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Ms. Susan M. Cospers  
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23 August 2013

**Re: Proposed Accounting Standards Update, *Accounting for Goodwill*, a proposal of the Private Company Council (File Reference No. PCC-13-01B)**

Dear Ms. Cospers:

As the auditor of more than 3,000 private entities, we appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Accounting for Goodwill*, a proposal of the Private Company Council (the proposed Update).

We strongly support providing relief to private companies under US GAAP while continuing to provide relevant information for users of private company financial statements. While we acknowledge the observation of the Private Company Council (PCC) that certain users of private company financial statements may ignore goodwill and goodwill impairment losses in their analysis of a private company's financial condition and operating performance, we challenge whether this is sufficient justification for amending the goodwill accounting model for private companies. We believe that any change to the goodwill accounting model should be fundamentally consistent with the conceptual underpinnings in US GAAP in addition to being convenient to apply.

When the FASB issued Statement No. 142, *Goodwill and Other Intangible Assets* (Statement 142), it debated whether goodwill should be amortized and in the Basis for Conclusions to Statement 142 the Board acknowledged that "many users of financial statements ignore goodwill amortization expense in making investment and credit decisions." In addition, the FASB said that not amortizing goodwill and requiring an adequate impairment test provides financial information that more faithfully reflects the economic impact of acquired goodwill on the value of an entity than amortizing goodwill would. Further, the FASB observed that straight-line amortization of goodwill over an arbitrary period would not reflect economic reality and, thus, would not provide decision-useful financial information. This is due in part to the fact that goodwill is principally a non-wasting asset. Moreover, in the Basis for Conclusions to Accounting Standards Update No. 2011-08, *Testing Goodwill for Impairment*, the Board reaffirmed its conclusion not to require amortization for the same reasons cited during its deliberations of Statement 142. Thus, we do not believe that the PCC has sufficiently justified why amortizing goodwill would now result in more representationally faithful and decision-useful information for private companies.

If the Board elects to move forward with this proposal, we believe that certain aspects of the proposed Update should be modified to improve its operationality and facilitate its implementation. We summarize our more significant concerns below.

### **Use of primary asset**

We believe that tying the subsequent amortization of goodwill to the primary asset acquired in a business combination adds unnecessary complexity to the model. Further, we believe it is inconsistent to look to the primary asset for purposes of determining the useful life of goodwill but not for purposes of determining the amortization method. It is not uncommon for a business combination to result in the primary asset being either an indefinite-lived intangible asset or an asset that has a pattern of consumption that isn't straight line.

Because users of private company financial statements largely indicated that they ignore goodwill and goodwill impairment losses, we recommend simplifying the model by requiring private companies to subsequently amortize goodwill on a straight-line basis over 10 years, rather than over the life of the primary asset.

### **Tracking goodwill at the acquisition level**

We believe that the requirement to track goodwill at the acquisition level would add unnecessary complexity. Under the proposal, a private company would be required to track goodwill at the individual acquisition level for purposes of amortizing goodwill and allocating any goodwill impairment loss calculated at the entity level. Again, because users of private company financial statements largely indicated that they ignore goodwill and goodwill impairment losses, we do not see the benefit of tracking goodwill at the acquisition level. We recommend simplifying the model by allowing private companies to aggregate the goodwill into a single unit of account that is subsequently amortized over its weighted-average useful life.

### **The need for transition requirements for private companies that transition back to current US GAAP**

It is unclear to us how a private company that chooses to apply the accounting alternative in the proposed Update would transition to US GAAP for public business entities if it later elects to or is required to apply those requirements (e.g., a company that files financial statements with the Securities and Exchange Commission in connection with an initial public offering). Because this issue is broader than this specific proposal, we believe that the PCC should develop separate guidance that provides transition provisions for any private company that will transition back to current US GAAP.

Our responses to the Questions for Respondents, along with other comments about clarifications that would help make the proposed Update operational, are included in the Appendix.

