To our clients and other friends

Accounting for goodwill and intangible assets can involve various financial reporting issues, including determining the useful life and unit of accounting for intangible assets, identifying reporting units and performing impairment evaluations.

We have updated this Financial reporting developments publication to help you understand the accounting for goodwill and intangible assets. This publication includes excerpts from and references to the FASB’s Accounting Standards Codification, interpretive guidance and examples. We have updated this publication to enhance our interpretive guidance. Appendix A highlights the important changes to this publication.

We hope this publication will help you identify and understand the issues related to the accounting for goodwill and other intangible assets. We are also available to answer your questions and discuss any concerns you may have.

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Notice to readers:

This publication includes excerpts from and references to the FASB Accounting Standards Codification ("the Codification" or "ASC"). The Codification is the single source of authoritative nongovernmental US generally accepted accounting principles (US GAAP), with the exception of guidance issued by the SEC, and is effective for interim and annual periods ending after 15 September 2009. The Codification comprises all US GAAP issued by a standard setter, excluding those standards for state and local governments, and supersedes previously issued accounting standards.

The Codification uses a hierarchy that includes Topics, Subtopics, Sections and Paragraphs. Each Topic includes an Overall Subtopic that generally includes pervasive guidance for the topic, and additional Subtopics, as needed, with incremental or unique guidance. Each Subtopic includes Sections which in turn include numbered Paragraphs. Thus, a codification reference includes the Topic (XXX), Subtopic (YY), Section (ZZ) and Paragraph (PP). Throughout this publication references to guidance in the codification are shown using these reference numbers. For example, references to specific Topics within the Codification are presented as ASC XXX, references to specific Subtopics are presented as ASC XXX-YY and references to specific Paragraphs are shown as ASC XXX-YY-ZZ-PP. Certain content from pre-codification standards (e.g., basis for conclusions) is excluded from the Codification.

Throughout this publication, references are made to certain pre-codification standards (and specific sections or paragraphs of pre-codification standards) in situations in which the content being discussed is excluded from the Codification. We have included the following items as appendices to this publication:

- Appendix A  A summary of important changes to this publication
- Appendix B  A listing of differences between ASC 350 and IFRS
- Appendix C  Illustrative examples on accounting for intangible assets other than goodwill
- Appendix D  A listing of abbreviations for accounting standards used throughout this publication
- Appendix E  A listing of relevant terms from the glossary for this ASC Topic
- Appendix F  An index of specific Codification paragraphs and the relevant sections within this publication in which those paragraphs are included or discussed
1 General provisions

1.1 Scope

Excerpt from Accounting Standards Codification

Intangibles — Goodwill and Other — Overall

Overview and Background

350-10-05-1
The Intangibles—Goodwill and Other Topic provides guidance on financial accounting and reporting related to goodwill and other intangibles, other than the accounting at acquisition for goodwill and other intangibles acquired in a business combination or an acquisition by a not-for-profit entity. That acquisition guidance is provided in the following Subtopics:

a. Subtopic 805-20 provides acquisition guidance for intangible assets acquired in a business combination or an acquisition by a not-for-profit entity.

b. Subtopic 805-30 provides guidance on recognition and initial measurement of goodwill acquired in a business combination.

c. Subtopic 958-805 provides guidance on recognition and initial measurement of goodwill acquired in an acquisition by a not-for-profit entity.

350-10-05-4
Subtopic 350-20 addresses financial accounting and reporting for goodwill subsequent to its acquisition.

350-10-05-5
Subtopic 350-30 addresses financial accounting and reporting for intangible assets acquired individually or with a group of other assets. However, it does not discuss the recognition and initial measurement of intangible assets acquired in a business combination or in an acquisition by a not-for-profit entity. That acquisition guidance is provided in Subtopic 805-20. Subtopic 805-30 also addresses the financial accounting and reporting for intangible assets after acquisition, including intangible assets acquired in a business combination or an acquisition by a not-for-profit entity.

Scope and Scope Exceptions

350-10-15-2
The guidance in the Intangibles—Goodwill and Other Topic applies to all entities, including business entities, mutual entities, and not-for-profit entities (NFPs).

Intangibles — Goodwill and Other — Goodwill

Overview and Background

350-20-05-1
This Subtopic addresses financial accounting and reporting for goodwill subsequent to its acquisition and for the cost of internally developing goodwill.
Subtopic 805-30 provides guidance on recognition and initial measurement of goodwill acquired in a business combination. Subtopic 958-805 provides guidance on recognition and initial measurement of goodwill acquired in an acquisition by a not-for-profit entity.

While goodwill is an intangible asset, the term intangible asset is used in this Subtopic to refer to an intangible asset other than goodwill.

**Scope and Scope Exceptions**

The guidance in this Subtopic applies to the following transactions and activities:

a. Goodwill that an entity recognizes in accordance with Subtopic 805-30 or Subtopic 958-805 after it has been initially recognized and measured

b. The costs of internally developing goodwill and other unidentifiable intangible assets with indeterminate lives

c. [Subparagraph not used]

d. 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 Topic 852.

e. [Subparagraph not used]

As indicated in paragraph 350-20-05-3, while goodwill is an intangible asset, the term intangible asset is used in this Subtopic to refer to an intangible asset other than goodwill.

**Recognition**

The excess reorganization value recognized by entities that adopt fresh-start reporting in accordance with Topic 852 shall be reported as goodwill and accounted for in the same manner as goodwill.

**Intangibles — Goodwill and Other — General Intangibles Other than Goodwill**

This Subtopic addresses financial accounting and reporting for intangible assets (other than goodwill) acquired individually or with a group of other assets. However, it does not discuss the recognition and initial measurement of intangible assets acquired in a business combination or in an acquisition by a not-for-profit entity. That acquisition guidance is provided in Subtopics 805-20 and 958-805. This Subtopic also addresses financial accounting and reporting for intangible assets after their acquisition, including intangible assets acquired in a business combination or an acquisition by a not-for-profit entity.

While goodwill is an intangible asset, the term intangible asset is used in this Subtopic to refer to an intangible asset other than goodwill.
350-30-15-3
The guidance in this Subtopic applies to the following:

a. Intangible assets acquired individually or with a group of other assets (but not the recognition and initial measurement of those acquired in a business combination or an acquisition by a not-for-profit entity)

b. Intangible assets (other than goodwill) that an entity recognizes in accordance with Subtopic 805-20 or 958-805 after they have been initially recognized and measured, except for those identified in the following paragraph

c. [Subparagraph not used]

d. Costs of internally developing identifiable intangible assets that an entity recognizes as assets.

350-30-15-4
The guidance in this Subtopic does not apply to the following:

a. [Subparagraph not used]

b. [Subparagraph superseded by Accounting Standards Update No. 2010-07]

c. Except for certain disclosure requirements as noted in the preceding paragraph, capitalized software costs

d. Intangible assets recognized for acquired insurance contracts under the requirements of Subtopic 944-805.

The initial recognition and measurement provisions of ASC 350-30 apply to intangible assets acquired individually or as part of a group that does not constitute a business, as defined in ASC 805. ASC 805 addresses the recognition and measurement of intangible assets acquired in a business combination. Likewise, ASC 958 addresses the recognition and measurement of intangibles assets acquired in an acquisition of a business or nonprofit activity by a not-for-profit entity. This Standard does not apply to intangible assets recognized for acquired insurance contracts under the requirements of ASC 944.

ASC 350 addresses the subsequent accounting for goodwill and intangible assets acquired either individually, with a group of other assets, or in a business combination. Goodwill embedded in the difference between the cost of an equity method investment and the investor’s interest in the underlying net assets of the investee (such goodwill is referred to as “equity method goodwill”) must not be amortized or tested for impairment in accordance with ASC 350-20. Instead, equity method goodwill and the associated equity method investments are evaluated for impairment in accordance with ASC 323-10-35-32.

ASC 350 also applies to the excess reorganization value recognized by companies that adopt fresh-start reporting in accordance with ASC 852-10. The excess reorganization value resulting from certain reorganizations under the Bankruptcy Code is an intangible asset. The FASB believes that excess reorganization value is similar to goodwill and, therefore, excess reorganization value should be reported as goodwill and accounted for under ASC 350-20.

For further information on ASC 805 and ASC 360-10, see our FRD, Business combinations and our FRD, Impairment or disposal of long-lived assets.
1.1.1 Not-for-profit entities

Subsequent to the adoption of the guidance in ASC 958, not-for-profit entities must apply the guidance in ASC 350. Therefore, goodwill and indefinite-lived intangible assets of not-for-profit entities are subject to an impairment test at least annually, as is the case for for-profit entities. The guidance in ASC 958 requires previously recognized goodwill assigned to a reporting unit predominantly supported by contributions and returns on investments to be written-off as a change in accounting principle and presented as a separate line item in the statement of activities.

All other previously recognized goodwill is subject to the transitional impairment evaluation\(^1\) of ASC 350 as of the beginning of the year of adoption (i.e., 1 January 2010 for calendar year-end entities). That previous guidance allowed six months to perform the first step of the goodwill impairment test (i.e., comparing the carrying amount of reporting units to their fair value). If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test (calculating the implied fair value of goodwill and comparing that amount to the carrying amount of goodwill) must be performed by the end of the year of adoption.

1.1.2 Mutual entities

During the deliberations leading to Statements 141 and 142, the FASB concluded that combinations involving only mutual entities (for example, credit unions, cooperatives, etc.) should be accounted for using the acquisition method of accounting. However, the FASB decided to defer the effective date of Statements 141 and 142 for combinations involving only mutual entities until additional implementation guidance could be issued about how mutual entities should apply the acquisition method. After further consideration in the deliberations of ASC 805, the FASB concluded that business combinations involving only mutual entities are economically similar to combinations between other entities and, therefore, there is no need to issue separate application guidance for those business combinations. As a result, ASC 805 requires the acquisition method of accounting to be applied to business combinations between mutual entities.

The guidance in ASC 805 states that a mutual entity that has not yet applied ASC 350 in its entirety must apply that guidance in its entirety at the same time that it applies ASC 805. Transition considerations for mutual entities are described in section 5.3.

1.1.3 Accounting by producers or distributors of films

Movies, television programs and other assets within the scope of ASC 926-20 will continue to be accounted for in accordance with that guidance as opposed to ASC 350. ASC 926-20 applies to films, which are defined as feature films, television specials, television series or similar products (including animated films and television programming) that are sold, licensed or exhibited, whether produced on film, video tape, digital or other video recording formats. ASC 350-30 is not applicable to these intangible assets, and ASC 926-20 does not contemplate the concept of an indefinite useful life as set forth in ASC 350-30. Therefore, these assets should continue to be amortized under ASC 926-20 (i.e., using the individual-film-forecast-computation method).

\(^1\) Note that the transitional guidance included in paragraphs 54 – 58 of Statement 142 was not codified. Although this guidance was not codified, not-for-profit entities must apply this guidance to previously recognized goodwill.
1.2 Initial recognition and measurement of intangible assets

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**Scope and Scope Exceptions**

**350-10-15-3**

The guidance in the Intangibles–Goodwill and Other Topic does not apply to the following transactions and activities:

a. The accounting at acquisition for goodwill acquired in a business combination (for guidance see Subtopic 805-30)

b. [Subparagraph not used]

c. The accounting at acquisition for goodwill acquired in an acquisition by a not-for-profit entity (for guidance see Subtopic 958-805)

d. The accounting at acquisition for intangible assets (other than goodwill) acquired in a business combination or in an acquisition by a not-for-profit entity (for guidance see Subtopics 805-20 and 958-805).

**Intangibles – Goodwill and Other – General Intangibles Other than Goodwill**

**Recognition**

**350-30-25-1**

An intangible asset that is acquired either individually or with a group of other assets shall be recognized.

**350-30-25-2**

As indicated by paragraph 805-50-30-3, the cost of a group of assets acquired in a transaction other than a business combination or an acquisition by a not-for-profit entity shall be allocated to the individual assets acquired based on their relative fair values and shall not give rise to goodwill.

**350-30-25-4**

Intangible assets that are acquired individually or with a group of assets in a transaction other than a business combination or an acquisition by a not-for-profit entity may meet asset recognition criteria in FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, 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 provides reliable evidence about the existence and fair value of those assets. Thus, those assets shall be recognized as intangible assets.

**350-30-25-5**

A defensive intangible asset, other than an intangible asset that is used in research and development activities, shall be accounted for as a separate unit of accounting. Such a defensive intangible asset shall not be included as part of the cost of an entity’s existing intangible asset(s). For implementation guidance on determining whether an intangible asset is a defensive intangible asset, see paragraph 350-30-55-1. For guidance on intangible assets acquired in a business combination or an acquisition by a not-for-profit entity that are used in research and development activities (regardless of whether they have an alternative future use), see paragraph 350-30-35-17A. For guidance on intangibles that are purchased from others for a particular research and development project and that have no alternative future uses (in other research and development projects or otherwise), see Subtopic 730-10.
Initial Measurement

350-30-30-1
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 measured based on the guidance included in paragraphs 805-50-15-3 and 805-50-30-1 through 30-4.

Intangible assets acquired either individually or with a group of other assets outside of a business combination are initially recognized and measured based on their cost to the acquiring entity. The cost of a group of assets that does not meet the definition of a business in ASC 805 is allocated to the individual assets based on their relative fair value. The recognition of goodwill is precluded in such asset acquisitions, as goodwill can be recognized only in a business combination. The relative fair value allocation process could result in acquired assets being valued in excess of or less than their individual fair values.

