

April 28, 2015

Mr. Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Accounting for Goodwill in Nonprofit Organizations via Simplified Amortization

Dear Chairman Golden and Members of the Board,

As part of a graduate level course in governmental and nonprofit accounting, we completed a group project that involved looking at the treatment of goodwill in nonprofit organizations and wanted to share our thoughts to support the Board's pursuit of policy in the area.

Upon reviewing the proposed alternatives for simplifying the measurement of goodwill in accounting by not-for-profit [NFP] entities, my colleagues and I have come to the conclusion that the Private Company Council [PCC] model is preferential. The PCC model of allowing amortization as an option to private companies was adopted by the FASB via ASU 2014-02 and codified in ASC 350-20-35-64, and should be extended to NFP entities as well in our view.

Currently, NFPs must utilize qualitative impairment testing (provided by ASU 2011-08 and codified in ASC 350-20-35-3A through 35-3G) and/or the two-step impairment test (ASC 350-20-35-4 through 35-13) annually, in order to determine whether the amount of goodwill carried on the entity's books should be reduced, and if so to what extent. As the Board itself has pointed out, NFP entities have unique characteristics which bear consideration in determining whether each of the proposed methods is appropriate.

In contrast to private and publicly traded for-profit companies, NFPs lack beneficial ownership, and instead are organized for the purpose of mission fulfillment. The mission-oriented nature of NFPs often places immense pressure on these organizations to allocate as much of their available resources as possible to program expenses. Furthermore, given this justifiable bias toward program spending, the resources available for support functions are often minimal.

In theory, greater accuracy and representational faithfulness can be obtained from direct annual assessment of the fair value of goodwill. However, my colleagues and I are greatly concerned that given the mission focus, lack of a profit motive, and lack of available resources for accounting functions at many NFPs, in practice goodwill may often stay on the books of NFP

entities far past the point at which it should have been reduced in some manner. Goodwill is not an asset with infinite life, and should be accounted for in manner consistent with U.S. GAAP, and in particular the matching principle.

We recognize the valid concern of opponents of the PCC model that the economic fair value of goodwill may not perfectly decrease in a straight-line. However, we believe that this concern applies to other long-lived assets, as well. For example, consider that the components of a building are not likely to devalue in a linear fashion. Roofs, electrical systems, plumbing systems, and air-conditioning systems all have varied useful lives and values. Despite this there are no current proposals to disallow the declining balance methods of ASC 360-10-35, though the option of cost segregation studies is available.

We are concerned that under-resourced NFPs may often choose to do nothing when there is a lack of certainty as to whether goodwill should be impaired. These NFPs are relying substantially on their own limited judgment for estimation of the present fair value. We believe that as a result, at a later time when it becomes undeniably apparent that goodwill must be impaired, an unreasonably large impairment expense will likely be improperly allocated to a single accounting period. There is likely to be little, if any, consistency in how accounting staff at various NFPs utilize their varying levels of training and expertise in creating these estimates. This is a potentially disastrous outcome for financial statement users who need comparability in order to make evidence-based judgments about where best to allocate their resources.

The proposal to allow the direct write-off of goodwill is markedly effective at addressing the problem of inconsistency in goodwill reporting amongst electing entities. Additionally, there is little question that such an accounting method represents a massive simplification over the current guidance. However, direct write-off greatly exacerbates the matching problem by specifically endorsing that the reduction in the fair value of goodwill be taken as an immediate, lump-sum period expense. Therefore allowing the direct write-off of goodwill is entirely inconsistent with the matching principle of U.S. GAAP by design in our view. We feel that it is dubious to expect that goodwill arising from a business combination would typically produce all of its expected future benefit within a single accounting period. Also, if that were the case, then a company would be permitted to amortize such goodwill in that amount of time if it could be shown to be warranted.

The extent of simplification by the PCC proposal over current guidance is not quite as substantial as direct write-off. Nonetheless, we feel that the additional burden of preparing and maintaining a schedule of goodwill, accumulated amortization, and the current period amortization expense is so marginal that even the smallest NFPs should be eminently capable of full compliance. Moreover, reliance on judgment and estimates at NFPs that may lack the resources, skills, and

expertise to accurately and consistently apply the impairment testing provisions of ASC 350-20-35 is almost entirely eliminated.

Ultimately, we feel that the PCC recommendation to allow the use of 10-year (or less when warranted) straight-line amortization for NFP entities will lead to the best possible reporting outcomes for financial statement users, given the mixed objectives of representational faithfulness, matching, and comparability. Under the proposal, reductions in the fair value of goodwill will be smoothly allocated over accounting periods that benefit from said goodwill. This is preferable to improperly allocating said reductions to a single period either in part or in whole, which is neither rational nor systematic. Furthermore, the accounting treatment of reductions in the carrying value of goodwill at different electing NFPs will be entirely consistent and comparable.

Thank you for your consideration, and we look forward to further discussion on the ideal treatment of goodwill in nonprofit organizations in the future.

Sincerely,

Bryan Harman, Xue Ying Li, Michael Straney, Jason Wojkiewicz, Xuyang Xie
Spring 2015, ACG 6519: Governmental and Nonprofit Accounting – Dr. Lynda Dennis
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