

**Goodwill and Other Intangible Assets: An Exploratory Study
into the Effectiveness of the Accounting Standards Codification**

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INTRODUCTION

Financial statements are one of the primary tools used to assess a company's performance and financial health. Maintaining clear financial statements is important not only for the company itself but also for other stakeholders, such as agencies and investors. To regulate classification, valuation, and disclosure practices for financial matters, entities are required to abide by authoritative U.S. generally accepted accounting principles (U.S. GAAP), as set forth in the Accounting Standards Codification (ASC or Codification). Before 2009, there was a hierarchy for selecting accounting principles to be used in preparing financial statements, including issuances beyond statements made by the Financial Accounting Standards Board (FASB).¹ Applicable literature was difficult to access given the multitude of policy boards releasing statements. In 2009, the Financial Accounting Standards Board introduced the Accounting Standards Codification as the "single official source of authoritative, nongovernmental U.S. generally accepted accounting principles."² Producing the Codification was a major undertaking involving more than 200 individuals and taking over five years to complete.³ However, the introduction of the Codification was a successful milestone in accounting standards. With this structural overhaul, all authoritative U.S. GAAP can be easily accessed in one spot, reducing time and complexity in financial reporting.

FINANCIAL ACCOUNTING STANDARDS BOARD (FASB)

The Financial Accounting Standards Board is a not-for-profit organization recognized by the Securities and Exchange Commission "as the designated accounting standard setter for public

¹ FASB, Financial Accounting Standards Board. "FASB Issues Statement No. 162, The Hierarchy of Generally Accepted Accounting Principles." Accessed March 20, 2017. <http://www.fasb.org/news/nr050908fas162.shtml>.

² FASB, Financial Accounting Standards Board. "About the Codification." Accessed March 20, 2017. <https://asc.fasb.org/help&cid=1176163588636>.

³ Ibid.

companies.”⁴ Following U.S. GAAP principles, the FASB aims to establish or improve financial reporting standards in a way that provides stakeholders with useful financial information and enables entities to effectively implement those standards.⁵ In order to achieve this mission, the FASB is comprised of seven appointed individuals from diverse backgrounds that typically serve five year terms, but are allowed to serve up to ten years. Maintaining diverse perspectives is essential to ensure that the public’s interests are properly represented and the best accounting solutions are achieved. To provide additional guidance on more technical aspects or particular sectors, there are several advisory groups that report to the FASB. Table 1 details the groups and their purpose.

Table 1: FASB Advisory Groups

Group	Description
Financial Accounting Standards Advisory Council (FASAC)	Advises the FASB on technical issues on the Board’s agenda, possible new agenda items, project priorities, procedural matters that may require the attention of the FASB, and other matters as may be requested by the FASB or its chairman.
Investor Advisory Committee (IAC)	Provides advice, from the investors’ perspective, on current and potential FASB agenda projects.
Not-for-Profit Advisory Committee (NAC)	Provides advice on existing guidance, current and proposed technical agenda projects, and longer-term issues related to the not-for-profit sector.
Small Business Advisory Committee (SBAC)	Provides advice on FASB projects related to the operationally and the anticipated costs, complexities, and benefits of potential solutions principally from a small public company perspective.
Private Company Council (PCC)	Advises the FASB on private company matters. The PCC uses the Private Company Decision-Making Framework to advise the FASB on the appropriate accounting treatment for private companies for items under active consideration on the FASB’s technical agenda. The PCC also advises the FASB on possible alternatives within GAAP to address the needs of users of private

⁴ FASB, Financial Accounting Standards Board. “About the FASB.” Accessed March 20, 2017. <http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176154526495>.

⁵ Ibid.

Emerging Issues Task Force (EITF)	<p>company financial statements. Any PCC proposed changes are subject to endorsement by the FASB.</p> <p>Assists the FASB in improving financial reporting through the timely identification, discussion, and resolution of financial accounting issues within the FASB Accounting Standards Codification.</p> <p>Any EITF proposed changes are subject to endorsement by the FASB.</p>
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Source: FASB.org – About the FASB⁶

Two of the six advisory groups help the FASB implement new standards pertaining to accounting for goodwill and intangible assets. The Private Company Council assists the FASB in releasing two new updates in 2014 and 2016, while the Emerging Issues Task Force assists the FASB in releasing a new update in 2010.

ASC Updates

Due to the nature of our evolving business world, the FASB is constantly working to update the accounting standards to reflect issues or concerns as noted by the Board, advisory groups, or outside entities. To enact changes and modifications to U.S. GAAP, the FASB issues an Accounting Standards Update (Update or ASU). An Accounting Standards Update does not serve as a form authoritative guidance, but rather is an informative document used to communicate the amendments made to GAAP and the Codification, the rationale behind the FASB's decision, and the timing implications for adopting these modified standards.⁷ Unless early adoption is permitted, these amendments do not become authoritative standards until the effective date.

⁶ Ibid.

⁷ FASB, Financial Accounting Standards Board. "Accounting Standards Updates Issued." Accessed March 22, 2017. <http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156316498>.

SECURITIES AND EXCHANGE COMMISSION (SEC)

Much like the FASB, the Securities and Exchange Commission (SEC) serves to uphold a three-pronged mission statement: protect investors, maintain fair, orderly, and efficient markets, and facilitate capital information.⁸ However, the two operate as distinct entities, both playing a vital role in financial accounting. The SEC's primary function is to serve as a federal regulator, overseeing the actions and financial reporting of publicly traded entities. Relevant portions of SEC guidance are included in the Codification, but the FASB regulates and controls the Accounting Standards Codification. The SEC relies on the FASB to develop, maintain, and update the Codification with applicable U.S. GAAP regulations to keep financial reporting fair and accurate. However, while the FASB has the power to set the standards, the SEC maintains the power to enforce the standards. Although occurring infrequently, the SEC has the ability to make the FASB change guidance in the Codification. For example, in March 2016 the FASB released ASU 2016-11 which reflects the SEC's decision to rescind certain SEC observer comments as codified in Topic 605, Revenue Recognition, and Topic 932, Extractive Activities—Oil and Gas.⁹ These amendments to U.S. GAAP were issued to update the Codification to reflect current market transactions for revenue recognition and hedge accounting.¹⁰

⁸ U.S. Securities and Exchange Commission. "What We Do." Accessed March 20, 2017. <https://www.sec.gov/Article/whatwedo.html>.

⁹ FASB, Financial Accounting Standards Board. "Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting." Accessed April 14, 2017. http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176168115180&acceptedDisclaimer=true.

¹⁰ Thomson Reuters Tax & Accounting. "U.S. GAAP Updated to Reflect SEC's Removal of Some EITF Guidance for Hedging, Revenue Recognition." Accessed May 6, 2017. <https://tax.thomsonreuters.com/media-resources/news-media-resources/checkpoint-news/daily-newsstand/u-s-gaap-updated-to-reflect-secs-removal-of-some-eitf-guidance-for-hedging-revenue-recognition/>.

Comment Letters

One of the ways in which the SEC serves to protect public interest involves issuing comment letters. Broadly speaking, there are two types of “comment letters.” The first type of comment letter includes “public comment letters related to SEC rulemaking and regulatory actions” sent by concerned individuals or entities.¹¹ For purposes of this study, the term “comment letter” refers to the second type, which are letters exchanged between SEC staff and SEC filers “in connection with [the] review of disclosure filings.”¹² These letters serve to increase financial transparency and protect stakeholders by requesting reporting entities clarify or provide additional information pertaining to the issues discovered in the review. The SEC does not consider comment letters to be an official form of SEC expression, but rather nonbinding guidance on accounting rules and practices. SEC comment letters are not intended to result in an immediate restatement of financial statements. Rather, the purpose of these letters is to seek clarification and ensure accounting practices are being used appropriately. Steven Jacobs, an SEC official, stated that “too often, companies that receive a comment letter from the SEC rush to restate financial results without first discussing the matter with the reviewers.”¹³ In general, SEC comment letters require a thoughtful response addressing each of the questions or concerns raised by the SEC within ten business days; however, this is subject to an extension if additional time will enhance the quality of the response.¹⁴ The agency’s form of oversight helps

¹¹ U.S. Securities and Exchange Commission. “Fast Answers – Comment Letters.” Accessed March 20, 2017. <https://www.sec.gov/fast-answers/answerscommentlettershtm.html>.

¹² Ibid.

¹³ Leone, Marie. “How to Answer an SEC Comment Letter.” *CFO Magazine*, September 23, 2009. Accessed March 29, 2017. <http://ww2.cfo.com/accounting-tax/2009/09/how-to-answer-an-sec-comment-letter/>.