Moreover, the measurement of deferred tax assets acquired and deferred tax liabilities assumed in an acquisition of a group of assets that does not constitute a business will usually require an iterative approach that impacts the measurement of other individual assets acquired and liabilities assumed in the net asset group. See section 2.1 of our FRD, Business combinations for a discussion of the definition of a business and transactions that are considered business combinations. In addition, see Appendix A in our FRD, Business combinations for more detailed discussion on the accounting for asset acquisitions.

1.3 Internally developed intangible assets

Excerpt from Accounting Standards Codification

Intangibles – Goodwill and Other – Goodwill

Recognition

350-20-25-3
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.

Intangibles – Goodwill and Other – General Intangibles Other than Goodwill

Recognition

350-30-25-3
Costs of internally developing, maintaining, or restoring intangible assets that are not specifically identifiable, that have indeterminate lives, or that are inherent in a continuing business or nonprofit activity and related to an entity as a whole, shall be recognized as an expense when incurred.

Costs to internally develop, maintain or restore unidentifiable intangible assets (including goodwill) that have indeterminate lives or that are inherent in a continuing business and related to the business as a whole are recognized as expense as incurred unless explicitly capitalizable under other US GAAP (e.g., internally developed software).

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2 Transaction costs incurred in the acquisition of a group of assets generally are a component of the consideration transferred and as such, are capitalized as a component of the cost of the assets acquired. This approach differs from the new basis approach for business combinations, under which all transaction costs are expensed because they are not a component of the fair value of the acquired entity.
2 Subsequent accounting for intangible assets other than goodwill

2.1 Determining the useful lives of intangible assets

Excerpt from Accounting Standards Codification
Intangibles – Goodwill and Other – General Intangibles Other than Goodwill
Subsequent Measurement

350-30-35-1
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 shall be amortized; an intangible asset with an indefinite useful life shall not be amortized.

350-30-35-2
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. The useful life is not the period of time that it would take that entity to internally develop an intangible asset that would provide similar benefits. However, a reacquired right recognized as an intangible asset is amortized over the remaining contractual period of the contract in which the right was granted. If an entity subsequently reissues (sells) a reacquired right to a third party, the entity includes the related unamortized asset, if any, in determining the gain or loss on the reissuance.

350-30-35-3
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, all of the following factors with no one factor being more presumptive than the other:

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.

c. Any legal, regulatory, or contractual provisions that may limit the useful life. 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.

d. The entity’s own historical experience in renewing or extending similar arrangements, consistent with the intended use of the asset by the entity, regardless of whether those arrangements have explicit renewal or extension provisions. In the absence of that experience, the entity shall consider the assumptions that market participants would use about renewal or extension consistent with the highest and best use of the asset by market participants, adjusted for entity-specific factors in this paragraph.

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

Further, if an income approach is used to measure the fair value of an intangible asset, in determining the useful life of the intangible asset for amortization purposes, an entity shall consider the period of expected cash flows used to measure the fair value of the intangible asset adjusted as appropriate for the entity-specific factors in this paragraph.

350-30-35-4
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 the same as infinite or indeterminate. 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. Such intangible assets might be airport route authorities, certain trademarks, and taxicab medallions.

Implementation Guidance and Illustrations
350-30-55-1C
This paragraph provides implementation guidance on paragraph 350-30-35-3(d). For a recognized intangible asset, there might continue to be a difference between the useful life of the asset and the period of expected cash flows used to measure the fair value of the asset. However, that difference likely will be limited to situations in which the entity's own assumptions about the period over which the asset is expected to contribute directly and indirectly to the future cash flows of the entity are different from the assumptions market participants would use in pricing the asset. In those situations, it is appropriate for the entity to use its own assumptions because amortization of a recognized intangible asset should reflect the period over which the asset will contribute both directly and indirectly to the expected future cash flows of the entity.

Regardless of how an intangible asset (other than goodwill) is acquired (i.e., in a business combination, in an asset acquisition or internally generated), the accounting treatment after the initial recognition of the asset depends on the estimated useful life of that asset to the reporting company. The useful life of an intangible asset is the period over which the asset is expected to contribute directly or indirectly to the future cash flows of the company. The following are some observations regarding estimated useful lives:

- The useful life should reflect the period over which an intangible asset will contribute directly or indirectly to the cash flows of the reporting company, not the period of time that it would take that company to internally develop an intangible asset that would provide similar benefits. However, a reacquired right is amortized only over the remaining duration of the contract in which the right was granted, irrespective of any existing renewal terms (i.e., the contract period existing at the acquisition date, not considering future renewal periods).3

- The useful life does not necessarily represent the intangible asset’s economic or productive life. The useful life is only the period that the asset is expected to contribute to the future cash flows of that company. That is, the acquiring company may believe that the intangible asset will generate cash

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3 If the reacquired right is subsequently reissued to a third party, the related unamortized asset is included in determining the gain or loss on the reissuance.
flows for a period longer than the company expects to own the asset (e.g., the company expects to sell the asset before it is fully consumed). In this case, the asset would be amortized over the period of expected ownership, considering the expected residual value.

- Some intangible assets contribute only indirectly to future cash flows, and the useful life is based on that period. For example, non-compete agreements contribute only indirectly to future cash flows for the expected period that the agreement will preclude competition. In addition, intangible assets that an acquirer does not intend to use might contribute indirectly to future cash flows (see section 2.4).

An intangible asset with a finite useful life is amortized, while an intangible asset with an indefinite useful life is not amortized, but is tested at least annually for impairment. In estimating the useful life of an intangible asset, a company should analyze all pertinent factors. In particular, a company should consider the following factors with no one factor being more presumptive than the other:

- The expected use of the intangible asset by the company.
- The expected useful life of another asset or a group of assets to which the useful life of the asset may relate.
- Any legal, regulatory or contractual provisions that may limit the useful life.
- The entity’s own historical experience in renewing or extending similar arrangements (consistent with the intended use of the asset by the entity), regardless of whether those arrangements have explicit renewal or extension provisions. In the absence of that experience, the entity shall consider the assumptions that market participants would use about renewal or extension (consistent with the highest and best use of the asset by market participants), adjusted for entity-specific factors (see section 2.1.2).
- The effects of obsolescence, demand, competition, and other economic factors (e.g., stability of the industry, known technological advances, legislative action that results in an uncertain or changing regulatory environment, and expected changes in distribution channels).
- The level of maintenance expenditures required to obtain the expected future cash flows from the asset (e.g., a material level of required maintenance in relation to the carrying amount of the asset may suggest a very limited useful life).4

If a company performs an analysis of all pertinent factors that should be considered in determining the useful life of an intangible asset and concludes that there is no limit on the useful life of an intangible asset, that asset should be deemed to have an indefinite life. In other words, if no legal, regulatory, contractual, competitive, economic or other factors limit the useful life of an intangible asset to the reporting company, the useful life of that intangible asset should be considered to be indefinite. Indefinite does not mean infinite or indeterminate. 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. Further, just because a precise useful life is not determinable does not mean that the useful life is indefinite.

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4 As in determining the useful life of depreciable tangible assets, regular maintenance may be assumed but enhancements may not.
2.1.1 Legal rights

Assets are sometimes based on legal rights that are conveyed in perpetuity rather than a defined finite term. Those assets may have cash flows associated with them that may be expected to continue for many years, or indefinitely. If the cash flows are expected to continue only for a finite period, the useful life of the asset should be limited to that finite period. However, if the cash flows are expected to continue indefinitely, the useful life of the asset may be indefinite.

2.1.2 Renewal and extension rights

ASC 350-30 requires an entity to consider its own assumptions about renewal or extension of the term of the arrangement, consistent with its expected use of the asset when determining the useful life of an intangible asset. An entity is required to use its own historical experiences in renewing or extending similar arrangements when determining the useful life of an intangible asset, adjusted for the entity-specific factors in ASC 350-30-35-3. In the absence of historical experience, an entity must consider the assumptions that market participants would use about renewal or extension (consistent with the highest and best use of the asset by market participants), adjusted for the entity-specific factors in ASC 350-30-35-3. These provisions are applied even if there is a substantial cost or material modification upon renewal.

Illustrations C-10 and C-11 in Appendix C provide factors to consider when determining the useful life of an intangible asset when an entity lacks historical experience.

2.1.2.1 Effect of using an income valuation approach

It is common for an income approach to be used to measure the fair value of a recognized intangible asset. In determining the useful life of the asset, the period of expected cash flows used to measure the fair value of the recognized intangible asset, adjusted for the entity-specific factors in ASC 350-30-35-3, should be considered. Those entity-specific factors include, but are not limited to, the entity's expected use of the asset and the entity's historical experience in renewing or extending similar arrangements.

For a recognized intangible asset, there might continue to be a difference between the useful life of the asset and the period of expected cash flows used to measure the fair value of the asset. However, the FASB believes that any such difference will likely be limited to situations in which the entity’s own assumptions about the period over which the asset is expected to contribute directly and/or indirectly to the future cash flows of the entity are different from the assumptions market participants would use in pricing the asset. In those situations, the FASB noted in ASC 350-30-55-1C that it believes it is appropriate for the entity to use its own assumptions because amortization of a recognized intangible asset should reflect the period over which the asset will contribute both directly and indirectly to the expected future cash flows of the entity.

2.1.3 Other factors to consider

In a 16 August 2001 letter to the EITF on Statements 141 and 142 implementation issues, the SEC staff stated there may be factors other than those codified in ASC 350-30-35-3 that bear upon the determination of the appropriate estimated useful life of an intangible asset. For instance, the staff believes that the following other factors may need to be considered in determining the useful lives of intangible assets:

- Uncertain continuity of revenues dependent on retention of key employees
- The “churn” rate of customers
- The mobility of the customer and employee base
In response to the SEC staff’s letter, the FASB staff noted that the list of factors codified in ASC 350-30-35-3 is illustrative and agreed that the factors the SEC staff identified also may be relevant factors to consider depending on the nature of the asset. The FASB staff further indicated that there may be other relevant factors to consider in addition to those codified in ASC 350-30-35-3 and those identified by the SEC staff, depending on the nature of the asset. All pertinent information should be considered when estimating an intangible asset’s useful life.

2.1.4 Considerations in determining the useful life of a customer relationship intangible

Per ASC 805-20-55-25, a customer relationship exists between an entity and its customers if (a) the entity has information about the customer and has regular contact with the customer and (b) the customer has the ability to make direct contact with the entity. Based on the definition of a customer relationship and the nature of those relationships, we believe that it would be rare for a recognized customer relationship intangible asset to have a useful life that is indefinite. This is due in part to the fact that customers frequently turnover as a result of changes in relationships, customers going out of business, etc.

At the 2003 Thirty-First Annual AICPA National Conference on Current SEC Developments, Chad A. Kokenge of the SEC staff noted the following:

- Paragraph 11 of Statement 142 addresses how to determine the useful life of an intangible asset. In general, we believe an indefinite life conclusion for a customer related intangible asset would be extremely rare. Among the factors that cause me to say this are the following:
  - The asset being inherently related to relationships with "people", where people in organizations are subject to turnover;
  - More broadly, the customer churn rate. Generally, an established customer turnover rate and likewise, forecasted customer turnover rate, would directly affect the life estimate;
  - The relative cost or penalty to the customer for terminating the relationship. Generally, a customer is not "controlled" by an entity such that the customer can't transfer its business elsewhere without undue cost or penalty; and
  - Economic effects such as competition and demand. Economic effects will vary depending on each situation; however, higher demand elasticity and switching availability would typically correspond to a shorter life estimate.

In considering whether a customer relationship intangible asset has an indefinite life, it is important to consider how the entity determines the fair value of the customer relationship intangible asset. For example, if the income approach is used to measure the customer relationship intangible and the associated cash flows shows a declining trend, assigning an indefinite useful may be inconsistent. See section 2.2.1 for further discussion.

Appendix C includes examples and illustrates different intangible assets and how they should be accounted for in accordance with this Subtopic, including determining whether the useful life of an intangible asset is indefinite.
2.2 Intangible assets with finite lives

Excerpt from Accounting Standards Codification
Intangibles – Goodwill and Other – General Intangibles Other than Goodwill

Subsequent Measurement

350-30-35-6
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.

350-30-35-7
An intangible asset shall not be written down or off in the period of acquisition unless it becomes impaired during that period. However, paragraph 730-10-25-2(c) requires amounts assigned to intangible assets acquired in a transaction other than a business combination or an acquisition by a not-for-profit entity 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.

As noted above, an acquired intangible asset must be amortized over its useful life, unless the useful life is indefinite. If an intangible asset has a finite useful life, but the precise length of that life is not known, the intangible asset should be amortized over the best estimate of its useful life.

An intangible asset should not be written down or off in the period of acquisition unless it becomes impaired during that period. However, amounts assigned to intangible assets acquired in a transaction other than a business combination that are to be used in a particular research and development project and that have no alternative future use should be charged to expense in the period acquired in accordance with ASC 730.

2.2.1 Amortization method

In Statement 142’s Basis for Conclusions, the FASB noted that in considering the methods of amortization, 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 FASB 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 FASB 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.

