

Statement of Financial Accounting Standards No. 142

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Goodwill and Other Intangible Assets

June 2001



Financial Accounting Standards Board
of the Financial Accounting Foundation
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FAS 142: Goodwill and Other Intangible Assets

FAS 142 Summary

This Statement addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, *Intangible Assets*. It addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This Statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements.

Reasons for Issuing This Statement

Analysts and other users of financial statements, as well as company managements, noted that intangible assets are an increasingly important economic resource for many entities and are an increasing proportion of the assets acquired in many transactions. As a result, better information about intangible assets was needed. Financial statement users also indicated that they did not regard goodwill amortization expense as being useful information in analyzing investments.

Differences between This Statement and Opinion 17

This Statement changes the unit of account for goodwill and takes a very different approach to how goodwill and other intangible assets are accounted for subsequent to their initial recognition. Because goodwill and some intangible assets will no longer be amortized, the reported amounts of goodwill and intangible assets (as well as total assets) will not decrease at the same time and in the same manner as under previous standards. There may be more volatility in reported income than under previous standards because impairment losses are likely to occur irregularly and in varying amounts.

This Statement changes the subsequent accounting for goodwill and other intangible assets in the following significant respects:

- Acquiring entities usually integrate acquired entities into their operations, and thus the acquirers' expectations of benefits from the resulting synergies usually are reflected in the premium that they pay to acquire those entities. However, the transaction-based approach to

accounting for goodwill under Opinion 17 treated the acquired entity as if it remained a stand-alone entity rather than being integrated with the acquiring entity; as a result, the portion of the premium related to expected synergies (goodwill) was not accounted for appropriately. This Statement adopts a more aggregate view of goodwill and bases the accounting for goodwill on the units of the combined entity into which an acquired entity is integrated (those units are referred to as reporting units).

- Opinion 17 presumed that goodwill and all other intangible assets were wasting assets (that is, finite lived), and thus the amounts assigned to them should be amortized in determining net income; Opinion 17 also mandated an arbitrary ceiling of 40 years for that amortization. This Statement does not presume that those assets are wasting assets. Instead, goodwill and intangible assets that have indefinite useful lives will not be amortized but rather will be tested at least annually for impairment. Intangible assets that have finite useful lives will continue to be amortized over their useful lives, but without the constraint of an arbitrary ceiling.
- Previous standards provided little guidance about how to determine and measure goodwill impairment; as a result, the accounting for goodwill impairments was not consistent and not comparable and yielded information of questionable usefulness. This Statement provides specific guidance for testing goodwill for impairment. Goodwill will be tested for impairment at least annually using a two-step process that begins with an estimation of the fair value of a reporting unit. The first step is a screen for potential impairment, and the second step measures the amount of impairment, if any. However, if certain criteria are met, the requirement to test goodwill for impairment annually can be satisfied without a remeasurement of the fair value of a reporting unit.
- In addition, this Statement provides specific guidance on testing intangible assets that will not be amortized for impairment and thus removes those intangible assets from the scope of other impairment guidance. Intangible assets that are not amortized will be tested for impairment at least annually by comparing the fair values of those assets with their recorded amounts.
- This Statement requires disclosure of information about goodwill and other intangible assets in the years subsequent to their acquisition that was not previously required. Required disclosures include information about the changes in the carrying amount of goodwill from period to period (in the aggregate and by reportable segment), the carrying amount of intangible assets by major intangible asset class for those assets subject to amortization and for those not subject to amortization, and the estimated intangible asset amortization expense for the next five years.

This Statement carries forward without reconsideration the provisions of Opinion 17 related to the accounting for internally developed intangible assets. This Statement also does not change the requirement to expense the cost of certain acquired research and development assets at the date of acquisition as required by FASB Statement No. 2, *Accounting for Research and Development Costs*, and FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*.

How the Changes in This Statement Improve Financial Reporting

The changes included in this Statement will improve financial reporting because the financial statements of entities that acquire goodwill and other intangible assets will better reflect the underlying economics of those assets. As a result, financial statement users will be better able to understand the investments made in those assets and the subsequent performance of those investments. The enhanced disclosures about goodwill and intangible assets subsequent to their acquisition also will provide users with a better understanding of the expectations about and changes in those assets over time, thereby improving their ability to assess future profitability and cash flows.

How the Conclusions in This Statement Relate to the Conceptual Framework

The Board concluded that amortization of goodwill was not consistent with the concept of representational faithfulness, as discussed in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*. The Board concluded that nonamortization of goodwill coupled with impairment testing *is* consistent with that concept. The appropriate balance of both relevance and reliability and costs and benefits also was central to the Board's conclusion that this Statement will improve financial reporting.

This Statement utilizes the guidance in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, for estimating the fair values used in testing both goodwill and other intangible assets that are not being amortized for impairment.

The Effective Date of This Statement

The provisions of this Statement are required to be applied starting with fiscal years beginning after December 15, 2001. Early application is permitted for entities with fiscal years beginning after March 15, 2001, provided that the first interim financial statements have not previously been issued. This Statement is required to be applied at the beginning of an entity's fiscal year and to be applied to all goodwill and other intangible assets recognized in its financial statements at that date. Impairment losses for goodwill and indefinite-lived intangible assets that arise due to the initial application of this Statement (resulting from a transitional impairment test) are to be reported as resulting from a change in accounting principle.

There are two exceptions to the date at which this Statement becomes effective:

- Goodwill and intangible assets acquired after June 30, 2001, will be subject immediately to the nonamortization and amortization provisions of this Statement.
- The provisions of this Statement will not be applicable to goodwill and other intangible assets arising from combinations between mutual enterprises or to not-for-profit organizations until the Board completes its deliberations with respect to application of the purchase method by those entities.

INTRODUCTION

1. This Statement addresses financial accounting and reporting for intangible assets acquired individually or with a group of other assets (but not those acquired in a business combination) at acquisition. This Statement also addresses financial accounting and reporting for goodwill and other intangible assets subsequent to their acquisition. FASB Statement No. 141, *Business Combinations*, addresses financial accounting and reporting for goodwill and other intangible assets acquired in a business combination at acquisition. ¹

2. This Statement supersedes APB Opinion No. 17, *Intangible Assets*; however, it carries forward without reconsideration the provisions in Opinion 17 related to internally developed intangible assets. The Board did not reconsider those provisions because they were outside the scope of its project on business combinations and acquired intangible assets. The guidance carried forward from Opinion 17 has been quoted, paraphrased, or rephrased as necessary so that it can be understood in the context of this Statement. The original source of that guidance has been noted parenthetically.

3. Appendix A to this Statement provides implementation guidance on how intangible assets should be accounted for in accordance with this Statement. Appendix A is an integral part of the standards provided in this Statement. Appendix B provides background information and the basis for the Board's conclusions. Appendix C provides illustrations of some of the financial statement disclosures that this Statement requires. Appendix D lists other accounting pronouncements superseded or amended by this Statement. Appendix E includes relevant excerpts from FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*. Appendix F provides a glossary of terms used in this Statement.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

4. The initial recognition and measurement provisions of this Statement apply to **intangible assets** ² acquired individually or with a group of other assets (but not those acquired in a business combination). ³ The remaining provisions of this Statement apply to **goodwill** that an entity ⁴ recognizes in accordance with Statement 141 and to other intangible assets that an entity acquires, whether individually, with a group of other assets, or in a business combination. While goodwill is an intangible asset, the term *intangible asset* is used in this Statement to refer to an

intangible asset other than goodwill.

5. This Statement applies to costs of internally developing goodwill and other unidentifiable intangible assets with indeterminate lives. Some entities capitalize costs incurred to develop identifiable intangible assets, while others expense those costs as incurred. This Statement also applies to costs of internally developing identifiable intangible assets that an entity recognizes as assets (Opinion 17, paragraphs 5 and 6).

6. This Statement applies to goodwill and other intangible assets recognized on the acquisition of some or all of the noncontrolling interests in a subsidiary—whether acquired by the parent, the subsidiary itself, or another affiliate. ⁵ This Statement, including its transition provisions, applies to amounts recognized as goodwill in applying the equity method of accounting and to the excess reorganization value recognized by entities that adopt fresh-start reporting in accordance with AICPA Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code*. That excess reorganization value shall be reported as goodwill and accounted for in the same manner as goodwill.

7. This Statement amends FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, to exclude from its scope goodwill and intangible assets that are not amortized.

8. Except as described in Appendix D, this Statement does not change the accounting prescribed in the following pronouncements:

- a. FASB Statement No. 2, *Accounting for Research and Development Costs*
- b. FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*
- c. FASB Statement No. 44, *Accounting for Intangible Assets of Motor Carriers*
- d. FASB Statement No. 50, *Financial Reporting in the Record and Music Industry*
- e. FASB Statement No. 61, *Accounting for Title Plant*
- f. FASB Statement No. 63, *Financial Reporting by Broadcasters*
- g. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation* (paragraphs 29 and 30)
- h. FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions* (paragraphs 4–7)
- i. FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed* (paragraph 7)
- j. FASB Statement No. 109, *Accounting for Income Taxes* (a deferred tax asset)
- k. FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (a servicing asset or liability)
- l. FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*.

Initial Recognition and Measurement of Intangible Assets

9. An intangible asset that is acquired either individually or with a group of other assets (but not those acquired in a business combination) shall be initially recognized and measured based on its **fair value**. General concepts related to the initial measurement of assets acquired in exchange transactions, including intangible assets, are provided in paragraphs 5–7 of Statement 141. ⁶ The cost of a group of assets acquired in a transaction other than a business combination shall be allocated to the individual assets acquired based on their relative fair values and shall not give rise to goodwill. ⁷ Intangible assets acquired in a business combination are initially recognized and measured in accordance with Statement 141. ⁸

Internally Developed Intangible Assets

10. Costs of internally developing, maintaining, or restoring intangible assets (including goodwill) that are not specifically identifiable, that have indeterminate lives, or that are inherent in a continuing business and related to an entity as a whole, shall be recognized as an expense when incurred (Opinion 17, paragraph 24).

Accounting for Intangible Assets

Determining the Useful Life of an Intangible Asset

11. The accounting for a recognized intangible asset is based on its **useful life** to the reporting entity. An intangible asset with a finite useful life is amortized; an intangible asset with an indefinite useful life is not amortized. The useful life of an intangible asset to an entity is the period over which the asset is expected to contribute directly or indirectly to the future cash flows of that entity. ⁹ The estimate of the useful life of an intangible asset to an entity shall be based on an analysis of all pertinent factors, in particular:

- a. The expected use of the asset by the entity
- b. The expected useful life of another asset or a group of assets to which the useful life of the intangible asset may relate (such as mineral rights to depleting assets)
- c. Any legal, regulatory, or contractual provisions that may limit the useful life
- d. Any legal, regulatory, or contractual provisions that enable renewal or extension of the asset's legal or contractual life without substantial cost (provided there is evidence to support renewal or extension and renewal or extension can be accomplished without material modifications of the existing terms and conditions)
- e. The effects of obsolescence, demand, competition, and other economic factors (such as the stability of the industry, known technological advances, legislative action that results in an uncertain or changing regulatory environment, and expected changes in distribution channels)

- f. The level of maintenance expenditures required to obtain the expected future cash flows from the asset (for example, a material level of required maintenance in relation to the carrying amount of the asset may suggest a very limited useful life). **10**

If no legal, regulatory, contractual, competitive, economic, or other factors limit the useful life of an intangible asset to the reporting entity, the useful life of the asset shall be considered to be indefinite. The term *indefinite* does not mean infinite. Appendix A includes illustrative examples of different intangible assets and how they should be accounted for in accordance with this Statement, including determining whether the useful life of an intangible asset is indefinite.

Intangible Assets Subject to Amortization

12. A recognized intangible asset shall be amortized over its useful life to the reporting entity unless that life is determined to be indefinite. If an intangible asset has a finite useful life, but the precise length of that life is not known, that intangible asset shall be amortized over the best estimate of its useful life. The method of amortization shall reflect the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up. If that pattern cannot be reliably determined, a straight-line amortization method shall be used. An intangible asset shall not be written down or off in the period of acquisition unless it becomes impaired during that period. **11**

13. The amount of an intangible asset to be amortized shall be the amount initially assigned to that asset less any **residual value**. The residual value of an intangible asset shall be assumed to be zero unless at the end of its useful life to the entity the asset is expected to continue to have a useful life to another entity and (a) the reporting entity has a commitment from a third party to purchase the asset at the end of its useful life or (b) the residual value can be determined by reference to an exchange transaction in an existing market for that asset and that market is expected to exist at the end of the asset's useful life.

14. An entity shall evaluate the remaining useful life of an intangible asset that is being amortized each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization. If the estimate of an intangible asset's remaining useful life is changed, the remaining carrying amount of the intangible asset shall be amortized prospectively over that revised remaining useful life. If an intangible asset that is being amortized is subsequently determined to have an indefinite useful life, the asset shall be tested for impairment in accordance with paragraph 17. That intangible asset shall no longer be amortized and shall be accounted for in the same manner as other intangible assets that are not subject to amortization.

Recognition and Measurement of an Impairment Loss

15. An intangible asset that is subject to amortization shall be reviewed for impairment in accordance with Statement 121 by applying the recognition and measurement provisions in paragraphs 4–11 of that Statement. In accordance with Statement 121, an impairment loss shall

be recognized if the carrying amount of an intangible asset is not recoverable and its carrying amount exceeds its fair value. After an impairment loss is recognized, the adjusted carrying amount of the intangible asset shall be its new accounting basis. Subsequent reversal of a previously recognized impairment loss is prohibited.

Intangible Assets Not Subject to Amortization

16. If an intangible asset is determined to have an indefinite useful life, it shall not be amortized until its useful life is determined to be no longer indefinite. An entity shall evaluate the remaining useful life of an intangible asset that is not being amortized each reporting period to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, the asset shall be tested for impairment in accordance with paragraph 17. That intangible asset shall then be amortized prospectively over its estimated remaining useful life and accounted for in the same manner as other intangible assets that are subject to amortization.

Recognition and Measurement of an Impairment Loss

17. An intangible asset that is not subject to amortization shall be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. (Paragraph 5 of Statement 121 includes examples of impairment indicators.) The impairment test shall consist of a comparison of the fair value of an intangible asset with its carrying amount. ¹² If the carrying amount of an intangible asset exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess. After an impairment loss is recognized, the adjusted carrying amount of the intangible asset shall be its new accounting basis. Subsequent reversal of a previously recognized impairment loss is prohibited.

Accounting for Goodwill

18. Goodwill shall not be amortized. Goodwill shall be tested for impairment at a level of reporting referred to as a reporting unit. (Paragraphs 30–36 provide guidance on determining reporting units.) Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. ¹³ The two-step impairment test discussed in paragraphs 19–22 shall be used to identify potential goodwill impairment and measure the amount of a goodwill impairment loss to be recognized (if any).

Recognition and Measurement of an Impairment Loss

19. The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. The guidance in paragraphs 23–25 shall be used to determine the fair value of a reporting unit. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, thus the second step of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill

impairment test shall be performed to measure the amount of impairment loss, if any.

20. The second step of the goodwill impairment test, used to measure the amount of impairment loss, compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. The guidance in paragraph 21 shall be used to estimate the implied fair value of goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss shall be recognized in an amount equal to that excess. The loss recognized cannot exceed the carrying amount of goodwill. After a goodwill impairment loss is recognized, the adjusted carrying amount of goodwill shall be its new accounting basis. Subsequent reversal of a previously recognized goodwill impairment loss is prohibited once the measurement of that loss is completed.

21. The implied fair value of goodwill shall be determined in the same manner as the amount of goodwill recognized in a business combination is determined. That is, an entity shall allocate the fair value of a reporting unit to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit. **14** The excess of the fair value of a reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. That allocation process shall be performed only for purposes of testing goodwill for impairment; an entity shall not write up or write down a recognized asset or liability, nor should it recognize a previously unrecognized intangible asset as a result of that allocation process.

22. If the second step of the goodwill impairment test is not complete before the financial statements are issued and a goodwill impairment loss is probable and can be reasonably estimated, the best estimate of that loss shall be recognized in those financial statements. **15** Paragraph 47(c) requires disclosure of the fact that the measurement of the impairment loss is an estimate. Any adjustment to that estimated loss based on the completion of the measurement of the impairment loss shall be recognized in the subsequent reporting period.

Fair Value Measurements

23. The fair value of an asset (or liability) is the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Thus, the fair value of a reporting unit refers to the amount at which the unit as a whole could be bought or sold in a current transaction between willing parties. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. However, the market price of an individual equity security (and thus the market capitalization of a reporting unit with publicly traded equity securities) may not be representative of the fair value of the reporting unit as a whole. **16** The quoted market price of an individual equity security, therefore, need not be the sole measurement basis of the fair value of a reporting unit.

24. If quoted market prices are not available, the estimate of fair value shall be based on the best information available, including prices for similar assets and liabilities and the results of using other valuation techniques. A present value technique is often the best available technique with which to estimate the fair value of a group of net assets (such as a reporting unit). If a present value technique is used to measure fair value, estimates of future cash flows used in that technique shall be consistent with the objective of measuring fair value. Those cash flow estimates shall incorporate assumptions that marketplace participants would use in their estimates of fair value. If that information is not available without undue cost and effort, an entity may use its own assumptions. Those cash flow estimates shall be based on reasonable and supportable assumptions and shall consider all available evidence. The weight given to the evidence shall be commensurate with the extent to which the evidence can be verified objectively. If a range is estimated for the amounts or timing of possible cash flows, the likelihood of possible outcomes shall be considered. Concepts Statement 7 discusses the essential elements of a present value measurement (paragraph 23), provides examples of circumstances in which an entity's cash flows might differ from the market cash flows (paragraph 32), and discusses the use of present value techniques in measuring the fair value of an asset or a liability (paragraphs 39–54 and 75–88). Appendix E of this Statement incorporates those paragraphs of Concepts Statement 7.

25. In estimating the fair value of a reporting unit, a valuation technique based on multiples of earnings or revenue or a similar performance measure may be used if that technique is consistent with the objective of measuring fair value. Use of multiples of earnings or revenue in determining the fair value of a reporting unit may be appropriate, for example, when the fair value of an entity that has comparable operations and economic characteristics is observable and the relevant multiples of the comparable entity are known. Conversely, use of multiples would not be appropriate in situations in which the operations or activities of an entity for which the multiples are known are not of a comparable nature, scope, or size as the reporting unit for which fair value is being estimated.

When to Test Goodwill for Impairment

26. Goodwill of a reporting unit shall be tested for impairment on an annual basis and between annual tests in certain circumstances (refer to paragraph 28). The annual goodwill impairment test may be performed any time during the fiscal year provided the test is performed at the same time every year. Different reporting units may be tested for impairment at different times.

27. A detailed determination of the fair value of a reporting unit may be carried forward from one year to the next if all of the following criteria have been met:

- a. The assets and liabilities that make up the reporting unit have not changed significantly since the most recent fair value determination. (A recent significant acquisition or a reorganization of an entity's segment reporting structure is an example of an event that might significantly change the composition of a reporting unit.)
- b. The most recent fair value determination resulted in an amount that exceeded the carrying

amount of the reporting unit by a substantial margin.

- c. Based on an analysis of events that have occurred and circumstances that have changed since the most recent fair value determination, the likelihood that a current fair value determination would be less than the current carrying amount of the reporting unit is remote.
28. Goodwill of a reporting unit shall be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Examples of such events or circumstances include:
- a. A significant adverse change in legal factors or in the business climate
 - b. An adverse action or assessment by a regulator
 - c. Unanticipated competition
 - d. A loss of key personnel
 - e. A more-likely-than-not expectation that a reporting unit or a significant portion of a reporting unit will be sold or otherwise disposed of
 - f. The testing for recoverability under Statement 121 of a significant asset group within a reporting unit
 - g. Recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit.

In addition, paragraph 39 requires that goodwill be tested for impairment after a portion of goodwill has been allocated to a business to be disposed of.

29. If goodwill and another asset (or asset group) of a reporting unit are tested for impairment at the same time, the other asset (or asset group) shall be tested for impairment before goodwill. For example, if a significant asset group is to be tested for impairment under Statement 121 (thus potentially requiring a goodwill impairment test), the impairment test for the significant asset group would be performed before the goodwill impairment test. If the asset group was impaired, the impairment loss would be recognized prior to goodwill being tested for impairment.

Reporting Unit

30. A reporting unit is an operating segment or one level below an operating segment (referred to as a component). ¹⁷ A component of an operating segment is a reporting unit if the component constitutes a business ¹⁸ for which discrete financial information is available and segment management ¹⁹ 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. ²⁰ 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.

31. An entity that is not required to report segment information in accordance with Statement

131 is nonetheless required to test goodwill for impairment at the reporting unit level. That entity shall use the guidance in paragraphs 10–15 of Statement 131 to determine its operating segments for purposes of determining its reporting units.

Assigning acquired assets and assumed liabilities to reporting units

32. For the purpose of testing goodwill for impairment, acquired assets and assumed liabilities shall be assigned to a reporting unit as of the acquisition date if both of the following criteria are met:

- a. The asset will be employed in or the liability relates to the operations of a reporting unit.
- b. The asset or liability will be considered in determining the fair value of the reporting unit.

Assets or liabilities that an entity considers part of its corporate assets or liabilities shall also be assigned to a reporting unit if both of the above criteria are met. Examples of corporate items that may meet those criteria and therefore would be assigned to a reporting unit are environmental liabilities that relate to an existing operating facility of the reporting unit and a pension obligation that would be included in the determination of the fair value of the reporting unit. This provision applies to assets acquired and liabilities assumed in a business combination and to those acquired or assumed individually or with a group of other assets.

33. Some assets or liabilities may be employed in or relate to the operations of multiple reporting units. The methodology used to determine the amount of those assets or liabilities to assign to a reporting unit shall be reasonable and supportable and shall be applied in a consistent manner. For example, assets and liabilities not directly related to a specific reporting unit, but from which the reporting unit benefits, could be allocated according to the benefit received by the different reporting units (or based on the relative fair values of the different reporting units). In the case of pension items, for example, a pro rata allocation based on payroll expense might be used.

Assigning goodwill to reporting units

34. For the purpose of testing goodwill for impairment, *all* goodwill acquired in a business combination shall be assigned to one or more reporting units as of the acquisition date. Goodwill shall be assigned to reporting units of the acquiring entity that are expected to benefit from the synergies of the combination even though other assets or liabilities of the acquired entity may not be assigned to that reporting unit. The total amount of acquired goodwill may be divided among a number of reporting units. The methodology used to determine the amount of goodwill to assign to a reporting unit shall be reasonable and supportable and shall be applied in a consistent manner. In addition, that methodology shall be consistent with the objectives of the process of assigning goodwill to reporting units described in paragraph 35.

35. In concept, the amount of goodwill assigned to a reporting unit would be determined in a manner similar to how the amount of goodwill recognized in a business combination is determined. In essence, the fair value for each reporting unit representing a “purchase price”

would be determined, and that purchase price would be allocated to the assets and liabilities of that unit. ²¹ If the purchase price exceeds the amount assigned to those net assets, that excess might be the goodwill assigned to that reporting unit. However, if goodwill is to be assigned to a reporting unit that has not been assigned any of the assets acquired or liabilities assumed in that acquisition, the amount of goodwill to be assigned to that unit might be determined by applying a “with and without” computation. That is, the difference between the fair value of that reporting unit before the acquisition and its fair value after the acquisition represents the amount of goodwill to be assigned to that reporting unit.

Reorganization of reporting structure

36. When an entity reorganizes its reporting structure in a manner that changes the composition of one or more of its reporting units, the guidance in paragraphs 32 and 33 shall be used to reassign assets and liabilities to the reporting units affected. However, goodwill shall be reassigned to the reporting units affected using a relative fair value allocation approach similar to that used when a portion of a reporting unit is to be disposed of (refer to paragraph 39). For example, if existing reporting unit A is to be integrated with reporting units B, C, and D, goodwill in reporting unit A would be assigned to units B, C, and D based on the relative fair values of the three portions of reporting unit A prior to those portions being integrated with reporting units B, C, and D.

Goodwill Impairment Testing by a Subsidiary

37. All goodwill recognized by a public or nonpublic subsidiary (subsidiary goodwill) in its separate financial statements that are prepared in accordance with generally accepted accounting principles shall be accounted for in accordance with this Statement. Subsidiary goodwill shall be tested for impairment at the subsidiary level using the subsidiary’s reporting units. If a goodwill impairment loss is recognized at the subsidiary level, goodwill of the reporting unit or units (at the higher consolidated level) in which the subsidiary’s reporting unit with impaired goodwill resides must be tested for impairment if the event that gave rise to the loss at the subsidiary level would more likely than not reduce the fair value of the reporting unit (at the higher consolidated level) below its carrying amount (refer to paragraph 28(g)). Only if goodwill of that higher-level reporting unit is impaired would a goodwill impairment loss be recognized at the consolidated level.

Goodwill Impairment Testing When a Noncontrolling Interest Exists

38. Goodwill arising from a business combination with a continuing noncontrolling interest shall be tested for impairment using an approach consistent with the approach used to measure the noncontrolling interest at the acquisition date. (A noncontrolling interest is sometimes referred to as a minority interest.) For example, if goodwill is initially recognized based only on the controlling interest of the parent, the fair value of the reporting unit used in the impairment test should be based on that controlling interest and should not reflect the portion of fair value attributable to the noncontrolling interest. Similarly, the implied fair value of goodwill that is determined in the second step of the impairment test and used to measure the impairment loss

should reflect only the parent company's interest in that goodwill.

Disposal of All or a Portion of a Reporting Unit

39. When a reporting unit is to be disposed of in its entirety, goodwill of that reporting unit shall be included in the carrying amount of the reporting unit in determining the gain or loss on disposal. ²² When a portion of a reporting unit that constitutes a business ²³ is to be disposed of, goodwill associated with that business shall be included in the carrying amount of the business in determining the gain or loss on disposal. The amount of goodwill to be included in that carrying amount shall be based on the relative fair values of the business to be disposed of and the portion of the reporting unit that will be retained. For example, if a business is being sold for \$100 and the fair value of the reporting unit excluding the business being sold is \$300, 25 percent of the goodwill residing in the reporting unit would be included in the carrying amount of the business to be sold. However, if the business to be disposed of was never integrated into the reporting unit after its acquisition and thus the benefits of the acquired goodwill were never realized by the rest of the reporting unit, the current carrying amount of that acquired goodwill shall be included in the carrying amount of the business to be disposed of. That situation might occur when the acquired business is operated as a stand-alone entity or when the business is to be disposed of shortly after it is acquired. When only a portion of goodwill is allocated to a business to be disposed of, the goodwill remaining in the portion of the reporting unit to be retained shall be tested for impairment in accordance with paragraphs 19–22 (using its adjusted carrying amount).

Equity Method Investments

40. The portion of the difference between the cost of an investment and the amount of underlying equity in net assets of an equity method investee that is recognized as goodwill in accordance with paragraph 19(b) of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* (equity method goodwill) shall not be amortized. However, equity method goodwill shall not be reviewed for impairment in accordance with this Statement. Equity method investments shall continue to be reviewed for impairment in accordance with paragraph 19(h) of Opinion 18.

