Technical Director  
Financial Accounting Standards Board  
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October 7, 2019  

File Reference No. 2019-720  

ITC: Identifiable Intangible Assets and Subsequent Accounting for Goodwill  

We are pleased to respond to the FASB’s Invitation to Comment on *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*. Duff & Phelps is a global advisor in the areas of valuation, corporate finance, investigations, disputes, cyber security, compliance and regulatory matters, and other governance-related issues. Our valuation advice is sought by hundreds of global clients annually as we work with them in developing pragmatic solutions for applying fair value measurement techniques.  

We are happy to discuss in more detail the basis for our views. 

Sincerely,  

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KEY SENTIMENTS AND OBSERVATIONS

In evaluating the current accounting for goodwill impairment and deciding upon a course of action, it is important to consider the history of accounting for goodwill; maintaining convergence with IFRS; recent cost-saving standard-setting; the availability of robust industry guidance around fair value measurements and goodwill impairment; and the existing valuation professional infrastructure. Since the issuance of SFAS 142, *Goodwill and Other Intangible Assets* (“FAS 142”) and SFAS 141, *Business Combinations* (“FAS 141”), we do not believe that anything has changed in terms of user needs or decision-usefulness of the information provided to warrant a change in the current impairment-only goodwill accounting model or in the intangible asset recognition criteria. Considering these factors, we believe that maintaining the status quo of an impairment-only test is the preferred course of action. We are of the same opinion regarding identifiable intangible assets, because we believe that generally there is consensus for the current recognition criteria. However, we believe that there are certain simplifications that could be considered that would remove additional costs from the system, without the loss of significant decision-useful information.

We fully recognize that in our role as valuation consultants our comments may be perceived as biased, but we note that we are also users of financial information as are analysts and other parties. In addition, we note that in the past, we have publicly supported cost-reduction initiatives, where we believed that the cost-benefit objective had been met (for example, we supported the introduction of Step 0 and the elimination of Step 2 of the goodwill impairment test). However, in the case of goodwill and goodwill impairment, we believe that there is no conceptual or theoretical justification to reintroduce amortization of goodwill. Additionally, there is no economic justification to subsume into goodwill certain intangibles (such as contractual-based customer assets) when they provide key information about expected cash flows and risk, and especially in so many industries.

Our comments in this letter are intended to provide our objective view on the issues raised in the ITC, and we hope that they also convey the conceptual, economic and practical rationale for our views. While we have addressed the specific questions that the ITC has posed, below are a few key points we would like to highlight.

I. **We oppose the idea of reintroducing goodwill amortization.** Below are various facts and considerations that led us to our position.

1. **Loss of information through goodwill amortization vs. impairment.**

   By eliminating the current goodwill impairment-only model, relevant information will be lost and will be replaced by a meaningless periodic charge. For example, among other significant impairments announced by several companies in the last 12 months, Kraft Heinz announced a $7 billion goodwill impairment in February 2019, followed by another goodwill impairment charge of $0.7 billion in August 2019. The company's share price plummeted, closing 27% and 9% down, respectively, at the two announcement dates. Markets and observers were focused on the impairment news and the implications on the company, not only re-assessing past deal making, but also the company's prospects. With goodwill amortization in place, it is possible that these impairments would have never been taken, and the market would have never known the extent to which a specific acquisition or a confluence of company-specific and/or industry factors have eroded value. An important piece of information for users would be lost.

   Some argue that indications of impairment are apparent prior to the actual impairment and that an impairment charge is a lagging indicator. However, while the recent large
impairments of the past year may or may not have been reflected, to varying degrees, in the share prices leading up to the announcements, the spotlight put on the underperformance of a specific business may not have been there with the same intensity if goodwill was subject to amortization.

We also believe that the view that goodwill impairment is a trailing indicator and that the market has already adjusted to the underlying economics that caused the impairment may be skewed by focusing on share price performance on the day of the announcement and is not considering any prior disclosures about goodwill-at-risk.

MD&A disclosures for reporting units at risk of failing Step 1 of the impairment test likely contribute to market adjustments in advance of the recognition of a goodwill impairment. These disclosures would not exist but for a potential impairment.

And even in the presence of various indicators that a business is facing challenges, the impairment charge reflects the point at which the collective impact of factors and circumstances have reached a critical mass. Regardless of the treatment of impairment charges and amortization in user’s cash flow models, the additional information may influence their underlying expectations of growth, margin and investments incorporated in their projections.

It is also important to note that we are still experiencing the longest cycle of economic expansion on record, with robust M&A activity, and very significant levels of leverage. Introducing a model that has the potential to obscure, rather than highlight the permanent decline in the value of an asset when a downturn ultimately occurs may not be prudent at this time.

2. Significant costs have already been taken out of the system while keeping the signaling effect of a goodwill impairment.

FASB has already taken significant costs out of the system by first introducing Step 0, and then eliminating Step 2 of the goodwill impairment test and has dramatically reduced the involvement of external advisors.

We have observed that since the introduction of Step 0, many companies have not only opted to apply this qualitative assessment in increasing numbers, as reported in our Duff & Phelps U.S. Goodwill Impairment Studies, but also many of our clients perform Step 0 internally (no external cost).

