MINUTES

FINANCIAL ACCOUNTING STANDARDS BOARD

MEMORANDUM

To:	Board Members		
From:	Lazar (x384) and Garrett (x353)		
Subject:	Minutes of November 15, 2019 Roundtable	**Date:**	December 20, 2019
cc:	Tosches		

The roundtable meeting minutes are provided for the information and convenience of constituents who want to follow the standard setting process; these minutes do not represent official positions of the FASB. Official positions of the FASB are reached only after extensive due process and deliberations.

Topic: Identifiable Intangible Assets and Subsequent Accounting for Goodwill

Basis for Discussion: Invitation to Comment, *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*

Length of Discussion: 8:30 a.m. to 11:30 a.m. and 12:30 p.m. to 3:30 p.m. (EST)

Attendance:

External Participants

Morning Session

Nerissa Brown	University of Illinois
Steve Choi	RICS
Josh Forgione	EY
Greg Franceschi	Duff & Phelps
Ron Graziano	Credit Suisse
Yasunobu Kawanishi	ASBJ
John Kratschmer	LSC Communications
Angela Newell	BDO
Andreas Ohl	PwC
Sandra Peters	CFA Institute
Nancy Reed	US Concrete, Inc.
Kevin Spataro	The Allstate Corporation
Bennett Stewart	ISS EVA

Mary Tokar	IASB
Kevin Vaughn	SEC
Megan Zietsman	PCAOB

Afternoon Session

Chris Ackerlund	Bank of America
Ryan Bergstrom	Zions Bancorporation
Nick Burgmeier	KPMG
Todd Castagno	Morgan Stanley
Dimitri Drone	Houlihan Lokey Financial Advisors
Tom Hillman	Credit Suisse
Yasunobu Kawanishi	ASBJ
Dominick Kerr	Connor Group
Kevin MacKay	Pfizer
Michael Morrissey	Deloitte & Touche LLP
PJ Patel	Valuation Resource Corporation
Doug Reynolds	Grant Thornton
Mary Tokar	IASB
Kevin Vaughn	SEC
Dan Wangerin	Wisconsin School of Business
Megan Zietsman	PCAOB

FASB Participants

Russ Golden	Board Chair
Jim Kroeker	Board Vice Chair
Christine Botosan	Board Member
Gary Buesser	Board Member
Sue Cosper	Board Member
Marsha Hunt	Board Member
Hal Schroeder	Board Member
Shayne Kuhaneck	Acting Technical Director
Jeffrey Mechanick	Assistant Director
Chandy Smith	Senior Investor Liaison
Joy Sy	Supervising Project Manager
David Yates	Practice Fellow
Kelly Garrett	Postgraduate Technical Assistant
Emma Lazar	Postgraduate Technical Assistant

Topic A: Current Practice with Current GAAP

User Views

Participants discussed the information utility provided to users under the current model.

Morning Session

1. Users noted that recurring cash flows and cash flow return on investment are important measures in assessing companies. These participants would add back goodwill impairments as well as goodwill amortization to earnings measures. However, one user clarified that the adjustment for impairments does not mean that the information is not meaningful. Rather, these adjustments are made to normalize the earnings measures for comparability.

2. One user explained that goodwill impairments prompts important conversations about acquisitions and emphasized that goodwill amortization would not distinguish between managers with strong and weak stewardship.

3. Users also noted that often with public companies the market price adjusts before the company records goodwill impairments, but that in certain circumstances goodwill impairments convey new information to the market. One practitioner with valuation experience explained that deal models in acquisitions include perpetual assumptions related to a business' going concern, and that impairments are recorded after the going concern assumptions are no longer perpetual. An academic explained that while impairments are generally delayed, research related to stock price reaction shows that impairments are still useful in analyst forecasting and reflected in stock price. For example, forecasts may be revised downward and future performance may be lower.

4. Practitioners and preparers discussed that, over time, the financial results from a specific acquisition is comingled as the business is integrated, and acquisition-specific goodwill is difficult to isolate because of the shielding effect with other internally generated goodwill within a reporting unit. Similarly, a user noted that impairments are more relevant within the first few years following an acquisition, with the utility of impairments declining over time.

5. Users discussed the relative importance of assessing the performance of a specific acquisition and assessing an entity as a whole. Users monitor acquisition-related performance for short-term assessment and monitor the entity's overall performance longer term. Users noted that goodwill impairments are more useful when they occur within a few years after an acquisition and recognize that acquired goodwill can quickly lose its identity with other aspects of the business.