\* \* \* \* \*



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

Very truly yours,

*Ernst & Young LLP*

**Responses to the Questions for Respondents in the Proposed Accounting Standards Update, Accounting for Goodwill, a proposal of the Private Company Council**

This Appendix includes our responses to questions addressed to all respondents or specifically to auditors. We have not responded to questions addressed only to preparers or users.

**Question 1:** Please describe the entity or individual responding to this request. For example:

Please indicate whether you primarily are a preparer, user, or public accountant. If other, please specify.

- a. If you are a preparer of financial statements, please indicate whether your entity is privately held or publicly held and describe your primary business and its size (in terms of annual revenue, the number of employees, or other relevant metric).
- b. If you are a public accountant, please describe the size of your firm (in terms of number of partners or other relevant metric) and indicate whether your practice focuses primarily on public entities, private entities, or both.
- c. If you are a user of financial statements, please indicate in what capacity (for example, lender, investor, analyst, or rating agency) and whether you primarily use financial statements of private entities or those of both private entities and public entities.

Ernst & Young LLP is one of the largest firms auditing both public and private entities. We currently audit more than 3,000 private entities, ranging from small start-ups and family-owned enterprises to large privately held multinational corporations.

**Question 2:** Should any types of entities be excluded from the scope of this proposed Update? Should any types of transactions or accounts be excluded, or are there any other types of transactions or accounts that should be included in the scope?

We encourage the FASB to finalize its proposal on the definition of a public business entity, which will drive the scope of the Private Company Decision-Making Framework, before concluding on whether any types of entities should be excluded from the scope of this proposed Update. We will respond in a separate comment letter on the proposed definition.

**Question 3:** Should the Board consider expanding the scope of the accounting alternative to other entities, such as publicly traded companies or not-for-profit entities? If the scope is expanded to other entities, what changes, if any, should the Board consider to the accounting alternative for the subsequent measurement of goodwill? If the scope is expanded to public companies or not-for-profit entities, should the accounting alternative continue to be elective?

Because the proposed Update does not provide a conceptual basis for the accounting alternative it would provide to private companies, we do not believe the accounting alternative should be extended to public entities (see our cover letter for additional information). Further, we believe that one of the

primary arguments for the proposal – the unique users of private company financial statements and their unparalleled access to management – would not extend to users of public company financial statements.

We believe that the scope of the proposed Update should be expanded to include not-for-profit entities. The primary users of not-for-profit entities' financial statements are typically donors, trustees, regulatory agencies, rating agencies and bondholders. In general, these users are concerned about an entity's ability to meet its mission and its liquidity (e.g., debt coverage and current ratios) and largely ignore the recognition and impairment of goodwill. We believe these users generally share more of the characteristics of private company users that the proposal cites as a basis for providing the accounting alternative. We believe that if the scope is expanded to not-for-profit entities, the accounting alternative should continue to be elective.

**Question 4:** Would the proposed amendments reduce overall costs and complexity compared with existing guidance? If not, please explain why.

In general, we believe that the proposed amendments would reduce overall costs and complexity compared with existing guidance for many of the reasons noted in the Basis for Conclusions (e.g., removal of the requirements to determine reporting units and to perform an annual goodwill impairment test).

We believe the cost and complexity would be reduced even further if the Board follows our recommendations (see "Use of primary asset" and "Tracking goodwill at the acquisition level" in our cover letter).

**Question 5:** Do you agree that the accounting alternative for goodwill would provide relevant and decision-useful information to users of private company financial statements? If not, what accounting alternative, if any, would provide relevant information to users?

We believe that some users monitor goodwill impairment as a benchmark (or report card) for evaluating whether an acquisition is a success or a failure and ultimately in the evaluation of management. If goodwill could be amortized, users will no longer have the ability to make this evaluation. For example, an unsuccessful acquisition may be masked by the fact that goodwill is being amortized.