Deferred Income Taxes

41. Paragraph 30 of Statement 109 states that deferred income taxes are not recognized for any portion of goodwill for which amortization is not deductible for income tax purposes. Paragraphs 261 and 262 of that Statement provide additional guidance for recognition of deferred income taxes related to goodwill when amortization of goodwill is deductible for tax purposes. This Statement does not change the requirements in Statement 109 for recognition of deferred income taxes related to goodwill and intangible assets.

Financial Statement Presentation

Intangible Assets

42. At a minimum, all intangible assets shall be aggregated and presented as a separate line item in the statement of financial position. However, that requirement does not preclude presentation of individual intangible assets or classes of intangible assets as separate line items. The amortization expense and impairment losses for intangible assets shall be presented in income statement line items within continuing operations as deemed appropriate for each entity. Paragraphs 14 and 16 require that an intangible asset be tested for impairment when it is determined that the asset should no longer be amortized or should begin to be amortized due to a reassessment of its remaining useful life. An impairment loss resulting from that impairment test shall *not* be recognized as a change in accounting principle.

Goodwill

43. The aggregate amount of goodwill shall be presented as a separate line item in the statement of financial position. The aggregate amount of goodwill impairment losses shall be presented as a separate line item in the income statement before the subtotal *income from continuing operations* (or similar caption) unless a goodwill impairment loss is associated with a discontinued operation. A goodwill impairment loss associated with a discontinued operation shall be included (on a net-of-tax basis) within the results of discontinued operations.

Disclosures

44. For intangible assets acquired either individually or with a group of assets, the following information shall be disclosed in the notes to the financial statements in the period of acquisition:

- a. For intangible assets subject to amortization:
 - (1) The total amount assigned and the amount assigned to any major **intangible asset class**
 - (2) The amount of any significant residual value, in total and by major intangible asset class
 - (3) The weighted-average amortization period, in total and by major intangible asset class
- b. For intangible assets *not* subject to amortization, the total amount assigned and the amount assigned to any major intangible asset class
- c. The amount of research and development assets acquired and written off in the period and the line item in the income statement in which the amounts written off are aggregated.

45. The following information shall be disclosed in the financial statements or the notes to the financial statements for each period for which a statement of financial position is presented:

- a. For intangible assets subject to amortization:
 - (1) The gross carrying amount and accumulated amortization, in total and by major

- intangible asset class
- (2) The aggregate amortization expense for the period
- (3) The estimated aggregate amortization expense for each of the five succeeding fiscal years
- b. For intangible assets *not* subject to amortization, the total carrying amount and the carrying amount for each major intangible asset class
- c. The changes in the carrying amount of goodwill during the period including:
 - (1) The aggregate amount of goodwill acquired
 - (2) The aggregate amount of impairment losses recognized
 - (3) The amount of goodwill included in the gain or loss on disposal of all or a portion of a reporting unit.

Entities that report segment information in accordance with Statement 131 shall provide the above information about goodwill in total and for each reportable segment and shall disclose any significant changes in the allocation of goodwill by reportable segment. If any portion of goodwill has not yet been allocated to a reporting unit at the date the financial statements are issued, that unallocated amount and the reasons for not allocating that amount shall be disclosed.

Illustration 1 in Appendix C provides an example of those disclosure requirements.

46. For each impairment loss recognized related to an intangible asset, the following information shall be disclosed in the notes to the financial statements that include the period in which the impairment loss is recognized:

- a. A description of the impaired intangible asset and the facts and circumstances leading to the impairment
- b. The amount of the impairment loss and the method for determining fair value
- c. The caption in the income statement or the statement of activities in which the impairment loss is aggregated
- d. If applicable, the segment in which the impaired intangible asset is reported under Statement 131.

47. For each goodwill impairment loss recognized, the following information shall be disclosed in the notes to the financial statements that include the period in which the impairment loss is recognized:

- a. A description of the facts and circumstances leading to the impairment
- b. The amount of the impairment loss and the method of determining the fair value of the associated reporting unit (whether based on quoted market prices, prices of comparable businesses, a present value or other valuation technique, or a combination thereof)
- c. If a recognized impairment loss is an estimate that has not yet been finalized (refer to paragraph 22), that fact and the reasons therefor and, in subsequent periods, the nature and amount of any significant adjustments made to the initial estimate of the impairment loss.

Illustration 1 in Appendix C provides an example of those disclosure requirements.

Effective Date and Transition

48. This Statement shall be effective as follows:

- a. All of the provisions of this Statement shall be applied in fiscal years beginning after December 15, 2001, to all goodwill and other intangible assets recognized in an entity's statement of financial position at the beginning of that fiscal year, regardless of when those previously recognized assets were initially recognized. Early application is permitted for entities with fiscal years beginning after March 15, 2001, provided that the first interim financial statements have not been issued previously. In all cases, the provisions of this Statement shall be initially applied at the beginning of a fiscal year. Retroactive application is not permitted. (Refer to paragraphs 53–61 for additional transition provisions.)
- b. As described in paragraphs 50 and 51, certain provisions of this Statement shall be applied to goodwill and other acquired intangible assets for which the acquisition date is after June 30, 2001, even if an entity has not adopted this Statement in its entirety.
- c. This Statement shall not be applied to previously recognized goodwill and intangible assets acquired in a combination between two or more mutual enterprises, acquired in a combination between not-for-profit organizations, or arising from the acquisition of a for-profit business entity by a not-for-profit organization until interpretive guidance related to the application of the purchase method to those transactions is issued (refer to paragraph 52). **24**

49. Paragraph 61 of Statement 141 includes the following transition provisions related to goodwill and intangible assets acquired in business combinations for which the acquisition date was before July 1, 2001, that were accounted for by the purchase method.

- a. The carrying amount of acquired intangible assets that do not meet the criteria in paragraph 39 of Statement 141 for recognition apart from goodwill (and any related deferred tax liabilities if the intangible asset amortization is not deductible for tax purposes) shall be reclassified as goodwill as of the date this Statement is initially applied in its entirety.
- b. The carrying amount of (1) any recognized intangible assets that meet the recognition criteria in paragraph 39 of Statement 141 or (2) any unidentifiable intangible assets recognized in accordance with paragraph 5 of Statement 72 that have been included in the amount reported as goodwill (or as goodwill and intangible assets) shall be reclassified and accounted for as an asset apart from goodwill as of the date this Statement is initially applied in its entirety. **25**

Goodwill and Intangible Assets Acquired after June 30, 2001

50. Goodwill acquired in a business combination for which the acquisition date is after June

30, 2001; shall not be amortized. For example, an entity with a December 31, 2001 fiscal year-end would be required to initially apply the provisions of this Statement on January 1, 2002; if that entity completed a business combination on October 15, 2001, that gave rise to goodwill, it would not amortize the goodwill acquired in that business combination even though it would continue to amortize until January 1, 2002, goodwill that arose from any business combination completed before July 1, 2001. Intangible assets other than goodwill acquired in a business combination or other transaction for which the date of acquisition is after June 30, 2001, shall be amortized or not amortized in accordance with paragraphs 11–14 and 16 of this Statement.

51. Goodwill and intangible assets acquired in a transaction for which the acquisition date is after June 30, 2001, but before the date that this Statement is applied in its entirety (refer to paragraph 48(a)), shall be reviewed for impairment in accordance with Opinion 17 or Statement 121 (as appropriate) until the date that this Statement is applied in its entirety. Similarly, the financial statement presentation and disclosure provisions of this Statement shall not be applied to those assets until this Statement is applied in its entirety.

52. Goodwill and intangible assets acquired in a combination between two or more mutual enterprises, acquired in a combination between not-for-profit organizations, or arising from the acquisition of a for-profit business entity by a not-for-profit organization for which the acquisition date is after June 30, 2001, shall continue to be accounted for in accordance with Opinion 17 (refer to footnote 24).

Previously Recognized Intangible Assets

53. To apply this Statement to intangible assets acquired in a transaction for which the acquisition date is on or before June 30, 2001, the useful lives of those previously recognized intangible assets shall be reassessed using the guidance in paragraph 11 and the remaining amortization periods adjusted accordingly. ²⁶ That reassessment shall be completed prior to the end of the first interim period of the fiscal year in which this Statement is initially applied. Previously recognized intangible assets deemed to have indefinite useful lives shall be tested for impairment as of the beginning of the fiscal year in which this Statement is initially applied (in accordance with paragraph 17). That transitional intangible asset impairment test shall be completed in the first interim period in which this Statement is initially applied, and any resulting impairment loss shall be recognized as the effect of a change in accounting principle. The effect of the accounting change and related income tax effects shall be presented in the income statement between the captions *extraordinary items* and *net income*. The per-share information presented in the income statement shall include the per-share effect of the accounting change.

Previously Recognized Goodwill

54. At the date this Statement is initially applied, an entity shall establish its reporting units based on its reporting structure at that date and the guidance in paragraphs 30 and 31. Recognized net assets, excluding goodwill, shall be assigned to those reporting units using the

guidance in paragraphs 32 and 33. Recognized assets and liabilities that do not relate to a reporting unit, such as an environmental liability for an operation previously disposed of, need not be assigned to a reporting unit. *All* goodwill recognized in an entity's statement of financial position at the date this Statement is initially applied shall be assigned to one or more reporting units. Goodwill shall be assigned in a reasonable and supportable manner. The sources of previously recognized goodwill shall be considered in making that initial assignment as well as the reporting units to which the related acquired net assets were assigned. The guidance in paragraphs 34 and 35 may be useful in assigning goodwill to reporting units upon initial application of this Statement.

55. Goodwill in each reporting unit shall be tested for impairment as of the beginning of the fiscal year in which this Statement is initially applied in its entirety (in accordance with paragraphs 19–21). An entity has six months from the date it initially applies this Statement to complete the first step of that transitional goodwill impairment test. However, the amounts used in the transitional goodwill impairment test shall be measured as of the beginning of the year of initial application. If the carrying amount of the net assets of a reporting unit (including goodwill) exceeds the fair value of that reporting unit, the second step of the transitional goodwill impairment test must be completed as soon as possible, but no later than the end of the year of initial application.

56. An impairment loss recognized as a result of a transitional goodwill impairment test shall be recognized as the effect of a change in accounting principle. The effect of the accounting change and related income tax effects shall be presented in the income statement between the captions *extraordinary items* and *net income*. The per-share information presented in the income statement shall include the per-share effect of the accounting change. Although a transitional impairment loss for goodwill may be measured in other than the first interim reporting period, it shall be recognized in the first interim period irrespective of the period in which it is measured, consistent with paragraph 10 of FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. The financial information for the interim periods of the fiscal year that precede the period in which the transitional goodwill impairment loss is measured shall be restated to reflect the accounting change in those periods. The aggregate amount of the accounting change shall be included in restated net income of the first interim period of the year of initial application (and in any year-to-date or last-12-months-to-date financial reports that include the first interim period). Whenever financial information is presented that includes the periods that precede the period in which the transitional goodwill impairment loss is measured, that financial information shall be presented on the restated basis.

57. If events or changes in circumstances indicate that goodwill of a reporting unit might be impaired before completion of the transitional goodwill impairment test, goodwill shall be tested for impairment when the impairment indicator arises (refer to paragraph 28). A goodwill impairment loss that does *not* result from a transitional goodwill impairment test shall not be recognized as the effect of a change in accounting principle; rather it shall be recognized in accordance with paragraph 43.

58. In addition to the transitional goodwill impairment test, an entity shall perform the required annual goodwill impairment test in the year that this Statement is initially applied in its entirety. That is, the transitional goodwill impairment test may not be considered the initial year's annual test unless an entity designates the beginning of its fiscal year as the date for its annual goodwill impairment test.

Equity Method Goodwill

59. Upon initial application of this Statement, the portion of the excess of cost over the underlying equity in net assets of an investee accounted for using the equity method that has been recognized as goodwill shall cease being amortized. However, equity method goodwill shall not be tested for impairment in accordance with this Statement (refer to paragraph 40).

Transitional Disclosures

60. Upon completion of the first step of the transitional goodwill impairment test, the reportable segment or segments in which an impairment loss might have to be recognized and the period in which that potential loss will be measured shall be disclosed in any interim financial information.

61. In the period of initial application and thereafter until goodwill and all other intangible assets have been accounted for in accordance with this Statement in all periods presented, the following information shall be displayed either on the face of the income statement or in the notes to the financial statements: income before extraordinary items and net income for all periods presented adjusted to exclude amortization expense (including any related tax effects) recognized in those periods related to goodwill, intangible assets that are no longer being amortized, any deferred credit related to an excess over cost (amortized in accordance with Opinion 16), and equity method goodwill. The adjusted income before extraordinary items and net income also shall reflect any adjustments for changes in amortization periods for intangible assets that will continue to be amortized as a result of initially applying this Statement (including any related tax effects). In addition, the notes to the financial statements shall disclose a reconciliation of reported net income to the adjusted net income. Similarly adjusted earnings-per-share amounts for all periods presented may be presented either on the face of the income statement or in the notes to the financial statements. Illustration 2 in Appendix C provides an example of those transitional disclosure requirements.

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

This Statement was adopted by the unanimous vote of the six members of the Financial Accounting Standards Board:

Edmund L. Jenkins, *Chairman*
G. Michael Crooch
John M. Foster
Gaylen N. Larson
Gerhard G. Mueller
Edward W. Trott

Appendix A: IMPLEMENTATION GUIDANCE ON INTANGIBLE ASSETS

A1. This appendix provides guidance on how intangible assets should be accounted for in accordance with paragraphs 11–17 of this Statement and is an integral part of the standards of this Statement. Each of the following examples describes an acquired intangible asset and the facts and circumstances surrounding the determination of its useful life and the subsequent accounting based on that determination. The facts and circumstances unique to each acquired intangible asset need to be considered in making similar determinations.

Example 1

An acquired customer list. A direct-mail marketing company acquired the customer list and expects that it will be able to derive benefit from the information on the acquired customer list for at least one year but for no more than three years.

The customer list would be amortized over 18 months, management’s best estimate of its useful life, following the pattern in which the expected benefits will be consumed or otherwise used up. Although the acquiring entity may intend to add customer names and other information to the list in the future, the expected benefits of the acquired customer list relate only to the customers on that list at the date of acquisition (a closed-group notion). The customer list would be reviewed for impairment under FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.

Example 2

An acquired patent that expires in 15 years. The product protected by the patented technology is expected to be a source of cash flows for at least 15 years. The reporting entity has a commitment from a third party to purchase that patent in 5 years for 60 percent of the fair value of the patent at the date it was acquired, and the entity intends to sell the patent in 5 years.

The patent would be amortized over its five-year useful life to the reporting entity following the pattern in which the expected benefits will be consumed or otherwise used up. The amount to be amortized is 40 percent of the patent's fair value at the acquisition date (residual value is 60 percent). The patent would be reviewed for impairment under Statement 121.

Example 3

An acquired copyright that has a remaining legal life of 50 years. An analysis of consumer habits and market trends provides evidence that the copyrighted material will generate cash flows for approximately 30 more years.

The copyright would be amortized over its 30-year estimated useful life following the pattern in which the expected benefits will be consumed or otherwise used up and reviewed for impairment under Statement 121.

Example 4

An acquired broadcast license that expires in five years. The broadcast license is renewable every 10 years if the company provides at least an average level of service to its customers and complies with the applicable Federal Communications Commission (FCC) rules and policies and the FCC Communications Act of 1934. The license may be renewed indefinitely at little cost and was renewed twice prior to its recent acquisition. The acquiring entity intends to renew the license indefinitely, and evidence supports its ability to do so. Historically, there has been no compelling challenge to the license renewal. The technology used in broadcasting is not expected to be replaced by another technology any time in the foreseeable future. Therefore, the cash flows from that license are expected to continue indefinitely.

The broadcast license would be deemed to have an indefinite useful life because cash flows are expected to continue indefinitely. Therefore, the license would not be amortized until its useful life is deemed to be no longer indefinite. The license would be tested for impairment in accordance with paragraph 17 of this Statement.

Example 5

The broadcast license in Example 4. The FCC subsequently decides that it will no longer renew broadcast licenses, but rather will auction those licenses. At the time the FCC decision is made, the broadcast license has three years until it expires. The cash flows from that license are expected to continue until the license expires.

Because the broadcast license can no longer be renewed, its useful life is no longer indefinite. Thus, the acquired license would be tested for impairment in accordance with paragraph 17 of this Statement. The license would then be amortized over its remaining three-year useful life

following the pattern in which the expected benefits will be consumed or otherwise used up. Because the license will be subject to amortization, in the future it would be reviewed for impairment under Statement 121.

Example 6

An acquired airline route authority from the United States to the United Kingdom that expires in three years. The route authority may be renewed every five years, and the acquiring entity intends to comply with the applicable rules and regulations surrounding renewal. Route authority renewals are routinely granted at a minimal cost and have historically been renewed when the airline has complied with the applicable rules and regulations. The acquiring entity expects to provide service to the United Kingdom from its hub airports indefinitely and expects that the related supporting infrastructure (airport gates, slots, and terminal facility leases) will remain in place at those airports for as long as it has the route authority. An analysis of demand and cash flows supports those assumptions.

Because the facts and circumstances support the acquiring entity's ability to continue providing air service to the United Kingdom from its U.S. hub airports indefinitely, the intangible asset related to the route authority is considered to have an indefinite useful life. Therefore, the route authority would not be amortized until its useful life is deemed to be no longer indefinite and would be tested for impairment in accordance with paragraph 17 of this Statement.

Example 7

An acquired trademark that is used to identify and distinguish a leading consumer product that has been a market-share leader for the past eight years. The trademark has a remaining legal life of 5 years but is renewable every 10 years at little cost. The acquiring entity intends to continuously renew the trademark, and evidence supports its ability to do so. An analysis of product life cycle studies; market, competitive, and environmental trends; and brand extension opportunities provides evidence that the trademarked product will generate cash flows for the acquiring entity for an indefinite period of time.

The trademark would be deemed to have an indefinite useful life because it is expected to contribute to cash flows indefinitely. Therefore, the trademark would not be amortized until its useful life is no longer indefinite. The trademark would be tested for impairment in accordance with paragraph 17 of this Statement.

Example 8

A trademark that distinguished a leading consumer product that was acquired 10 years ago. When it was acquired, the trademark was considered to have an indefinite useful life because the product was expected to generate cash flows indefinitely. During the annual impairment test of

the intangible asset, the entity determines that unexpected competition has entered the market that will reduce future sales of the product. Management estimates that cash flows generated by that consumer product will be 20 percent less for the foreseeable future; however, management expects that the product will continue to generate cash flows indefinitely at those reduced amounts.

As a result of the projected decrease in future cash flows, the entity determines that the estimated fair value of the trademark is less than its carrying amount, and an impairment loss is recognized. Because it is still deemed to have an indefinite useful life, the trademark would continue to not be amortized and would continue to be tested for impairment in accordance with paragraph 17 of this Statement.

Example 9

A trademark for a line of automobiles that was acquired several years ago in an acquisition of an automobile company. The line of automobiles had been produced by the acquired entity for 35 years with numerous new models developed under the trademark. At the acquisition date, the acquiring entity expected to continue to produce that line of automobiles, and an analysis of various economic factors indicated there was no limit to the period of time the trademark would contribute to cash flows. Because cash flows were expected to continue indefinitely, the trademark was not amortized. Management recently decided to phase out production of that automobile line over the next four years.

Because the useful life of that acquired trademark is no longer deemed to be indefinite, the trademark would be tested for impairment in accordance with paragraph 17 of this Statement. The carrying amount of the trademark after adjustment, if any, would then be amortized over its remaining four-year useful life following the pattern in which the expected benefits will be consumed or otherwise used up. Because the trademark will be subject to amortization, in the future it would be reviewed for impairment under Statement 121.

Appendix B

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

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Appendix B: BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

B1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

B2. Prior to the issuance of this Statement, the guidance on accounting for goodwill and other intangible assets was provided by APB Opinion No. 17, *Intangible Assets*, which the Accounting Principles Board (APB) of the American Institute of Certified Public Accountants (AICPA) issued in 1970. Opinion 17 required that intangible assets that are acquired in business combination transactions or other transactions be recognized as assets in the financial statements of acquiring entities and that the costs incurred to develop intangible assets that are not specifically identifiable be recognized as expenses in the financial statements of entities incurring those costs. It also required that goodwill and other intangible assets be amortized by systematic charges over the period expected to be benefited by those assets, not to exceed 40 years.

B3. During the 1970s, the FASB had an active project on its agenda to reconsider the accounting for business combinations and purchased intangible assets. However, the Board later decided to defer consideration of the issues in that project until after it completed development of its conceptual framework for accounting and reporting. In 1981, the Board removed the inactive business combinations project from its agenda to focus on higher priority projects.

B4. In August 1996, the Board added the current project on accounting for business combinations to its agenda. The objective of this project was to improve the transparency of accounting and reporting of business combinations, including the accounting for goodwill and other intangible assets, by reconsidering the requirements of Opinion 17 and APB Opinion 17 and APB Opinion No. 16, *Business Combinations* (which also was issued in 1970). In 1999, the Board decided that that objective would best be achieved through several projects focused on specific issues. In the first of those projects, which ended with the concurrent issuance of this Statement and FASB Statement No. 141, *Business Combinations*, the Board reconsidered the accounting for goodwill and other intangible assets and the methods of accounting for business combinations. Another project will address issues associated with the accounting for

combinations between not-for-profit organizations, the acquisition of a for-profit entity by a not-for-profit organization, and combinations between mutual enterprises. The Board intends to consider issues related to the accounting for the formation of joint ventures and other new entities, push-down accounting (including spinoffs), and common control transactions in another project. In still another project, the Board intends to consider issues related to the provisions of Opinion 16 and FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*, that were carried forward in Statement 141 without reconsideration, and other issues related to the application of the purchase method, such as the accounting for step acquisitions. ²⁷

Reasons the FASB Took on the Project

B5. A principal reason for taking on this project in 1996 was the increase in merger and acquisition activity that brought greater attention to the fact that two transactions that are economically similar may be accounted for by different methods that produce dramatically different financial statement results. Consequently, both the representational faithfulness and the comparability of those financial statements suffer.

B6. Another reason that the Board decided to undertake this project was that many perceived the differences in the pooling-of-interests method (pooling method) and purchase method to have affected competition in markets for mergers and acquisitions. Entities that could not meet all of the conditions for applying the pooling method believed that they faced an unlevel playing field in competing for targets with entities that could apply that method. That perception and the resulting attempts to expand the application of the pooling method placed considerable tension on the interpretation and application of the provisions of Opinion 16. The volume of inquiries fielded by the staffs of the FASB and Securities and Exchange Commission (SEC) and the auditing profession was evidence of that tension.

B7. The unlevel playing field that was perceived to stem from the application of the pooling and purchase methods extended internationally as well. Cross-border differences in accounting standards for business combinations and the rapidly accelerating movement of capital flows globally heightened the need for accounting standards to be comparable internationally. Promoting international comparability in accounting standards is part of the Board's mission, and many members of the Financial Accounting Standards Advisory Council (FASAC) cited the opportunity to promote greater international comparability in the standards for business combinations as a reason for adding this project to the Board's agenda. (FASAC had consistently ranked a possible project on business combinations as a high priority for a number of years.)

International Cooperation

B8. Largely because of concerns about the perception of an unlevel cross-border playing field with the United States in the accounting standards for business combinations, the Accounting Standards Board (AcSB) of the Canadian Institute of Chartered Accountants conducted a

business combinations project concurrently with the FASB's project. The goal of that concurrent effort was to establish common standards on business combinations and intangible assets.

B9. The FASB also worked with other members of an international organization of standard-setting bodies with the aim of achieving convergence internationally with respect to the methods of accounting for business combinations. That organization, known as the "Group of 4 plus 1" (G4+1), consisted of the Australian Accounting Standards Board, the New Zealand Financial Reporting Standards Board, the United Kingdom Accounting Standards Board (UK ASB), the AcSB, the FASB, and an observer, the International Accounting Standards Committee (IASC).

Conduct of the FASB's Project

B10. The Board formed a business combinations task force comprising individuals from a number of organizations representing a wide range of the Board's constituents. The first meeting of that task force was held in February 1997. Relevant academic research was reviewed, and the meeting discussion centered on a background paper that addressed the project's scope, the direction the project should take, and how the project should be conducted.

B11. The June 1997 FASB Special Report, *Issues Associated with the FASB Project on Business Combinations*, was based on that background paper and indicated some of the Board's initial decisions about the project's scope, direction, and conduct. The 54 comment letters received in response to that Special Report generally expressed agreement with those decisions.

B12. In 1998, the FASB participated in the development of a G4+1 Position Paper, *Recommendations for Achieving Convergence on the Methods of Accounting for Business Combinations*. The Board issued the Position Paper as an FASB Invitation to Comment, *Methods of Accounting for Business Combinations: Recommendations of the G4+1 for Achieving Convergence*, in December 1998, the same date on which other G4+1 member organizations issued similar documents for comment.

B13. After considering the recommendations of the G4+1 and the responses to the Invitation to Comment, the Board decided that only the purchase method should be used to account for business combinations. The Board also decided that certain changes should be made in how the purchase method should be applied, particularly in the accounting for and financial statement presentation of goodwill and other intangible assets. Those changes included limiting the maximum amortization period for goodwill to 20 years, presenting goodwill amortization expense on a net-of-tax basis in the income statement, and not amortizing certain intangible assets. Those changes were proposed in the September 1999 FASB Exposure Draft, *Business Combinations and Intangible Assets* (1999 Exposure Draft). The Board received 210 comment letters in response to that Exposure Draft. In February 2000, the Board held 4 days of public hearings, 2 days in San Francisco and 2 days in New York City, at which 43 individuals or organizations presented their views on the 1999 Exposure Draft.

B14. In redeliberating the proposals in the 1999 Exposure Draft, the Board considered changes suggested by various constituents, in particular those related to the accounting for goodwill. During October and November 2000, Board and staff members explored the suggested changes to the accounting for goodwill in field visits with 14 companies. The Board's deliberations resulted in significant changes to the proposed requirements related to goodwill but not to other issues addressed in the 1999 Exposure Draft. In particular, the Board decided that goodwill should no longer be amortized and should be tested for impairment in a manner different from other assets. In February 2001, the Board also affirmed the proposal that only the purchase method should be used to account for business combinations. In February 2001, the Board issued a revised Exposure Draft, *Business Combinations and Intangible Assets—Accounting for Goodwill* (2001 Exposure Draft), that proposed changes to the 1999 Exposure Draft with regard to the accounting for goodwill and the initial recognition of intangible assets other than goodwill. The Board received 211 comment letters on the 2001 Exposure Draft.

B15. The Board decided to separate the guidance for goodwill and other intangible assets from that for business combinations and issue that guidance in two final documents, this Statement and Statement 141. Those two Statements parallel and supersede Opinions 17 and 16, respectively. Statement 141 was issued concurrently with this Statement.