The removal of Step 2 has further reduced costs while maintaining the usefulness of information provided by a goodwill impairment test. Based on preliminary data in our Duff & Phelps 2018 Goodwill Impairment Study, among the group of companies that recorded the top 30 impairments in calendar 2018, 29 had adopted ASU 2017-04. Based on preliminary data for the top 10 impairments for calendar 2019, as of the time of this writing, 8 of those companies had adopted ASU 2017-04.
3. The current goodwill impairment only model is more suited to providing users with information helpful to their capital allocation decisions.

FASB acknowledged in the Basis for Conclusions of SFAS 142 that:

“not only do many users of financial statements ignore goodwill amortization expense in making investment and credit decisions, entities often do not consider goodwill amortization expense in evaluating the performance of management.”

Please note this was highlighted at the June 28, 2018 FASB Investor Advisory Committee (IAC) meeting, where IAC members supported the goodwill & intangibles project’s objective to reduce cost and complexity but disagreed with extending the Private Company Council (PCC) alternative to amortize goodwill to public business entities. IAC members also discussed both goodwill and intangible assets disclosures.

Consider the following excerpt from the IAC committee’s June 28, 2018 meeting minutes, which outlines views we agree with:

“...[A]n IAC member stated that one of management’s most important responsibilities is to invest capital successfully, and investors want to hold management accountable for their capital allocation decisions. The member commented that the current impairment model for goodwill was designed to provide investors with this ability. He continued by noting that the large impairments observed by other IAC members are therefore not unintended consequences of the impairment model, but rather information purposely provided by the model that is useful for investors. He explained that changing to a model that requires amortization over an arbitrary period loses this discipline, and, therefore, the consensus of the committee was to not move to such a model...”

We believe that the user perspective is important. In that regard, it may be appropriate and prudent for FASB to consider the views of FASB’s Investment Advisory Committee (IAC) and the views of the SEC’s IAC.

4. We believe that a potential lack of comparability with IFRS, if a goodwill amortization model is reinstituted in US GAAP, is counterproductive in globalized capital markets.

The elimination of Step 2 by FASB made the US GAAP goodwill impairment test similar to the IAS 36 test. Goodwill amortization in US GAAP would introduce significant differences. In addition, we understand that IASB’s work in the area of goodwill impairment is predominantly focused on simplifying the current test and providing additional acquisition performance-related disclosures.

The IASB’s current majority views\(^1\) are that “reintroducing amortisation of goodwill would not provide significantly better information” and that the accounting model “should not allow more intangible assets to be included in goodwill”.

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IASB recognizes that many stakeholders hold firm views that have been known for many years and that repeating these arguments is unlikely to move the debate forward; thus, it is interested if any new practical or conceptual arguments exist. We understand that the current majority views of the IASB members are that an impairment-only model provides useful confirmatory information for users of financial statements.

If US GAAP reinstitutes a goodwill amortization model, financial statements would differ significantly in this area and would not be as transparent to users under the two accounting frameworks. Additionally, preparers reporting under both would still be applying the IAS 36 test on the same business even if US GAAP does not require so.

5. We recognize that FASB has performed a significant amount of work in the area of accounting for goodwill and identifiable intangibles in the not-so-distant past.

FASB members deliberated goodwill impairment and business combinations accounting extensively and with significant public input in developing SFAS 141 and SFAS 142. We believe the FASB’s position stated the in SFAS 142 continues to hold true:

“Analysts and other users of financial statements, as well as company managements, noted that intangible assets are an increasingly important economic resource for many entities and are an increasing proportion of the assets acquired in many transactions. As a result, better information about intangible assets was needed. Financial statement users also indicated that they did not regard goodwill amortization expense as being useful information in analyzing investments.”

“The changes included in this Statement will improve financial reporting because the financial statements of entities that acquire goodwill and other intangible assets will better reflect the underlying economics of those assets. As a result, financial statement users will be better able to understand the investments made in those assets and the subsequent performance of those investments.”

“The Board concluded that amortization of goodwill was not consistent with the concept of representational faithfulness, as discussed in FASB Concepts Statement No. 2, Qualitative Characteristics of Accounting Information. The Board concluded that nonamortization of goodwill coupled with impairment testing is consistent with that concept. The appropriate balance of both relevance and reliability and costs and benefits also was central to the Board’s conclusion that this Statement will improve financial reporting”

“[R]espondents [to the 2001 Exposure draft] noted that not amortizing goodwill is consistent with both how an entity manages its business and how investors view goodwill.”

SFAS 142 also stated the following, emphasizing the more aggregated and integrated view of goodwill, which reflects the general underlying rationale for acquisitions:

“Acquiring entities usually integrate acquired entities into their operations, and thus the acquirers’ expectations of benefits from the resulting synergies usually are reflected in
the premium that they pay to acquire those entities. However, the transaction-based approach to accounting for goodwill under Opinion 17 treated the acquired entity as if it remained a stand-alone entity rather than being integrated with the acquiring entity; as a result, the portion of the premium related to expected synergies (goodwill) was not accounted for appropriately. This Statement adopts a more aggregate view of goodwill and bases the accounting for goodwill on the units of the combined entity into which an acquired entity is integrated (those units are referred to as reporting units).

6. While we believe that the current impairment-only model should be retained, we think that FASB should consider certain simplifications of this model.