Afternoon Session

6. Some analysts rely on cash flow metrics, while others rely heavily on earnings. Many users noted that they assess goodwill as a percentage of an acquisition purchase price. Additionally, a user and valuation professional stated that goodwill impairments provide information about future returns, volatility, and risk, all of which influence investor decisions and subsequent valuation estimates.

7. A different user noted that goodwill and intangible asset impairments are generally ignored in lending decisions for small businesses. Rather, this information is used to identify high-risk loans for longer-term clients who require acquisition financing.

8. A few participants, including a user and a practitioner, noted that tracking the performance of an acquisition is difficult over time because of the integration of acquired businesses into the existing entity. Instead of trying to isolate and monitor acquisition performance, one user described a return on capital framework that is used to continually distinguish operating versus transactional performance metrics. This user also analyzes acquisitive and non-acquisitive companies by capitalizing certain expenditures that normalize the capital investments made by both types of companies.

9. An academic commented that based on research, impairments are, on average, delayed. This academic added that impairments in the first few years after an acquisition correlates with overpayment. Practitioners and preparers added that sometimes impairments are recorded because of factors unrelated to the acquisition, such as industry downturns.

Level at Which Goodwill Is Tested

10. Stakeholders discussed the possibility of testing for impairments at a level other than the reporting unit level.

Morning Session

11. Some participants, including a user and a preparer, expressed discontentment with testing goodwill at the reporting unit level. The user noted that current disclosures around reporting units are ambiguous. The preparer noted that often the way management runs their business and integrates acquisitions into legacy reporting units makes it difficult to assess specific acquisitions. Specifically, management often assesses businesses at the segment level rather than the reporting unit level, and integrated acquisitions are difficult to distinguish from the overall business. Moving the goodwill impairments test up to the operating segment level would further dilute the ability to assess the performance of an acquisition. One Board member added that a single segment often accounts for a significant portion of a company’s revenues. Therefore, testing at the segment level may not be significantly different from testing at the entity level.

12. One stakeholder representing preparers and practitioners commented that testing at a higher level, such as the operating segment level, would reduce costs and align more closely with how a business is managed. She noted that the reporting unit level already has a shielding effect such that testing for impairments at the operating segment level would provide an effective compromise.

Afternoon Session

13. Similar to the morning session, users noted that investors lack familiarity with the concept of a reporting unit, and they would like more information on reporting units. Some participants supported goodwill impairments testing at the reporting unit level, especially during the first few years after an acquisition, because it would provide more granularity and reduce the likelihood that impairments would be shielded. One preparer added that significant information would be lost, and it would be a disservice to users if impairment testing is raised to a level above a reporting unit.

14. Participants representing some of the preparer and practitioner base supported testing for goodwill at the operating segment level because of the challenges and cost associated with testing at the reporting unit level. For example, testing goodwill at the reporting unit level is particularly difficult through reorganizations and goodwill reallocations after an acquisition business is integrated. Additionally, companies manage businesses and communicate financial information at the segment level and otherwise do not prepare financial statement information at the reporting unit level.

Cost Drivers

15. Participants discussed the preparation, valuation, and auditing costs associated with the subsequent accounting for goodwill.

Morning Session

16. Several preparers noted that relying on third-party valuation professionals, developing carrying value information at the reporting unit level, and applying judgments and assessments to develop long-term forecasts contribute to the cost of the current impairments test. One preparer noted that the impairment test is more costly for private companies with public company exit strategies because of limited resources and the effective controls needed to manage the risks associated with impairment testing. Another preparer explained that he spends more time with his auditors on the qualitative screen (Step 0) rather than Step 1 of the goodwill impairments test because of the subjectivity associated with Step 0.

17. The stakeholders also discussed critical audit matters (CAMs) in light of goodwill often being identified as a CAM in recent audits in the United States

and the United Kingdom. A stakeholder added that CAMs are intended to be the areas that are most challenging to audit, not necessarily the areas of highest cost, although the two may be aligned. A participant clarified that there is not yet a significant population of CAMs to reference because of the recent issuance of the auditing standard.

18. One user commented on the importance of quantifying costs associated with the impairment test because investors ultimately pay for them.

