October 7, 2019

Technical Director
File Reference No. 2019-720
FASB
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Re: Invitation to Comment—Identifiable Intangible Assets and Subsequent Accounting for Goodwill (File Reference No. 2019-720)

Ladies and Gentlemen:

Stout Risius Ross, LLC (Stout) is pleased to submit the following response to the Financial Accounting Standards Board (FASB or the Board) related to the Invitation to Comment—Identifiable Intangible Assets and Subsequent Accounting for Goodwill.

Stout is a global advisory and consulting firm specializing in Investment Banking, Valuation Advisory, Dispute Consulting, and Management Consulting. We serve a range of clients, from Fortune 100 corporations to privately held companies in numerous industries around the world.

Stout’s Valuation Advisory practice, one of the largest independent valuation practices in the country, provides independent valuations for financial reporting, corporate tax planning, estate tax and regulatory filings, employee stock ownership plans and ERISA advisory services, fairness opinions and solvency opinions, and shareholder disputes, among other purposes.

In this capacity, not only do we assist our clients in their role as preparers of financial statements, but we are also users of financial statements in the execution of our valuation engagements. From that dual perspective we have prepared comments for the Board’s consideration, as well as the following general remarks.

The analysis of a company considers several factors depending on the nature of the company, the type of analysis being performed, and the objective of the analysis. However, the company’s net earnings and cash flow commonly receive a significant amount of attention, particularly in cases where the analysis is focused on assessing the long-term growth and financial viability of the company.

Depreciation and amortization expenses give rise to key differences between net operating earnings and cash flow. For a company that grows organically through investment in tangible assets or capitalized software development costs, it is important to show depreciation of those assets over lives that reflect the time periods of their respective economic benefits. The analysis would be compromised if the company depreciated all tangible assets and capitalized software development costs over prescribed time periods (which may or may not accurately reflect the time period of economic benefit). For a company that grows through business combinations, it is equally important to separately identify, value, and amortize the acquired tangible and intangible assets over lives that reflect the time periods of their respective economic benefits, while at the same time only amortizing those assets that have a finite life.

In both cases, it is important for the analyst to assess whether management’s decisions regarding investment of company resources generate appropriate returns on investment (ROI). In order to assess ROI, it is critical to have accurate net operating earnings and cash flow figures that appropriately reflect the economic benefits generated from the investment.
For these reasons and others outlined herein, we believe the current practice for identifying and valuing acquired assets and liabilities under Topic 805 should be left unchanged.

With respect to goodwill, we also believe the current impairment model should generally be left unchanged. We believe that elimination of the two-step test has reduced the complexity of measuring goodwill impairments. However, we suspect that many financial statement preparers that have not recorded impairment charges in recent years have yet to realize the reduced cost and complexity of this change. Nonetheless, we support two additional modifications to the current impairment model that would further reduce cost and complexity. The first change is to require an impairment assessment only when a triggering event has occurred. The second change is to perform the goodwill impairment test for reportable segments rather than reporting units. If a company has reportable segments, then it already has the systems and procedures in place to create, report, use, and audit the corresponding financial statement data. This would avoid effort and costs to allocate and test goodwill and intangible assets by reporting unit.

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SECTION 1: WHETHER TO CHANGE THE SUBSEQUENT ACCOUNTING FOR GOODWILL

Question 1 – What is goodwill, or in your experience what does goodwill mainly represent?

The fair value of a going concern business can be viewed as the combination of the fair values of the assets that comprise the business. Those assets reside in two categories: (1) items that are both identifiable and quantifiable, such as cash, net working capital, machinery and equipment, real property, and intangible assets; and (2) elements of the business that are not easily defined or measured. The second category is the goodwill of the business. It represents a collection of elements, characteristics, and expectations that generate value incremental to the assets that are identifiable and quantifiable, both now and into perpetuity. That is, goodwill can include products and technologies not yet developed, customers not yet acquired, target markets not yet pursued, strategic partnerships not yet signed, and other business opportunities not yet explored. Goodwill is the engine that allows businesses to grow, develop, and evolve.

Put differently, goodwill reflects the value of a going concern company generated through the assemblage of various assets such that the whole is worth more than the sum of its parts. This is a key reason why businesses are formed in the first place – to deploy capital as a means to acquire and develop productive assets that can generate returns in excess of their costs.