For example:

- The test could be conducted slightly above the Reporting Unit (RU) level, such as the operating segment level. However, conducting the test at the entity level would be meaningless.

- The requirement to conduct the impairment test (including a Step 0 assessment) could be limited to a trigger-based test only, rather than an annual assessment, while leaving the current impairment-only model in place.

- The Step 0 passing criteria could be refined so that the level of documentation supporting the conclusion can be reduced.

II. We oppose the idea of subsuming certain identifiable intangibles into goodwill:

1. Customer intangibles are key assets, and especially so in many industries.

This includes but is not limited to, defense contractors, cable and technology companies. In these industries, existing customer contracts are a critical intangible asset and the fair value of the backlog of contracts in place (and expected renewals) provide a meaningful indication of contracts in hand as opposed to those that have yet to be won.

Retention metrics are key operating indicators in these industries, and the data underlying these metrics is very robust. Many deal models include explicit assumptions about retention/renewal rates of customers - for example, in Software as a Service (SaaS) acquisitions. Additionally, expected retention/renewal rates are real value-driving considerations as they affect the risk of the target and the discount rates used in the deal models. Thus, existing customer contracts and contract renewal expectations provide relevant and decision useful information about expected cash flows and their risk.

In contrast, the narrow PCC definition of Customer Relationship Intangibles (CRIs) precludes the recognition of certain contractual-based CRIs that would be of interest to investors in certain industries, and especially in the industries listed above, and will result in the loss of relevant information.

In addition, the way companies interact with their customers and leverage customer information has changed dramatically in the modern information age. For example, the retail
and consumer products industry has been utilizing customer contact information (email and text) to track customer behavior and predict and drive future customer revenue. This is a critical new strategy in these industries, which shows that customer-related intangibles have further evolved in importance.

IFRS 3 and ASC 805 are for the most part converged standards and we see no good justification for divergence. Narrowing the recognition criteria to exclude certain customer relationships, if the PCC definition of CRIs were to be applied, would result in significant loss of information for users of US GAAP information, as discussed above.

We believe comparability with IFRS regarding identifiable intangible asset recognition criteria is useful for the global capital markets.

2. While we strongly believe that the identifiable intangibles should be separately recognized and measured at fair value, we think that FASB should consider subsuming noncompete agreements (NCAs) into goodwill.

In our experience, NCAs are not a significant consideration in deals compared to other assets, such as brands and technology.

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In concluding our key observations, we think that FASB should study the impact of any changes to the current goodwill impairment-only model before they are finalized.
Questions for Respondents

Section 1: Whether to Change the Subsequent Accounting for Goodwill

1. What is goodwill, or in your experience what does goodwill mainly represent?
   In our extensive experience, based on our work on thousands of M&A transactions and their valuation implications for financial reporting, goodwill includes but is not limited to the following:
   - Future, yet to be developed intangibles;
   - Market share;
   - Reputation;
   - The ability to create future intangibles, products, enter new markets;
   - Workforce and institutional knowledge;
   - Going concern (or assemblage value);
   - Cost and revenue synergies.

   Note that the first six components listed above exist even absent a transaction. Additional value across this spectrum, along with the last component (cost and revenue synergies) can be created in an acquisition and would reflect market participant assumptions.

   From a valuation standpoint, goodwill value is linked with the terminal value, which represents cash flows modeled into perpetuity (and this is the case even absent a transaction) for a business that is a going concern. The characteristics of goodwill are inextricably linked to this terminal (continuing) value, and as a result, economically, goodwill is not a wasting asset.

   It is also important to note that as part of the valuation analysis, deal model cash flow projections are aligned with market participant projection assumptions that are in turn used in the valuation of intangible assets. The residual cash flows are associated with goodwill. These are not two distinct projections, rather, deal models are evaluated in detail to remove any elements of specific company synergies and the same fundamental projections serve as the basis for the intangible assets’ valuation. All deal models assume a perpetual growth in cash flows in the estimation of terminal values as do market participants. Since a purchase price allocation is essentially an exercise in allocating operating cash flows to assets, the residual cash flows not assigned to an asset provide the underlying economic support for goodwill. In that deal models and market participants assume an overall perpetual growth in cash flows when pricing a transaction, this translates to cash flows associated with goodwill also growing into perpetuity, well beyond any artificial life for goodwill.

   We understand that there may be a lack of understanding by some constituents of what goodwill represents, including that goodwill is a “buyer’s cost”, or “premium” as in “overpayment” that it has limited or diminishing value. We fundamentally disagree with describing goodwill generally in such terms, as discussed earlier in our comments.

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.

   We believe that the benefits of the information provided through the current goodwill impairment-only model outweigh the costs, and we do not believe a fundamental change to the impairment-only model is warranted.
• **Costs**: The costs of the goodwill impairment test have been *reduced significantly* with the introduction of Step 0 and the elimination of Step 2. These costs are also kept down by the natural alignment of the RU concept with the way management monitors and operates the business(es). We understand this is by design, and that FASB never intended for companies to be required to prepare projections solely for the purpose of the goodwill impairment test, outside of the financial planning and analysis (FP&A) process. We believe that the incremental costs are outweighed by the benefits to users of financial statements. In addition, we are aware that some preparers would continue evaluating RUs at this level in a similar manner - *with or without a goodwill impairment test requirement*. This further reinforces the usefulness of a goodwill impairment/RU analysis from a managerial standpoint.