The evaluation of “reliably determined” as it relates to the pattern in which the asset is consumed involves judgment based on the facts and circumstances. While not defined in GAAP, we believe that the “reliably determined” threshold suggests there should be a relatively high level of confidence that actual cash flows (or the pattern of cash flows) will not deviate significantly from those used in the measurement of the intangible asset. For example, the higher the discount rate assumption used in the valuation, indicating the inherent risk in the cash flows, the less likely it would be that a pattern of amortization commensurate with the pattern of cash flows used in the valuation would be considered reliably determinable. In those instances, the straight-line method of amortization would likely be more appropriate.

5 In many instances, intangible assets that are not often bought or sold separately outside of a business combination are generally valued using an income approach.
Certain intangible assets, such as those that are customer-related, derive their value from the future cash flows expected from the customers of the acquired entity. These types of intangible assets are often valued using the income approach, with an attrition rate resulting in a dissipation of the cash flows over time. If the pattern of declining cash flows is reliably determinable, an accelerated amortization method that reflects the economic benefit to the entity should be used. However, if it has been determined that the pattern of economic benefit to the entity cannot be reliably determined, but the underlying cash flows supporting the measurement of the customer-related intangible asset shows a decay, we believe that the straight-line method of amortization using a shortened estimated useful life is appropriate. The SEC staff has accepted the straight-line method of amortization over a shorter period if the difference in amortization is not material from amortization using an accelerated method.

When a method of amortization other than straight-line is used and the accelerated pattern is based on the estimated cash flows used in the valuation, a question arises as to whether the ratio of estimated period cash flows to total cash flows should be determined on a discounted or undiscounted basis. Neither the FASB nor SEC staff has provided any guidance on the use of discounted versus undiscounted cash flows in the determination of amortization pattern. Absent any such guidance, we believe that selection of discounted or undiscounted cash flows to determine the amortization is an accounting policy election that should be consistently applied to all intangible assets of the entity subjected to such amortization method. Appropriate disclosure of the accounting policy applied should be provided, consistent with ASC 235-10.

2.2.1.1 Back-end loaded patterns of consumption

We believe that it will be rare that entities would have persuasive evidence to support an amortization method for an intangible asset with a finite useful life that results in a lower amount of accumulated amortization than under the straight-line method. The SEC staff believes that for many intangible assets that have patterns of consumption other than straight-line patterns, benefits are generally skewed towards the earlier years. Consequently, the SEC staff has indicated that it will view with skepticism an intangible asset with an amortization pattern that favors greater charges in later years.

2.2.2 Residual value

Excerpt from Accounting Standards Codification

<table>
<thead>
<tr>
<th>Intangibles – Goodwill and Other – General Intangibles Other than Goodwill</th>
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</thead>
<tbody>
<tr>
<td>Subsequent Measurement</td>
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<tr>
<td>350-30-35-8</td>
</tr>
</tbody>
</table>

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 either of the following conditions is met:

a. The reporting entity has a commitment from a third party to purchase the asset at the end of its useful life.

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.

The amount of an intangible asset to be amortized is the amount initially assigned to that asset less its residual value, which is the estimated fair value of the intangible asset at the end of its useful life to the company (less any disposal cost). Residual value of an intangible asset should be assumed to be zero unless at the end of its useful life to the company, the asset is expected to have a useful life to another entity and (a) the reporting company 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. The residual value of an intangible asset should be determined net of any costs to dispose of the intangible asset. We believe that it will be rare for an intangible asset to have a residual value.

2.2.3 Periodic evaluation of the estimated useful life

Excerpt from Accounting Standards Codification

Intangibles – Goodwill and Other – General Intangibles Other than Goodwill

Subsequent Measurement

350-30-35-9

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.

350-30-35-10

An intangible asset that initially is deemed to have a finite useful life shall cease being amortized if it is subsequently determined to have an indefinite useful life, for example, due to a change in legal requirements. 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 paragraphs 350-30-35-18 through 35-20.

350-30-35-11

Any resulting impairment loss would be due to a change in accounting estimate and thus, consistent with Topic 250, shall be recognized as a change in estimate, not as a change in accounting principle. Therefore, that loss shall be presented in the income statement in the same manner as other impairment losses.

350-30-35-12

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.

The useful life of the intangible asset should be evaluated each reporting period (e.g., annually) to determine whether events and circumstances warrant a revision to the remaining useful life. Changes in the estimated remaining useful life would be reflected prospectively as the intangible asset is amortized over the revised remaining useful life.

If an intangible asset that is being amortized is subsequently deemed to have an indefinite life (we believe that this will be rare), then the asset should be tested for impairment in the same manner as other indefinite-lived intangible assets (i.e., compare the carrying amount to the fair value of the asset) before the change in classification and accounting for the asset. Any resulting impairment loss is recognized in a manner consistent with other impairments of indefinite-lived intangible assets and not as a change in accounting principle. Therefore, the loss would be presented in the income statement in the same manner as other impairment losses. The amortization of the asset should then cease, and the guidance on indefinite-lived intangible assets should be applied to that asset going forward. Such a reclassification of the asset might result in an impairment charge because the recoverability of the asset under ASC 360-10’s undiscounted cash flow approach that is used in assessing whether an amortizable intangible asset is impaired would no longer be considered in determining if the asset is impaired under the indefinite-lived intangible asset approach.
2.2.4 Impairment of finite-lived intangible assets

Excerpt from Accounting Standards Codification

Intangibles – Goodwill and Other – General Intangibles Other than Goodwill

Subsequent Measurement

350-30-35-14

An intangible asset that is subject to amortization shall be reviewed for impairment in accordance with the Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10 by applying the recognition and measurement provisions in paragraphs 360-10-35-17 through 35-35. In accordance with the Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10, 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 that are being amortized under ASC 350-30 should be reviewed for impairment in accordance with ASC 360-10. The indicators included in ASC 360-10-35-21 should be used in determining when an intangible asset should be tested for impairment. Those indicators are examples of events or changes in circumstances that indicate that the carrying amount of an asset may not be recoverable, and include:

- A significant decrease in the market price of an asset.
- A significant adverse change in the extent or manner in which an asset is being used.
- A significant adverse change in legal factors or in the business climate that could affect the value of an asset, including an adverse action or assessment by a regulator.
- An accumulation of costs significantly in excess of the amount originally expected for the acquisition or development of an asset.
- A current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of an asset.
- A current expectation that, more likely than not, an asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

See our FRD, Impairment or disposal of long-lived assets for a detailed discussion on the impairment assessment for finite-lived intangible assets.

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6 The term “more likely than not” refers to a level of likelihood that is more than 50 percent.
2.3 Intangible assets with indefinite lives

Excerpt from Accounting Standards Codification

Intangibles — Goodwill and Other — General Intangibles Other than Goodwill

Subsequent Measurement

350-30-35-15
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.

350-30-35-16
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.

350-30-35-17
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 paragraphs 350-30-35-18 through 35-20. 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.

350-30-35-17A
Intangible assets acquired in a business combination or an acquisition by a not-for-profit entity that are used in research and development activities (regardless of whether they have an alternative future use) shall be considered indefinite lived until the completion or abandonment of the associated research and development efforts. During the period those assets are considered indefinite lived they shall not be amortized but shall be tested for impairment in accordance with the following paragraph. Once the research and development efforts are completed or abandoned, the entity shall determine the useful life of the assets based on the guidance in this Section. Consistent with the guidance in paragraph 360-10-35-49, intangible assets acquired in business combination or an acquisition by a not-for-profit entity that have been temporarily idled shall not be accounted for as if abandoned.

350-30-35-13
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.

ASC 350-30-35-4 indicates 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. As a result, entities should perform a detailed analysis of all relevant factors before a determination is made that there is no limit on the useful life of an intangible asset and that it therefore has an indefinite useful life.

An intangible asset that is deemed to have an indefinite life should not be amortized until its useful life is determined to be finite. Companies should review the useful life of an indefinite-lived intangible asset each reporting period to determine whether events and circumstances continue to support the indefinite useful life classification.

When a company determines that the life of an intangible asset is no longer indefinite, that asset should be tested for impairment in the same manner as other indefinite-lived intangible assets, as described below. The intangible asset, after recognition of any impairment, should then be amortized over its remaining estimated useful life.
2.3.1 Acquired research and development assets

ASC 805 requires that all intangible assets acquired in a business combination that are used in research and development activities (i.e., IPR&D assets) be capitalized as indefinite-lived intangible assets, regardless of whether they have an alternative future use. These acquired assets remain indefinite-lived assets until the completion or abandonment of the associated research and development efforts. As discussed in section 2.3.2, during the period in which those acquired assets are considered indefinite-lived (i.e., the period prior to completion or abandonment), they shall not be amortized but shall be tested for impairment in accordance with ASC 350-30-35-18 through 35-20. Once the research and development efforts are completed or abandoned, the entity shall determine the useful life of the assets, as discussed in section 2.1. Once the research and development efforts are completed or are considered abandoned, an entity is required to perform an impairment test of the IPR&D asset in accordance with ASC 350-30-35-18 through 35-20. Pursuant to ASC 360-10-35-47 through 35-49, intangible assets acquired in a business combination that have been temporarily idled shall not be accounted for as if abandoned.

<table>
<thead>
<tr>
<th>Illustration 2-1: Acquired IPR&amp;D asset subsequently completed</th>
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<tbody>
<tr>
<td>On 1 January 20X1, Pharma X acquires Biotech Y in a business combination accounted for under ASC 805. Prior to the business combination, Biotech Y incurred research and development costs for new projects. These research and development costs have been expensed as incurred by Biotech Y as appropriate under ASC 730. Pharma X believes that the in-process project of Biotech Y has potential and decides to continue the project after acquisition.</td>
</tr>
<tr>
<td>On the acquisition date, Pharma X determines that the fair value of the IPR&amp;D assets is $15 million using the appropriate market participant assumptions as described in ASC 820. As a result, Pharma X recognizes an indefinite-lived intangible asset of $15 million for the IPR&amp;D asset.</td>
</tr>
<tr>
<td>On 1 June 20X2, Pharma X completes Phase III clinical trials and applies for and receives FDA approval to commercially market the drug. From 1 January 20X1 to 1 June 20X2, Pharma X has appropriately tested the IPR&amp;D asset for impairment annually. All impairment tests indicated that the fair value of the IPR&amp;D asset exceeded its carrying amount and, accordingly, Pharma X has recorded no impairment loss on the IPR&amp;D asset as of 1 June 20X2.</td>
</tr>
<tr>
<td>Analysis:</td>
</tr>
<tr>
<td>Because the IPR&amp;D asset is no longer indefinite-lived on 1 June 20X2, Pharma X must determine the useful life of the IPR&amp;D asset and reclassify the intangible asset from indefinite-lived to finite-lived. Also with this reclassification, Pharma X is required to perform an impairment test (as discussed in section 2.3.1) of the IPR&amp;D asset in accordance with ASC 350-30-35-18 through 35-20. After recording any impairment, Pharma X amortizes the finite-lived intangible asset over its remaining estimated useful life.</td>
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</tbody>
</table>

Note that the accounting for IPR&D in a business combination is different than that of acquisitions of a group of assets not constituting a business, as discussed in section 2.2.
Illustration 2-2: Acquired IPR&D asset subsequently tested for impairment

Assume the same information regarding the business combination in Illustration 2-1, except that Pharma X did not receive FDA approval. However, Pharma X still intends to continue the development of the product but now anticipates that cash flows and the related future benefits would be less than originally anticipated on the acquisition date. As a result of identifying this triggering event, on 1 June 20X2, Pharma X determines that the fair value of the IPR&D asset is now $12 million.

Analysis:

Because of the triggering events (e.g., no FDA approval and decline in expected future cash flows) on 1 June 20X2, Pharma X must record an impairment loss of $3 million and reduce the carrying amount of the IPR&D asset from $15 million to $12 million. If the project becomes successful and receives FDA approval, at that time, Pharma X must reclassify the IPR&D asset from indefinite-lived to finite-lived and determine the appropriate useful life. Pharma X would then amortize the remaining carrying amount of $12 million (assuming there were no other impairments) over that estimated useful life.

Illustration 2-3: Acquired IPR&D asset subsequently abandoned

Assume the same information regarding the business combination in Illustration 2-1, except that Pharma X did not receive FDA approval and decides to abandon the project (i.e., will not pursue further development of the asset, will not derive defensive value from it and will not sell, license or rent it).

Analysis:

Because Pharma X decided to abandon the project and assuming the IPR&D asset has no alternative future use or value to a market participant, Pharma X must expense, in the income statement, the entire carrying amount of the asset as of the abandonment date.

2.3.2 Impairment of indefinite-lived intangible assets

Excerpt from Accounting Standards Codification

Intangibles – Goodwill and Other – General Intangibles Other than Goodwill

Subsequent Measurement

350-30-35-18
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 360-10-35-21 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. 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.

350-30-35-19
After an impairment loss is recognized, the adjusted carrying amount of the intangible asset shall be its new accounting basis.

350-30-35-20
Subsequent reversal of a previously recognized impairment loss is prohibited.
An intangible asset that is deemed to have an indefinite useful life is not subject to the impairment testing guidance in ASC 360-10. The FASB noted that the nonamortization of the asset merits a more stringent model for the measurement and recognition of impairment. Additionally, because the cash flows associated with indefinite-lived intangible assets would extend into the future indefinitely, those assets might never fail the undiscounted cash flows recoverability test under ASC 360-10. As a result, the recognition of impairment losses on indefinite-lived intangible assets is based solely on a comparison of their fair value to book value, without consideration of any recoverability test.

