Thank you for the opportunity to submit my comments on File Reference Number 2019-720, “Identifiable Intangible Assets and Subsequent Accounting for Goodwill.”

I need to preface my comments. I sent a number of comment letters to the FASB when the fair value for financial reporting framework was developing. After submitting a number of responses, I felt that the FASB and the valuation profession had taken a path that I did not believe in and could not support. I pulled away from any subsequent invitations to comment and have not kept up with any changes for the past few years. As a result, my comments below may miss some changes the FASB has made in the intervening period. I hope you will forgive me if I have missed something the FASB has issued in recent years.

Related to your specific questions, I offer the following comments that I hope you will find useful:

**Amortization period** – if you address the amortization period, I hope you would consider a 20-year amortization period for goodwill because that time frame is consistent with what we believe is appropriate in the valuation of businesses. When we prepare a business valuation and develop a weighted average cost of capital (“WACC”) we need to develop a cost of equity (“Ke”). The Ke is generally developed with a capital asset pricing model (“CAPM”) or a modified capital asset pricing model (“MCAPM”). The CAPM and MCAPM are built of a risk free rate (“Rf”), which is generally considered to be the rate of return for a US Treasury obligation with a maturity that matches the time horizon of the asset we are valuing. We believe that the appropriate time horizon in the valuation of a business is lengthy, and the default Rf in most business valuations is the yield-to-maturity for a 20-year constant-maturity US T-Bond. This idea is firmly ingrained in the valuation profession. The major resources that have prepared data on the market risk premium (“RPm”), have long used a 20-year constant maturity US T-Bond as the Rf (please see Stocks, Bonds, Bills and Inflation by Ibbotson, or the Cost of Capital Navigator website by Duff & Phelps). It has been written that a 30-year T-Bond would have been used, but that 30-year T-Bonds have not been continually issued over the historical period that the RPm is measured. The longest maturity US T-Bond that has been continually available in the market since the 1920’s is 20-years, and that is the underlying time horizon that valuation analysts use when valuing a business.

**Impairment testing vs. amortization** – Both amortization and impairment testing have weaknesses. Amortization is understandable and easy to implement, but it can miss situations in which a company or business reporting unit have dramatically changed for the worse. Impairment testing can capture dramatic changes, but it is not necessarily objective or cost-effective, and can lead to “big-bath accounting.” My belief is that the most objective method would be to simply record an acquisition intangible and not amortize it or test it for impairment.
The company’s return on invested capital (“ROIC”) will indicate if management made a wise acquisition or not.

If you stay with an impairment-testing model of reporting, I hope you would consider the following comments:

**Impairment testing should only be performed upon a triggering event, not annually.** If there are no indications that an impairment occurred, then no testing should be performed. An annual test causes our clients to incur costs that will likely have no benefit to clients or users of financial statements, and provides no useful insights about the company.

**Impairment testing should be done at the reporting unit level.** Valuation really only has meaning when it captures circumstances that are specific to the business being valued. If you are going to value something due to a triggering event, you should value the business unit in which the triggering event occurred. If you prepare a valuation at some level above that, the whole idea of a triggering event and its effect on value becomes muddled because circumstances can be very different between reporting units in the same corporate entity.

**Triggering events should be very specifically focused on the business unit, and not related to general movements in the industry or economy.** Triggering events should be strictly limited to matters that arise from the specific business unit’s operations, strategy and competitive position, and should be quantifiable and have some certainty. Matters that are related to the economy or industry overall, or are a general risk of doing business would not rise to the level of a triggering event that would require an impairment test. All companies in the market are subject to “systematic risk,” which is a term that valuation analysts use to describe the general risk environment that all companies experience simply as a result of being in business. Systematic risk would arise from macro-economic conditions.

Triggering events should focus on “un-systematic” risk, which is a term that valuation analysts use to describe risks that are particular to the company itself. With this definition, if sales in a business unit are down because of an economic recession that would not be a triggering event. If currencies fluctuate, putting the business unit at a disadvantage, that would not be a triggering event. Both an economic recession and currency fluctuations could have a negative impact on the value of a business, but these arise from general conditions that affect many companies not just the business unit being valued. Macro-economic conditions move in cycles and downturns are followed by upturns. When we use a long horizon to assess a businesses’ value, we can look past macro-economic cycles knowing that they will tend to balance-out over the long-run.

**Other intangible assets** – Regarding the measurement of other intangible assets, I think it would be useful if the FASB moved away from the “separable” concept to a “likely to be separated” or “potentially separated” concept. By using the term separable in the definition of other intangible assets, the FASB opens clients to an exhausting and overly theoretical analysis of intangible assets that causes many people to question the usefulness of the insights derived relative to the cost incurred. Many intangible assets are theoretically separable, but for all practical purposes they will never be separated.
If an intangible asset is likely to be separated or has a realistic potential of being separated, the measurement of that intangible asset may be useful. But the measurement of other intangible assets is where the exit price premise of value and the push for uniformity in reporting become deeply troublesome.

Upon completing an acquisition, the value pool of intangible assets is known, and it could be a fairly simple matter to allocate that value pool between goodwill and other intangible assets. In many other areas of business valuation, a recent, arm’s-length transaction is accepted as an indicator of fair market value. But for financial reporting purposes, because of the exit price premise of value, we are told to ignore the client’s acquisition of the business and develop a business valuation from the perspective of a “market participant.” This one requirement leads to many problems in implementing the fair value for financial reporting standards and adds a tremendous amount of cost to the process.