• **Benefits**: Against this backdrop, a fair value-based impairment only model does provide decision useful information - both confirmatory and other - that would be lost in other models for the subsequent accounting for goodwill.

> For example, a CFA Institute paper stated the following about amortization: “What this [amortization] approach fails to consider is the loss of information for investors. Goodwill write-offs, if done in a timely manner, are of interest to investors in terms of the signal they send about the value of the company’s intangible assets, the company’s future earnings prospects, and an assessment of the amounts paid for acquisitions”. In addition, the CFA Institute has stated it believes that a decrease in transparency (loss of information) would increase complexity for users of financial information.2

The usefulness of goodwill impairment information is not limited to equity investors:

- Goodwill impairment announcements are viewed as credit-negative/negative events. See, for example, a few illustrative announcements/news stories from the major ratings agencies3:
  
  - There has also been a recent study examining the impact of goodwill impairment losses on bond credit ratings.

> The empirical results show a negative relationship between the amount of goodwill impairment losses and bond credit ratings, suggesting that firms with goodwill impairment losses receive lower credit ratings.4

In addition, this information is provided on a more granular, business unit (or RU) level, and it could also be useful if provided on an operating segment level. Furthermore, given the current market uncertainty and associated volatile economic environment, an impairment-only model provides the greatest transparency and linkage to expected

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4 Goodwill Impairment Loss and Bond Credit Rating, Li Sun, Joseph H. Zhang, International Journal of Accounting & Information Management, March 6, 2017, ISSN: 1834-7649.
performance, when evaluated against other alternatives. Thus, we believe that the current goodwill impairment-only model is superior to amortization.

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, with or without a goodwill impairment test.

We also oppose goodwill amortization for the following reasons:

- Goodwill amortization “spreads the cost” of bad decisions over time through amortization. Amortization will certainly mitigate future impairments, both in frequency and amount, or completely remove impairments.

- Users who find the goodwill impairment information useful in making capital allocation decisions will lose this insight. Even if there may be differences among users in the way or extent they utilize such information, there continue to be users who value such information, and this has not changed since the issuance of SFAS 142 and SFAS 141.

In other words, “simplification” may not serve all users of financial information equally well. We think that the differences in users of financial statements of private vs. public companies may warrant a difference in accounting models. As one example, IFRS for Small and Medium-sized Entities (SMEs) also provides certain modifications and simplifications of full IFRS aimed at this group of entities, however, the IASB has not considered it appropriate to extend this simplified version to public companies. We do not believe FASB should extend the PCC alternatives to PBEs either. As one illustration, the simplification afforded to private entities to test goodwill at the entity level would not be meaningful for PBEs.

The public capital markets remain a major venue for investor capital allocation and transparency in these markets is of utmost importance.

As stated earlier, we believe that the user perspective is important. In that regard, it may be appropriate and prudent for FASB to consider the views of FASB’s IAC and the views of the SEC’s IAC.

- The choice of amortization life could range from subjective to plain arbitrary and would reduce comparability among companies as it relates to actual performance.

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.**

As we have stated earlier in our response, goodwill is not a wasting asset. From a measurement perspective, the expectation of ongoing value is evidenced in the terminal (continuing) value calculation. There is generally no limit to the period over which cash flows are projected; the essence of a terminal value calculation is that it captures the present value of cash flows grown into perpetuity. The economic benefit pattern of these cash flows is one of continuous growth.
Additionally, it is difficult to grasp why goodwill should be treated any differently from an indefinite-lived brand. The valuation assumptions underlying both are premised on continuing value.

We believe that any amortization period for goodwill would be either arbitrary, or at best, a broad approximation that does not have a bearing to the nature of goodwill. Amortizing goodwill further disconnects the accounting from the reality of the transaction and the economic premise of the acquisition. Thus, we believe that any choice of a goodwill amortization period is vastly inferior to the information provided by an impairment-only model.

We also disagree with the following statement (p. 7 of the ITC): “Because goodwill is generally not infinite lived, but rather indefinite lived, impairment may represent cumulative amortization not previously recognized.” We believe this is essentially equivalent to saying that “there is no perpetuity value attached to a business, because sooner or later all businesses go out of business…”

a. **A default period**

   We do not support a default period as this provides no meaningful information.

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

   We do not support a cap on the amortization period. Like a. above, this approach provides no useful information.

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

   We do not support a floor for the same reasons outlined in a. and b. above.

d. **Justification of an alternative amortization period other than a default period**

   Any amortization period would be arbitrary and potentially costly for companies to estimate, and for auditors to audit. The time and effort spent on coming up with a “tailored” amortization period and supporting it in an audit is better invested in setting up the foundation for a goodwill impairment assessment – a qualitative and/or a quantitative test.

   In addition, in acquisitions comprising multiple businesses, it is possible to have a different mix of assets and risk characteristics, which may lead to different conclusions about the goodwill “life” under this approach depending on which RUs the goodwill is assigned to. This issue further extends to RUs of the acquirer when a portion of goodwill is expected to benefit the buyer’s existing operations.