Afternoon Session

19. Preparers noted that using Step 0 is helpful and reduces the time spent on the overall process, especially if there is a significant amount of headroom noted in a prior year's quantitative test (although some documentation is still required). One valuation professional noted that removing Step 2 from impairment testing reduced costs, although some entities are electing to continue performing Step 2 until the amendments to remove Step 2 are effective.

20. Additionally, participants discussed CAMs and the valuation and audit costs associated with impairment testing. Specifically, one preparer noted that goodwill impairment testing is not meaningful in later periods, for example, testing goodwill that is 15 years old.

21. One user acknowledged and understood preparers' concerns about the ongoing cost related to producing information that is subjective and complex to audit. A different user also explained that while goodwill impairments can provide useful information about poor performance, such information can be found from other parts of the financial statements.

Topic B: Potential Ways to Further Reduce Cost

Goodwill Amortization Model and Period

22. Roundtable participants discussed a potential amortization model for the subsequent accounting for goodwill. Stakeholders also provided views on various amortization periods that could be considered. Although the objective of the project is focused on cost-benefit considerations, some participants provided conceptual rationales while others provided practical reasons in support of their perspectives. Diverse views were discussed.

Morning Session

23. During the beginning discussion of this topic, a user started by questioning whether any asset lasts infinitely. That same user commented about the distinction between goodwill impairments and amortization for which goodwill impairments are potentially an accumulation of amortization that has not yet

occurred. One valuation professional noted that views on the amortization period would depend on one's view of what goodwill economically represents.

24. In support of amortization, an academic cited research that shows goodwill should be reduced because the balance after a few years is not correlated with equity returns, demonstrating that goodwill is not infinite or indefinite lived.

25. Regarding amortization that is based on management judgment, an international standard setter, from a jurisdiction that requires management estimates in determining the amortization period not to exceed 20 years, noted that users find estimated useful lives to be helpful. Certain users commented that management should determine the life of goodwill if it is amortized because a default period provides no informational value. One user added that it is not worth the cost to subsequently reevaluate the life of goodwill. This user proposed that a business' performance can be compared with initial determination of the life of goodwill. Separately, a practitioner noted that a management judgment approach could capture the different views among companies on what goodwill represents.

26. Another preparer was concerned that a short amortization period could mask goodwill impairments in the first few years when goodwill impairments are most useful. An academic stakeholder discussed research that shows a shorter amortization period signals profitability while firms that select maximum amounts are viewed as masking unprofitable acquisitions.

27. Regarding a default amortization period, practitioners stated that this method would be the least costly and a majority of preparers would apply it. One practitioner noted that if judgment were used to determine the useful life, the current challenges and costs related to the subjectivity with determining fair value would shift to the subjectivity in determining the useful life. Therefore, that practitioner would support a default period. Another practitioner added that the cost savings would depend on the amortization period selected and the goodwill impairment model that remains. Users, however, noted the lack of informational value with a default period, which would be widely ignored and increase use of non-GAAP measures.

28. A different user representative who does not support amortization stated that ratios, such as return on assets, will appear more favorable under an amortization model. She expressed concern with an amortization and goodwill impairment model because impairment testing would be less rigorous.

Afternoon Session

29. Similar to some of the comments from the morning session, both users in the afternoon session were open to amortization based on cost-benefit considerations, albeit with management judgment. A practitioner and a user

added that the management judgment approach would provide useful and relevant information about management's intent for an acquisition.

30. Some practitioners also supported amortization because assessing the subsequent performance of an acquisition and tracking goodwill over time is difficult, especially after integration. A user also added his support for amortization because goodwill balances over time do not provide useful information and they are a significant portion of total assets. Specifically, some participants noted that goodwill or synergies diminish unless entities reinvest to maintain them, yet goodwill balances remain on the balance sheet when there are no goodwill impairments.

31. Another practitioner supported amortizing goodwill over the weighted-average life of acquired assets; however, one of the users did not agree with determining a life based on the existing physical asset base. Instead, that user preferred that the life be based on the magnitude and timing of the expected economic profits. A practitioner noted that determining an amortization period is a subjective estimate and may not reduce costs. A different practitioner noted that amortization periods vary across industries, so he supported constraining the amortization period with a cap and floor. An academic explained that there is research that suggests goodwill is a wasting asset. He added that amortizing goodwill over a shorter period of time correlates with the variation in stock price more than goodwill impairments alone.

32. On the contrary, a valuation professional noted that investors would not gain useful information from amortization. Rather, he stated that goodwill impairments result in meaningful and informative conversations between management and investors that amortization is unlikely to provide.

