Topic No. D-101

**Topic:** Clarification of Reporting Unit Guidance in Paragraph 30 of FASB Statement No. 142

**Date Discussed:** November 14–15, 2001

An FASB representative announced that the staff has received inquiries about the application of paragraph 30 of FASB Statement No. 142, *Goodwill and Other Intangible Assets*. In particular, the inquiries have focused on the meaning of the phrase *discrete financial information*.

Paragraph 30 of Statement 142 includes the following guidance for determining reporting units:

> A reporting unit is an operating segment or one level below an operating segment (referred to as a component). A component of an operating segment is a reporting unit if the component constitutes a business or nonprofit activity for which discrete financial information is available and segment management regularly reviews the operating results of that component. However, two or more components of an operating segment shall be aggregated and deemed a single reporting unit if the components have similar economic characteristics. An operating segment shall be deemed to be a reporting unit if all of its components are similar, if none of its components is a reporting unit, or if it comprises only a single component. The relevant provisions of Statement 131 and related interpretive literature shall be used to determine the reporting units of an entity.

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17 For purposes of determining reporting units, an operating segment is as defined in paragraph 10 of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

[Note: Prior to the adoption of FASB Statement No. 141 (revised 2007), *Business Combinations* (effective for business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after 12/15/08), footnote 18 should read as follows:]

[Note: After the adoption of Statement 141(R) and the adoption of Statement 164 (effective for not-for-profit entities prospectively in the first set of initial or annual financial statements for a reporting period beginning on or after December 15, 2009), footnote 18 should read as follows:]

18 FASB Statement No. 141 (revised 2007), Business Combinations, includes guidance on determining whether an asset group constitutes a business. Statement 164 includes guidance on determining whether an asset group constitutes a nonprofit activity.

19 Segment management consists of one or more segment managers, as that term is defined in paragraph 14 of Statement 131.

20 Paragraph 17 of Statement 131 shall be considered in determining if the components of an operating segment have similar economic characteristics.

This staff announcement summarizes the FASB staff’s understanding of the Board’s intent with respect to the determination of whether a component of an operating segment is a reporting unit.

Determining whether a component of an operating segment is a reporting unit is a matter of judgment based on an entity’s individual facts and circumstances. Although paragraph 30 of Statement 142 includes a number of characteristics that must be present for a component of an operating segment to be a reporting unit, no single factor or characteristic is determinative. The FASB staff believes that how an entity manages its operations and how an acquired entity is integrated with the acquiring entity are key to determining the reporting units of the entity. As noted in the basis for conclusions of Statement 142, “The Board’s intent was that a reporting unit would be the level of internal reporting that reflects the way an entity manages its business or operations and to which goodwill naturally would be associated” (paragraph B102). “That approach reflects the Board’s belief that the information an entity reports for internal use will reflect the way the overall entity is managed” (paragraph B103).

The characteristics identified in paragraph 30 of Statement 142 that must be present for a component to be a reporting unit are discussed below.
The Component Constitutes a Business or Nonprofit Activity

[Note: Prior to the adoption of Statement 141(R) (effective for business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after 12/15/08), the following paragraph should read:]

The determination of whether a component constitutes a business requires judgment based on specific facts and circumstances. The guidance in Issue No. 98-3, “Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business,” should be considered in determining whether a group of assets constitutes a business. That guidance states that, among other things, “for a transferred set of activities and assets to be a business, it must contain all of the inputs and processes necessary for it to continue to conduct normal operations after the transferred set is separated from the transferor.” The fact that operating information (revenues and expenses) exists for a component of an operating segment does not mean that the component constitutes a business. For example, a component for which operating information is prepared might be a product line or a brand that is part of a business rather than a business itself. [See Subsequent Developments section below.]

[Note: After the adoption of Statement 141(R) and the adoption of Statement 164 (effective for not-for-profit entities prospectively in the first set of initial or annual financial statements for a reporting period beginning on or after December 15, 2009), the following paragraph should read:]

The determination of whether a component constitutes a business or nonprofit activity requires judgment based on specific facts and circumstances. The guidance in Statement 141(R) should be considered in determining whether a group of assets constitutes a business or nonprofit activity. [Note: See Subsequent Developments section below.]
Discrete Financial Information

The term discrete financial information should be applied in the same manner that it is applied in determining operating segments in accordance with paragraph 10 of Statement 131. The Statement 131 implementation guidance indicates that it is not necessary that assets be allocated for a component to be considered an operating segment (that is, no balance sheet is required). Thus, discrete financial information can constitute as little as operating information. Therefore, in order to test goodwill for impairment in accordance with Statement 142, an entity may be required to assign assets and liabilities to reporting units (consistent with the guidance in paragraphs 32 and 33 of Statement 142).