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

   We do not support this amortization approach either, as it is conceptually wrong. The primary identifiable asset has a diminishing pattern of economic benefit, like other finite-lived identifiable intangibles. This declining benefit is also the reason most companies select a (straight-line) remaining useful life shorter than the economic life of the asset to accommodate the front-loaded economic benefit.

   *This pattern is the inverse of the economic benefit pattern of the cash flows related to goodwill, which shows continuous growth.*
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 do not believe goodwill should be amortized. See our discussion elsewhere in this letter.

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.

We believe that equity investors will receive misleading information as it relates to the life of goodwill, regardless of how the amortization period is justified. Goodwill is not a wasting asset.

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.

The elimination of Step 2 has significantly reduced the cost of the test. Based on preliminary data in our Duff & Phelps 2018 Goodwill Impairment Study, among the group of companies that recorded the top 30 impairments in calendar 2018, 29 had adopted ASU 2017-04. Based on preliminary data for the top 10 impairments for calendar 2019, as of the time of this writing, 8 of those companies had adopted ASU 2017-04.

The amendments also change the nature of the test from a goodwill impairment test to more of a “RU test” but do not reduce its usefulness overall. This also makes the goodwill impairment test similar to the IAS 36 impairment test.
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.

The qualitative screen in and of itself reduces costs. This is demonstrated in our Duff & Phelps 2016 U.S. Goodwill Impairment Study where 63% of FEI member respondents indicated that the qualitative screen does reduce costs (this question was not asked in subsequent surveys). In circumstances where a transaction or series of transactions have clearly met or exceeded expectations, the qualitative assessment should be straightforward in its application. We note that the AICPA Goodwill Impairment Guide provides excellent guidance for the application of this screen, contributing to the cost effectiveness of the assessment.

Since Step 0 only applies to RUs for which it is “not more likely than not that the fair value of a reporting unit is less than its carrying amount” (and given evidence to the contrary, the RU would be subject to a quantitative impairment test), we believe that the qualitative screen does not reduce the usefulness of the financial information relative to the outcome of the goodwill impairment test.

Given preliminary data in our Duff & Phelps 2018 Goodwill Impairment Study, among the group of companies that recorded the top 30 impairments in calendar 2018, over one-third utilized Step 0 in the last two years.

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.

While we believe that the current goodwill impairment-only model should be retained, we think that FASB should consider certain simplifications of this model. For example:

- The requirement to conduct the impairment test (including a Step 0 assessment) could be limited to a trigger-based test only, rather than an annual assessment, while leaving in place the impairment-only model.

- The Step 0 passing criteria could be refined so that the level of documentation supporting the conclusion can be reduced.

That said, we believe that the annual goodwill impairment test was designed to align with the annual planning process of the entity at the business level and should simply be integrated into that process. This can be also operational at the operating segment level. Also, additional insights as to value creation and competitive threats – which are evaluated in a goodwill impairment test - may enhance the planning process at the entity as a side benefit.

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 do not support an entity level goodwill impairment test. This is a level of aggregation too high for PBEs to provide meaningful information. The result would likely obscure many
performance issues that would otherwise be apparent at the RU level (or that would be evident even at the operating segment level).

It should also be noted that under the current model of testing goodwill for impairment, a reconciliation of the sum of the fair values of RUs to an entity’s market capitalization is considered a best practice. This procedure ensures the integrity of the goodwill impairment analysis.

While we believe that the current impairment-only model should be retained as the annual goodwill impairment test was designed to align with the annual planning process of the entity at the business level, we think that FASB should consider certain simplifications of this model, such as conducting the test slightly above the RU level, e.g., the operating segment level.

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

We believe that the current goodwill impairment accounting model, with the significant cost savings from the introduction of Step 0 and the elimination of Step 2, should remain in place as it is most appropriate and decision-useful. In addition, a significant amount of best practice guidance has been issued around goodwill impairment and fair value concepts (among other financial reporting valuation topics\(^5\)), which greatly facilitates and streamlines the analysis.

If the Board would still like to pursue simplifications, we think that a trigger-based test can be considered, rather than an annual assessment. A secondary consideration may be to seek a slightly higher level of aggregation for the test, such as for example, to conduct it at the operating segment level, but no higher.

As stated earlier, the RU concept was intentionally aligned with the way businesses are managed, and financial and operating information is monitored and evaluated.

\(^5\) For example, consider the following non-exhaustive list of technical literature in the area of valuation for financial reporting:

- AICPA Accounting and Valuation Guide Assets Acquired to Be Used in Research and Development Activities;
- AICPA Accounting and Valuation Guide Valuation of Privately-Held-Company Equity Securities Issued as Compensation;
- AICPA Accounting and Valuation Guide Testing Goodwill for Impairment;
- The Appraisal Foundation’s APB VFR Valuation Advisory #1 (Toolkit): The Identification of Contributory Assets and Calculation of Economic Rents;
- The Appraisal Foundation’s APB VFR Valuation Advisory #2: The Valuation of Customer-Related Assets;
- AICPA Accounting and Valuation Guide Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies;
- The Appraisal Foundation’s The Measurement and Application of Market Participant Acquisition Premiums;
- The Appraisal Foundation’s APB VFR Valuation Advisory #4 The Valuation of Contingent Consideration;
- Corporate and Intangibles Valuation Organization, LLC’s (CIVO’s) The Mandatory Performance Framework (MPF) for the CEIV Credential;
- CIVO’s The Application of the Mandatory Performance Framework (AMPF) for the CEIV Credential;
- AICPA’s Financial Instrument Performance Framework (FIPF) for the CVFI Credential; and the soon to be released AICPA Accounting and Valuation Guide Business Combinations.
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.

