

**FASB Emerging Issues Task Force**  
**Draft Abstract**  
**EITF Issue 08-7**

<b>Notice for Recipients of This Draft EITF Abstract</b>
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October 1, 2008

This draft abstract for EITF Issue No. 08-7, "Accounting for Defensive Intangible Assets," addresses the following issue:

The determination of the unit of accounting and subsequent measurement of intangible assets acquired, including intangible assets acquired in a business combination, in situations in which the acquirer does not intend to actively use the asset but intends to hold (lock up) the asset to prevent its competitors from obtaining access to the asset (a defensive intangible asset).

The attached draft abstract reflects the consensus-for-exposure reached by the Task Force at the September 10, 2008 EITF meeting. The Task Force invites individuals and organizations to send written comments on all matters within this draft abstract. Comments are requested from those who agree with the provisions in this draft abstract as well as from those who do not. Comments are most helpful if they identify the issue and the specific paragraph or group of paragraphs to which they relate and clearly explain the issue or question. Those who disagree with the consensus-for-exposure presented in this draft abstract are asked to describe their suggested alternatives, supported by specific reasoning.

The Task Force specifically requests that constituents provide comments on:

- a. Whether the guidance in this Issue is operational and provides a principle that could be applied consistently.
- b. Whether constituents agree with the illustrative examples provided in Exhibit 08-7A and whether those examples will be useful in applying the principles of this Issue consistently.
- c. Whether constituents agree that no incremental disclosures beyond those already required by Statement 142 should be required for defensive intangible assets accounted

for under this Issue or whether a requirement to consider defensive assets as a separate asset class should be included in this Issue.

### **New Format for FASB Documents**

This draft abstract has been written in a new format intended to improve its understandability. Notable changes from previous formats include the use of bold text at the beginning of each section to convey the accounting principle for that section and the inclusion of examples in the body of the standard to illustrate the proposed accounting guidance for certain paragraphs, when applicable.

Comments will be considered by the Task Force at the November 13, 2008 EITF meeting.

Responses from interested parties wishing to comment on the draft abstract must be received in writing by October 22, 2008. Interested parties should submit their comments by email to [director@fasb.org](mailto:director@fasb.org), File Reference No. EITF0807. Responses should not be sent by fax.

*EITF ABSTRACTS (DRAFT\*)*

**Issue No. 08-7**

**Title:** Accounting for Defensive Intangible Assets

**Dates Discussed:** September 10, 2008; [November 13, 2008]

**References:** FASB Statement No. 2, Accounting for Research and Development Costs  
FASB Statement No. 141, *Business Combinations*  
FASB Statement No. 141 (revised 2007), *Business Combinations*  
FASB Statement No. 142, *Goodwill and Other Intangible Assets*  
FASB Statement No. 157, *Fair Value Measurements*

**Objective**

**1. The objective of this Issue is to clarify how to account for defensive intangible assets subsequent to initial measurement.**

<p><b>All paragraphs in this Issue have equal authority. Paragraphs in bold set out the main principles.</b></p>
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**Background**

2. An intangible asset acquired in a business combination or an asset acquisition that an entity does not intend to actively use has been commonly referred to as a "defensive asset" or a "locked-up asset" because while the asset is not being actively used, it is likely contributing to an increase in the value of other assets owned by the acquiring entity.

3. Historically, when an entity acquired a business or group of assets, it typically allocated little or no value to the intangible assets that it did not intend to actively use, regardless of whether another acquirer might have continued to actively use them. However, after the effective date of Statement 141(R), an intangible asset must be recognized at fair value in accordance with Statement 157, regardless of how the entity intends to use that asset.

4. Upon the effective date of both Statement 141(R) and Statement 157, acquirers will generally assign a greater value to a defensive intangible asset than would have typically been assigned under Statement 141. As a result, questions have arisen in practice regarding how

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\* This draft abstract is being exposed for a public comment period that will end on October 22, 2008.

defensive intangible assets should be accounted for subsequent to their acquisition, including the estimated useful life that should be assigned to such assets.

### Scope

**5. This Issue applies to acquired intangible assets in situations in which the acquirer does not intend to actively use the asset but intends to hold (lock up) the asset to prevent its competitors from obtaining access to the asset (a defensive intangible asset), unless the intangible asset must be expensed in accordance with other literature.<sup>1</sup>**

6. A defensive intangible asset could include an asset that the acquirer will never actively use, as well as an asset that will be used by the acquirer during a transition period when the intention of the acquirer is to discontinue the use of that asset.

