

July 8, 2016

Financial Accounting Standards Board  
401 Merritt 7, PO Box 5116  
Norwalk, CT 06856-5116

**Reference: Technical Director, File Reference No. 2016-230**

Dear Technical Director:

Duff & Phelps is pleased to provide a response to the above-referenced Exposure Draft on Simplifying the Accounting for Goodwill Impairment. Our valuation advice, particularly with regards to financial reporting, is sought by hundreds of global clients annually as we work with them in developing pragmatic solutions for applying fair value techniques.

**Question 1**

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

**Response**

Yes, we agree with the proposal for a number of practical reasons:

- It achieves the goal of simplifying the current test while retaining the most significant information inherent in an impairment model that users of financial statements have indicated they utilize.
- It is a more straightforward model for preparers to implement.
- As a one-step test, it appears convergent with IFRS.

**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?**

**Response**

Should Step 2 of the current goodwill impairment test no longer be required, we believe that it should also not be available as an option, since this would reduce comparability among preparers.

### 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?**

### Response

We are aware that the Board has sufficiently deliberated the issue, both currently and in prior years, and has concluded that it is not appropriate to prescribe an enterprise level test in applying ASC 350. The Basis for Conclusions of the proposed ASU states:

“Some Board members also thought that the “enterprise premise” might be difficult to apply given various interpretations of what constitutes a financing liability and pointed out that this approach is not precluded under current guidance.”

When performing the goodwill impairment test of a reporting unit (RU) with a zero or negative carrying amount, we believe that if an enterprise level test is possible, it should be applied, and this point could be clarified by the Board. Thus, an RU with a zero or negative carrying amount would not get an “automatic pass” of the impairment test.

Where an enterprise level test is not possible for an RU with a zero or negative carrying amount, we suggest including additional disclosures:

- 1) A discussion of the factors that have contributed to the zero or negative carrying amount of the RU; and,
- 2) A disclosure of the fair value (FV) of equity relative to the carrying amount of the RU. This would provide investors with some context to evaluate the financial position of the RU and its impairment risk.

### 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?**

### Response

We agree with the disclosures proposed in 350-20-50-1A regarding the existence of RUs with zero or negative carrying amounts and amount of goodwill allocated to each. This would also encourage and provide an incentive for preparers to exercise increased care in allocating assets and liabilities to RUs.

Also please see the suggested additional disclosures in our response to Question 3.

### 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?**

#### **Response**

We think that this guidance should be retained, including the illustrations, as we have found them to be useful. Thus, it would be clear that what is currently on the balance sheet is being tested, even if market participants would price and sell the RU in a transaction with different tax attributes.

Furthermore, the examples also illustrate that the selection of a hypothetical transaction structure involves a determination of the “highest economic value” for the seller (i.e., a structure that is feasible and that would maximize the expected after-tax proceeds, as the entity would act in its economic best interest). The highest economic value to the seller is not the same basis as fair value – it is after the effect of transaction taxes and costs. It is possible for the highest economic value to the seller to be realized in a scenario in which the starting fair value (gross proceeds) is lower than in the alternative transaction structure.

We do not think any amendments are necessary. Relying exclusively on ASC 820 guidance would reduce available guidance and would potentially lead to diversity in practice.

#### **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?**

#### **Response**

No comment.

#### **Question 7**

**How much time would be necessary to adopt the amendments in this proposed Update? Should early adoption be permitted? Would the amount of time needed to apply the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities?**

#### **Response**

We think that the proposed changes do not appear costly or time consuming to implement.

#### **Question 8**

**Would the proposed amendments meet the Board’s objective of reducing the cost of the subsequent accounting for goodwill while maintaining the usefulness of the information provided to users of financial statements? Why or why not?**

## Response

We believe that the proposed amendments will meet the objective of reducing costs.

As stated earlier, they achieve the goal of simplifying the test while retaining the important information that users of financial statements have indicated they utilize.

As suggested in our response to Question 9, some additional disclosures around goodwill impairment could also be very useful.