These concepts have foundation in other GAAP. Topic 820-10-35-10E addresses the valuation premise used to measure the fair value of an asset based on its highest and best use. “Use in combination” value assumes the asset’s value is measured as a collective, productive unit, where as “standalone basis” value assumes the asset is sold independent of its current use. In the context of a tangible asset (e.g., a manufacturing production line), the difference in value is often easily quantifiable. For example, installation costs are included in fair value when measured through their use in combination with other assets, but excluded when measured on a standalone basis. In the context of a going concern company, we typically quantify “use in combination” value based on the company’s capacity to generate cash flows over the long term, while we quantify “standalone basis” value considering the discrete values of the company’s identifiable assets without goodwill.
Question 2 – Do the benefits of the information provided by the current goodwill impairment model justify the cost of providing that information? Please explain why or why not in the context of costs and benefits.

Yes, the benefits justify the costs. A business combination is perhaps the most significant transaction a company can undertake. The investment of capital in this context has only two outcomes: the transaction is successful and value is created or the transaction is unsuccessful and value is destroyed. Acquirers consummate transactions with the expectation of creating value over time. In the current goodwill impairment model, the increase in value from a successful transaction is achieved through higher earnings similar to internally developed assets. The acquirer’s earnings in this instance should not be unnecessarily penalized through a forced goodwill amortization charge that has no basis in reality. If the transaction is unsuccessful, however, the current impairment model provides for a reliable mechanism to measure the amount of value destroyed. Amortizing goodwill is an oversimplification of reality at best, and a misleading financial statement assertion at worst.

The benefit to investors derived from the cost of impairment testing is that the current impairment model provides the best information to assess the degree to which companies are successful in deploying investor capital to execute, integrate, and generate economic benefits from acquired businesses. Moving away from this framework towards an amortization model, or to a method that could minimize the likelihood of reporting this information to investors, serves no purpose other than to reduce cost at the expense of useful information. Business combinations are inevitably complex. The initial and subsequent measurements for such transactions are correspondingly, and appropriately, complex.

In the ITC, the Board cites PBE feedback that the benefits of the accounting for intangible assets and goodwill do not justify the cost to prepare and audit the information on the basis that (a) impairment charges are nonrecurring and adjusted in investors’ analyses or eliminated through the use of non-GAAP metrics and (b) goodwill impairment charges are often a lagging indicator of the economic factors that lead to the charge.

In response, we would first like to expand on our rationale for adjusting historical operating results for noncash and nonrecurring metrics as valuation practitioners. The value of a business is premised on its ability to generate future cash flows, and accordingly we analyze historical financial information with the principal objective of assessing the capacity of a business to generate cash flows in the future. Noncash charges or nonrecurring items may be removed from historical results to evaluate the reasonableness of future projections that commonly exclude such items. While these items may not be explicitly captured in a valuation analysis, they impact our estimations of relative risk and reward depending on their nature and materiality. Importantly, however, the events that gave rise to the noncash or nonrecurring items still happened and should be measured. We find arguments in favor of goodwill amortization premised investors’ use of adjusted earnings to be hollow and a capitulation of GAAP metrics in favor of non-GAAP metrics.

Second, we disagree with the notion that the current goodwill impairment model should be eliminated on the basis that impairment charges are often a lagging indicator. As stated above, the events that gave rise to the impairment still happened and should be measured. Moreover, we contend that market, industry, and company-specific factors disclosed or observed through other means is not a failing of the current goodwill impairment model, but simply a practical reality that a periodic test cannot react as quickly as the capital markets.
We further contend that investors have demonstrated that impairment charges can be decision-useful. In connection with our response to this ITC, we performed a study to evaluate whether a relationship exists between impairment charges and equity trading activity. Specifically, we identified all PBEs traded on U.S. stock exchanges whereby goodwill and other impairment charges (in aggregate) exceeded 5% of their respective market capitalizations on the trading day preceding announcement of the impairment charge, over a lookback period of five years. We then calculated the change in market capitalization on the day following the announcement of the impairment charge, excluding companies in which stock prices increased on the basis that either (a) other news or events in public filings offset the impact of the impairment charge, or (b) the magnitude of the announced impairment charge was less significant than that already priced in. We present three primary findings from our study as follows:

1. In 326 instances stock prices declined in the day following announcement of the impairment charge.
2. Of these 326 instances, 191 involved a change in stock price that was at least 25% of the impairment charge (i.e., for every $4 of impairment per share, the stock price decreased by $1).
3. Of these 191 instances, 71 involved a change in stock price that exceeded the impairment charge (i.e., for every $1 of impairment per share, the stock price decreased by $1 or more).