¹⁴ Ernst & Young. “Technical Line: 2016 trends in SEC comment letters.” September, 29, 2016, Accessed April 6, 2017. [http://www.ey.com/Publication/vwLUAssets/TechnicalLine_03099-161US_CommentsTrends_29September2016/\\$FILE/TechnicalLine_03099-161US_CommentsTrends_29September2016.pdf](http://www.ey.com/Publication/vwLUAssets/TechnicalLine_03099-161US_CommentsTrends_29September2016/$FILE/TechnicalLine_03099-161US_CommentsTrends_29September2016.pdf).

reduce the number of misleading financial statements, as entities are able to develop a better understanding of accounting methods and practices through conversation with the SEC.

According to the Sarbanes-Oxley Act of 2002, the SEC is required to review financial filings at least every three years.¹⁵ By reviewing statements with such frequency, there is less room for abuse and hopefully more accurate information is released to investors. Approximately “75% of the staff at the Division of Corporation Finance is dedicated to the filings review process,” allowing the SEC to regulate and scrutinize a significant volume of financial statements.¹⁶ In addition to reducing financial statement fraud, the SEC review process can be informative for assessing reporting entities’ level of understanding of the accounting standards. In this review process, comment letters are sent as necessary.

Although it is difficult to say if this holds true today, in 2008 it took the SEC an average of 25.2 days to review and comment (as necessary) on a company’s registration statements.¹⁷ Though the exact time cannot be determined, the reviews of 10-Ks occurred at the earliest 25 days following the file date, but could be much later. However, comments were always sent before the next fiscal year-end to provide for timely adjustments.

To get a better understanding of the timing for comment letters, an analysis conducted by Audit Analytics found that the average number of days to complete a conversation between the SEC and a particular SEC filer has decreased about 47% (from 86 days to 46 days) since 2010.¹⁸ In addition, the total number of conversations has significantly decreased, which could imply that either reporting entities are gaining a better understanding of U.S. GAAP standards or that

¹⁵ Sarbanes-Oxley Act of 2002. <https://www.sec.gov/about/laws/soa2002.pdf>.

¹⁶ Leone, Marie. “How to Answer an SEC Comment Letter.” *CFO Magazine*, September 23, 2009. Accessed March 29, 2017. <http://ww2.cfo.com/accounting-tax/2009/09/how-to-answer-an-sec-comment-letter/>.

¹⁷ Ibid.

¹⁸ Bonaldi, Joey. “Update on ‘SEC Comment Letters: A Five Year Trend’ (2015).” *Audit Analytics*, August 1, 2016. Accessed April 1, 2017. <http://www.auditanalytics.com/blog/update-on-sec-comment-letters-a-five-year-trend-2015/>.

the SEC may lack a sufficient budget to carry out its core responsibilities. According to past budget reports, the SEC's budget has only continued to increase since the financial crisis of 2008. However, the "SEC's jurisdiction has grown, along with the size and complexity of the markets and entities within it."¹⁹ This may contribute to the shorter conversations between the SEC and SEC filers, as the agency may be unable to spare as many resources on lengthy conversations during the review process.

For purposes of this study, the volume of SEC comment letters is used to address both the sensitivity of an accounting issue for stakeholders and the complexity of a particular accounting standard. A high volume of SEC comment letters pertaining to an accounting topic may imply that the SEC has placed a particular interest in that topic. Additionally, a high volume of SEC comment letters can imply that reporting entities have questions about how an accounting standard is applied, suggesting that the standard may be unclear or too complex.

MOTIVATION

The motivation for this study stems from accounting research conducted in the 2015-2016 academic year on the effectiveness of the Codification. The research focused on reporting entities' ability to understand the accounting standards and used comment letters as a measure of this level of understanding. The underlying theory was that if the SEC finds recurring issues in various companies' financial statements, one could infer that there is an issue with the Codification itself (i.e. Codification is unclear or misleading companies). This study expands on that concept using two additional measures and focusing on the topic of goodwill and intangible assets (see appendix for data collected from past research).

¹⁹ SEC. "Agency and Mission Information – Executive Summary (2016)." February, 2015. Accessed April 24, 2017. <https://www.sec.gov/about/reports/sec-fy2016-agency-mission-information.pdf>.

When selecting a topic, I considered both the frequency with which an area of concern was referenced as well as the consistency of references throughout the years. Selecting a rather contentious issue should provide a higher volume of comment letter data; however, some issues may be too complex by nature to appropriately analyze. According to reviews of comment letter trends provided by accounting firms, impairment of goodwill and other long-lived assets continues to be a focus of SEC comment letters. A report generated by Ernst & Young noted that intangible assets and goodwill accounted for 14% of the comment letters issued by the SEC in 2012 and 2013.²⁰ In 2014 and 2015, intangible assets and goodwill remained a frequent comment area but decreased to being 12% of all comment letters.²¹ Focusing on the past three years, Audit Analytics cites that intangible assets and goodwill account for 6.9%, 6.82%, and 8.19% of all comment letters in 2014, 2015, 2016, respectively.²² Intangible assets and goodwill proved to be a frequent comment area consistent with prior years, but not the top area of concern, thus, providing an appropriate focus for the current study.

The rationale behind choosing intangible assets and goodwill opposed to another area of concern lies in its sensitivity to adjustments to the Codification. Being a fairly complex topic that requires fair value estimates and projections of future economic benefits, accounting for goodwill can be difficult and is always subjective. By providing guidance for reporting entities, some of the complexity may be mitigated resulting in more accurate financial disclosures. As entities adopt these updated standards, this study assumes that the volume of SEC comment

²⁰ Ernst & Young. "SEC Comments and Trends: 2013 supplement – an update of current reporting issues." September, 2013. Accessed April 1, 2017.

[http://www.ey.com/Publication/vwLUAssets/SECCommentsTrends_CC0376_September2013/\\$FILE/SECComment sTrends_CC0376_September2013.pdf](http://www.ey.com/Publication/vwLUAssets/SECCommentsTrends_CC0376_September2013/$FILE/SECComment sTrends_CC0376_September2013.pdf).

²¹ Ernst & Young. "Technical Line: 2015 trends in SEC comment letters." September, 24, 2015, Accessed April 6, 2017. [http://www.ey.com/publication/vwluassetsdld/technicalline_cc0420_commentsandtrends_24september2015/\\$file/technicalline_cc0420_commentsandtrends_24september2015.pdf?OpenElement](http://www.ey.com/publication/vwluassetsdld/technicalline_cc0420_commentsandtrends_24september2015/$file/technicalline_cc0420_commentsandtrends_24september2015.pdf?OpenElement).

²² McKeon, Jessica. "SEC Comment Letters: A Look at Top Issues in 2016." *Audit Analytics*, December 12, 2016. Accessed April 1, 2017. <http://www.auditanalytics.com/blog/sec-comment-letters-a-look-at-top-issues-in-2016/>.

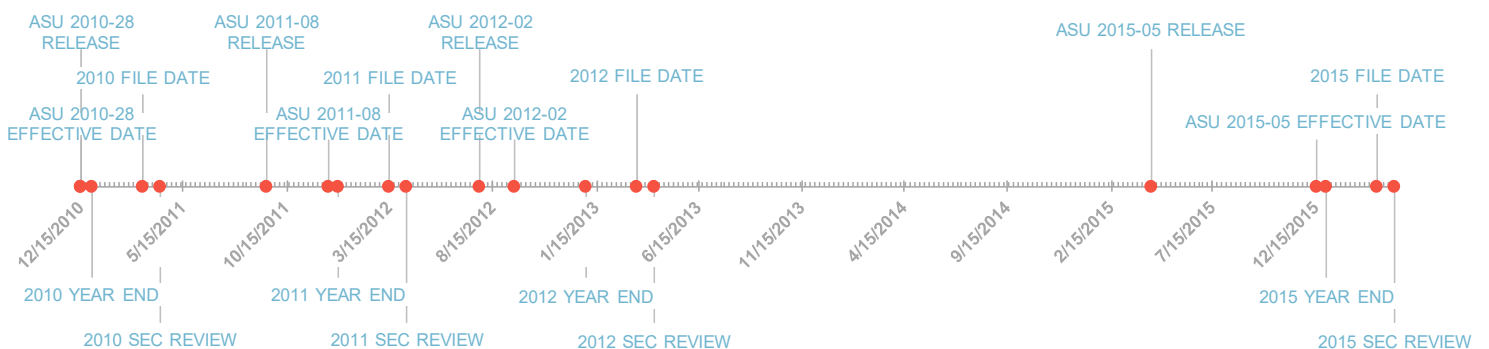
letters, issuances of financial restatements, and modifications in financial statement data should indicate each update's effectiveness.