Indefinite-lived intangible assets are to be tested for impairment annually, or more frequently if events or changes in circumstances between annual tests indicate that the asset might be impaired. (The examples of impairment indicators in ASC 360-10-35-21, as well as other indicators not included therein, should be considered in determining if an interim impairment test is necessary.) The impairment test requires the determination of the fair value of the intangible asset in accordance with ASC 820. If the fair value of the intangible asset is less than its carrying amount, an impairment loss should be recognized in an amount equal to the difference. The asset will then be carried at its new fair value. Thus, companies will have to determine fair values for these intangible assets every year and apply, in effect, a lower of cost or fair value model. Any subsequent reversal of a previously recognized impairment loss is prohibited. Further, recognition of an impairment charge for an intangible asset that was previously considered indefinite-lived may be an indication that the asset no longer meets the indefinite-lived criteria, and thus should be amortized over its remaining useful life.

Unlike the impairment test for amortizable intangibles and for goodwill, the impairment test for indefinite-lived intangible assets does not include a recoverability test. Because acquired intangible assets are initially recognized at fair value, any decrease in the fair value of the indefinite-lived intangible asset will result in an impairment charge. For example, if discounted cash flows are used to determine the fair value of indefinite-lived intangible assets, any increase in interest rates, without an offsetting increase in future cash flows, will cause those discounted cash flows to decrease, resulting in an impairment charge. Therefore, in periods of rising interest rates, companies may be required to record one or more impairment charges as interest rates rise, leading to earnings volatility.

ASC 350-30 is silent as to the timing of the annual impairment test. We believe that an annual test date (for each intangible asset, each class of intangible asset, or all intangible assets) can be established at any date during the year as long as that date is used consistently in subsequent years. This is consistent with the FASB’s requirements related to the annual goodwill impairment test. However, we recommend that companies select a date in the fourth quarter of their fiscal year to mitigate the risk that an interim impairment has arisen during the year that has gone undetected. We believe that the beginning of a company’s fourth fiscal quarter is a practical date to select as an annual measurement date because book balances from the end of the preceding quarter are available and companies have a reasonable period of time to estimate fair value prior to their annual reporting deadlines.

2.3.2.1 Order of impairment testing

Sometimes an indefinite-lived intangible asset, related long-lived and amortizable intangible assets and the goodwill of the reporting unit in which those assets reside may all need to be tested for impairment (e.g., due to an impairment indicator that impacts all of them). In that scenario, the indefinite-lived intangible asset is tested for impairment in accordance with ASC 350-30 first, then the asset group is tested for impairment in accordance with ASC 360-10 and goodwill is tested for impairment at the reporting unit level in accordance with ASC 350-20 last. The reason the order is important is because the impairment test of asset groups under ASC 360-10 and goodwill under ASC 350-20 is dependent on the carrying amounts of the underlying assets first being properly adjusted for impairment. See section 3.8 for more discussion.
2.3.3 Unit of accounting

Excerpt from Accounting Standards Codification

Intangibles – Goodwill and Other – General Intangibles Other than Goodwill

Subsequent Measurement

350-30-35-21
Separately recorded indefinite-lived intangible assets, whether acquired or internally developed, shall be combined into a single unit of accounting for purposes of testing impairment if they are operated as a single asset and, as such, are essentially inseparable from one another.

350-30-35-22
Determining whether several indefinite-lived intangible assets are essentially inseparable is a matter of judgment that depends on the relevant facts and circumstances. The indicators in paragraph 350-30-35-23 shall be considered in making that determination. None of the indicators shall be considered presumptive or determinative.

350-30-35-23
Indicators that two or more indefinite-lived intangible assets shall be combined as a single unit of accounting for impairment testing purposes are as follows:

a. The intangible assets were purchased in order to construct or enhance a single asset (that is, they will be used together).

b. Had the intangible assets been acquired in the same acquisition they would have been recorded as one asset.

c. The intangible assets as a group represent the highest and best use of the assets (for example, they yield the highest price if sold as a group). This may be indicated if it is unlikely that a substantial portion of the assets would be sold separately or the sale of a substantial portion of the intangible assets individually would result in a significant reduction in the fair value of the remaining assets as a group.

d. The marketing or branding strategy provides evidence that the intangible assets are complementary, as that term is used in paragraph 805-20-55-18.

350-30-35-24
Indicators that two or more indefinite-lived intangible assets shall not be combined as a single unit of accounting for impairment testing purposes are as follows:

a. Each intangible asset generates cash flows independent of any other intangible asset (as would be the case for an intangible asset licensed to another entity for its exclusive use).

b. If sold, each intangible asset would likely be sold separately. A past practice of selling similar assets separately is evidence indicating that combining assets as a single unit of accounting may not be appropriate.

c. The entity has adopted or is considering a plan to dispose of one or more intangible assets separately.

d. The intangible assets are used exclusively by different asset groups (see the Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10).
Subsequent accounting for intangible assets other than goodwill

Financial reporting developments

Intangibles—Goodwill and other

The economic or other factors that might limit the useful economic life of one of the intangible assets would not similarly limit the useful economic lives of other intangible assets combined in the unit of accounting.

350-30-35-26
All of the following shall be included in the determination of the unit of accounting used to test indefinite-lived intangible assets for impairment:

a. The unit of accounting shall include only indefinite-lived intangible assets—those assets cannot be tested in combination with goodwill or with a finite-lived asset.

b. The unit of accounting cannot represent a group of indefinite-lived intangible assets that collectively constitute a business or a nonprofit activity.

c. A unit of accounting may include indefinite-lived intangible assets recorded in the separate financial statements of consolidated subsidiaries. As a result, an impairment loss recognized in the consolidated financial statements may differ from the sum of the impairment losses (if any) recognized in the separate financial statements of those subsidiaries.

d. If the unit of accounting used to test impairment of indefinite-lived intangible assets is contained in a single reporting unit, the same unit of accounting and associated fair value shall be used for purposes of measuring a goodwill impairment loss in accordance with paragraphs 350-20-35-9 through 35-18.

350-30-35-27
If, based on a change in the way in which intangible assets are used, an entity combines as a unit of accounting for impairment testing purposes indefinite-lived intangible assets that were previously tested for impairment separately, those intangible assets shall be separately tested for impairment in accordance with paragraphs 350-30-35-18 through 35-20 prior to being combined as a unit of accounting.

In reaching on a consensus on EITF 02-7, which was codified into the preceding excerpts from ASC 350, the EITF agreed that indefinite-lived intangible assets, whether acquired or internally developed, “should be combined into a single unit of accounting for purposes of testing impairment if they are operated as a single asset and, as such, are essentially inseparable from one another.” The determination of whether indefinite-lived intangible assets are “essentially inseparable” from one another will require judgment and should be based on all relevant facts and circumstances. ASC 350-30-35-23 includes a list of indicators to aid in making that determination. None of the indicators should be considered presumptive or determinative. ASC 350-30-35-26 also provides general observations of the unit of accounting for indefinite-lived intangible assets.

If a company changes the way in which indefinite-lived intangible assets are used, resulting in the company’s combining indefinite-lived intangible assets that were previously tested for impairment separately into a single unit of accounting for impairment testing purposes, the company should first test those intangible assets separately for impairment in accordance with ASC 350-30-35-18 through 35-20.

The following examples illustrate the determination of the unit of accounting to use in impairment testing for indefinite-lived intangible assets.
Illustration 2-4: Easements

Company X is a distributor of natural gas. Company X has two self-constructed pipelines, the Northern pipeline and the Southern pipeline. Each pipeline was constructed on land for which Company X owns perpetual easements. The Northern Pipeline was constructed on 50 easements acquired in 50 separate transactions. The Southern Pipeline was constructed on 100 separate easements that were acquired in a business combination and were recorded as one asset. Although each pipeline functions independently of the other, they are contained in the same reporting unit. Operation of each pipeline is directed by a different manager. There are discrete, identifiable cash flows for each pipeline; thus, each pipeline and its related easements represent a separate asset group under ASC 360-10. While Company X has no current plans to sell or otherwise dispose of any of its easements, Company X believes that if either pipeline were sold, it would most likely convey all rights under the easements with the related pipeline.

Analysis:

Company X would have two units of accounting for purposes of testing the easements for impairment – the collection of easements supporting the Northern pipeline and the collection of easements supporting the Southern pipeline. The 50 easements supporting the Northern pipeline represent a single unit of accounting as evidenced by the fact that (a) they are collectively used together in a single asset group under ASC 360-10, (b) if acquired in a single transaction, they would have been recorded as one asset, and (c) if sold, they would likely be sold as a group with the related pipeline. For the same reason, the easements supporting the Southern pipeline would represent a single unit of accounting.

Because the collective land easements underlying the Northern and Southern pipelines generate cash flows independent of one another and are used exclusively by separate asset groups under ASC 360-10, they should not be combined into a single unit of accounting.

Illustration 2-5: Trade name

Company Y purchases an international vacuum cleaner manufacturer, Company A, which sells vacuums under a well-known trade name. The operations of Company A are conducted through separate legal entities in three different countries with each of those legal entities owning the registered trade name used in that country. When the business combination was recorded, Company Y recorded three separate intangible trade name assets because separate financial statements are required to be prepared for each separate legal entity. There are separate identifiable cash flows for each country, and each country represents an asset group under ASC 360-10. A single brand manager is responsible for the Company A trade name, the value of which is expected to be recovered from the worldwide sales of Company A’s products.

Analysis:

The three separately recorded trade name assets should be combined into a single unit of accounting for purposes of testing the acquired trade name for impairment. The three registered trade names were acquired in the same business combination and, absent the requirement to prepare separate financial statements for subsidiaries, would have been recorded as a single asset. The trade name is managed by a single brand manager. If sold, Company X would most likely sell all three legally registered trade names as a single asset.
Illustration 2-6: Brands

Company Z manufactures and distributes cereals under two different brands, Brand A and Brand B. Both brands were acquired in the same business combination. Company Z recorded two separate intangible assets representing Brand A and Brand B. Each brand represents a group of complementary indefinite-lived intangible assets including the trademark, the tradedress and a recipe. Brand A has two underlying tradenames for its Honey and Cinnamon cereals. The trade name and recipe of Cinnamon were internally generated subsequent to the acquisition of Brand A. Sales of Honey have decreased while sales of Cinnamon have increased over the past several years. Despite the decline in sales of Honey, the combined sales of Honey and Cinnamon have increased at the levels expected by management. Sales of Brand B also have increased at expected levels. There are discrete cash flows for Honey, Cinnamon and Brand B, and each represents a separate asset group under ASC 360-10. Both Honey and Cinnamon are managed by one brand manager. A separate brand manager is responsible for Brand B; however, there are some shared resources used by these groups, such as procurement. While Company Z has no current plans to sell its brands or exit the cereal business, it believes if it ever did, it would exit the cereal business in its entirety.

Analysis:

Company Z would have two units of accounting for purposes of testing the acquired brands for impairment. Brand A’s purchased Honey and internally generated Cinnamon trademarks should be combined as a single unit of accounting for purposes of impairment testing. The intangible asset associated with the Cinnamon trademark is simply a variation of the previously acquired Brand A Honey trademark. Although they are associated with different asset groups under ASC 360-10, they are managed by a single brand manager. Company Z would consider Brand B to be a separate unit of accounting for purposes of testing impairment because that brand is managed separately from Brand A and is used exclusively by a separate asset group under ASC 360-10.

2.3.3.1 Allocating an impairment loss to an indefinite-lived intangible asset when removing the asset from a single accounting unit

As noted above, the EITF agreed that indefinite-lived intangible assets, whether acquired or internally developed, “should be combined into a single unit of accounting for purposes of testing impairment if they are operated as a single asset and, as such, are essentially inseparable from one another.” An indefinite-lived intangible asset may need to be removed from the accounting unit if it is disposed of, the accounting unit is reconsidered or one or more of the separate indefinite-lived intangible asset(s) within the accounting unit is now considered finite-lived rather than indefinite-lived. There is no specific guidance regarding how to determine the carrying amount of an indefinite-lived intangible asset when it is removed from the accounting unit that had previously recognized an impairment charge.

The EITF Agenda Committee Report dated 29-30 September 2004 acknowledged that the EITF considered adding to its agenda a discussion on how to determine the carrying amount of an intangible asset that previously was combined with other indefinite-lived intangible assets for impairment purposes. The Agenda Committee however decided not to add this issue to the EITF’s agenda. Without specific guidance, we believe that the carrying amount of the indefinite-lived intangible asset removed from the accounting unit should be based on the historical carrying amount when the asset was placed into the accounting unit, less the allocation of any impairment recognized by the accounting unit. The allocation of any impairment loss should be based on a pro rata basis using the relative historical carrying amount of the individual indefinite-lived intangible assets. If the historical carrying amount of the indefinite-lived intangible asset is not readily available, the entity should establish a reasonable and supportable method to determine the historical carrying amount at the time of removal of the asset. Because under ASC 350-30, accounting units are
created solely for impairment testing purposes, the individual indefinite-lived intangible assets remain as separately recorded assets. This approach is consistent with that described in ASC 360-10-35-28 for the allocation of an impairment loss to individual long-lived assets within an asset group.