**Question 6:** Do you agree with the PCC's decision to amortize goodwill on a straight-line basis over the life of the primary asset acquired in a business combination, not to exceed 10 years? If not, please tell us what alternative approach or useful life you would prefer?

See "Use of primary asset" in our cover letter for our concerns with this approach.

**Question 7:** Do you agree that goodwill accounted for under this alternative should be tested for impairment at the entity-wide level? If not, should an entity be either required or given an option to test goodwill at the reporting unit level? What issues, if any, arise from amortizing goodwill at the individual acquired goodwill level while testing for goodwill impairment at the entity-wide level?

We agree that goodwill accounted for under this alternative should be tested for impairment at the entity level. We do not believe that private companies should be allowed to test goodwill at the reporting unit level. We think applying the guidance in ASC 280, *Segment Reporting*, which currently is required only for public companies, would add unnecessary complexity to the proposed model and would create greater diversity in the subsequent accounting for goodwill among private companies.

**Question 8:** Do you agree that goodwill accounted for under this alternative should be tested for impairment only upon the occurrence of a triggering event that would indicate that the fair value of the entity may be below its carrying amount? If not, when should goodwill be tested for impairment? Should there be an annual requirement to test goodwill?

We agree that goodwill accounted for under this alternative should be tested for impairment only when a triggering event indicates that the fair value of the entity may be below its carrying amount. Because goodwill would be amortized and users of private company financial statements indicated that they largely ignore goodwill and goodwill impairment losses, we believe an impairment evaluation that is based on triggering events is appropriate. Therefore, we do not believe there should be an annual requirement to test goodwill for impairment.

**Question 9:** In the proposed amendments, an entity would consider the same examples of events and circumstances for the assessment of triggering events as those considered for the qualitative assessment. However, the PCC intends the nature and extent of those two assessments to be different. The assessment of triggering events would be similar to the current practice of how an entity evaluates goodwill impairment between annual tests. In contrast, the optional qualitative assessment would be part of an entity's goodwill impairment test, requiring a positive assertion, consistent with current practice, about its conclusion reached and the events and circumstances taken into consideration. Should the assessment of triggering events be performed consistently with how entities currently assess for goodwill impairment between annual tests? If not, how should an entity assess for triggering events? Do you agree that there should be a difference in how an entity would perform its assessment of triggering events and how it would perform the qualitative assessment?

We agree that the assessment of triggering events under the proposed model should be performed consistently with how entities currently assess goodwill for impairment between annual tests. Further, we agree that there should be a difference between how an entity would perform its assessment of triggering events and how it would perform the qualitative assessment.

**Question 10:** Do you agree with the alternative one-step method of calculating goodwill impairment loss as the excess of the carrying amount of the entity over its fair value? Why or why not?

We agree that an impairment loss should be calculated using the alternative one-step method of the excess of the carrying amount of the entity over its fair value. We believe this simplified one-step approach would reduce the cost and complexity of accounting for goodwill. Because users of private company financial statements largely indicated that they ignore goodwill and goodwill impairment losses, we believe the costs of calculating a more precise impairment loss, which would be based on subjective assumptions, would outweigh the benefits to those users.

However, we would like to highlight that under this approach, goodwill impairment also could include impairment of long-lived assets that are tested for impairment in accordance with ASC 360, *Property, Plant and Equipment*. For example, a long-lived asset that is held for sale could have a fair value that is below its carrying amount, yet still pass ASC 360's undiscounted cash flow impairment test as part of an asset group. If the entity then performs the impairment test under this proposal and fails, the amount recognized as goodwill impairment would include the difference between the fair value and carrying amount of the long-lived asset. Thus, the possibility that goodwill impairment may include impairment of other long-lived assets will not be transparent to users of the private company's financial statements and it is not clear to us whether the PCC considered this in its deliberations.

