**DELOITTE’S INTANGIBLE ASSET CLIENTS REVISITED**

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Recently, we enjoyed a wonderful article titled “[Buyers Beware: The Goodwill Games,](http://online.wsj.com/article_email/SB10000872396390444042704577587302625535444-lMyQjAxMTAyMDIwNTAyODU3Wj.html?mod=wsj_valettop_email)” by Scott Thurm who discussed an interesting rubric by which to evaluate goodwill’s value: *the ratio of a company’s goodwill to the total entity’s market value*. Thurm seems to suggest that companies whose goodwill exceeds market capitalization may be prime candidates for future write-downs. Very interesting indeed, especially as goodwill is such a queer asset (see [Goodwill Games](http://blogs.smeal.psu.edu/grumpyoldaccountants/archives/89)).

Thurm’s article reminded us that it was time to revisit the list of companies that we provided to Deloitte back in November of 2011 to help them with their audits of intangible assets (in “[Are Fourth Quarter Write-Offs Looming for Deloitte’s Clients?](http://blogs.smeal.psu.edu/grumpyoldaccountants/archives/434)” We wanted to know how many firms in our suggested list of write-off candidates actually recorded goodwill impairment.

As you may recall, we applied simple intuition and financial analysis to create a list of 24 companies, based on their relative level of intangible assets and anemic returns on equity (ROE), that we asserted were at significant risk for some type of impairment charge in 2011. We found that, of the 24 companies we enumerated, 9 (37.5 percent) reported some type of earnings charge for impairment of goodwill or other intangibles during 2011. So, it appears that common sense and fundamental financial statement analysis may have won out over auditing, yet again! Maybe the FASB should add these two traits to their “qualitative criteria” for evaluating goodwill impairment—and Thurm’s as well.

To assess impairment charges for our 24 company listing, we again turned to the Wharton Research Data Services COMPUSTAT North America (WRDS) data set to search for P&L charges for the following variables: pre-tax goodwill impairments (GDWLIP) , pre-tax restructuring costs (RCP), and pre-tax write-downs (WDP). And we were not disappointed! The following nine companies reported intangible related earnings charges (in millions of dollars).

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| **Company** | **Intangible Charge (pretax)** | **Goodwill Write-down as %** |
| INFUSYSTEM HOLDINGS | -67.592 | -66.27% |
| CHINA REAL ESTATE INFO-ADR | -417.822 | -65.39% |
| APRIA HEALTHCARE GROUP | -569.868 | -44.63% |
| LANTHEUS MEDICAL IMAGING | -54.9 | -9.44% |
| PENTAIR | -202.02 | -7.54% |
| NATIONAL MENTOR HOLDINGS | -14.5 | -2.12% |
| QUEST SOFTWARE | -9.0 | -1.07% |
| EPIQ SYSTEMS | -1.278 | -0.34% |
| VITAMIN SHOPPE | -0.325 | -0.12% |

The total pre-tax charge includes impairment losses for both goodwill and any other intangibles reported by the company for 2011. These amounts include charges reported as restructuring costs or other write-downs. Except for CHINA REAL ESTATE INFO–ADR which has been delisted, all amounts were verified by tracing them to 2011 10-K filings. The percentage write-down indicates the percentage of the 2011 impairment loss recognized to the total intangibles we originally raised concerns about.

So, what can we conclude? Did Deloitte take our advice and check out these companies? Or did the companies police themselves and “come clean” about the real value prospects of these fake assets? Or, most likely, did our simple model serve as a predictive tool for analysts to evaluate companies’ goodwill positions?

And what does Thurm’s goodwill to market cap rubric show us at the end of 2011 for the above eight companies that are still listed? Once again, we turned to WRDS data, this time using common share outstanding data (CSHO), end of period share price (prcc\_c and prcc\_f), and market cap data (mkvalt). Unfortunately, of the remaining eight companies (recall that CHINA REAL ESTATE INFO was delisted), three more companies are no longer publicly traded: APRIA HEALTHCARE GROUP, NATIONAL MENTOR HOLDINGS INC, and LANTHEUS MEDICAL IMAGING. That leaves us with the following five companies:

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| --- | --- |
| **Company** | **% Goodwill to Market Capitalization** |
| EPIQ SYSTEMS | 93.71% |
| PENTAIR | 69.26% |
| QUEST SOFTWARE | 55.51% |
| VITAMIN SHOPPE | 15.21% |
| INFUSYSTEM HOLDINGS | 0.00% |

INFUSYSTEM HOLDINGS reports a zero percentage because the company has no goodwill. It was all written off during 2011. As the percentages exceed 50 percent for only three companies, apparently the market continues to believe that the reported goodwill still has some value.

So what do we conclude from this analysis? We hope that our accounting colleagues, academic and practitioner alike, wake up and realize that sometimes common sense and fundamental analysis can give us insights about asset value. As Emanuel Derman in his recent book *Models Behaving Badly* states:

*Finding the truth about nature takes cunning and intuition. The invisible worm of financial economics is its dark secret love of mathematical elegance regardless of its efficacy, and its belief that rigor can replace fact and intuition.*

In today’s world of fair value reporting, maybe we should require companies to prove that an intangible has value (above and beyond what managers tell us)! No consulting reports based on “pie in the sky” estimates and discounted cash flow analysis allowed. Show us the actual, asset specific cash flows coming from these so called assets. Prove that they are generating above average returns. Show us the money! If you can’t, then don’t book it! Probably too uncomplicated for anyone to grasp, except for two grumpy simpletons.

*This essay reflects the opinion of the authors and not necessarily the opinions of The Pennsylvania State University, The American College, or Villanova University.*