Scope

B16. This Statement applies to all entities, including mutual enterprises and not-for-profit organizations. The 2001 Exposure Draft excluded from its scope goodwill and other intangible assets acquired in combinations between two or more not-for-profit organizations and goodwill and other intangible assets acquired in an acquisition of a for-profit entity by a not-for-profit organization. Rather than exclude goodwill and other intangible assets acquired in those transactions from the scope of this Statement, the Board concluded that it would be more appropriate to include those assets in the scope of this Statement. However, the Board agreed to delay the effective date of this Statement as it applies to not-for-profit organizations and combinations between two or more mutual enterprises until it completes the project on its agenda addressing issues related to combinations of those entities. The Board noted that goodwill and intangible assets acquired in those types of combinations would be accounted for in the same manner as goodwill and intangible assets acquired in business combinations unless distinguishing characteristics or circumstances are identified justifying a different accounting treatment.

B17. This Statement applies to excess reorganization value recognized in accordance with AICPA Statement of Position (SOP) 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code*. SOP 90-7 states that the excess reorganization value resulting from reorganization under the Bankruptcy Code is an intangible asset that should be amortized in accordance with Opinion 17, generally over a period substantially less than 40 years. Because this Statement supersedes Opinion 17, respondents to the 2001 Exposure Draft requested that the

Board address whether excess reorganization value should be accounted for like goodwill and not be amortized or accounted for like an intangible asset and thus possibly continue to be amortized.

B18. Most respondents stated that excess reorganization value is similar to goodwill and therefore should be accounted for in the same manner as goodwill. The Board agreed with those respondents and concluded that excess reorganization value recognized in accordance with SOP 90-7 should be accounted for as goodwill in accordance with this Statement. The Board decided that the transition provisions in this Statement should apply to previously recognized excess reorganization value that is being accounted for in accordance with Opinion 17.

B19. The Board decided that this Statement should not change the accounting for an unidentifiable intangible asset recognized in an acquisition of a bank or thrift institution that is prescribed in FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions*. The Board noted that Statement 72 does not refer to the unidentifiable intangible asset as goodwill and concluded that it would not be appropriate to account for that intangible asset as if it were goodwill without a full reconsideration of the issues associated with that industry, which is beyond the issues addressed in this Statement.

Intangible Assets

Scope and Definition

B20. The Board initially decided that the focus of this project with respect to intangible assets should be limited to those intangible assets acquired in a business combination. However, the Board acknowledged in the Special Report that it would consider the need to expand the scope to other intangible assets as the project progressed.

B21. The Board observed that the scope of Opinion 17 is not limited to intangible assets acquired in a business combination but rather encompasses intangible assets generally. Other standards, such as Financial Reporting Standard (FRS) 10, *Goodwill and Intangible Assets*, issued by the UK ASB, and International Accounting Standard (IAS) 38, *Intangible Assets*, issued by the IASC, also apply to intangible assets generally.

B22. The Board considered whether to include in the scope of this project all acquired intangible assets rather than only those acquired in a business combination. The Board noted that doing so would have the advantage of treating all acquired intangible assets similarly regardless of whether they were acquired in a business combination or in another transaction. The Board also noted that it might result in greater convergence with the requirements in standards outside the United States.

B23. The Board noted, however, that the guidance in Opinion 17 does not specify how the costs

of internally developing specifically identifiable intangible assets that have limited lives should be treated. As a result, those costs may be either recognized as assets and amortized or expensed as incurred. The only provisions of Opinion 17 that relate to such assets are those concerning amortization, which relate to other intangible assets as well. The Board further noted that guidance for certain types of intangible assets, such as computer software, is provided in other standards and that the Board's intent generally was not to amend those standards as part of the business combinations project.

B24. Internally developed intangible assets raise many accounting issues that have little to do with business combinations, so the Board decided not to address them in the business combinations project. ²⁸ However, the Board concluded that the accounting issues associated with intangible assets acquired in transactions other than business combinations are sufficiently similar to those associated with such assets acquired in business combinations and thus decided to address them in this project.

B25. The Board also noted that research and development costs are excluded from the scope of Opinion 17 by FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*, but not from the scope of Opinion 16. The Board therefore considered issues related to the accounting for research and development assets acquired in business combinations. During the development of the 1999 Exposure Draft, the Board noted that some of the issues associated with research and development assets are unique to those assets and not directly related to other business combinations issues. The Board concluded that it was not possible to address those issues without considering the issues associated with accounting for research and development costs generally. Consequently, the Board decided not to address issues associated with research and development assets in this project.

B26. Statement 141, which supersedes Opinion 16, addresses the initial recognition and measurement of intangible assets, including goodwill, that are acquired in a business combination. This Statement addresses the initial recognition and measurement of intangible assets acquired in transactions other than business combinations, as well as the subsequent recognition and measurement of intangible assets generally.

B27. In the deliberations that led to the 1999 Exposure Draft, the Board concluded that the characteristics that distinguish intangible assets from other assets are that they are (a) without physical substance, (b) not financial instruments, and (c) not current assets. The 1999 Exposure Draft defined intangible assets in terms of those characteristics. Several respondents to that Exposure Draft noted that some intangible assets (such as order or production backlogs) are current assets. They observed that some might interpret that proposed definition as prohibiting recognition of those intangible assets as intangible assets, which they believed was not the Board's intent. The Board agreed with those respondents and decided that this Statement should define intangible assets more broadly, that is, as assets (not including financial assets) that lack physical substance.

Initial Recognition of Intangible Assets Acquired in Transactions Other Than Business Combinations

B28. At the inception of this project, the Board observed that intangible assets make up an increasing proportion of the assets of many (if not most) entities, but despite their importance, those assets often are not recognized as such. Accordingly, the Board concluded in the 1999 Exposure Draft that the decision usefulness of financial statements would be enhanced by the recognition of more intangible assets. The Board affirmed that view in its redeliberations.

B29. The Board noted that, to be recognized, intangible assets acquired in transactions other than business combinations must meet the four fundamental recognition criteria for assets in paragraph 63 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*. Those criteria are that the item meets the assets definition, it has an attribute that is measurable with sufficient reliability, the information about it is capable of making a difference in user decisions, and the information is representationally faithful, verifiable, and neutral.

B30. The Board observed that bargained exchange transactions that are conducted at arm's length provide reliable evidence about the existence and fair value of acquired intangible assets. Accordingly, the Board concluded that those transactions provide a basis for recognizing those assets in the financial statements of the acquiring entities. The Board also observed that similarly reliable evidence about the existence and fair value of intangible assets that are developed internally is not generally available.

B31. The Board also considered how to distinguish intangible assets from each other. The Board observed that, conceptually, the main reason for distinguishing intangible assets from each other is to enhance the decision usefulness of financial statements. As stated in Concepts Statement 5:

Classification in financial statements facilitates analysis by grouping items with essentially similar characteristics and separating items with essentially different characteristics. Analysis aimed at objectives such as predicting amounts, timing, and uncertainty of future cash flows requires financial information segregated into reasonably homogenous groups. For example, components of financial statements that consist of items that have similar characteristics in one or more respects, such as continuity or recurrence, stability, risk, and reliability, are likely to have more predictive value than if their characteristics are dissimilar.
[paragraph 20]

B32. In the 1999 Exposure Draft, the Board observed that many intangible assets are based on rights that are conveyed legally by contract, statute, or similar means. It also noted that many such assets are exchangeable, as are other intangible assets that are not based on such rights. The Board noted that intangible assets span a spectrum, with intangible assets that are readily

exchangeable at one end and others that are “goodwill like” at the other end. In that regard, it noted that exchangeability is a useful basis for distinguishing different types of intangible assets because those that are capable of being sold or otherwise transferred constitute a potential source of funds.

B33. In considering responses to the 1999 Exposure Draft, the Board reconsidered the guidance proposed for the recognition of intangible assets apart from goodwill. As a result, Statement 141 requires that an intangible asset be recognized apart from goodwill if it meets either of two criteria.

B34. Statement 141 requires that an intangible asset be recognized apart from goodwill if it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations (the contractual-legal criterion). In that regard, the Board observed that the values of many intangible assets arise from rights conveyed legally by contract, statute, or similar means. For example, franchises are granted to automobile dealers, fast-food outlets, and professional sports teams. Trademarks and service marks may be registered with the government. Contracts often are negotiated with customers or suppliers. Technological innovations are often protected by patents. The Board concluded that the fact that an intangible asset arises from contractual or other legal rights is an important characteristic and intangible assets with that characteristic should be recognized apart from goodwill.

B35. Statement 141 also requires that an acquired intangible asset be recognized apart from goodwill if the intangible asset is separable, that is, it is capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, regardless of whether there is an intent to do so (the separability criterion). The Board noted that some acquired intangible assets may have been developed internally by the acquired entity. The Board noted that although some intangible assets do not arise from rights conveyed by contract or other legal means, they are nonetheless capable of being separated and exchanged for something else of value. Other intangible assets cannot be separated and sold or otherwise transferred. The Board concluded that separability is another important characteristic and, therefore, intangible assets with that characteristic should be recognized apart from goodwill. ²⁹

B36. The Board observed that the contractual-legal criterion and the separability criterion are the basis for distinguishing between intangible assets and goodwill acquired in business combination transactions and are not applicable to other transactions in which intangible assets are acquired (because goodwill arises only in business combinations or in transactions accounted for like business combinations). However, the Board observed that those criteria may constitute a useful basis for distinguishing between different types of recognized intangible assets that are acquired in other transactions, thereby enhancing the decision usefulness of the financial statements, consistent with paragraph 20 of Concepts Statement 5.

B37. The Board also noted that Statement 141 contains a presumption that an intangible asset

that meets the contractual-legal criterion or the separability criterion also would meet the asset recognition criteria in Concepts Statement 5.³⁰ The Board observed that intangible assets that are acquired individually or with a group of assets in a transaction other than a business combination also may meet the asset recognition criteria in Concepts Statement 5 even though they do not meet either the contractual-legal criterion or the separability criterion (for example, specially-trained employees or a unique manufacturing process related to an acquired manufacturing plant). Such transactions commonly are bargained exchange transactions that are conducted at arm's length, which the Board concluded provides reliable evidence about the existence and fair value of those assets. Thus, those assets should be recognized as intangible assets.

Initial Measurement of Intangible Assets Acquired in Transactions Other Than Business Combinations

B38. Both Statement 141 and this Statement require that acquired intangible assets initially be assigned an amount based on their fair values, which is consistent with the requirements of Opinions 16 and 17 and the proposals of the 1999 Exposure Draft. As noted in paragraph 7 of FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, in recent years the Board has identified fair value as the objective for most measurements at initial recognition. None of the respondents to the 1999 Exposure Draft suggested alternative measurement approaches.

B39. In Statement 141 the Board affirmed the basic principles of historical-cost accounting included in paragraphs 66–69 of Opinion 16. Specifically, the Board affirmed that an asset acquisition should be measured on the basis of the values exchanged and that measurement of the values exchanged should be based on the fair value of the consideration given or the fair value of the net assets acquired, whichever is more reliably measurable. For similar reasons, the Board concluded in this Statement that acquired intangible assets should be initially measured based on their fair values. The Board also agreed that when groups of assets are acquired, the value of the asset (or net asset) group as a whole should be allocated to the individual assets (or assets and liabilities) that make up the group on the basis of their relative fair values.

B40. The Board noted that an intangible asset arising from a contractual or other legal right represents the future cash flows that are expected to result from ownership of that contract or legal right. Fair value represents the amount at which that asset could be bought or sold in a current transaction between willing parties, that is, in other than a forced or liquidation sale. For example, the fair value of an order backlog would represent the amount a buyer would be willing to pay to acquire the future cash flows expected to arise from that order backlog.

B41. The Board recognizes that the requirements of this Statement might change current practice with respect to the amounts assigned to some intangible assets, in particular those that arise from contractual or other legal rights. For example, the Board has been informed that in current practice the amount assigned to acquired operating lease contracts (from the lessor's

perspective) and customer contracts often is based on the amount by which the contract terms are favorable relative to market prices at the date of acquisition. Thus, no amount is typically assigned to lease and other contracts that are “at the money”—that is, when the contract terms reflect market prices at the date of acquisition. The Board observed, however, that such “at the money” contracts are bought and sold in exchange transactions—the purchase and sale of airport gates (an operating lease) within the airline industry and customer contracts in the home security industry are two examples of those exchange transactions. The Board believes that those transactions provide evidence that a contract may have value for reasons other than terms that are favorable relative to market prices. The Board relative therefore concluded that the amount by which the terms of a contract are favorable to market prices would not always represent the fair value of that contract.

B42. Several respondents noted that a present value technique might often be the best available technique with which to estimate the fair value of an acquired intangible asset. Some of those respondents asked whether the estimated cash flows used in applying that technique should be limited to the cash flows expected over the remaining legal or contractual term of the acquired asset. The Board noted that judgment is required in estimating the period of expected cash flows. Those estimates should be consistent with the objective of measuring fair value and, thus, should incorporate assumptions that marketplace participants would use in estimating fair value, such as assumptions about contract renewals and other benefits, such as those that might result from acquisition-related synergies.

B43. The Board noted that if such information is not available without undue cost and effort, an entity should use its own assumptions. The Board also noted that while many contracts or other rights (including customer contracts) are fixed in duration, past history (and industry practice) often provides evidence that the contracts or rights generally are renewed without substantial cost and effort. For example, although contracts to manage investments of mutual funds are often short-term contracts (one-year term or less), the Board has been informed that in many (if not most) cases those contracts are continuously renewed. The Board has also been informed that while some legal rights such as trademarks and broadcast licenses have finite legal lives, those rights are renewable and are often renewed without challenge. In those cases, the Board believes that estimates of future cash flows used in measuring the fair value of the acquired intangible asset would reflect cash flows for periods that extend beyond the remaining term of the acquired contract or legal right. The Board noted that Concepts Statement 7 discusses the essential elements of a present value measurement (paragraph 23), provides examples of circumstances in which an entity’s expected cash flows might differ from the market cash flows (paragraph 32), and discusses the use of present value techniques in measuring the fair value of an asset or liability (paragraphs 39–54 and 75–88).

Subsequent Recognition and Measurement

Useful Lives of Intangible Assets

B44. The Board observed that the useful lives of intangible assets are related to the expected cash inflows that are associated with those assets. Accordingly, the Board concluded that the amortization periods for intangible assets should generally reflect those useful lives and, by extension, the cash flow streams associated with them. The Board noted that the useful lives and amortization periods of intangible assets should reflect the periods over which those assets will contribute to cash flows, not the period of time that would be required to internally develop those assets.

B45. The Board agreed that the useful life of an intangible asset is indefinite if that life extends beyond the foreseeable horizon—that is, there is no foreseeable limit on the period of time over which it is expected to contribute to the cash flows of the reporting entity. The Board concluded that if an entity performs an analysis of all of the pertinent factors that should be considered in determining the useful life of an intangible asset (such as those in paragraph 11) and finds that there is no limit on the useful life of an intangible asset, that asset should be deemed to have an indefinite useful life.

B46. The Board noted that the cash flows and useful lives of intangible assets that are based on legal rights are constrained by the duration of those legal rights. Thus, the useful lives of such intangible assets cannot extend beyond the length of their legal rights and may be shorter. Accordingly, the Board concluded that in determining the useful lives of those intangible assets, consideration should be given to the periods that the intangible assets contribute to cash flows, which are subject to the expiration of the legal rights.

B47. The Board observed that legal rights often are conveyed for limited terms that may be renewed, and therefore it considered whether renewals should be assumed in establishing useful lives for those intangible assets. The Board noted that some types of licenses are initially issued for finite periods but renewals are routinely granted with little cost, provided that licensees have complied with the applicable rules and regulations. Such licenses trade at prices that reflect more than the remaining term, thereby indicating that renewal at minimal cost is the general expectation, and thus their useful lives may be indefinite. However, renewals are not assured for other types of licenses, and even if they are renewed, substantial costs may be incurred for their renewal. Because the useful lives of certain intangible assets depend on renewal and on the associated costs, the Board concluded that the useful lives assigned to those assets may reflect renewal only if there is evidence to support renewal without substantial cost.

B48. The Board observed that renewals could result in some of those intangible assets having long or indefinite useful lives. The Board also observed that some assets are based on legal rights that are conveyed in perpetuity rather than for finite terms. As such, those assets may

have cash flows associated with them that may be expected to continue for many years or even indefinitely. If the cash flows are expected to continue for a finite period, then the useful life of the asset is limited to that finite period. However, if the cash flows are expected to continue indefinitely, the useful life may be indefinite rather than finite. The Board also observed that intangible assets that are not based on legal rights also may have long or indefinite useful lives. Such assets, for example, may be ones that can be and are bought and sold, thereby providing evidence of their continued existence. Those markets also provide evidence of the fair values of those assets, either directly from transactions in which those assets are exchanged, or indirectly, utilizing models that incorporate transaction prices for similar assets as inputs.

Amortization

Amortization Period

B49. The Board observed that Opinion 17 required intangible assets to be amortized over their expected useful lives; however, amortization periods were limited to 40 years. The Board noted that standards elsewhere that address intangible assets are generally similar. However, in some cases, the maximum amortization period is less than 40 years, with 20 years frequently being the presumed or absolute maximum. The Board noted that both FRS 10 and IAS 38 have presumptive maximums of 20 years. However, FRS 10 permits some intangible assets not to be amortized at all, provided that (a) the durability of the asset can be demonstrated ³¹ and justifies an amortization period longer than 20 years and (b) the asset is capable of continued measurement so that annual impairment reviews can be conducted. IAS 38 requires all intangible assets to be amortized but does not specify a maximum amortization period.

B50. Because of the potential for at least some intangible assets to have long or indefinite useful lives, the Board initially considered whether a maximum amortization period of 20 years should be applied to all of those assets, as it initially had decided with respect to goodwill (in developing the 1999 Exposure Draft). The Board observed that reducing the maximum amortization period for those assets from 40 years to 20 years would be a significant change from the requirements of Opinion 17.

B51. The Board noted in the 1999 Exposure Draft that having the same maximum amortization periods for intangible assets as for goodwill might discourage entities from recognizing more intangible assets apart from goodwill. Not independently recognizing those intangible assets when they exist and can be reliably measured adversely affects the relevance and representational faithfulness of the financial statements. Accordingly, the Board concluded in the 1999 Exposure Draft that setting a maximum amortization period of 20 years for all intangible assets would not have been appropriate.

B52. The Board observed, however, that a 20-year limitation constituted a useful benchmark or hurdle and concluded that it should be a presumptive maximum. Accordingly, the concluded in the 1999 Exposure Draft that intangible assets that have useful lives exceeding 20 years could be

amortized over periods exceeding 20 years if they generate clearly identifiable cash flows that are expected to continue for more than 20 years. Support for that amortization period would have been provided by a legal life exceeding 20 years or exchangeability of the asset.

B53. Responses to the 1999 Exposure Draft varied. Some respondents stated that no intangible assets should be amortized; others stated that a presumption about the length of the amortization period was not necessary, nor was a maximum. The Board reaffirmed in this Statement that intangible assets with finite useful lives should be amortized. The Board noted that the revised criteria for an intangible asset to be recognized apart from goodwill (contractual-legal and separability) are similar to the criteria in the 1999 Exposure Draft for overcoming the 20-year useful life presumption (the 1999 Exposure Draft would have required an intangible asset to have clearly identifiable cash flows in order to overcome that presumption). The Board noted that the useful life of an intangible asset is defined in this Statement as the period over which an asset is expected to contribute directly or indirectly to future cash flows. The Board therefore concluded that a recognized intangible asset should be amortized over its useful life to the reporting entity and that there should be no limit, presumed or maximum, on that amortization period. However, the Board agreed that an entity is required to periodically evaluate the remaining useful lives of intangible assets and revise the amortization period of an intangible asset if it is determined that the useful life of the asset is longer or shorter than originally estimated.

Amortization method

B54. In considering the methods of amortization, the Board noted that Opinion 17 required that a straight-line method be used to amortize intangible assets unless another method was demonstrated to be more appropriate. However, the Board also noted that circumstances may exist in which another method may be more appropriate, such as in the case of a license that entitles the holder to produce a finite quantity of product. The Board therefore concluded that the amortization method adopted should reflect the pattern in which the asset is consumed if that pattern can be reliably determined, with the straight-line method being used as a default.

Amortizable amount and residual value

B55. The Board noted that some intangible assets could have residual values at the ends of their useful lives to the entity that acquired them. Opinion 17 was silent about the role of residual values in determining the amortizable amount; however, both FRS 10 and IAS 38 address residual values. Thus, the Board concluded that explicit mention should be made of the use of residual values in determining amortizable amounts. Specifically, the Board decided that the residual value of an intangible asset should be assumed to be zero unless the asset's useful life to the reporting entity is less than its useful life generally and reliable evidence is available concerning the residual value. Such evidence should be in the form of either a commitment by a third party to purchase the asset at the end of its useful life or an existing market for the asset that is expected to exist at the end of the asset's useful life. During its redeliberations of the 1999 Exposure Draft, the Board clarified that the residual value is the net amount that an entity

expects to obtain for an intangible asset at the end of its useful life to that entity—not at the end of its useful life in general. The Board also clarified that the residual value should be determined net of any costs to dispose of the intangible asset.

Nonamortization

B56. In developing the 1999 Exposure Draft, the Board observed that all certain intangible assets may have useful lives that are indefinite and amortizing those assets would not be representationally faithful. However, because most intangible assets have finite useful lives, the Board noted that an assertion of an indefinite useful life should have to meet a high hurdle in terms of evidence to justify nonamortization. In the 1999 Exposure Draft, the Board concluded that the only evidence that would be sufficient to overcome such a hurdle would be that the intangible asset generates cash flows indefinitely and that there is an observable market for it. Examples of such intangible assets might be airport route authorities, certain trademarks, and taxicab medallions.

B57. Respondents to the 1999 Exposure Draft generally supported nonamortization of certain intangible assets; however, some respondents suggested that all intangible assets be amortized (over a maximum of 20 years). Some respondents noted that the existence of an observable market is not pertinent to the decision as to whether an asset's useful life is finite or indefinite; therefore, an observable market should not be a criterion for nonamortization of intangible assets. The Board affirmed its decision that intangible assets with indefinite useful lives should not be amortized and reconsidered the need for an observable market criterion. The Board observed that in light of the revised criteria for determining which intangible assets are to be recognized apart from goodwill, an observable market might not be necessary to support nonamortization of intangible assets deemed to have indefinite useful lives.

B58. The Board reasoned that an intangible asset that is separable or is subject to contractual or legal-based rights will have an observable market or will have identifiable cash flows associated with it. The Board noted that Concepts Statement 7 (issued after issuance of the 1999 Exposure Draft) provides guidance for using cash flows to determine the fair value of an asset in the absence of an observable market. Because there are different ways to determine fair value, the Board concluded that it was not necessary that there be an observable market for an intangible asset in order for that asset not to be amortized. Therefore, any intangible asset that is determined to have an indefinite useful life should not be amortized until that life is determined to be no longer indefinite.

B59. The Board observed that an indefinite useful life is not necessarily an infinite useful life. As noted in paragraph B45, the useful life of an intangible asset is indefinite if no limit is placed on the end of its useful life to the reporting entity. The Board also observed that indefinite does not mean the same as indeterminate. Thus, even if the precise useful life of a finite-lived intangible asset is not determinable, the intangible asset still would have to be amortized, and the amortization period would reflect the best estimate of the useful life of that asset.

B60. The Board affirmed that an intangible asset like a taxicab medallion may be considered to have an indefinite useful life because the right associated with that asset can be renewed indefinitely at little or no cost. The Board observed that paragraph 11(d) requires an entity to consider the ability to renew or extend a specified limit on an intangible asset's legal or contractual life in determining the length of its useful life to the reporting entity if evidence supports renewal or extension without substantial cost. The Board noted that whether the cost of renewal is substantial should be determined based on the relationship of the renewal cost to the fair value of the intangible asset at the time it is acquired.

B61. As noted previously, the Board agreed that an entity should periodically evaluate the remaining useful lives of intangible assets. The Board affirmed that when an intangible asset's useful life is no longer considered to be indefinite, such as when unanticipated competition enters the market, the intangible asset must be amortized over the remaining period that it is expected to contribute to cash flows. Similarly, the Board agreed that an intangible asset that initially is deemed to have a finite useful life should cease being amortized if it is subsequently determined to have an indefinite useful life, for example, due to a change in legal requirements.

Reviews for Impairment

B62. The Board concluded that intangible assets that are being amortized should continue to be reviewed for impairment in accordance with FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. However, the Board noted that a different approach to impairment reviews was needed for intangible assets that are not being amortized. As the Board observed in conjunction with its consideration of goodwill impairment, nonamortization places heavy reliance on the reviews for impairment. Because the cash flows associated with intangible assets having indefinite useful lives would extend into the future indefinitely, those assets might never fail the undiscounted cash flows recoverability test in Statement 121, even if those cash flows were expected to decrease over time.

B63. Accordingly, the Board decided that the recognition of impairment losses on intangible assets with indefinite useful lives should be based on the fair values of those assets without performing the recoverability test, noting that that would be an exception to Statement 121. However, the impairment losses would be measured as the excess of the carrying amount over fair value, which is consistent with Statement 121.

B64. Because the Board eliminated the observable market criterion for nonamortization of intangible assets, the Board addressed how fair value should be determined for impairment purposes in the absence of an observable market price. When it agreed to eliminate the observable market criterion, the Board noted that Concepts Statement 7 provides guidance for using cash flows to determine the fair value of an asset in the absence of an observable market. The Board concluded that the fair value measurement guidance included in this Statement that is based on Concepts Statement 7 should be used to determine the fair value of intangible assets for

impairment purposes.

B65. The 1999 Exposure Draft required that the fair value of an intangible asset not being amortized be tested for impairment on an annual basis. The Board reaffirmed that requirement after it decided that goodwill should be tested for impairment on an annual basis. The Board also concluded that an intangible asset not being amortized should be tested for impairment whenever events occur or circumstances change between annual tests indicating that the asset might be impaired. The Board agreed that the examples of impairment indicators in paragraph 5 of Statement 121 were appropriate for intangible assets not being amortized.

B66. The Board agreed that when the estimate of the remaining useful life of an intangible asset changes from finite to indefinite or vice versa, the asset should be tested for impairment (in accordance with paragraph 17) prior to the change in the method of accounting for that intangible asset. The Board observed that any resulting impairment loss would be due to a change in accounting estimate and thus, consistent with APB Opinion No. 20, *Accounting Changes*, should be recognized as a change in estimate, not as a change in accounting principle. Therefore, that loss would be presented in the income statement in the same manner as other impairment losses (except a transitional impairment loss).

Goodwill

Initial Recognition and Measurement

B67. Statement 141 addresses the initial recognition and measurement of acquired goodwill. In that Statement, the Board concluded that acquired goodwill meets the assets definition in FASB Concepts Statement No. 6, *Elements of Financial Statements*, and the asset recognition criteria in Concepts Statement 5. In addition, the Board concluded that goodwill should be measured as the excess of the cost of an acquired entity over the sum of the amounts assigned to assets acquired and liabilities assumed. This Statement addresses the recognition and measurement of goodwill subsequent to its acquisition.