**Question 11:** Do you agree with the disclosure requirements of the proposed Update, which largely are consistent with the current disclosure requirements in Topic 350? Do you agree that an entity within the scope of the proposed amendments should provide a rollforward schedule of the aggregate goodwill amount between periods? If not, what disclosures should be required or not required, and please explain why.

We agree with the proposed disclosure requirements, including that an entity within the scope of the proposed Update should provide a goodwill rollforward schedule.

**Question 12:** Do you agree that the proposed Update should be applied on a prospective basis for all existing goodwill and for all new goodwill generated in business combinations after the effective date? Should retrospective application be permitted?

We agree that the proposed Update should be applied prospectively. We do not believe retrospective application would be possible, given the potential need to reassess previous impairment assessments after adjusting for amortization. We believe this typically would be an impractical exercise given the inevitable application of hindsight in that evaluation. Further, it is unclear to us why a private company would want to apply the accounting alternative on a retrospective basis. Therefore, we do not believe retrospective application should be permitted.

**Question 13:** Do you agree that goodwill existing as of the effective date should be amortized on a straight-line basis prospectively over its remaining useful life not to exceed 10 years (as determined on the basis of the useful life of the primary asset of the reporting unit to which goodwill is assigned) or 10 years if the remaining useful life cannot be reliably estimated? Why or why not?

We agree that goodwill existing as of the effective date should be amortized on a straight-line basis prospectively over its remaining useful life not to exceed 10 years (as determined on the basis of the useful life of the primary asset of the reporting unit to which goodwill was previously assigned) or 10 years if the remaining useful life cannot be reliably estimated. Please see "Use of primary asset" in our cover letter for our recommendation on the amortization of goodwill.

**Question 14:** When should the alternative accounting method be effective? Should early application be permitted?

Because adoption of the proposed Update would be elective, we believe that an effective date in the first period after issuance of a final standard would be appropriate. Further, we would support permitting early application.

**Question 15:** For preparers and auditors, how much effort would be needed to implement and audit the proposed amendments?

While the proposal likely will reduce cost and effort associated with the subsequent accounting for goodwill, we believe that this question is difficult to answer broadly because the effort needed to implement and audit the proposed amendments would depend on an entity's facts and circumstances.

**Question 17:** If an entity elects the accounting alternative in the amendments in this proposed Update, do you think that entity also should be required to apply the PCC's proposed accounting alternative for recognition, measurement, and disclosure of identifiable intangible assets acquired in a business combination (in Topic 805)? Alternatively, if an entity elects the accounting alternative in Topic 805, should that entity also be required to adopt the proposed accounting alternative? (No decisions have been reached by the Board and the PCC about this question.)

We believe that the proposed Update and the accounting alternative in Topic 805 for recognition, measurement and disclosure of intangible assets acquired in a business combination should be linked so that an entity that elects either accounting alternative would be required to adopt the other. We believe that not doing so would diminish the representational faithfulness of the financial statements. We make the same point in our comment letter on the PCC's proposed accounting alternative for recognition, measurement and disclosure of identifiable intangible assets acquired in a business combination and provide reasons why the proposals should be linked.

**Question 18:** The scope of this proposed Update uses the term **publicly traded company** from an existing definition in the Master Glossary. In a separate project about the definition of a nonpublic entity, the Board is deliberating which types of business entities would be considered public and would not be included within the scope of the Private Company Decision-Making Framework. The Board and PCC expect that the final definition of a **public business entity** resulting from that project would be added to the Master Glossary and would amend the scope of this proposed Update. The Board has tentatively decided that a public business entity would be defined as a business entity meeting any one of the following criteria:

- a. It is required to file or furnish financial statements with the Securities and Exchange Commission.
- b. It is required to file or furnish financial statements with a regulatory agency in preparation for the sale of securities or for purposes of issuing securities.
- c. It has issued (or is a conduit bond obligor) for unrestricted securities that can be traded on an exchange or an over-the-counter market.
- d. Its securities are unrestricted, and it is required to provide U.S. GAAP financial statements to be made publicly available on a periodic basis pursuant to a legal or regulatory requirement.

