7 October 2019

via email: director@fasb.org
File Reference No. 2019-720

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

Dear Technical Director:

Re: Financial Accounting Standards Board’s Invitation to Comment – Identifiable Intangible Assets and Subsequent Accounting for Goodwill

RICS is pleased to submit its response to the Financial Accounting Standards Board’s (FASB) Invitation to Comment dated July 9, 2019 pertaining to the ‘Identifiable Intangible Assets and Subsequent Accounting for Goodwill’ (the ‘ITC’). RICS appreciates the opportunity to provide observations and comments, which we set out in detail on the pages that follow. We would be happy to discuss any aspect of this response if you would find that helpful.

Yours sincerely,

Steve K. Choi

Steve Choi
Global Director of Business Valuation

Copy:  Alder, Chris – Director of Regulation
Creighton, Kenneth - Director of Professional Standards
Elder, Ben - Global Valuation Standards Director
Zuriff, Michael - Head of Regulation, Americas
About RICS

Founded in 1868, RICS is a standards organization and an independent ‘regulator’ with a mandate to protect the public interest.

RICS promotes and enforces the highest professional qualifications and standards in valuation, development and management of land, construction and infrastructure. We accredit over 130,000 professionals in these sectors and any individual or firm registered with RICS is subject to our quality assurance.

Within the valuation sector, RICS has over 25,000 valuation professionals in over 100 countries. Their expertise covers valuations of businesses, intangible assets, real estate, machinery and equipment, and to a limited extent valuation of financial instruments. Many of our professionals provide fair value measurements for financial reporting purposes under U.S. GAAP and IFRS.

In response to public comments made by the U.S. Securities and Exchange Commission about five years ago, RICS along with two other valuation professional organizations have created the Mandatory Performance Framework and have developed the requirements of the Certified in Entity and Intangible Valuations (or CEIV) credential for valuation professionals performing valuations of a business, business interest, intangible asset, certain liabilities, and inventory used to support management assertions made in financial statements issued for financial reporting purposes.

In addition, at the request of regulators, RICS is enhancing valuation professionalism and standards in other regions of the world. We are also a major supporter and sponsor of two of the largest valuation standard setters - The Appraisal Foundation and the International Valuation Standards Council.
Preamble

RICS would like to thank the Financial Accounting Standards Board (FASB) for their time and effort in preparing the Invitation to Comment on the ‘Identifiable Intangible Assets and Subsequent Accounting for Goodwill’ document (the ‘ITC’) July 9, 2019. We believe the ITC will provide useful insight for FASB to determine a path forward that will preserve the relevance of financial statements and enhance the accounting for identifiable intangible assets and goodwill.

RICS contends that the primary purpose of financial statements is to provide information about an organization’s operations, financial performance, and cash flows at a particular point in time. This information is (or can be) utilized by readers including users of financial statements to make an informed decision. Thus, we believe more information rather than less information is preferred by the readers of financial statements.

We also acknowledge, in some cases, the benefits of the current accounting for intangible assets and goodwill may not always justify the cost to prepare and audit the information. Therefore, we believe the FASB should consider revisions in the accounting of these assets. We have provided alternatives in this comment letter.

We have not provided responses to each question posed by the FASB specifically as it relates to costs and benefits, rather the comments provided are by section as noted in the ‘Overview’ of the ITC.
Section 1: Whether to Change the Subsequent Accounting for Goodwill

Goodwill

Goodwill is only recognized as part of a business combination analysis under ASC 805, however, ‘economic’ goodwill exists in nearly all going concern businesses. Furthermore, in almost all instances, a business is acquired under a going concern premise – as acquisition models generally reflect a perpetual growth assumption of cash flows.

In response to the ITC (specifically Question 1), the following represent the components of goodwill but are not limited to:

1. A company’s reputation
2. A new intangible asset (or yet to be developed intangible asset)
3. A skilled assembled workforce that embodies critical knowledge
4. Synergies of joining two separate businesses
5. ‘Assemblage Value’ - the concept that a collection of assets is worth more than the sum of the individual asset values.

