MINUTES

To:	Board Members
From:	Kispert (ext. 310)
Subject:	Intangible Assets: Minutes of the April 6, 2005 Board Meeting
Date:	April 13, 2005
cc:	Bielstein, L. Smith, Petrone, Leisenring, Project Team, McBride, Westerlund, Mahoney, Business Combinations Team, MacDonald, Thompson, Sutay, Gabriele, Swift, Polley, Attmore, Bean, McGeachin (IASB), Crook (IASB), Getz, Willis, Richards, Golden, FASB Intranet

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 March 25, 2005
Length of Discussion:	9:55 a.m. to 11:10 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, Golden, and Kispert
Outside participants:	Leisenring

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 intangible assets. Specifically, the Board decided that:

a. An amortization methodology that reflects the "pattern of economic benefit" to the reporting entity should not be developed.

b. A renewable intangible asset is comprised of a single asset.

c. The scope of this project should be limited to intangible assets.

The Board has yet to clarify whether the scope of this project includes all intangible assets or just renewable intangibles. The Board also asked the staff to further research and develop a model for the single asset approach that would include a reconsideration of the residual value guidance in paragraph 13 of Statement 142. Additionally, the Board requested that the staff specifically address measurement and impairment issues associated with this proposed model.

Objective of Meeting:

Based upon the directive of the Board at the January 19, 2005 Board meeting, the staff explored alternative methodologies to address the practice issue that was identified at that meeting. Specifically, the practice issue relates to the evaluation of the criteria in subparagraph 11(d) of Statement 142 (that is, the notion of "substantial cost" and "material modifications") that can often result in an amortization period for renewable intangible assets that is less than both the period cash flows used to initially value an asset under Statement 141 and the period over which an asset is expected to contribute to future cash flows.

In order to assist in the development of a model that addresses this practice issue, the objective of this Board meeting is for the Board to consider the following questions, each of which has proposed accounting consequences:

Question 1: Should an amortization methodology be developed that reflects the "pattern of economic benefit" to the reporting entity?

Question 2: Does a renewable intangible asset comprise a single asset or multiple assets (that is, the first asset being the value associated with the initial period of use and the second asset represented by the value of the renewals)?

Matters Discussed and Decisions Reached:

1. Mr. Moss opened the meeting by discussing the practice issue described above. He then asked the Board whether an amortization methodology should be developed that reflects the pattern of economic benefit to the reporting entity.

2. Mr. Moss noted that at the January 19, 2005 Board meeting, the Board acknowledged that the straight-line method of amortization was not expected to be used as the default methodology based on the guidance in paragraph 12 of Statement 142. It believed that while the guidance appears to be clear, entities have not applied what is perceived to be the pattern of economic benefit amortization methodology in practice. For purposes of determining the pattern in which the economic benefits of the intangible asset are consumed, this model assumes that undiscounted cash flows included in the valuation model for any given period would be compared with the sum of the undiscounted cash flows included in the fair value estimate to develop the ratio of the fair value of the asset that would be amortized during that respective period. Subsequent to the initial valuation and development of the amortization pattern, that pattern would be used until the intangible asset is tested for impairment, at which point the subsequent amortization would use the pattern indicated by the valuation performed in connection with the impairment analysis.

3. Mr. Moss stated that the staff believes that while this approach could potentially alleviate the identified practice issue, it might create certain operational concerns. These concerns include, but are not limited to, the cost and complexity of application and the reliability of the pattern of cash flows. Therefore, the staff does not recommend development of an amortization methodology that reflects the pattern of economic benefit to a reporting entity. Mr. Moss noted that if the Board decides that

an amortization methodology should be developed that reflects the pattern of economic benefit, it would eliminate the need to discuss the second question. He then opened the discussion to the Board.

4. Mr. Batavick stated that an amortization methodology that reflects the pattern of economic benefit may be complex under certain arrangements. Also, all valuation models may not result in a pattern of economic benefit. Thus, he supports the staff's recommendation for this first question and is in favor of discussing the second question.

5. Ms. Seidman clarified that the staff is not recommending changing Statement 142. Mr. Moss agreed, and Ms. Seidman stated that she supports the staff's recommendation with that clarification.

6. Mr. Trott stated that the preferable answer is that an amortization methodology should be developed that reflects the pattern of economic benefit to an entity. However, he noted that the models that will be discussed later during the meeting obtain similar results as an amortization based on expected benefit, but those models are labeled differently and are applied in a different way to achieve that outcome. The question is to resolve the practice issue that people believe current accounting, which accelerates amortization, results in less useful information.

7. Mr. Moss agreed that the other models to be presented do achieve similar results as developing an amortization methodology based on the pattern of economic benefit without many of the operationality issues.

8. Ms. Schipper stated that the conceptually correct answer to the first question is yes. However, that leads her to wonder why a pattern of economic benefit amortization methodology is not done for all assets. Because the Board was asked to solve a specific problem in financial reporting, she agrees with the staff's recommendation based on pragmatic grounds.