A deeper discussion supporting our responses below is presented elsewhere in this letter (in the prior questions and in the Key Sentiments and Observations section).

<table>
<thead>
<tr>
<th>Impairment only</th>
<th>Do You Support Requiring an Impairment Assessment Only upon a Triggering Event? Yes/No</th>
<th>Do You Support the Indicated Model? Yes/No</th>
<th>Do You Support Allowing Testing at the Entity Level or a Level Other Than the Reporting Unit? Yes/No</th>
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<td>Yes</td>
<td>Impairment only Yes</td>
<td>Not at the entity level Yes, possibly at the operating segment level</td>
</tr>
<tr>
<td>No</td>
<td>No</td>
<td>Amortization with impairment No</td>
<td>Amortization only No</td>
</tr>
<tr>
<td>Not applicable</td>
<td>Not applicable</td>
<td></td>
<td>Not applicable</td>
</tr>
</tbody>
</table>

Section 2: Whether to Modify the Recognition of Intangible Assets in a Business Combination

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.

Noncompete Agreements

Eliminating noncompete agreements would result in certain cost savings and generally these assets are not material or valued when the acquiree is a PBE. In our experience, NCAs are not a significant consideration in deals compared to other assets, such as brands and technology or contractual-based customer assets.
Certain Customer Relationship Intangibles

We caution that the elimination of certain CRI assets - or what could potentially be “many CRI assets” if the very narrow PCC recognition criterion is applied - would result in loss of key information on existing contractual-based customer assets (including corresponding renewals), which are very important in many industries. This can also lead to diminished analytics in performing the Purchase Price Allocation (PPA), which may not be a good consequence for the sake of a minimal amount of cost savings. We address our concerns in greater detail in Question 14.

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.

Noncompete Agreements

In our experience, NCAs are not a significant consideration in acquisitions of PBEs compared to other assets, such as brands and technology and contractual-based customer assets.

Certain Customer Relationship Intangibles

As stated earlier, the group of customer assets that are being excluded from recognition under the PCC definition is too broad. The PCC alternative allows an acquirer to not recognize separately from goodwill customer-related intangibles assets unless they are capable of being sold or licensed independently from other assets of the business. Thus, the customer-related intangibles that would be recognized are very few, and include customer lists, mortgage servicing rights, commodity supply contracts and core deposits. Applying the very narrow PCC definition of identifiable customer-related assets to PBEs would not be appropriate and will not provide decision-useful information, compared to the current PBE accounting model for these assets.

Customer intangibles are key assets, and especially so in certain industries. This includes but is not limited to, defense contractors, cable and technology companies. In these industries, existing customer contracts are a material intangible asset and the fair value of the backlog of contracts in place (and expected renewals) provide a meaningful indication of contracts in hand as opposed to those that have yet to be won.

Retention metrics are key operating indicators in these industries and the data underlying these metrics is very robust. Many deal models include explicit assumptions about retention of customers. Renewal rates are very important to the acquirer, for example in SaaS acquisitions, and for transactions with large contracts where the contracts are specifically modeled. Additionally, expected retention/renewal rates affect the risk of the target and the discount rates used in the deal models. These are real value-driving considerations. In summary, existing customer contracts and the corresponding renewal expectations – provide relevant and decision useful information about expected cash flows and their risk. Customers in place are less risky than the future yet-to-be won (new) customers.
In addition, as stated earlier, the way companies interact with their customers and leverage customer information has changed dramatically in the modern information age. For example, the retail and consumer products industry has been utilizing customer contact information (email and text) to track customer behavior and predict and drive future customer revenue. This is a critical new strategy in these industries, which shows that customer-related intangibles have further evolved in importance.

More broadly, recognizing intangibles provides a glimpse into assets that management has invested in. In many cases these investments are material. In the current knowledge-based economy, intangible assets provide insight into the value drivers of the company and crystallize sources of competitive advantage. Subsuming such assets into goodwill and amortizing goodwill would create an opaqueness to these acquired assets.

15. How reliable is the measurement of certain recognized intangible assets (for example, noncompete agreements or certain customer-related intangible assets)?

The valuation of identifiable intangibles, including CRIs and NCAs, follows established industry best practices documented in the valuation and accounting guides issued by the AICPA and The Appraisal Foundation, among others, and follow the scope of work and documentation requirements of the Mandatory Performance Framework (MPF). These factors work in concert to provide reliable, auditable and useful intangible asset valuations. See Footnote 5 in this letter for a non-exhaustive list of the various technical and performance guides available to valuation professionals and management in the context of financial reporting.

