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Mr. Shayne Kohaneck  
Technical Director  
Financial Accounting Standards Board  
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Schwyz, Oct 6th, 2019

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**File Reference No. 2019-720  
Identifiable Intangible Assets and Subsequent Accounting for Goodwill  
Comment Letter**

Dear Mr. Konaheck:

I appreciate the opportunity to comment on the Board's Invitation to Comment, Identifiable Intangible Assets and Subsequent Accounting for Goodwill (the "ITC"). This letter is to comment on certain questions raised in the ITC.

I am neither a preparer, nor an auditor, regulator, investor or equity analyst. The firm I represent analyses purchase price allocations from public companies worldwide, and provides such information in a structured database ([www.markables.net](http://www.markables.net)) to interested users. Our users are active in transaction advisory services, valuation, tax, and litigation. As of this day, we have approximately 5.350 registered users worldwide. Auditors are among our regular users, preparers and regulators are not.

To build and update this database, we browse the financial reporting of approximately 13,500 listed companies worldwide once every year, to locate purchase price allocations that we can use for our database. Through this process, we qualify approx. 1,500 new PPAs every year and add them to our database of over 12,000 different cases. To be very clear: our browsing yields many more PPAs reported in one way or another in financial statements. Many of them are however useless for our purposes.

In my capacity described above, I have seen, read, analyzed and tried to comprehend many thousands of PPAs. I believe I have a profound overview of what is reported in PPAs, and what it is

useful for or not. In this capacity, I am pleased to provide my responses below to selected of the 29 questions in the ITC.

I would be pleased to answer any questions that the FASB staff or the Board may have. Please do not hesitate to contact me directly regarding this submission.

Yours sincerely,

A handwritten signature in blue ink that reads "Ch. Binder". The signature is written in a cursive, flowing style.

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1. What is goodwill, or in your experience what does goodwill mainly represent?

The most frequent justifications for goodwill that can be found in financial statements relate to synergies and acquired workforce, and typically read like this: “Goodwill recognized is attributable primarily to the **acquired workforce, expected synergies**, and other benefits that ...” Such explanations pay tribute to the disclosure guidance outlined in accounting standards (SFAS141R: “a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations, intangible assets that do not qualify for separate recognition or other factors”) but are hardly suited to explain goodwill.

In our database, we can analyze how goodwill relates to **synergies** in cases where synergies have been reported in the form of expected pre-tax run rate cost synergies. Such synergies are often reported for acquisitions of listed companies, or for larger acquisitions.

As of the acquisition/valuation date, synergies are not yet realized and cannot be factored into the value of existing (identifiable, separable) assets. Conceptually, the value of synergies must be reflected in goodwill, or (in parts) beyond the PPA in the form of (unrecognized) underpayment.

One challenge is how to translate an annual run rate of expected (pre-tax) synergies into a present value. This is a function of discounting, tax deductibility, one-time expenses and time lapsed to fully achieve synergies. Full run-rate synergies are typically achieved in years 2 or 3 after acquisition, and one-time expenses are often in the area of one year of full run rate synergies. We have approximated the net value of synergies as expected run rate of synergies times 10. This factor compares to an average 14x EBITDA multiple of enterprise value paid in acquisitions, and accounts for one-time expenses and delays.

In our dataset, we find the following distribution of net present value of synergies to goodwill ratios for US issuers:

	NPV of synergies / goodwill (in percent)
25% quartile	42%
Median	79%
75% quartile	157%
Mean	184%
Sample size: 336 business combinations reported by US issuers	

In 38% of the cases, synergies have a higher value than goodwill – which would mean that the value of identifiable intangibles was overstated, or that the acquisition was underpriced, or both. In 30% of the cases, the value of synergies is less than 50% of the value of goodwill, thus explains goodwill only in minor parts. This distribution illustrates that expected synergies and goodwill show little if any correlation.