Subsequent Recognition and Measurement

B68. The Board considered the following alternatives for accounting for goodwill after it has been initially recognized: (a) write off all or a portion of goodwill immediately, (b) report goodwill as an asset that is amortized over its useful life, (c) report goodwill as an asset that is not amortized but is reviewed for impairment, or (d) report goodwill as an asset, a portion of which is amortized and a portion of which is not amortized (a mixed approach).

Immediate Write-off

B69. As explained in Statement 141, the Board concluded that goodwill meets the criteria for recognition of an asset and therefore should not be written off at the date of an acquisition its initial. In discussing whether goodwill should be written off immediately subsequent to its

initial recognition, the Board noted that it would be difficult to explain why goodwill is written off immediately after having just been recognized as an asset. If goodwill had been worthless on the date of acquisition, it would not have met the assets definition and would not have been recognized. However, if goodwill had value initially, virtually no event other than a catastrophe could subsequently occur in which it instantaneously became worthless.

B70. Some respondents to both Exposure Drafts argued that goodwill should be written off immediately because of the uncertainties associated with goodwill subsequent to its initial recognition. The Board noted that if the uncertainties associated with goodwill were so great as to mandate its write-off immediately following initial recognition, those same uncertainties should have been present when it was acquired and would have been reflected in the purchase price of the acquired entity. Furthermore, the Board questioned whether an informational purpose would be served if goodwill were to be recognized only momentarily as an asset unless it were in fact only momentarily an asset. The Board additionally noted that difficulties arise in determining the diminution in value of goodwill in subsequent periods but observed that such difficulties are not unique to goodwill. The Board accordingly concluded that immediate write-off subsequent to initial recognition was not justifiable.

A Mixture of Amortization and Nonamortization

B71. Early in the project, the Board concluded that useful at least part of goodwill may be a nonwasting asset and thus may have an indefinite life. To the extent that recognized goodwill is a composite of several “discernible elements” having different useful lives, the Board concluded that goodwill should in concept be accounted for in such a way as to reflect those lives. That is, ideally, the portion of goodwill that has an indefinite useful life would not be amortized, and the portion of goodwill that has a finite useful life would be amortized over that life. Accordingly, the Board considered what it described as the “discernible-elements approach” as the basis for determining the portion of goodwill that should not be amortized and the amortization period for the portion of goodwill that should be amortized.

B72. The discernible-elements approach may be described broadly as follows. At acquisition, the reasons for paying a premium over the fair value of the acquired entity’s identifiable net assets would be identified and documented, with that analysis supporting and justifying the amount of goodwill recorded. The recorded amount of goodwill would be allocated to each of its discernible elements based on that analysis. Those elements would be assessed to determine whether they had finite or indefinite useful lives, based on the length of time that they were expected to contribute to cash flows. The lengths of the finite useful lives also would be determined. The portion of goodwill with a finite useful life would then be amortized over the weighted-average useful life of the discernible elements. The portion of goodwill with an indefinite useful life would not be amortized but would be subject to impairment reviews (if an appropriate impairment test could be developed).

B73. The Board acknowledged, however, that such an approach would involve numerous

subjective judgments on the part of entities in identifying discernible elements, allocating the purchase premium to them, and assessing their useful lives. As a result, the Board conducted a field test of its proposed approach in mid-1998. Participants supported the approach conceptually but expressed concerns about the subjective judgments required to apply it and noted that it affords opportunities for manipulation of reported amounts in financial statements. Moreover, comparisons of how those participants applied the approach to prior business combinations demonstrated significant differences, thereby underscoring concerns about its operationality. The Board concluded that the discernible-elements approach was not sufficiently operational to require its use in amortizing goodwill. Because the Board concluded that segregating the parts of goodwill that are wasting and nonwasting is not feasible, it proposed in the 1999 Exposure Draft that all goodwill should continue to be amortized.

Amortization

B74. The 1999 Exposure Draft proposed that goodwill would be amortized over its useful life and that the amortization period would not exceed 20 years. At the time, the Board observed that one argument for amortizing goodwill was that goodwill should be allocated to achieve a proper allocation of its costs to future operations. Another argument was that acquired goodwill is an asset that is consumed and replaced with internally generated goodwill and that the acquired goodwill therefore must be amortized (even though the internally generated goodwill that is replacing it cannot be recognized as an asset). Another argument was that the useful life of goodwill cannot be predicted with a satisfactory level of reliability, nor can the pattern in which goodwill diminishes be known. Hence, in the 1999 Exposure Draft the Board concluded that amortization over an arbitrary period of time was the only practical solution to an intractable problem and was preferable to the alternative of writing off goodwill immediately because that would be even less representationally faithful.

B75. The Board acknowledged that achieving an acceptable level of reliability in the form of representational faithfulness was one of the primary challenges it faced in deliberating the accounting for goodwill. The useful life of goodwill and the pattern in which it diminishes are both difficult to predict, yet its amortization depends on such predictions. As a result, the Board acknowledged that the amount amortized in any given period can be described as only a rough estimate of the decrease in goodwill during that period. However, the Board noted that users of financial statements can be expected to understand such limitations of goodwill amortization.

B76. To assist users in understanding those limitations, the Board concluded in the 1999 Exposure Draft that goodwill amortization expense should be separated from other items on the income statement to make it more transparent. In reaching that conclusion, the Board noted the anomalous accounting between acquired goodwill and internally generated goodwill and that goodwill is different from other assets. The Board concluded that those differences justified displaying charges associated with goodwill (amortization expense and impairment losses) differently, particularly because goodwill may be a nonwasting asset in part and because measures of its amortization and impairment may be less precise than other measures of income

items.

B77. The Board further acknowledged constituents' assertions that many users assess goodwill charges differently than other income items, in some cases eliminating them from their analysis of earnings per share. The Board therefore concluded that a more transparent display would facilitate the analyses of those users but would not impair the analyses of users that do not assess those charges differently. Thus, the 1999 Exposure Draft proposed that goodwill charges be presented on a net-of-tax basis as a separate line item in the income statement. That line item would have been immediately preceded by a required subtotal of income after taxes but before goodwill charges and would have been immediately followed by an appropriately titled subtotal.

B78. Respondents' views on the requirements proposed in the 1999 Exposure Draft varied. Some respondents agreed with the Board that goodwill should be amortized like other assets; others favored not amortizing goodwill but testing it for impairment; still others suggested that goodwill be written off immediately. Many respondents that expressed support for the requirement to amortize goodwill stated that although amortization was not necessarily their first preference, they were willing to accept the proposed requirement given the method proposed in the 1999 Exposure Draft of displaying goodwill amortization in the income statement. Many respondents, however, did not agree with the proposal to place an arbitrary limit of 20 years on the goodwill amortization period. Others expressed the view that 20 years was too long.

Reconsideration of a Nonamortization Approach

B79. When it issued the 1999 Exposure Draft, the Board acknowledged that not all goodwill declines in value and that goodwill that does decline in value rarely does so on a straight-line basis. Because the Board agreed with respondents who stated that straight-line amortization of goodwill over an arbitrary period does not reflect economic reality and thus does not provide useful information, the Board reconsidered its decision to require amortization of goodwill. The Board reaffirmed its belief that immediate write-off of goodwill was not appropriate and thus focused its reconsideration on nonamortization of goodwill.

B80. As part of its reconsideration of the 1999 Exposure Draft, the Board sought additional input from its constituents. Two groups of constituents met with the Board to discuss their proposed approaches to accounting for goodwill, under which goodwill would not be amortized but would be tested for impairment. Based on those presentations, informal discussion with Board members, and additional research, a general approach to testing goodwill for impairment (general impairment approach) was developed.

B81. During October and November 2000, the Board discussed that general impairment approach with 14 companies in a variety of industries to gather input on how it might be implemented. Those field visits also included a discussion of the methods currently used by companies to value potential acquisitions, analyze the subsequent performance of an acquired business, test goodwill for impairment, and determine the amount of goodwill to write off when an acquired business is subsequently sold or disposed of. Field visit participants offered

suggestions to change and improve the general impairment approach. After contemplating and summarizing the findings from those field visits, the Board reconsidered its reasons for concluding in the 1999 Exposure Draft that a nonamortization approach was *not* appropriate for goodwill.

Some portion of goodwill is a wasting asset

B82. The 1999 Exposure Draft noted that, conceptually, at least part of what is recognized as goodwill may have an indefinite useful life that could last as long as the business is considered a going concern. However, the Board concluded that some of what is recognized as goodwill might have a finite useful life partly because goodwill is measured as a residual and may include components (representing assets or components of assets) that are wasting assets and therefore should be amortized. As discussed previously, prior to issuing the 1999 Exposure Draft, the Board considered the discernible-elements approach that would have required amortization of the wasting portion of goodwill and nonamortization of the nonwasting portion (that is, the portion with an indefinite useful life). However, the Board concluded that segregating the portion of recognized goodwill that might not be a wasting asset from the portion that is a wasting asset would not be practicable.

B83. The 1999 Exposure Draft proposed that an intangible asset that could not be reliably measured should be recognized as part of goodwill. The Board decided to change that proposed treatment to require that only intangible assets that do not have an underlying contractual or other legal basis or are not capable of being separated and sold, transferred, licensed, rented, or exchanged be recognized as part of goodwill. The Board believes that application of those criteria should result in more recognition and reporting uniformity in the intangible assets that are recognized apart from goodwill. In addition, the intangible assets that would be recognized as part of goodwill using the revised criteria generally would be “goodwill like” in nature. The Board concluded that by revising the criteria for separating intangible assets from goodwill, the portion of recognized goodwill that might be wasting would be smaller than it might have been using the criteria in the 1999 Exposure Draft. Thus, Board members viewed nonamortization of all goodwill as more appropriate than it would have been under the 1999 Exposure Draft. However, the Board still needed to overcome its concerns with testing goodwill for impairment and develop an operational impairment test.

Concerns with testing goodwill for impairment

Internally generated goodwill

B84. Unlike many other assets that are tested for impairment, goodwill does not have a set of cash flows uniquely associated with it. Instead, the cash flows associated with acquired goodwill usually are intermingled with those associated with internally generated goodwill and other assets because entities generally enter into business combinations to reduce costs and achieve synergies, which entails integrating the acquired entity with the acquiring entity.

B85. In its reconsideration of the goodwill impairment issue, the Board assessed to what extent it would be appropriate to allow the accounting model to compensate for the fact that acquired goodwill might be replaced by internally generated goodwill. Many respondents noted that the current accounting model does not permit recognition of internally generated intangible assets, including goodwill. They also noted that a good portion of an entity's value may be related to those unrecognized intangible assets. Respondents mentioned the growing disparity between the market capitalization of many entities and their book values as strong evidence of that unrecognized value. Board members concluded that it is appropriate to assume that acquired goodwill is being replaced by internally generated goodwill provided that an entity is able to maintain the overall value of goodwill (for example, by expending resources on advertising and customer service).

Integration of an acquired entity

B86. Prior to issuing the 1999 Exposure Draft, the Board's discussions of goodwill impairment tests generally centered on testing goodwill specific to an acquisition. The Board concluded that keeping track of acquisition-specific goodwill for impairment purposes would be almost impossible once an acquired entity was integrated with the acquiring entity. The Board considered the alternative of testing goodwill at the combined entity (total company) level to be unacceptable. The Board learned in its field visits that synergies occur below the combined entity level and that management is often held accountable for acquisitions at a lower level. In addition, Board members noted that the higher the level of review, the more difficult it would be to develop a robust impairment test and the less confident investors would be with the results of the impairment tests. The Board considered further the fact that an acquired entity often is integrated with a part of the acquiring entity and concluded that, in those cases, goodwill should be tested for impairment in conjunction with more than just the net assets of the acquired entity. The Board concluded that, in most cases, it is appropriate to test goodwill for impairment in the aggregate at a level higher than that of the acquired entity and lower than that of the combined entity. Thus, the 2001 Exposure Draft proposed that goodwill be tested for impairment at a level referred to as a reporting unit. The Board envisioned that a reporting unit generally would be at a level somewhere between a reportable operating segment (as defined in FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*) and an asset group (as that term is used in Statement 121). (Paragraphs B101–B112 discuss the reporting unit in more detail.)

B87. The Board noted that the anomalies that result from the differences in how acquired goodwill and internally generated goodwill are accounted for also justify a departure from the current model of accounting for goodwill on an acquisition-specific basis subsequent to an acquisition. The Board observed that an entity often has internally generated goodwill and goodwill-like assets that are not recognized on its balance sheet. Thus, it would be infrequent that the value of the actual (recognized and unrecognized) goodwill and goodwill-like assets of an entity would be less than the amount portrayed as goodwill in its balance sheet even if the value of the goodwill associated with a specific acquisition declined subsequent to its

acquisition. This point was significant to some Board members in agreeing to accept a nonamortization approach and depart from the normal acquisition-specific model for testing goodwill for impairment.

Undiscounted cash flows

B88. Prior to issuing the 1999 Exposure Draft, the Board discussed testing goodwill for impairment using an undiscounted cash flow method similar to that required for long-lived assets in Statement 121. The Board concluded at that time that a similar method would not be appropriate for goodwill because the cash flows in question could continue for many years—longer than most other assets.

B89. Another reason the Board ultimately decided against using an undiscounted cash flow method to test goodwill for impairment was that constituents generally agreed with the 1999 Exposure Draft proposal that intangible assets that are not being amortized should not be tested for impairment in accordance with Statement 121 and thus should be excluded from the scope of that Statement. The 1999 Exposure Draft would have required that an intangible asset not being amortized be tested for impairment on an annual basis and that an impairment loss be recognized if the carrying amount of the intangible asset exceeded its fair value. That proposed fair value impairment test would have differed from the impairment test used for all other assets. Thus, the Board decided to continue to pursue an approach that would exclude nonamortized intangible assets—including goodwill—from the scope of Statement 121 and to test for impairment using a fair-value-based approach.

Decision usefulness

B90. During its field visits, the Board learned that, in addition to the many analysts that ignore goodwill amortization expense in their analyses, many entities ignore goodwill amortization expense in measuring operating performance for internal reporting purposes; rather, they hold management responsible for the amount invested in an acquired entity (including goodwill). A number of field visit participants noted, for example, that in measuring return on net assets, management would include goodwill in the denominator (asset base) but would exclude the amortization expense from the numerator (operating earnings). Thus, Board members acknowledged that not only do many users of financial statements ignore goodwill amortization expense in making investment and credit decisions, entities often do not consider goodwill amortization expense in evaluating the performance of management.

B91. In addition, Board members noted that reported earnings often increase in the period following the final amortization expense of goodwill even though operations may not have changed significantly. Some Board members believe that result is not representationally faithful because that earnings increase arises from the cessation of prior “doubling-up” of expenses related to goodwill, which occurs when the income statement is charged for expiring goodwill (amortization of past outlays for acquired goodwill) at the same time it is charged for current outlays to create goodwill (internally generated goodwill). As a result, reported earnings in those

prior periods were decreased in such a way that they did not faithfully reflect the economic changes that occurred in those periods.

Nonamortization in some or all cases

B92. Upon reconsideration of all of those issues, the Board concluded that an acceptable impairment test could be developed based on aggregate goodwill rather than only acquired goodwill and that nonamortization of goodwill coupled with a fair-value-based impairment test would result in more representationally faithful and decision-useful financial information. The Board then considered whether it was appropriate to permit entities to amortize acquired goodwill in certain circumstances, noting that impairment issues would have to be considered regardless of whether goodwill was being amortized.

B93. The Board was doubtful that it could develop operational criteria to identify the circumstances in which goodwill should be amortized. The Board noted that if it were to permit both nonamortization and amortization of goodwill (a variation of the mixed approach), entities effectively would have a free choice as to which method to use to account for goodwill, resulting in a significant potential for noncomparable financial reporting among entities. More important, because the Board concluded that its approach would result in more representationally faithful financial information, to permit goodwill to be amortized would be inappropriate.

B94. The Board also concluded that not amortizing goodwill in all circumstances would provide information that is more useful to investors than adopting a mixed approach under which goodwill would be permitted to be amortized in some circumstances. The Board observed that adopting a nonamortization approach for all goodwill would not mean that goodwill would never be written down or that it would only be written down occasionally in large amounts. Board members noted that if the carrying amount of goodwill of a reporting unit cannot be maintained, the impairment test would accommodate both periodic and irregular write-downs of goodwill to reflect that decline in value. For example, an entity might acquire a mature business that is considered a “cash cow” and is not expected to grow. Specifically, the acquired business is expected to generate cash flows for a limited period of time as it winds down its operations and eventually ceases to operate. The Board acknowledged that if that acquired business were to be operated as a separate reporting unit, that reporting unit would recognize goodwill impairment losses on a regular basis until its goodwill is reduced to zero, presumably when operations cease. Thus, the Board concluded in the 2001 Exposure Draft to depart from the prior view that all goodwill should be amortized and adopted a nonamortization approach for all goodwill.

Nonamortization of Goodwill and Related Impairment Tests

B95. Most respondents to the 2001 Exposure Draft agreed with the Board’s conclusions on the fundamental aspects of the proposed nonamortization approach. They said that nonamortization of goodwill, coupled with impairment testing and appropriate disclosure, promotes transparency in financial reporting and thus provides useful information to those who rely on financial statements. In addition, respondents noted that not amortizing goodwill is consistent with both

how an entity manages its business and how investors view goodwill.

B96. Most respondents that disagreed with the Board's conclusions did so because they consider goodwill to be a wasting asset or because the proposed nonamortization approach in essence allows acquisitive entities to capitalize internally generated goodwill. Respondents argued that effectively capitalizing internally generated goodwill is inconsistent with the general accounting model and introduces an unlevel playing field favoring entities that grow by acquisition rather than internally. Most respondents who disagreed with nonamortization of goodwill suggested that goodwill be amortized over a life of up to 20 years with "below-the-line" income statement presentation, as proposed in the 1999 Exposure Draft.

B97. The Board acknowledged that the proposed impairment test would ensure only that the carrying amount of goodwill of a reporting unit does not exceed the total goodwill (acquired and internally generated) of that unit and thus could be viewed as effectively capitalizing internally generated goodwill. However, acquired goodwill cannot be isolated from internally generated goodwill after the acquired business is integrated with a larger part of the acquiring entity. Moreover, acquired goodwill and goodwill created subsequent to the acquisition cannot be separately identified even if the acquired business is not integrated with other parts of the entity.

B98. Without the ability to measure internally generated goodwill and factor that measure into the impairment test, the carrying amount of goodwill that is tested for impairment always will be shielded by goodwill internally generated both before and after the acquisition. Thus, the Board was unable to determine a way to apply a nonamortization approach coupled with impairment testing and avoid the possibility of what some describe as "backdoor" capitalization of internally generated goodwill. The Board noted that some consider amortization of goodwill to be unfair to entities whose growth comes largely from acquisitions rather than from internal sources because of the "doubling-up" of expenses that occurs within a specific reporting period as the result of expensing current outlays that generate goodwill (such as advertising and research and development outlays) and concurrently amortizing acquired goodwill. Thus, the Board did not consider it possible to develop a method of accounting for acquired goodwill that all would agree established a level playing field in all circumstances. Accordingly, the Board focused on which method better reflects the economic impact of goodwill on an entity.

B99. The Board reaffirmed its decision that nonamortization of goodwill combined with an adequate impairment test will provide financial information that more faithfully reflects the economic impact of acquired goodwill on the value of an entity than does amortization of goodwill. The Board concluded that the goodwill impairment test prescribed by this Statement will adequately capture goodwill impairment. It thus concluded that nonamortization of goodwill will result in the most useful financial information within the constraints of the current accounting model and available valuation techniques.

B100. Some respondents to the 2001 Exposure Draft stated that while their preference is an impairment-only (nonamortization) model for goodwill, it would be appropriate to amortize

goodwill in certain circumstances. Examples include acquisition of a business that is a cash cow, a small business that is unable to devote resources to the impairment test, and acquisitions of high-tech companies. In developing the 2001 Exposure Draft, the Board considered whether a mixed model would be more appropriate than an impairment-only model. At that time, the Board was concerned that unless operational criteria could be developed that would limit amortization of goodwill to specific circumstances, preparers might interpret this Statement as allowing free choice in accounting for goodwill. In addition, the Board was not confident that operational criteria could be developed that would distinguish those circumstances in which amortization would be appropriate from those in which it would *not* be appropriate. The Board noted that allowing some entities to amortize goodwill might impair comparability in financial reporting. For those same reasons, the Board concluded that amortization of goodwill should not be permitted in any circumstance, noting that the impairment test will capture steadily declining goodwill provided that the level of testing is low enough.

Reporting unit

B101. The 2001 Exposure Draft proposed that goodwill be tested for impairment at the reporting unit level. A reporting unit was defined in that Exposure Draft as the lowest level of an entity that is a business and that can be distinguished, physically and operationally and for internal reporting purposes, from the other activities, operations, and assets of the entity. As defined, a reporting unit could be no higher than a reportable operating segment (segment) and would generally be lower than that level of reporting. However, the Board acknowledged that for some entities, a reporting unit would be the same as a segment and that for narrowly focused entities, the entity as a whole might be one reporting unit.

B102. The Board initially considered testing goodwill at the segment level in all cases, based on the presumption that that level generally is the lowest reporting level that captures all of the goodwill of a specific acquisition. However, field visit participants informed the Board that they often allocate goodwill below the segment level—for example, to operating or business unit levels. After considering the views of field visit participants and others, the Board concluded that the Statement should permit some flexibility in the level at which goodwill is tested for impairment and that it should allow the level to differ as appropriate from entity to entity and industry to industry. Board members noted that goodwill by its nature will be associated with the operations of an entity at different levels—possibly different levels within the same overall entity. 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.

B103. It was important to the Board that the impairment test be performed at a level at which information about the operations of an entity and the assets and liabilities that support those operations are documented for internal reporting purposes (as well as possibly for external reporting purposes). 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. Therefore, the Board did not intend the concept of a reporting unit and the requirement to test goodwill for impairment

at that level to create a new internal reporting level. The Board believed that information entities currently generate about their operations, such as cash flows by business unit for planning purposes, would be used in measuring the fair value of a reporting unit. Similarly, information about the underlying assets and liabilities currently reported by an entity, such as a balance sheet for each division, would be used to identify the net assets of a reporting unit.

B104. However, many respondents to the 2001 Exposure Draft interpreted the reporting unit to be a level much lower than the level the Board had intended. Some respondents asserted that an entity could have hundreds or possibly thousands of reporting units. Also, there were differences of opinion about whether the reporting unit as defined in the 2001 Exposure Draft allowed for the flexibility that the had Board intended. Many respondents asserted that they would be required to test goodwill for impairment at a level that had no bearing on how the acquisition was integrated into the acquiring entity or how the overall combined entity was managed.

B105. Most respondents who disagreed with using the reporting unit as defined in the 2001 Exposure Draft suggested that goodwill be tested at the reportable segment level or at the operating segment level (both as defined in Statement 131). Respondents stated that testing goodwill for impairment at a level based on Statement 131 would be more operational and more consistently applied. Respondents observed that public entities currently apply the operating segment concept for financial reporting purposes and have processes in place to identify and accumulate information about operating segments. Thus, the operating segment concept is more easily understood than the proposed reporting unit concept and also takes advantage of the processes currently in place. In addition, respondents noted that segments would be a more manageable level for impairment testing because segments are changed far less often than lower level units. It was also observed that because financial statement users are more familiar with Statement 131, testing goodwill for impairment at the segment level would provide information that financial statement users can relate to other segment information provided in the financial statements.

B106. However, many respondents who suggested that goodwill be tested for impairment at the segment level also suggested that entities be permitted to test goodwill for impairment at a lower “reporting unit” level as long as the entity documented its policy for doing so and applied that policy on a consistent basis. The Board reaffirmed its belief that there should be a common methodology for determining the unit of account (the reporting unit) and that permitting exceptions would raise comparability and unlevel playing field issues.

B107. Because it did not intend the requirement to test goodwill for impairment at the reporting unit level to create a new level of reporting and because of concerns about inconsistent application, the Board reconsidered the definition of a reporting unit proposed in the 2001 Exposure Draft. The Board considered and rejected attempting to revise the reporting unit definition to better describe what the Board originally intended. While revising the definition would allow for the most flexibility in determining the appropriate level at which to test goodwill for impairment, Board members did not think it would be possible to devise a

definition that would be interpreted and applied in a consistent manner.

B108. The Board agreed with respondents who suggested that the level of impairment testing should relate to the segment reporting requirements of Statement 131. The Board thus considered requiring goodwill to be tested for impairment at the operating segment level in all instances. An operating segment is defined in Statement 131 (paragraph 10) as a component of an enterprise:

- (a) That engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same enterprise),
- (b) Whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and
- (c) For which discrete financial information is available.

B109. The Board concluded that in many cases the operating segment level may be too high a level at which to perform the goodwill impairment test. That conclusion was based on the requests of respondents that the Statement permit entities to test goodwill for impairment below the operating segment level if the entity is able to do so.

B110. Consequently, the Board considered defining a reporting unit to be one reporting level below the operating segment level, which would be the business units or components of an operating segment whose operating results are regularly reviewed by the segment manager. (As described in Statement 131, segment managers are the direct reports of the chief operating decision maker.) Under that approach, reporting units would align with how operating results are regularly reviewed by the segment manager to make decisions about resource allocation and to assess segment performance. That definition also would be similar to what the Board intended the proposed definition of a reporting unit to capture.

B111. The Board concluded that this Statement should retain the term *reporting unit* but should redefine the term using the concepts in Statement 131 so that the concept would be familiar to both preparers and users. However, the Board wanted to retain some flexibility in application of the reporting unit definition such that a reporting unit could vary somewhat from entity to entity and even within an entity, as appropriate under the circumstances. Thus, as defined in this Statement, a component of an operating segment is a reporting unit if the component is a business for which discrete financial information is available and segment management regularly reviews the operating results of that component. However, the Board acknowledged that even though segment management might review the operating results of a number of business units (components of an operating segment), components with similar economic characteristics should be aggregated into one reporting unit. The Board reasoned that the benefits of goodwill would be shared by components of an operating segment that have similar economic characteristics and that requiring goodwill to be allocated among components with similar economic characteristics

would be arbitrary and unnecessary for purposes of impairment testing. Consider an operating segment that consists of four components. Segment management reviews the operating results of each component, all of which are businesses for which discrete financial information is available. If three of those components share similar economic characteristics, the operating segment would consist of two reporting units. The component that has economic characteristics dissimilar from the other components of the operating segment would be its own reporting unit, and the three components with similar economic characteristics would constitute one reporting unit.

B112. Therefore, reporting units will vary depending on the level at which performance of the segment is reviewed, how many businesses the operating segment includes, and the similarity of those businesses. Thus, as in the 2001 Exposure Draft, a reporting unit could be the same as an operating segment, which could be the same as a reportable segment, which could be the same as the entity as a whole (entity level). Board members observed that the revised definition of a reporting unit will yield the same results for many entities as was intended by the reporting unit definition proposed in the 2001 Exposure Draft.