### Illustration 2–7: Allocation of an indefinite-lived intangible asset impairment loss

XYZ Corp has grouped four licenses (A, B, C and D) in an accounting unit for impairment purposes based on the requirements in ASC 350. XYZ Corp has no past practice of selling licenses separately. Licenses A and B were acquired together and were valued at $200 and $250, respectively. License C was acquired for $150 and License D was acquired for $400 in two separate transactions.

Assume that, subsequent to the acquisition of the licenses, XYZ Corp recorded an impairment charge of $100 related to the accounting unit. Assume that License B was sold separately. In this case, the carrying amount of the license sold (License B) would be determined as follows: [Carrying amount of $250 less pro rata allocation of impairment loss (($250/$1000)x $100)] equals an allocated impairment loss of $25, resulting in a carrying amount of the license sold of $225.

### 2.4 Useful life of an acquired intangible asset that will not be fully utilized (defensive intangible asset)

**Excerpt from Accounting Standards Codification**

#### Intangibles — Goodwill and Other — General Intangibles Other than Goodwill

**Subsequent Measurement**

350-30-35-5A

This guidance addresses the application of paragraphs 350-30-35-1 through 35-4 to a defensive intangible asset other than an intangible asset that is used in research and development activities. A defensive intangible asset shall be assigned a useful life that reflects the entity's consumption of the expected benefits related to that asset. The benefit a reporting entity receives from holding a defensive intangible asset is the direct and indirect cash flows resulting from the entity preventing others from realizing any value from the intangible asset (defensively or otherwise). An entity shall determine a defensive intangible asset's useful life, that is, the period over which an entity consumes the expected benefits of the asset, by estimating the period over which the defensive intangible asset will diminish in fair value. The period over which a defensive intangible asset diminishes in fair value is a proxy for the period over which the reporting entity expects a defensive intangible asset to contribute directly or indirectly to the future cash flows of the entity.

350-30-35-5B

It would be rare for a defensive intangible asset to have an indefinite life because the fair value of the defensive intangible asset will generally diminish over time as a result of a lack of market exposure or as a result of competitive or other factors. Additionally, if an acquired intangible asset meets the definition of a defensive intangible asset, it shall not be considered immediately abandoned.

**Implementation Guidance and Illustrations**

350-30-55-1B

The determination of whether an intangible asset is a defensive intangible asset is based on the intentions of the reporting entity and that determination may change as the reporting entity’s intentions change. For example, an intangible asset that was accounted for as a defensive intangible asset on the date of acquisition will cease to be a defensive asset if the entity subsequently decides to actively use the asset.)
Assets acquired in a business combination must be measured at fair value using market participant (not entity specific) assumptions in accordance with ASC 805 and ASC 820. This includes intangible assets that the acquirer does not intend to use in the same manner as a market participant. A defensive intangible asset could include any of the following:

- An asset that the entity will never actively use
- An asset that will be used by the entity during a transition period when the intention of the entity is to discontinue the use of the asset

An acquirer must recognize at fair value all acquired intangible assets, including those it intends to hold for defensive purposes (intangible assets that the acquirer does not intend to actively use). Similarly, defensive intangible assets acquired in asset acquisitions will be recognized based on their relative fair values at acquisition.

An issue arises in determining the appropriate unit of account and the appropriate useful life for defensive intangible assets. ASC 350-30 provides guidance on the subsequent accounting for defensive intangible assets and requires an entity to assign a useful life in accordance with ASC 350-30-35-1 through 35-5.

The EITF, in reaching a consensus on EITF 08-7 (codified in ASC 350-30), concluded that intangible assets that an acquirer intends to use as defensive assets are a separate unit of account from the existing intangible assets of the acquirer. The EITF also concluded that a defensive intangible asset should be amortized over the period it is expected to contribute directly or indirectly to the entity's future cash flows. That period is the period that the asset provides significant value to the reporting entity, but would not extend beyond the date the reporting entity effectively waives its rights to the intangible asset (i.e., is not using the asset, either directly or defensively). This does not preclude the acquirer from assigning an indefinite life to the defensive intangible asset; however, the EITF concluded that the assignment of an indefinite life to a defensive intangible asset likely would be rare. In reaching this conclusion, the EITF stated that the acquirer's intention to not actively use the intangible asset, but instead to maintain it for defensive purposes, is a form of use of the intangible asset. Additionally, if an acquired intangible asset meets the definition of a defensive intangible asset, it cannot be considered immediately abandoned.

We believe that in practice it may prove difficult to estimate the period over which the fair value of the defensive intangible asset diminishes. The process of estimating the useful life of defensive intangible assets will require close collaboration with valuation professionals.

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A defensive intangible asset is an asset that an acquirer does not intend to actively use but intends to hold to prevent others from obtaining access to that asset.
Subsequent accounting for goodwill

Excerpt from Accounting Standards Codification

Intangibles – Goodwill and Other – Goodwill

Overall Accounting for Goodwill

350-20-35-1
Goodwill shall not be amortized. Instead, goodwill shall be tested for impairment at a level of reporting referred to as a reporting unit. (Paragraphs 350-20-35-33 through 35-46 provide guidance on determining reporting units.)

350-20-35-2
Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. The fair value of goodwill can be measured only as a residual and cannot be measured directly. Therefore, this Subtopic 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 as the implied fair value of goodwill.

350-20-35-3
An entity may first assess qualitative factors, as described in paragraphs 350-20-35-3A through 35-3G, to determine whether it is necessary to perform the two-step goodwill impairment test discussed in paragraphs 350-20-35-4 through 35-19. If determined to be necessary, the two-step impairment test shall be used to identify potential goodwill impairment and measure the amount of a goodwill impairment loss to be recognized (if any).

Under ASC 805, goodwill should be recognized initially as an asset in the financial statements and initially measured as any excess of the fair value of the acquired business over the fair value of the net identifiable assets acquired. Any acquired intangible assets that do not meet the criteria for recognition as a separate asset should be included in goodwill. For further information, please refer to our FRD, Business combinations. ASC 350-20 addresses the subsequent accounting for goodwill including the requirement that goodwill should not be amortized, but should be tested for impairment, at least annually, at a level within the company referred to as the reporting unit. Goodwill cannot be tested for impairment at any level within the company other than the reporting unit level. ASC 350-20 outlines the methodology used to determine if goodwill has been impaired and to measure any loss resulting from an impairment. These requirements are discussed in detail in the following sections.
3.1 Measurement and recognition of goodwill impairment

Excerpt from Accounting Standards Codification

Intangibles — Goodwill and Other — Goodwill

Recognition and Measurement of an Impairment Loss

Qualitative Assessment

350-20-35-3A
An entity may assess qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount, including goodwill.

350-20-35-3B
An entity has an unconditional option to bypass the qualitative assessment described in the preceding paragraph for any reporting unit in any period and proceed directly to performing the first step of the goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period.

Step 1

350-20-35-4
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.

350-20-35-5
The guidance in paragraphs 350-20-35-22 through 35-24 shall be considered in determining the fair value of a reporting unit.

350-20-35-6
If the carrying amount of a reporting unit is greater than zero and its fair value 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 the reporting unit is zero or negative, the guidance in paragraph 350-20-35-8A shall be followed.

350-20-35-8
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.

Step 2

350-20-35-9
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.

350-20-35-10
The guidance in paragraphs 350-20-35-14 through 35-17 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 recognized.

The implied fair value of goodwill shall be determined in the same manner as the amount of goodwill recognized in a business combination or an acquisition by a not-for-profit entity was determined. That is, an entity shall assign 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 or an acquisition by a not-for-profit entity. Throughout this Section, the term business combination includes an acquisition by a not-for-profit entity.

The relevant guidance in Subtopic 805-20 shall be used in determining how to assign 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 350-20-35-39.

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 assignment process discussed in paragraphs 350-20-35-14 through 35-16 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 shall it recognize a previously unrecognized intangible asset as a result of that allocation process.

Goodwill should not be amortized, but should be tested for impairment at the reporting unit level at least annually in accordance with ASC 350-20. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. Goodwill is tested for impairment in accordance with the following flowchart, taken from ASC 350-20-55-25:
An entity has the unconditional option to skip the qualitative assessment and proceed directly to performing Step 1, except in the circumstance where a reporting unit has a carrying amount that is zero or negative. An entity having a reporting unit with a carrying amount that is zero or negative would proceed directly to Step 2 if it determines, as a result of performing its required qualitative assessment, that it is more likely than not that a goodwill impairment exists. To perform Step 2, an entity must calculate the fair value of a reporting unit.

The implied fair value of goodwill is calculated by deducting the fair value of all net assets of the reporting unit from its fair value (as determined in Step 1), including determining the fair value of any unrecognized intangible assets (including in process research and development) and any applicable corporate level assets or liabilities that had been included in the determination of the carrying amount and fair value of the reporting unit in Step 1. The remaining fair value of the reporting unit after assigning fair values to all of the reporting unit’s assets and liabilities represents the implied fair value of goodwill for the reporting unit. This assignment is performed only for the purpose of measuring goodwill impairment and should not result in a change in basis of the recognized net assets or in the recognition of any unrecognized assets of the reporting unit.
ASC 805 amended the guidance for the annual goodwill impairment test performed under ASC 350-20. The determination of the implied fair value of goodwill requires all of the assets and liabilities of the reporting unit to be measured at fair value, with certain limited exceptions, pursuant to the guidance in ASC 805 (see our FRD, Business combinations for further discussion). This means that to the extent the recognition and measurement principles in ASC 805 differ from ASC 350, a different implied fair value of goodwill may arise. In addition, the fair value of a reporting unit and the valuation of assets and liabilities required to be measured at fair value in Step 2 must be consistent with the definition of fair value under ASC 820, and must include both the controlling and noncontrolling interests in the reporting unit.

The guidance in ASC 805 did not require a transitional goodwill impairment test upon its adoption, except for goodwill recognized in business combinations of mutual entities before its effective date. Accordingly, any effect of the application of the amended requirements in ASC 350-20 would be included in any recognized impairment charge. See section 5.3 for the discussion regarding transition considerations related to mutual entity business combinations.

### 3.1.1 Optional qualitative assessment

**Excerpt from Accounting Standards Codification**

| Intangibles – Goodwill and Other – Goodwill |
|Qualitative Assessment|
|350-20-35-3C|

In evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, an entity shall assess relevant events and circumstances. Examples of such events and circumstances include the following:

a. Macroeconomic conditions such as a deterioration in general economic conditions, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets

b. Industry and market considerations such as a deterioration in the environment in which an entity operates, an increased competitive environment, a decline in market-dependent multiples or metrics (consider in both absolute terms and relative to peers), a change in the market for an entity's products or services, or a regulatory or political development

c. Cost factors such as increases in raw materials, labor, or other costs that have a negative effect on earnings and cash flows

d. Overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods

e. Other relevant entity-specific events such as changes in management, key personnel, strategy, or customers; contemplation of bankruptcy; or litigation

f. Events affecting a reporting unit such as a change in the composition or carrying amount of its net assets, a more-likely-than-not expectation of selling or disposing all, or a portion, of a reporting unit, the testing for recoverability of a significant asset group within a reporting unit, or recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit

g. If applicable, a sustained decrease in share price (consider in both absolute terms and relative to peers).
If, after assessing the totality of events or circumstances such as those described in the preceding paragraph, an entity determines that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then the first and second steps of the goodwill impairment test are unnecessary.

If, after assessing the totality of events or circumstances such as those described in paragraph 350-20-35-3(a) through (g), an entity determines that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then the entity shall perform the first step of the two-step goodwill impairment test.

The examples included in paragraph 350-20-35-3C(a) through (g) are not all-inclusive, and an entity shall consider other relevant events and circumstances that affect the fair value or carrying amount of a reporting unit in determining whether to perform the first step of the goodwill impairment test. An entity shall consider the extent to which each of the adverse events and circumstances identified could affect the comparison of a reporting unit’s fair value with its carrying amount. An entity should place more weight on the events and circumstances that most affect a reporting unit’s fair value or the carrying amount of its net assets. An entity also should consider positive and mitigating events and circumstances that may affect its determination of whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity has a recent fair value calculation for a reporting unit, it also should include as a factor in its consideration the difference between the fair value and the carrying amount in reaching its conclusion about whether to perform the first step of the goodwill impairment test.

An entity shall evaluate, on the basis of the weight of evidence, the significance of all identified events and circumstances in the context of determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. None of the individual examples of events and circumstances included in paragraph 350-20-35-3C(a) through (g) are intended to represent standalone events or circumstances that necessarily require an entity to perform the first step of the goodwill impairment test. Also, the existence of positive and mitigating events and circumstances is not intended to represent a rebuttable presumption that an entity should not perform the first step of the goodwill impairment test.