9. Mr. Herz stated that he supports the staff's recommendation, and would like the staff to continue with the next question.

10. Mr. Moss stated that since the Board has answered “no” to the first question, the staff believes that in order to develop a model that achieves a similar objective to the pattern of economic benefit amortization methodology, without some of the inherent operational concerns, the Board should consider whether a renewable intangible asset comprises a single asset or multiple assets (that is, the first asset being the value associated with the initial period of use and the second asset represented by the value of the renewals).

11. Mr. Moss noted that this question is important because the staff has developed alternative models for consideration that are dependent upon this response. For example, if the Board believes that a renewable intangible asset is a single asset, the staff has proposed a model that proposes reconsidering the residual value guidance in paragraph 13 of Statement 142. Alternatively, if the Board believes a renewable intangible asset is comprised of multiple assets, the staff believes that value of the asset should be bifurcated between the period of initial use (which would be treated as an amortizable asset) and the value associated with the renewals (which would be treated as an indefinite lived intangible asset).

12. Mr. Moss stated that the staff believes that, based on the guidance in FASB Statement No. 141, *Business Combinations*, a renewable intangible asset is comprised of a single asset. Once the Board has answered this question, the staff will explain the respective proposed model in further detail.

13. Ms. Seidman stated that she agrees with the staff. Although she understands how some would conceptually view a renewable intangible asset as multiple assets, Ms. Seidman stated that, for pragmatic reasons, there is an easier way to solve the problem and to not add complexity.

14. Mr. Trott stated that he supports developing the multiple assets model. In that model, you would separate the first value of the current right from the value you expect at the end of the current right, which is the second asset. At the time you get to the second asset, you capitalize the cost to acquire the second asset. That process will continue to be rolled forward. Mr. Trott noted that renewable intangible assets have

characteristics of both indefinite-lived intangible assets and finite-lived intangible assets because of the right to renew.

15. Messrs. Crooch and Batavick support a single asset approach.

16. Mr. Young stated that he does not have a strong preference for either method, but prefers the multiple assets approach because it is more of a reflection of the underlying economics. However, he noted that the single asset approach would be better for simplicity and operationality purposes.

17. Ms. Schipper stated that her view is that the single asset approach and the multiple assets approach are the same. They both involve taking the present value of the cash flows beyond the useful life before the first renewal and calling it an indefinite-lived intangible asset associated with renewals under the multiple assets approach, and a salvage value under the single asset approach. In both cases, it is assumed that the enterprise would separate the total stream of value into two pieces. Piece 1 would be the amortizable part over the contractual life, and Piece 2 would be called an indefinite-lived intangible asset associated with renewals (or a salvage value). The difference in the two approaches is what happens to Piece 2. Ms. Schipper noted that the attractiveness of the multiple assets approach is dampened by the inability to remeasure the amount upward because, in some cases, it will be an appreciated item. Therefore, she prefers the single asset approach.

18. Ms. Seidman asked what the scope would be for a change in the impairment guidance. Mr. Moss stated that the scope would only be renewable intangible assets. However, he noted that this situation is not unique to renewable intangible assets and the Board may want to consider whether it would like to expand the scope to all intangible assets.

19. The Board agrees on a single asset approach.

20. Mr. Moss stated that many constituents believe that the requirement for an existing or future market for an intangible asset for purposes of recognizing a residual value is restrictive, since such markets are extremely rare. They believe that modifying the

restrictive requirements for recognizing a residual value could help to eliminate most of the practice issues that have been identified with subparagraph 11(d) of Statement 142, without requiring the removal of this language. For example, Mr. Moss noted that proponents of this alternative believe that when entity-specific use of an intangible asset results in a useful life that is less than the period of cash flows used to initially value the asset (for example, an entity "fails" the material modifications criteria in subparagraph 11(d) of Statement 142), the difference between the assumptions inherently would represent a residual value. That is, the present value of the cash flows used to value the asset under a marketplace participant view that extend beyond the useful life determined in accordance with Statement 142 should be recorded as a residual value. Under the current guidance, however, an entity is unable to record this amount as a residual value and, therefore, the entire amortization is accelerated into the initial period of use.

21. Mr. Moss stated that at the January 19, 2005 Board meeting, certain Board members indicated that if the Board was to reconsider the guidance for recording residual values, it would need to reconsider impairment methodologies for this asset. The concern is that the current impairment model would not be rigorous enough to reflect any potential impairment of the asset. Accordingly, the staff has identified two views for consideration by the Board:

View A—The current impairment methodology provides the appropriate rigor in assessing renewable intangible assets for impairment. In current practice, the residual value, as prescribed in Statement 142, would be accounted for similarly to a salvage value as described in ARB No. 43, Chapter 9C, "Emergency Facilities: Depreciation, Amortization and Income Taxes," and APB Opinion No. 20, *Accounting Changes*. That is, the residual value would be reassessed periodically, and changes in this amount would be reflected prospectively in amortization expense as a change in accounting estimate.