TIMING CONSIDERATIONS

After choosing to analyze the impact of Accounting Standards Updates to Topic 350, the timing of the testing is determined based on the amount of data available. With the Codification's release in 2009, the FASB did not release any ASUs pertaining to goodwill and intangible assets until 2010. After the update in 2010, there is an update each year except 2013. However, this study does not consider the impact of all updates to Topic 350, as two of the updates are only applicable to private companies which have limited publicly available data.

Using past research, the SEC review date is projected and used to analyze the effects of amended accounting guidance on the volume of comment letters and financial restatements. A timeline is illustrated and described below in Figure 1.

Figure 1: ASUs Timeline



Note: Individual timelines for ASUs are included in the appendix

For each update, in order to determine the SEC review date, the update's release and effective date as well as the entity's fiscal year-end and file date are considered. Though the timing for each update's release and effective date differ slightly, for all updates the SEC review

date is predicted to occur in April following the update's release based on available data. Given that "roughly 71% of filers have a year-end date on-or-around December 31st", this study assumes all entities file using a calendar year-end to make the analysis more straightforward.²³ The file date depends on the size of the SEC filer, but each company has between 60 and 90 days to file their annual reports.²⁴ For purposes of this study, the file date is predicted to be 75 days following year-end, as that is the average time for SEC registrants to file. Following the file date, the SEC review date is determined to be at the earliest 25 days later and at the latest almost one year later. With these considerations and assumptions, this study uses the earliest possible SEC review date (100 days following year-end) to gather data and analyze the impact of each accounting standards update.

INHERENT RISKS

Although the FASB and the SEC have made several efforts to control accuracy in financial documentation, management still exercises a fair amount of discretionary decision-making in producing annual reports. As stated in SAS no. 106, "management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation, and disclosure of information in the financial statements and related disclosures."²⁵ Due to these assertions, outsiders, including auditors, investors, and agencies, may find it difficult to draw reasonable conclusions regarding an entity and its risk for material misstatement. Furthermore, certain accounts and transactions inherently pose greater risks, as they require more subjective decisions by management. According to EY, "the most frequent SEC staff comment areas are those

²³ Derryck Coleman. "When Does a Company's Year End?" Audit Analytics, March 23, 2015. Accessed May 7, 2017. <http://www.auditanalytics.com/blog/when-does-a-companys-year-end/>.

²⁴ U.S. Securities and Exchange Commission. "Fast Answers – Form 10-K." Accessed April 20, 2017. <https://www.sec.gov/fast-answers/answers-form10khtm.html>.

²⁵ AICPA, The American Institute of CPAs. "AU Section 326: Audit Evidence." Accessed March 11, 2017. <http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-00326.pdf>.

accounting topics that require significant judgments and estimates.”²⁶ This study recognizes that certain risks cannot fully be mitigated and considers such factors in the analysis.

GOODWILL

Goodwill, as defined by the FASB, is “an asset representing the future economic benefits arising from other assets acquired in a business combination or an acquisition by a not-for-profit entity that [is] not individually identified and separately recognized.”²⁷ Some examples include a company’s customer and employee relations.²⁸ Due to the nature of these assets and factors like a merger’s success or lack thereof, goodwill is difficult to price and the value can change over time. To regulate goodwill valuations and ensure that assets are not overstated, companies are required by GAAP to test for goodwill impairment at least annually.

Goodwill Impairment Test

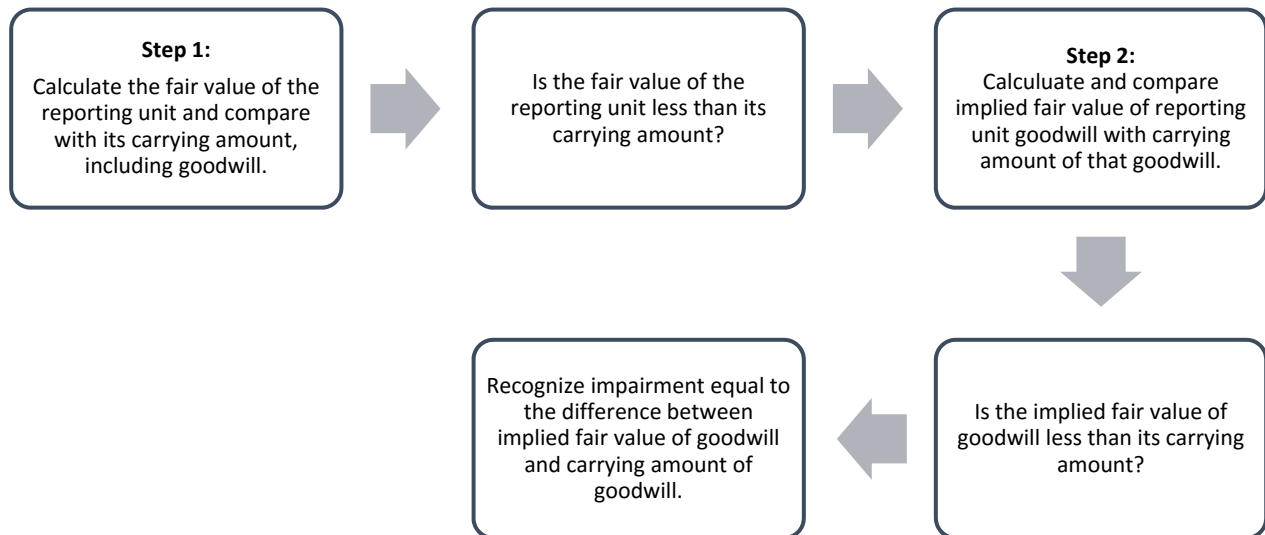
In order to determine goodwill impairment, reporting entities rely on implied fair value measurements to determine a reasonable carrying amount. Given that “the fair value of goodwill can be measured only as a residual and cannot be measured directly,” FASB provides guidance within the Codification to help make fair value estimates much more precise and less vulnerable to abuse.²⁹ The flowchart in Figure 2 illustrates the process for recognizing goodwill impairment.

²⁶ Ibid.

²⁷ ASC 350-20-20 (Goodwill)

²⁸ Investopedia. “Goodwill.” Accessed February 18, 2017. <http://www.investopedia.com/terms/g/goodwill.asp>.

²⁹ ASC 350-20-35-2

Figure 2: Recognizing Goodwill Impairment

Source: ASC 350-20-55-25

To calculate the fair value, entities should use an appropriate valuation technique based on the nature of the reporting unit. The implied value of goodwill can be determined using measurable values, such as comparing values for similar businesses or using a discounted cash flow analysis. However, this implied value can fluctuate if triggered by positive or negative events. If it is concluded during testing that the implied value is less than the carrying amount of goodwill on an entity's balance sheet, an impairment loss must be recorded to mark down the value to reflect current market conditions.

Since 2009, FASB has issued several updates for goodwill accounting and made adjustments to the Accounting Standards Codification as a means of providing additional guidance and reducing costs and complexity. However, even with this guidance, goodwill requires managers to make highly subjective judgments and assumptions.

GENERAL INTANGIBLES AND OTHER

Guidance under Topic 350 also pertains to “intangible assets other than goodwill that are either: acquired individually or with a group of assets in a transaction that is not a business combination or [acquired] by a not-for-profit entity, or internally generated.”³⁰ Intangible assets include assets that lack physical substance, such as patents, trademarks, or an entity’s brand.³¹ In general, this guidance covers the recognition and measurement of intangible assets unless specifically prescribed in another area of the Codification.

In addition to intangible assets and goodwill, ASC 350 provides guidance on the cost of internal-use software and website development costs. These costs can be capitalized before being amortized off the balance sheet. Topic 350 describes the necessary characteristics, considerations, and steps for impairment.

OBJECTIVE

This study analyzes the trends in comment letters, financial restatements, and financial statement data, as updates or modifications are made to ASC Topic 350, Intangibles – Goodwill and Other. This study aims to determine entities’ level of understanding of the accounting guidance pertaining to ASC 350 in relation to updates made to the Codification. To measure the effectiveness, three aspects of the financial reporting process are analyzed relative to the release of accounting standards updates. Each aspect of the analysis provides a slightly different perspective due to the nature and timing of these various financial components. Assuming SEC comment letters serve as an indication of the complexity of a particular accounting topic, the volume of correspondence between the SEC and registered filers is recorded – a lower volume of

³⁰ ASC 350-10-05-03

³¹ ASC 350-30-05 (Intangible Asset)

letters suggests a better understanding of accounting standards or better compliance with requirements. By nature, financial restatements reveal an incorrect application of accounting standards, which could be caused by a misunderstanding or intentional misreporting. This study assumes a reduction in the amount of financial restatements pertaining to ASC 350 indicates better compliance, which is typically a result of more effective financial standards that serve to reduce diverse accounting practices. Although providing more descriptive data, information on the financial statements can help illustrate the impact of updates to the Codification in relation to internal and external factors, such as mergers and acquisitions.

