



Leading / Thinking / Performing

June 3, 2011

Technical Director
File Reference No. 2011-180
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5115

Dear Sir:

We have read the Proposed Accounting Standards Update entitled “Intangibles – Goodwill and Other (Topic 350) Testing Goodwill for Impairment” with great interest, and submit our comments in this letter.

Our initial comment is directed at the rationale stated on page 1 for issuing the update. You state that preparers of nonpublic entity financial statements have expressed concern about the cost and complexity of performing the first step of the two step goodwill impairment test. To address these concerns, the Board proposes to allow an entity to use a qualitative approach for testing goodwill for impairment. An entity would not be required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount.

It is difficult for us to see how the proposal will achieve the FASB’s objective of reducing cost and complexity.

In those situations where the reporting unit would clearly pass the proposed qualitative test (robust market for products or services, actual financial results above budget and projections, etc.), the cost of documenting the qualitative factors may be no less than the cost of performing a simplified quantitative test, such as applying conservative guideline company multiples to historical operating results.

And in those situations where the reporting unit fails the qualitative test, the first step of the quantitative test must still be performed for purposes of the “deemed allocation” under the second step, providing no cost savings or reduced complexity to the entity testing its reporting units.

Finally, in the remainder of cases where the qualitative test is inconclusive, or the entity is unable to document their conclusions to the satisfaction of the auditor, it is our belief that they will be forced to perform the quantitative test; again, no cost savings will be achieved.



We suggest that greater cost savings could be achieved for nonpublic entities through one of the following approaches:

- Relieving an entity of performing interim impairment tests; stating that only annual testing is needed.
- Allowing an entity to skip an annual test for several years if a Step 1 quantitative test is passed by a significant margin, and qualitative factors indicate positive trends for the company and the industry in which it operates.
- Allowing an entity to perform the test on a consolidated basis (one reporting unit).

Our second area of concern is the guidance provided when the carrying amount of the reporting unit is zero or negative. In these cases, you state that the entity shall not perform the first step of the (quantitative) test because the entity always would pass that step of the impairment test. While we have heard this argument made by reporting entities as well as their auditors, we have categorically rejected it. To a valuation professional charged with estimating the fair value of a reporting unit, negative carrying value of the equity can indicate that the reporting unit is experiencing operating difficulties, the book value of the assets (including goodwill, if any) may be overstated, and/or the fair value of the long term debt is less than face. But concluding that Step 1 of the Goodwill Impairment Test is automatically satisfied is erroneous.

In his book entitled "Investment Valuation," Aswath Damodaran discusses and compares two approaches to valuing a firm: the free cash flows to the equity ("FCFE"), and the free cash flows to the firm ("FCFF"). He argues that "Firms that either have very high leverage or are in the process of changing their leverage are best valued using the FCFF approach. The calculation of FCFE is much more difficult in these cases because of the volatility introduced by debt payments, and the value of equity, which is a small slice of the total value of the firm, is more sensitive to assumptions about growth and risk."

Furthermore, Damodaran states that "if the FCFF approach is used to value the equity in a firm, the debt either has to trade at a "fair" price or has to be explicitly valued using updated interest rates that reflect the risk of the debt." The amendments in the proposed update do not provide guidance on the measurement of the fair value of the debt of a reporting unit. We must resort to the limited guidance in Topic 820 on the valuation of liabilities. And, if that guidance is followed, we are left with another dilemma: the debt on the balance sheet of a reporting unit is typically stated at its face or principal amount (or original fair value). But the valuation of the equity would consider the current fair value of the debt in cases where the debt is transferable, which could be lower than face, thus increasing the probability of the reporting unit passing Step 1 even though the carrying value of goodwill exceeds its fair value.



To summarize, it is our opinion that the premise upon which this guidance is based is flawed. The valuation of the equity of a reporting unit is generally achievable, as is the valuation of the enterprise. The most important consideration is the appropriate comparison called for in Step 1: carrying value of equity with fair value of equity, or carrying value of the enterprise with fair value of the enterprise. Mandating the use of an equity comparison will create a myriad of issues in those situations where there is currently only a perceived problem.

There is also an operational issue with this guidance. The second step of the (quantitative) impairment test shall be performed to measure the amount of impairment loss, if any, when it is more likely than not that a goodwill impairment exists. Without performing the first step, the amount that needs to be allocated among the underlying assets in Step 2 to determine the implied fair value of the goodwill is unknown.

Our responses to the nine specific questions in the Update are found in Attachment 1.

Respectfully submitted,

A handwritten signature in black ink that reads "American Appraisal" in a cursive script.

American Appraisal Associates



Attachment 1

Question 1: American Appraisal Associates is a global valuation services provider.

Questions 2 through 5: Not applicable

Question 6: The proposed examples of events and circumstances to be assessed in a qualitative test are adequate examples of issues to be considered.

Question 7: The guidance for a qualitative test is clear.

Question 8: We do not agree with the Board's decision to make the proposed amendments applicable to both public entities and nonpublic entities, for the reasons stated in the body of our letter.

Question 9: The proposed effective date provisions are agreeable to us.