Transition Related to Accounting Standards Update No. 2011-08, Intangibles — Goodwill and Other (Topic 350): Testing Goodwill for Impairment

The following represents the transition and effective date information related to Accounting Standards Update No. 2011-08, Intangibles — Goodwill and Other (Topic 350): Testing Goodwill for Impairment:

a. The pending content that links to this paragraph shall be applied prospectively for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011.

b. Earlier application is permitted.

c. Earlier application also is permitted for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if the entity’s financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance.
ASC 350 requires companies to test goodwill for impairment annually and more frequently if indicators of impairment exist. Testing goodwill for impairment requires companies to compare the fair value of a reporting unit with its carrying amount, including goodwill. With the issuance of Accounting Standards Update (ASU) 2011-08, Intangibles — Goodwill and Other (Topic 350): Testing Goodwill for Impairment (ASU 2011-08) the FASB introduced an optional qualitative assessment for testing goodwill for impairment (qualitative screen) that may allow companies to skip the annual two-step test. The qualitative screen permits companies to qualitatively assess whether it is more likely than not (i.e., a likelihood of greater than 50%) that the fair value of a reporting unit is less than its carrying amount. If that is the case, the company would have to perform the annual two-step test. If a company concludes otherwise, it has completed its goodwill impairment test and does not need to perform the two-step test.

The goal of ASU 2011-08 was to simplify how companies test goodwill for impairment, and to reduce the cost and complexity of performing the goodwill impairment test. While ASU 2011-08 may change how goodwill impairment testing is performed, it should not change the timing or measurement of goodwill impairments.

### 3.1.1 Key considerations

Before ASU 2011-08, companies were required to calculate the fair value of each reporting unit annually and compare that value with its carrying amount, including goodwill (Step 1). If the calculated fair value was less than the carrying amount, the company would calculate the implied fair value of the reporting unit’s goodwill to determine the amount of impairment to recognize, if any (Step 2). If a company believed that there was only a remote (i.e., slight) likelihood that a reporting unit’s fair value was less than its carrying amount, it could carry forward a prior period’s fair value calculation (see section 3.6).

The new guidance gives companies the option to evaluate, based on the weight of evidence, the significance of all identified events and circumstances in the context of determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. It does not prescribe how to weigh positive and negative evidence when both affect the fair value of a reporting unit, nor does it define the term “significance.”

### 3.1.1.1 Weighing evidence

ASC 350 directs companies to place more weight on the events and circumstances that most affect a reporting unit’s fair value or the carrying amount of its net assets. Weighing the effect of various positive and negative factors may be challenging and will require the use of significant judgment. Companies will have to monitor and evaluate all positive and negative events that have occurred since the most recent quantitative assessment.

The qualitative screen is distinct from other impairment evaluations in that it requires a company to evaluate all events and circumstances, including both positive and negative events, in their totality to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Other asset impairment models (e.g., finite-lived intangible assets, long-lived assets) do not require weighing positive and negative evidence, but rather require companies to identify certain interim triggering events. A quantitative goodwill impairment test is required only if one (or more) of the triggering events occurred, causing the company to believe that the event(s) indicated that a potential impairment had arisen (i.e., that it is more likely than not that the fair value of the reporting unit is less than its carrying amount).

This new concept of weighing the effect of various factors may be more difficult and will likely require a more rigorous evaluation than the previous requirement to identify negative factors.

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9 As listed in ASC 350, Intangibles — Goodwill and Other and ASC 360, Property, Plant, and Equipment
3.1.1.2 Meaning of “significant”

The FASB refers to but does not define the concept of “significant” in ASC 350 or in the Basis for Conclusions to ASU 2011-08. Accordingly, questions have arisen about whether there are any bright-line rules for performing qualitative goodwill impairment assessments (i.e., whether the existence of any particular circumstance would always – or never – result in the requirement to perform the annual two-step test).

The Board did not establish any bright-line rules or provide an example of events or circumstances that would always result in the conclusion that a quantitative assessment is or is not necessary. Similarly, there are no bright-line rules when using the term “significant” in other contexts (e.g., evaluating whether the fair value exceeded the carrying amount by a “significant” amount in the most recent quantitative test, or evaluating whether a change in an event or circumstance during the period has a “significant” effect on fair value). Companies will have to evaluate all facts and circumstances to determine whether they believe, based on all factors, it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

3.1.1.3 Revised list of events and circumstances

ASC 350-20-35-3C includes an updated list of events and circumstances to consider when evaluating a reporting unit’s goodwill for impairment. The Board revised the factors previously considered for interim impairment evaluations to better reflect the reasons that companies have disclosed in recent years as the causes of goodwill impairments. The updated list of events and circumstances is as follows:

- Macroeconomic conditions such as a deterioration in general economic conditions, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets
- Industry and market considerations such as a deterioration in the environment in which an entity operates, an increased competitive environment, a decline in market-dependent multiples or metrics (consider in both absolute terms and relative to peers), a change in the market for an entity’s products or services, or a regulatory or political development
- Cost factors such as increases in raw materials, labor, or other costs that have a negative effect on earnings and cash flows
- Overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods
- Other relevant entity-specific events such as changes in management, key personnel, strategy, or customers; contemplation of bankruptcy; or litigation
- Events affecting a reporting unit such as a change in the composition or carrying amount of its net assets, a more-likely-than-not expectation of selling or disposing all, or a portion, of a reporting unit, the testing for recoverability of a significant asset group within a reporting unit, or recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit
- If applicable, a sustained decrease in share price (consider in both absolute terms and relative to peers).
None of the revised factors listed above alone is determinative. In other words, the existence of one of these negative factors by itself would not necessarily indicate that Step 1 of the goodwill impairment test must be performed. Instead, a company must evaluate how significant each of the identified factors could be to the fair value or carrying amount of a reporting unit, and weigh those factors against any positive or mitigating factors relevant to that reporting unit. In addition, ASC 350-20-35-3F states clearly that the events and circumstances it describes are only examples of factors a company should consider. Companies will need to identify the factors that most affect a reporting unit’s fair value.

3.1.1.2 Applying the qualitative screen

While the specific factors that must be evaluated will vary depending on the reporting unit, company and industry, we generally believe that the framework provided below will be useful for companies if they choose to apply the qualitative screen.

3.1.1.2.1 Determine your starting point

We believe that companies should use the most recent calculation of a reporting unit’s fair value as a starting point for the qualitative screen. In doing so, companies should consider the amount of excess fair value in that calculation as well as developments in its own operations, the industry in which it operates and overall macroeconomic factors that could have affected fair value since the date of that calculation.

3.1.1.2.1.1 Look at your excess fair value

The margin between the fair value and carrying amount in the most recent fair value calculation may indicate the amount and severity of negative evidence that can be absorbed by a reporting unit. However, as noted in section 3.1.1.1.2, there is no percentage threshold that constitutes a “significant” amount of excess fair value over carrying amount. Judgment must be applied to evaluate how much negative evidence may cause a company to conclude that it can no longer make a more-likely-than-not assertion about the fair value of a reporting unit.

Accordingly, we generally believe that companies that have reporting units whose fair values have recently exceeded their carrying amounts by significant margins are likely to benefit from the qualitative screen. Companies that have recently recognized goodwill impairments or that do not have a significant margin between the carrying amount and fair value of a reporting unit may find it challenging to apply the qualitative screen and may elect to move directly to Step 1.

3.1.1.2.2 Consider the market

When companies begin thinking about performing a goodwill impairment evaluation, they often look at company-specific information, such as current-year and future financial performance. While this information is crucial for determining whether it is more likely than not that a reporting unit’s fair value is less than its carrying amount, companies also must consider external factors that could affect the fair value or carrying amount of their reporting units.
**Illustration 3-1: Consider the market**

Assume Company A is a public company with a reporting unit (RU) operating in the telecommunications industry. In its qualitative screen, Company A determined the following:

- The fair value of RU in the prior year’s quantitative analysis exceeded its carrying amount by 22%
- RU’s revenues and operating margins increased 10% over the prior year and exceeded current-year projections by 2%
- RU gained two large customers in the current year, which account for 6% of current-year revenues

Based on only these facts, Company A may conclude that it does not need to perform a quantitative goodwill impairment test for RU. However, the following also occurred since the last fair value calculation was performed:

- Overall equity markets are down 10% in the current year
- RU’s competitors have experienced revenue growth of 15%-20% over the prior year
- Despite gaining two large customers, RU still lost 2% market share

Based on the company-specific information alone, Company A appears to have a sufficient level of positive evidence to support a qualitative assertion that RU’s goodwill is not impaired. However, once the industry and market information is considered, the conclusion requires further consideration. With this negative information (overall market decline, RU growing slower than industry and loss of market share), it is clear that Company A must perform further analysis to determine the significance that each of these factors and other relevant information may have on the fair value of RU and weigh such factors into its qualitative screen.

**Illustration 3-2: Consider the market**

Assume the same facts as in Illustration 3-1, except that the industry and market information since the last fair value calculation was performed is as follows:

- Overall equity markets are up 5% in the current year
- Other telecom companies operating in RU’s industry experienced revenue and operating margin growth of 3%-5% over the prior year
- The two new customers caused RU’s market share to increase by 10%

With this predominantly positive industry and market information, and assuming there are no further negative factors to consider, Company A may have a sufficient level of positive evidence to support a qualitative assertion that it does not need to perform the annual two-step test.

Weighing the positive and negative events that have occurred since the last fair value calculation may be difficult, particularly when there are multiple positive and negative factors. Professional judgment must be applied to all facts and circumstances to appropriately evaluate how such factors, in their totality, ultimately affect the fair value of a reporting unit.
3.1.1.2.1.3  

**Review changes to carrying amount**

Another key aspect of determining the starting point for the qualitative screen is for companies to update the carrying amount of their reporting units to reflect the balance as of the testing date, including allocating corporate assets and intercompany items that should be kept in the calculation for a reporting unit (and not eliminated). This will provide another relevant data point about the relationship between each reporting unit’s most recently calculated fair value and the level of effort that would be required to apply the qualitative screen. For example, if a reporting unit had a series of smaller acquisitions since the most recent quantitative test, the increase in the carrying amount could be larger than if it had been adjusted by normal recurring operations alone.

3.1.1.2  

**Identify the most relevant drivers of fair value**

To evaluate how events and circumstances may have affected the fair value of a reporting unit, a company must first understand how fair value is derived and identify the key inputs or assumptions that most affect it. To do so, a company must first understand the method used to calculate the fair value of each of its reporting units.

3.1.1.2.2.1  

**Understanding the key inputs**

To apply the qualitative screen, companies must understand each of the key inputs used to determine fair value. For example, if a reporting unit operating in the consumer products industry derives its fair value predominantly using an income approach (e.g., discounted cash flow model), that fair value calculation would likely focus on future projected net income or EBITDA, while a reporting unit operating in the asset management industry that derives its value using an income approach would likely focus on assets under management.

Understanding the inputs that most affect the fair value of a reporting unit will enable companies to focus their efforts on evaluating the key assumptions that can most affect the outcome of the qualitative screen so that those factors are given more weight in the analysis. For example, a reporting unit that is valued using the income approach would be more affected by fluctuations in the weighted-average cost of capital (WACC) available to its business than a reporting unit that is valued using a market approach, which would focus more on the applicable industry multiples.

When evaluating the key inputs to determine fair value, companies should remember that more than one valuation technique may be used to determine the fair value of a reporting unit. Depending on the nature of the reporting unit or the availability of observable market prices, a company may use multiple valuation approaches to calculate fair value. If that is the case, the company should consider the inputs to all valuation techniques used in calculating fair value to determine those that it believes are the key inputs.
3.1.2.2.2 Market valuation

Regardless of which method was used for determining and calculating fair value for a reporting unit in the past, it is important to remember that the determination of fair value is based on a market participant concept. Accordingly, companies will need to evaluate trends in industry peers' values, which are typically readily available data points.

As discussed in section 3.1.2.2.1, once a company identifies the method used to determine fair value and the key assumptions involved, it should determine how sensitive those inputs are to market and industry factors that occurred during the period since the last quantitative test. The following three illustrations highlight specific procedures that a company should consider performing depending on the most significant drivers of value that it identifies. These illustrations are not meant to indicate that these are the only procedures to perform or factors to consider. Companies applying the qualitative screen must also keep in mind that other facts may still be relevant because the key drivers affecting fair value can evolve over time. Similarly, in practice, companies may use multiple fair value approaches, so ample consideration must be given to all relevant key inputs to calculating fair value.

<table>
<thead>
<tr>
<th>Illustration 3-3: Drivers of value – income approach, external factors</th>
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</thead>
<tbody>
<tr>
<td>In the prior year, Company A evaluated its consumer products reporting unit (RU1) using the income approach. In the current year, Company A has elected to apply the qualitative screen to test RU1's goodwill balance for impairment. As part of its qualitative screen, Company A reviewed its prior-year fair value calculation and determined that the fair value of RU1 was most sensitive to changes in the WACC.</td>
</tr>
<tr>
<td>Based on these facts, Company A should focus on revisiting the assumptions made in determining the WACC in the prior year. In doing so, Company A could update those with more current-year information (e.g., updated market risk premium, updated beta estimate, current risk-free rate, company-specific risk premium) and evaluate how using the newly calculated WACC would change the prior-year fair value calculation.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Illustration 3-4: Drivers of value – income approach, internal factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assume the same facts in Illustration 3-3, except that in reviewing the prior-year fair value calculation, Company A determined that in addition to the external factors associated with WACC, the fair value of RU1 was most sensitive to changes in the expected growth rates over the forecast period, which also affect the calculated terminal value. In that fact pattern, Company A should verify the accuracy of its forecasts over the past few years by comparing its projections with actual results. Company A should also evaluate the company-specific events and circumstances that have occurred since the prior year's calculation and consider their effect on management's growth rate assumptions for RU1. In addition, since management's growth rate assumption affects projections during both the forecast period and the terminal period, Company A should verify that the growth rate assumptions used to calculate the forecast period cash flows and the terminal value are internally consistent.</td>
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</table>

Financial reporting developments Intangibles – Goodwill and other
Identifying the most relevant drivers of fair value will help companies focus their efforts on the factors that are most likely to affect the analysis.