While a company’s reputation and the assembled workforce may contain a small finite-lived component, nearly all of these goodwill components, we believe, are indefinite in nature. That said, we are not opposed to revisiting and revising the ‘goodwill impairment test’ to take into account all the insight accumulated by the FASB in the form of comment letters.

Cost versus Benefit

In reference to Question 2 of the ITC, as we noted earlier, we believe in some cases the benefits of the current accounting for intangible assets and goodwill may not always justify the cost to prepare and audit the information. Although there have been recent revisions made on the accounting for goodwill to lessen the burden on preparers and companies, we concur the FASB should consider further revisions.

Also, we note that the direct and indirect costs to account for goodwill can be reasonably quantified. Conversely, we do not think all the benefits of this information can be truly measured from a user standpoint and the benefits will differ in almost all circumstances. Therefore, we do not provide a comprehensive cost-benefit analysis.
**Goodwill – Amortization and Life**

Consistent with the going concern premise of a business, acquisition models used to price transactions often reflect a perpetual growth assumption of cash flows. The identified intangible assets as well as tangible assets, represent the identifiable finite lived assets of the business (except in rare cases certain indefinite lived intangibles). The residual amount paid for the business (or goodwill) represents the going concern portion of the acquired business. Thus, if goodwill were assumed to be a finite lived asset in a transaction, it would be inconsistent with the premise of going concern inherent in the consideration paid to buy a business.

We also understand that there are also counter arguments to the previous statement - that goodwill requires ongoing capital investment to maintain its value and indefinite life, and that synergistic value of an acquisition and such synergies could be estimated over a discrete period, and thus goodwill can be amortized to match this period.

Although we believe goodwill is still an indefinite life asset and tends to reflect a company’s financial performance at a specific time, for purposes of the accounting for goodwill, we are in favor of revising the impairment testing which we believe would allow for a step change as opposed to complete ‘overhaul.’ We will address the amortization period next and then we will address modifications to the goodwill impairment test in the next section.

There are a few alternatives and considerations with regard to the amortization period:

- Under the PCC alternative, goodwill is amortized over a 10-year default period.
- Under Section 197 of the US Internal Revenue Code, all intangible assets and goodwill are amortized over 15 years.
- Consideration of the local amortization periods for transactions which involve assets acquired in countries outside the US.
- The ITC only addresses intangible assets. Depending on the nature of the company, tangible assets such as buildings are sometimes acquired and accounted for under a business combination (ASC 805). Such assets tend to have a long life (greater than 15 years) if separately identified and valued.

Should the FASB decide to amortize goodwill, given the nature and lives of certain tangible assets, specifics of the company, the industry the company operates in, and the country where the assets reside in, we believe the FASB should consider an amortization life between 10 and 20 years.
Modifying the Goodwill Impairment Test

Update 2017-04 removed Step 2 from the goodwill impairment test. We believe a ‘reallocation of the purchase price’ under this step was an unnecessary cost and a cumbersome process for all parties involved, and we would concur that this step did not add any value or benefits to readers of financial statements.

On the other hand, we believe the qualitative screen or Step 0 test should significantly reduce the costs to prepare and audit the information – should companies elect this option. We believe there is adequate guidance when considering and preparing a Step 0 analysis today, and this would provide readers of financial information the necessary information about the company’s financial performance and its goodwill. During a bull market, we believe many goodwill impairment tests would fall under this category. On the contrary, during a bear market, the company and its auditors may require a Step 1 goodwill impairment analysis.

In the situation the fees to audit a Step 0 analysis have in fact not been streamlined, we then implore the FASB to provide additional guidance which should make the accounting process for goodwill impairment seamless. In this instance and because we are not an audit entity, we have assumed the Step 0 test offers a viable and cost-effective option for many companies and preparers today.

Under the assumption when a Step 0 test cannot be utilized when it is unclear that the company would pass the qualitative screen, we believe the FASB should consider revisions to the Step 1 test when accounting for goodwill (and any indefinite lived assets).

We have provided alternative solutions ranked in the order of preference as follows.