We can also analyze how goodwill reported in acquisition relates to the **acquired workforce**. If valued separately which is reported in few cases, the value of an acquired workforce is typically calculated as the cost of its replacement, including cost to find, hire and train individuals, and to get the whole new workforce to the same productivity level. Under such approach, average replacement cost per employee typically ranges from 0.5x to 1.25x annual salary.

In reality, average goodwill per employee is far higher than its cost of replacement. In our dataset, we find the following distribution of goodwill per employee ratios for US issuers:

	GW / employee in kUSD
25% quartile	102.6
Median	260.6
75% quartile	596.9
Mean	541.4
Sample size: 1.356 business combinations reported by US issuers	

This distribution illustrates that the two measures “reported goodwill per employee” and “replacement cost per employee” do not match. In reporting reality, the lowest 10% of the values are less than 37 kUSD. The highest 60% of all values are above 250 kUSD. So, it is very hard to explain goodwill in at least 70% of the cases with the replacement cost of the acquired workforce.

In conclusion, the most often reported justifications of goodwill – assembled workforce and synergies – prove to be of little relevance in valuation reality. What then is goodwill?

In my view, the **going concern** principle is important for the understanding of goodwill. An enterprise is expected to generate cash flows for an indefinite term. Businesses need assets to generate returns. All assets of a business wear out, and are constantly maintained and/or renewed. An existing customer relation may end, and the business tries to get new customers all the time. An older product is phased out, and a new product is added to the range. An old, ineffective business process is replaced by a more effective one. The asset portfolio of a business is under a constant process of change and renewal. Under a going concern concept, goodwill describes the ability of an organization to replace worn-out intangible assets. To survive or grow, a business continuously needs to renew its products, to find new customers, to reposition its brands, and to streamline its organization and cost base. The need to innovate and change is permanent. **Goodwill describes the ability of a business – more precisely of its people (both management and workforce) - to cope with the challenges of the future, and to transform these challenges into identifiable and separable future assets.**

In reality, there is a strong (negative) **correlation** between goodwill, and the **useful life** of identifiable intangible assets. The average useful life of recognized intangible assets is 12 years. This means, that on average all intangible assets must be replaced after or before 12 years to continue the business. The lower the useful lives of identifiable intangibles, the higher the need to replace them rather soon, and the higher the amount of required goodwill to achieve this. Also, there is a strong (positive) correlation between goodwill, and the sector **dynamics** of the subject business. A tobacco business or a liquor business are rather non-dynamic. Consumption is stable, the product range and packaging variants are also quite constant. Therefore, businesses like Altria or Absolut Vodka would have a high share of identifiable intangibles, and a low share of goodwill. A firm like Apple replaces its full product range every five years. They don't know yet what exactly they are going to sell in five years, and to whom. Their existing intangible assets have rather short lives, resulting in a higher share of goodwill. And still, Apple is a very established business with some stability. There are much more dynamic businesses than Apple. Simply think of high-techs and start-ups.

4. If the Board were to decide to amortize goodwill, which amortization period characteristics would you support? Please include all that apply in your response and explain why you did not select certain characteristics.

Considering the negative correlation between goodwill and useful life of identifiable intangible assets, alternatives

*e. Amortization based on the useful life of the primary identifiable asset acquired*

*f. Amortization based on the weighted-average useful lives of identifiable asset(s) acquired*

would be clearly counterproductive.

I would expect most issuers to opt for a long amortization period of 40 or 50 years.

*6. Regarding the goodwill amortization period, would equity investors receive decision-useful information when an entity justifies an amortization period other than a default period? If so, does the benefit of this information justify the cost (whether operational or other types of costs)? Please explain.*

A requirement for issuers to justify assumptions related to useful life is not new. I.e. issuers are required to explain why they assigned an indefinite life to a particular asset, i.e. to trade names. Such justifications are often blank (“management intends to continue to use the trade name for an indefinite period”) and provide no decision-useful information at all, i.e. about the history and strength of the tradename, obsolescence rates in the sector, etc. It is hard to imagine why this would be different for the useful life of goodwill, unless the regulatory requirements for such justifications are precise and tight, and will be closely monitored by institutions like SEC and PCAOB.