Given that over 20% of impairment charges had a corresponding change in market capitalization that exceeded the impairment charge, it seems apparent that the information provided by the goodwill impairment model is highly meaningful to financial statement users.

**Question 3 – On a cost-benefit basis, relative to the current impairment-only model, do you support (or oppose) goodwill amortization with impairment testing? Please explain why in your response.**

We oppose goodwill amortization for the reasons noted in our response to question 2.

**Question 4 – If the Board were to decide to amortize goodwill, which amortization period characteristics would you support? Please include all that apply in your response and explain why you did not select certain characteristics.**

a. **A default period**

No. Using a default period is inappropriately rigid and would not allow company management to assess the nature of goodwill being amortized. Related, using a default period reflects a “rules-based” accounting system rather than a “principles-based” system, which contrasts with the general direction of GAAP in other areas.

b. **A cap (or maximum) on the amortization period**

Yes. The cap should be sufficiently high so as to not diverge from reality while avoiding abuse. We would suggest 40 years.

c. **A floor (or minimum) on the amortization period**

Yes. The floor should be the greater of the useful life of the primary intangible (or tangible) asset acquired or 10 years.
d. **Justification of an alternative amortization period other than a default period**

Yes. Our foregoing responses suggest that company management would select an amortization period based on the facts and circumstances of the nature of goodwill being amortized (e.g., the period over which substantially all of the projected cash flows to be generated by an acquisition target are expected to be achieved, on a present value basis), but within the cap and floor.

e. **Amortization based on the useful life of the primary identifiable asset acquired**

No. We believe the amortization period should be longer, in no small part because of the future opportunity that goodwill represents (i.e., products and technologies not yet developed, customers not yet acquired, target markets not yet pursued, strategic partnerships not yet signed, and other business opportunities not yet explored, all of which may not come to fruition until after the identifiable assets are utilized). However, the amortization period of the primary asset could be a factor considered by company management in selecting an amortization period for goodwill.

f. **Amortization based on the weighted-average useful lives of the identifiable asset(s) acquired**

No. For the same reasons as 4(e) above, the amortization period should be longer.

g. **Management’s reasonable estimate (based on expected synergies or cash flows as a result of the business combination, the useful life of acquired processes, or other management judgments).**

Yes, in part, as suggested by our response to 4(d), but within the cap and floor.

**Question 5** – Do your views on amortization versus impairment of goodwill depend on the amortization method and/or period? Please indicate yes or no and explain.

No. We disagree with the premise of amortizing goodwill by PBEs for the reasons outlined above.

**Question 6** – Regarding the goodwill amortization period, would equity investors receive decision-useful information when an entity justifies an amortization period other than a default period? If so, does the benefit of this information justify the cost (whether operational or other types of costs)? Please explain.

Yes. Just as investors can glean informational utility from the nature and magnitude of identifiable intangible assets, and their respective remaining useful lives, investors would receive additional insight into the nature of goodwill if management selects an amortization period rather than uses a default period. We do not believe there would be any discernable incremental costs related to management’s selection of an amortization period for goodwill, as companies must already assess and disclose appropriate amortization periods for other assets, including intangibles. Moreover, justification of an amortization period would simply be an extension of current disclosure requirements related to the qualitative elements of goodwill.
Question 7 – Do the amendments in Update 2017-04 (eliminating Step 2 of the goodwill impairment test) reduce the cost to perform the goodwill impairment test? Do the amendments in Update 2017-04 reduce the usefulness of financial reporting information for users? Please explain.

Yes, the amendments in Update 2017-04 reduce the cost to perform the goodwill impairment test. Prior to Update 2017-04, following an indication of impairment in Step 1, the scope and fee estimate for valuation engagements we performed on our clients' behalf would be expanded to incorporate Step 2. Moreover, in our experience, Step 2 of the goodwill impairment test is frequently performed on an accelerated timetable given the shrinking runway between the completion of Step 1 and reporting deadlines. Following Update 2017-04, the incremental scope and fees associated with Step 2 have effectively been eliminated, as the measurement of impairment is significantly simpler.

