### DUFF&PHELPS

Ms. Sue Cosper Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116 August 23, 2013

Re: File Reference No. PCC-13-01B

Dear Ms. Sue Cosper,

Duff & Phelps appreciates the opportunity to provide comments on the Exposure Draft of the Proposed Accounting Standards Update – *Intangibles*–*Goodwill and Other (Topic 350): Accounting for Goodwill* (a proposal of the Private Company Council).

Duff & Phelps is a global independent financial advisory and investment banking services firm. The comments herein reflect the experiences and insights gained not only in assisting our clients (both public and nonpublic business entities) with the goodwill impairment testing under Topic 350, but also the initial recognition of goodwill resultant from the purchase accounting for their business combinations under Topic 805. We have thus focused our comments on highlighting some of the practical challenges of applying, as well as some unintended consequences of, the proposed accounting alternative.

We would be pleased to further discuss our comments below with the Board and staff. Please direct any questions to either of us via the contact information set forth below.

Sincerely,

Paul Barnes

Global Leader – Valuation Advisory Services and Office of Professional Practice

Greg S. Franceschi

Global Leader Financial Reporting Practice

## General Comments

Although we understand the Board's concern regarding the costs versus benefits for private companies, the accounting alternative proposed in this Exposure Draft (ED) creates a divergence within U.S. GAAP and contributes little to the Board's efforts to converge with IFRSs. We believe the proposed accounting alternative is inconsistent with the FASB's commitment to reach a unified set of high-quality global accounting standards.

Given the interdependency of the accounting for identifiable intangible assets in a business combination and the subsequent accounting for goodwill, we encourage the Board and Staff to concurrently consider our comment letters to this ED and FASB File Reference No. PCC 13-01A.

## Response to Specific Questions

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

#### **Duff & Phelps Response:**

Duff & Phelps is a global independent financial advisory and investment banking services firm. As part of providing our services, we analyze financial statements and other financial information of our clients and their industry peers.

We have gained significant experience and insights in assisting both our public and nonpublic clients with the purchase accounting for their business combinations under Topic 805 and subsequent impairment testing of goodwill, indefinite-lived intangible assets, and long-lived assets under Topic 350 and Section 360-10-35. We have thus focused our comments on highlighting some of the practical challenges of applying, as well as some unintended consequences of, the proposed accounting alternative.

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?

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?

#### Duff & Phelps Response to Questions 6 and 13:

 The proposed accounting alternative represents a significant change in the Board's view on the practicability of amortizing goodwill. In the basis for conclusion of FAS 142,<sup>1</sup> the Board made the following comments:

Because the Board agreed with respondents who stated that straight-line amortization of goodwill over an arbitrary period does not reflect economic reality and thus does not provide useful information, the Board reconsidered its decision to require amortization of goodwill. The Board reaffirmed its belief that immediate write-off of goodwill was not appropriate and thus focused its reconsideration on nonamortization of goodwill. — FAS 142, B79

...the Board concluded that segregating the portion of recognized goodwill that might not be a wasting asset from the portion that is a wasting asset would not be practicable. – FAS 142, B82

Adopting the accounting alternative as proposed would represent a significant shift from the Board's historic views on the relevance of information provided by the amortization of goodwill.

 The proposed accounting alternative would accelerate the amortization of the cancelable portion of identifiable intangible assets arising from contractual rights.

The guidance in paragraph 350-30-35-6 states that "[a recognized intangible asset shall be amortized over its useful life to the reporting entity unless that life is determined to be indefinite...The method of amortization shall reflect the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up."

For a nonpublic entity that elects to apply the proposed accounting alternative for goodwill and the proposed accounting alternative for business combinations (see FASB File Reference No. PCC 13-01A), the amounts recognized as goodwill as a result of a business combination would include any renewals or portions of contracts that fail to meet the definition of noncancelable contractual terms (e.g., customer relationships). In this instance, the amortization of goodwill would essentially accelerate the amortization of the identifiable intangible assets subsumed in goodwill in advance of the entity consuming their economic benefits.

 The requirement to first look to the remaining useful life of the primary asset acquired in a business combination to establish the period over which to amortize the amounts recognized as goodwill may not always be practicable or relevant.

<sup>&</sup>lt;sup>1</sup> FAS 142 has been codified as Topic 350 in the Accounting Standards Codification. However, the basis for conclusion was not included in the Codification.

A primary asset is defined in the ED as the principal identifiable long-lived tangible or intangible asset that is the most significant asset from which the acquired business derives its cash-flow-generating capacity. The proposal presumes that a primary asset drives the cash-flow-generating capacity of the acquired business entity and is a reasonable barometer for the consumption of the amounts recognized as goodwill. The economic drivers of business entities that focus on the research and development of new drug therapies, for example, are likely to be the in-process research and development project(s) with indefinite useful life rather than any of its other tangible or intangible assets.

- It is unclear whether the consideration of the primary asset for estimating the
  period over which to amortize existing goodwill could include internally
  generated (that is, unrecognized) intangible assets. We encourage the Board
  to provide additional guidance if it decides to proceed with the proposed
  accounting alternative.
- Lastly, in the basis for conclusions some PCC members supported the
  amortization model because those members noted that acquired goodwill is an
  asset that is consumed and replaced with internally generated goodwill. These
  PCC members voted for the amortization model because they believe
  amortization is a better representation of the underlying economics of goodwill
  than the current impairment-only model. In addition, the useful life was limited
  to 10 years on the belief that generally most of the assets and liabilities
  acquired and assumed in a business combination to which goodwill can be
  attributed would be fully used up or satisfied by the tenth year.