*13. Please describe what, if any, cost savings would be achieved if certain recognized intangible assets (for example, noncompete agreements or certain customer-related intangible assets) were subsumed into goodwill and amortized. Please be as specific as possible. For example, include specific purchase price allocation or subsequent accounting cost savings. Please list any additional intangible items the Board should consider subsuming into goodwill.*

On page 15, the ITC conveys the notion of a trend of an **increasing proportion** of intangible assets in business combinations over time (“this trend has continued”), eventually resulting in **increased cost** to recognize them. From our database, I cannot confirm such trend. Neither the share of identifiable intangibles, nor their number, have substantially increased. The share of goodwill in PPAs has been remarkably stable over the last 15 years (except for the post-crisis year when acquisition prices were down). The share of identifiable intangibles increased very slightly from 39% to 43% in our (global) sample. Hard to imagine that this increase resulted in substantially increased cost for their valuation and recognition. To the same effect, non-interest-bearing liabilities have increased, and eventually the cost to value them. Should we consider this as a reason to no longer recognize them?

Also, I am not aware of valuers who talk about increasing **fees** they receive for purchase price allocations; it is rather the opposite. If there is an issue of cost with the recognition of intangible assets, this issue is 15 years old and did rather not increase. Subsuming particular intangibles assets under goodwill would have no significant effect on costs.

Moreover, cost arguments brought forward against PPAs are often double language. Some of those who complain about high cost perform the valuations for other purposes anyway. Today, doing **pre-deal PPAs** during the due diligence phase is a standard exercise for most acquirors. The pre-deal PPA helps to develop a better understanding of the returns and risks of (intangible) assets that are acquired, and to model the impact of the acquisition on future balance sheets, P&L and cash flows. Further, valuations of intangible assets for **tax** purposes are also standard, to optimize tax deductibility. I am not saying that these valuations can be used 1:1 in the PPA. But they rely on the same basics as the PPA valuation, thereby reducing the effective cost of the PPA.

Overall, I believe that cost savings effectively achieved from subsuming intangible assets into goodwill are minor if not negligible.

*16. To gauge the market activity, are you aware of instances in which any recognized intangible assets are sold outside a business acquisition? If so, how often does this occur? Please explain.*

First and foremost, the criterion for intangible assets to be both recognizable and useful/meaningful is that they can be bought/sold outside a business acquisition. I am not aware that NCAs are bought and

sold on a stand-alone basis. However, all other intangible assets, like customer relations, trade names and brands, technology and patents, software, databases, copyrights, licenses and concessions - to name the most frequent classes of intangible assets - are effectively bought and sold independently.

The board inquires about the **market activity** with such assets. Personally, I have assisted in the stand-alone sale of numerous trademarks. I have also assisted in some cases in the sale/acquisition of the customer relations of the former trademark licensee if the license was not renewed but granted to a new licensee. I am aware of numerous acquisitions of customer portfolios in insolvency procedures.

Although reporting requirements for the acquisition of such stand-alone intangible assets are weak (compared to business combinations), we often find them in financial statements. In most cases, we see in the intangible asset section that a certain amount was spent to acquire a particular intangible asset (trademarks, customer lists, software, knowhow/technology) outside a business combination, but such acquisitions typically remain unexplained beyond the dollar amount spent. So, we don't know what exactly was acquired, who was the seller, etc.

Although difficult, I would estimate that the number of stand-alone intangible asset transactions is similar to the number of business combinations. In terms of deal value, stand-alone intangible assets are certainly much less than intangibles in business combinations. Those stand-alone intangible asset transactions that are explained in the comments are however quite important. We have 109 trademark only deals on file, with an average purchase price of US\$ 81 million (which is very important). What is more, we observe that approximately 5% of all business acquisitions are dominated by one particular intangible asset which accounts for 75% or more of the total deal value. Overall, I have no doubts that the market activity of stand-alone and near-stand-alone intangibles is substantial.

