July 28, 2011

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

File Reference No. 2011-180

Dear Director,

We would like to take this opportunity to comment on the Exposure Draft, *Intangibles – Goodwill and Other (Topic 350).*

**Summary**

Emerson is a diversified global manufacturing company with revenue of approximately $25 billion. We believe reducing complexity in accounting and reporting is necessary to provide a clear picture of an entity’s results of operations and financial strength. Simplicity in accounting produces comparable results that are both easy for financial statement users to understand and operationally practical for preparers. We support efforts to reduce complexity in goodwill impairment testing and agree adding a qualitative step will help achieve that goal. Likewise, providing additional qualitative factors to consider in that analysis are useful. However, we believe if an effort is being made to improve testing for goodwill impairment, then a more comprehensive review is warranted that begins with how goodwill and other intangibles are initially identified and valued and how impairment is calculated. Also, any new guidance that is issued should move toward convergence with IFRS.

Our key comments regarding the exposure draft follow:

- We agree with the proposal to add an initial qualitative step to impairment testing. A qualitative analysis will avoid complicated calculations and save time and effort when it is apparent a reporting unit is not impaired.

- The hypothetical acquisition method used to calculate the fair value of implied goodwill is overly complicated, highly subjective and costly. The true fair value for a reporting unit at any point in time can only be known if there is a negotiated transaction between willing parties.

- To reduce complexity and improve comparability, the impairment model for goodwill should mirror the model for long-lived assets: an undiscounted cash flow recoverability test, followed, if necessary, by a write-down to a discounted cash flow derived fair value (consistent with how IAS 36 calculates impairment).
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- Only contractual intangible assets that exist at the balance sheet date should be separately valued. Separate valuation of intangibles that are not explicitly contract-based is highly theoretical, highly judgmental, and provides no real value to financial statement users. Assumptions about future activity, including anticipated renewals, should not be considered.

- Customer relationships should not be separately valued unless they are contractually specified. Quantifying a customer relationship based on purchase orders does not guarantee future orders. Customer relationships only have value to the extent of the last order successfully completed.

- A practical and easier approach, instead of the complex and expensive task of valuing poorly-defined intangibles plus goodwill, would be to amortize all non-contract intangibles. This is just as accurate as amortization of subjectively valued intangible assets and supports the notion that goodwill “turns over.” Impairment review could occur when circumstances such as those proposed in the exposure draft indicate it is more likely than not goodwill is impaired by directly writing down book value to fair value.

Impairment Model

We support the FASB’s proposal to allow for a qualitative analysis before performing the impairment test and believe this option would reduce complexity for preparers. A qualitative step will reduce the time, cost and effort spent on complicated calculations for reporting units that are clearly not impaired. The qualitative factors listed in the proposal will aid in streamlining the impairment review process to focus on the reporting units that may be impaired. We would also support applying this qualitative analysis to the impairment review of other intangible assets for consistency and increased efficiency. However, we believe a more comprehensive review of accounting for goodwill is warranted that analyzes all aspects of how intangibles are identified and valued and how impairment is calculated. There is a disconnect between goodwill impairment testing under US GAAP versus IFRS, as well as compared to testing for other long-lived assets under US GAAP, that should be resolved.

The current approach to calculate goodwill impairment by determining the reporting unit’s fair value using a hypothetical acquisition model to re-value all assets and liabilities is overly complicated and costly. An acquisition price simply cannot be known without a negotiated deal between willing participants. It would be much more practical to use the undiscounted cash flow recovery test which is outlined for other long-lived assets in ASC 360-10-35. A single impairment review method for all long-lived assets, including goodwill and identifiable intangibles, would allow companies to efficiently and consistently apply the guidance. Once it is determined a reporting unit has failed step one, the impairment amount should simply be calculated as the excess of the book value compared to a discounted cash flow derived fair value amount, similar to IAS 36. Goodwill impairment testing under IAS 36 compares the carrying value to the “recoverable amount,” which is the higher of the fair value of the asset less costs to sell, or the discounted value of expected future cash flows from continuing use of the asset. Likewise, ASC 360-10-35-36 also suggests calculating the fair value of long-lived assets with uncertainties in timing and amounts by using the present value technique.

