

ValueKnowledge LLC

BUSINESS VALUATIONS | Seeking Fairness

343 West Erie Street, Suite 200 Chicago, IL 60654
tel: 312-450-8330 fax: 312-450-8335
www.valueknowledge.com

November 5, 2010

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Via email to director@fasb.org

Re: File Reference No. EITF100A

To Whom it May Concern:

ValueKnowledge LLC appreciates the opportunity to respond to the Financial Accounting Standards Board's ("FASB" or the "Board") exposure draft of proposed Accounting Standards Update (ASU), *Intangibles-Goodwill and Other (Topic 350) – How the Carrying Amount of a Reporting Unit Should be Calculated When Performing Step 1 of the Goodwill Impairment Test* (the "ED"). As a valuation specialist, we support the Board's objective of eliminating diversity in practice and improving the application of the goodwill impairment test. However, we do not support the proposed guidance detailed in the ED regarding the uniform imposition of the equity premise in calculating the carrying amount of the reporting unit. Rather, should the Board decide to require one uniform basis for calculating the carrying amount, we suggest that the enterprise premise, rather than an equity premise, be uniformly imposed as the premise to calculate the carrying amount.

The ED states in the seventh paragraph in the Summary and Questions for Respondents section that, "this proposed Update would improve the application of the goodwill impairment test by requiring entities with reporting units with zero or negative carrying amounts to perform Step 2 if there are adverse qualitative factors that indicated that goodwill is more likely than not impaired." If this is the FASB's main driver, this is not per se an argument against the use of calculating the carrying amount on an enterprise premise. In fact, the ED states in the first sentence of the third paragraph on page one of this same section that, "In practice, an enterprise premise sometimes is used when an entity has reporting units with zero or negative carrying amounts resulting from the equity premise." This seemingly would support use of the enterprise premise. Additionally, the same "adverse qualitative factors" identified in this ED could be used

to trigger a Step 2 under an enterprise premise for the carrying amount, if the equity component of the carrying amount was zero or negative. Therefore, it is not clear why the ED advocates the equity premise as the basis for calculating the carrying amount.

Should the Board decide to require one uniform basis for calculating the carrying amount, we suggest the enterprise premise is a better option of the two premises. The main benefits of the enterprise premise are two-fold. Each benefit is discussed below.

1) Enterprise Premise Appropriately Eliminates Consideration of Financing Liabilities in Tests of Asset Impairment

An enterprise premise for calculating the carrying amount will eliminate scenarios where a reporting unit passes Step 1 only because of a write-down from book value to fair value of the liabilities that are part of the capital structure of the reporting unit (hereafter referred to as “financing liabilities”). See the following summary for an example of such a scenario.

	Carrying Amount	Fair Value	Result of Step 1
Enterprise Value	\$10,000	\$9,500	• Fail
Less: Financing liabilities	3,000	2,000	
Equals: Equity Value	\$7,000	\$7,500	• Pass

We deem the pass rendered in Step 1 under the equity premise in the scenario above to be an erroneous outcome due to the fact that under an enterprise premise the result is a fail and the source for the disconnect between the two options is the equity premise’s inclusion of the financing liabilities at fair value, which in this case are below book value. When fair value of a financing liability is below book value, and when the reporting entity is under some financial distress (which in our experience is not a bright line determination), this condition indicates that the reporting entity (and by extension the reporting unit) may not honor its commitment to the holders of its financing liabilities. Thus, in these cases, the ED may allow for a reporting entity to enter into default on its financing liabilities but the goodwill impairment test of the reporting entity does not fail under Step 1 (thus the goodwill test does not indicate impairment). This seems contrary to the true economics of the situation the reporting entity is in. Furthermore, relying on a future settlement of the financing liabilities below their book values (implicit in a scenario where the fair value of the financing liabilities is below its book value) appears to us to be a technicality that ignores the purpose of impairment testing. We believe the purpose of impairment testing should be to assess whether the asset is impaired (and if so how much), without regard for the fair value of the reporting unit’s financing liabilities.