We do not believe that the amendments in Update 2017-04 reduce the usefulness of financial reporting information for users. Although the two-step impairment test provided a more accurate determination of the magnitude of impairment for goodwill specifically, eliminating Step 2 and simplifying the measurement of impairment provides a more accurate assessment of impairment for the reporting unit's total assets (including goodwill). The result is more intuitive from an investor's point of view. If the carrying amount of a reporting unit exceeds its fair value, the carrying amount is adjusted accordingly. In effect, per Update 2017-04 we test the business for impairment and not goodwill specifically.

To this end, we have observed many instances in which a reporting unit fails Step 1 of the impairment test, but passes Step 2, because the identifiable intangible assets had declined in value commensurate with, or even faster than, the reporting unit overall. However, given that the impairment test for definite-lived intangibles is more difficult to fail, no goodwill impairment would be recognized. We believe that most financial statement users would disagree with this outcome, even if it provided for a more accurate measurement of goodwill impairment.

Question 8 – Do the amendments in Update 2011-08 (qualitative screen) reduce the cost to perform the goodwill impairment test? Do the amendments in Update 2011-08 reduce the usefulness of financial reporting information for users? Please explain and describe any improvements you would recommend to the qualitative screen.

From our vantage point as valuation practitioners, the qualitative screen reduces the cost of the goodwill impairment test by avoiding a quantitative assessment for reporting units that have significant cushion between their carrying amounts and the most recent fair value measurement. However, in regard to aggregate cost (i.e., the cost of third-party specialists, internal company resources, and audit fees), we defer to preparer respondents, as we are engaged less frequently to assist with qualitative goodwill impairment assessments.

In its current form, we believe the qualitative screen can be improved in two ways. First, we recommend simplifying the examples of the events and circumstances to be considered in the “more likely than not” evaluation, as outlined in Topic 350-20-35-3C. The qualitative screen should be reserved for instances in which it is obvious, based on prior quantitative tests and subsequent reporting unit-specific facts and circumstances, that no impairment exists. While the facts and circumstances outlined in Topic 350-20-35-3C are all applicable, we believe that the recommended examples of factors to be considered be limited to:
Overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods;

Other relevant entity-specific events such as changes in management, key personnel, strategy, or customers; contemplation of bankruptcy; or litigation; and

Events affecting a reporting unit such as a change in the composition or carrying amount of its net assets, a more-likely-than-not expectation of selling or disposing of all, or a portion, of a reporting unit, the testing for recoverability of a significant asset group within a reporting unit, or recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit.

We acknowledge the list of relevant events and circumstances is intended to be examples only and may not be all encompassing nor all required. However, the reality is that lists of examples outlined in the Codification are frequently used by reporting entities as a checklist. If the three remaining factors above are not persuasive, perhaps the reporting entity should proceed with a quantitative assessment.

Second, the current model leaves too much room for judgment with respect to when the qualitative screen is a reasonable approach. We recommend a more discrete, tiered approach depending on the amount of historical “cushion” (i.e., the degree by which a reporting unit passed prior quantitative tests) to set guidelines as to how much work should be done in the qualitative assessment.

For example, a reporting unit with 100% or more cushion (measured on an invested capital basis) in the most recent quantitative test would require only an assessment of current trailing 12 months (TTM) performance preceding the testing date relative to the TTM period preceding the prior quantitative test, as well as actual performance relative to forecast at the time of the previous quantitative test.

For reporting units with 50% to 100% cushion (measured on an invested capital basis), the qualitative screen would also include an analysis of market multiples, interest rates, and other economic and industry factors. Then, we recommend a minimum threshold be set for reporting units in order to guide PBEs as to when the qualitative screen would not be appropriate (e.g., less than 50% cushion).

As a final note regarding the qualitative screen, it is our opinion that if FASB adopted an impairment model whereby goodwill were tested quantitatively only upon a triggering event, we would support the elimination of the qualitative screen, with any factors to be considered in a qualitative screen to be captured through evaluation of the occurrence of a triggering event.

**Question 9 – Relative to the current impairment model, how much do you support (or oppose) removing the requirement to assess goodwill (qualitatively or quantitatively) for impairment at least annually? Please explain why in your response.**

We support performing the goodwill impairment assessment only in the event of a triggering event rather than annually. This modification would reduce (or potentially eliminate) the cost of an impairment assessment for many companies that lack any evidence of such events.
Question 10 – Relative to the current impairment model, how much do you support (or oppose) providing an option to test goodwill at the entity level (or at a level other than the reporting unit)? Please explain why in your response.