1. Non-amortization of goodwill and annual test initially only for the first three (3) years, and then followed by a trigger-based approach starting in year four (4)

   We believe the FASB should not amend the existing guidance on goodwill. Instead, the annual impairment test should be altered from *an annual test* to *an annual test only for the first three (3) years*, and then a triggered-based approach – which would be utilized for any impairments starting in year four (4). We believe that non-amortization of goodwill still provides useful financial reporting information for users, and the likelihood of impairment would occur in the first few years after the transaction.
2. Non-amortization of goodwill and a trigger-based approach

Following the previous point, we would also be in favor of a trigger-based approach starting in year one (1) as a substitute for any annual tests. We note that extra due care must be used when considering triggers under this approach in the early years of the impairment tests.

3. Amortization of goodwill and annual test initially only for the first three (3) years, and then followed by a trigger-based approach starting in year four (4)

Should an overwhelming majority of readers (users, preparers, and other stakeholders) of financial statements would like to ease the burden on costs to prepare and audit information on goodwill in the future, we also think this is a reasonable approach.

4. Amortization of goodwill and trigger-based approach

Should the FASB decide to amortize goodwill, we would also be in favor of a trigger-based approach starting in year one (1) as a substitute for any annual tests.

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

**Customer-related intangible assets and noncompete agreements.**

The two intangible assets in question, under this ITC, are the customer-related intangible assets (CRIs) and the noncompete agreements (NCAs). We understand that the FASB is considering whether to recognize these two assets separate from goodwill.

Our rationale for preserving these assets apart from goodwill are as follows:

1. By subsuming CRIs and NCA into goodwill, at first glance it would seem that one would recognize some cost savings. However, these intangible assets are never truly considered individually – rather they are considered with other assets and as part of a business.

For example, in-process research and development intangibles (IPR&D) valued using the multi-period excess earnings method (MPEEM), would need to take a charge for NCAs (if these were presumed to have material value). Thus, an analysis of the NCAs (like the assembled workforce) under a MPEEM would need to be measured to ensure the appropriate amount of the purchase price is allocated the IPR&D asset.
With respect to CRIs and depending on the industry the entity / business operates in, other assets such as sales order backlog (which is generally contractual in nature) along with the inventory are often valued separately but are all ‘connected,’ and must all be considered to ensure the purchase price is allocated to these assets properly.

2. We acknowledge that the costs of complete a transaction as well as all the audit and compliance requirements can be enormous. However, the fees to account for business combinations are, relatively speaking, small compared to the total costs paid to other third-parties such as investment bankers, attorneys, etc.

3. Depending on certain industries such as the manufacturing or distribution industry, the CRIs are generally the primary intangible asset in a transaction. Under the scenario where the CRIs are eliminated as an identifiable intangible asset, some shareholders may question what assets were ultimately acquired at the time of the acquisition, and what was the value of the transaction. We realize there are arguments to both – to value CRIs separately and to subsume CRIs into goodwill. However, we believe the readers of financial statements would generally prefer more information, and to analyze certain intangible assets such as CRIs separately from goodwill.

Under the assumption CRIs were eliminated as an identifiable intangible asset, the goodwill balance would be larger – thus, the entity may potentially be subject to a greater goodwill impairment.

4. With respect to the reliability of the measurement of certain recognized intangible assets namely, CRIs and NCAs, we believe this needs some enhancements. However, we also believe the reliability will improve as firms implement the Mandatory Performance Framework (MPF) for fair value measurements.

The MPF contains requirements that cover how much work should be performed in order to prepare a professional work product. It addresses scope of work, extent of documentation and analysis, consideration of contrary evidence, evaluation of prospective financial information, and documentation in both the report and the supporting working papers. For additional information about the MPF as well as the CEIV credential, please find a link to the CEIV site - https://ceiv-credential.org/.

In the current MPF, we believe there is sufficient guidance to measure CRIs, which can often be one of the largest intangible assets in a business combination. Although there are no sections specifically on NCAs, the MPF principles can still be considered and applied to this asset. As one
of the organizations involved in developing the MPF, we would naturally be happy to include a section on NCAs in the second edition of the MPF.