We offer an alternative perspective on this view. Transactions are priced with the expectation of cash inflows well beyond a 10 year horizon. A very simple example of this is the present value of a cash flow projection with a 3% growth rate. Upon discounting such a cash flow, ½ of the present value would be attributable to cash flows occurring after 10 years (at a 10% discount rate) and 1/3 of the present value would be attributable to cash flows occurring after 10 years (at a 15% discount rate). The expectation of cash flows and how they are reflected in the pricing a transaction seems to run counter to some of the supporting logic for the 10-year amortization of goodwill.

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?

#### **Duff & Phelps Response:**

Entity-wide level testing, for all intents and purposes, eliminates indications of poor performance for the individual acquisitions. The combination of performing the goodwill impairment test at the entity-wide level with the annual decline in the carrying amount of goodwill due to amortization virtually assures that impairments will not be recorded except with extremely poor overall company operating performance. In other words, testing goodwill for impairment at the entity level would result in information loss, and would be inconsistent with the manner in which purchase accounting is applied and acquired assets are recognized on an acquisition-specific/business specific basis.

One issue that arises from entity-wide testing combined with the reality of individual acquisitions relates to the allocation of any goodwill impairment to the individual amortizable units of goodwill. Such an allocation is to be performed on a reasonable and rational basis (including relative carrying amounts). However, this has the potential to misallocate the goodwill impairment loss to the amortizable units, which will distort post-impairment goodwill amortization if the primary assets of the amortizable units have different lives. This is one of the shortfalls of not testing for impairment at the reporting unit level. Accordingly, if the Board proceeds with the proposed accounting alternative to permit the amortization of goodwill, we believe the Board should retain the existing requirement to test goodwill at the reporting unit level.

The following example elaborates on the potential for misallocation.

The accounting alternative for goodwill requires the entity to test for goodwill
impairment at the entity-wide level. Absent indicators of fair value of the
reporting units, the carrying amounts of goodwill or net assets would seem to
be a logical basis for entities to turn to in allocating any goodwill impairment
loss.

The reporting unit construct is intended to provide some alignment with the management and operations of an entity's business units. Furthermore, reporting units better capture the economics of the utilization of acquired assets and goodwill. The carrying amount of goodwill is dependent on the number of business combinations undertaken by the reporting unit and/or the magnitude of amounts recognized as goodwill in the business combination; and the carrying amount of the net assets of a reporting unit can be affected by a number of factors unrelated to its financial performance.

To illustrate the potential for misallocation, assume an entity has two reporting units (see also Table 1 below). The more profitable reporting unit (RU-1) has a lower carrying amount of net assets due to a disproportionately large amount of depreciable assets and amortizable intangible assets. The less profitable reporting unit (RU-2) has a higher carrying amount of net assets as its asset base is comprised primarily of indefinite lived intangible assets and goodwill. The total goodwill impairment loss was determined to be 40. The remaining

useful lives of goodwill are 2- and 8-years for RU-1 and RU-2, respectively. The allocation of goodwill impairment loss based on either the carrying amount of goodwill or net assets may result in a significant misallocation. This example assumes that the carrying amounts of net assets at RU-1 and RU-2 includes goodwill and reflect appropriate adjustments for any impairment of long-lived and indefinite lived intangible assets.

Table 1

able i				ARTER SELECTION
		RU-1	RU-2	Total
Carrying Amounts of:	- · ·			
- Goodwill		20	80	100
- Net Assets		100	120	220
Fair Value of Net Assets		170	80	250
Goodwill Impairment Loss-alloca	ated based on:	ii ii riigii ir vidaci olidab aliidaviyosaa s		1800-001810100 - 1-0 101811 101810 101810
Carrying Amounts of Goodwill		8	32	40
- Carrying Amounts of Net Assets		18	22	40
- Fair Value of Net Asset (in accordance with Topic 350)		0	40	40
Annual Goodwill Amortization (F	Post-Impairment), when			
allocated based on:				
- Carrying Amounts of Goods	vill	6	6	12
Carrying Amounts of Net Assets		1	7.25	8.25
Fair Value of Net Assets (in accordance with Topic 350)		10	5	15

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.
- 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.

#### **Duff & Phelps Response:**

Additional clarification may be necessary regarding criteria [a] above (defining a public business entity as a business entity that is required to file or furnish financial statements with the Securities and Exchange Commission)). For example, does the requirement of registered investment advisers (including advisers to hedge funds) to file financial information under Form PF constitute a provision of financial statements to the Commission? Similarly, would Proposed Rule 17Ad-22(c)(2) that requires a clearing agency to post on its Web site an annual audited financial report also be construed as having filed or furnished financial statements with the Commission?

# Other Comments

- We suggest relocating paragraph 350-20-35-67 to follow paragraph 350-20-35-70.
- It is unclear to us whether it was the Board's intent for the pattern of amortization for amounts recognized as goodwill as a result of a business combination (that is, on a straight-line basis; see paragraph 350-20-35-63) to differ from goodwill existing as of the effective date (which is not specified in paragraph 350-10-65-2(b)).