33. There were two preparers from the banking industry in the afternoon session. One of the preparers (from a smaller sized bank) supported amortization because of cost reasons, while the other preparer (from a larger sized bank) did not support amortization because goodwill resulting from successful acquisitions can retain its value indefinitely. The preparer who supported amortization suggested a default period with the ability for management to justify an alternative period.

Impairment Testing Frequency

34. Roundtable participants discussed a trigger-based approach to impairment testing, in contrast with the current annual requirement. Overall, stakeholders did not oppose a trigger-based approach.

Morning Session

35. A Board member questioned what factors differentiate the subjectivity issues surrounding Step 0 and the subjectivity issues surrounding a trigger-based goodwill impairment test. He also questioned whether there would be increased pressure for the precision of Step 1. A preparer commented that amortization would remove tension from trigger-based goodwill impairment testing, so the precision of an annual quantitative test would not be needed. A user also supported trigger-based testing such that management and auditors conduct testing when necessary.

36. A practitioner noted that a trigger-based model is similar to the existing Step 0 model. Additionally, trigger-based testing paired with amortization would take tension off the impairment test. One user noted that trigger-based testing would likely be similar to annual testing but prefers a trigger-based approach to put more faith in management to come forward upon triggering events.

37. One of the stakeholders suggested a hybrid approach in which entities could perform impairment testing for the first few years when impairment informational utility is most useful, then subsequently amortize goodwill to reduce the cost of continually performing the goodwill impairment test. With respect to the hybrid model, a valuation professional added that goodwill impairments most likely occur two to five years after an acquisition. One user supported the hybrid approach because goodwill impairments provide more information in earlier years and are less meaningful as time progresses. Another user noted that the hybrid approach could be appropriate but might result in reduced comparability among entities and may introduce complexity.

Afternoon Session

38. One preparer did not object to amortization with trigger-based testing. One practitioner supported trigger-based testing, while another noted that trigger-based impairment testing would be more operable under a shorter default period with amortization. By contrast, a longer amortization period could require adjusting the existing triggers. For example, the practitioner noted that entities do not benefit from Step 0 in all circumstances.

39. A valuation professional suggested that if an amortization model were applied, quantitative goodwill impairment triggers (rather than qualitative factors) could be considered. For example, one could compare market multiples with coefficient-of-variation ratios. A user took interest in this idea, recognizing cost, materiality, and potential safe harbor implications.

Topic C: Optionality and Comparability

40. Participants discussed comparability considerations among entities:
    a. Optionality for public business entities (PBEs) under GAAP
    b. Comparability between private companies and PBEs under GAAP
    c. Comparability internationally.

Optionality for PBEs

Morning and Afternoon Sessions

41. In the morning session, no roundtable participants stated views in favor of optionality for PBEs.

42. In the afternoon session, no participants specifically expressed support for optionality for PBEs. Participants discussed how optionality would affect comparability. One practitioner noted that optionality would create complexity because of reduced comparability. The practitioner stated optionality would not necessarily simplify the impairment test for all entities.

Comparability between Private Companies and PBEs

Morning Session

43. One user noted that his methodology standardizes between different entity types, such that goodwill impairment and amortization do not hinder comparability. A different user expressed a general concern regarding Private Company Council (PCC) alternatives and options. She expressed that these alternatives should not be introduced to PBEs because PBEs operate in a distinctly different reporting environment.

44. One public company preparer noted that his firm frequently invests in private companies alongside PBEs such that consistency between these entities would be preferable. A practitioner observed that many larger private companies are not adopting the alternative and stated that optionality would not be preferable.

Afternoon Session

45. Similar to the morning session, a practitioner noted that comparability between private companies and PBEs matters particularly when private companies have a public exit strategy. A valuation professional agreed that private companies that are regularly bought and sold generally do not adopt the PCC alternatives for accounting for goodwill and intangible assets.

Comparability Internationally

46. In both sessions, an IASB Board member provided an update on the IASB's project on goodwill, noting that the IASB expects to release a discussion paper, presenting a variety of issues, in the first quarter of 2020, with a 6-month comment period.

Morning and Afternoon Sessions

47. The morning group discussion focused on potential unintended consequences of divergence. A practitioner noted that international convergence is extremely important because different models could have real economic effects in the mergers and acquisitions market globally. More specifically, one participant stated that different accounting models would likely affect how much companies are willing to pay. However, a preparer countered that he has not seen any non-economic decisions made based on accounting models.