Reviewed by Segment Management

Segment management, as defined in paragraph 14 of Statement 131, is either a level below or the same level as the chief operating decision maker. According to Statement 131, a segment manager is “directly accountable to and maintains regular contact with the chief operating decision maker to discuss operating activities, financial results, forecasts, or plans for the segment.” The approach used in Statement 142 to determine reporting units is similar to the one used to determine operating segments in Statement 131; however, Statement 142 focuses on how operating segments are managed rather than how the entity as a whole is managed. The approach in Statement 142 is consistent with the Board’s intent that reporting units should reflect the way an entity manages its operations.

Similar Economic Characteristics

Evaluating whether two components have similar economic characteristics is a matter of judgment that depends on specific facts and circumstances. That assessment should be more qualitative than quantitative.
In determining whether the components of an operating segment have similar economic characteristics, footnote 20 to paragraph 30 of Statement 142 states that the guidance in paragraph 17 of Statement 131 should be considered. The Board intended that all of the factors in paragraph 17 of Statement 131 be considered in making that determination. However, the Board did not intend that every factor must be met in order for two components to be considered economically similar. In addition, the Board did not intend that the determination of whether two components are economically similar be limited to consideration of the factors described in paragraph 17 of Statement 131. In determining whether components should be combined into one reporting unit based on their economic similarities, factors that should be considered in addition to those in paragraph 17 include but are not limited to:

- The manner in which an entity operates its business or nonprofit activity and the nature of those operations
- Whether goodwill is recoverable from the separate operations of each component business or nonprofit activity or from two or more component businesses or nonprofit activities working in concert (which might be the case if the components are economically interdependent)
- The extent to which the component businesses or nonprofit activities share assets and other resources, as might be evidenced by extensive transfer pricing mechanisms
- Whether the components support and benefit from common research and development projects.

The fact that a component extensively shares assets and other resources with other components of the operating segment may be an indication that the component either is not a business or nonprofit activity or may be economically similar to those other components. [Note: See Subsequent Developments section below.]

Components that share similar economic characteristics but relate to different operating segments may not be combined into a single reporting unit. For example, an entity might
have organized its operating segments on a geographic basis. If its three operating
segments (Americas, Europe, and Asia) each have two components (A and B) that are
dissimilar to each other but similar to the corresponding components in the other
operating segments, the entity would not be permitted to combine component A from
each of the operating segments to make reporting unit A.

Additional Observations

Some constituents have noted that two operating segments may have been aggregated
into a reportable segment by applying the aggregation criteria in paragraph 17 of
Statement 131, and have inquired about whether one or more of the components of those
operating segments can be reporting units under Statement 142. The FASB staff believes
it would be possible for one or more of those components to be economically dissimilar
from the other components and thus be a reporting unit for purposes of testing goodwill
for impairment. In particular, the FASB staff believes that that situation might occur
when an entity’s operating segments are based on geographic areas. The following points
need to be considered in addressing this question:

- The determination of reporting units under Statement 142 begins with the definition
  of an operating segment in paragraph 10 of Statement 131 and considers
  disaggregating that operating segment into economically dissimilar components for
  the purpose of testing goodwill for impairment. The determination of reportable
  segments under Statement 131 also begins with a paragraph 10 operating segment,
  but considers whether certain economically similar operating segments should be
  aggregated into a single operating segment or into a reportable segment.
- The level at which operating performance is reviewed differs between the two
  Statements—it is the chief operating decision maker who reviews operating segments
  and the segment manager who reviews reporting units (components of operating
  segments). Therefore, a component of an operating segment would not be considered
  an operating segment for Statement 131 purposes unless the chief operating decision
  maker regularly reviews its operating performance; however, that same component
  might be a reporting unit under Statement 142 if a segment manager regularly
  reviews its operating performance (and if other reporting unit criteria are met).
Subsequent Developments

Statement 141(R), which was issued in December 2007, includes guidance on determining whether an asset group constitutes a business. Statement 141(R) is effective for business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after 12/15/08.

FASB Statement No. 164, Not-for-Profit Entities: Mergers and Acquisitions, issued in April 2009, makes the guidance in Statements 141(R) and 142 fully applicable to not-for-profit entities. References to business and businesses have been amended also to refer to nonprofit activity and nonprofit activities, respectively.