DESCRIPTION OF UPDATES

Although only four updates are pertinent to this analysis, all six post-2009 updates are described below.

ASU 2010-28

In 2010, the FASB's Emerging Issues Task Force determined that an update should be released in order to "address questions about entities with reporting units with zero or negative carrying amounts."³² Since fair value is generally larger than zero, entities with a zero or negative carrying amount were failing to recognize goodwill impairment regardless of whether factors indicated they should. Critics "argued that the reporting unit will always pass step one [of the impairment] test because equity's fair value will always exceed its zero or negative carrying amount" due to the nature of equity itself.³³ This lack of clarity generated a diversity in practice

³² FASB, Financial Accounting Standards Board. "Update No. 2010-28—Intangibles—Goodwill and Other (Topic 350): 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)." Accessed January 20, 2017.

http://fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176158032833&acceptedDisclaimer=true.

³³ Zyla, Mark. "FASB Issues Accounting Standards Update 2010 – 28." Accessed April 12, 2017.

https://www.aicpastore.com/Content/media/PRODUCER_CONTENT/Newsletters/Articles_2011/CPA/Jan/FASBU_pdate2010-28.jsp.

for applying these accounting standards. To address this issue, FASB modified step one of the goodwill impairment test to include a “more likely than not” phrase that requires qualitative factors be considered to determine if goodwill impairment exists. By modifying this standard, entities no longer have the ability to ascertain that step two of the impairment test is not required for reporting units with negative or zero carrying values if certain qualitative factors are present. The resulting financials should present users of financial information with a more accurate depiction of an entity’s financial health, as goodwill impairment may be reported earlier and more consistently across comparable statements.

ASU 2011-08

In 2011, the FASB made further adjustments to simplify how entities test goodwill for impairment. ASU 2011-08 modified language in the standards to allow all entities to assess qualitative factors “to determine whether it is necessary to perform the two-step goodwill impairment test.”³⁴ FASB included a new list of examples and circumstances that entities should consider when determining if the threshold for impairment is reached. The release of this update was intended to reduce complexity and costs by allowing entities to use a qualitative evaluation to determine if goodwill may be impaired. However, in some regards, entities may have found this update made it more difficult to draw conclusions based solely on qualitative factors, due to “the highly subjective nature of a qualitative assessment.”³⁵ It is likely that outside valuation specialists were needed to assist in this assessment given that “the assessment should consider not only company-specific information but all significant inputs used to determine fair value.”³⁶

³⁴ ASC 350-20-35-3

³⁵ Deloitte. “FASB’s new qualitative goodwill impairment assessment implication and opportunities.” Accessed January 22, 2017. http://deloitte.wsj.com/cfo/files/2013/02/qualitative_goodwill_impairment_assessment.pdf.

³⁶ EY Technical Line. “How to use the new qualitative screen to test goodwill for impairment” Accessed April 9, 2017. http://www.ey.com/Publication/vwLUAssets/TechnicalLine_BB2216_Goodwill_17November2011/%24FILE/TechnicalLine_BB2216_Goodwill_17November2011.pdf.

Furthermore, given that there is no requirement for a periodic update, more time may elapse between calculations of fair value for a reporting unit, making it difficult to reach a valid conclusion based solely on relevant events and circumstances.³⁷

ASU 2012-02

In 2012, the same guidelines using qualitative factors were amended to be appropriate for indefinite-lived intangible assets. This update made impairment testing guidance consistent among all long-lived asset categories.

ASU 2014-02

In 2014, adjustments were made for private entities regarding the treatment of subsequently measured goodwill. Given that there is limited information available for private companies and that the SEC does not review their financials, this update was not included in the current analysis. Without publicly available financials or SEC comment letters, the impact of the ASU cannot be determined.

ASU 2015-05

In 2015, an update was released pertaining to a cloud computing arrangement as part of FASB's Simplification Initiative. Given that explicit guidance did not exist about a customer's accounting for fees paid through a cloud computing software, the FASB discovered a diversity in accounting practices as well as entities suffering from unnecessary costs to compute these fees. ASU 2015-05 included amendments that provided guidance for calculating and recognizing these fees.

³⁷ FASB, Financial Accounting Standards Board. "Update No. 2011-08—Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment." Accessed January 20, 2017.
http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176158924168&acceptedDisclaimer=true.

ASU 2016-03

In 2016, the FASB released an update specific to private entities pertaining to the required assessment of preferability for choosing an alternative accounting method after its effective date. Similar to ASU 2014-02, due to limited available information for private companies, this study did not include this update in its analysis.

ASU 2017-04

The most recent update this year amended the impairment test to eliminate step two. The Board concluded that all reporting units should abide by the same impairment assessment to improve consistency and reduce complexity. However, this update is too recent to provide sufficient data and will not be included in the analysis.

PREDICTIONS

Broadly speaking, this study predicts that simplifying an existing accounting practice will result in a decrease in the number of SEC comment letters, as the ASU should increase an entity's understanding of the applicable guidance. Transition guidance primarily influenced the predictions for the impact of these updates on financial restatements. As intuition would suggest, retrospective guidance should increase the number of financial restatements, while prospective guidance should have little impact on financial restatements, either decreasing or maintaining the volume of financial restatements compared to the prior period. For financial statement data, it is difficult to generalize predictions as they are specific to each update. Predictions relative to each update are described in Table 2 below.

Table 2: Topic 350: Testing Predictions

Update	Description	Complex?	Impact on Comment Letters	Impact on Financial Restatements	Impact on Financial Statements
2010-28	When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts	No	Decrease	Increase	Impairment will increase
2011-08	Testing Goodwill for Impairment	No	Decrease	Same or Decrease	Impairment will decrease
2012-02	Testing Indefinite-Lived Intangible Assets for Impairment	No	Decrease	Same or Decrease	Impairment will decrease
2015-05	Internal-Use Software: Customer's Accounting for Fees Paid in a Cloud Computing Arrangement	Yes	Increase	Increase	n/a

Based on the nature of these updates to goodwill accounting, it is likely that none of the updates will affect financials in the same manner. ASU 2010-28 modifies the goodwill impairment test specifically for entities with reporting units of zero or negative carrying amounts. Given that this update is intended to simplify impairment testing guidelines for such entities, this study predicts the volume of SEC comment letters will decrease. However, since the simplification involves eliminating a diversity in practice and is applied retrospectively, this study predicts the volume of financial restatements following the update will increase. The direct impact on financial statements is harder to predict and heavily relies on the specific amendments included in each update. ASU 2010-28 resulted from concerns about entities failing to recognize impairment; consequently, this update should address these issues, increasing the volume of impairment recognized compared to the prior period.

ASU 2011-08 greatly alters goodwill impairment testing by essentially adding a “step zero” that allows entities to perform an optional qualitative assessment to determine if goodwill impairment is likely present. These adjustments simplify the guidelines for goodwill testing and

often provide entities with cost benefits: “companies that appropriately apply the qualitative screen and achieve a positive result can skip the annual two-step test and achieve the intended cost relief.”³⁸ For these reasons, this study predicts that the addition of the optional qualitative assessment for goodwill impairment should help reduce the number of comment letters sent by the SEC, unless they are specifically addressing an entity’s qualitative assessment. Guidance within this update is applied prospectively, so the volume of financial restatements should remain relatively unchanged or even decrease from the prior period, as entities develop a better understanding of the accounting standards. For the amount of goodwill recognized on the balance sheet, this study predicts that the amount of goodwill impairment will decrease, meaning, all other factors constant, the amount of goodwill should remain the same or increase. Given that the qualitative factors can help entities bypass the impairment test, recognized impairment may decrease marginally.

Predictions for ASU 2012-02 follow the same rationale as the update in 2011. Since the update modifies goodwill testing to be consistent among all indefinite-lived intangible assets by including an optional qualitative assessment, it is likely that the fluctuations in comment letters, financial restatements, and goodwill on the balance sheet will follow the same trends. The optional qualitative assessment should reduce complexity within the accounting standards, reducing the volume of comment letters and financial restatements necessary to adhere to the accounting practices. Furthermore, the amount of impairment on the balance sheet may decrease, given that the optional qualitative assessment may allow entities to skip testing for impairment.

³⁸ EY Technical Line. “How to use the new qualitative screen to test goodwill for impairment” Accessed April 9, 2017. http://www.ey.com/Publication/vwLUAssets/TechnicalLine_BB2216_Goodwill_17November2011/%24FILE/TechnicalLine_BB2216_Goodwill_17November2011.pdf.