## 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?**

## Response

We would suggest additional disclosures around goodwill impairment along the following lines:

- An explicit acknowledgment by a reporting entity when a Step 0 test (a qualitative goodwill impairment assessment) has been *applied and passed for a given RU*. Current disclosures about this issue are inconsistent among preparers and often difficult to discern.
- Also in the context of improving Step 0 disclosures, a disclosure of the timing (date/reporting period) of the last *quantitative analysis* for a RU to which a qualitative assessment was applied.

As to Phase 2 of the Board's project, we believe that a fair value-based impairment model is superior to amortization. A fair value-based impairment model does provide decision useful information (both confirmatory and other<sup>1</sup>) that would be lost in other models for the subsequent accounting of goodwill<sup>2</sup>. Furthermore, given the current market uncertainty and associated volatile economic environment, an impairment model would provide the greatest transparency and linkage to expected performance, when evaluated against other alternatives.

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<sup>1</sup> Goodwill impairment announcements are viewed as credit-negative/negative events. See, for example, the following announcements/news stories from the three major ratings agencies:

- <https://www.moodys.com/research/Moodys-Marubenis-Impairment-Charge-Is-Credit-Negative-But-Has-No-PR-317237>
- <https://www.moodys.com/research/Moodys-says-that-Leidos-goodwill-impairment-charge-is-a-negative-PR-308148>
- [http://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/6993981](http://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/6993981)
- <http://www.insurancenews.com.au/corporate/ratings-agencies-downgrade-qbe-after-loss-guidance>

<sup>2</sup> For example, a CFA Institute paper stated the following about amortization: "What this [amortization] approach fails to consider is the loss of information for investors. Goodwill write-offs, if done in a timely manner, are of interest to investors in terms of the signal they send about the value of the company's intangible assets, the company's future earnings prospects, and an assessment of the amounts paid for acquisitions", *Addressing Financial Reporting Complexity: Investor Perspectives, Separate Private Company Accounting and Beyond*, January 2015. ISBN: 978-0-938367-99-4

Compared to an impairment model, a write-off of goodwill provides no useful information, no accountability, is difficult to interpret, and is disconnected from the economics underpinning a transaction. It is reminiscent of the days when acquired IPR&D used to be written off immediately in a business combination. Modern economies, even more so today than in the recent decades, are largely based on intellectual property. A goodwill write-off model would go counter to the very essence of such modern economies where intangible assets – including unrecognized future intangibles subsumed in goodwill, which buyers pay for in acquisitions – drive the value creation process.

Likewise, compared to an impairment model, amortization does not provide any incremental information, as it is merely an allocation of historical cost. Furthermore, the choice of amortization life could range from subjective to plain arbitrary, and if a useful life for goodwill is prescribed, the carrying amount of goodwill would generally be a function of the elapsed time since the acquisition was made; both of these would reduce comparability among preparers.

The nature and mechanics of pricing a transaction inherently assumes that the value creation process continues well beyond any *artificial life* for goodwill. Entities enter into acquisitions with the intent of meeting – if not exceeding – the expectations used to establish the purchase price. Goodwill captures the expectation that the target entity will continue to develop future assets and contribute to overall value creation. If an entity were to simply meet their expectations and projections, there should be no impairment of goodwill. Impairments are the result of underperforming transactions or unexpected events. These events are far better suited for measurement with an impairment model rather than an amortization model.

#### 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)?**

#### Response

We are not aware of any unintended consequences.

#### Other Observations & Suggestions

Par. 350-20-35-57A of the proposal slightly changes the wording around the determination of the FV of a RU that is less than wholly owned by making a specific reference to including any portion attributed to non-controlling interest (NCI).

It would be clearer if the guidance stated that the RU FV is determined *as if wholly owned*. The specific reference to NCI in the proposed changes might cause one to think that the FV of NCI is added to the FV of the entity-owned portion of the RU, which may lead to a different valuation result in aggregate than if the approach to the FV measurement of the RU was described *as if wholly owned*.

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

Sincerely,



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