Do you agree with the Board's tentative decisions reached about the definition of a public business entity? If not, please explain why.

We will answer this question in our upcoming comment letter on the FASB's Proposed Accounting Standards Update, *Definition of a Public Business Entity*.

\* \* \* \* \*

### Other recommendations

- ▶ We recommend striking the word "remaining" in the following sentence in paragraph ASC 350-20-35-63: "Useful life shall be based on the remaining useful life of the primary asset acquired in a business combination." After the primary asset is recognized in the business combination, the useful life of the primary asset is initially determined (that is, there is no remaining useful life).
- ▶ We recommend striking the following sentence in paragraph ASC 350-20-35-63: "Goodwill with similar remaining useful lives can be grouped together for amortization purposes." We do not see the benefit of this sentence and it may cause confusion in determining the appropriate unit of accounting for allocating a goodwill impairment loss calculated at the entity level.
- ▶ We recommend the following change (in **bold**) to paragraph ASC 350-20-35-64: "If the estimate of goodwill's remaining life is changed, the remaining carrying amount of goodwill shall be amortized prospectively on a straight-line basis over that revised remaining useful life, **not to exceed 10 years.**"

- ▶ Paragraph 350-20-35-65 states “Goodwill of an entity shall be tested for impairment if an event occurs or circumstances change that would indicate that the fair value of the entity may be below its carrying amount (a triggering event).” The phrase “may be below” is unclear to us and we are not aware of such a phrase used elsewhere in US GAAP. We recommend that the Board include a well understood threshold such as “more-likely-than-not” as the trigger of a goodwill impairment test.
- ▶ We recommend the following change (in **bold**) to paragraph ASC 350-20-35-68: “If after qualitatively assessing the totality of events or circumstances, **such as those described in paragraph 350-20-35-3C(a) through (g)**, an entity determines that it is not more likely than not that the fair value of the entity is less than its carrying amount, then further testing is unnecessary.
- ▶ We found the use of the term “entity” in paragraphs ASC 350-20-40-9 through 40-11 to be unclear. For example, does entity mean the consolidated reporting entity or a subsidiary? Further, if entity means a subsidiary, it appears that this guidance presumes goodwill is associated with a particular subsidiary. However, that would not be the case if the goodwill arose from an acquisition of a business outside of a legal entity. In that case, it is not clear to us how goodwill would be allocated to the full or partial disposal of that business. For example, would the allocation be based on the entire goodwill balance or just the goodwill balance associated with the business? Determining the goodwill associated with the business could be difficult if the goodwill from the acquisition was commingled with goodwill from other acquisitions.
- ▶ We recommend the following changes (in **bold**) to paragraph ASC 350-20-50-6 “The changes in the carrying amount of goodwill during the period shall be disclosed in aggregate, showing the following separately:
  - a. The gross carrying amount of goodwill, accumulated amortization, and accumulated impairment loss at the beginning of the period
  - b. Additional goodwill recognized during the period, **except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with paragraph ASC 360-10-45-9**
  - c. **Adjustments resulting from the subsequent recognition of deferred tax assets during the period in accordance with paragraphs 805-740-25-2 through 25-4 and 805-740-45-2**
  - d. Goodwill included in a disposal group classified as held for sale in accordance with paragraph 360-10-45-9 and goodwill derecognized during the period without having previously been reported in a disposal group classified as held for sale
  - e. The aggregate impairment loss for the period
  - f. The aggregate amortization expense for the period
  - g. **Net exchange differences arising during the period in accordance with Topic 830**
  - h. Any other changes in the carrying amount of goodwill during the period
  - i. The gross carrying amount, accumulated amortization, and accumulated impairment loss at the end of the period.