*15. How reliable is the measurement of certain recognized intangible assets (for example, noncompete agreements or certain customer-related intangible assets)?*

Measuring the value of intangible assets will never be an exact exercise, for the unique nature of intangibles. Further, the results of the measurement remain untested. So, how do we know or judge if it is reliable or not?

I agree that some intangible assets are more difficult to measure than others. Noncompete agreements are difficult to separate and to measure, and of minor importance in a PPA. Customer-related intangible assets have a high importance and are measured in almost all PPAs. The methods to value them are well developed and described. Their measurement is certainly more reliable than that of **NCA**s.

For other intangible assets and generally speaking, what is the **reference** for their measurement to be considered reliable or not? From my perspective, I would like to provide two clues.

We observe that the results of PPA valuations have become considerably more **consistent** over time. Consistency in this context means the variance of the allocation of the excess amount to various intangible assets and goodwill. In sector-specific peer group analyses we observe that both the number and the distance of statistical **outliers** has decreased over time. We analyze outliers in particular for trade names, customer relations and goodwill. Overall, the number of outliers is <5%. The improvement over time is certainly a result of increased collective experience, education and standards.

Another clue for reliability of measurement is the number and extent of non-regular **impairments**. If the measurement was unreliable, management or audit would observe this sometime later, and impair the asset. From many thousands of financial statements I browse every year, I cannot confirm that there is a significant impairment activity for recognized intangible assets. Even for indefinite lived

trademarks, impairment is surprisingly rare and low. For finite-lived intangible assets, it is close to negligible.

14. Please describe what, if any, decision-useful information would be lost if certain recognized intangible assets (for example, noncompete agreements or certain customer-related intangible assets, or other items) were subsumed into goodwill and amortized. Please be as specific as possible. For example, include specific analyses you perform that no longer would be possible.

As I said before, **NCAs** cannot be considered as separable intangibles assets. I feel sympathy towards not recognizing this particular asset. NCAs prevent key employees to exploit specific knowhow and trade secrets on behalf of competitors. NCAs are – in effect – some sort of securitization of other unsecured assets, in particular customer relations and unpatented technology. Instead of recognizing NCAs, their existence or nonexistence is better reflected in the discount rates or attrition rates applied to future revenues or returns from unsecured assets. Therefore, abandoning NCAs as separable intangible assets would not constitute a major loss of decision-useful information. Beyond NCAs, I am not aware of any other intangible asset which could be abandoned without losing substantial information.

Nobody doubts that the **importance of intangibles** as both assets and value drivers has increased very substantially over time. The understanding of such assets, the investments required to build and/or maintain their value, and the returns they generate, is of vital importance.

PPAs are the major source of the existing **collective knowledge** and **experience** to value intangible assets. Since the early days 20 years ago, this collective knowledge grew enormously. And with it the standards, methods and quality of the valuations. Without PPA valuations, collective knowledge would be far less. I am far from saying that this collective knowledge has achieved perfection. But the good thing is that it is constantly improving. Reducing or abandoning the recognition of identifiable intangible assets in PPAs would have destructive effects on this collective knowledge. And this would not only affect financial reporting and equity investment decisions, but also pre-deal valuations, tax valuations, litigation valuations, and securitization valuations. Too bad for the future of corporate finance, value-based management and investments in intangible assets.

M&A/business combinations are the most important investments companies can make. Various **academic research** has found that **PPA disclosures are useful and relevant** for investors' decisions.<sup>1</sup> One particular aspect of such research is the concept of "abnormal goodwill" which is highly relevant for investors' decisions. Subsuming identifiable intangible assets under goodwill would result in increased goodwill, and more frequent cases of abnormal goodwill, with negative effect on stock prices and shareholder return. It is in issuer's own interest to provide detailed and structured disclosures of their PPAs, including all identifiable intangible assets.

