MINUTES

To:	Board Members
From:	Ryan Bergstrom (ext. 296)
Subject:	Intangible Assets: Minutes of the August 17, 2005 Board Meeting
Date:	August 30, 2005
cc:	

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic:	Useful Life and Amortization of Intangible Assets
Basis for Discussion:	Board memorandum dated July 28, 2005
Length of Discussion:	9:30 a.m. to 10:30 a.m.

Attendance:

Board members present:	Herz, Batavick, Crooch, Schipper, Seidman, Trott, and Young
Board members absent:	None
Staff in charge of topic:	Moss
Other staff at Board table:	L. Smith, Gerard, Todorova, and Bergstrom
Outside participants:	None

Summary of Decisions Reached:

The Board reconsidered certain aspects of FASB Statement No. 142, *Goodwill and Other Intangible Assets,* as they relate to the determination of the useful life and amortization of renewable intangible assets. Specifically, the Board discussed a model that addresses previously identified practice issues associated with the application of the criteria in paragraph 11(d) of Statement 142 and made the following decisions:

1. At acquisition, the value of the renewable intangible asset should be attributed to the initial contractual period of use and all future renewal periods based upon the relative value of the discounted cash flows of each period and amortized to expense over those respective periods.

2. Incremental and direct costs of renewal should be capitalized and amortized over that renewal period.

3. Renewable intangible assets should be subject to a fair-value based test (similar to the impairment test for indefinite lived intangible assets under Statement 142). In the event of an impairment charge, the updated valuation should be utilized for purposes of attributing amortization expense to the remaining renewal periods.

4. Paragraph 11(d) of Statement 142 should be retained and modified as follows:

   a. 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)~~ renewal is reasonably assured).

Objective of Meeting:

The objective of the Board meeting was to reach a consensus on a proposed model that addresses certain practice issues related to the application of the criteria in paragraph 11(d) of Statement 142. Specifically, the staff wanted the Board to reach a consensus on the following aspects of the proposed model: (1) initial accounting for renewable intangible assets, (2) treatment of renewal costs, (3) subsequent accounting after initial valuation, (4) impairment methodology, and (5) proposed changes to paragraph 11(d) of Statement 142. The objective was accomplished.

Matters Discussed and Decisions Reached:

1. Mr. Moss opened the meeting by discussing the perceived conflict in guidance related to the initial valuation of a renewable intangible asset in accordance with Statement 141 and the determination of the useful life of a renewable intangible asset in accordance with Statement 142. In particular, constituents have questioned whether the limitations around the useful life determination included in paragraph 11(d) of Statement 142 are consistent with the factors that an entity would consider in valuing the asset under Statement 141. At the January 19, 2005 Board meeting, certain Board members indicated that the guidance in Statement 141 regarding the initial value of an intangible asset was not intended to be consistent with the useful life determination in accordance with Statement 142. They indicated that this perceived "inconsistency" was intentionally included in the standard to prevent entities from utilizing unreasonably long amortization periods related to renewable intangible assets.
2. Further, Mr. Moss stated that constituents have indicated that the application of paragraph 11(d) of Statement 142 has resulted in two main practice issues. The first issue is that the useful life to a reporting entity is often significantly less than the period of cash flows used to initially value the asset. This often results in an accelerated recognition of amortization expense over the contractual period of use (that is, it often excludes renewal periods). The second issue is that constituents have had difficulty in interpreting the phrase "material modifications."
3. Mr. Moss introduced the framework for the model that the staff developed to address the practice issues noted above. The first issue discussed was the initial accounting for renewable intangible assets. He noted that at the date of the initial valuation, the value of the renewable intangible asset would be allocated between the existing contractual period of use and all future renewal periods based upon

the relative value of each period. Amortization expense would be recognized for the portion attributed to the existing period of contractual use through the next renewal date. Mr. Moss asked the Board whether the value of the asset should be allocated based upon the relative value of discounted or undiscounted cash flows. The Board unanimously supported the staff's recommendation that at acquisition, amortization expense would be attributed to the contractual period of use and all future renewal periods based upon the relative value of the discounted cash flows of each period.

4. Mr. Moss introduced a related aspect of the initial valuation of a renewable lived intangible asset—assets that are valued using a method other than the income approach. Mr. Moss noted that based upon discussion with valuation specialists, it appears that the use of valuation techniques other than the income approach for these types of assets is not common. The Board supported the staff's recommendation not to provide specific guidance for assets valued using a different technique in the proposed FSP (other than including a general statement that indicates a reasonable and supportable approach should be used for assets valued using another approach).
5. Mr. Moss stated that frequently an entity will incur certain incremental and direct costs as part of the renewal process for these types of assets. Mr. Moss asked the Board whether these costs should be expensed or capitalized. The Board supported the staff's recommendation to capitalize renewal costs (Mr. Crooch, Mr. Batavick, Mr. Trott, and Ms. Siedman).
6. Mr. Batavick supported capitalization of renewal costs because he believes that renewal costs meet the definition of an asset, renewal costs contribute to future revenues, and capitalization of renewal costs is consistent with the treatment of similar costs for other similar asset. However, Ms. Schipper did not agree with capitalization of renewal costs, but stated that she would not object because she believes that capitalization of renewal costs can be conceptually defensible. . Mr. Young and Mr. Herz also disagreed with capitalizing renewal costs because they believe that renewal costs are already reflected in the valuation of the asset,

consequently, only renewal costs that add additional value to the asset should be capitalized.