We strongly oppose providing an option to test goodwill at the entity level. For many companies, this would essentially render the goodwill impairment test meaningless. For example, in a company where a large reporting unit has grown organically while a smaller reporting unit has made several acquisitions, the impairment test would not be done at a level that would evaluate the success of the acquisitions at the smaller, acquisitive reporting unit. That is, the larger reporting unit could conceal potential problems at the smaller reporting unit.

However, we believe that conducting the goodwill impairment test at the reportable segment level, rather than at the reporting unit level (if different), would reduce the complexity and cost of the current impairment model while at the same time striking a balance with our concerns above regarding testing at the entity level.

Many PBEs do not regularly manage their businesses by reporting unit, and consequently may prepare reporting unit-level financial statements only for the purpose of the impairment test. While we believe the reporting unit framework has its advantages in terms of more discretely monitoring the success of acquisitions, this is an area where the burden could be alleviated. If a company has reportable segments, then it already has systems and procedures in place to create, report, use, and audit the corresponding financial data on that basis. The incremental effort and cost to perform the goodwill impairment test by reportable segment would not be significant.

Question 11 – What other changes to the impairment test could the Board consider? Please be as specific as possible.

Certain of our clients in cyclical industries have expressed frustration at the permanence of goodwill impairment, which could be ameliorated through the reversal of previous impairment losses, not to exceed the initial carrying amount. Often the accounting for subsequent measurement of goodwill is criticized for focusing on the diminution of value attributed to a prior acquisition without offering a mechanism to credit a company for restoring value. We believe an ability to reverse impairment losses would also be appealing where new management teams were not responsible for the events that led to an impairment loss, but are responsible for returning an acquisition to prosperity. The above notwithstanding, however, we acknowledge that this change would be contradictory to IFRS accounting for goodwill, could introduce additional GAAP earnings volatility, and would increase costs.

Question 12 – The possible approaches to subsequent accounting for goodwill include (a) an impairment-only model, (b) an amortization model combined with an impairment test, or (c) an amortization-only model. In addition, the impairment test employed in alternative (a) or (b) could be simplified or retained as is. Please indicate whether you support the following alternatives by answering “yes” or “no” to the questions in the table below. Please explain your response.
SECTION 2: WHETHER TO MODIFY THE RECOGNITION OF INTANGIBLE ASSETS IN A BUSINESS COMBINATION

Question 13 – Please describe what, if any, cost savings would be achieved if certain recognized intangible assets (for example, noncompete agreements or certain customer-related intangible assets) were subsumed into goodwill and amortized. Please be as specific as possible. For example, include specific purchase price allocation or subsequent accounting cost savings. Please list any additional intangible items the Board should consider subsuming into goodwill.

Third-party appraisal costs for business combinations may decline in certain instances if noncompete agreements or certain customer-related intangible assets were subsumed into goodwill and amortized. We see evidence of this occurring under the private company GAAP election. However, it has been our experience that the reduction in cost may not be significant, as preparing the valuation models for these particular assets is only a small part of any valuation engagement performed in accordance with Topic 805.

We would also note that when customer-related intangibles are not the primary intangible asset in a business combination, these assets often must be valued as a contributory asset supporting the primary income-generating intangible. Further, even when customer-related intangibles are the primary intangible asset, we are often asked to determine their fair values in support of weighted average return on asset (WARA) analyses and excess profit analyses to assess the reasonableness of royalty rates or other inputs to valuation methodologies employed for other intangible assets.

Question 14 – Please describe what, if any, decision-useful information would be lost if certain recognized intangible assets (for example, noncompete agreements or certain customer-related intangible assets, or other items) were subsumed into goodwill and amortized. Please be as specific as possible. For example, include specific analyses you perform that no longer would be possible.

