October 7, 2019

Mr. Shayne Kuhaneck
Acting Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

Re: File Reference No. 2019-720, Invitation to Comment – *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*

Dear Mr. Kuhaneck:

The Financial Reporting Committee (FRC or Committee) of the Institute of Management Accountants (IMA) is writing to share its views on the Financial Accounting Standards Board’s (FASB or Board) Invitation to Comment (ITC) – *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*.

The IMA is a global association representing over 130,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities, and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The Committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world’s largest accounting firms, valuation experts, accounting consultants, academics, and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals, and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org (About IMA, Advocacy, Financial Reporting Committee).

The Committee applauds the Board’s ongoing efforts to address the topics raised in the ITC. Goodwill impairment (GWI) and the recognition of intangible assets are topics subject to diversity of views and ongoing debate in the financial community. This diversity is also reflected within the FRC where we have no clear consensus regarding the use of an Impairment Only or Amortization with Impairment GWI model, although there is a uniform opposition to an Amortization Only model. On the other hand, there is a consensus on a variety of other issues.

*Consensus Views*

During our deliberations, while as noted we could not reach a consensus on the issue of an Impairment Only vs. an Impairment with Amortization GWI model, there were a number of topics on which the Committee has a unified view.

*Focus on further simplification*

The Committee recognizes the challenges that the annual goodwill impairment test imposes on preparers and welcomes the FASB’s actions to simplify and streamline the process through the introduction of Step 0 and elimination of Step 2. However, there is concern that excess costs remain in the system relative to the perceived benefits of the current impairment only model.
Eliminating Step 2 clearly removes unnecessary cost from the system without the loss of decision useful information. The elimination should be given the opportunity to display its full benefits as it becomes mandatory. As an additional benefit the elimination has also brought the GWI test in closer alignment with IFRS.

Step 0 is well intentioned, but unlike the elimination of Step 2 which effectively streamlines the process, Step 0 added requirements to make a more likely than not determination of impairment. Unfortunately, in practice the interpretation of the documentation required to apply Step 0 has mitigated the expected cost reduction and for some entities it is so burdensome that it became more costly than simply applying Step 1. The Committee believes that the concepts underlying Step 0 are sound and that the desired cost reduction could be obtained with some refinement. Potential refinements may take the form of revisiting the more likely than not determination or perhaps developing specific attributes that could be referenced when making the Step 0 determination with the goal of reducing audit firm documentation requirements.

Simplification efforts should also be considered for the general structure of the Step 1 test. The annual GWI Step 1 test is particularly demanding when auditor documentation requirements are compounded by a large number of reporting units as discussed below. Therefore, the Committee believes a significant cost burden can be removed from the GWI testing requirements by revisiting the reporting unit structure to allow reporting units to be defined at the operating segment level. The Committee does recognize that the current reporting unit structure criteria were to some degree the result of a compromise between preparers and users and encourages further user outreach to assess their current views on this issue.

The Committee has mixed views with respect to moving to a GWI assessment based only on a triggering event, with a majority in favor of exploring this option as it would likely serve to reduce costs. However, such an option should be pursued with caution as it has the potential to trigger new audit documentation requirements similar to those that now accompany Step 0 tests.

Convergence with IFRS

The Committee agreed that comparability of the accounting for goodwill between Public Business Entities (PBEs) under U.S. GAAP and IFRS is considered more important than comparability with private business entities and not-for-profit entities. While the Committee recognizes that there are differences in the specific elements of the respective current GWI models, they are fundamentally aligned regarding impairment vs. amortization. Therefore, the Committee shared a concern that any changes made to U.S. GAAP prior to a clearer understanding of the direction of the International Accounting Standards Board’s (IASB) impairment project may result in divergence. The Committee believes it is critical for the Board to consider feedback from the upcoming IASB discussion paper.

Users routinely consider comparable company and industry performance globally. The Board should make great efforts to maintain the consistency of performance metrics derived under U.S. GAAP and IFRS. We understand that the new leasing standard is a recent example of how differences in something that was generally thought to be converged can create significant comparability issues for users.