Unlike the other updates, ASU 2015-05 added new guidance to the Codification for accounting practices that did not previously exist. Given that guidance did not exist for this area, entities were recognizing these fees in various manners. FASB recognized the diversity in practice and released the update to standardize the accounting practice, providing entities with clearer guidance and outside stakeholders with clearer financial statements. Since this is newly recognized accounting guidance pertaining to more complex practices, this study predicts that the volume of SEC comment letters will likely increase. Entities may struggle with the guidance, as it is unfamiliar and pertains to complex practices. Although it is not always the case, this study predicts that with greater complexity, there will be an increase in the number of comment letters sent by the SEC. SEC comment letters “illuminate disclosures that may conflict with rules or the applicable accounting standards or disclosures that may be deficient.”³⁹ For more complex accounting standards, it may be harder for reporting entities to ascertain the proper accounting disclosures, resulting in a greater correspondence from the SEC to resolve such issues or discrepancies. Since this guidance is released to eliminate a diversity in practices, it is applied retrospectively. With such transition guidance, it is likely that the volume of financial restatements will increase following the update. As for the impact on financial statements, it is difficult to predict given that the update may not be reflected in one specific account. Due to the inability to easily measure the effect, ASU 2015-05’s impact on financial statements will not be predicted.

³⁹ PwC. “Securities and Exchange Commission (SEC) comment letters.” Accessed March 3, 2017. <http://www.pwc.com/us/en/audit-assurance-services/accounting-advisory/sec-comment-letters.html>.

TESTING PROCEDURES

Audit Analytics

Audit Analytics is “an independent research provider of audit, regulatory, and disclosure intelligence.”⁴⁰ This data service allows users to track and analyze various aspects of a public entity’s financial disclosures supplying data from over 10,000 accounting firms.⁴¹ For purposes of this study, Audit Analytics will provide the necessary data for assessing trends in SEC comment letters as well as financial restatements. The Audit Analytics SEC Comment Letter database includes review filings for SEC registrants and is “indexed according to approximately 2,500 proprietary issues regarding specific accounting rules and regulations.”⁴² This classification makes the database easily searchable and allows users to tabulate the frequency of SEC concerns. Similarly, the Audit Analytics Financial Restatements database tracks all disclosed financial restatements since 2000 and categorizes each restatement by the appropriate accounting related issue.⁴³ In addition to the issues taxonomy, the financial restatement database classifies each restatement into three broader categories to enhance user access: accounting rule (GAAP) application failures (1), financial fraud, irregularities and misrepresentations (2), or errors – accounting and clerical applications (3).

Comment Letters

To gain a better understanding of comment letter trends pertaining to accounting for goodwill and intangible assets, all available data from Audit Analytics is gathered to approximate the volume of comment letters from 2004 to 2016. While this study’s focus is from

⁴⁰ Audit Analytics. “Corporate + Legal.” Accessed March 27, 2017.

http://www.auditanalytics.com/doc/AA_Corporate_Legal_ds.pdf.

⁴¹ Audit Analytics. “Overview.” Accessed April 11, 2017. <http://www.auditanalytics.com/0002/>.

⁴² Audit Analytics. “Corporate + Legal.”

⁴³ Audit Analytics. “Audit + Compliance.” Accessed March 27, 2017.

http://www.auditanalytics.com/doc/AA_Audit_Compliance_ds.pdf.

2010 to 2016, having a broader understanding of the past trends can influence the analysis. Since the Codification was released in 2009, comment letters could not simply be searched by topic ASC 350, as stated in the Codification. Instead, four searches are used to assess comment letter trends over the twelve-year period: “goodwill,” “intangible,” “intangible or goodwill,” and “ASC 350.”

To analyze the impact each ASU has on SEC comment letters, this study collects data pertaining to intangibles from 2010 to 2016 from Audit Analytics. For each update, the volume of letters specifically referencing ASC Topic 350 is recorded six months before and after the predicted SEC review date, which is determined to be the earliest possible date that an entity could receive a comment letter from the SEC. Though this date is still an approximation, the six month periods are used to minimize inconsistencies in the data due to timing effects.

Initially, the volume of letters includes all correspondence between the SEC and reporting entities pertaining to intangibles. This allows the study to analyze a larger volume of comment letters in order to make more representative assessments. To ensure that the larger sample reflects SEC actions, a second search is limited to comment letters sent by the SEC and excludes correspondence from entities. If the two samples show a clear correlation between the volume of letters before and after the SEC review date, it can be assumed that the sample containing all correspondence will appropriately illustrate each update’s effectiveness on comment letters sent by the SEC. Furthermore, the difference in the volume of letters can attest to the complexity of each update. This study assumes that a higher volume of correspondence suggests a lack of understanding.

To delineate each specific amendment’s impact on SEC comment letters, the same periods are used but the search is limited to the specific ASC code amended in each update.

Correspondence is limited to letters sent on behalf of the SEC to reporting entities. These letters are then analyzed as a percentage of all SEC comment letters sent pertaining to ASC Topic 350 for each period.

Financial Restatements

Similar to the comment letters, data for financial restatements is gathered from Audit Analytics six months before and after the SEC review date using the file date (or disclosure date) of the financial restatement. However, the financial restatement database varies slightly from the SEC comment letter database; instead of searching for data using the keyword “ASC 350,” data was collected using the database’s classification system that categorizes restatements by the appropriate accounting related issue. This study tests for accounting rule (GAAP) application failures (1), financial fraud, irregularities, or misrepresentations (2), and errors (3) for restatements within the accounting related issue category “PPE issues – intangible assets and goodwill.”⁴⁴

Financial Statements

To collect data for the financial statements, this study analyzes several annual reports from companies in various industries. For each company, goodwill is recorded from 2004 to 2016, including any adjustments made. The percent change between the years is noted, but is not compared between companies just internally. Given that each company is selected at random, goodwill should be considered relative to company size. To increase comparability and assess trends, goodwill is taken as a percentage of total assets. This percentage helps account for merger and acquisition effects as well as provides a more consistent measure of goodwill to assess how the value varies throughout the years.

⁴⁴ Ibid.

ASSUMPTIONS

Several assumptions are made in order to comprehend the data collected. These assumptions are listed below, but explained in further detail throughout the study.

Comment Letters

- High volume of SEC comment letters reflects either or both:
 - SEC concerns for that accounting issue
 - Questions about how an accounting standards is applied (complex or unclear)
- Conversely, a lower volume of SEC comment letters suggests either:
 - Better understanding of accounting standards
 - Better compliance with requirements

Financial Restatements

- A reduction in the amount of financial restatements indicates better compliance
 - Better compliance is assumed to be a result of more effective financial standards

Financial Statements

- Consistent level of goodwill with new acquisitions – some impairment recognized

Timing

- Year-end: December 31st
- File Date: 75 Days after year-end
- SEC Review: 25 Days after file date

LIMITATIONS

Beyond these assumptions, there are still a few limitations to the study that should be considered. For the volume of comment letters and financial restatements, the month of April (month of the SEC review) is not included in the analysis. Due to the way in which the database is organized, data can only be collected by month. In order to properly analyze the effects of the update before and after the SEC review date, the month of the review is excluded provided that it is neither before nor after. Additionally, there is a small quantity of data available for financial restatements pertaining to goodwill and intangibles in relation to these updates. While this may be indicative of effective accounting guidance and compliance to the standards, it is difficult to make a representative assessment with such a small quantity of data. The data will still be

analyzed, but the limitation should be factored into the analysis. Lastly, the financial statement data only considers the amount of goodwill reported on the financial statements. Due to this limitation, the effect of updates pertaining to other intangible assets cannot be determined.

ANALYSIS

Comment Letters

Throughout the years, the volume of comment letters issued by the SEC pertaining to goodwill and intangible assets has continued to decrease since 2009 as illustrated in Figure 3 and Figure 4. Before the Codification was issued, the volume of comment letters pertaining to accounting for goodwill fluctuated. However, in 2009, the volume of comment letters seemed to peak before rapidly diminishing. While there is a slight lag for letters referencing ASC 350, this delay is logical given the Codification's release in 2009 and reasonable timing effects. The Codification completely restructured accounting guidance, thus, the language set forth in the Codification should not show immediate effects, as entities, including the SEC, transitioned to adopting the new accounting literature.