The end result of this ED if adopted could therefore be fewer Step 2 analyses being performed and less identification of asset impairment, which seems contrary to part of the intent of this ED.

2) Enterprise Premise Is Superior to Equity Premise in Reducing Diversity in Practice and Improving Application of the Goodwill Impairment Test

Despite this ED's stipulation of the equity premise for calculating the carrying amount, we understand the valuation specialist will still have two premises for estimating the fair value of the reporting unit. The valuation specialist could elect to utilize a valuation technique based on an enterprise premise, then estimate and deduct the fair value of the financing liabilities in order to compare to the equity premise carrying amount. Management of the reporting entity may favor this option as it avoids the need to include future capital structure decisions and assumptions (e.g., debt refinancing, future interest rates, hedging activities) in the prospective financial information ("PFI") of the reporting unit. Alternatively, the valuation specialist could utilize a valuation technique on an equity premise, thus avoiding the need to estimate the fair value of the financing liabilities. Valuation specialists may favor this as it reduces the scope of what is opined to – i.e., one subject interest, the enterprise of the reporting unit, vs. two subject interests; the equity and the financing liabilities of the reporting unit. In the event the ED is revised to stipulate the enterprise premise for calculating the carrying amount, it is likely that most valuation specialists will elect only one premise in estimating the fair value of the reporting unit. The valuation specialist will elect to utilize a valuation technique on an enterprise premise, thus avoiding the need for management to include capital structure decisions in the PFI and reducing the scope of what the valuation specialist opines to. Therefore, under the enterprise premise for the carrying amount, the diversity in practice related to the premise of the valuation technique may actually decrease relative to the equity premise.

In terms of the application of valuation techniques in arriving at the fair value of the reporting unit, we believe the enterprise premise is more useful than the equity premise, and will accordingly better reduce diversity in practice, particularly for the market approach valuation technique. Enterprise value ("EV")-to-revenue, EV-to-EBITDA and EV-to-EBIT, are three useful valuation multiple metrics on an enterprise basis under the market approach. This compares to, in our experience, only one pervasive equity premise valuation metric under the market approach, the price-to-earnings ratio. The price-to-earnings ratio can of course be rendered meaningless for entities with low to no positive net income. Under the enterprise premise, this type of limitation has no parallel when utilizing an EV to revenue valuation multiple metric (other than for pre-revenue startups), and the frequency of a meaningless EV-to-EBITDA and EV-to-EBIT valuation metric respectively would be far less than a price-to-earnings ratio as EBITDA and EBIT are further up the income statement relative to net income, thus they are less likely to be low or negative relative to net income. Thus, application of valuation techniques using an enterprise premise will likely be more useful and may reduce variability of valuation results through having more meaningful value indications to triangulate in on the final estimated fair value. Therefore, under the enterprise premise for the carrying amount, the application of the goodwill impairment test may improve relative to the equity premise due to more useful valuation metrics available for use.

Assuming an equity premise for the carrying amount as stipulated in this ED, for those valuation specialists that still select a valuation technique on an enterprise premise before subtracting financing liabilities to arrive at an equity premise (i.e., the option that may be preferred by management), the valuation specialist will need to estimate the fair value of the financing

liabilities. There will likely be significant diversity in practice in how the fair value of the financing liabilities are estimated, both methodology wise (e.g., income approach vs. market approach; income and market approach; market approach based on recent issuances vs. debt trading prices; etc.) as well as underlying assumptions (e.g., imputed credit rating for non-public debt; impact of bond features; potential for refinancing; Level 1-2-3 inputs; etc.). Alternatively, for those valuation specialists that select a valuation technique on an equity premise (i.e., the option that may be preferred by valuation specialists), it is likely there will also be diversity in practice in how robust the PFI is with regard to the forecast of the financing liabilities. It is also likely there will be diversity in how the valuation specialist, the independent auditor and the independent auditor's valuation specialist (collectively the "Independent Reviewers") assess the reasonableness of the forecast of the financing liabilities. Therefore, under the enterprise premise for the carrying amount, the diversity in practice may actually decrease.