The Committee believes that prior to any decision to diverge from IFRS on the general principle of impairment vs. amortization that the Board should include the issue of comparability and the potential need for ongoing adjustments to financial metrics in its user outreach.
Avoid giving PBEs options

The Committee strongly believes that PBEs should not be given accounting options in the same manner that they are available under the Private Company Council (PCC) alternative. Comparability among all PBEs reporting under U.S. GAAP is considered important for most Committee members and permitting optional reporting requirements places an undue burden on users to make ongoing adjustments to ensure comparability. We understand that the Accounting Standards Board of Japan is proposing an optional approach to choose from either the current impairment only model or one based on amortization and impairment. While this may serve to address preparer preferences on this topic, the Committee believes the incremental costs that would be incurred by the user community far outweigh the benefits to preparers.

Entity level test is not appropriate

The Committee acknowledged that performing the GWI test at the entity level would reduce costs, but the loss of decision useful information would be excessive. The Committee agrees that refinements to the reporting unit definition should be considered and that the merits of performing the impairment test at the operating segment level should be explored as noted below.

Don’t make major changes to intangible asset recognition

Question 17 of the ITC addresses the preferred approach to the recognition of intangible assets on a cost-benefit basis. A majority of Committee members prefer not to amend existing guidance. However, there were dissenting views regarding this issue. There is general agreement not to overhaul the entire system although certain limited modifications would be acceptable.

The Committee discussed the narrow recognition scope of customer-related intangible assets under the PCC alternative being limited to those capable of being sold or licensed independently from the other assets of the business. There is particular concern that if the PCC alternative were applied to PBEs in its current form, many critical contractual relationship intangible assets such as contracts with military or intelligence departments of a government and Software as a Service (SaaS) customer contracts would not be recognized. However, the Committee does not oppose reconsidering whether customer relationships formed solely by short-term purchase orders (noncontractual) should meet the recognition criteria.

Another example to simplify purchase price allocations is to include a scope exception for the recognition of noncompete agreements (NCAs) regardless of whether goodwill will be amortized. NCAs derive value through their protection of intangible assets, most frequently customer-related intangible assets, and if they were no longer recognized their fair value would be absorbed or reallocated to the intangible assets that the NCA is assumed to protect.

Consolidation of related topics

The Board has alluded to the potential for consolidating a number of issues related to acquisition accounting. A number of topics were mentioned for this potential project including the subject of the ITC, business combinations vs. asset acquisitions, and contract liabilities. The Committee is very supportive of such a project and recommends that other topics that have been the source of diversity in practice such as the unit of account for the valuation of previously held equity interests in a step acquisition be considered for the project.
Goodwill Impairment Only vs. Amortization with Impairment Views

The Committee debated the issues and the alternative GWI models included in the ITC over the course of multiple meetings. A wide variety of views were discussed but the Committee members could not converge on a predominant view regarding the existing Impairment Only model versus an Amortization with Impairment model. These discussions spanned a wide spectrum of topics, none of which were individually compelling to achieve a consensus view.

FRC membership consists of a variety of disciplines with a similar diversity of views regarding certain topics. It is noteworthy that this diversity of opinion is not isolated to differences between disciplines but also exists within them.

Existing annual impairment only model

The Committee evaluated the application of the current Impairment Only model. For some entities, the use of Step 0 has reduced the cost of GWI testing and there is full agreement that it does not reduce the usefulness of financial reporting information. Further, as noted the Committee does have a consensus that there are burdens of the current application that could benefit from further simplification.

For example, while less to do with the accounting standards, the auditor documentation requirements were referenced as a common source of burden for GWI tests. Specifically, auditor documentation requirements for Step 0 are seen by some members as being more burdensome than doing a Step 1 quantitative test and, therefore, they bypass Step 0 and elect the Step 1 test.

Another challenge, highlighted by several members, was the detailed level of required audit support for reporting unit projection assumptions (and for cyclical companies this is even more of a challenge, such as when a recent decline in performance is a shift to a different part of the cycle rather than the baseline for future growth expectations) used in a Step 1 test. The Committee acknowledges the benefits of aligning reporting units with internal management reporting and planning; however, this may result in a large number of reporting units that are not providing the user additional useful information. Therefore, the annual GWI Step 1 tests are particularly demanding when auditor documentation requirements are compounded by a large number of reporting units.