Figure 3: Comment Letter Volume (All Correspondence)

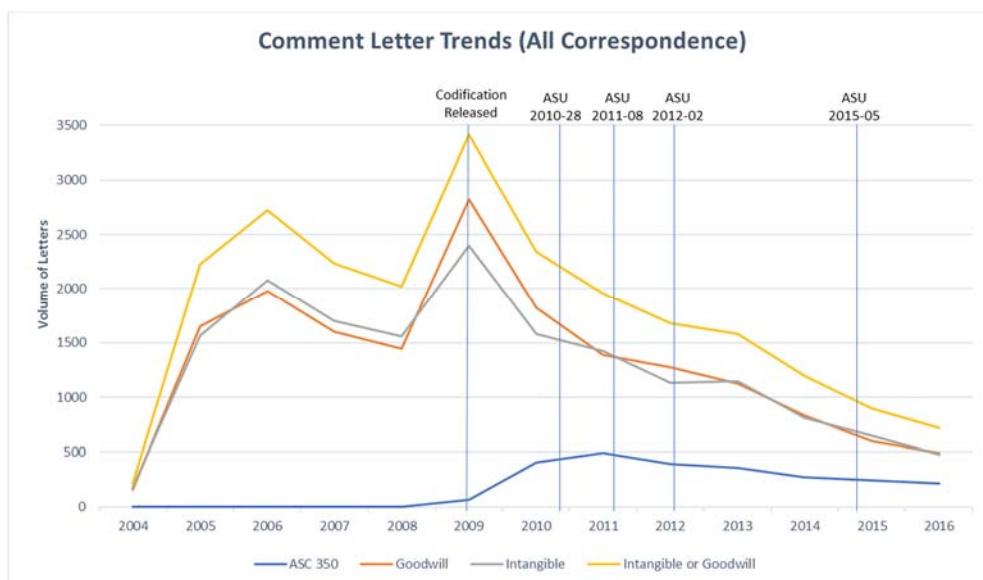
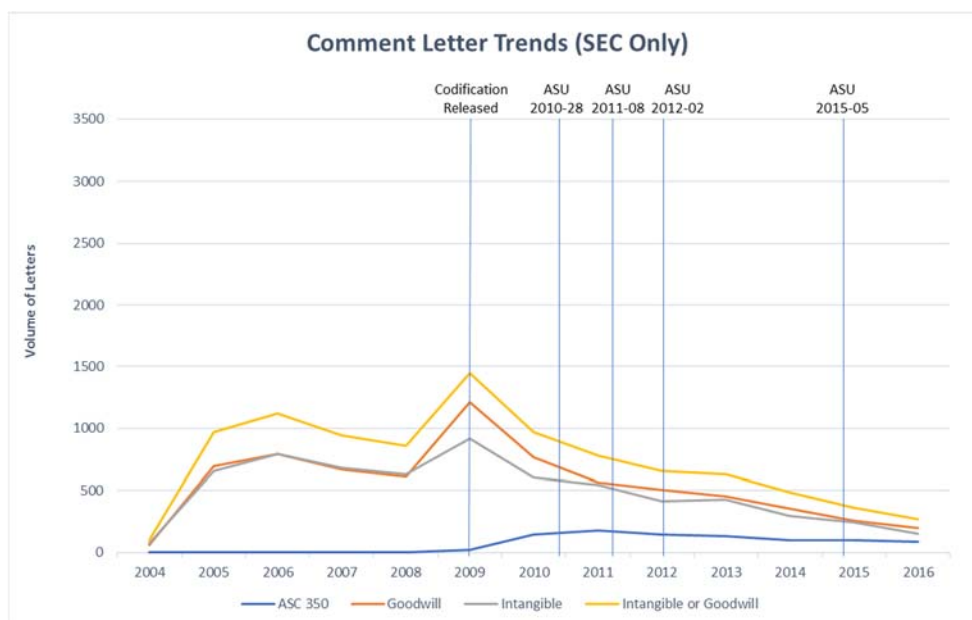


Figure 4: Comment Letter Volume (SEC Only)

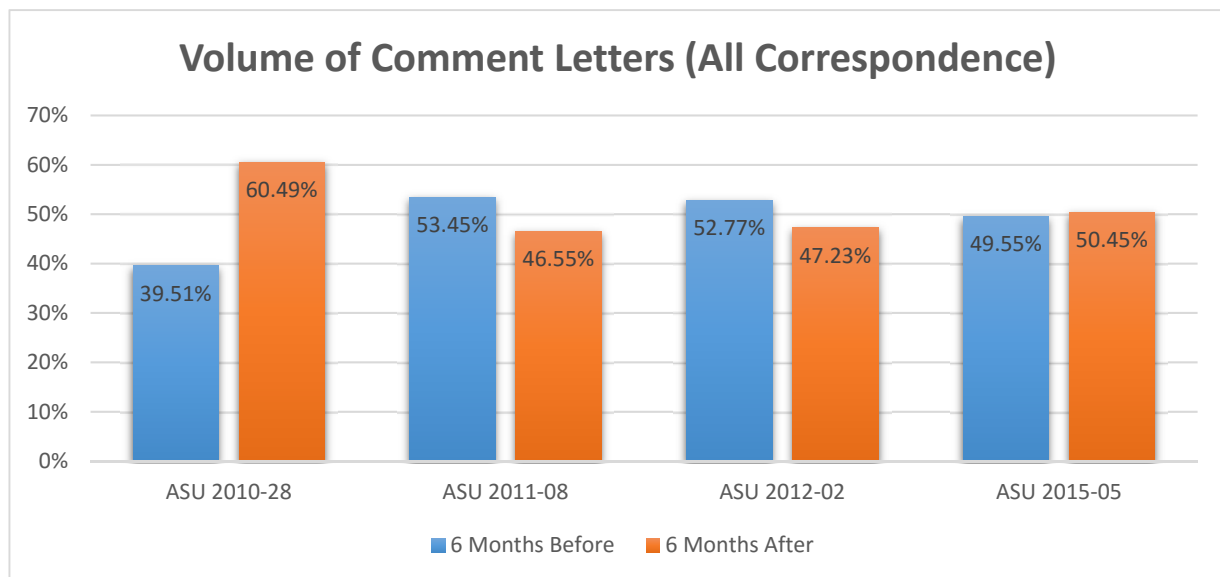
For the comment letters obtained after 2009 referencing ASC Topic 350, the fluctuations in volume generally align with the study’s predictions as illustrated in Table 3. Given the timing considerations, the impact of each update is considered six months before and after the earliest possible SEC review for the specific guidance – for all updates the predicted SEC review is April of the following year. Comparing the study’s expectations with the data collected, three of the four outcomes are correctly predicted (2011, 2012, 2015). However, the increased volume of comment letters six months after the SEC review pertaining to ASU 2010-28 is not expected.

Table 3: SEC Letters vs. All Correspondence

ASC Update	All Correspondence		SEC Only	
	6 Months Before	6 Months After	6 Months Before	6 Months After
ASU 2010-28	194	297	79	103
ASU 2011-08	209	182	82	66
ASU 2012-02	181	162	71	55
ASU 2015-05	111	113	43	44

Limiting the data to letters sent by the SEC, the study found fluctuations in the volume of letters follow the same trends. Given that the letter volume of all correspondence correlates with the volume of SEC letters, this study will focus on all correspondence in order to make a more representative assessment of the data. To better understand the impact of the released updates on comment letters, the volume of all correspondence is expressed as a percentage of the total number of letters collected for the two six month periods (Figure 5).

Figure 5: Volume of Comment Letters (All Correspondence) Expressed as a Percentage



For ASU 2010-28, the volume of letters increases by nearly 20% after the earliest possible SEC review date. Although the increase cannot be completely explained, it may be a result of increased oversight by the SEC due to the lasting impact of the 2008 financial crisis. One of the efforts made to rebuild and protect the capital markets included the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) in 2010. The Dodd-Frank act “create[d] significant additional work for the SEC” in order to restore faith in the

capital markets and protect consumers.⁴⁵ With this act, the SEC had additional responsibilities to reduce risk and increase transparency. As a result, the SEC may have dedicated more time and effort to filing reviews, which may have led to more comment letters in general.

Unlike the 2010 update, ASU 2011-08 led to a decrease in comment letters after the SEC review date. This decrease could be due to the nature of this update. Given that this update slightly modified goodwill impairment testing by adding an optional qualitative assessment, if entities chose to skip the optional test, accounting for goodwill would remain the same. Consequently, with all other factors constant, entities should receive a similar or lesser volume of comment letters from the prior year. Following the same accounting principles, entities will likely use the same accounting methods to account for goodwill. SEC comment letters may still be issued to address unclear disclosures, but it is likely that entities will have resolved previous issues in their accounting methods, as noted by comment letters.

Since introducing an optional qualitative assessment allowed entities to cut costs if evidence indicated goodwill impairment did not exist, most entities probably chose to perform this test. Considering the rationale discussed above, it is likely that most of the comment letters pertaining to ASU 2011-08 addressed a specific entity's application of the qualitative assessment for goodwill impairment. However, as long as entities properly disclosed the results of the assessment, SEC comment letters would not be necessary.

For ASU 2012-02, the number of comment letters decreases again after SEC reviews. This is presumably due to the fact that this update added the qualitative impairment test for indefinite-lived intangibles. Following the same logic pertaining to ASU 2011-08, an optional

⁴⁵ SEC. "Congressional Justification FY 2012 in Brief." February, 2011. Accessed on April 24, 2017. <https://www.sec.gov/files/secfy12congbudgjust.pdf>.

qualitative assessment for indefinite-lived intangible assets should not greatly impact comment letters unless the SEC is specifically addressing a company's specific qualitative assessment.