In addition, the existence of an observable purchase price in a bargained transaction lays out some very concrete boundaries within which the PPA is to be performed and the PFI allocated, and various analytical tools are available to ensure the integrity of the analysis. These include, but are not limited to, industry benchmarking; transaction Internal Rate of Return (IRR) vs. Weighted Average Cost of Capital (WACC) comparison; Weighted Average Return on Assets (WARA) diagnostic; and a “financial overlay”. A “financial overlay” ensures that the PFI has been identified and appropriately attributed to recognized intangible assets.

The PPA process, in conjunction with the accounting recognition and measurement requirements, explains what investments have been made as part of the transaction, considering the company’s business model, value drivers, competitive dynamics and by employing the principles of corporate finance. The more intangibles are “forcibly” subsumed in goodwill, the more unexplained the substance of the transaction becomes. For example, in our experience, a large amount of goodwill is likely to spark questions from both auditors and regulators as to what exactly the acquirer purchased and the rationale for the transaction.

Level 3 measurements are often critiqued for measurement uncertainty and subjectivity. However, this does not make these measurements any less relevant. A Level 3 intangible asset measurement is not any less relevant than a Level 3 financial instrument measurement. We think that equal, if not greater measurement challenges can be encountered in the measurement of Level 3 financial instruments and these have been successfully dealt with by preparers, auditors and users.

Furthermore, a performance framework - the MPF - and credential, the Certified in Entity and Intangibles Valuations™ (CEIV), have been introduced to address quality and consistency in valuations for financial reporting. The MPF is considered to be best practice and is mandatory for CEIV credential holders. The MPF also enhances the auditability of fair value measurements.
Lastly, we believe that the upcoming publication of the AICPA Accounting and Valuation Guide *Business Combinations* will contribute to more consistent application of valuation methods in such Level 3 measurements.

### 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.

Broadly, patents, IP-based intangibles, brands, pharmaceutical products, software code, product manufacturing rights can be sold outside of a business combination. Many of the foregoing can also be licensed. It should be noted, however, that licensing of the asset is not a sale, and the pricing observed may not capture the fair value of the asset, but only the portion related to the rights to the underlying IP. The licensor would in turn commercialize the product or technology. A fair value measurement of an asset would capture both components, or the asset would be undervalued.

We believe that the consideration of *standalone sales* has no merit in the context of a business acquisition, where the valuation and operational premise is overwhelmingly “in use” or “in combination with other assets”.

If the valuation premise and the market participant perspective required liquidation values in the specific circumstances, that would be a distinctly different analysis. Naturally, the value of most operating businesses far exceeds their liquidation value; the latter can often see the value of certain asset classes evaporate.

### 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**

   We do not agree with this approach and have not included it in our ranking. As we stated prior, the narrow definition of CRIs as provided in the PCC alternative precludes the recognition of many existing contractual-based assets (and their corresponding renewals) that are drivers of future performance in many industries.

   See our responses to Questions 13 and 14 for more discussion.

b. **Approach 2: Apply a Principles-Based Criterion for Intangible Assets**

   *We rank this approach as #2. However, this ranking is predicated upon the principles used.*

   We are concerned that the principle put forth as an example in the ITC, which focuses on the ability to generate cash flows independently from the business, would lead to very rigid and narrow bounds around the types of recognized intangible assets, as well as understatements in the fair value of certain identifiable intangibles. See Question 16.
In addition, as stated earlier, the consideration of whether an asset can generate cash flows independently (standalone) from the business has no merit in the context of a business combination, where the valuation and operational premise is overwhelmingly “in use” or “in combination with other assets”. If the valuation premise and the market participant perspective required liquidation values, this would be a distinctly different analysis.

The proper identification and valuation of identifiable intangibles provides a better proxy for invested capital, and the analysis of Return on Invested Capital (ROIC).

c. **Approach 3: Subsume All Intangible Assets into Goodwill**

We do not agree with this approach and have not included it in our ranking. This approach provides no decision useful information.

*We note that FASB has also indicated in the ITC there are practical issues with this approach.*

d. **Approach 4: Do Not Amend the Existing Guidance.**

*We rank this approach as #1. We believe that the existing guidance is appropriate and operational, and that any associated costs are small compared to other transaction-related costs.*

*Please see the IASB current majority views. See Footnote 1 in this letter.*

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.**

See b. above.

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 disagree. First, the intangible assets subsumed into goodwill may not be significant. For example, NCAs are typically not significant relative to the goodwill balance.

Second, even if certain (finite-lived) intangibles that are currently recognized are subsumed into goodwill, it would still be more appropriate to continue testing goodwill for impairment. The very notion of subsuming certain assets in goodwill implies that they are either not sufficiently important to be separately broken out, or indistinguishable from goodwill in their nature from an *accounting* perspective. This in and of itself should not cause goodwill to change its character and become a finite-lived asset. If any intangibles subsumed into goodwill no longer meet the separability criterion and are indistinguishable from goodwill, then the act of subsuming them into goodwill should not necessitate goodwill amortization. As stated elsewhere in this letter, goodwill’s nature is closely related to the continuing value of a business.
Section 3: Whether to Add or Change Disclosures about Goodwill and Intangible Assets

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?

We believe there will be benefits and no significant incremental costs associated with such disclosure. In general, these would either be attributable to 1) identifiable triggering events or factors; 2) a periodic Step 0-related “quantitative baseline refresh”; 3) a routine annual goodwill impairment test, where Step 0 has not been elected.