Nonpublic entities

B113. Having decided that the determination of reporting units should be linked to segment reporting in Statement 131, the Board considered whether to make an exception or provide additional guidance for entities that are not required to apply Statement 131. The Board concluded that although nonpublic entities are not required to follow the segment disclosure requirements in Statement 131, those entities should *not* be exempt from testing goodwill for impairment at the reporting unit level. The Board noted that many nonpublic entities have internal reporting systems that currently gather or are capable of gathering the data necessary to test goodwill for impairment at a level below the entity level. As with public entities, the reporting unit level for many nonpublic entities may be the same as the entity level. Thus, nonpublic entities would not be precluded from testing for impairment at the entity level—if in fact that level meets the definition of a reporting unit. The Board believes that the guidance in this Statement and Statement 131 is sufficient for nonpublic entities with more than one reporting unit to test goodwill for impairment at the reporting unit level.

Assigning acquired assets and assumed liabilities to reporting units

B114. The 2001 Exposure Draft proposed that for purposes of testing goodwill for impairment, the assets and liabilities of an acquired entity (including goodwill) that would be used in the operations of a reporting unit or that relate to those operations would have to be assigned to that reporting unit as of the acquisition date. The Board concluded that assigning assets and liabilities to reporting units would be necessary to make the goodwill impairment test that incorporates the values of those net assets operational. The Board noted that to the extent corporate assets or liabilities related to a reporting unit (such as pension and environmental liabilities), those assets and liabilities should be assigned as well.

B115. Respondents to the 2001 Exposure Draft expressed concerns with the requirement to assign goodwill and other assets and liabilities to reporting units. Respondents were particularly concerned with the requirement to assign corporate assets and liabilities to reporting units because of the difficulty, cost, inconsistency of application, and loss of synergies in making what they viewed as subjective and arbitrary allocation decisions. Other respondents disagreed with that requirement, noting that many businesses are best managed with the evaluation and responsibility of corporate assets and liabilities occurring at the overall entity level. Some respondents noted that their concerns would be minimized if goodwill were to be tested for impairment at the segment level instead of the proposed reporting unit level.

B116. The Board noted that the 2001 Exposure Draft would not have required *all* acquired assets and assumed liabilities to be assigned to reporting units, only those that would be employed in or were related to the operations of a unit. The Board concluded that the objective of the assignment process should be to ensure that the assets and liabilities that are assigned to a reporting unit are the same net assets that are considered in determining the fair value of that unit—an “apples-to-apples” comparison. Therefore, to the extent corporate items are reflected in the value of a reporting unit, they should be assigned to the reporting unit. For example, pension liabilities related to active employees would normally be assumed when acquiring a business; thus, that type of liability generally would be considered in determining the fair value of a reporting unit.

B117. The Board agreed that this Statement should clarify that an asset or liability should be assigned to a reporting unit only if it would be considered in determining the fair value of the unit. To do otherwise would not result in an apples-to-apples comparison. The Board confirmed that another objective of the exercise is to assign to a reporting unit all of the assets and liabilities that would be necessary for that reporting unit to operate as a business. Board members noted that it is those net assets that will generate the cash flows used to determine the fair value of a reporting unit.

B118. The Board agreed to retain the general guidance proposed in the 2001 Exposure Draft for determining how to assign assets and liabilities to reporting units. That is, the methodology used to assign assets and liabilities to reporting units should be reasonable, supportable, and applied in a consistent manner. Board members observed that it is possible for a reasonable allocation method to be very general.

Assigning goodwill to reporting units

B119. The 2001 Exposure Draft included limited guidance on how to assign acquired goodwill to reporting units. Respondents to the 2001 Exposure Draft questioned whether an entity would be required to assign goodwill only to the reporting units where the net assets acquired have been assigned and whether it would be possible to have overall “enterprise” goodwill that would not be assigned to any reporting unit. Respondents suggested that enterprise goodwill could be tested for impairment at the total entity level.

B120. The Board affirmed that all goodwill should be allocated to reporting units. Board members observed that if some portion of goodwill is deemed to relate to the entity as a whole, that portion of goodwill should be assigned to all of the reporting units of the entity in a reasonable and supportable manner. The Board also concluded that goodwill should be assigned to the reporting units of the acquiring entity that are expected to benefit from the synergies of the combination even though those units may not be assigned any other assets or any liabilities of the acquired entity.

B121. The Board acknowledged that the requirement in this Statement to assign what some view as corporate assets and liabilities to reporting units could be considered inconsistent with the requirements in Statement 131. For purposes of reporting information about assets by segment, entities are required by Statement 131 to include in reported segment assets only those assets that are included in the measure of the segment's assets that is used by the chief operating decision maker. Thus, goodwill and other assets and liabilities may not be included in reported segment assets. This Statement does not require that goodwill and all other related assets and liabilities assigned to reporting units for purposes of testing goodwill for impairment be reflected in the entity's reported segments. However, even though an asset may not be included in reported segment assets, the asset (or liability) should be allocated to a reporting unit for purposes of testing for impairment if it meets the criteria in paragraph 32 of this Statement. This Statement also requires that the amount of goodwill in each segment be disclosed in the notes to the financial statements.

Reorganization of reporting structure

B122. The 2001 Exposure Draft did not address how goodwill and the other assets and liabilities that make up a reporting unit should be reassigned when an entity reorganizes its reporting structure. The Board concluded that the guidance provided in the Statement for assigning acquired assets and assumed liabilities should be used to reassign assets and liabilities of reporting units that are reorganized. However, this Statement requires goodwill to be reassigned to reorganized reporting units using a relative fair value allocation method similar to that used to determine the amount of goodwill to allocate to a business being disposed of. The Board concluded that reorganizing a reporting unit is similar to selling off a business within that reporting unit; thus, the same allocation methodology should be used.

Recognition and measurement of an impairment loss

B123. In the 2001 Exposure Draft, the Board concluded that a fair-value-based impairment test should estimate the implied fair value of goodwill, which would be compared with the carrying amount of goodwill to determine whether goodwill is impaired. The Board acknowledged that it is not possible to directly measure the fair value of goodwill, noting that goodwill is measured as a residual amount at acquisition. The Board concluded that a method similar to the method of allocating the purchase price to the net assets acquired could be used to measure the value of goodwill subsequent to its initial recognition. Thus, the Board decided that some measure of net assets of a reporting unit should be subtracted from the fair value of a reporting unit to determine

the implied fair value of that reporting unit's goodwill.

B124. The Board then considered how to measure the value of net assets that will be subtracted from the fair value of a reporting unit to determine the implied fair value of goodwill. The Board considered the following alternatives: (a) the fair value of recognized net assets (excluding goodwill), (b) the fair value of *both* recognized *and* unrecognized net assets (excluding goodwill), (c) the book value of recognized net assets (excluding goodwill), and (d) the book value of recognized net assets (excluding goodwill) adjusted for any known differences between book value and fair value. The Board concluded that subtracting the fair value of *both* recognized *and* unrecognized net assets would result in an estimate closest to the implied fair value of goodwill. However, the Board concluded that the cost of identifying the unrecognized net assets and determining their fair values in addition to the costs of determining the fair values of the recognized net assets outweighed the benefits of that alternative.

B125. The Board acknowledged that subtracting the fair value of only *recognized* net assets (excluding goodwill) from the fair value of a reporting unit generally would result in a residual amount that includes more than acquired goodwill. That is, the residual amount also would include the fair value of unrecognized goodwill and other intangible assets that were internally generated both before and after an acquisition and the fair value of any unrecognized goodwill and other intangible assets that were acquired in prior business combinations accounted for by the pooling method, as well as asset "step-ups" in basis that were not recognized. The Board referred to the above amounts as adding "cushion" to the estimate of the implied fair value of goodwill. The Board was not as concerned about the cushion resulting from unrecognized internally generated goodwill as it was about the cushion arising from other unrecognized assets of the reporting unit because the latter confuses different types of assets while the former does not. The Board noted that if the *book value* of recognized net assets was subtracted, the cushion also would include the unrecognized increase (or decrease) in the fair value of the reporting unit's recognized net assets.

B126. The Board concluded that subtracting the fair value of recognized net assets (excluding goodwill) would result in the next best estimate of the implied fair value of goodwill, even though it would include an additional cushion attributable to the fair value of the *unrecognized* net assets. Even though that choice had its associated costs, after considering the remaining two choices—subtracting the book value or adjusted book value of recognized net assets—both of which generally would include even more cushion, the Board decided that subtracting the fair value of recognized net assets would strike an acceptable balance between costs and benefits. Thus, the 2001 Exposure Draft proposed that the implied fair value of reporting unit goodwill be estimated by subtracting the fair value of the recognized net assets of a reporting unit from the fair value of the reporting unit as a whole. If the resulting implied fair value of goodwill were less than the carrying amount of that goodwill, an impairment loss equal to that difference should have been recognized.

B127. While a few respondents to the 2001 Exposure Draft supported the proposed impairment

test, most respondents asserted that the proposed test would not be cost-effective. Their concerns related primarily to the requirement to determine the fair value of recognized net assets (in order to estimate the implied fair value of goodwill). Most respondents said that the costs related to estimating the fair value of recognized net assets did not outweigh the benefits associated with having a better estimate of the implied fair value of goodwill to use in the impairment test. Respondents noted that a goodwill impairment test by its very nature will include some level of imprecision.

B128. Respondents suggested a variety of approaches to test goodwill for impairment, including using an approach similar to that in Statement 121 (and the June 2000 FASB Exposure Draft, *Accounting for the Impairment or Disposal of Long-Lived Assets and for Obligations Associated with Disposal Activities*, which would amend Statement 121). Some respondents argued for a Statement 121 approach on the basis of familiarity, reliability, practicality, and consistency. However, the recoverability test in Statement 121 uses undiscounted cash flows, and the Board again rejected that approach because it results in an unacceptably large cushion in the impairment test.

B129. Very few respondents to the 2001 Exposure Draft took exception to using the fair value of a reporting unit as the starting point for the impairment test or with the conceptual soundness of basing the impairment test on the implied fair value of goodwill. Thus, the Board agreed that it would consider only an approach that began with a determination of the fair value of a reporting unit, and it reaffirmed its conclusion that a fair-value-based impairment model should be used for goodwill. The Board thus sought to develop an approach that would lessen the cost of performing the impairment test.

B130. The suggestion that was provided most often by respondents to reduce the cost of the impairment test was to compare the fair value of a reporting unit with its carrying amount, including goodwill (carrying amount approach). Respondents observed that carrying amounts may be a reasonable proxy for fair values. Under that approach, if the carrying amount of a reporting unit exceeds its fair value, goodwill would be considered impaired, and an impairment loss would be recognized equal to that excess. The carrying amount approach is the least costly of all the suggested approaches because it requires only an estimate of the reporting unit's fair value and not of the fair value of its associated assets and liabilities.

B131. The Board decided not to adopt the carrying amount approach for the dual purpose of (a) identifying situations in which goodwill is impaired and (b) measuring the amount of impairment in the situations identified. The Board noted that comparing the carrying amount of a reporting unit, including goodwill, with the fair value of that unit could not be said to be an estimate of the implied fair value of goodwill. The difference generally would include too much cushion, and that approach also would be inconsistent with the way in which impairments of other assets and asset groups are measured under Statement 121.

B132. Some respondents suggested that the Board adopt a two-step approach if it found the

measure of impairment under a carrying amount approach unacceptable. They noted that the comparison of the carrying amount with the fair value of a reporting unit could be the first step—a screen to identify potential goodwill impairment. If the carrying amount of a reporting unit exceeded its fair value, the actual amount of impairment loss could be measured on a different basis.

B133. The Board considered the extent to which adding the carrying amount comparison as a screen to identify potential goodwill impairment would allow possibly significant impairments to go unrecognized. The Board noted that use of that screen would add a cushion to the impairment test proposed in the 2001 Exposure Draft equal to the difference between the carrying amounts of tangible and intangible assets and their fair values—with the greater disparity likely to be in the intangible assets. That cushion would exist, however, only if the value of the intangible assets is being maintained or increased. In that situation, the value of goodwill is most likely also being maintained. That is, the Board observed that the appreciation of intangible assets and the appreciation of goodwill likely are correlated to some extent. The Board observed that the converse is likely also to be true—if the value of goodwill is *not* being maintained, the value of intangible assets probably also is not being maintained, and the value of recognized intangible assets would provide little or no cushion to the impairment test. Thus, using a carrying amount comparison as a screen for potential goodwill impairment likely would not allow as many impairments to go unrecognized as it might at first appear to do.

B134. Thus, the Board concluded that adding a carrying amount comparison to the impairment test would reduce the costs of applying the goodwill impairment test without unduly compromising the integrity of the model. Having decided that a two-step test would be a reasonable response to the cost-benefit challenge posed by its constituents, the Board considered whether to retain the measure of impairment proposed in the 2001 Exposure Draft or whether an improved measure would be feasible.

B135. As noted in paragraph B124, in developing the 2001 Exposure Draft, the Board observed that the best estimate of goodwill impairment would be based on a purchase price allocation approach in which the fair value of both recognized and unrecognized net assets is subtracted from the fair value of a reporting unit to determine the implied fair value of goodwill. Because that method is the same method by which goodwill is initially measured, the resulting reported amount of goodwill (after the impairment charge) would be the best available estimate consistent with the initial measurement of goodwill upon its acquisition. The Board rejected that approach in its deliberations of the 2001 Exposure Draft because it considered the process of identifying unrecognized net assets and determining their fair values to be too costly to require on a relatively frequent basis. However, the Board reasoned that if the measurement of goodwill impairment was preceded by a less costly screen for potential impairment, the cost of measuring goodwill impairment using a purchase price allocation process would be justifiable. The measurement process would be required relatively infrequently, and it would produce better information in those situations in which there was potential goodwill impairment. Therefore, this Statement requires goodwill impairment to be measured using a purchase price allocation

process. That is, if the first step of the goodwill impairment test indicates potential impairment, then the implied fair value of goodwill would be estimated by allocating the already estimated fair value of the reporting unit to all the assets and liabilities associated with that unit, including unrecognized intangible assets.

B136. The Board concluded that this Statement should require that the allocation of the total fair value of the reporting unit to its net assets follow the purchase price allocation guidance in Statement 141. That process is familiar to all entities that would be testing goodwill for impairment because it is the same process the entity would have used to initially measure the goodwill recognized in its financial statements.

When to test goodwill for impairment

B137. After discussions with field visit participants, the Board proposed in the 2001 Exposure Draft that goodwill be tested for impairment whenever events occur or circumstances change indicating potential impairment (an events-and-circumstances approach) and not on an annual basis. The Board acknowledged that management often reviews the operating performance of reporting units on a regular basis; therefore, a requirement for an annual impairment test might be redundant and thus might involve unnecessary time and expense.

B138. The 1999 Exposure Draft included examples of events and circumstances that would give rise to a goodwill impairment test (in addition to the examples in Statement 121). The Board revised those examples to reflect its decision that goodwill should be tested for impairment at the reporting unit level. The 2001 Exposure Draft included the revised examples of events or circumstances that would require an entity to test goodwill in one or more reporting units for impairment (impairment indicators). The Board affirmed that the list of impairment indicators is not meant to be exhaustive and that an individual event, as well as a series of events, might give rise to the need for an impairment test.

B139. Most respondents agreed with the Board's conclusion in the 2001 Exposure Draft to test goodwill for impairment using an events-and-circumstances approach. Most of those respondents stated that such an approach would be cost-effective because it would generally result in testing goodwill for impairment less frequently than once a year and because the fair value of each reporting unit would not have to be determined annually. However, respondents expressed concern that because the proposed list of impairment indicators included events that occur often in the common course of business, goodwill impairment tests would be required more frequently than is feasible. Respondents offered a number of suggestions for ways to reduce the frequency of an impairment test under an events-and-circumstances approach, including requiring the impairment test only if two or more indicators are present and using the indicators as a guide for testing instead of as a mandatory requirement to test for impairment.

B140. Some respondents disagreed with the proposal that goodwill be tested for impairment using only an events-and-circumstances approach, preferring that goodwill be tested for impairment annually. Attestors noted that under an annual approach, they would be able to

provide positive assurance about whether goodwill is impaired, rather than negative assurance that no event occurred or circumstance changed that would require an impairment test. Other respondents noted that an annual approach would result in more consistent application and comparable financial statements and would reduce the subjectivity of and second-guessing about the timing of an impairment charge.

B141. The Board noted that although most respondents supported the proposed events-and-circumstances approach, the concerns that were expressed with the list of impairment indicators suggest that such an approach might not be operational. That is, even if the list of impairment indicators was revised, the revised list still might not be applied or interpreted consistently—thereby undermining the integrity of the impairment model itself. Furthermore, if goodwill was tested for impairment on an annual basis, the recognition of an impairment loss would be less dependent on the subjective interpretation of the performance of reporting units. In addition, Board members observed that goodwill impairments generally do not occur suddenly but occur as a result of a series of events that might not be captured by a list of impairment indicators. An annual test would provide a safety net for impairments that arise as the result of a series of events.

B142. A principal reason that the Board concluded not to propose an annual test in the 2001 Exposure Draft was the cost associated with the proposed impairment test. Having decided to reduce the cost of the impairment test by adding a screen for potential impairment and also to decrease in many cases the number of reporting units, the Board observed that the cost of an annual impairment test would be lower than under the 2001 Exposure Draft, thereby making an annual approach more feasible.

B143. The Board acknowledged that an annual test would entail some cost to preparers because fair value determinations will have to be made for each reporting unit. However, for most entities, the most labor-intensive and potentially expensive part of the process relates to assigning goodwill and net assets to reporting units and establishing the model and key assumptions that will be used to measure the fair value of each reporting unit. Board members observed that those costs will be incurred whether goodwill is tested for impairment annually or on an events-and-circumstances basis. Thus, once the initial fair value of each reporting unit has been determined, the incremental costs associated with annual testing generally will be much lower than those one-time costs.

B144. The Board concluded that the incremental cost of an annual impairment test can be justified because of the benefit to users of financial statements in the form of positive assurance that the carrying amount of goodwill is not overstated. Annual testing would also enhance comparability between entities, since every entity would be testing goodwill for impairment with the same frequency.

B145. Integral to the Board's decision that goodwill should be tested for impairment annually was the view that an annual requirement should not call for a "fresh start" effort in determining

the fair value of each reporting unit every year. That is, many entities should be able to conclude that the fair value of a reporting unit is greater than its carrying amount without actually recomputing the fair value of the reporting unit. That conclusion could be supported if the last fair value determination exceeded the carrying amount by a substantial margin and nothing had happened since the last fair value determination that would make the likelihood that the current fair value of the reporting unit would be less than its current carrying amount remote. However, if a recent acquisition, divestiture, or reorganization affected a reporting unit, the fair value of the reporting unit would need to be remeasured for purposes of impairment testing.

B146. The Board noted that testing annually for goodwill impairment would not negate the need for management to be aware of events occurring or circumstances changing between annual tests indicating potential impairment. Should there be such an event or circumstance, an entity would be required to test goodwill for impairment at that time and not wait until the next annual test. Board members observed that when an impairment indicator arises toward the end of an interim reporting period, an entity might not be able to complete the goodwill impairment test before its financial statements are issued. The Board concluded that it would be appropriate for an entity to recognize its best estimate of that impairment loss in those circumstances.

Benchmark assessment

B147. The 2001 Exposure Draft proposed that a benchmark assessment be performed in conjunction with most significant acquisitions and in conjunction with a reorganization of an entity's reporting structure. As proposed, a benchmark assessment involved identifying and documenting the goodwill and net assets associated with a reporting unit, the expectations related to the performance of the unit, and the valuation model and key assumptions to be used in measuring the fair value of the reporting unit. In addition, an entity would have been required to measure the fair value of the reporting unit, compare the fair value of the reporting unit with its carrying amount, and possibly test goodwill for impairment. The purpose of the benchmark assessment was to establish a starting point for future goodwill impairment tests.

B148. Most respondents to the 2001 Exposure Draft disagreed with the specific steps of the benchmark assessment, stating that the assessment would be time-consuming, costly to implement and comply with, and in excess of what is necessary to establish a baseline for performing future impairment tests. Most respondents agreed that entities should be required to document expectations, assumptions, and valuation models after an acquisition. However, respondents stated that a determination of the fair value of the unit should not be required unless an impairment indicator is present.

B149. The Board concluded that a requirement to perform a benchmark assessment was no longer necessary because goodwill would be tested for impairment annually and because the first step of the impairment test would be a comparison of the fair value of a reporting unit with its carrying amount. Board members observed that most of the identification and documentation steps inherent in the benchmark assessment would have to be performed subsequent to an acquisition or reorganization and prior to any impairment test regardless of whether this

Statement required performance of those steps. However, this Statement does not require that the groundwork for performing an impairment test be completed within a set time period, other than that necessary to perform the transitional goodwill impairment test.

Fair value of a reporting unit

B150. Prior to issuing the 2001 Exposure Draft, the Board considered various valuation methods that could be used in testing goodwill for impairment, including methods based on market capitalization, discounted cash flow, residual income valuation, cash flow return on investment, and economic value added. Board members generally agreed that each of those methods could be used to determine the fair value of a reporting unit and that entities should be permitted to use a valuation method with which they are familiar, providing that the result is consistent with the objective of fair value.

B151. Some respondents to the 2001 Exposure Draft stated that because of the subjectivity inherent in measuring the fair value of a reporting unit, the Board should provide more guidance in this Statement on using present value techniques to estimate fair value. In particular, respondents requested that this Statement provide guidance on how to use cash flows to measure the fair value of a reporting unit. Some respondents suggested that this Statement incorporate the guidance from FRS 11, *Impairment of Fixed Assets and Goodwill*, including growth rate assumptions used in estimating cash flows.

B152. The Board observed that the goodwill impairment test in FRS 11 is focused on acquisition-specific goodwill. Thus, the unit of account in FRS 11 is inconsistent with the use of the reporting unit in this Statement as the unit of account for goodwill impairment testing. The Board concluded that because the restrictions on growth assumptions in FRS 11 could be inconsistent with the requirement to measure the reporting unit at fair value, similar assumptions should *not* be included in this Statement. However, Board members observed that when cash flows are used to estimate fair value, those cash flows should be consistent with the most recent budgets and plans approved by management. As noted previously, one of the reasons the Board decided to test goodwill for impairment at the reporting unit level is that it is generally the level at which information about cash flows is generated for planning purposes. Board members also observed that in estimating cash flows for purposes of determining the fair value of a reporting unit, some consideration should be given to industry trends.

B153. The Board noted that addressing the various issues raised by respondents would require the Board to develop “how to” guidance (including valuation guidance) on using present value techniques to estimate fair value that is beyond the scope of this Statement. The Board reaffirmed that this Statement should explain the objective of the fair value measurement exercise and allow preparers latitude in applying that objective to their specific circumstances based on the guidance in Concepts Statement 7. To assist preparers in applying that guidance, the Board decided to include in Appendix E of this Statement excerpts from Concepts Statement 7 that discuss present value techniques (both expected and traditional) and when those techniques should be used.

B154. The Board reaffirmed its conclusion that if a reporting unit has publicly traded equity securities, the ability of a controlling shareholder to benefit from synergies and other intangible assets that arise from control might cause the fair value of a reporting unit as a whole to exceed its market capitalization. Therefore, in those few instances in which a reporting unit has publicly traded equity securities, the fair value measurement need not be based solely on the quoted market price of an individual share of that security. The Board acknowledges that the assertion in paragraph 23 that the market capitalization of a reporting unit with publicly traded equity securities may not be representative of the fair value of the reporting unit as a whole can be viewed as inconsistent with the definition of fair value in FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Those Statements maintain that “if a quoted market price is available, the fair value is the product of the number of trading units times that market price.” However, the Board decided that measuring the fair value of an entity with a collection of assets and liabilities that operate together to produce cash flows is different from measuring the fair value of that entity’s individual equity securities. That decision is supported by the fact that an entity often is willing to pay more for equity securities that give it a controlling interest than an investor would pay for a number of equity securities that represent less than a controlling interest. Thus, consideration of the impact of a control premium when control is known to exist in measuring the fair value of a reporting unit is appropriate, whereas it is not for a noncontrolling position in equity interests.

B155. The Board noted that in most instances quoted market prices for a reporting unit would not be available and thus would not be used to measure the fair value of a reporting unit. The Board concluded that absent a quoted market price, a present value technique might be the best available technique to measure the fair value of a reporting unit. However, the Board agreed that this Statement should not preclude use of valuation techniques other than a present value technique, as long as the resulting measurement is consistent with the objective of fair value. That is, the valuation technique used should capture the five elements outlined in paragraph 23 of Concepts Statement 7 and should result in a valuation that yields results similar to a discounted cash flows method. The Board also noted that, consistent with Concepts Statement 7, the fair value measurement should reflect estimates and expectations that marketplace participants would use in their estimates of fair value whenever that information is available without undue cost and effort. This Statement, like Concepts Statement 7, does not preclude the use of an entity’s own estimates, as long as there is no information indicating that marketplace participants would use different assumptions. If such information exists, the entity must adjust its assumptions to incorporate that market information. The Board clarified that use of a valuation technique based on multiples of earnings or revenues or similar performance measures should not be precluded so long as the resulting measurement is consistent with a fair value objective. Use of such multiples may be appropriate when both the fair value and multiple of a comparable entity are available. The Board also agreed that if an acquired entity is a significant portion of a reporting unit (or a reporting unit itself) and the technique used to value the acquisition (determine the purchase price) is consistent with the objective of measuring fair

value, the assumptions underlying that valuation should be used in measuring the fair value of the reporting unit. Board members noted that a valuation technique similar to that used to value the acquisition would most likely be used by the entity to determine the fair value of the reporting unit. For example, if the purchase price were based on an expected cash flow model, that cash flow model and related assumptions would be used to measure the fair value of the reporting unit.

Goodwill impairment testing by a subsidiary

B156. Some respondents to the 2001 Exposure Draft raised issues about how goodwill should be tested for impairment when the reporting entity has one or more subsidiaries that prepare separate financial statements in accordance with generally accepted accounting principles (separate GAAP financial statements). They questioned whether goodwill that is reported in the separate GAAP financial statements of a subsidiary (subsidiary goodwill) should be tested for impairment at the subsidiary level (that is, at the level of the subsidiary's reporting units) or at the higher consolidated level (that is, at the level of the parent's reporting unit or units that encompass the subsidiary).

B157. The Board noted that subsidiary goodwill might arise from (a) acquisitions that a subsidiary made prior to its being acquired by the parent, (b) acquisitions that a subsidiary made subsequent to its being acquired by the parent, and (c) goodwill arising from the business combination in which a subsidiary was acquired that the parent company pushed down to the subsidiary's financial statements. Some respondents urged that subsidiary goodwill be tested for impairment only at the reporting units at the higher consolidated level, with any impairment losses recognized being pushed down to the subsidiary. Other respondents urged that subsidiary goodwill be tested for impairment at the subsidiary level, and some also urged that any impairment losses recognized at the subsidiary level also be recognized at (pushed up to) the consolidated level.