In most instances, no decision-useful information would be lost if noncompete agreements were no longer recognized, but customer-related intangibles continued to be recognized. While noncompete agreements can be, and are, measured as separately identified assets, one can also view the existence of a noncompete agreement as a separate legal agreement that ultimately
supports and protects other identifiable intangible assets, such as technology or customer-related intangibles. When noncompete agreements are valued, they are then used as a contributory asset charge against the income streams protected by the noncompete agreements. If noncompete agreements were excluded from the recognition criteria in Topic 805, most often the associated value would be subsumed into other intangible assets and not goodwill, thus resulting in limited information loss to financial statement users. We would further note that noncompete agreements are rarely significant intangible assets in a business combination, and they have been rendered unenforceable in certain jurisdictions.

Substantive decision-useful information would be lost, however, if other identifiable intangible assets were subsumed into goodwill, including customer-related intangible assets. First, we reference our response to question 2 in support of retaining the goodwill impairment model, and correspondingly the separate identification of intangible assets. Second, in an increasingly intangible-oriented economy (including technology companies in which intangibles and goodwill can exceed the purchase price), we believe that measuring and recognizing intangible assets in a business combination provides financial statement users with the only viable answer to the question “what did you buy?” that cannot be addressed through a narrative disclosure. The relative importance of brand, technology, customers, other intangibles, and goodwill, as separately measured and identified, provides investors and other financial statement users with a snapshot view of what to expect from the acquisition. For example:

- A greater share of customer-related intangible assets relative to goodwill implies that the acquisition target is mature and may experience growth in line with the industry overall. The acquisition is lower risk, and perhaps lower reward.
- Limited customer-related intangibles, a greater proportion of technology-related assets, and a majority of goodwill indicates significant opportunity and growth is expected, but at the same time investment will likely be required to build a customer base and fully exploit the underlying technology. The acquisition is higher risk, and perhaps higher reward.

**Question 15 – How reliable is the measurement of certain recognized intangible assets (for example, noncompetition agreements or certain customer-related intangible assets)?**

Noncompete agreements are often difficult to reliably measure, as the valuation method commonly employed uses hypothetical assumptions and conditions. By definition, hypothetical assumptions and conditions can be difficult to measure, test, or otherwise verify for reasonableness.

While measuring the fair value of customer-related assets requires the use of assumptions and estimates, such as existing customer growth rates and retention rates, those are more commonly grounded in the historical experience of the target, acquirer, other market participants, and general industry data. Moreover, these inputs are often critical operating metrics analyzed by company management and investors (e.g., retention rates, recurring revenue, etc.). This improves the reliability of the fair value of customer-related assets.

**Question 16 – To gauge the market activity, are you aware of instances in which any recognized intangible assets are sold outside a business acquisition? If so, how often does this occur? Please explain.**

Recognized intangible assets are not commonly sold outside of a business combination in large part because employing identifiable intangible assets in conjunction with working capital, tangible
assets, and an assembled workforce generates more value than on a standalone basis. That is, the whole is worth more than the sum of its parts, as outlined in our response to question 1.

The above notwithstanding, when independent transactions do occur, they often include intangible assets that are somewhat specialized, including:

(a) Player contracts in the context of professional sports teams, including esports
(b) Customer lists
(c) Patents / patent portfolios
(d) Certain licenses
(e) Trade names and trademarks
(f) Film / content libraries

**Question 17** – Of the possible approaches presented, which would you support on a cost-benefit basis? Please rank the approaches (1 representing your most preferable approach) and explain why you may not have selected certain approaches.

a. **Approach 1: Extend the Private Company Alternative to Subsume Certain CRIs and all NCAs into Goodwill**
b. **Approach 2: Apply a Principles-Based Criterion for Intangible Assets**
c. **Approach 3: Subsume All Intangible Assets into Goodwill**
d. **Approach 4: Do Not Amend the Existing Guidance**

We rank these options as follows:

1. Approach 4: Do Not Amend the Existing Guidance
2. Approach 2: Apply a Principles-Based Criterion for Intangible Assets
3. Approach 1: Extend the Private Company Alternative to Subsume Certain CRIs and all NCAs into Goodwill
4. Approach 3: Subsume All Intangible Assets into Goodwill

The recognition and subsequent valuation of identifiable intangible assets should be based on principles rather than strict rules or formulas, as doing so provides appropriate alignment between the economic and strategic underpinnings of the transaction (and purchase price paid) to the values of the acquired assets recorded in purchase accounting.