Early stage of eliminating Step 2 pursuant to ASU 2017-04

There is general agreement that eliminating Step 2 will reduce the cost of performing the GWI test for companies failing Step 1 of the test while not reducing the usefulness of information. However, some members believe that it is likely that Step 1 will be under increased auditor scrutiny mitigating, to some degree, the cost reductions. Many Committee members point to the fact that the elimination will not be fully adopted until 2020 and that this simplification should be given a chance to demonstrate the full impact on costs before making further changes to the Codification.

Cost/benefit of the current GWI model

The Committee has divergent views regarding preferences for the current impairment only model or an amortization with impairment model solely on a cost-benefit basis. Some members appreciate the simplification efforts of Step 0 and elimination of Step 2 but believe there is a greater cost burden inherent in the annual impairment testing requirements and support any efforts to either further simplify the annual test or evolve to a triggering event-based impairment model. In addition, some members raised the issue
regarding the burden that would be imposed on entities if they were required to change from the current impairment-only model to the amortization and impairment model.

**Imposing an amortization cost for successful transactions**

Under the current impairment only model, successful transactions that are meeting forecast expectations and were properly priced and effectively integrated into the acquirer’s operations would not be subject to a GWI. However, under an amortization with impairment model that would no longer be true. Amortization would essentially impose a “cost” for all acquisitions regardless of subsequent performance. This would place a high performing company on equal footing with regards to goodwill amortization with an underperforming competitor (assuming the amortization averts an impairment charge) whereas an impairment only model is more likely to highlight the competitor’s underperformance. Committee members’ views varied on this issue. Those supporting an amortization with impairment model are of the view that all goodwill, regardless of transaction performance, decays over time. Others believe there is merit in providing the market performance feedback through impairment rather than imposing amortization on all companies regardless of performance.

**Other developing efforts impacting GWI**

In addition to the ongoing efforts of the IASB, there are a number of valuation industry efforts currently underway that may have a bearing on GWI analyses. The American Institute of Certified Public Accountants (AICPA) is nearing completion of an exposure draft of an Accounting and Valuation Guide on Business Combinations that will address specific valuation issues inherent in a business combination that can also provide insight into the nature and composition of goodwill and its economic underpinnings.

In addition, three valuation professional organizations (the AICPA, American Society of Appraisers and the Royal Institution of Chartered Surveyors) have recently introduced the Certified in Entity and Intangible Valuations (CEIV) credential founded on a Mandatory Performance Framework (MPF). The MPF and related application documents establish the extent to which valuation professionals should perform their work in terms of depth of analysis and documentation to provide consistent, supportable, and auditable fair value measurements. The MPF documents are intended to reflect best practice for performing valuations of a business, business interest, intangible assets, certain liabilities, and inventory used to support management assertions made in financial statements issued for financial reporting purposes. They apply to CEIV credential holders as well as valuation professionals who do not have the CEIV credential or to employees of an entity making use of the valuation for its financial reporting requirements under U.S. GAAP. While the rollout of these best practices is ongoing, when fully adopted their rigor will have a positive impact on the GWI testing process.

**Whether or not goodwill is a wasting asset**

Committee members differed in their views as to whether goodwill is a wasting asset. Some members are of the belief that goodwill consists primarily of synergistic value and these synergies are realized over a finite period, justifying amortization. Others believe that goodwill requires ongoing investment to maintain its value and without this investment, it would diminish over time, again supporting amortization. However, Committee members with the contrary view that goodwill is not a wasting asset point to the deal models, used to derive transaction prices, that generally assume synergies are perpetual in nature and also deduct ongoing investments in the cash flows. In addition, these members also highlight the perpetual cash flow growth expectations inherent in transaction cash flow projections and deal models. This
expected perpetual growth is reflected in long-term residual cash flow projections (that in excess of the finite-lived assets) which underlies the economic value of goodwill.

