



June 3, 2011

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File Reference - 2011-180 Testing for Goodwill Impairment, Topic 350

The Business Valuation Committee of the Pennsylvania Institute of Certified Public Accountants (“PICPA”) met on April 27, 2011, (and its subcommittee on standards met by conference thereafter), to debate and discuss the Exposure Draft of a Proposed Standards Update of Topic 350 on Testing for Goodwill Impairment. During our deliberations, the following points of consensus were developed:

1. The Pennsylvania valuation community strongly supports the concept of moving to principle based standards, as opposed to rule based standards, and therefore suggests that Topic 350 not be amended as proposed.
2. Annual testing of the economic recoverability of assets, based on current market conditions, (intangible or not) is a firmly established accounting principle.
3. Suggesting that some set of rules might justify a departure from this principle does not advance the argument that the accounting profession is committed to transparency in financial reporting.
4. Valuation commentators have suggested that a more appropriate label for the term Goodwill is “Amount that Management Overpaid to Acquire a Business Unit.” Accordingly, Goodwill is the intangible asset most worth accounting scrutiny. Goodwill typically arises when Management acquires a business unit with the expectation that they will be able to deploy the acquired assets in a manner that results in higher future earnings. An impairment assessment performed based upon the proposed rules would not be likely to detect goodwill impairment that results from a departure between the projected and actual results achieved in the subject business unit. Goodwill impairment may result from a failure to achieve

projected revenue goals, not necessarily a factor to be considered in the proposed qualitative factors. These failures might result from overly optimistic revenue goals when the purchase price was first determined. A change in quantitative economic factors would not explain the failure to achieve overly optimistic revenue projections. Accordingly, preparers of financial statements, not performing the comprehensive testing contained in the existing impairment structure, relying on a lack of a material adverse change in economic conditions contained in the new rules, would improperly conclude that there is not the likelihood that goodwill is impaired, and thereby avoiding the need for the detailed impairment testing. This would likely result in postponement of impairment losses.

5. The lack of an annual testing of goodwill impairment is inconsistent with established GAAP principles. The principles of lower-of-cost-or-market testing for inventory measurement assures that those assets are valued at an amount that reflects current market conditions. When market conditions change in an amount that indicates impairment, inventory is written down to reflect the economic reality of the realizable value of the asset. This comparison is required annually, not just when there is a material adverse change in market prices.
6. Deferred Policy Acquisition Costs (“DAC”) in life insurance accounting represent another type of intangible asset subject to annual impairment testing under existing GAAP. No shortcut in impairment testing exists in the insurance industry. DAC recoverability is dependent on a number of interrelated economic factors, including changes in policy persistence, investment yields, mortality or morbidity assumptions and ultimate development, and other factors. No one expects shortcut estimates of whether or not these changes in assumptions individually would be material if measured in aggregate, because recoverability must be proved at least annually. The proposed exposure draft would increase differences in comparability of accounting principles across different industries.
7. The exposure draft assumes that accountants are capable of estimating the aggregate impact of a number of interrelated economic relationships without performing detailed computations. Minor modifications in costs that result in margin compression, changes in competition that result in lower gross margins, changes in exchange rates, changes in product demand that lower sales, and changes in estimated economic lives of customer assets might all be immaterial when measured in a vacuum. However, when the aggregate impact of all these



- changes is measured, the result could well be material. The only way to accurately measure the impact is to perform the computations.
8. The proposed exposure draft would increase the differences between GAAP and IFRS, making the conversion to IFRS more difficult for users of financial statements that lack accounting sophistication.
 9. The proposed exposure draft fails to learn from the lessons of the Enron accounting debacle. The stock market recognized the valuation problems at Enron when Goodwill impairment testing demanded that a substantial asset write down be recorded. How much longer would the market have remained deceived if the proposed rules been in place, and management could have argued that whatever qualitative economic changes were present, they did not justify detailed testing? The accounting profession should not be willing to offer management teams the opportunity to take the impairment testing shortcuts proposed in the exposure draft.
 10. The proposed exposure draft fails to adequately consider the likelihood that the proposed impairment short cuts will lead to more attempts by preparers of financial statements at earnings mismanagement, for all entities with stock valuation based incentive plans.
 11. The proposed exposure draft fails to follow recent guidance offered by the SEC. On December 1, 2010, the SEC Staff published guidance to financial statement preparers based on their review of Common Financial Reporting Issues facing Smaller Issuers. That guidance indicated that the SEC expected companies to consider “revisions to forecasts, and restructuring plans” among other indicators of the need to perform interim goodwill impairment testing. Given that the SEC staff has concerns about goodwill intangible and long lived assets reporting practices among smaller reporting companies, it is difficult to believe that a shortcut test for eliminating at least annual testing would be favorably received by the SEC Staff.
 12. The exposure draft changes, if implemented, are not likely to lead to reduced audit fees paid by preparers of financial statements. Moreover, these standards may ultimately act to increase the risks in preparing accurate financial statements and as a result creating greater liability potential to auditors (in the form of future malpractice lawsuits) ultimately increasing the cost of an audit.



13. We offer our comments to the questions posed in pages 4 and 5 of the Exposure Draft on the attached exhibit.

We appreciate your consideration of our comments. We are available to discuss any of these comments with you at your convenience.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "S. Scherf", is written above the name.

Stephen J. Scherf
Chair, Business Valuation Committee

A handwritten signature in black ink, appearing to read "Charles S. Lunden", is written above the name.

Charles S. Lunden
Subcommittee on Standards, Business Valuation Committee

Response to Questions Set forth in Pages 4 and 5 of the Exposure Draft

Question 1 – Description of Responders

Most of the members of the Committee are valuation analysts hired by non public preparers and some of the members are valuation analysts hired by public preparers of financial statements. One of the responders is a member of the audit committee of a venture funded private company.

Question 2 – Expectations of analysts retained by preparers of overall costs

We believe the majority of the auditing community of public companies will not support assertions that it is more likely than not that the quantitative analysis of economics justifies a bypass of a more robust analysis of goodwill impairment. Accordingly, this group expects no reduction of costs, and no reduction of complexity.

Question 3 – Expectations of analysts retained by preparers of impact of bypass

We believe the majority of the auditing community of public companies will not support assertions that it is more likely than not that the quantitative analysis of economics justifies a bypass of a more robust analysis of goodwill impairment. Accordingly, this group expects all Big 4 audit firms, and most second tier firms, to require their clients to proceed directly to the first step in the current impairment structure.

Questions 6 and 7 – Adequacy of Proposed Examples of events and circumstances

We believe that substantial guidance on consideration about departure of actual revenues compared to projected revenues needs to be added, if a “rules” based approach inherent in the exposure draft is adopted. We fear that this will lead to another “800 Page Gorilla” concern that other users of hedge accounting complained about in early 2000 to 2003 time frame (see CFO article dated June 11, 2008).



Response to Questions Set forth in Pages 4 and 5 of the Exposure Draft

Question 8 – Public v. Non Public application

We believe the changes should apply equally to all preparers of financial statements.

Question 9 – Effective Date

We believe the effective date is reasonable.