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File Reference No. 2016-230
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30 June 2016

Proposed Accounting Standards Update, *Intangibles — Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment* (File Reference No. 2016-230)

Dear Ms. Cosper:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update (ASU), *Intangibles — Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment* (the Proposal), issued by the Financial Accounting Standards Board (FASB or Board).

We support the FASB's objective of simplifying the accounting for goodwill impairment. Overall, we believe the Proposal would reduce the complexity of applying the goodwill impairment assessment for entities that otherwise would be required to perform Step 2 of today's impairment test and maintain the usefulness of information provided to users of financial statements. However, we recommend that the Board consider certain changes as we discuss in the Appendix to this letter.

While we support the Proposal, we believe the Board should continue to simplify the subsequent accounting for goodwill in the next phase of this project. To do this, the Board should evaluate a model that would not require an annual impairment assessment (e.g., amortization with impairment only upon a triggering event). A significant amount of the complexity, including the related costs, of performing a goodwill impairment assessment today relates to the determination of the fair value of an entity's reporting units under Step 1 of the impairment test. We would be happy to share our thoughts on possible next steps with the FASB staff.

The Appendix to this letter contains our responses to certain questions posed in the Proposal.

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

Very truly yours,

Ernst & Young LLP

Appendix — Responses to questions raised in the Proposed Accounting Standards Update, *Intangibles — Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment*

Question 1: Do you agree with the proposed amendments to eliminate Step 2 from the goodwill impairment test? Why or why not?

We agree with the Proposal to eliminate Step 2 of the goodwill impairment test and believe that this would reduce the costs and complexity of financial reporting and maintain the usefulness of information provided to users of financial statements. In particular, it would eliminate the additional cost and complexity of the goodwill impairment test for entities that fail Step 1.

Effect of recognizing an impairment loss on deferred taxes of a reporting unit

Paragraph 350-20-35-2 of the Proposal states that "a goodwill impairment loss generally is recognized for the amount that the carrying amount of a reporting unit, including goodwill, exceeds its fair value. However, the loss recognized shall not exceed the total amount of goodwill allocated to that reporting unit."

An entity in a tax jurisdiction where amortization of goodwill is deductible for tax purposes recognizes deferred taxes on the temporary difference between the tax-deductible goodwill and the first component of book goodwill. Under the Proposal, if such an entity recognizes a goodwill impairment loss, the result would be an increase of the deferred tax asset or a decrease of the deferred tax liability assigned to the reporting unit, which would raise the carrying value of the reporting unit above its fair value. In such circumstances, we believe the entity would need to allocate the excess of the carrying value over the fair value of the reporting unit between goodwill and the deferred tax balances (e.g., by performing an iterative calculation to measure the goodwill impairment loss and the corresponding income tax effect as described in Accounting Standards Codification (ASC) 740-805-55-9 through 55-13, which is used to measure the tax consequences of goodwill recognized at the acquisition date in a business combination).

To address this concern, we recommend that the Board amend proposed paragraph 350-20-35-2 to state that the excess of a reporting unit's carrying value over its fair value would represent a goodwill impairment loss net of any income tax effect. That is, for reporting units with tax-deductible goodwill, the amount of the goodwill impairment loss recognized would likely be greater than the excess of a reporting unit's carrying value over its fair value due to the effect of income taxes. This would make clear that preparers must consider the tax effect when measuring any goodwill impairment loss.

Incomplete impairment test at a reporting date

We believe that ASC 350-20-35-18 and 35-19 (and 350-20-50-2(c)), which relate to the recognition of an estimate of an impairment loss when Step 2 of the impairment test is incomplete, should be modified, rather than removed, to reflect the change to a one-step impairment test. Although the concept of an incomplete Step 1 assessment is not contemplated under today's guidance, we believe there could be circumstances in which the measurement of a goodwill impairment loss may not be finalized at the reporting date. For example, an entity may not finalize the measurement of an impairment loss when it is required to perform an interim goodwill impairment assessment due to a triggering event. In such circumstances, we believe that entities should be required to make additional disclosures similar to the ones required in ASC 350-20-50-2(c) to explain the reasons why the impairment test is not final and to state that the impairment loss recognized is an estimate that has not yet been finalized.