In summary, we suggest an enterprise premise for calculating the carrying amount (and by extension, for estimating the fair value of the reporting unit) is superior to the equity premise both in terms of reducing diversity of practice and in terms of improving application of the goodwill impairment test.

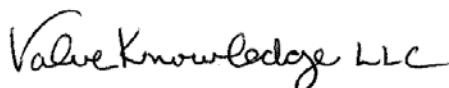
Other Comments

Our experience has been that the enterprise premise relative to the equity premise is much more pervasive not only amongst valuation specialists (particularly in a financial reporting context) but also amongst market participants that transact for controlling interests in reporting units and reporting entities. Enterprise value to EBITDA is likely the most ubiquitous valuation metric used by both strategic and financial buyers sellers (i.e., market participants). This may translate into more market data available and a better ability to use this data to assess, estimate and communicate final conclusions. Matching this premise on the calculation of the carrying amount seems like a more appropriate choice compared to the equity, particularly after considering the benefits described above.

As the Board redeliberates the proposals and its preliminary decisions, we suggest the enterprise premise be the selected premise, to the extent the Board feels compelled to stipulate one required method for calculating the carrying amount. Our responses to the specific questions on which the Board is seeking comments are included in the Attachment to this letter.

If you have any questions about our comments, please contact John Schumacher at (312) 450-8330 or JCS@VKnow.com.

Yours sincerely,



ValueKnowledge LLC



Attachment

ValueKnowledge LLC's responses to specific questions in the FASB's Proposed Accounting Standards Update, *Intangibles-Goodwill and Other (Topic 350) – How the Carrying Amount of a Reporting Unit Should be Calculated When Performing Step 1 of the Goodwill Impairment Test*

Question 1: Do you agree that the equity premise should be the only permissible methodology for Step 1 of the goodwill impairment test? If not, why not?

Response:

No. As further described in our cover letter and in our responses to the questions that follow herein, if only one permissible methodology needs to be specified, the enterprise premise is the preferred option for several reasons, including:

- 1) enterprise premise appropriately eliminates consideration of financing liabilities in test of asset impairment;*
- 2) enterprise premise is superior to equity premise in reducing diversity in practice and improving application of the goodwill impairment test*
- 3) enterprise premise is more pervasive amongst market participants*

Question 2: Do you agree with the qualitative factors that have been provided for reporting units with zero or negative carrying amounts to consider in determining whether it is more likely than not that a goodwill impairment exists? If not, why not? Are there additional factors that also should be included?

Response:

We agree with the qualitative factors. We also suggest the Board consider adding in a sentence or two to provide additional emphasis that the list is not exhaustive and that the assessment will vary based on the specific facts and circumstances of the reporting entity at that time. For example, loss of a key supplier or raw material is another potential addition to the list that may have limited applicability but may be important to specific reporting units.

Question 3: Do you need more guidance on how to determine if it is more likely than not that goodwill is impaired at transition? If so, please describe what may be helpful with that determination.

Response:

No

Question 4: For reporting entities that have used an enterprise premise to calculate the carrying amount of a reporting entity for Step 1 of the goodwill impairment test, do you believe that applying the amendments in this proposed Update would result in different conclusions about the need to perform Step 2? If so, please describe such scenarios.

Response:

Yes. As further described in our cover letter, in cases where the fair value of the financing liabilities is below book value, it is possible that the reporting entity would fail under an enterprise premise but pass under an equity premise. This is an outcome that, in our view, is inconsistent with the intent of asset impairment testing in general and with part of the intent of this ED because it may actually result in fewer Step 2 analyses being performed.

Question 5: Do you agree with the proposed effective dates for public and non-public entities? Are they operational? If not, why not?

Response:

Yes. They are operational. However, the concern is not the amount of notification time, it is the amount of additional time needed for each analysis to appropriately contemplate and address the forecast and underlying assumptions of the capital structure of the reporting unit.