7. Based on the Board's decision to capitalize renewal costs, the staff asked the Board the period over which renewal costs should be amortized. Mr. Moss presented two views: Amortize renewal costs over the renewal period (View A) or amortize renewal costs over the remaining useful life of the asset (View B). The Board agreed that the amortization of renewal costs should be limited to the renewal period (View A). Mr. Crooch noted that View B may result in the back-loading of the renewal costs over the life of the asset; thereby leaving significant renewal costs to be amortized in the final period. Mr. Trott added that he believes that View A is the simplest method to explain and apply.

8. However, Ms. Seidman stated that she believes that since renewal costs are included in the initial valuation, they should be expensed in the same manner as any other cash flow that contributed to the relative value of the asset. Additionally, she indicated that both View A and View B were equally simple to understand and apply.

9. Mr. Batavick also believes that View B is conceptually superior because the renewal costs not only benefit the current renewal period, but also benefit future renewal periods. Mr. Herz agreed with Mr. Batavick's comments, but noted the difficulty in determining how much of the cost to renew benefited only the renewal period and how much should be attributed to the future periods. Consequently, Mr. Herz supported View A. Mr. Young agreed with View A, but noted that there are likely instances when the renewal costs actually enhance the asset's value, which extends beyond the renewal period. Mr. Young supported allowing preparers' judgment in deciding whether the renewal costs only benefits the renewal period or if they extend to future renewal periods. Ms. Schipper added that View A ignores the real option of the ability to renew the asset in future periods, however; she also noted the impracticability of determining the value of the real option to renew.

10. Mr. Moss then addressed an issue that arose at the April 6, 2005 Board meeting in which the staff presented an alternative that would require amending the criteria

in paragraph of 13 Statement 142 for recording a residual value. The Board unanimously supported the staff's recommendation to not pursue this alternative because it would likely require expanding the scope of the project to all intangible assets.

11. The next issue discussed was subsequent accounting after the initial valuation of a renewable intangible. Mr. Moss presented three different views for the Board to evaluate.
    a. View A: The initial valuation (including the value associated with each renewal period) should be used for purposes of recognizing amortizations expense during renewal periods. In the event of an impairment charge, the updated valuation should be utilized for purposes of attributing amortization expense to renewal periods.
    b. View B: At each renewal date (and at any interim period in which impairment analyses are performed), the asset would be revalued (upward revaluation would not be permitted). Similar to the initial valuation, the asset's value would split between the existing contractual period of use and future renewal periods. The value associated with the existing period of use would be amortized through the next renewal date.
    c. At each renewal date, the renewal value (that is, the estimated value of all future renewal periods) would be revalued (upward revaluation would not be permitted). To the extent revaluation results in an overall decrease in the renewal value, this decrease would be amortized prospectively through the next renewal period.
12. The Board supported View A. Mr. Batavick noted that in evaluating the alternatives, two criteria are important: (1) consistency with how other finite-lived assets are treated and (2) simplicity. Based on these two criteria, Mr. Batavick supported View A. Mr. Trott also supported View A, based on his belief that it was the only alternative consistent with the decisions that had been made to this point. Ms. Schipper stated that she believed that View C was the conceptually correct view, but stated that she would accept View A.

13. Mr. Moss introduced Issue 4, which addressed concerns voiced at prior Board meetings that if the accounting model is changed for renewable intangible assets, a more rigorous impairment model should be provided. Accordingly, Mr. Moss offered two alternatives:
    a. View A: Renewable intangible assets should continue to be subject to the Statement 144 impairment test.
    b. View B: Renewable intangible assets should be subject to a fair value based test (similar to the impairment test for indefinite lived intangible assets under Statement 142)
14. The Board supported view B (Mr. Crooch, Ms. Schipper, Mr. Trott, and Mr. Young). Several Board members noted their concern with the current impairment testing under FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* because of the inherent cushion that it provides due to the use of undiscounted cash flows and testing at the asset group level. However, Mr. Batavick stated that although renewable intangible assets are different than other finite-lived assets, he did not believe that these differences were significant enough to require a separate impairment methodology. Consequently, Mr. Batavick supported view A. Ms. Seidman noted that the decisions reached earlier establish renewable intangible assets as finite-lived intangible assets. Based on that conclusion, Ms. Seidman believes that renewable intangible assets should be tested for impairment in the same fashion as other finite-lived intangible assets (View A). Ms. Seidman objected to View B.
15. Mr. Moss then asked the Board how paragraph 11(d) of Statement 142 should be impacted by the new accounting model that has been developed through today's decisions. Mr. Moss presented the three alternative views:
    a. View A: Paragraph 11(d) of Statement 142 should be retained in its entirety.
    b. View B: Paragraph 11(d) of Statement 142 should be removed.
    c. View C: Paragraph 11(d) of Statement 142 should be retained, however the criteria for "material modifications" should be replaced with the following:

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)~~ renewal is reasonably assured).

16. Mr. Moss stated that the staff supported View C, with the language "reasonably assured" because it is a term that has been used extensively in practice by constituents in determining the lease term of leases that contain a renewal option in accordance with FASB Statement No. 13, *Accounting for Leases*. The Board also supported View C.

Follow-Up Items:

None

General Announcements:

None