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

We would like to emphasize that additional goodwill-related disclosures cannot be an effective substitute for the goodwill impairment test. Disclosure is not an alternative for measurement - but could be useful as a supplement. In general, additional disclosures related to post-acquisition performance could be helpful but may be difficult to stipulate for broad application; will often contain commercially sensitive information; or may have limited utility.

Any disclosures around performance targets and actuals and other metrics related to acquisitions may be useful but could come with drawbacks. For example:

- There is a risk of disclosing potentially sensitive information.
- The disclosures may not be at a level that is sufficiently detailed or insightful to users.
- They could be costly to provide on an ongoing basis and companies that complete multiple acquisitions would be affected to an even greater degree.
- The period of intended disclosures is also unclear. Given continued integration of most acquired businesses, it may be difficult to provide such disclosures over a meaningful period.
- Even if certain disclosures are made, users of financial statements may be unable to gauge the actual overall impact of the disclosed data/metrics. This could lead to over-reaction, underreaction or confusion as users may not be able to translate the disclosure into a gauge of the overall impact on value.
- For example, an acquisition may still be performing well and be value-accretive to shareholders, even if it did not meet its original targets. In addition, other synergies, advantages and strategies may have materialized following the acquisition that were not focused on in the original assumptions. Thus, management may be doing a great job managing its investment, but this may not be readily reflected in a comparison of pre- and post-acquisition metrics. Meanwhile, all these nuances would be captured in a fair value measurement of the RU, as part of the impairment test or if otherwise required.
- Disclosures may not be as timely as ideally desired.

FASB should liaise with the IASB, which is attempting to improve the disclosures around business combinations, goodwill and goodwill impairment. Most importantly, as we stated elsewhere, disclosure is not a substitute for measurement, though it could be a useful supplement.
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.

As it relates to the period of the acquisition, much of this information would be available as part of the PPA analysis. Disclosing subsequent changes to terms and reporting performance would be data that management has access to. However, given the potential granularity of this disclosure, we think that this would be commercially sensitive information that companies would be unwilling to disclose. Also see our discussion in response to Question 21.

Here as well, a critical point to make is that additional intangible asset related disclosures cannot be an effective substitute for the recognition of intangible assets. Disclosure is not an alternative for measurement but could be useful as a supplement.

As mentioned earlier, FASB should liaise with the IASB in improving disclosures around business combinations, goodwill and impairment.

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.

See our response to Question 21.

Section 4: Comparability and Scope

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.

We do not believe that a discrepancy between PBEs and private companies in this area has a significant impact on the usefulness of financial reporting information overall.

PBE information requirements should be more expansive than those of private business entities; the users and their access to management differ, and so do their information needs. Also, PBEs are the primary source of valuation parameters and performance indicators.

Also, consider the fact that the IASB has SME standards and certain differences in the reporting between SMEs and large enterprises simply coexist. The PCC’s decisions and simplification agenda should not be a driving factor in what is appropriate for PBEs.

As stated earlier, given that the public capital markets remain a major venue for investor capital allocation, transparency in these markets is essential.
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).

There should be no option for PBEs. An option may only be feasible for private companies as many may never plan on going public or being acquired by a PBE. Furthermore, users do not like options as they lead to incremental analyses to benchmark performance metrics.

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.

See d. below.

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)

Comparability among all PBEs and keeping financial reporting by PBEs robust, by providing relevant information about goodwill impairment and intangibles, prevails over the need for comparability among PBEs, private and not-for-profit entities.

b. Comparability among all PBEs reporting under GAAP

Comparability among all PBEs reporting under US GAAP is very important. This is a critical issue when one considers ROIC and other metrics.

A goodwill impairment-only model and recognizing identifiable intangible assets in accordance with the current ASC 805 criteria for PBEs provides insight to those users that consider this information in their analyses. “Simplification” along the lines of the PCC alternative would deprive such users of this information.

c. Comparability among all private business entities and all not-for-profit entities reporting under GAAP

We do not believe that comparability here is a critical consideration.

However, we are aware that FASB has aligned the accounting for goodwill and intangibles among these two sets of entities through ASU 2014-02, ASU 2014-18 and ASU 2019-06.

d. Comparability among all PBEs reporting under GAAP and PBEs reporting under IFRS.

We believe that a potential lack of comparability with IFRS if a goodwill amortization model is reinstituted in US GAAP is counterproductive in globalized capital markets. The elimination of Step 2 by FASB made the US GAAP goodwill impairment test similar to the IAS 36 goodwill impairment test. Goodwill amortization in US GAAP would introduce significant differences. In addition, we understand that the IASB’s work in the area of
goodwill impairment is aimed to first and foremost, simplify the current test and provide additional acquisition-performance related disclosures.

Financial statements may differ significantly in this area and would not be as transparent to users under the two accounting frameworks, and preparers reporting under both would still be applying the IAS 36 test on the same business even if US GAAP does not require so.

Other Topics for Consideration

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

Please see our introductory comments.

Next Steps

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

Yes. We believe our position of a global valuation provider for financial reporting purposes as well as our significant participation on the AICPA’s Goodwill Impairment and Business Combination task forces affords us a deep understanding of the valuation issues related to the topics of the ITC.