For additional interpretive guidance on determining fair value, refer to our FRD, *Fair value measurements and disclosures*.

### 3.1.1.2.3 Identify events and circumstances

After considering its starting point and identifying the key drivers of fair value for its reporting unit, a company must identify the events and circumstances (including but not limited to those outlined in (ASC 350-20-35-3C) that may have an effect on the fair value of a reporting unit.

A company’s analysis of events and circumstances should focus on factors that have changed since the last quantitative calculation. Using the most recent fair value calculation as your starting point and focusing on changes in events and circumstances will indicate directionally how a current-period fair value calculation would compare with the last quantitative analysis.

In assessing which events and circumstances most affect the fair value of a reporting unit, a company should consider how it describes its business, risk factors and accounting policies in its annual report and other public filings as well as in any other public forums, including its company website and earnings calls. We believe that management’s qualitative goodwill impairment analysis should be consistent with how it views and discusses the reporting unit. Accordingly, the assertions made by management in its qualitative screen should be consistent with statements made to the public regarding the future state of the business (whether formally in its annual report or informally on an earnings call) and (or) with the projected financial information being provided to the Board of Directors and other stakeholders. In their analyses, companies should also consider information that has not yet been disclosed publicly, such as pending litigation or plans to enter new or exit existing service lines.

### 3.1.1.2.3.1 Cumulative analysis

The qualitative evaluation must consider all events and circumstances since the most recent fair value calculation was performed. It is important for companies to remember that this requires a cumulative analysis of factors rather than a review of events that transpired during the current year.
Illustration 3-6: Cumulative analysis

Assume it is the third year after Company A initially adopted the qualitative screen. In each of the last three years, Company A has applied the qualitative screen for one of its reporting units (RU1) and concluded that a quantitative analysis is not necessary. The results of the most recent fair value calculation (i.e., as of four years ago) indicated that the fair value of the reporting unit exceeded its carrying amount by 44%. Company A has considered the following in its current-year qualitative screen for RU1:

> Revenue for RU1 increased 7% over the prior year.

> Gross margin increased 3% year-to-date from the same period last year (mostly due to “bolt-on” acquisitions).

> The overall S&P 500 Index is 12% lower than it was at the last measurement date and public entities within RU1’s industry are down a more modest 3%.

Analysis

While the market and industry information included in Company A’s analysis provides information since the last fair value calculation, the company-specific information focuses too narrowly on current-year events. As time goes on, the relevance of the most recent fair value calculation diminishes. The excess fair value that existed four years ago is no longer as precise as it was on the date of the calculation, as various factors have occurred since then that will change both the fair value and the carrying amount of the reporting unit. All events and circumstances that have transpired since the last quantitative test must be considered.

In addition to the factors already considered, Company A should consider how RU1 has performed for the cumulative three-year period leading to the current-year evaluation. Additionally, Company A should consider that it may have more difficulty determining the likelihood of an impairment based on qualitative factors alone since the current-year increase is driven largely by acquisitions. In addition, if RU1 has done a number of similar small “bolt-on” acquisitions over the past three years, the ratio of excess fair value to the increased carrying amount will need to be considered. However, if RU1 showed internal growth in revenue and gross margins in each of the three previous years, that positive evidence, absent other negative factors, may tip the scale in favor of a conclusion that the qualitative screen is appropriate for assessing RU1’s goodwill for impairment.

Like the concept of weighing evidence (as opposed to monitoring only for triggering events), evaluating the effect of cumulative factors (as opposed to those confined to an annual or interim period) is new. Companies’ current policies for performing impairment tests will likely include processes and controls to monitor for triggering events in the current year and (or) on a quarterly or interim basis, but not to weigh evidence over a longer period of time, as required by the qualitative screen.

3.1.1.2.4 Weigh the identified factors

Determine your starting point | Identify the most relevant drivers of fair value | Identify events and circumstances | Weigh the identified factors | Make a conclusion
Once a company identifies the events and circumstances that most affect the fair value of a reporting unit, it must weigh all factors in their totality to determine whether they support a conclusion that it is more likely than not that a reporting unit’s fair value is less than its carrying amount. Given the potential for many events and circumstances to affect the fair value of a reporting unit in a given period, it is crucial for companies to give more weight in their qualitative screens to those factors that most affect fair value.

**Illustration 3-7: Weighing factors**

Company A is a public company with multiple reporting units operating in the media and entertainment industry. Company A has identified the following positive and negative evidence about the fair value of its publishing reporting unit (Pub), which sells both physical and digital books:

- Two years ago, Pub recorded a goodwill impairment charge, due in large part to the overall decline in the economy and the valuation of the publishing industry. As the economy started to recover, in Pub’s prior-year goodwill impairment test, the quantitative analysis concluded that the fair value of the reporting unit exceeded its carrying amount by 18%.

- As the industry has rebounded from the lows of two years ago, revenue for the past two years increased by 12% and 7%, respectively. However, increased competition in the publishing industry resulted in declines in gross margins over the past two years of 2% and 3%, respectively.

- Four months ago, a retail bookseller that accounted for 7% of Pub’s gross margin filed for bankruptcy protection and left the industry. However, Pub is exploiting new digital distribution networks that it expects to account for 4% of its gross margin. Pub’s two largest remaining physical distribution customers account for 45% of its gross margin.

- Pub’s president retired during the year and was replaced by the chief operating officer of a smaller competitor.

- During the last year, the overall S&P 500 Index is 8% lower than it was at the last measurement date and public entities in the publishing industry are down 12%.

- Pub’s carrying amount increased by 2%.

**Analysis**

Company A will have to weigh the various positive and negative events above in performing its qualitative screen. However, Company A can simplify its analysis by giving more weight to the drivers of fair value that most affect the fair value of Pub.

The impairment charge that Pub recorded two years ago is not significant to the current analysis. Given the fact that Pub’s fair value was 18% greater than its carrying amount a year ago, there was clearly an improvement in the fair value of Pub subsequent to the impairment being recorded.

Another factor that Company A may give less weight to is the positive effects of increases in revenues. Since gross margins are declining while revenues are growing, that revenue growth could be driven by the overall rebound in the economy from two years ago. Although the high-percentange revenue growth appears positive, it is not increasing at the same pace as expenses, likely resulting in declining value overall.

Similarly, Company A may determine that the relatively quick replacement of the reporting unit’s president with an executive of a competitor with industry experience weighs less on the fair value calculation than other factors. However, if the president was a prominent figure in the industry and a significant factor in the market valuation of the company and the departure was unexpected and (or) without a transition plan, this factor may have a significant effect on the fair value of the reporting unit.
The bankruptcy of the physical retailer and expansion into digital distribution representing a negative 7% and positive 4% effect on gross margin, respectively, could potentially cancel each other out and will have less weight on the overall analysis. However, the deterioration of the physical market (which is not fully being offset by gains in the digital market) should be evaluated to see whether this is an ongoing trend that could indicate future projections should be updated to reflect diminishing revenues. Lastly, the company should evaluate the contract terms and financial health (e.g., creditworthiness) of Pub’s two largest remaining physical customers because this assessment will likely have a larger effect on the fair value of Pub.

In addition to the weight of the factors as discussed above, Company A must consider the effect of the overall declines in market and industry values and the change in RU’s carrying amount in order to make a qualitative conclusion about the fair value of RU.

3.1.2.4.1  
Inverse relationship to level of documentation

As discussed in section 3.1.1.2.1, the starting point for a qualitative screen should be reviewing the most recent fair value calculation and determining based on recent events the margin between fair value and carrying amount. Illustration 3-8 below indicates the level of effort that will be required to perform the qualitative screen depending on the amount of margin that existed in the last quantitative test.

<table>
<thead>
<tr>
<th>Illustration 3-8: Relationship between excess fair value over carrying amount in most recent calculation and level of current-year documentation</th>
</tr>
</thead>
</table>

Excess fair value over carrying amount  
Relationship between excess fair value over carrying amount in most recent fair value calculation and level of documentation required to use the screen  
Level of documentation
As the chart indicates, the larger the margin that existed the easier it may be to come to a conclusion about the fair value of a reporting unit using the qualitative screen. For example, depending on the factors, if a reporting unit’s fair value exceeded its carrying amount by 100% in the prior year, a company would likely not have to perform as rigorous an evaluation of events and circumstances as a company would if its margin between fair value and carrying amount for a reporting unit was 5%. Similarly, companies should remember that as time passes from the date of the most recent fair value calculation, the less relevant that fair value calculation becomes.

When the most recent fair value calculation indicates that a reporting unit’s fair value is close to its carrying amount, more robust documentation and stronger supporting evidence will be required to qualitatively conclude that it is more likely than not that there is no impairment in the current year. In situations such as this, companies might also consider performing corroborative procedures, such as evaluating assumptions used in the current-year qualitative analysis against actual results within the market and industry in which the reporting unit operates (e.g., analyst reports or recent public transactions).

3.1.1.2.4.2 Sensitivity analyses

Since the concept of fair value is inherently quantitative (i.e., its end result is a value), in certain cases making a qualitative assertion about the fair value of a reporting unit may require supporting or corroborating quantitative analysis. While determining the effect of an individual event or circumstance may be straightforward, weighing various factors against each other will require additional judgment. Due to the complexities of fair value calculations (under any method), weighing the factors that could affect fair value will become cumbersome without some sort of sensitivity analysis to help quantify which factors most affect fair value.

<table>
<thead>
<tr>
<th>Illustration 3-9: Sensitivity analysis — market approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company A is a public oil and gas company with multiple reporting units based on geography. Assume the following with respect to the US reporting unit (RU) of Company A:</td>
</tr>
<tr>
<td>• In the prior year’s quantitative analysis, the fair value of RU exceeded its carrying amount by 19%. Company A used the market approach to determine RU’s fair value.</td>
</tr>
<tr>
<td>• Overall equity markets are down 14% in the current year, and recent transactions in the oil and gas industry indicate multiples have decreased 11% from the assumptions used in the prior year.</td>
</tr>
<tr>
<td>• Company A has not yet reviewed its company-specific factors from the prior year, and is considering whether the declines in the oil and gas industry and overall market, absent offsetting positive evidence, would have such a negative effect on the fair value of RU that Company A would not be able to make a qualitative assertion that it is not more likely than not that the fair value of RU is less than its carrying amount.</td>
</tr>
</tbody>
</table>

Analysis

In this fact pattern, because of the negative indicators, Company A could consider performing some sort of sensitivity analysis on the fair value of RU before determining whether to proceed with the qualitative screen. By updating the assumptions used in the prior year’s fair value calculation to reflect the declines in oil and gas multiples, Company A can quickly evaluate how sensitive its most recent fair value is to the industry-wide declines in value. In doing this sensitivity comparison, Company A should also update its carrying amount to reflect current-year information, which will provide a better indication of whether Company A would pass the Step 1 test if all other factors remained the same.
If updating the assumptions to reflect current industry multiples causes the Step 1 test from the prior year to fail and there are no other significant offsetting positive factors, Company A likely would conclude that it should perform the annual two-step impairment test in the current year. Alternatively, if after reflecting the declines in multiples and changes in carrying amounts the sensitivity analysis indicates that there is still excess fair value, Company A may likely conclude that it will continue with the qualitative screen and identify and evaluate the other events and circumstances affecting fair value to complete its analysis.

**Illustration 3-10: Sensitivity analysis – income approach**

Assume the same facts as in Illustration 3-9, except that Company A used the income approach (i.e., discounted cash flow method) to determine RU’s fair value. Additionally, the market capitalizations of public US companies in the oil and gas industry also have declined on average 11% from the time of the prior-year fair value calculation.

**Analysis**

In this fact pattern, Company A might consider performing a sensitivity analysis using the information in the most recent fair value calculation. By updating the WACC used in the prior-year calculation to better reflect the additional perceived risk related to companies operating in the oil and gas industry and to capture any incremental risk specific to the RU and its projections, Company A could determine the significance of the decline in equity values of its industry on its fair value calculation. If performing this sort of sensitivity analysis causes the Step 1 test from the prior year to fail and there are no other significant offsetting positive factors, Company A likely would conclude that it should perform the annual two-step impairment test in the current year.

Company A may also consider performing a breakeven sensitivity analysis to determine how high the WACC would have to rise before it triggered impairment in the prior-year fair value calculation. Company A could then evaluate the probability that RU would be subject to a WACC rate consistent with the implied breakeven WACC. For example, if the WACC needed to rise by 10% for the fair value of RU to be less than its carrying amount, Company A may conclude that the likelihood of potential impairment would be low and conclude that performing the qualitative screen would be sufficient. In contrast, if the WACC needed to rise by only 1% before triggering a potential impairment, the company may conclude that performing a full Step 1 analysis would be necessary.