Valuation premise

ASC 350, *Intangibles — Goodwill and Other*, does not prescribe which valuation premise should be used to calculate the fair value of a reporting unit. In addition, in paragraph BC4 of ASU 2010-28, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts* (a consensus of the FASB Emerging Issues Task Force), the Task Force acknowledged that there is no mandated approach for calculating the carrying amount of a reporting unit for purposes of Step 1, but the manner in which the fair value and carrying amount of a reporting unit is determined should be consistent.

In practice, some entities use the equity premise, in which debt is assigned to the reporting units, while others use the enterprise premise, which excludes debt related to the reporting units. The carrying value of debt may approximate its fair value. However, there may be situations when the carrying value of debt may not approximate its fair value due to changes in underlying interest rates or nonperformance risk. Under the current two-step impairment model, the selection of either the equity or enterprise valuation premise may affect the outcome of Step 1 of the goodwill impairment test, but it generally would not result in a difference in the amount of any impairment loss under Step 2.

Under a one-step impairment model, the selected valuation premise may directly affect the amount of the impairment loss if the fair value of debt assigned to a reporting unit differs from its carrying amount. We recommend that the Board acknowledge in the Basis for Conclusions that the valuation premise used to determine the fair value of the reporting unit may have an effect on the measurement of a goodwill impairment loss. Further, we recommend that the Board consider emphasizing in ASC 350-20-35 that, absent changes in facts and circumstances, the valuation premise used should be applied in a consistent manner from period to period.

Question 2: Should the requirement to perform Step 2 of the current goodwill impairment test be retained as an option? Why or why not? If the use of Step 2 is optional, should an entity be allowed to apply that option by reporting unit or should it be a policy election at the entity level applicable to all reporting units?

We do not support retaining Step 2 as an option because this would generate complexity within the guidance and introduce a lack of comparability in the measurement of a goodwill impairment loss.

However, if the Board were to make Step 2 optional, we believe it should require an entity that selects this option to make a policy election that applies to all reporting units. That would eliminate the possibility of an entity using different methods to measure goodwill impairment across its own reporting units.

Question 3: Do you agree with the proposed amendments to require all entities to apply the same one-step impairment test to all reporting units, including those with zero or negative carrying amounts? Why or why not? If not, what would be the suggested goodwill impairment test for reporting units with zero or negative carrying amounts?

We agree that all entities should be required to apply the same one-step impairment test to all reporting units, including those with zero or negative carrying amounts. We believe this requirement would promote consistency and would be less complex than applying the current accounting model. In addition, we believe that this requirement would affect only a relatively small population of reporting units.

Question 4: Should entities with reporting units with zero or negative carrying amounts be required to disclose the existence of those reporting units and the amount of goodwill allocated to them? Why or why not? Are there additional disclosures that would provide useful information to users of financial statements?

We support requiring entities with reporting units with zero or negative carrying amounts to disclose the existence of those reporting units and the amount of goodwill allocated to them. We believe these disclosures would appropriately alert users that a reporting unit has a negative carrying value and has not reflected a goodwill impairment loss.

In addition, we recommend that the Board consider adding guidance that would require entities that report segment information in accordance with ASC 280, *Segment Reporting*, to disclose which reportable segment contains the reporting unit with a zero or negative carrying amount. Such disclosure would help a user understand the amount of goodwill in a reportable segment that is assigned to a zero or negative carrying value reporting unit, which it could compare to the disclosure of total goodwill for each reportable segment. A similar disclosure was added in Example 3 of the Proposal in paragraph 350-20-55-24.

Question 5: Should the guidance on deferred income tax considerations when determining the fair value of a reporting unit outlined in paragraphs 350-20-35-25 through 35-27 and illustrated in Example 1 and Example 2 be retained, or should this Subtopic rely on the fair value guidance in Topic 820, Fair Value Measurement? If the guidance on the tax structure is retained, what, if any, amendments are necessary to address the potential difference in the impairment charge calculated under the proposed amendments, depending on which tax structure is used in calculating the fair value of the reporting unit?