5. If in fact the FASB were to decide to amortize goodwill with a range of recommended lives, the valuation of CRIs could be used as a proxy to estimate the amortizable life of the goodwill. This is another reason for preserving CRIs as a separable intangible asset.

**Possible Approaches**

Of the four possible approaches presented in the ITC, we would support in order of preference Approach 4 (Do not Amend the Existing Guidance) and then Approach 2 (Apply a Principles-Based Criterion for Intangible Assets).

For the reasons stated previously, we are not in favor of Approach 1 (Extend the Private Company Alternative to Subsume Certain CRIs and all NCAs into Goodwill). In addition, we are not in favor of Approach 3 (Subsume All Intangible Assets into Goodwill) as we believe this would make financial statements less relevant by eliminating all identifiable intangible assets and presumably any step ups in tangible assets.

**Section 3: Whether to Add or Change Disclosures about Goodwill and Intangible Assets**

**Additional Disclosures about Goodwill**

Providing as much information as possible such as an early indication of changes in facts and circumstances that led to a goodwill impairment test which did not result in a goodwill impairment would be very useful, when combined with the quantitative information of any changes in facts and circumstances that may lead to a future goodwill impairment loss. On a quarterly basis, the company and its auditors can determine whether there is enough information to warrant such a disclosure - to potentially limit some of the costs. This would address the issue of providing timely and useful information to investors.

**Additional Disclosures about Intangible Assets**

Although the report noted and issued by the SEC is a slightly dated, the recommended disclosures on intangible assets and operating performance measures that would enable investors to better assess future performance, we believe, would be valuable information for investors.
The disclosures outlined in section 3 of the ITC would all seem to provide useful information to readers, including investors.

Section 4: Comparability and Scope

Ideally, the comparability of accounting information that allows the financial statements of various organizations to be compared to each other is a fundamental principle and a necessity by the users (especially the investors) of financial statements. However, not all users will expect similar information as it relates to goodwill and identifiable intangible assets for each type of entity – PBEs, private business entities, and not-for-profit entities.

In response to the question of comparability, our views are as follows:

- **Comparability among all public business entities (PBEs) reporting under US GAAP and PBEs reporting under IFRS.**

  We believe this comparability is the most important one. Some companies with operations around the world may account for intangible assets and goodwill under both US GAAP and IFRS. Over ten years ago, the two accounting ‘standards’ were very different. Today, some view the accounting for intangible assets and the goodwill impairment tests under US GAAP and IFRS to be similar, although there are still some differences in the guidance and in practice. Much progress has been made over the years, and we hope the two standards will continue to converge as much as possible.

- **Comparability among all PBEs reporting under US GAAP**

  This would be important for users of financial information in the US. However, the points raised by the FASB in the ITC for US GAAP will have many parallels from a global standpoint. This is not to say that there will not be specific issues relevant to US GAAP that will justify a specific focus, but we believe what is done in the US will have global consequences. We are aware that the International Accounting Standards Board (IASB) are considering several topics discussed in this ITC and will issue a discussion paper in the near future. Thus, we beseech a global approach, and in conjunction with the IASB, when considering any significant changes to the accounting of identifiable intangible assets and goodwill.
• Comparability among all private business entities and all not-for-profit entities reporting under US GAAP.

In general, these entities are not driven by the same motivations as the PBEs, and thus preserving comparability of private business and not-for-profit entities reporting under US GAAP should continue to be encouraged.

• Comparability among all entities reporting under US GAAP (one requirement for PBEs, private business entities, and not-for-profit entities).

Ideally, this would be ‘nice’ but not necessary as the users of the private business and not-for-profit entities’ financial statements will have different expectations and motivations than those of PBEs. Furthermore, we believe the cost would be too burdensome for the private business and not-for-profit entities’ with very little benefits for readers of these financial statements.

**Closing Comments**

We applaud the FASB staff for their time and effort in preparing the ITC. By no means is this a small task. We believe the FASB will receive a lot of valuable insight to determine a path forward that will continue to benefit the public interest. We have appreciated the opportunity to provide our observations and comments. Finally, and in response to the last question, we would very much be interested, and we look forward to joining the roundtable later this year.