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<sup>1</sup> To list a few:

- *Anne Jeny, Luc Paugam and Pierre Astolfi*: The usefulness of intangible assets' disclosure for financial analysts. Insights from Purchase Price Allocation conditional on deal quality, *Comptabilité - Contrôle - Audit*, 2019, vol. 25, issue 2, 5-53.
- *Pierre Astolfi, Luc Paugam and Olivier Ramond*: Accounting for business combinations: Do purchase price allocations matter?, *Journal of Accounting and Public Policy*, Elsevier, 2015 07.
- *John McInnis and Brian Monsen*: The Operating Returns to Acquired Intangible Assets, Feb 20 2019.
- *Shin Hyoung Kwon and Guannan Wang*: The change in the value relevance of accounting information after mergers and acquisitions: evidence from the adoption of SFAS 141(R), *Accounting & Finance*, Oct 2018.
- *Ron Shalev*: The Information Content of Business Combination Disclosure Level, *THE ACCOUNTING REVIEW* Vol. 84, No. 1, 2009, pp. 239–270.

Rather than reducing the disclosure level of PPAs, I would like to encourage FASB to think about increasing it. This does not mean the valuations themselves, but the **level of details** from the valuations that make into the disclosure in the financial statements, and the **delays**. This could be achieved at no or little additional cost, and substantially increase the level of usefulness of PPA disclosures.

There is a big difference between what we see in a PPA disclosure, and what we don't see. Sadly, the majority of issuers still hide **details** which are important for the PPA disclosure to be useful. Accordingly, PPAs are often condensed horizontally and/or vertically. Horizontally means that several acquisitions made throughout the reporting period are summed up into one. Vertically means that the different line items of a PPA are summed up, i.e. "intangible assets" are not reported in single asset classes, or in a caption containing different elements like "trademarks and patents", or in the "other intangibles" caption. Such compression still prevails in PPA disclosures, rendering their informational content often useless. The majority of all PPA disclosures is compressed in one way or another.

Another area to improve decision-usefulness is the **measurement period** (12 months from the acquisition date). Some issuers disclose the final PPA in their quarterly statement following the acquisition date. There is ample evidence that this is possible. Other issuers disclose the final PPA only in the annual statement at the end of the year following the acquisition year. In the worst case, an acquisition happens in January of year 1, and the final PPA is disclosed in March of year 3. Most are somewhere in between. In any case, PPA information disclosed 12 months after the deal lost much of its relevance for investment decisions.

Even if PPAs are disclosed early and in detail, there are huge differences regarding their informational content. Beyond the value of the different (intangible) assets, a PPA involves liabilities, useful lives, attrition rates, royalty rates, discount rates, tax deductibility, pro-forma information about revenues and profits, and more. Some issuers have an open information policy towards their audience and stakeholders, some are very restrictive. Restrictive disclosures should not be misconceived as a lack of decision-usefulness of the valuing.

Finally, how do we know if a PPA – and the related measurements of intangible assets – is reliable, accurate and decision-useful? This is the same question as for the value of a business, real estate or any other asset. We are used to **compare** it with similar cases. It is from such references to **comparable or similar cases** that we conclude if a value is realistic, optimistic (high), conservative (low), or outside the usual range (outlier). This comparison is the last element to make a PPA decision-useful. Finding such comparable PPAs requires either a deep rooting in a particular sector, or a structured database which provides such data. Several of such databases do exist. For valuers, making use of past PPAs for their valuations is widespread and popular. For auditors, this is rather new, but they are getting increasingly acquainted. For analysts and investors, this is largely unknown territory. Motivating them to do more of such comparative analyses would certainly improve their understanding of PPAs and their perception of the usefulness of PPA disclosures.

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