The update in 2015 results in an increase in SEC comment letters, but only marginally. In fact, the increase in letters following the SEC review is approximately 1% greater than the six-month period before the earliest SEC review. Although this study expected a larger increase, this slight difference may be explained by the nature of the update. Since ASU 2015-05 addresses more technical accounting practices involving cloud-computing software, the complexity may have led to an increase in comment letters. However, given the specificity of the update and the accounting practices it relates to, few entities may engage in such transactions making the ASU irrelevant to their filing process. A slight increase seems appropriate given the complexity of the update yet infrequent application by reporting entities. However, it is also likely that the difference may not be indicative of effects from the update but rather a result of normal fluctuations in the number of comment letters. Thus, given the insignificant increase, it is difficult to ascertain the impact ASU 2015-05 has on comment letters.

While the change in the volume of letters may be indicative of the ASC updates serving as an effective measure to improve financial statement accuracy, the volume does not necessarily reflect improvements specific to these four updates. These measurements simply reflect the frequency of correspondence between entities and the SEC pertaining to all intangible assets. To distinguish if the letters referenced one of these four updates, data is gathered for the same time periods, but the search query is limited to the amended ASC paragraphs. Overall, with few exceptions, these amendments are rarely addressed in the SEC comment letters.

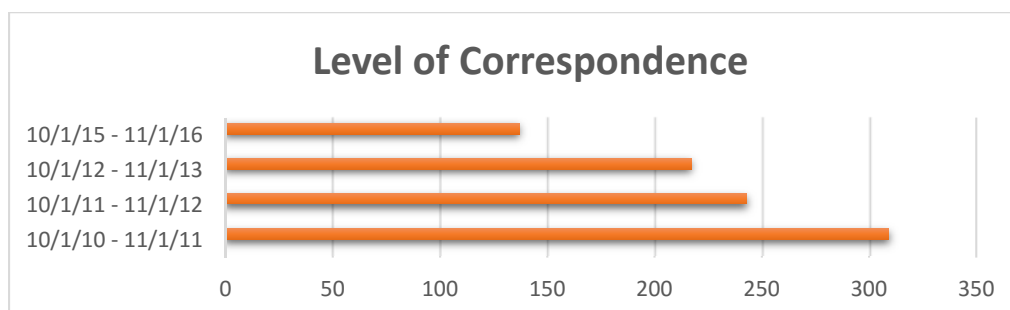
In 2010, for the letters referencing ASC 350, approximately 5% address the amendments included in ASU 2010-28 before the SEC review and approximately 6% address the amendments

in the update following the SEC review. Given all the applicable guidance in the Codification for Topic 350, this percentage is surprisingly high given that only four subsections are amended. This could be a result of increased oversight by the SEC or may be an indication of a lack of understanding surrounding this accounting practice, especially since the number of letters specific to this code increased after filings were reviewed.

SEC comment letters also addressed, though less frequently, ASU 2012-02 pertaining to an optional qualitative assessment for indefinite-lived intangible assets. There are five letters pertaining to this amended guidance before the SEC review and five letters following the review. This consistency may be representative of ordinary issues or necessary clarifications for this accounting practice. However, this also may indicate that the update may not have been as effective in clarifying guidance and reducing complexity as intended. Even so, the small number of letters makes it difficult to ascertain the effectiveness of the update.

In general, the lack of SEC letters addressing these specific amendments implies that the updates serve as an influential control for assisting with discrepancies in accounting for goodwill and intangible assets. Furthermore, to support that assessment, the level of correspondence between the SEC and SEC filers can be determined to evaluate the level of complexity within an update (Figure 6). It is assumed that a lower level of correspondence indicates a greater understanding of the accounting practices.

Figure 6: Level of Correspondence between the SEC and SEC Filers



Throughout the years, the volume of correspondence, excluding the initial SEC letter sent to reporting entities, has steadily decreased. This implies that reporting entities may have obtained a better understanding of the accounting standards for Topic 350, or at least have achieved better compliance.

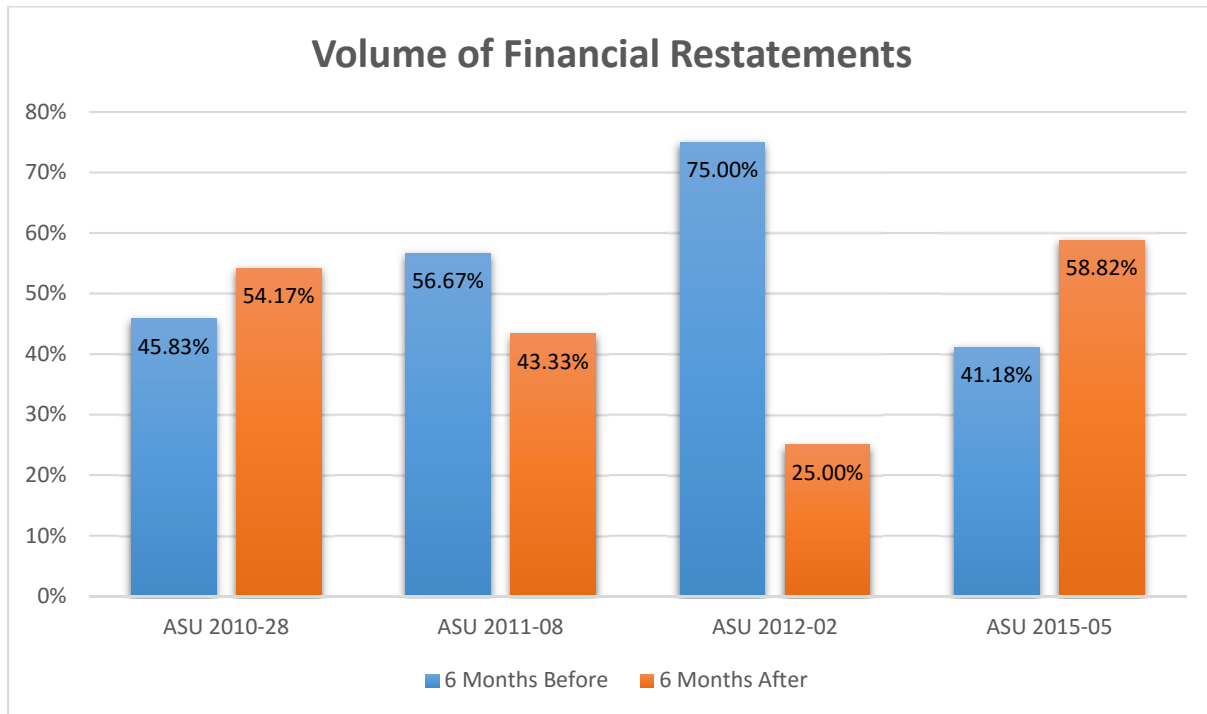
In late 2016, Audit Analytics released a study depicting the number of comment letters by year of origination since 2010. This study revealed that since 2010, the total number of comment letters has continued to decline year after year, producing a 60% decline from 2010 to 2015.⁴⁶ Researchers at Audit Analytics cited two probable explanations: “companies are simply getting better at financial reporting” and/or “the SEC is finding fewer material issues, in which case it would send out fewer comment letters.”⁴⁷ In regards to the current study on accounting for goodwill, the decrease in comment letter correspondence may also be a factor of this larger trend in SEC comment letters. Even so, if the volume of letters is decreasing due to entities improving their financial reporting, this would still signify that updates to the accounting standards, including those specific to goodwill and intangibles, are influential in improving financial transparency.

Financial Restatements

Data collected pertaining to financial restatements illustrates that the fluctuations in volume following an update aligns with the study’s expectations (Figure 7).

⁴⁶ Bonaldi, Joey. “Update on ‘SEC Comment Letters: A Five Year Trend’ (2015).” *Audit Analytics*, August 1, 2016. Accessed April 1, 2017. <http://www.auditanalytics.com/blog/update-on-sec-comment-letters-a-five-year-trend-2015/>.

⁴⁷ Ibid.

Figure 7: Volume of Financial Restatements Expressed as a Percentage

In 2010, the number of financial restatements increases by about 10%. Given that this update stems from questionable accounting practices by entities, it is likely that entities need to modify the amount of goodwill impairment for reporting units with zero or negative carrying amounts. By bypassing step two of the impairment test, material misstatements may have occurred if companies were failing to properly account for goodwill impairment.

For 2011, the number of financial restatements decreases by nearly 13% following SEC filings review. This may indicate that the update to the standards serves as a helpful tool in reducing the number of financial restatements due to misapplication or misunderstanding. However, it is more likely that the decrease corresponds to the transition guidance.