B158. Some respondents asked that a distinction be made between the requirements for subsidiaries that are public entities and those that are nonpublic entities. Those respondents suggested that goodwill of a public subsidiary be tested for impairment at the subsidiary level but that goodwill of a nonpublic subsidiary be tested only at the consolidated level, with any impairment losses recognized at the consolidation level being allocated to the subsidiaries. The Board observed that subsidiaries prepare separate GAAP financial statements largely because the information needs of minority stockholders, creditors, and regulators of those subsidiaries cannot be filled by the GAAP financial statements of the consolidated group. Information that pertains to the consolidated group is not relevant to them because their interests are limited to the subsidiary. Users of subsidiary financial statements therefore should be entitled to expect that the same accounting requirements have been applied regardless of whether the reporting entity in question is a subsidiary of another reporting entity. The Board accordingly concluded that goodwill that is reported on the separate GAAP financial statements of a subsidiary should be tested for impairment at the subsidiary level.

B159. The Board observed that if goodwill impairment testing is performed at the subsidiary level, the question of whether to push down impairment losses from the consolidated level is not pertinent. However, it noted that an impairment loss that is recognized at the subsidiary level may indicate potential goodwill impairment in the reporting unit or units at the consolidated level at which the subsidiary resides. The Board therefore concluded that if an impairment loss is recognized at the subsidiary level, that loss should not be recognized at (pushed up to) the consolidated level; rather, an entity should consider whether an interim impairment test should be performed on goodwill in the reporting unit or units of the parent company in which the subsidiary resides. (Paragraph 28 addresses when an entity should test goodwill for impairment between annual tests.) If testing at the consolidated level leads to an impairment loss, that loss should be recognized at that level separately from the subsidiary's loss. The Board further concluded that the requirements for testing goodwill should be the same for both public and nonpublic subsidiaries because the needs of the users of those subsidiaries' separate GAAP financial statements are the same.

Disposal of all or a portion of a reporting unit

B160. The 1999 Exposure Draft proposed that when goodwill is associated with assets to be sold or otherwise disposed of, some amount of goodwill should be included in the cost of the assets disposed of. The June 2000 impairment Exposure Draft proposed guidance for associating assets to be disposed of with related goodwill. That Exposure Draft proposed that goodwill generally should be allocated to assets to be disposed of on a pro rata basis using the relative fair values of the acquired long-lived assets and intangible assets at the acquisition date. In developing the 2001 Exposure Draft, the Board observed that the guidance proposed in the June 2000 impairment Exposure Draft was based on the current acquisition-specific model of accounting for goodwill subsequent to an acquisition. Thus, the Board considered whether that guidance was appropriate given its fundamental decision to move to a model that considers the reporting unit to be the unit of account for goodwill after an acquisition.

B161. The Board concluded that because the reporting unit is the unit of account for goodwill, goodwill cannot be identified or associated with an asset group at a level lower than the reporting unit, other than in an arbitrary manner. However, the Board realized that when a significant portion of a reporting unit is to be disposed of, it is necessary to determine whether the net assets of the reporting unit that remain after the disposition can support the carrying amount of goodwill. Thus, the 2001 Exposure Draft would have required that goodwill be tested for impairment in those circumstances; however, the assets to be disposed of would not have been included in that test. In that Exposure Draft, if the implied fair value of the reporting unit's goodwill were determined to be less than its carrying amount, the excess of the carrying amount of goodwill over its implied fair value would have been included in the carrying amount of the net assets to be disposed of. The 2001 Exposure Draft also proposed that when a reporting unit is to be disposed of in its entirety, all of that reporting unit's goodwill would be included in the carrying amount of its net assets.

B162. Many respondents to the 2001 Exposure Draft did not agree with the proposed

accounting for disposal of a significant portion of a reporting unit because it might distort the calculation of the gain or loss to be recognized on disposal. Those respondents noted that because the proposed goodwill impairment approach may result in capitalization of internally generated goodwill and other unrecognized assets, goodwill associated with the net assets disposed of might not be included in the gain or loss calculation, thus exaggerating any gain or minimizing any loss. Some respondents suggested that some amount of goodwill should always be allocated to the portion of a reporting unit that is sold.

B163. Having redefined the reporting unit to be generally a higher level than that proposed in the 2001 Exposure Draft, the Board assessed whether it would be possible for goodwill to be meaningfully allocated below the reporting unit level. For example, the Board considered how frequently a reporting unit would consist of one or more businesses. The Board acknowledged that if this Statement were to permit or require allocation of goodwill below the reporting unit for disposal accounting purposes, it would be nearly impossible to limit how low that allocation could go.

B164. The Board concluded that it would not be possible to describe the circumstances in which goodwill should be allocated to a portion of a reporting unit being disposed of with sufficient rigor that the guidance would be interpreted and applied consistently. However, the Board acknowledged that when a business is being disposed of, it would be appropriate to presume that some amount of goodwill is associated with that business. Thus, the Board concluded that an allocation should be required only when the net assets being disposed of constitute a business. The Board noted that that would be consistent with recognizing goodwill when a business is acquired.

B165. The Board considered various allocation approaches, recognizing that any allocation approach would be arbitrary. The Board agreed that this Statement should prescribe use of a specific allocation method such that the amount of goodwill allocated to a business to be disposed of would be determined consistently from entity to entity. The Board concluded that a relative-fair-value allocation method would result in a reasonable estimation of the amount of goodwill that might be associated with a business being disposed of and would not be overly complex to apply. Therefore, this Statement requires that when a portion of a reporting unit being disposed of constitutes a business, the amount of goodwill assigned to that business should be based on the relative fair values of the business to be disposed of and the remaining portion of the reporting unit. However, due to the imprecision of any allocation approach, the Board concluded that the goodwill remaining with the reporting unit should be tested for impairment after goodwill has been allocated to the business being sold.

B166. The Board observed that when an acquired business is being disposed of and the benefits of goodwill acquired with that business have not been realized by any portion of the reporting unit other than the acquired business, the carrying amount of that acquired goodwill should be included in the net assets disposed of. Therefore, this Statement requires that the relative-fair-value allocation method *not* be used to allocate goodwill to a business being

disposed of if that business was not integrated into the reporting unit after its acquisition. Board members noted that those situations (such as when the acquired business is operated as a stand-alone entity) would be infrequent because some amount of integration generally occurs after an acquisition.

Amendment of Statement 121

B167. This Statement amends Statement 121 to eliminate the requirement that the carrying amount of goodwill associated with a long-lived asset be combined with that asset's carrying value when testing that long-lived asset (or group of assets) for impairment. Goodwill is to be tested for impairment only in accordance with this Statement. The 2001 Exposure Draft proposed that when an asset group being tested for impairment is also a reporting unit, goodwill would be tested for impairment (and any impairment loss recognized) *before* the other long-lived assets are tested for impairment. The Board reconsidered that proposal given its decision to add a step to the impairment test that is based on the carrying amounts of the assets and liabilities of the reporting unit. Board members considered it important that the carrying amount used to identify potential impairment reflect amounts that have already been adjusted for impairment. Thus, this Statement requires goodwill to be tested for impairment *after* all other assets have been tested for impairment when more than one impairment test is required at the same time. The Board clarified that that requirement applies to all assets that are tested for impairment, not just those included in the scope of Statement 121.

B168. The Board observed that in situations in which a reporting unit consists of multiple lower-level asset groups, an event might occur that requires an impairment test of some, but not all, of those asset groups. That same event might or might not require an impairment test of reporting unit goodwill. The Board concluded that because the reporting unit is the unit of account for goodwill, the reporting unit *is* the lowest level with which goodwill can be associated; therefore, goodwill is not associated with a lower-level asset group. Based on that view, the Board decided that reporting unit goodwill should not be allocated to or otherwise associated with a lower-level asset group as previously required by Statement 121. This Statement amends Statement 121 to eliminate that requirement.

Equity method investments

B169. Under APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, an investor is required to apply the equity method of accounting if its investment in voting stock gives it the ability to exercise significant influence over operating and financial policies of the investee. The investor's cost and the underlying equity in net assets of the investee often differ, and Opinion 18 requires that that difference be accounted for as if the investee were a consolidated subsidiary. An investor is therefore required to complete a purchase price allocation, which often results in identification of part of the difference as goodwill. (However, that amount is not reported as goodwill in the investor's statement of financial position.) The Board reasoned that goodwill associated with equity method investments (equity method goodwill) should be accounted for in the same manner as goodwill

arising from a business combination. Thus, the 2001 Exposure Draft proposed that equity method goodwill should not be amortized.

B170. Equity method investments are reviewed for impairment in accordance with Opinion 18, and it is the equity investment as a whole that is reviewed for impairment, not the underlying net assets. The Board concluded that because equity method goodwill is not separable from the related investment, that goodwill should not be tested for impairment in accordance with this Statement. Thus, the 2001 Exposure Draft proposed that equity method goodwill be exempt from the impairment provisions of this Statement. Respondents generally agreed with the Board's conclusions related to equity method goodwill, and the Board reaffirmed those conclusions.

Deferred Income Taxes

B171. The 2001 Exposure Draft proposed that the requirement in Statement 109, *Accounting for Income Taxes* (paragraphs 30, 262, and 263), to recognize deferred taxes related to goodwill when amortization of goodwill is deductible for tax purposes not be changed. Some respondents to that Exposure Draft, however, objected to recognition of a deferred tax liability related to tax-deductible goodwill.

B172. In a taxable business combination, the purchase price is allocated to the acquired assets and liabilities for tax purposes similarly to the way it is allocated for financial reporting (book) purposes. Because usually there is no temporary difference created at the date of acquisition, no deferred tax liability related to goodwill is recognized at that date. However, taxable temporary differences will arise in the future as goodwill is amortized for tax purposes but not for book purposes. In those circumstances, an excess of the book basis over the tax basis of goodwill is a taxable temporary difference for which a deferred tax liability must be recognized under Statement 109. This issue does not arise for nontaxable business combinations because Statement 109 prohibits recognition of a deferred tax liability related to goodwill when amortization is not deductible for tax purposes.

B173. Respondents to the 2001 Exposure Draft noted that a deferred tax liability would not be settled until some indefinite future period when goodwill is impaired, sold, or otherwise disposed of—all of which are future events that respondents asserted are unlikely to occur. They requested that this Statement amend Statement 109 to require recognition of a deferred tax liability related to tax-deductible goodwill only at such time as a goodwill impairment loss is recognized or goodwill is assigned to a business that is sold or otherwise disposed of.

B174. Board members observed that similar issues exist for intangible assets other than goodwill, because they also could have a book basis with little or no tax basis. Statement 109 requires recognition of a deferred tax liability related to other intangible assets. Like goodwill, absent amortization, the deferred tax liability will remain on the balance sheet until such time as the intangible asset is impaired, sold, or otherwise disposed of.

B175. The Board acknowledged that nonamortization of goodwill and intangible assets with indefinite useful lives was not contemplated when the Board deliberated Statement 109. However, the arguments used by respondents to the 2001 Exposure Draft for nonrecognition of deferred tax liabilities related to goodwill and intangible assets with indefinite useful lives were made at that time and were extensively debated. Statement 109 requires comprehensive recognition of deferred taxes subject only to a limited number of exceptions. Statement 109 continues exceptions for some of the areas addressed by APB Opinion No. 23, *Accounting for Income Taxes—Special Areas*, but prohibits nonrecognition of a deferred tax liability for all analogous types of taxable temporary differences. Therefore, the Board reconfirmed that Statement 109 should not be amended for the purposes of permitting additional exceptions to comprehensive recognition of deferred income taxes.

Financial Statement Presentation

Presentation in Statement of Financial Position

B176. The Board observed that Opinion 17 did not require that goodwill be displayed separately in the statement of financial position and that, in practice, goodwill has been displayed together with other intangible assets. However, the Board agreed that goodwill is unique among assets and that different users of financial statements may assess it differently in their analyses. The Board therefore concluded that goodwill differed sufficiently from other assets and other intangible assets to justify being displayed separately in the statement of financial position.

B177. The Board further observed that intangible assets other than goodwill also differ significantly from other assets and therefore concluded that they also should be displayed in the aggregate separately in the statement of financial position. The Board noted that such a requirement would not preclude separately displaying individual intangible assets or classes of those assets that are material. The Board clarified that an entity should continue to display intangible assets in their proper classification whether that be as a current asset or a noncurrent asset.

B178. The 1999 Exposure Draft proposed that both goodwill and other intangible assets be displayed in the aggregate separately in the statement of financial position, and the 2001 Exposure Draft (which focused only on goodwill) affirmed that display for goodwill. Respondents agreed that separate presentations of those items provide useful information. The Board therefore decided to retain those presentation requirements in this Statement, noting that separating goodwill from other assets in the statement of financial position is even more important under a nonamortization model.

Presentation in the Income Statement

B179. The Board observed that amortization and impairment charges for goodwill and other

intangible assets traditionally have been displayed in the income statement among those expenses that are presented on a pretax basis. Moreover, in practice, those charges often have been commingled with other expenses, such as depreciation and amortization or selling and administrative expenses. The Board noted concerns that such commingling can make the analysis of financial statements more difficult. Some respondents urged that the charges for goodwill and other intangible assets be separated from charges for other items, as well as from each other.

B180. Under the 1999 Exposure Draft, goodwill impairment losses would have been combined with goodwill amortization expense and presented on a net-of-tax basis as a separate line item in the income statement. The Board noted that the special income statement treatment proposed in the 1999 Exposure Draft was aimed at making goodwill amortization expense more transparent. Therefore, the special display provisions were designed primarily for goodwill amortization expense—not goodwill impairment losses. The 1999 Exposure Draft also proposed that charges for the amortization or impairment of intangible assets continue to be displayed on a pretax basis in line items as deemed appropriate by the reporting entity, as they traditionally had been displayed.

B181. Some respondents to that Exposure Draft suggested that all of the charges related to the entire premium of the purchase price of an entity over the book value of its net assets (including charges related to the step-up in basis of recorded net assets and the recognition of previously unrecognized assets and liabilities) be afforded a special presentation, similar to that proposed in the 1999 Exposure Draft for goodwill charges. They argued that such a presentation would facilitate the analysis of earnings trends related to the combining entities following the business combination. They also argued that those charges should be accorded similar presentation because (a) goodwill is an intangible asset, (b) the amount recognized as goodwill may include certain intangible assets that cannot be recognized apart from goodwill, and (c) some intangible assets are “goodwill like.”

B182. The Board observed that there may have been cases in practice in which much or all of the premium over book value had been assigned to goodwill and thus the amortization charge for goodwill would have included much or all of the charges relating to that premium. However, the Board noted that accounting standards have consistently differentiated goodwill from the premium over book values. Moreover, the Board noted that such a presentation would be akin to those produced by the pooling method, which would conflict with the Board’s decision to eliminate that method. The Board further noted that its subsequent adoption of the contractual-legal criterion and separability criterion sharpened the differences between what would be recognized as goodwill and what would be recognized as other intangible assets. The Board therefore rejected suggestions that other charges related to the purchase premium (other than goodwill charges) should be afforded a special presentation.

B183. In developing the 2001 Exposure Draft, the Board discussed whether goodwill impairment losses should be presented in the income statement in the same manner as any other

impairment loss (as a component of pretax operating income) or in accordance with the special display provisions proposed in the 1999 Exposure Draft. The 2001 Exposure Draft proposed that a goodwill impairment loss recognized under a nonamortization model be reported in the same manner as an impairment loss recognized on other assets. Respondents to the 2001 Exposure Draft agreed with that proposal. The Board therefore reaffirmed its conclusion that a goodwill impairment loss (other than a transitional goodwill impairment loss) should be reported as a component of income from operations (before income taxes) unless the goodwill impairment loss is associated with a discontinued operation—in which case it would be included within the results of the discontinued operation.

B184. Consistent with its decision that the impairment charges for goodwill should be displayed on a pretax basis like that for charges related to other intangible assets, the Board reaffirmed its conclusion in the 1999 Exposure Draft that the charges related to other intangible assets should continue to be displayed on a pretax basis as a component of income from continuing operations. As noted in paragraph B66, the Board concluded that an impairment loss recognized as the result of a change in the estimate of the remaining useful life of an intangible asset should not be recognized as the effect of a change in accounting principle.

Disclosures

Information about Intangible Assets in the Year of Acquisition

B185. The 1999 Exposure Draft proposed that certain information be disclosed in the notes to the financial statements for each class of intangible asset. The information that would have been required to be disclosed included (a) a description of the intangible assets and the amounts assigned to them at the acquisition date, (b) the key assumptions and methodologies used to determine those amounts, (c) a description of the amortization method, and (d) the weighted-average amortization period. Many respondents to that Exposure Draft commented on the proposed disclosure requirements. Most agreed that additional information about acquired intangible assets would be useful, but many urged the Board to consider reducing the extent of the disclosure requirements. They argued that the cost of providing the information would exceed the benefits derived from it.

B186. After considering the suggestions made by those respondents, the Board reaffirmed its conclusion that financial statements should provide additional information about acquired intangible assets other than goodwill. However, the Board agreed that eliminating certain proposed disclosures would not significantly diminish the decision usefulness of the information provided.

B187. The Board concluded that the following information should be disclosed for use in assessing the amount and timing of future cash inflows: (a) the total amounts assigned to intangible assets subject to amortization and those that are not subject to amortization, (b) the

amount assigned to each major class of intangible asset, and (c) the weighted-average amortization period in total and for each major class of asset. The Board also concluded that disclosure should be made of the amount of any significant residual values assumed both in total and for each major class of intangible asset. Although not proposed in the 1999 Exposure Draft, the Board also decided that when an entity acquires research and development assets and writes off those assets at the date of acquisition, it should be required to disclose the amount written off as well as the line item in which that write-off is aggregated.

Information about Intangible Assets Subsequent to an Acquisition

B188. The Board decided to require disclosure of certain information for each class of intangible asset subject to amortization in periods following the acquisition. That information includes the gross carrying amount, amortization method, accumulated amortization, current-period amortization expense, and the estimated aggregate amortization expense for each of the five succeeding fiscal years. The Board noted that presenting that information in tabular form would be a concise way to meet the disclosure requirement. The Board concluded that that disclosure requirement was appropriate, given its decision to permit entities to aggregate the presentation of intangible assets in the statement of financial position.

B189. In addition, the Board concluded that in the years subsequent to an acquisition, entities should disclose by major class information about the total carrying amount of those intangible assets not subject to amortization. That information is useful because those intangible assets are tested for impairment on an annual basis.

Information about Goodwill Subsequent to an Acquisition

B190. In its redeliberations of the 1999 Exposure Draft, the Board reconsidered all of the proposed goodwill disclosure requirements because they were based on a model that would have required amortization of goodwill. The Board consulted with a group of financial statement users before deciding what information about goodwill should be disclosed in the notes to the financial statements if goodwill is to be tested for impairment rather than amortized. The 2001 Exposure Draft proposed that in the years subsequent to an acquisition, entities should disclose information about changes in the carrying amount of goodwill and the reasons for those changes. The Board observed that that information might be concisely disclosed in a tabular format. The 2001 Exposure Draft also proposed that entities presenting segment information in accordance with Statement 131 should disclose information about the changes in the carrying amount of goodwill by segment.

B191. Some respondents stated that the requirement to disclose the changes in the carrying amount of goodwill is not necessary because that information is presented elsewhere in the financial statements. In addition, respondents questioned why the 2001 Exposure Draft would require disclosure of goodwill information at the segment level when Statement 131 does not require disclosure of that information. The Board agreed that if the required information about goodwill is disclosed elsewhere in the financial statements, it would not need to be repeated in

the notes. In addition, the Board decided to retain the requirement to disclose information about goodwill by segment, noting that the unit of account used for impairment testing (the reporting unit) is based on the segment reporting structure.

B192. In its discussions about what information should be disclosed when a goodwill impairment loss is recognized, the Board considered the disclosures required by Statement 121 when an impairment loss is recognized for a long-lived asset or group of assets. The 2001 Exposure Draft proposed disclosure of similar information when a goodwill impairment loss is recognized—including the facts and circumstances leading to the impairment of goodwill, such as the events or series of events that gave rise to the impairment test. The Board agreed to retain that requirement in this Statement, noting that it is important for users to understand whether an impairment loss is due to external factors or events that should have been within management's control and whether the loss is related to a recently acquired entity.

B193. The 2001 Exposure Draft proposed that when an impairment loss is recognized, information should be disclosed at the reporting unit level. That information would have included a description of the reporting unit for which the loss is recognized, the adjusted carrying amount of reporting unit goodwill, and the amount of the impairment loss. The Board observed that when an impairment loss is recognized, disclosure of information about goodwill at the reporting unit level would be helpful both in assessing the magnitude of the loss recognized and in assessing the amount of potential future impairment losses.

B194. Most respondents disagreed with that requirement, noting that no other information is provided at the reporting unit level and that disclosing only one piece of information at that level would be both confusing and useless. The Board agreed, further noting that based on the revised definition of a reporting unit, information provided to users about impairment losses at a level below the segment level would not be significantly different from the information available at the segment level. Therefore, the Board concluded that disclosure of general information about an impairment loss and of the segment to which the impaired goodwill relates would be sufficient.

Effective Date and Transition

B195. The 2001 Exposure Draft proposed that all entities initially apply this Statement at the beginning of the first fiscal quarter following its issuance. Based on that proposed effective date, it was estimated that an entity with a fiscal year ending on December 31, 2001, would initially apply this Statement on July 1, 2001. That proposed effective date was based on the Board's conclusion that because nonamortization of goodwill results in financial statements that are more representationally faithful, it would be important for this Statement to become effective as soon as possible after issuance. The Board also noted that for comparability reasons, amortization of all previously recognized goodwill should stop within the same interim (three month) reporting period following issuance of this Statement.

B196. A number of respondents to the 2001 Exposure Draft indicated a preference for applying this Statement as of the beginning of a fiscal year. Those respondents noted that mid-year implementation of this Statement would hinder comparability of financial statements and cause confusion for financial statement users. Most respondents who suggested changing the effective date to the beginning of a fiscal year suggested that this Statement be effective for fiscal years beginning after its issuance date. Others preferred allowing entities some lead time and suggested that this Statement be effective for fiscal years beginning after December 15, 2001. The Board noted that under either approach the vast majority of entities would be required to initially apply this Statement on or after January 1, 2002—at least six months after the proposed effective date.

Previously Recognized Goodwill

B197. The 2001 Exposure Draft proposed that this Statement apply to goodwill already recognized in an entity's financial statements at the date an entity initially applies this Statement (previously recognized goodwill) as well as to goodwill recognized in its financial statements after that date. Respondents agreed that previously recognized goodwill should no longer be amortized upon initial application of this Statement. The Board reaffirmed that provision, noting that if amortization of previously recognized goodwill were to continue after an entity initially applies this Statement, financial statements would suffer from the noncomparability the Board was concerned about in discussing whether to adopt a mixed approach to account for goodwill. In addition, the Board noted that to be operational the goodwill impairment provisions in this Statement must apply to previously recognized goodwill as well as to goodwill recognized in the future. Most important, the Board concluded that nonamortization of goodwill in conjunction with testing for impairment is the most representationally faithful method of accounting for goodwill and that a nonamortization approach should be applied in all circumstances.

B198. Board members concluded that, for the reasons provided by respondents, this Statement should be applied as of the beginning of a fiscal year and that entities should be provided additional time to prepare for its initial application. Therefore, this Statement is to be applied to previously recognized goodwill and other intangible assets in fiscal years beginning after December 15, 2001, and is to be applied at the beginning of the year of initial application. Retroactive application of this Statement is not permitted. However, the Board did not want to preclude an entity that was prepared to initially apply this Statement sooner than the required effective date from being able to initially apply it earlier than that date. Thus, an entity with a fiscal year beginning after March 15, 2001, may initially apply this Statement as of the beginning of that fiscal year provided its first interim financial statements have not been issued.

B199. However, mutual enterprises and not-for-profit organizations may not apply this Statement until interpretive guidance related to the application of the purchase method by those entities is issued. The Board plans to consider issues related to the application of the purchase method to combinations between two or more mutual enterprises, combinations between not-for-profit organizations, and the acquisition of a for-profit business entity by a not-for-profit

organization in a separate project. In the interim, Opinions 16 and 17 continue to apply to those transactions.

B200. Upon initial application of this Statement, an entity will have to establish its reporting units and assign recognized assets and liabilities that meet the criteria in paragraph 32 to those reporting units. The Board concluded that the guidance in this Statement on assigning acquired assets and assumed liabilities to reporting units should be used to make the initial assignment of assets and liabilities to reporting units. Board members noted that recognized assets and liabilities that do not relate to a reporting unit (such as an environmental liability for an operation previously disposed of) should not be allocated to a reporting unit.

B201. Once those reporting units are established, all previously recognized goodwill will have to be assigned to those units—no matter how long ago it was acquired. However, because of the difficulties in reconstructing conditions that existed when past acquisitions were made, the Board concluded that previously recognized goodwill should be assigned based on the current reporting unit structure and not the structure that existed when the goodwill was acquired. However, the Board observed that in making that assignment, an entity should consider the source of previously recognized goodwill and the reporting units to which the related acquired net assets were assigned. Board members noted that the guidance provided in paragraphs 34 and 35 might also be helpful in assigning previously recognized goodwill to reporting units.

Transitional Goodwill Impairment Test

B202. Having decided that previously recognized goodwill should no longer be amortized upon initial application of this Statement, the Board addressed whether previously recognized goodwill should be tested for impairment concurrent with the cessation of amortization. The Board observed that previously recognized goodwill is currently subject to the limited impairment guidance in Opinion 17 and ARB 43, Chapter 5, “Intangible Assets.” Many entities currently test goodwill for impairment on an undiscounted cash flow basis, similar to the method that Statement 121 requires to test long-lived assets for recoverability. Thus, it is possible that previously recognized goodwill that is not considered impaired under current U.S. GAAP would be determined to be impaired if the impairment provisions in this Statement were applied to goodwill at the date an entity initially applied this Statement.

B203. In developing the 2001 Exposure Draft, Board members observed that requiring goodwill in each reporting unit to be tested for impairment upon initial application of this Statement—particularly determining the fair value of the underlying net assets of each reporting unit—would be both costly and difficult. Thus, for cost-benefit reasons the 2001 Exposure Draft proposed that, absent an impairment indicator, previously recognized goodwill should not be tested for impairment upon initial application of this Statement. However, an entity would have been required to perform a transitional benchmark assessment within six months of the date it initially applied this Statement. As part of that transitional benchmark assessment, an entity would have been required to compare the fair value of each reporting unit having goodwill with

the carrying amount of its net assets (including goodwill). If the carrying amount of the reporting unit exceeded its fair value, goodwill of that reporting unit would have been required to be tested for impairment.

B204. Most respondents to the 2001 Exposure Draft agreed with the proposed requirement to perform a benchmark assessment on previously recognized goodwill upon initial application of this Statement rather than a full impairment test. However, those respondents stated that entities would need more than the proposed six months to complete the transitional benchmark assessment. Respondents suggested that it would take up to one year for an entity to complete all of the steps of the transitional benchmark assessment.

B205. Recognizing that the step added to the goodwill impairment test to identify potential impairment is the same as the last step of the proposed benchmark assessment (a comparison of the fair value of a reporting unit with its carrying amount), the Board reconsidered its prior decision to not require previously recognized goodwill to be tested for impairment upon initial application of this Statement. Because of the revisions made to the reporting unit definition and goodwill impairment test during its redeliberations of the 2001 Exposure Draft, the Board believes that the revised impairment test will not be as costly or as difficult to apply as the proposed impairment test. Therefore, the Board concluded that previously recognized goodwill *should* be tested for impairment upon initial application of this Statement.