7. The determination of whether an intangible asset is a defensive intangible asset is based on the intentions of the reporting entity and that determination may change as the reporting entity's intentions change (for example, an intangible asset that was accounted for as a defensive intangible asset on the date of acquisition will cease to be a defensive asset if an acquirer subsequently decides to actively use the asset). Exhibit 08-7A contains examples illustrating the determination of whether an acquired intangible asset is a defensive intangible asset.

8. This Issue does not address the identification of market participants, market participant assumptions, or valuation issues associated with defensive intangible assets.

### Recognition

**9. A defensive intangible asset should be accounted for as a separate unit of accounting. It should not be included as part of the cost of the acquirer's existing intangible asset(s) because the defensive intangible asset is separately identifiable.**

### Subsequent Measurement

**10. A defensive intangible asset shall be assigned a useful life in accordance with paragraph 11 of Statement 142.**

11. A defensive intangible asset shall be assigned a useful life which reflects the entity's consumption of the expected benefits related to that asset. The benefit a reporting entity receives from holding a defensive intangible asset is the indirect cash flows resulting from the entity preventing others from realizing any value from the intangible asset (defensively or otherwise). An entity shall determine a defensive intangible asset's useful life, that is, the period over which an entity consumes the expected benefits of the asset, by estimating the period over which the defensive intangible asset will diminish in fair value. The period over which a defensive intangible asset diminishes in fair value is a proxy for the period over which the reporting entity expects a defensive intangible asset to contribute indirectly to the future cash flows of the entity.

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<sup>1</sup> Statement 2, paragraph 11(c), requires an entity to expense the cost of a research and development intangible asset acquired in a transaction that does not qualify as a business combination, if the intangible asset has no alternative future use.

**Transition**

12. This Issue is effective for intangible assets acquired on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.

**The provisions of this Issue need not be applied to immaterial items.**

## **Exhibit 08-7A**

### **EXAMPLES OF DEFENSIVE INTANGIBLE ASSETS WITHIN THE SCOPE OF ISSUE 08-7**

The following examples illustrate the determination of whether an intangible asset meets the definition of a defensive intangible asset and is within the scope of this Issue. The examples do not address all possible ways of determining whether an intangible asset meets the definition of a defensive intangible asset. The examples also do not address the determination of the useful life of intangible assets that are within the scope of this Issue.

#### **Example 1**

Company A, a consumer products manufacturer, acquires an entity that sells a product that competes with one of Company A's existing products. Company A plans to discontinue the sale of the competing product within the next six months, but will maintain the rights to the trade name, at minimal expected cost, to prevent a competitor from using the trade name. As a result, Company A's existing product will experience an increase in market share. Company A does not have any current plans to reintroduce the acquired trade name in the future.

*Analysis:* Because Company A does not intend to actively use the acquired trade name, but intends to hold the rights to the trade name to prevent its competitors from using it, the trade name meets the definition of a defensive intangible asset.

#### **Example 2**

Company A acquires a group of assets, one of which is billing software developed by the selling entity for its own use. After a six month transition period, Company A plans to discontinue use of the internally developed billing software. In valuing the billing software in connection with the acquisition, Company A determines that a market participant would use the billing software, along with other assets in the asset group, for its full remaining economic life (that is, Company A does not intend to use the asset in a way that is at its highest and best use). Due to the specialized nature of the software, Company A does not believe the software could be sold to a third party without the other assets acquired.

*Analysis:* Although Company A does not intend to actively use the internally developed billing software after a six month transition period, Company A is not holding the internally developed software to prevent its competitors from using it. Therefore, the internally developed software asset does not meet the definition of a defensive intangible asset.

#### **Example 3**

Company A acquires a research and development intangible asset in a business combination. The reporting entity does not intend to complete the acquired research and development project because if the project was completed, the technology developed would compete with one of Company A's existing products. Instead, Company A intends to hold the project to prevent its competitors from obtaining access to the technology. Company A believes that holding the project will delay the development of a competing product, allowing Company A to keep its current market share for a longer period than it would if the competing project was completed.

*Analysis:* Because Company A does not intend to actively use the research and development intangible asset, but intends to hold the rights to the asset to prevent its competitors from using it, the intangible research and development asset meets the definition of a defensive intangible asset.

**Example 4**

Company A acquires a research and development intangible asset in a business combination. The project under development is similar to an existing project of Company A and Company A does not intend to immediately pursue the acquired project. However, if Company A's existing project is not successful in the next six months, Company A intends to resume work on the acquired project. If Company A's existing project is successful, the acquired project will be abandoned and Company A would not be concerned if a third party gained access to that project.

*Analysis:* Company A is not holding the intangible research and development asset to prevent its competitors from using it. Instead, Company A is holding the asset as an alternative to its existing research and development project. Therefore, the research and development intangible asset does not meet the definition of a defensive intangible asset.