Identifiable Intangibles

We believe a review is warranted for the subjective and costly process an entity must perform to identify and value certain identifiable intangibles, such as customer relationships, when the entity acquires a company. In particular, we believe the separability language in ASC 805-20-55-5 creates a category of intangibles that is poorly defined and differs little in substance from a company’s distribution system or assembled workforce; values which are logically subsumed into goodwill per ASC 805. Entities continually create new intangible value through operations, but that value is not separately identified and quantified. Whether acquired or internally generated, all assets “turn over” and it is not worth the effort
and cost to isolate these assets if they cannot be separately traded or reliably valued. There is no real benefit to shareholders to go through the costly exercise to subjectively value acquired intangible assets at that level of granularity and which do not exist separate from goodwill in reality. The fact that appraisers are able to estimate values for almost any item does not mean such values are relevant or reliable. To simplify the process, we believe recording identifiable intangibles should be limited to those assets which: 1) have a genuinely determinable fair value, 2) contractually exist at the balance sheet date, with assumptions about anticipated renewals excluded from consideration, and 3) can clearly be sold or exchanged separately from the business. Limiting identifiable intangibles to these factors would reduce unnecessary complexity and subjectivity that arises from valuing these assets. To further achieve this goal, we believe a practical solution would also include separate identification and capitalization of only significant acquired contractual intangibles (i.e. greater than 10% of the purchase price).

Customer Relationships

Customer relationships are a perfect example of intangibles that should not be separately identified because they cannot be traded or exchanged and they cannot be reliably measured apart from goodwill. Customer relationships are capitalized when acquired in a business combination, but as existing relationships “turn over” and new relationships are created, they are not capitalized. The costly process appraisers must go through to value customer relationships is highly theoretical and subjective, making valuations vulnerable to significant variability and therefore having questionable reliability. Customer relationships are developed through knowledgeable and skilled employees working in concert who are in reality an element of an assembled workforce, which is not differentiated from enterprise goodwill. Differentiating and quantifying a customer relationship from enterprise goodwill is judgmental and easily second-guessed at a later date. We especially disagree with assigning value to customer relationships where business is based only on projected purchase orders as they do not represent a contractual or legal right at the acquisition date. Past purchase orders or historical fact patterns do not guarantee future orders. The relationship only provides an opportunity for another sale, but no value is guaranteed. Ultimately the salespeople and all other members of an enterprise’s workforce must interact to continually deliver better products and services with the best function, price, quality, delivery, and terms and conditions in order to maintain the relationship beyond the last sale. As any sales and marketing executive could explain, a customer relationship is only as good as the last order successfully filled to the customer’s satisfaction. While we recognize there is value in having customers, these future cash flows cannot be separately identified and should be attributed to enterprise goodwill, which is the benefit of all facets of an entity working together to deliver solutions to current and future customers.

Goodwill Amortization

In concert with our suggested change in approach for customer relationships, a shift in accounting for goodwill is warranted. We suggest simply amortizing goodwill instead of spending significant time and money to identify non-contract-related intangibles that cannot be sold separately from the business. Amortization is no less accurate than the current hypothetical acquisition method used to calculate goodwill impairment. If goodwill was amortized, such as under IFRS for small and medium-sized entities, the rigor and costs associated with impairment testing would be greatly alleviated as the balance would be reduced each reporting period. This also recognizes the notion that enterprise goodwill “turns over.” Amortization of all intangibles, including goodwill, would improve comparability by lessening some of the inconsistency between companies who are acquisitive and have large amounts of goodwill recorded and those who are not as acquisitive and have little goodwill recorded. Amortizing goodwill would also match the expense during the same period an entity benefits from the value. To balance the fact that acquired enterprise goodwill turns over, while new goodwill is created through ongoing operations yet not recognized as an asset, we support an amortization period of 35 to 40 years together with a qualitative impairment review, as proposed in the exposure draft, when circumstances indicate impairment may exist.
Conclusion

In conclusion, we support the FASB's effort to improve and reduce complexity in goodwill impairment testing for preparers and believe a qualitative step will be helpful. However, we believe a more comprehensive review of the accounting and reporting for intangible assets is warranted, including impairment testing and better alignment of US GAAP with IFRS. For enhanced consistency and understanding, impairment testing for goodwill should be based on a two-step cash flow model, the same as other long-lived assets. If the book value of the business exceeds fair value, write down the book value to fair value based on the discounted cash flow model. The existing hypothetical acquisition method is not practical. In addition, only contractual intangible assets existing at the balance sheet date, without regard to assumed future events, should be recorded if they can be clearly sold or exchanged separately from the business. Separately identifying intangibles not arising contractually, such as customer relationships, is a highly theoretical, subjective and costly effort for preparers and provides no real benefit for financial statement users. These intangibles should be considered part of goodwill, similar to an assembled workforce. Finally, we support amortization of goodwill over a 35 to 40 year period to improve comparability and reduce complexity for all constituents. This approach is no less accurate than the existing model for intangibles and goodwill.

We appreciate the opportunity to respond to the exposure draft and trust that our comments will be seriously considered in future deliberations on these issues.

Sincerely,

Richard J. Schluter
Vice President & Chief Accounting Officer

cc: Frank J. Dellaquila
    Senior Vice President and Chief Financial Officer