View B—The current impairment model should be changed to ensure that the residual value is not overstated. Proponents of this view acknowledge that under View A, current practice provides for an impairment test on the residual value that is in some ways similar to a fair value based test. However, the impact of any write-down of the residual value is recorded on a prospective basis as a component of amortization expense. Proponents believe that any write-down should be recorded in the period in which the facts and circumstances resulting in the diminished value occurred.

Accordingly, proponents of this view believe that the impairment methodology for renewable intangible assets should be fair value based similar to that for indefinite lived intangible assets.

22. Mr. Moss stated that the staff believes that the current guidance for reassessing the residual value is in essence a fair value based test that would apply the appropriate rigor in assessing the residual value for overstatement. Additionally, this approach would result in recording amortization expense that is closer to reflecting the pattern of economic benefit. Therefore, the staff recommends View A. Mr. Moss also noted that the Board may now want to consider, if the guidance for residual values changes, whether the impairment model should be changed for just renewable intangible assets or all intangible assets.

23. Mr. Young stated he supports View B because it is more representationally faithful to immediately reflect the change in the value.

24. Mr. Trott expressed concern about only focusing on the residual value in regards to an impairment model. He asked whether the impairment model should change for the single asset. Mr. Moss stated that if the Board chooses the View A approach, the staff would ask the Board additional clarifying questions.

25. Mr. Golden stated that the complete asset (both the amortizable portion and residual value) is tested for impairment under FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* because it is a single amortizable asset. The staff is asking the Board about the need to periodically evaluate the residual value. Currently, if there is a need for a write-down, that is accounted for prospectively. Mr. Golden stated that the impairment guidance in Statement 144 does not need to be changed as a result of this project.

26. Mr. Trott stated that he would not object to the staff further developing this area. He noted that the staff should focus on scope. Depreciation and amortization does not only apply to intangible assets. He suggested that the staff look at the definitions of residual value in Statement 142 and IAS 16, *Property, Plant and Equipment*, because one of the issues arising from residual value is how to anticipate changes in

appreciation. He also suggested looking at the IAS guidance for a revaluation approach and the ability to recover a previous write-down.

27. Ms. Seidman stated that she is supportive of reconsidering the guidance on residual values. However, she would prefer to not change the impairment guidance relating to amortizable intangibles. Therefore, she supports View A.

28. Mr. Batavick stated that he supports broadening the scope to include all intangibles, and believes that the residual value guidance needs to be revised.

29. Mr. Crooch supports View A, but also noted that he agrees with Mr. Trott in that the staff should do further research.

30. Ms. Schipper stated that the Board who developed Statements 141 and 142 put in place, as she would call them, conservative rules. The rule in Statement 141 states that the fair value measurement is over a longer period than the potential immediate useful life. This rule prevents too long amortization periods. The rule in Statement 142 relates to residual value, and Ms. Schipper believes that that rule was put in place to prevent too small amortization amounts. The problem class of assets (that is, those which cause a conflict between Statements 141 and 142) is described in paragraph 11(d) of Statement 142. Ms. Schipper stated that she recommends the Board restrict its analysis to arrangements that have a specific legal, contractual, or regulatory provision for renewal.

31. Ms. Schipper questioned how an entity can estimate a residual value for assets that are not measured using discounted cash flows. She stated that if guidance can be written for that issue, the Board will then need to determine whether the scope should extend beyond this narrow class of assets and what type of impairment testing to apply. Ms. Schipper noted that she would prefer to keep the scope narrow. Mr. Moss stated that the staff would have to further explore how a residual value can be estimated in the situation Ms. Schipper described.

32. Mr. Herz stated that he did not want to widen the scope and would prefer to limit the project to renewable intangible assets. He also expressed that Ms. Schipper's

question regarding how to determine residual value is something that needs to be further considered. Mr. Herz stated that his preference on impairment is View A.

33. Ms. Schipper noted that she does not believe the term residual value is the right term to use to describe this amount. She stated that the amount is the portion of fair value that represents all periods subsequent to the first renewal date. Mr. Leisenring stated that he views the renewal as an embedded option.

34. Mr. Gerard asked whether the problem could be solved by simply removing the tests in paragraph 11(d) of Statement 142 regarding substantial cost and material modifications.

35. Mr. Trott disagreed with that simplification and noted that the issue is determining whether the intangible asset has a definite or indefinite life which is triggered off of the application of paragraph 11(d) of Statement 142.

36. Mr. Golden stated that the Board appears to have mixed views on whether the scope should encompass all intangible assets or only renewable intangible assets. Ms. Seidman noted that if View A is supported, the decision could apply to all intangible assets.

37. Based on the discussion, Mr. Herz asked the staff to further explore a model for a single asset approach that would reconsider the residual value guidance, as well as specifically address measurement and impairment issues. The Board agreed that the scope should be narrow, but did not decide whether the scope should include all intangibles or only renewable intangibles.

Follow-Up Items:

None

General Announcements:

None