48. Users in the morning group added that the potential unintended consequence being discussed is not a result of an accounting issue, but rather a failure of compensation alignment. A few participants cited a study that found that dilution of earnings per share resulted in more favorable stock price reactions; this implies that companies that are confident in their investment acquisitions are willing to report diluted earnings per share. In contrast, an academic described research comparing pre- and post-Statement 142 time periods showing that there is a greater allocation of purchase price to goodwill post-Statement 142, because larger proportions of goodwill limits negative earnings impacts.

49. The afternoon group discussion focused on practical consequences of divergence. A practitioner noted that accounting standards today are not comparable internationally because many countries have their own versions of IFRS Standards. A preparer in the banking industry noted that differences in IFRS Standards and GAAP, especially if the United States applied an amortization model, would increase costs to prepare financial statements and increase operational risk in adhering to international filing requirements. A valuation professional added that comparability between GAAP and IFRS Standards is important.

<u>Topic D: Potential Ways to Increase Informational Utility</u>

Disclosures

50. Participants discussed existing and potential disclosures on goodwill and intangible assets.

Morning and Afternoon Sessions

51. In the morning session, a preparer representative commented that preparers are able to disclose almost anything in the first few years. However, she described that as time passes post-acquisition date, the more challenging the information becomes to provide due to the integration of the business.

52. Overall, stakeholders opposed the potential disclosures related to when an impairment test was performed but did not result in an impairment charge. Stakeholders, including users, questioned the usefulness and cost benefit of the information. One practitioner added that there are mechanisms already in place today to provide information about at-risk reporting units.

53. Stakeholders stated that there already is a lot of disclosure and questioned whether the disclosures under discussion are meaningful and the correct disclosures. One user expressed that there is insufficient disclosure of value creation and destruction. Another preparer suggested disclosing the primary intangible acquired in an acquisition. One user noted that additional disclosure may be unnecessary if incremental information is provided with an entity-specific amortization period.

54. In the afternoon session, one user commented that there is sufficient quality of information related to acquisitions on Day 1. However, there is ambiguity related to the expected synergies and tracking the results post acquisition. This is similar to another stakeholder’s comment in the morning session. Another user added that tracking results of an acquisition can be difficult, and the quality of disclosures vary by company. That user suggested increasing the granularity of disclosure on acquisitions, for example, disclosing how an acquisition marginally affected segments or line items.

55. Another user observed diversity in practice in whether entities disclose the remaining life of goodwill. He suggested requiring the disclosure of net and gross values of goodwill and intangible assets over time. This user also supported information that can capture internally generated intangible assets through the further disaggregation of selling, general, and administrative expenses.

<u>Topic E: Identifiable Intangible Assets</u>

56. Participants discussed the valuation and informational utility of identifiable intangible assets.

Morning and Afternoon Sessions

57. In the morning session, one user noted that intangible assets have a significant effect on how companies are valued; however, users stated that there are many questions around valuation methods and practice. A user stated that perhaps there is an opportunity to provide investors with that

information. Valuation professionals explained that there is a body of knowledge and standards that have been consistently applied for the valuation of intangible assets. They noted that the issues observed are related to the inputs and assumptions, rather than the methods.

58. Users emphasized that the main issue surrounding intangible assets is the discrepancy between organically grown and acquired intangible assets. Those discrepancies impede comparability.

59. In the afternoon session, a user and a valuation professional commented that the purchase price allocation in an acquisition provides relevant information. This comment is similar to what was stated in the morning session.

60. Separately, an academic noted that some intangible assets significantly correlate with market value, while more than half of recognized intangible assets do not correlate with equity value. To this point, a different user noted that he evaluates the return on investment both with and without intangible assets.

61. Related to customer-related intangible assets (CRIs), one user noted that he treats them as goodwill equivalents. An academic explained that there is research that shows that the user treatment of CRIs is the same as the treatment of goodwill in practice. Specifically, both CRIs and goodwill are less associated with equity market values than other assets such as patents or in-process research and development. A valuation professional, however, commented on how the incremental time and cost to value CRIs is minimal and CRIs should be separately recognized from goodwill.

Closing

62. The staff concluded the roundtable by discussing next steps. A staff member noted that the staff plans to present a comment letter summary at a future Board meeting.