B206. The 2001 Exposure Draft proposed that a goodwill impairment loss recognized as the result of a transitional benchmark assessment (a transitional impairment loss) should be presented as a component of operating income, not as a change in accounting principle. That proposed requirement was based on the Board's belief that it would not be possible to determine the amount of a transitional impairment loss related to current and past reporting periods.

B207. Most respondents disagreed with the Board's conclusion that transitional impairment losses should be recognized in the same manner as all other impairment losses. Those respondents observed that the majority of transitional impairment losses would relate to adoption of the new impairment method and that few, if any, of the losses would relate to current-period losses. Accordingly, respondents asserted that it would be more representationally faithful to depict any transitional impairment losses as stemming from changes in accounting principles rather than as occurring in the current period.

B208. The Board acknowledged that the preponderance of any transitional impairment losses recognized are likely to result from the change in methods and that treating those losses as stemming from changes in accounting principles would be more representationally faithful than treating them as ordinary impairment losses. Therefore, the Board concluded that a transitional impairment loss should be recognized as the effect of a change in accounting principle.

B209. Because the transitional impairment loss is to be reported as a change in accounting principle, the Board considered whether it was necessary to place any parameters around the

transitional goodwill impairment test. For example, without parameters, an entity would be permitted to wait until the end of the year of initial application to complete the transitional goodwill impairment test and still report any resulting impairment loss as a change in accounting principle. Board members observed that the reason they decided that a transitional impairment loss should be reported as a change in accounting principle was because most losses would relate primarily to the change in methodology used to test goodwill for impairment. Thus, ideally, the transitional goodwill impairment test should apply to reporting unit goodwill as of the date this Statement is initially applied—not as of any date in the year of initial application.

B210. To address those concerns, the Board concluded that this Statement should require the first step of the transitional impairment test to be performed within six months of the date the Statement is initially applied. Board members observed that that requirement is similar to the proposed requirement to complete the transitional benchmark assessment within six months of initial application. The purpose of that first step is to identify potential goodwill impairment. The Board noted that because this Statement is not required to be initially applied until at least six months after the date proposed in the 2001 Exposure Draft, entities will have the additional time that respondents to the 2001 Exposure Draft requested to establish reporting units and measure the fair value of those reporting units. The Board concluded that, given the change in the effective date and the change in the definition of a reporting unit, six months is adequate time for preparers to establish their reporting units and develop systems for testing goodwill for impairment at the reporting unit level.

B211. The Board concluded that the fair value of a reporting unit used to identify any potential impairment existing upon initial application of this Statement should be measured as of the beginning of the year in which this Statement is initially applied. Therefore, this Statement requires the amounts used to identify potential impairment (the fair value of a reporting unit and its corresponding carrying amount) to be measured *as of* the first of the year of initial application. The Board noted that specifying an initial measurement date would ensure that transitional goodwill impairment losses would be measured on a consistent basis.

B212. This Statement requires that if the first step of the transitional goodwill impairment test identifies potential impairment, the second step of the impairment test should be completed as soon as possible, but no later than the end of the year of initial application. Regardless of the interim period in which a transitional goodwill impairment loss is measured, the resulting accounting change should be reflected as of the beginning of an entity's fiscal year. The Board observed that this is consistent with the requirements in FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*.

B213. The Board concluded that because any transitional goodwill impairment loss would be measured as of the first of the year of initial application, an entity should perform the required annual impairment test also in the year of initial application. Otherwise, depending on the measurement date chosen for future annual tests, almost two years could elapse between the transitional goodwill impairment test and the next goodwill impairment test. Notwithstanding

the requirement to perform the required annual test in addition to the transitional impairment test, Board members observed that given the provisions in paragraph 27 governing when a detailed determination of the fair value of a reporting unit might not be necessary, it is likely that an entity will not have to recompute the fair value of all its reporting units in the year this Statement is initially applied.

Previously Recognized Intangible Assets

B214. This Statement applies to intangible assets already recognized in an entity's financial statements at the date it initially applies this Statement (previously recognized intangible assets) as well as to intangible assets recognized in its financial statements after that date. The Board concluded that the most representationally faithful method of accounting for intangible assets is to amortize an intangible asset over its useful life with no limit on that amortization period and to not amortize an intangible asset that is deemed to have an indefinite useful life. Thus, upon initial application of this Statement an entity is required to reassess the useful lives of its previously recognized intangible assets using the factors in paragraph 11. As a result of that reassessment, the remaining amortization period for an intangible asset might need to be adjusted. In addition, a previously recognized intangible asset that is deemed to have an indefinite useful life would cease being amortized.

B215. The Board agreed that recognition of an impairment loss related to an intangible asset that will cease being amortized upon initial application of this Statement should be treated in a manner similar to a transitional goodwill impairment loss. Like goodwill, those intangible assets will be tested for impairment using a different method than had been previously applied to those assets. The Board therefore concluded that an intangible asset that is deemed to have an indefinite useful life should be tested for impairment upon initial application of this Statement and any resulting impairment loss recognized as the effect of a change in accounting principle. The Board clarified that, unlike goodwill, the measurement of that transitional intangible asset impairment loss should be completed in the first interim period in which this Statement is initially applied.

Equity Method Goodwill

B216. In considering the impact this Statement would have on the accounting for equity method investments, Board members noted that Opinion 18 requires entities to allocate the excess of cost over the underlying equity in net assets of an investee accounted for using the equity method to specific accounts of the investee (including intangible assets) and that only the amount remaining after that allocation should be recognized as goodwill (equity method goodwill). The Board clarified that upon initial application of this Statement, the amount previously recognized as equity method goodwill should also cease being amortized.

Transitional Disclosures

B217. As proposed in the 2001 Exposure Draft, many entities would have initially applied this Statement in the middle of their fiscal year. Thus, that Exposure Draft would have required

disclosure of income before extraordinary items and net income on a pro forma basis; that is, what those amounts would have been if the amortization and nonamortization provisions for goodwill and other intangible assets had been applied in all periods presented. However, that pro forma information would not have reflected the impact the impairment provisions might have had on prior-period information. The Board reasoned that requiring entities to determine the impact of the impairment provisions on prior periods would not be cost beneficial.

B218. Respondents to the 2001 Exposure Draft were generally supportive of the proposal to present pro forma information, noting that that information would be important for preparing trend analyses and providing comparable information. However, some respondents stated that because a prior-period impairment loss would *not* be adjusted to reflect what it would have been if goodwill had not been amortized, financial statement users will not have a complete picture of what an entity's pattern of goodwill charges would have been under a nonamortization approach. Those respondents suggested that because of that lack of information, pro forma information should *not* be presented in the financial statements.

B219. The Board acknowledged those concerns but concluded that the lack of certain information is an insufficient reason *not* to provide information about what prior earnings may have been if goodwill had not been amortized. However, Board members observed that describing the information to be disclosed as pro forma information might be misleading, since the adjustment to earnings is not all-inclusive. The Board agreed that this Statement should not refer to information as pro forma if in fact it is not. Therefore, this Statement retains the proposed requirements to present (a) prior-period income before extraordinary items and net income adjusted to exclude, among other things, amortization expense related to goodwill and intangible assets that will no longer be amortized and (b) a reconciliation of reported net income to the adjusted net income; however, those adjusted amounts are not to be labeled "pro forma."

Goodwill and Intangible Assets Acquired after June 30, 2001

B220. Because this Statement will not be effective immediately after it is issued as proposed in the 2001 Exposure Draft, the Board considered how an entity should account for goodwill and other intangible assets acquired in transactions completed after this Statement is issued but before an entity initially applies this Statement to previously recognized goodwill and intangible assets. The Board agreed that it was not appropriate to require such goodwill and intangible assets to be accounted for under the current accounting literature. Thus, the Board concluded that goodwill acquired in a business combination completed after June 30, 2001, but before the acquiring entity initially applies this Statement to previously recognized goodwill should not be amortized. However, the Board observed that because this Statement requires goodwill to be tested for impairment at the reporting unit level, the impairment provisions in this Statement cannot be applied to acquisition-specific goodwill. Therefore, an entity may not apply the goodwill impairment provisions to goodwill acquired in a business combination completed after June 30, 2001, until the date that an entity initially applies this Statement to its previously recognized goodwill and intangible assets. For example, an entity with a December 31, 2001

fiscal year-end is required to initially apply this Statement on January 1, 2002, to its previously recognized goodwill. If that entity completed a business combination on October 15, 2001, that gave rise to goodwill, it would not amortize that goodwill even though it would continue to amortize until January 1, 2002, goodwill that arose from business combinations completed before July 1, 2001. The recently acquired goodwill would not be tested for impairment in accordance with this Statement until January 1, 2002. In the interim, the recently acquired goodwill would be tested for impairment in the same manner as previously recognized goodwill.

B221. Similarly, the Board concluded that an intangible asset acquired in a transaction completed after June 30, 2001, but before the acquiring entity initially applies this Statement to previously recognized intangible assets should be accounted for in accordance with the amortization and nonamortization provisions in this Statement related to intangible assets. The impairment provisions in this Statement for intangible assets that are not being amortized differ from the impairment provisions in Chapter 5 of ARB 43, Opinion 17, and Statement 121. Thus, for consistency purposes, the Board concluded that the impairment provisions in this Statement should not apply to intangible assets acquired in a transaction completed after June 30, 2001, until the date that an entity initially applies this Statement to previously recognized goodwill and intangible assets.

Benefits and Costs

B222. The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including preparers, auditors, and users of financial information. In fulfilling that mission, the Board endeavors to determine that a proposed standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. Although the costs to implement a new standard may not be borne evenly, investors and creditors—both present and potential—as well as others, benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

B223. The Board believes that the requirements in this Statement will result in improved financial reporting. The Board observed that intangible assets constitute a growing share of assets for entities generally and are, in fact, most of the assets of some individual entities. However, information about the intangible assets owned by those entities is often incomplete and inadequate. This Statement should lead to the provision of more information about those assets. The Board also believes that the changes in how goodwill and other intangible assets are accounted for subsequent to their acquisition will provide investors with greater transparency with respect to the economic value of goodwill and other acquired intangible assets and the amount and timing of their impact on earnings.

B224. The Board concluded that the benefits of recognizing goodwill charges in the income statement only when goodwill is impaired rather than on a systematic basis over an arbitrary

period of time exceed the costs associated with the impairment test required by this Statement. The Board reached several conclusions related to the goodwill impairment test after weighing the costs and benefits of the possible choices. For example, the Board adopted a two-step impairment test that will be less costly to apply than the one-step impairment test proposed in the 2001 Exposure Draft. The step added to the impairment test serves as a screen to identify potential goodwill impairment. If the fair value of a reporting unit exceeds its carrying amount, goodwill is not considered impaired; thus, the more costly step of estimating the implied fair value of goodwill and the amount of impairment loss, if any, is not required. In addition, the Board agreed to revise the definition of a reporting unit proposed in the 2001 Exposure Draft such that it is defined using terminology similar to that in Statement 131—terminology familiar to both preparers and users. Based on that revised definition, an entity may have fewer reporting units than it would have had under the proposed definition.

B225. The Board observed that entities were required to test goodwill for impairment under Opinion 17 and Chapter 5 of ARB 43 and that costs were associated with those impairment tests. Because Opinion 17 and Chapter 5 of ARB 43 included little guidance on how to test goodwill for impairment, entities differed as to how they tested goodwill for impairment. In addition, some or a portion of goodwill was required to be tested for impairment in conjunction with related assets in accordance with Statement 121. Therefore, in some instances goodwill was being tested for impairment under more than one method. This Statement requires that all entities test goodwill for impairment only in accordance with the provisions of this Statement, which will result in financial statements that are more comparable.

B226. Finally, the requirement in this Statement to test previously recognized goodwill for impairment upon initial application of this Statement is similar to the requirement in the 2001 Exposure Draft to perform a transitional benchmark assessment. However, the Board agreed to defer the effective date of this Statement with respect to previously recognized goodwill and intangible assets, thus providing an entity with more time to perform the transitional impairment test than it would have had to perform the transitional benchmark assessment. While this Statement requires goodwill to be tested for impairment on an annual basis beginning with the year in which this Statement is initially applied, the Board agreed that this Statement should provide entities with some relief from having to recompute the fair value of each reporting unit every year.

Appendix C: DISCLOSURE ILLUSTRATIONS

Introduction

C1. This appendix provides illustrations of the financial statement disclosure requirements of this Statement. The information presented in the following examples has been included for

illustrative purposes only and, therefore, may not be representative of actual transactions. For simplicity, the illustrative disclosures do not provide all of the background information that would be necessary to arrive at the disclosed information.

Illustration 1—Disclosure Requirements in Periods Subsequent to a Business Combination

C2. In accordance with paragraphs 45 and 47, the following disclosures would be made by Theta Company in its December 31, 20X3 financial statements relating to acquired intangible assets and goodwill. Theta Company has two reporting units with goodwill—Technology and Communications—which also are reportable segments.

Note B: Acquired Intangible Assets

(\$000s)	<u>As of December 31, 20X3</u>	
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Amortized intangible assets		
Trademark	\$1,078	\$ (66)
Unpatented technology	475	(380)
Other	<u>90</u>	<u>(30)</u>
Total	<u>\$1,643</u>	<u>\$(476)</u>
Unamortized intangible assets		
Broadcast licenses	\$1,400	
Trademark	<u>600</u>	
Total	<u>\$2,000</u>	

Aggregate Amortization Expense:

For year ended 12/31/X3	\$319
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Estimated Amortization Expense:

For year ended 12/31/X4	\$199
For year ended 12/31/X5	\$ 74
For year ended 12/31/X6	\$ 74
For year ended 12/31/X7	\$ 64
For year ended 12/31/X8	\$ 54

Note C: Goodwill

The changes in the carrying amount of goodwill for the year ended December 31, 20X3,

are as follows:

(\$000s)	Technology Segment	Communications Segment	Total
Balance as of			
January 1, 20X3	\$1,413	\$904	\$2,317
Goodwill acquired during year	189	115	304
Impairment losses	—	(46)	(46)
Goodwill written off related to sale of business unit	<u>(484)</u>	<u>—</u>	<u>(484)</u>
Balance as of			
December 31, 20X3	<u>\$1,118</u>	<u>\$973</u>	<u>\$2,091</u>

The Communications segment is tested for impairment in the third quarter, after the annual forecasting process. Due to an increase in competition in the Texas and Louisiana cable industry, operating profits and cash flows were lower than expected in the fourth quarter of 20X2 and the first and second quarters of 20X3. Based on that trend, the earnings forecast for the next five years was revised. In September 20X3, a goodwill impairment loss of \$46 was recognized in the Communications reporting unit. The fair value of that reporting unit was estimated using the expected present value of future cash flows.

Illustration 2—Transitional Disclosures

C3. Paragraph 61 requires disclosure of what reported income before extraordinary items and net income would have been in all periods presented exclusive of amortization expense (including any related tax effects) recognized in those periods related to goodwill, intangible assets that are no longer being amortized, any deferred credit related to an excess over cost, equity method goodwill, and changes in amortization periods for intangible assets that will continue to be amortized (including any related tax effects). Similarly adjusted per-share amounts also are required to be disclosed for all periods presented. Omega Corporation initially applies this Statement on January 1, 2002. The amortization expense and net income of Omega Corporation for the year of initial application and prior two years follow (Omega Corporation recognized no extraordinary items in those years):

	<u>For the Year Ended December 31,</u>		
	<u>20X2</u>	<u>20X1</u>	<u>20X0</u>
Goodwill amortization	\$	\$ (40)	\$ (40)
Trademark amortization	\$	\$ (20)	\$ (20)
Copyright amortization	\$ (9)	\$ (12)	\$ (12)
Net income	\$1,223	\$1,450	\$1,360

C4. The copyright and the trademark were purchased on January 1, 19X9, and are being amortized on a straight-line basis over 40 years (maximum permitted by APB Opinion No. 17, *Intangible Assets*). Upon initial application of this Statement, Omega Corporation reassesses the useful lives of its intangible assets and determines that the copyright has a remaining useful life of 47 years. Omega Corporation will amortize the remaining balance of \$444 related to the copyright over 47 years. The trademark is deemed to have an indefinite useful life because it is expected to generate cash flows indefinitely. Thus, Omega Corporation ceases amortizing the trademark on January 1, 2002.

C5. The following disclosure would be made by Omega Corporation in its December 31, 20X2 financial statements.

Footnote D: Goodwill and Other Intangible Assets—Adoption of Statement 142

	<u>For the Year Ended December 31,</u>		
(\$000s except for earnings-per-share amounts)	<u>20X2</u>	<u>20X1</u>	<u>20X0</u>
Reported net income	\$1,223	\$1,450	\$1,360
Add back: Goodwill amortization		40	40
Add back: Trademark amortization		20	20
Adjust: Copyright amortization		<u>3</u>	<u>3</u>
Adjusted net income	<u>\$1,223</u>	<u>\$1,513</u>	<u>\$1,423</u>
Basic earnings per share:			
Reported net income	\$ 2.45	\$2.90	\$2.72
Goodwill amortization		0.08	0.08
Trademark amortization		0.04	0.04
Copyright amortization		<u>0.01</u>	<u>0.01</u>
Adjusted net income	<u>\$ 2.45</u>	<u>\$3.03</u>	<u>\$2.85</u>
Diluted earnings per share:			
Reported net income	\$ 2.23	\$2.64	\$2.47
Goodwill amortization		0.07	0.07
Trademark amortization		0.04	0.04
Copyright amortization		<u>0.01</u>	<u>0.01</u>
Adjusted net income	<u>\$ 2.23</u>	<u>\$2.76</u>	<u>\$2.59</u>

Appendix D: AMENDMENTS TO EXISTING PRONOUNCEMENTS

D1. This Statement supersedes the following pronouncements:

- a. APB Opinion No. 17, *Intangible Assets*
- b. Both AICPA Accounting Interpretations of Opinion 17
- c. ARB No. 43, Chapter 5, “Intangible Assets.”

D2. APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, is amended as follows:

- a. Footnote 9 to paragraph 19(b) is replaced by the following:

Investors shall not amortize goodwill associated with equity method investments after the date FASB Statement No. 142, *Goodwill and Other Intangible Assets*, is initially applied by the entity in its entirety.

- b. The following sentence is added to the end of paragraph 19(m):

If that retroactive adjustment is made on or after the date Statement 142 is initially applied in its entirety, the goodwill related to that investment (including goodwill related to step purchases made prior to the initial application of Statement 142) shall not be amortized in determining the amount of the adjustment.

- c. The last sentence of paragraph 19(n) is replaced by the following:

However, if the investor is unable to relate the difference to specific accounts of the investee, the difference shall be recognized as goodwill and not be amortized in accordance with Statement 142.

- d. Footnote 12 is deleted.

D3. The heading and first sentence of paragraph 11(c) of FASB Statement No. 2, *Accounting for Research and Development Costs*, are replaced by the following:

Intangible assets purchased from others. The costs of intangible assets that are purchased from others for use in research and development activities and that have alternative future uses (in research and development projects or otherwise) shall be accounted for in accordance with FASB Statement No. 142, *Goodwill and Other Intangible Assets*.

D4. FASB Statement No. 44, *Accounting for Intangible Assets of Motor Carriers*, is amended as follows:

- a. In the last sentence of paragraph 3, the two references to *identifiable intangible assets* are replaced by *recognized intangible assets*.

b. Paragraph 4 is amended as follows:

- (1) In the first sentence, *identifiable intangible assets* is replaced by *recognized intangible assets* and *paragraphs 24–26 of APB Opinion No. 17, Intangible Assets* is replaced by *paragraphs 9 and 10 of FASB Statement No. 142, Goodwill and Other Intangible Assets*.
- (2) In the third sentence, the two references to *identifiable intangibles* are replaced by *recognized intangible assets*.
- (3) The last sentence is deleted.

c. The first sentence of paragraph 7 is replaced by the following:

Other recognized intangible assets and goodwill relating to motor carrier operations shall be accounted for in accordance with Statement 142.

D5. FASB Statement No. 51, *Financial Reporting by Cable Television Companies*, is amended as follows:

- a. In the first sentence of paragraph 13, *APB Opinion No. 17, Intangible Assets* is replaced by *FASB Statement No. 142, Goodwill and Other Intangible Assets*.
- b. Paragraph 14, as amended by FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of*, is amended as follows:
 - (1) In the first sentence, which was added by Statement 121, *identifiable* is deleted.
 - (2) The following sentence is added after the first sentence:

Other intangible assets are subject to the provisions of Statement 142.

D6. In the table in paragraph 48 of FASB Statement No. 52, *Foreign Currency Translation*, under the subheading “Examples of revenues and expenses related to nonmonetary items:” *goodwill* is deleted from the line item “Amortization of intangible items such as goodwill, patents, licenses, etc.”

D7. The last sentence of footnote 3 to paragraph 11 of FASB Statement No. 68, *Research and Development Arrangements*, is replaced by the following:

The accounting for other recognized intangible assets acquired by the enterprise is specified in FASB Statement No. 142, *Goodwill and Other Intangible Assets*.

D8. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, is amended as follows:

- a. Paragraph 29 and the heading before it are replaced by the following:

Goodwill

FASB Statement No. 142, *Goodwill and Other Intangible Assets*, states that goodwill shall not be amortized and shall be tested for impairment in accordance with that Statement. For rate-making purposes, a regulator may permit an enterprise to amortize purchased goodwill over a specified period. In other cases, a regulator may direct an enterprise not to amortize goodwill or to write off goodwill.

- b. Paragraph 30 is replaced by the following:

If the regulator permits all or a portion of goodwill to be amortized over a specific time period as an allowable cost for rate-making purposes, the regulator's action provides reasonable assurance of the existence of a regulatory asset (paragraph 9). That regulatory asset would then be amortized for financial reporting purposes over the period during which it will be allowed for rate-making purposes. Otherwise, goodwill shall not be amortized and shall be accounted for in accordance with Statement 142.

D9. FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions*, is amended as follows:

- a. In the third sentence of paragraph 2, *Opinion 17* is replaced by *FASB Statement No. 142, Goodwill and Other Intangible Assets*.
- b. The following sentences are added after the last sentence of paragraph 4:

An enterprise shall evaluate the periods of amortization continually to determine whether later events and circumstances warrant revised estimates of useful lives. If estimates are changed, the unamortized cost shall be allocated to the increased or reduced number of remaining periods in the revised useful life but not to exceed 40 years after acquisition. Estimation of value and future benefits of an intangible asset may indicate that the unamortized cost should be reduced significantly. However, a single loss year or even a few loss years together do not necessarily justify an unusual charge to income for all or a large part of the unamortized cost of intangible assets. The reason for an unusual deduction shall be disclosed.

- c. The first sentence of paragraph 6 is replaced by the following:

Paragraph 14 of Statement 142 specifies that an entity should evaluate the remaining useful life of an intangible asset that is being amortized each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization.

- d. In the first sentence of paragraph 7, *For purposes of applying paragraph 32 of Opinion 17*, and related footnote are deleted.
- e. Footnote 6 is deleted.

D10. FASB Statement No 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, is amended as follows:

- a. The first sentence of paragraph 3 is replaced by the following:

This Statement applies to long-lived assets and certain recognized intangible assets (except those not being amortized) to be held and used, and to long-lived assets and certain recognized intangible assets (including those not being amortized) to be disposed of.

- b. In paragraph 4, *identifiable intangibles* is replaced by *recognized intangible assets*.
- c. In the last sentence of paragraph 6, *and amortization periods* is added after *policies*.
- d. Paragraph 12 and the heading before it are deleted.
- e. In the table in paragraph 147, the section relating to APB Opinion No. 17 is deleted.

D11. FASB Interpretation No. 9, *Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or a Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method*, is amended as follows:

- a. Paragraph 8, as amended by Statement 72, is amended as follows:

- (1) In the third sentence, *amortized over its estimated life as specified by APB Opinion No. 17* is replaced by *accounted for in accordance with the provisions of FASB Statement No. 142, Goodwill and Other Intangible Assets*.
- (2) The phrase *and accounted for in accordance with the provisions of Statement 142* is added to the end of the last sentence, which was added by Statement 72.

- b. Paragraph 9 is deleted.

Appendix E: EXCERPTS FROM CONCEPTS STATEMENT 7

[Best understood in context of full Concepts Statement.]

E1. Paragraph 24 of this Statement states that “a present value technique is often the best available technique with which to estimate the fair value of a group of net assets (such as a reporting unit).” Paragraphs 39–54 and 75–88 of FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, discuss the use of present value techniques in measuring the fair value of an asset or a liability. Those paragraphs of Concepts Statement 7 follow.

The Components of a Present Value Measurement

39. Paragraph 23 describes the following elements that together capture the economic differences between various assets and liabilities:⁷

- a. An estimate of the future cash flow, or in more complex cases, series of future cash flows at different times
- b. Expectations about possible variations in the amount or timing of those cash flows
- c. The time value of money, represented by the risk-free rate of interest
- d. The price for bearing the uncertainty inherent in the asset or liability
- e. Other, sometimes unidentifiable, factors including illiquidity and market imperfections.

⁷The effect of the entity’s credit standing on the measurement of its liabilities is discussed in paragraphs 75–88.

40. This Statement contrasts two approaches to computing present value, either of which may be used to estimate the fair value of an asset or a liability, depending on the circumstances. In the expected cash flow approach discussed in this Statement, only the third factor listed in paragraph 39 (the time value of money, represented by the risk-free rate of interest) is included in the discount rate; the other factors cause adjustments in arriving at risk-adjusted expected cash flows. In a traditional approach to present value, adjustments for factors (b)–(e) described in paragraph 39 are embedded in the discount rate.

General Principles

41. The techniques used to estimate future cash flows and interest rates will vary from one situation to another depending on the circumstances surrounding

the asset or liability in question. However, certain general principles govern any application of present value techniques in measuring assets or liabilities:

- a. To the extent possible, estimated cash flows and interest rates should reflect assumptions about the future events and uncertainties that would be considered in deciding whether to acquire an asset or group of assets in an arm's-length transaction for cash.
- b. Interest rates used to discount cash flows should reflect assumptions that are consistent with those inherent in the estimated cash flows. Otherwise, the effect of some assumptions will be double counted or ignored. For example, an interest rate of 12 percent might be applied to contractual cash flows of a loan. That rate reflects expectations about future defaults from loans with particular characteristics. That same 12 percent rate should not be used to discount expected cash flows because those cash flows already reflect assumptions about future defaults.
- c. Estimated cash flows and interest rates should be free from both bias and factors unrelated to the asset, liability, or group of assets or liabilities in question. For example, deliberately understating estimated net cash flows to enhance the apparent future profitability of an asset introduces a bias into the measurement.
- d. Estimated cash flows or interest rates should reflect the range of possible outcomes rather than a single most-likely, minimum, or maximum possible amount.

Traditional and Expected Cash Flow Approaches to Present Value

42. A present value measurement begins with a set of future cash flows, but existing accounting standards employ a variety of different approaches in specifying cash flow sets. Some applications of present value use contractual cash flows. When contractual cash flows are not available, some applications use an estimate of the single most-likely amount or **best estimate**.

