

Private Company Financial Reporting Committee

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Judith H. O'Dell CPA CVA
Chair

November 3, 2010

Ms. Leslie Seidman
Acting Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Re: Proposed Accounting Standards Update, *How the Carrying Amount of a Reporting Unit Should Be Calculated When Performing Step 1 of the Goodwill Impairment Test* (“proposed ASU”)

Dear Ms. Seidman:

The Private Company Financial Reporting Committee has reviewed the proposed ASU and offers the following recommendations and comments.

The PCFRC is strongly supportive of the changes to step 1 of the impairment analysis under Accounting Standards Codification (“ASC”) 350 for entities with zero or negative carrying values. However, for the reasons set forth below, the PCFRC recommends that changes in the Proposed ASU for entities with negative equity amounts should be expanded to all private entities.

Private entities with negative equity (or carrying amounts) are common. These entities are not necessarily entities undergoing distress or having a negative financial outlook. Private entities will often choose to capitalize themselves with related party debt as opposed to retaining equity. This can lead to negative equity in a viable, successful operating company.

The intention of step 1 of the goodwill impairment test under ASC 350 is to act as a cost screen to avoid the more costly Step 2 of the ASC 350 goodwill impairment analysis. The PCFRC believes that this cost screen may effectively function for public companies but does not function effectively for private companies.¹ Rather, the costly requirement

¹ It should be noted, however, that a multiyear study of Public Company Accounting Oversight Board (“PCAOB”) fair value related inspection findings of the largest accounting firms found that the top fair value issue noted was goodwill impairment, with 27 PCAOB inspection findings. (see exhibit from 2009 AICPA Fair Value Measurements

to annually determine the fair value of the equity of a private company has contributed to the dissatisfaction amongst private company users, preparers, and auditors with current standards setting. Public companies have the benefit of a market capitalization to reconcile back to when making determination of the fair value for step 1 of the goodwill impairment analysis. In fact, a market capitalization reconciliation is often required by the Securities and Exchange Commission. A private company does not have access to a Level 1 input on the fair value of its equity. The determination of the fair value of the equity of a private company can be an extremely time-consuming and costly exercise for which many users, preparers, and auditors question the benefit.

Goodwill impairments are generally not relevant to users of private company financial statements. These users are typically focused on cash flow and tangible assets. Unlike other areas of accounting that utilize fair value measurements, goodwill impairment provides little or no information about future cash flows. User apathy and preparer frustration with cost has created an environment in which it is challenging for auditors of private companies to uphold the standards set forth by the FASB.

The PCFRC believes that the qualitative factors set forth in the proposed ASU are a significant improvement in financial reporting for private companies. However, the PCFRC questions why a seemingly artificial distinction has been made to limit the use of these qualitative factors to only those entities with zero or negative carrying amounts. It doesn't appear that any theoretical justification exists for an entity with \$1 of equity to be required to determine the fair value of its equity but an entity with zero or negative equity would be permitted to use the qualitative factors.

The magnitude of the issue of cost for a private company under the current step 1 of the goodwill impairment is so large that the PCFRC has been told by some private companies that they will intentionally create negative carrying value in order to avail themselves of the relief in the proposed ASU. This will be accomplished by journal entries to debit distributions and to credit shareholder loans. Economically, this will leave the private company capital structure in the identical position, however, the relief from the costly fair value determination will provide real cash savings. We feel that the FASB should not be creating standards with this type of bias in the capital structure.

The PCFRC is aware of arguments raised by FASB members about differential accounting on recognition and measurement issues for public and private companies. However, in this case the difference we are seeking is not a recognition or measurement issue as the ultimate impairment under ASC 350 would still be determined by a step 2 analysis. Rather, the difference is a separate cost screen that is more responsive to the unique issues posed by determining the fair value of a private company's equity, specifically the lack of Level 1 inputs. As the FASB is aware, IFRS for SMEs has differential accounting for goodwill. We are not currently advocating that the FASB converge goodwill accounting with IFRS for SMEs. However, we would like

Conference) We cite this as evidence of the difficulty inherent in the current impairment process under ASC 350. This difficulty is further compounded for private companies because of the lack of Level 1 inputs to the determination of the fair value of equity.

to point out that other standard setters have recognized the unique challenges in goodwill accounting for private companies and provided standards that were responsive to those needs. We hope that the FASB will take the opportunity to address these issues for private companies in the United States.

Answers to Specific Respondent Questions

Respondent Question 1: *Do you agree that the equity premise should be the only permissible methodology for Step 1 of the goodwill impairment test? If not, why not?*

PCFRC Response: Many private companies were following the enterprise value premise for determination of the carrying value. The Working Group of the EITF identified several industries where the enterprise value premise would not be operational. Assuming this is true, the PCFRC agrees that the equity premise is the only permissible methodology.

Respondent Question 2: *Do you agree with the qualitative factors that have been provided for reporting units with zero or negative carrying amounts to consider in determining whether it is more likely than not that a goodwill impairment exists? If not, why not? Are there additional factors that also should be included?*

PCFRC Response: The PCFRC agrees that these factors are adequate but also notes, as discussed above, that private entities with positive equity should be able to use these factors for Step 1 of the goodwill impairment test instead of the costly fair value determination.

Respondent Question 3: *Do you need more guidance on how to determine if it is more likely than not that goodwill is impaired at transition? If so, please describe what may be helpful with that determination.*

PCFRC Response: The PCFRC believes the guidance is adequate.

Respondent Question 4: *For reporting entities that have used an enterprise premise to calculate the carrying amount of a reporting entity for Step 1 of the goodwill impairment test, do you believe that applying the amendments in this proposed Update would result in different conclusions about the need to perform Step 2? If so, please describe such scenarios.*

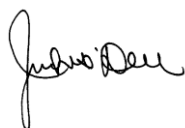
PCFRC Response: The current Step 1 of the goodwill impairment test is a prescriptive calculation when using the enterprise premise. It is possible that in cases where fair value slightly exceeds or is slightly less than carrying value different determination may be made than when applying the qualitative approach in the amendments. However, the PCFRC does not believe that these differences are relevant to users of private company financial statements.

Respondent Question 5: *Do you agree with the proposed effective dates for public and non-public entities? Are they operational? If not, why not?*

PCFRC Response: By issuing this document, the FASB has implicitly sanctioned that current standards can be read to permit an entity with negative equity as automatically passing Step 1 of the goodwill impairment test. The PCFRC is concerned that some entities may try to take advantage of this “loophole” during the next two reporting cycles. We understand that this situation is an unavoidable consequence of the due process that the FASB undertakes. The PCFRC believes that the consequences of this situation may be minimized by permitting early adoption upon issuance. This would provide an alternative in the interim periods before the mandatory effective date which is more consistent with the original intent of the FASB.

The PCFRC appreciates the FASB’s consideration of this letter. Please feel free to contact me if you have any questions or comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Judith H. O'Dell". The signature is fluid and cursive, with a large initial "J" and "O".

Judith H. O'Dell
Chair
Private Company Financial Reporting Committee