Following the review for ASU 2012-02, the number of financial restatements drops significantly. Since this update is intended to provide clarification and consistency among goodwill accounting, it is likely that this decrease reflects an increased understanding among

entities for the accounting standards. In conjunction with the update in 2011, the updates to the accounting guidance for goodwill and intangible assets may be useful in increasing an entity's ability to comply with the standards and avoid having to issue financial restatements. However, it is also important to consider that the small quantity of data may make the update appear to be more effective than it truly is. That being said, the decrease still is much larger than past years, indicating the update has some effect on entities' level of understanding.

In 2015, there is an increase in the number of financial restatements compared to the prior period by about 17%. The study's predictions rely on the fact that this update is very complex, dealing with technological advances to recognize cloud computing software services. Furthermore, since the update is released to eliminate a diversity in practice, the retrospective application of the guidance should correspond to a higher volume of financial restatements following the adoption of the accounting standards.

There is always the possibility that entities underwent financial restatements due to factors other than goodwill, but such changes also affected the value of goodwill. In order to better understand the reason for these financial restatements, each restatement is classified and separated based on the accounting issues that led to the financial restatement. Further analyzing the audit analytics data, 25% of these financial restatements are solely due to goodwill and intangible asset misapplications or changes in accounting practices. However, the other 75% of the restatements are a result of additional factors besides goodwill and intangible asset accounting issues.

In assessing all of the data gathered for financial restatements, it is important to consider that this is a relatively small sample size. Financial restatements pertaining to ASC Topic 350 during this time never exceed 17 restatements in one six-month period. As a result, this data

should be used considered as more descriptive evidence rather than inferential evidence, given that the sample is likely not representative of the entire population.

Financial Statements

To investigate how goodwill changes over time, data is collected from five reporting entities in various industries. Although entities are chosen at random within the industry, to ensure that updates to Topic 350 are applicable, the selection is limited to entities based on their tendency to engage in mergers and acquisitions. Entities with frequent mergers and acquisitions consistently need to test goodwill for impairment, even if it is not recognized. However, selecting companies that participate in business combinations makes the resulting data more susceptible to fluctuations in goodwill due to merger and acquisition effects. To minimize the fluctuations, goodwill is considered as a percent of total assets. While the companies lack comparability, goodwill as a percentage of total assets can be analyzed within each company in order to consider whether each ASC update impacts the financial statements (Table 4).

Table 4: Goodwill as a Percentage of Total Assets

	2009	2010	2011	2012	2013	2014	2015
PROCTER & GAMBLE	41.91%	42.14%	41.60%	40.66%	39.63%	37.23%	34.46%
WALT DISNEY	34.35%	34.82%	33.49%	33.54%	33.65%	33.14%	31.56%
BANK OF AMERICA	3.87%	3.26%	3.29%	3.17%	3.32%	3.32%	3.25%
CISCO SYSTEMS	18.97%	20.55%	19.33%	18.54%	21.67%	23.07%	21.56%
AT&T	27.30%	27.31%	25.91%	25.30%	24.62%	23.48%	25.97%

The five selected entities are Procter & Gamble, Walt Disney, Bank of America, Cisco Systems, and AT&T. Given that the Codification was not released until 2009, the available data is limited to the past seven years (2009-2016). Beginning with ASU 2010-28, this study predicts that entities will recognize a higher volume of impairment, resulting in a lower reported value of

goodwill. For all companies, within two years, goodwill is a lower percentage of total assets compared to that of 2010. None of the decreases are greater than 2%, some only being marginally lower. With this data specific to goodwill, it is difficult to separate the effects produced from updates to the accounting standards and those resulting from a merger or acquisition. Although goodwill is expressed as a percentage of total assets to reduce such fluctuations, one cannot fully extrapolate merger and acquisition effects. To make better sense of the data, the timing for acquisitions is considered relative to the ASUs for each of the five entities. This study assumes that if there are multiple acquisitions year to year and the level of goodwill remains consistent, some of goodwill impairment is recognized.

Although it is difficult to ascertain if all five entities engaged in acquisitions based on their financial statements, the data reveals that Proctor & Gamble and Cisco Systems participated in a series of acquisitions during 2010 and 2011. In 2010, Proctor & Gamble acquired Natura Pet Products, Inc. as well as Ambi Pur, though it is not reflected in the financial data until 2011.⁴⁸ Cisco Systems had a total of seven business combinations in fiscal 2010 and six business combinations in 2011.⁴⁹ For both companies, goodwill changed marginally from 2010 to 2011. With a rather consistent level of goodwill reported and continual series of acquisitions, it is reasonable to conclude that both companies recognized some goodwill impairment during those two years.

Considering the update in 2011, this study predicts that goodwill impairment will likely decrease. It is important to take into account that a decrease in goodwill impairment does not necessarily mean that the amount of goodwill on the balance sheet will increase. A decrease in

⁴⁸ Proctor & Gamble. "Annual Report 2011." Accessed April 3, 2017.
<http://annualreport.pg.com/annualreport2011/downloads/>.

⁴⁹ Cisco Systems. "Annual Report 2011." Accessed April 3, 2017.
https://s2.q4cdn.com/230918913/files/doc_financials/annual/2014/2011-ar.pdf.

goodwill impairment can also account for a consistent level of goodwill, if it is determined that the carrying amount appropriately reflects its implied fair value.⁵⁰ From 2011 to 2012, the amount of goodwill relative to assets remains relatively constant – changes are less than 1%. These levels of goodwill may validate the effectiveness of the accounting standards update, at least for P&G and Cisco Systems. With little change in goodwill and ongoing mergers and acquisitions, it can be inferred that the ASC update is effective in decreasing recognized impairment.

One of the limitations in collecting this data is that it only considers the reported value of goodwill, not intangible assets. Goodwill is the only value considered, as it is easier to isolate and is generally more susceptible to fluctuations in business combinations. With this limitation, the update in 2012 cannot be analyzed since it pertains to indefinite-lived intangible assets, which encompasses much more than goodwill. Additionally, ASU 2015-05 affects guidance related to cloud-computing software that likely is not reflected in goodwill on the balance sheet.

2017 PREDICTION

Due to the nature of ASU 2017-04 and its proposal to eliminate step two of the impairment test for goodwill, it is likely that the volume of SEC comment letters will increase. This accounting practice greatly differs from the current standards set for impairment testing and may result in a diversity in practice. One of the concerns of the Board includes is the fact that the elimination of step two for impairment testing “could result in a less precise amount of goodwill impairment and that this concern may be greater for companies in certain industries.”⁵¹ Given

⁵⁰ ASC 350-20-35-2

⁵¹ FASB, Financial Accounting Standards Board. “Update No. 2017-04—Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.” Accessed April 11, 2017.
http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176168778106&acceptedDisclaimer=true.

that it is the SEC's duty to protect the public's interest, comment letters may be used to increase financial transparency, addressing the amount of goodwill recognized. The Board argues that users of financial information are more concerned with the fact that impairment is recognized, rather than the precise amount of goodwill impairment. While this may be true, it is likely that this structural change in impairment testing alone will yield a greater volume of comment letters pertaining to ASC 350 in 2017 compared to 2016, as entities adopt the modified accounting methods.

In terms of financial restatements, it does not seem likely that ASU 2017-04 will yield a high volume of financial restatements as it is applied on a prospective basis and provides for a greater flexibility in goodwill impairment recognized.

Based on the change in impairment testing, it is likely that the amount of goodwill impairment recognized on financial statements will decrease. By eliminating step two of the impairment test, companies will record goodwill impairment based on the unit's fair value rather than the implied fair value. The implied fair value is computed as a residual whereas the unit's fair value can be measured directly. For instance, by using the fair value instead of the implied fair value, unrecognized assets and liabilities are no longer considered. This ASU will change the amount of impairment recognized, likely decreasing it, given timing and valuation implications.

CONCLUSION

Given the importance of clear and consistent financial reporting, this study serves to assess an entity's understanding of the Accounting Standards Codification as updates are made to the standards pertaining to accounting for goodwill and intangible assets. This data suggests that updates that are not complex can help entities obtain a better understanding of the accounting standards, as indicated by a decrease in comment letters. This study also found that

ASUs aimed to eliminate a diversity in practice will increase the number of financial restatements when applied retrospectively. As intuition suggests, applying guidance to change an accounting practice in prior periods should increase the volume of financial restatements, as entities are required to alter their previous inconsistent accounting methods. Furthermore, anecdotal evidence of Proctor & Gamble and Cisco Systems show that ASUs can be effective in achieving a lower value of goodwill impairment. Considering these three measures, this study can be used to provide insight into the effectiveness of the Accounting Standards Codification pertaining to Topic 350, Goodwill and Other Intangible Assets.

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