That being said, we believe a principles-based criterion must be sufficiently broad such that customer-related assets are recognized, consistent with the existing guidance. Customer-related assets have taken on a high degree of importance for investors and other users of financial statement data. This is particularly true for companies that offer products and services on some form of subscription or pay-as-you-go basis. Many companies routinely disclose supplemental financial data in that regard, including monthly (or annually) recurring revenue, customer acquisition costs, customer churn rates, etc. Subsuming customer value into goodwill would negatively impact the information available to financial statement users and public disclosures around acquisitions.

**Question 18** – As it relates to Approach 2 (a principles-based criterion), please comment on the operability of recognizing intangible assets based, in part, on assessing whether they meet the asset definition.
The existing asset definition in Concepts Statement 6 may be operable. For example, within the asset definition “probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events,” non-contractual customer-related assets maintain the following characteristics:

1. “Probable future economic benefits” refers to the expectation that past customers will continue to be customers in the future; and
2. “obtained or controlled by a particular entity as a result of past transactions or events” refers to previous sales, marketing, and other business development activities by the reporting entity that gave rise to the relationship and maintains the relationship.

**Question 19 – Approaches 1-3 assume that subsuming additional items into goodwill would necessitate the amortization of goodwill. Do you agree or disagree? Please explain why.**

We generally agree. While not amortizing goodwill in approaches 1-3 is an option, doing so would be an even greater departure from reality as it relates to amortizing goodwill derived under the current model. The higher goodwill recorded in approaches 1-3 would include known intangible assets which have finite lives and should be amortized accordingly.

**SECTION 3: WHETHER TO ADD OR CHANGE DISCLOSURES ABOUT GOODWILL AND INTANGIBLE ASSETS**

**Question 20 – What is your assessment of the incremental costs and benefits of disclosing the facts and circumstances that led to impairment testing that have not led to a goodwill impairment loss?**

Disclosing the facts and circumstances communicates useful information to financial statement users as the disclosures provide insight into a company’s internal assessment of the fundamental values and performance of its acquisition targets.

While we will defer to preparers in terms of the incremental costs, it is generally our experience that companies regularly track and assess an acquisition’s performance against management-designated targets, albeit internally. Thus, provided appropriate safe harbors apply, we would not expect the incremental costs to outweigh the benefits.

**Question 21 – What other, operable ideas about new or enhanced disclosures would you suggest the Board consider related to goodwill?**

We recommend the Board consider adding more qualitative disclosures about the primary factors considered in the valuation of a company’s reporting units (i.e., value drivers). These disclosures could include comments regarding strategy, operations, integration of acquired businesses and realization of expected synergies (if applicable), competition, and the overall market environment in which the reporting units operate, among other factors. Importantly, these factors should be compared relative to the period in which acquisitions were consummated.

**Question 22 – What is your assessment of the incremental costs and benefits of disclosing quantitative and qualitative information about the agreements underpinning material intangible items in (a) the period of the acquisition and (b) any changes to those agreements for several years post-acquisition? Please explain.**
Unless there have been material changes (positive or negative) to the agreements underpinning material intangible assets, we would not expect the incremental benefit to outweigh the cost of disclosing such information. If there have been material changes in the agreements, and those changes are considered to be important “value drivers” for the reporting entity or their intangible assets, then the incremental benefit should outweigh to cost of disclosing such information. However, we do not believe it to be necessary to disclose a substantial amount of quantitative information. Qualitative information would generally be sufficient.

**Question 23 – Are there other changes (deletions and/or additions) to the current disclosure requirements for goodwill or intangible items that the Board should consider? Please be as specific as possible and explain why.**

We have found that the requirement to disclose a qualitative description of the factors that make up goodwill, inclusive of examples (e.g., expected synergies and intangible assets that do not qualify for separate recognition), to be a “leading question” and consequently the related disclosures are often limited to synergies and an assembled workforce. As articulated in our response to question 1, we believe there are many other factors that support the existence of goodwill and recommend the Board either expand, or withhold, the list of recommended examples.

We also suggest including additional disclosures that provide insight into the specifics of a particular transaction (subject to safe harbors), including (a) key financial or operating metrics used to price the deal, including run-rate revenue or adjusted earnings, (b) valuation multiple(s) that management relied on to determine purchase price, (c) distinction between the base purchase price and incremental adjustments for cash, working capital, and other items, and (d) growth rates, margin improvements, and the implied internal rate of return (IRR) implicit in the reporting entity’s valuation model.

