - as a set - eventually to benefit the general 'IASB world' (vav US's FASB world), and hopefully the UK in particular more immediately.

Taking this opportunity, all accounting Standards which involve intangibles may benefit from being readdressed in the current situation, and critically examined and rewritten where appropriate and necessary – in pursuit of 'improved'/'correct solution'/'right answer' as mentioned by most participants, vis a vis uniformity. Thus, the UK Endorsement Board contributing to the achievement of accounting standards in the UK, and hopefully elsewhere, of greater clarity and practicability.

So, this current study needs ‘follow-up’, it being neither sufficiently granular in its examination of the constituents of Goodwill, nor wide enough to embrace the complex matter of intangibles and their involvement with/impingement on various accounting Standards, the valuations of companies world-wide, and the ‘wealth of nations’!

So, I am much looking forward, in hope, to opportunities for continuing my involvement in the development of this interesting, large and complex field.

The views expressed here are entirely my private opinions, as an independent investor from a perspective of science/engineering/technology; they do not reflect the views of any current or previous employer.

With best wishes that you keep safe, fit, and well in these uncertain times.

Yours sincerely,

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