**Market reactions to announcements of goodwill impairment charges**

A number of Committee members observed that goodwill impairment charge announcements do not directly drive the direction of share prices and are therefore not meaningful. In instances where there has been a negative share price impact, the goodwill impairment charge announcements are typically accompanied by other unfavorable disclosures making the precise impact of the goodwill impairment charge, if any, difficult to measure. Many were of the view that a goodwill impairment charge is a trailing indicator and that the market has already adjusted to the underlying economics that caused the impairment. Others point to MD&A disclosures for reporting units at risk of failing step one of the impairment test, which may contribute to market adjustments in advance of the recognition of a goodwill impairment charge. The Committee recommends continued outreach to users to ascertain whether annual amortization, which would be unrelated to performance or impairment assessments, would provide decision useful information.

**Consistency between goodwill amortization and the value of equity investments**

A number of Committee members are concerned that the amortization of goodwill, which implies a long-term expectation of declining cash flows, will create inconsistencies with the fair value measurement of equity investments. The fair value of an equity investment, as with deal models for acquisitions, is based on expected cash flow projections with perpetual cash flow growth assumptions in the terminal value (aka residual or continuing value). Therefore, these Committee members believe that when viewed from an economic perspective, goodwill amortization would essentially imply that when a company that holds an equity investment enters into a step transaction and gains control of the investee, the expectation of perpetual cash flow growth is suddenly reversed to one of a long-term decline in cash flows. This change in the underlying character of the subject company’s long-term cash flow expectations is counterintuitive. In addition, the valuation of portfolio company investments of venture capital funds, private equity funds and other investment companies, which generally assume perpetual growth in the terminal value calculation, would suffer from the same inconsistency.

**Holding management accountable**

Views also varied as to whether impairment or amortization is a more effective means to hold management accountable for their capital allocation decisions. Members favoring an amortization with impairment model believe that goodwill amortization in and of itself holds management accountable in particular when it is coupled with the potential for impairment. Other members who believe that goodwill is not a wasting asset view amortization as somewhat of an artificial cost and that impairment measures provide a better gauge of management performance. Furthermore, goodwill amortization would systematically reduce the exposure to a GWI and ultimately mitigate accountability for the capital allocation decisions related to business combinations.

**User views on goodwill impairment vs. amortization**

The Committee acknowledges that many users may be indifferent between amortization and impairment since they are both added back to derive operating cash flows. Some members recognize the direct adjustments for noncash charges but believe that GWI events may have an indirect effect as user projection assumptions may consider the underperformance inherent in an impairment event. In addition, other users
may use multiple perspectives, including earnings, in their analyses. For those that consider earnings, impairments may provide superior decision useful information to amortization based on an arbitrary period, which also has the impact of diluting indications of underperformance. The Committee, which does not have broad user participation, recommends further user outreach on this issue.

Components of goodwill

The Committee has a diverse view as to the components of goodwill. Synergies, brands and reputation, workforce, platform technology, intangible assets to be developed in the future or a combination thereof were all referenced. There is no clear correlation between the identified components and support for either an impairment only or amortization with impairment model.

Selection of an amortization period

The Committee also discussed the amortization period characteristics provided in Question 4 in the ITC and views were mixed on this issue as well. However, amortization based on the weighted-average useful lives of identifiable asset(s) acquired and management’s reasonable estimate (options f and g) have greater support than the other options. There is consensus that equity investors do receive decision-useful information when an entity justifies an amortization period other than a default period. However, the expected level of analysis and documentation to support the selection of an amortization period could be burdensome and certain members favor a default period with the ability to apply management judgment. As we have seen with the implementation of Step 0 there would likely be additional costs and they may be significant.

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The diversity of opinions on the Committee was clear during its discussions and the FRC ultimately settled on the view that the Board should avoid change for change’s sake and maintaining the status quo with respect to goodwill impairment vs. amortization is the preferred course of action. This perspective is driven not only by differences of opinion on the theoretical aspects of impairment vs. amortization but by a broad agreement that it will be difficult to please all interested parties, that recent efforts to reduce costs have not taken full effect, and the ongoing efforts of the IASB should be given full consideration. However, while the Committee does not recommend wholesale changes to the model, it does encourage any efforts to further simplify the current impairment only test.

We would be pleased to discuss our comments with the FASB or its staff at your convenience.

Sincerely,

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