**SECTION 4: COMPARABILITY AND SCOPE**

**Question 24 – Under current GAAP, to what extent does noncomparability in the accounting for goodwill and certain recognized intangible assets between PBEs and private business entities and not-for-profit entities reduce the usefulness of financial reporting information? Please explain your response.**

Net income is not comparable between acquisitive PBEs and private companies due to the treatment of customer relationships, noncompete agreements, and amortization of goodwill. However, it is important to consider the context through which the users of the financial information are evaluating such information.

In our experience, private companies fall into one of two categories: (1) closely held businesses that are principally concerned with cash generation and tax accounting and (2) private equity or venture capital-backed businesses for whom the principal financial statement users are either lenders or future acquirers that would buy the business as a whole.

For the first group, while we would contend that accurate reporting of intangible asset amortization and goodwill impairment (if any) is informative, closely held businesses should be afforded latitude to evaluate the financial performance of their business with fewer restrictions to suit their owners and other interested parties.
For the second group, again while lenders may be informed by the accounting for these items, their principal concern pertains to the reporting entity's capacity to repay its debts, and correspondingly are more focused on cash-flow generation. In this vein, stock compensation is frequently disregarded for the purpose of measuring capacity to repay debts. With respect to private equity or venture capital investors, these parties tend to view investments in portfolio companies through the lens of a controlling transaction, whereby they or a future buyer will be able to influence and direct capital allocation, constitution and compensation of the management team, and other factors embodied in adjusted earnings.

For PBEs, however, public investors and other financial statement users include a far more diversified and varied constituency with a longer aggregate investment horizon. These constituencies rely on reported net income and earnings per share in addition to non-GAAP metrics. Considering the significance of intangible assets and goodwill in modern business combinations, moving to an amortization model solely on the basis of cost prompts the question of whether GAAP has lost its relevance and should be replaced with a system of non-GAAP reporting.

**Question 25 – Please describe the implications on costs and benefits of providing PBEs with an option on how to account for goodwill and intangible assets and the option for the method and frequency of impairment testing (described previously in Sections 1 and 2).**

While there may be reduced costs for certain PBEs, it is our view that it would be highly problematic to allow PBEs to make a policy election as it pertains to goodwill and intangible assets on the basis of reduced comparability between companies.

**Question 26 – To what extent does noncomparability in the accounting for goodwill and certain recognized intangible assets between PBEs reporting under GAAP and PBEs reporting under IFRS reduce the usefulness of financial reporting information? Please explain your response.**

In an increasingly global market, and one in which acquisition activity may limit the pool of comparable companies analyzed within the scope of valuation engagements we perform for various purposes, we are increasingly expanding our datasets to include domestic and international companies. From an analytical perspective, we incur additional costs when adjustments must be made to enhance the comparability between firms.

**Question 27 – Please indicate the sources of comparability that are most important to you regarding goodwill and intangible assets. Please select all that apply and explain why comparability is not important to you in certain cases.**

- a. Comparability among all entities reporting under GAAP (one requirement for PBEs, private business entities, and not-for-profit entities)
- b. Comparability among all PBEs reporting under GAAP
- c. Comparability among all private business entities and all not-for-profit entities reporting under GAAP
- d. Comparability among all PBEs reporting under GAAP and PBEs reporting under IFRS.

We rank these options as follows:

1. Comparability among all PBEs reporting under GAAP and PBEs reporting under IFRS.
2. Comparability among all PBEs reporting under GAAP.
3. Comparability among all private business entities and all not-for-profit entities reporting under GAAP.
4. Comparability among all entities reporting under GAAP (one requirement for PBEs, private business entities, and not-for-profit entities).

As noted in our response to question 26, consistency between all PBEs is of paramount importance to us in an increasingly global market. Private business entities and not-for-profits have more limited constituencies and accordingly we believe it is appropriate, on a cost-benefit basis, for there to be additional latitude afforded to them.

OTHER TOPICS FOR CONSIDERATION

Question 28 – Do you have any comments related to the Other Topics for Consideration Section or other general comments?

We have no further comments to add related to this section.

NEXT STEPS

Question 29 – Would you be interested in and able to participate in the roundtable?

We would be pleased to participate in the roundtable.

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We appreciate the opportunity to comment on this topic and look forward to reviewing the comments received by the FASB.

Sincerely,

STOUT RISIUS ROSS, LLC