43. Accounting applications of present value have traditionally used a single set of estimated cash flows and a single interest rate, often described as “the rate commensurate with the risk.” In effect, although not always by conscious design, the traditional approach assumes that a single interest rate convention can reflect all the expectations about the future cash flows and the appropriate risk premium. The Board expects that accountants will continue to use the traditional approach for some measurements. In some circumstances, a traditional approach is relatively easy to apply. For assets and liabilities with contractual cash flows, it is consistent with the manner in which marketplace participants describe assets and liabilities, as in “a 12 percent bond.”

44. The traditional approach is useful for many measurements, especially those in which comparable assets and liabilities can be observed in the marketplace. However, the Board found that the traditional approach does not provide the tools needed to address some complex measurement problems, including the measurement of nonfinancial assets and liabilities for which no market for the item or a comparable item exists. The traditional approach places most of the emphasis on selection of an interest rate. A proper search for “the rate commensurate with the risk” requires analysis of at least two items—one asset or liability that exists in the marketplace and has an observed interest rate and the asset or liability being measured. The appropriate rate of interest for the cash flows being measured must be inferred from the observable rate of interest in some other asset or liability and, to draw that inference, the characteristics of the cash flows must be similar to those of the asset being measured. Consequently, the measurer must do the following:

- a. Identify the set of cash flows that will be discounted.
- b. Identify another asset or liability in the marketplace that appears to have similar cash flow characteristics.
- c. Compare the cash flow sets from the two items to ensure that they are similar. (For example, are both sets contractual cash flows, or is one contractual and the other an estimated cash flow?)
- d. Evaluate whether there is an element in one item that is not present in the other. (For example, is one less liquid than the other?)
- e. Evaluate whether both sets of cash flows are likely to behave (vary) in a similar fashion under changing economic conditions.

45. The Board found the expected cash flow approach to be a more effective measurement tool than the traditional approach in many situations. In developing a measurement, the expected cash flow approach uses all expectations about possible cash flows instead of the single most-likely cash flow. For example, a cash flow might be \$100, \$200, or \$300 with probabilities of 10 percent, 60 percent, and 30 percent, respectively. The expected cash flow is \$220.⁸ The expected cash flow approach thus differs from the traditional approach by focusing on direct analysis of the cash flows in question and on more explicit statements of the assumptions used in the measurement.

⁸ $(\$100 \times .1) + (\$200 \times .6) + (\$300 \times .3) = \220 . The traditional notion of a best estimate or most-likely amount in this example is \$200.

46. The expected cash flow approach also allows use of present value techniques when the timing of cash flows is uncertain. For example, a cash flow of \$1,000 may be received in 1 year, 2 years, or 3 years with probabilities of 10 percent, 60 percent, and 30 percent, respectively. The example below shows the

computation of **expected present value** in that situation. Again, the expected present value of \$892.36 differs from the traditional notion of a best estimate of \$902.73 (the 60 percent probability) in this example.⁹

Present value of \$1,000 in 1 year at 5%	\$ 952.38	
Probability	<u>10.00%</u>	\$ 95.24
Present value of \$1,000 in 2 years at 5.25%	\$ 902.73	
Probability	<u>60.00%</u>	541.64
Present value of \$1,000 in 3 years at 5.50%	\$ 851.61	
Probability	<u>30.00%</u>	<u>255.48</u>
Expected present value		<u><u>\$ 892.36</u></u>

⁹Interest rates usually vary with the length of time until settlement, a phenomenon described as the *yield curve*.

47. In the past, accounting standard setters have been reluctant to permit use of present value techniques beyond the narrow case of “contractual rights to receive money or contractual obligations to pay money on fixed or determinable dates.” That phrase, which first appeared in accounting standards in paragraph 2 of Opinion 21, reflects the computational limitations of the traditional approach—a single set of cash flows that can be assigned to specific future dates. The Accounting Principles Board recognized that the amount of cash flows is almost always uncertain and incorporated that uncertainty in the interest rate. However, an interest rate in a traditional present value computation cannot reflect uncertainties in timing. A traditional present value computation, applied to the example above, would require a decision about which of the possible timings of cash flows to use and, accordingly, would not reflect the probabilities of other timings.

48. While many accountants do not routinely use the expected cash flow approach, expected cash flows are inherent in the techniques used in some accounting measurements, like pensions, other postretirement benefits, and some insurance obligations. They are currently allowed, but not required, when measuring the impairment of long-lived assets and estimating the fair value of financial instruments. The use of probabilities is an essential element of the expected cash flow approach, and one that may trouble some accountants. They

may question whether assigning probabilities to highly subjective estimates suggests greater precision than, in fact, exists. However, the proper application of the traditional approach (as described in paragraph 44) requires the same estimates and subjectivity without providing the computational transparency of the expected cash flow approach.

49. Many estimates developed in current practice already incorporate the elements of expected cash flows informally. In addition, accountants often face the need to measure an asset or liability using limited information about the probabilities of possible cash flows. For example, an accountant might be confronted with the following situations:

- a. The estimated amount falls somewhere between \$50 and \$250, but no amount in the range is more likely than any other amount. Based on that limited information, the estimated expected cash flow is \$150 $[(50 + 250)/2]$.
- b. The estimated amount falls somewhere between \$50 and \$250, and the most likely amount is \$100. However, the probabilities attached to each amount are unknown. Based on that limited information, the estimated expected cash flow is \$133.33 $[(50 + 100 + 250)/3]$.
- c. The estimated amount will be \$50 (10 percent probability), \$250 (30 percent probability), or \$100 (60 percent probability). Based on that limited information, the estimated expected cash flow is \$140 $[(50 \times .10) + (250 \times .30) + (100 \times .60)]$.

50. Those familiar with statistical analysis may recognize the cases above as simple descriptions of (a) *uniform*, (b) *triangular*, and (c) *discrete* distributions.¹⁰ In each case, the estimated expected cash flow is likely to provide a better estimate of fair value than the minimum, most likely, or maximum amount taken alone.

¹⁰The uniform and triangular distributions are *continuous* distributions. For further information about these and other distributions, refer to:

- M. Evans, N. Hastings, and B. Peacock, *Statistical Distributions*, 2d ed. (New York: John Wiley & Sons, Inc., 1993).
- N. Johnson, S. Kotz, and N. Balakrishnan, *Continuous Univariate Distributions*, 2d ed., vol. 2. (New York: John Wiley & Sons, Inc., 1995).

51. Like any accounting measurement, the application of an expected cash flow approach is subject to a cost-benefit constraint. In some cases, an entity may have access to considerable data and may be able to develop many cash flow scenarios. In other cases, an entity may not be able to develop more than general statements about the variability of cash flows without incurring considerable cost. The accounting problem is to balance the cost of obtaining additional information

against the additional reliability that information will bring to the measurement. The Board recognizes that judgments about relative costs and benefits vary from one situation to the next and involve financial statement preparers, their auditors, and the needs of financial statement users.

52. Some maintain that expected cash flow techniques are inappropriate for measuring a single item or an item with a limited number of possible outcomes. They offer an example of an asset or liability with two possible outcomes: a 90 percent probability that the cash flow will be \$10 and a 10 percent probability that the cash flow will be \$1,000. They observe that the expected cash flow in that example is \$109¹¹ and criticize that result as not representing either of the amounts that may ultimately be paid.

¹¹ $(\$10 \times .9) + (\$1,000 \times .1) = \$109$. For purposes of illustration, this example ignores the time value of money.

53. Assertions like the one just outlined reflect underlying disagreement with the measurement objective. If the objective is accumulation of costs to be incurred, expected cash flows may not produce a representationally faithful estimate of the expected cost. However, this Statement adopts fair value as the measurement objective. The fair value of the asset or liability in this example is not likely to be \$10, even though that is the most likely cash flow. Instead, one would expect the fair value to be closer to \$109 than to either \$10 or \$1,000. While this example is a difficult measurement situation, a measurement of \$10 does not incorporate the uncertainty of the cash flow in the measurement of the asset or liability. Instead, the uncertain cash flow is presented as if it were a certain cash flow. No rational marketplace participant would sell an asset (or assume a liability) with these characteristics for \$10.

54. In recent years, financial institutions and others have developed and implemented a variety of pricing tools designed to estimate the fair value of assets and liabilities. It is not possible here to describe all of the many (often proprietary) pricing models currently in use. However, those tools often build on concepts similar to those outlined in this Statement as well as other developments in modern finance, including option pricing and similar models. For example, the well-known Black-Scholes option pricing model uses the elements of a fair value measurement described in paragraph 23 as appropriate in estimating the fair value of an option. To the extent that a pricing model includes each of the elements of fair value, its use is consistent with this Statement.

Present Value in the Measurement of Liabilities

75. The concepts outlined in this Statement apply to liabilities as well as to

assets. However, the measurement of liabilities sometimes involves problems different from those encountered in the measurement of assets and may require different techniques in arriving at fair value. When using present value techniques to estimate the fair value of a liability, the objective is to estimate the value of the assets required currently to (a) settle the liability with the holder or (b) transfer the liability to an entity of comparable credit standing.

76. To estimate the fair value of an entity's notes or bonds payable, accountants attempt to estimate the price at which other entities are willing to hold the entity's liabilities as assets. That process involves the same techniques and computational problems encountered in measuring assets. For example, the proceeds from a loan are the price that a lender paid to hold the borrower's promise of future cash flows as an asset. Similarly, the fair value of a bond payable is the price at which that security trades, as an asset, in the marketplace. As outlined in paragraphs 78–81, this estimate of fair value is consistent with the objective of liability measurement described in the preceding paragraph.

77. On the other hand, some liabilities are owed to a class of individuals who do not usually sell their rights as they might sell other assets. For example, entities often sell products with an accompanying warranty. Buyers of those products rarely have the ability or inclination to sell the warranty separately from the covered asset, but they own a warranty asset nonetheless. Some of an entity's liabilities, like an obligation for environmental cleanup, are not the assets of identifiable individuals. However, such liabilities are sometimes settled through assumption by a third party. In estimating the fair value of such liabilities accountants attempt to estimate the price that the entity would have to pay a third party to assume the liability.

Credit Standing and Liability Measurement

78. The most relevant measure of a liability always reflects the credit standing of the entity obligated to pay. Those who hold the entity's obligations as assets incorporate the entity's credit standing in determining the prices they are willing to pay. When an entity incurs a liability in exchange for cash, the role of its credit standing is easy to observe. An entity with a strong credit standing will receive more cash, relative to a fixed promise to pay, than an entity with a weak credit standing. For example, if 2 entities both promise to pay \$500 in 5 years, the entity with a strong credit standing may receive about \$374 in exchange for its promise (a 6 percent interest rate). The entity with a weak credit standing may receive about \$284 in exchange for its promise (a 12 percent interest rate). Each entity initially records its respective liability at fair value, which is the amount of proceeds received—an amount that incorporates that entity's credit standing.

79. The effect of an entity's credit standing on the fair value of particular liabilities depends on the ability of the entity to pay and on liability provisions that protect holders. Liabilities that are guaranteed by governmental bodies (for example, many bank deposit liabilities in the United States) may pose little risk of default to the holder. Other liabilities may include sinking-fund requirements or significant collateral. All of those aspects must be considered in estimating the extent to which the entity's credit standing affects the fair value of its liabilities.

80. The role of the entity's credit standing in a settlement transaction is less direct but equally important. A settlement transaction involves three parties—the entity, the parties to whom it is obligated, and a third party. The price of the transaction will reflect the competing interests of each party. For example, suppose Entity A has an obligation to pay \$500 to Entity B 3 years hence. Entity A has a poor credit rating and therefore borrows at a 12 percent interest rate.

- a. In a settlement transaction, Entity B would never consent to replace Entity A with an entity of lower credit standing. All other things being equal, Entity B might consent to replace Entity A with a borrower of similar credit standing and would probably consent to replace Entity A with a more creditworthy entity.
- b. Entity C has a good credit rating and therefore borrows at a 6 percent interest rate. It might willingly assume Entity A's obligation for \$420 (the present value at 6 percent). Entity C has no incentive to assume the obligation for less (a higher interest rate) if it can borrow at 6 percent because it can receive \$420 for an identical promise to pay \$500.
- c. However, if Entity A were to borrow the money to pay Entity C, it would have to promise \$590 (\$420 due in 3 years with accumulated interest at 12 percent).

81. Based on the admittedly simple case outlined above, the fair value of Entity A's liability should be approximately \$356 (the present value of \$500 in 3 years at 12 percent). The \$420 price demanded by Entity C includes the fair value of Entity A's liability (\$356) plus the price of an upgrade in the credit quality of the liability. There may be situations in which an entity might pay an additional amount to induce others to enter into a settlement transaction. Those cases are analogous to the purchase of a credit guarantee and, like the purchase of a guarantee, the additional amount represents a separate transaction rather than an element in the fair value of the entity's original liability.

82. The effect of an entity's credit standing on the measurement of its liabilities is usually captured in an adjustment to the interest rate, as illustrated above. This is similar to the traditional approach to incorporating risk and uncertainty in the measurement of assets and is well suited to liabilities with contractual cash flows.

An expected cash flow approach may be more effective when measuring the effect of credit standing on other liabilities. For example, a liability may present the entity with a range of possible outflows, ranging from very low to very high amounts. There may be little chance of default if the amount is low, but a high chance of default if the amount is high. In situations like this, the effect of credit standing may be more effectively incorporated in the computation of expected cash flows.

83. The role of an entity's credit standing in the accounting measurement of its liabilities has been a controversial question among accountants. The entity's credit standing clearly affects the interest rate at which it borrows in the marketplace. The initial proceeds of a loan, therefore, always reflect the entity's credit standing at that time. Similarly, the price at which others buy and sell the entity's loan includes their assessment of the entity's ability to repay. The example in paragraph 80 demonstrates how the entity's credit standing would affect the price it would be required to pay to have another entity assume its liability. However, some have questioned whether an entity's financial statements should reflect the effect of its credit standing (or changes in credit standing).

84. Some suggest that the measurement objective for liabilities is fundamentally different from the measurement objective for assets. In their view, financial statement users are better served by liability measurements that focus on the entity's obligation. They suggest a measurement approach in which financial statements would portray the present value of an obligation such that two entities with the same obligation but different credit standing would report the same carrying amount. Some existing accounting pronouncements take this approach, most notably FASB Statements No. 87, *Employers' Accounting for Pensions*, and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*.

85. However, there is no convincing rationale for why the initial measurement of some liabilities would necessarily include the effect of credit standing (as in a loan for cash) while others might not (as in a warranty liability or similar item). Similarly, there is no rationale for why, in initial or fresh-start measurement, the recorded amount of a liability should reflect something other than the price that would exist in the marketplace. Consistent with its conclusions on fair value (refer to paragraph 30), the Board found no rationale for taking a different view in subsequent fresh-start measurements of an existing asset or liability than would pertain to measurements at initial recognition.

86. Some argue that changes in an entity's credit standing are not relevant to users of financial statements. In their view, a fresh-start measurement that

reflects changes in credit standing produces accounting results that are confusing. If the measurement includes changes in credit standing, and an entity's credit standing declines, the fresh-start measurement of its liabilities declines. That decline in liabilities is accompanied by an increase in owners' equity, a result that they find counterintuitive. How, they ask, can a bad thing (declining credit standing) produce a good thing (increased owners' equity)?

87. Like all measurements at fair value, fresh-start measurement of liabilities can produce unfamiliar results when compared with reporting the liabilities on an amortized basis. A change in credit standing represents a change in the relative positions of the two classes of claimants (shareholders and creditors) to an entity's assets. If the credit standing diminishes, the fair value of creditors' claims diminishes. The amount of shareholders' residual claim to the entity's assets may appear to increase, but that increase probably is offset by losses that may have occasioned the decline in credit standing. Because shareholders usually cannot be called on to pay a corporation's liabilities, the amount of their residual claims approaches, and is limited by, zero. Thus, a change in the position of borrowers necessarily alters the position of shareholders, and vice versa.

88. The failure to include changes in credit standing in the measurement of a liability ignores economic differences between liabilities. Consider the case of an entity that has two classes of borrowing. Class One was transacted when the entity had a strong credit standing and a correspondingly low interest rate. Class Two is new and was transacted under the entity's current lower credit standing. Both classes trade in the marketplace based on the entity's current credit standing. If the two liabilities are subject to fresh-start measurement, failing to include changes in the entity's credit standing makes the classes of borrowings seem different—even though the marketplace evaluates the quality of their respective cash flows as similar to one another.

E2. Paragraph 24 of this Statement requires that estimates of future cash flows used in a present value technique be consistent with the objective of measuring fair value. Paragraph 23 of Concepts Statement 7 discusses the essential elements of a present value measurement. That paragraph of Concepts Statement 7 follows.

23. A present value measurement that fully captures the economic differences between the five assets described in paragraph 20 would necessarily include the following elements:

- a. An estimate of the future cash flow, or in more complex cases, series of future cash flows at different times²
- b. Expectations about possible variations in the amount or timing of those cash flows
- c. The time value of money, represented by the risk-free rate of interest

- d. The price for bearing the uncertainty inherent in the asset or liability
- e. Other, sometimes unidentifiable, factors including illiquidity and market imperfections.

²In complex measurements, such as measurements of liabilities settled by providing services, cash flow estimates necessarily include elements like overhead and profit margins inherent in the price of goods and services.

E3. Paragraph 24 of this Statement requires that estimates of future cash flows used in a present value technique incorporate assumptions that marketplace participants would use in their estimates of fair value. If that information is not available without undue cost and effort, an entity may use its own assumptions. Paragraph 32 of Concepts Statement 7 provides examples of circumstances in which an entity's cash flows (entity assumptions) might differ from the market cash flows (marketplace assumptions). That paragraph of Concepts Statement 7 follows.

32. An entity's best estimate of the present value of cash flows will not necessarily equal the fair value of those uncertain cash flows. There are several reasons why an entity might expect to realize or pay cash flows that differ from those expected by others in the marketplace. Those include:

- a. The entity's managers might intend different use or settlement than that anticipated by others. For example, they might intend to operate a property as a bowling alley, even though others in the marketplace consider its highest and best use to be a parking lot.
- b. The entity's managers may prefer to accept risk of a liability (like a product warranty) and manage it internally, rather than transferring that liability to another entity.
- c. The entity might hold special preferences, like tax or zoning variances, not available to others.
- d. The entity might hold information, trade secrets, or processes that allow it to realize (or avoid paying) cash flows that differ from others' expectations.
- e. The entity might be able to realize or pay amounts through use of internal resources. For example, an entity that manufactures materials used in particular processes acquires those materials at cost, rather than the market price charged to others. An entity that chooses to satisfy a liability with internal resources may avoid the markup or anticipated profit charged by outside contractors.

Appendix F: GLOSSARY

F1. This appendix contains definitions of certain terms used in this Statement.

Fair value

The amount at which an asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

Goodwill

The excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. The amount recognized as goodwill includes acquired intangible assets that do not meet the criteria in FASB Statement No. 141, *Business Combinations*, for recognition as an asset apart from goodwill.

Intangible assets

Assets (not including financial assets) that lack physical substance. (The term *intangible assets* is used in this Statement to refer to intangible assets other than goodwill.)

Intangible asset class

A group of intangible assets that are similar, either by their nature or by their use in the operations of an entity.

Mutual enterprise

An entity other than an investor-owned entity that provides dividends, lower costs, or other economic benefits directly and proportionately to its owners, members, or participants. Mutual insurance companies, credit unions, and farm and rural electric cooperatives are examples of mutual enterprises (FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*, paragraph 7).

Not-for-profit organization

An entity that possesses the following characteristics that distinguish it from a business enterprise: (a) contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return, (b) operating purposes other than to provide goods or services at a profit, and (c) absence of ownership interests like those of business enterprises. Not-for-profit organizations have those characteristics in varying degrees (Concepts Statement 4, paragraph 6). Entities that clearly fall outside this definition include all investor-owned entities and mutual enterprises.

Reporting unit

The level of reporting at which goodwill is tested for impairment. A reporting unit is an operating segment or one level below an operating segment (as that term is defined in paragraph 10 of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*).

Residual value

The estimated fair value of an intangible asset at the end of its useful life to an entity, less any disposal costs.

Useful life

The period over which an asset is expected to contribute directly or indirectly to future cash flows.

Footnotes

FAS142, Footnote 1—Statement 141 was issued concurrently with this Statement and addresses financial accounting and reporting for business combinations. It supersedes APB Opinion No. 16, *Business Combinations*, and FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*.

FAS142, Footnote 2—Terms defined in Appendix F, the glossary, are set forth in **boldface** type the first time they are used.

FAS142, Footnote 3—Statement 141 addresses the initial recognition and measurement of intangible assets acquired in a business combination.

FAS142, Footnote 4—This Statement applies to a business enterprise, a **mutual enterprise**, and a **not-for-profit organization**, each of which is referred to herein as an *entity*.

FAS142, Footnote 5—Statement 141 requires that the acquisition of some or all of the noncontrolling interests in a subsidiary be accounted for using the purchase method.

FAS142, Footnote 6—Although those paragraphs refer to determining the cost of the assets acquired, both paragraph 6 of Statement 141 and paragraph 18 of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, note that, in general, cost should be measured based on the fair value of the consideration given or the fair value of the net assets acquired, whichever is more reliably measurable.

FAS142, Footnote 7—Statement 141 requires intangible assets acquired in a business combination that do not meet certain criteria to be included in the amount initially recognized as goodwill. Those recognition criteria do not apply to intangible assets acquired in transactions other than business combinations.

FAS142, Footnote 8—Statement 2 and Interpretation 4 require amounts assigned to acquired intangible assets that are to be used in a particular research and development project and that *have no alternative future use* to be charged to expense at the acquisition date. Statement 141 does not change that requirement, nor does this Statement.

FAS142, Footnote 9—The useful life of an intangible asset shall reflect the period over which it will contribute to the cash flows of the reporting entity, not the period of time that it would take that entity to internally develop an intangible asset that would provide similar benefits.

FAS142, Footnote 10—As in determining the useful life of depreciable tangible assets, regular maintenance may be assumed but enhancements may not.

FAS142, Footnote 11—However, both Statement 2 and Interpretation 4 require amounts assigned to acquired intangible assets that are to be used in a particular research and development project and that have no alternative future use to be charged to expense at the acquisition date.

FAS142, Footnote 12—The fair value of an intangible asset shall be estimated using the guidance in paragraphs 23–25 (except the guidance specific to estimating the fair value of a **reporting unit**).

FAS142, Footnote 13—The fair value of goodwill can be measured only as a residual and cannot be measured directly. Therefore, this Statement includes a methodology to determine an amount that achieves a reasonable estimate of the value of goodwill for purposes of measuring an impairment loss. That estimate is referred to herein as the *implied fair value of goodwill*.

FAS142, Footnote 14—The relevant guidance in paragraphs 35–38 of Statement 141 shall be used in determining how to allocate the fair value of a reporting unit to the assets and liabilities of that unit. Included in that allocation would be research and development assets that meet the criteria in paragraph 32 of this Statement, even if Statement 2 or Interpretation 4 would require those assets to be written off to earnings when acquired.

FAS142, Footnote 15—Refer to FASB Statement No. 5, *Accounting for Contingencies*.

FAS142, Footnote 16—Substantial value may arise from the ability to take advantage of synergies and other benefits that flow from control over another entity. Consequently, measuring the fair value of a collection of assets and liabilities that operate together in a controlled entity is different from measuring the fair value of that entity’s individual equity securities. An acquiring entity often is willing to pay more for equity securities that give it a controlling interest than an investor would pay for a number of equity securities representing less than a controlling interest. That control premium may cause the fair value of a reporting unit to exceed its market capitalization.

FAS142, Footnote 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*.

FAS142, Footnote 18—Emerging Issues Task Force Issue No. 98-3, “Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business,” includes guidance on determining whether an asset group constitutes a business.

FAS142, Footnote 19—Segment management consists of one or more segment managers, as that term is defined in paragraph 14 of Statement 131.

FAS142, Footnote 20—Paragraph 17 of Statement 131 shall be considered in determining if the

components of an operating segment have similar economic characteristics.

FAS142, Footnote 21—Paragraphs 35–38 of Statement 141 provide guidance on allocating the purchase price to the assets acquired and liabilities assumed in a business combination.

FAS142, Footnote 22—For purposes of this Statement, the terms *disposal* and *disposed of* refer to assets to be disposed of as that term is used in Statement 121 and to assets of a segment of a business being accounted for as a discontinued operation under APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*.

FAS142, Footnote 23—Refer to footnote 18.

FAS142, Footnote 24—The Board plans to consider issues related to the application of the purchase method to combinations between two or more mutual enterprises, combinations between not-for-profit organizations, and the acquisition of a for-profit business entity by a not-for-profit organization in a separate project.

FAS142, Footnote 25—For example, when a business combination was initially recorded, a portion of the acquired entity was assigned to intangible assets that meet the recognition criteria in paragraph 39 of Statement 141. Those intangible assets have been included in the amount reported on the statement of financial position as goodwill (or as goodwill and other intangible assets). However, separate general ledger or other accounting records have been maintained for those assets.

FAS142, Footnote 26—For example, the amortization period for a previously recognized intangible asset might be increased if its original useful life was estimated to be longer than the 40-year maximum amortization period allowed by Opinion 17.

FAS142, Footnote 27—For example, AICPA Accounting Interpretation 2, “Goodwill in a Step Acquisition,” of Opinion 17 stated that when an entity acquires another entity or an investment accounted for by the equity method through a series of purchases (commonly referred to as a step acquisition), the entity should identify the cost of each investment, the fair value of the underlying assets acquired, and the goodwill for each step acquisition.

FAS142, Footnote 28—Because this Statement supersedes all of Opinion 17, this Statement carries forward the provisions in that Opinion related to internally developed intangible assets. As noted in paragraph 2, the Board has not reconsidered those provisions as they are outside the project’s scope.

FAS142, Footnote 29—As it did prior to issuing the 2001 Exposure Draft, the Board noted that some intangible assets are so closely related to another asset or liability that they usually are sold

as a “package” (as is the case with deposit liabilities and the related depositor relationship intangible asset). The Board concluded that an intangible asset that does not meet the separability criterion individually meets the separability criterion if it can be separated and divided from the entity and sold, transferred, licensed, rented, or exchanged with a related contract, asset, or liability.

FAS142, Footnote 30—Some respondents to both Exposure Drafts doubted their ability to reliably measure the fair values of many intangible assets, particularly those acquired in groups with other assets. The Board noted that the fair values of the assets acquired are established through bargained exchange transactions. The Board acknowledged that the fair value estimates for some intangible assets that meet the recognition criteria might lack the precision of the fair value measurements for other assets. However, the Board also concluded that the financial information that will be provided by recognizing intangible assets at their estimated fair values is more representationally faithful than that which would be provided if those intangible assets were not recognized as intangible assets on the basis of measurement difficulties.

FAS142, Footnote 31—Paragraph 20 of FRS 10 notes that durability depends on a number of factors such as the nature of the business, the stability of the industry in which the acquired business operates, typical lifespans of the products to which the goodwill attaches, the extent to which the acquisition overcomes market entry barriers that will continue to exist, and the expected future impact of competition on the business.