We recommend that the Board retain the guidance on tax considerations when determining the fair value of a reporting unit as outlined in paragraphs 350-20-35-25 through 35-27 and illustrated in Examples 1 and 2 of the Proposal. We acknowledge that applying the concepts in ASC 820, *Fair Value Measurement*, would provide entities with the appropriate framework, and we believe they would come to the same conclusion on the fair value of the reporting unit. However, we believe that retaining the guidance that gives prominence to these tax considerations within ASC 350 would be helpful and would eliminate potential confusion if the paragraphs were deleted (i.e., some entities may believe the selection of the appropriate tax structure is no longer a relevant consideration in determining the fair value of a reporting unit).

We do not believe that additional amendments are necessary to address the potential difference in the impairment loss calculated under the Proposal depending on which tax structure is used in calculating the fair value of the reporting unit. An entity would have to determine the appropriate assumption at the impairment testing date when the fair value of a reporting unit is determined, consistent with the guidance in paragraphs 350-20-35-25 through 35-27. The assumption about the appropriate tax structure is one of many assumptions in the determination of fair value that could change the amount of a goodwill impairment loss.

Question 6: Do you agree that the proposed guidance to remove Step 2 from the goodwill impairment test should be applied prospectively? Should there be specific transition guidance for companies that previously adopted the goodwill accounting alternative for private companies in current GAAP but decide to adopt this proposed guidance after it becomes effective?

We agree that this proposed guidance should be applied prospectively, which would be practical and cost effective.

Transition guidance for private companies

We recommend that the Board consider adding specific transition guidance for companies that previously adopted the Private Company Council (PCC) goodwill accounting alternative in current GAAP but want to adopt this proposed guidance after it becomes effective. Currently, there is no specific transition guidance for private companies that have adopted the goodwill accounting alternative (or any of the PCC alternatives) and later decide to use US GAAP that applies to public business entities (PBEs). In such cases, a private company is required to retrospectively apply US GAAP that applies to PBEs in all prior periods in accordance with ASC 250, *Accounting Changes and Error Corrections*, which in this case would mean performing Step 2 of the goodwill impairment test in all prior annual periods. As such, we recommend that the Board provide for use of the one-step impairment model under the Proposal when retrospectively adopting GAAP applicable to PBEs as opposed to the current two-step model applicable to PBEs.

Impairment indicator upon adoption of the Proposal

Paragraph 350-20-35-30 indicates that goodwill of a reporting unit should be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. We recommend that the Board consider acknowledging in the Basis for Conclusions that entities may have an indicator of impairment at the beginning of the annual period in which the proposed amendments are adopted. For example, assume that under current US GAAP an entity failed Step 1 of its annual goodwill impairment test in the fourth quarter of its fiscal year, but no goodwill impairment loss was recognized because the implied fair value of goodwill exceeded the carrying amount of goodwill. If the entity adopts the Proposal in its next fiscal year, it likely would have an indicator of impairment as of the beginning of the fiscal year of adoption based on the change in how a goodwill impairment loss is measured under the Proposal (i.e., using today's Step 1).

Question 9: Are there additional changes that should be made to the subsequent accounting for goodwill to meet this objective, including changes that might be considered in Phase 2 of the Board's project?

We are supportive of the Board's proposed amendments and believe that they would meet the Board's objective of reducing the complexity of the subsequent accounting for goodwill while maintaining the usefulness of the information provided to users of financial statements. However, we believe the Board should continue to simplify the subsequent accounting for goodwill in Phase 2 of its project. To do this, the Board should evaluate a model that would not require an annual impairment assessment (e.g., amortization with impairment only upon a triggering event). A significant amount of the complexity, including the related costs, of performing a goodwill impairment assessment today relates to the determination of the fair value of an entity's reporting units under Step 1 of the impairment test. We would encourage the Board to conduct outreach with investors and other users of financial statements to understand their views on approaches to further simplify the subsequent accounting for goodwill. In addition, we would be happy to share our thoughts on possible next steps with the FASB staff. We believe that any future amendments should be practical in nature and aimed at further simplifying the subsequent accounting for goodwill.

Question 10: Are there any unintended consequences resulting from the improvements to the Overview and Background Sections of the Subtopics (discussed in Part II of the proposed amendments)?

We do not believe the amendments in Part II of the Proposal would change the application of the relevant guidance and have not identified any unintended consequences that would result from such amendments.