The push for uniformity comes into play as well, because there has developed a detailed methodology that valuation analysts are taught to use in allocating fair value (not purchase price) to the acquired assets. After assessing the value of the business from the perspective of a market participant, that fair value is allocated to the fair value of specific assets in the balance sheet. Valuation analysts are taught that each asset has its own rate of return, and that the blended rate of return on the assets in total (Weighted Average Return on Assets, or “WARA”) should be reconciled to the WACC that is appropriate for the business that was acquired. The detailed calculations involved are extensive and nuanced. Uniform application of this process is stressed by many of the major accounting firms, even to the point of having a seemingly accepted hierarchy of rates of return assumed to apply to each category of assets – even though there is no reliable market data to support the seemingly accepted hierarchy of rates of return. Please see: https://www.corporatevaluepartners.com/news-data/fvle_31.pdf and https://www.corporatevaluepartners.com/news-data/art_081808.pdf.

Reliability of measuring other intangible assets - Current practice in fair value for financial reporting is not objective, and ignores fundamental truths about business valuation. It is dangerous to treat value measurements as though they were objective. People that are experienced with value measurements will tell you that they are, at their core, subjective. When I speak in valuation classes I often make two statements: 1) Value is like beauty; it is in the eye of the beholder, and 2) If you were to put 10 valuation analysts in a room to solve a problem, they would come out with 12 different answers. It is only through the functioning of markets that value becomes objective, and even then it is only briefly evident. The market moves on, conditions vary and the assessment of value changes by the minute. Trying to capture fair value measurements in our financial statements and treating them as though they are objective or reliable, even under the most uniform measurement system, is not helpful to preparers or users of financial statements.

In a push for uniformity, many major accounting firms have seemingly put what they have determined is a reasonable boundary on the assumptions used in allocating fair value to other intangible assets; but that does not make the assumptions any more reliable. It just means that their measurement will be consistent between companies. Consistency has no bearing on reliability or objectivity.
In order to simplify the recording of other intangible assets, I hope the FASB would consider the following comments:

1. Discontinue the use of the concept of separable, and move to likely to be separated or having the reasonable potential to be separated.
2. Discontinue the exit price premise of value, and allow clients to use the purchase price of the business as its fair value for financial reporting purposes, and eliminate the requirement to have a business valuation prepared for a business that was just acquired.
3. Simplify the allocation process to allow clients to allocate the value pool of intangible assets between goodwill and other intangible assets using the reasonable application of reasonable methods, not the currently existing framework. Allocation of fair value (or purchase price) to tangible assets is fairly straightforward, and the assumption of specific rates of return applicable to tangible assets adds complexity that is not necessary, objective or reliable (please see point 5 below as well).
4. Discontinue the rigorous focus on uniformity and focus instead on providing useful insights about a company’s performance at a reasonable cost.
5. Do away with the WACC to WARA reconciliation process. It is highly subjective, unreliable and has deep technical flaws (please see previously-cited articles).

I also hope you will consider the following general comments for background:

Concerns about uniformity have an important impact on our current problems. When SFAS 157 was first written, many complained that it was written too generally, that it didn’t provide enough guidance to ensure uniform compliance. We were told at the time that the idea with the new standards was that they were not intended to be a cookbook. The implication was that management teams would have some flexibility in reporting. But what has happened over time is that the FASB and the valuation profession have developed very specific requirements for the valuation of intangible assets, all in an attempt to ensure uniformity of reporting. The PCAOB and others determined that there were so many compliance problems with fair value for financial reporting, that the valuation profession responded by creating a new credential aimed at people that specialize in valuing intangible assets for financial reporting purposes. The new credential has an experience requirement that ensures that only analysts who spend a significant portion of their time valuing intangible assets for financial reporting will receive the credential; which is a fairly small group of people.

The above paragraph highlights several problems, one being management’s ability to produce their own financial statements. In 1986 I was sitting with a partner that I worked for and he was teaching me a few things about business. One thing I have always remembered was, “In America we believe that management teams should be able to prepare their own financial statements.” Yet the fair value for financial reporting requirements have become so nuanced and so specialized that most management teams are not able to prepare the disclosures without significant outside help. For that matter, even many full-time valuation analysts are not seen as qualified because they do not meet the experience requirement for fair value for financial reporting engagements.
I fully support your efforts to simplify reporting requirements. Fair value measurements are often referred to when people discuss undue complexity in financial reporting. Complexity has gotten so bad that some people in positions of authority have talked about moving away from the quarterly reporting model required by the SEC to a model requiring less-frequent disclosures. Such statements are heading in the exact opposite direction we need in order to have well-functioning capital markets. We should be moving to a reporting model that provides for simpler, more operationally-focused and more frequent disclosures. If you want to have an early warning system, move to a reporting model that provides for more frequent reporting on a near-contemporaneous basis. The model we have right now requires more complexity, which only delays reporting. Because of improvements in internal reporting systems (such as Enterprise Resource Planning software), more and more companies are able to report detailed data to internal users on a near-contemporaneous basis. We need to work with management teams to identify data they can report more frequently (and more timely) that will not harm their competitive position, but will still help market analysts make more timely and more accurate assessments of value.

On a side note, I would like to thank the FASB for the recent pension accounting update. The changes you made are more consistent with measuring the value of a company, and they have helped me in my work. I really appreciate it.

Thanks again for the opportunity to provide these comments. I hope that they are useful to you in your deliberations.

Sincerely,

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