The illustrations above show how a high-level quantitative calculation could help support certain qualitative assertions. However, it is important to remember that sensitivity analyses such as these should not be performed without consideration of all facts and circumstances. The qualitative assessment requires an evaluation of facts and circumstances in their totality to make a conclusion about whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

Depending on the facts and circumstances for a particular reporting unit, a company might consider involving external valuation specialists to help determine ranges for key assumptions to be used in the sensitivity analysis.

For additional guidance on determining fair value, refer to our FRD, *Fair value measurements and disclosures*. 

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If updating the assumptions to reflect current industry multiples causes the Step 1 test from the prior year to fail and there are no other significant offsetting positive factors, Company A likely would conclude that it should perform the annual two-step impairment test in the current year. Alternatively, if after reflecting the declines in multiples and changes in carrying amounts the sensitivity analysis indicates that there is still excess fair value, Company A may likely conclude that it will continue with the qualitative screen and identify and evaluate the other events and circumstances affecting fair value to complete its analysis.

**Illustration 3-10: Sensitivity analysis – income approach**

Assume the same facts as in Illustration 3-9, except that Company A used the income approach (i.e., discounted cash flow method) to determine RU’s fair value. Additionally, the market capitalizations of public US companies in the oil and gas industry also have declined on average 11% from the time of the prior-year fair value calculation.

**Analysis**

In this fact pattern, Company A might consider performing a sensitivity analysis using the information in the most recent fair value calculation. By updating the WACC used in the prior-year calculation to better reflect the additional perceived risk related to companies operating in the oil and gas industry and to capture any incremental risk specific to the RU and its projections, Company A could determine the significance of the decline in equity values of its industry on its fair value calculation. If performing this sort of sensitivity analysis causes the Step 1 test from the prior year to fail and there are no other significant offsetting positive factors, Company A likely would conclude that it should perform the annual two-step impairment test in the current year.

Company A may also consider performing a breakeven sensitivity analysis to determine how high the WACC would have to rise before it triggered impairment in the prior-year fair value calculation. Company A could then evaluate the probability that RU would be subject to a WACC rate consistent with the implied breakeven WACC. For example, if the WACC needed to rise by 10% for the fair value of RU to be less than its carrying amount, Company A may conclude that the likelihood of potential impairment would be low and conclude that performing the qualitative screen would be sufficient. In contrast, if the WACC needed to rise by only 1% before triggering a potential impairment, the company may conclude that performing a full Step 1 analysis would be necessary.

The illustrations above show how a high-level quantitative calculation could help support certain qualitative assertions. However, it is important to remember that sensitivity analyses such as these should not be performed without consideration of all facts and circumstances. The qualitative assessment requires an evaluation of facts and circumstances in their totality to make a conclusion about whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

Depending on the facts and circumstances for a particular reporting unit, a company might consider involving external valuation specialists to help determine ranges for key assumptions to be used in the sensitivity analysis.

For additional guidance on determining fair value, refer to our FRD, *Fair value measurements and disclosures*. 
3.1.1.2.5  **Make a conclusion**

The final step in performing the qualitative screen is to make a conclusion. As a reminder, if a company concludes that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, it must perform the annual two-step test. If it concludes otherwise, it has completed its goodwill impairment assessment and can skip the annual two-step test.

Concluding that a reporting unit has passed the qualitative screen (i.e., that it is not more likely than not that the fair value is less than the carrying amount) will require companies to apply significant judgment. Clear documentation of the factors considered, including any necessary supporting evidence or quantitative calculations, will be essential. Depending on the complexity of the reporting unit being evaluated, it may also be necessary to obtain input from valuation specialists.

A lack of a thorough analysis of the effects of all significant events and circumstances on the fair value or carrying amount of a reporting unit could lead to an incorrect conclusion. Developing clear, contemporaneous documentation also will help a company support its conclusions if regulators raise questions.

### 3.1.2  Reporting units with zero or negative carrying amounts

**Excerpt from Accounting Standards Codification**

**Intangibles – Goodwill and Other – Goodwill**

**Recognition and Measurement of an Impairment Loss**

**Step 1**

**350-20-35-8A**

If the carrying amount of a reporting unit is zero or negative, the second step of the impairment test shall be performed to measure the amount of impairment loss, if any, when it is more likely than not (that is, a likelihood of more than 50 percent) that a goodwill impairment exists. In considering whether it is more likely than not that a goodwill impairment exists, an entity shall evaluate, using the process described in paragraphs 350-20-35-3F through 35-3G, whether there are adverse qualitative factors, including the examples of events and circumstances provided in paragraph 350-20-35-3C(a) through (g). In evaluating whether it is more likely than not that the goodwill of a reporting unit with a zero or negative carrying amount is impaired, an entity also should take into consideration whether there are significant differences between the carrying amount and the estimated fair value of its assets and liabilities, and the existence of significant unrecognized intangible assets.

Because ASC 350 requires Step 2 of the goodwill impairment test to be performed only when the fair value of a reporting unit is less than its carrying amount, questions arose about whether performing Step 2 of the impairment test was necessary when the carrying amount of a reporting unit is zero or negative since the reporting unit would generally pass Step 1 (i.e., the fair value of the reporting would be greater than zero). Some were concerned that Step 2 of the test was not being performed despite factors indicating that goodwill was impaired. To address this, the FASB issued ASU No. 2010-28 (codified in ASC 350-20-35-8A). When the carrying amount of a reporting unit is zero or negative and there are
qualitative factors such as those in ASC 350-20-35-3C that indicate it is more likely than not that goodwill is impaired, a company is required to perform Step 2 of the goodwill impairment test. ASC 350 does not prescribe how a reporting unit’s carrying amount should be determined.

For public companies, this guidance was effective for fiscal years, and interim periods within those years, beginning after 15 December 2010. Early adoption was not permitted. However, for nonpublic companies, the guidance is effective for fiscal years, and interim periods within those years, beginning after 15 December 2011. Nonpublic companies may early adopt the amendments using the effective date for public entities.

Upon adoption of this guidance, any resulting goodwill impairment should be recorded as a cumulative-effect adjustment to beginning retained earnings in the period of adoption. Any goodwill impairments occurring after initial adoption should be included in earnings as required by ASC 350-20-35. See section 3.10.1 for further discussion.

### 3.1.3 Consideration of deferred income taxes in determining the carrying amount of a reporting unit

<table>
<thead>
<tr>
<th>Excerpt from Accounting Standards Codification</th>
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<tbody>
<tr>
<td><strong>Intangibles — Goodwill and Other — Goodwill</strong></td>
</tr>
<tr>
<td><strong>Recognition and Measurement of an Impairment Loss</strong></td>
</tr>
<tr>
<td><strong>350-20-35-7</strong></td>
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<tr>
<td>In determining the carrying amount of a reporting unit, deferred income taxes shall be included in the carrying amount of the reporting unit, regardless of whether the fair value of the reporting unit will be determined assuming it would be bought or sold in a taxable or nontaxable transaction.</td>
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<tr>
<td><strong>350-20-35-20</strong></td>
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<tr>
<td>For purposes of determining the implied fair value of goodwill, an entity shall use the income tax bases of a reporting unit’s assets and liabilities implicit in the tax structure assumed in its estimation of fair value of the reporting unit in Step 1. That is, an entity shall use its existing income tax bases if the assumed structure used to estimate the fair value of the reporting unit was a nontaxable transaction, and it shall use new income tax bases if the assumed structure was a taxable transaction.</td>
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<tr>
<td><strong>350-20-35-21</strong></td>
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<tr>
<td>Paragraph 805-740-25-6 indicates that a deferred tax liability or asset shall be recognized for differences between the assigned values and the income tax bases of the recognized assets acquired and liabilities assumed in a business combination in accordance with paragraph 805-740-25-3. To the extent present, tax attributes that will be transferred in the assumed tax structure, such as operating loss or tax credit carry forwards, shall be valued consistent with the guidance contained in paragraph 805-740-30-3.</td>
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</table>

When the EITF originally deliberated EITF 02-13 (codified in ASC 350-20), the EITF addressed certain issues related to consideration of deferred taxes when performing the goodwill impairment tests. In EITF 02-13, the EITF concluded that deferred tax assets and liabilities that arise from differences between the book and tax bases of assets and liabilities assigned to a reporting unit should be included in the carrying amount of the reporting unit, regardless of whether the fair value of the reporting unit will be determined assuming it would be bought or sold in a taxable or non-taxable transaction.

See section 3.3.2 for further discussion pertaining to the consideration of deferred taxes in the determination of the fair value of a reporting unit.
3.2 Goodwill impairment test incomplete

**Excerpt from Accounting Standards Codification**

Intangibles – Goodwill and Other – Goodwill

*Subsequent Measurement*

350-20-35-18

If the second step of the goodwill impairment test is not complete before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25) 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 (see Subtopic 450-10).

350-20-35-19

Paragraph 350-20-50-2(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.

It is possible that a company will have to issue financial statements before completing Step 2 of the impairment test and measuring any impairment loss. In this case, if the loss is probable and can be reasonably estimated, the best estimate of the loss should be recognized in the financial statements (using the guidance in ASC 450). Companies should disclose the fact that the measurement of the impairment loss is an estimate. Any adjustment to that estimated loss resulting from the completion of the measurement should be recognized in the subsequent period.

3.3 Fair value measurements of a reporting unit

**Excerpt from Accounting Standards Codification**

Intangibles – Goodwill and Other – Goodwill

*Subsequent Measurement*

350-20-35-22

The fair value of a reporting unit refers to the price that would be received to sell the unit as a whole in an orderly transaction between market participants at the measurement date. 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.

350-20-35-23

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. 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.
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.

The fair value of a reporting unit is the amount at which the unit as a whole could be sold in a current transaction between willing parties (i.e., other than in a forced or liquidation sale). If a public company has only one reporting unit (or a company owns a publicly traded subsidiary that represents a reporting unit), then the market capitalization of the public company (or its public subsidiary) provides certain evidence about the fair value of that reporting unit. However, the market price of a single share of common stock and the associated 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. Substantial value may arise from the ability to take advantage of synergies and other benefits that result from control over a company (i.e., a “control premium”). That control premium may cause the fair value of a reporting unit to exceed its market capitalization. Therefore, measuring the fair value of a controlled business may be different than measuring the fair value of that company’s individual equity securities. An acquiring company is often willing to pay more for equity securities that give it a controlling interest than would an investor acquiring less than a controlling interest (i.e., a noncontrolling interest). Quoted market prices generally represent the prices for stock lots that represent a minority interest. Therefore, the quoted market price of individual securities need not be the sole measurement basis of the fair value of a reporting unit.

ASC 820 establishes a framework for measuring fair value in GAAP, clarifies the definition of fair value within that framework, and expands disclosures about the use of fair value measurements. Additional guidance about measuring fair value is included in our FRD, Fair value measurements and disclosures.

### 3.3.1 Market capitalization as a corroboration of fair value

In situations in which an entity’s reporting unit is publicly traded (which would be the case if a registrant had only one reporting unit or if a registrant’s subsidiary is deemed a reporting unit and is publicly traded), as noted earlier, 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. 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.

When performing Step 1 of the goodwill impairment test, the estimated fair value of the company may approximate the market capitalization of the company. However, in many cases, public companies have multiple reporting units and the company may not use the estimated market value of the company to determine the fair market value of the reporting units. Regardless of whether a company has a single or multiple reporting units, they would need to document and explain, in sufficient detail, the underlying reasons for any significant difference between the sum of the fair values of its individual reporting units and the company’s total market capitalization. This exercise is commonly referred to as the reconciliation of the fair value of the reporting units to the company’s market capitalization. Although not required under US GAAP, when a registrant performs a goodwill impairment test, whether the test is an interim or annual test, we believe that the registrant should reconcile the fair value of the reporting unit(s) to the registrant’s stock price and market capitalization as a corroborative step.
While the discussion above discusses a publicly traded reporting unit, in noting the appropriateness of a control premium, a similar concept would apply in reconciling the fair value of multiple reporting units to the market capitalization of the company as a whole. Other factors giving rise to differences between the fair value of a reporting unit(s) and market capitalization include, but are not limited to, liquidity factors, any recent transaction in the industry, trading activity of the stock, current economic and market conditions and non-public information that existed at the assessment date but was not reflected in the market until after the assessment date. Any such factors are subject to the same rigor of documentation and support as the control premium. In addition, broad generalizations including assertions that the current market is not reflective of underlying values would not be appropriate reasons to explain differences between the fair value of a reporting unit(s) and market capitalization.

In discussing the control premium at the 2008 AICPA National Conference on SEC and PCAOB Developments, the SEC staff noted that they do not apply a bright-line test and instead understand that the application of judgment can result in a range of reasonably possible control premiums. Whether the analysis is quantitative, qualitative or some combination thereof, the SEC staff noted they would expect objective evidence to support the judgments that the implied control premium is reasonable. The SEC staff could request support for the implied control premium, including any identified transactions. The use of a “rule of thumb” to support the implied control premium would not provide sufficient evidence. The SEC staff also expects the amount of documentation supporting the implied control premium to increase as the control premium increases.

In addition, at the 2008 Conference, the SEC staff remarked with respect to enterprise market capitalization that the SEC staff does not expect a registrant to determine its market capitalization using a point-in-time market price as of the date of its goodwill impairment assessment. Instead, the registrant may consider recent trends in its stock price over a reasonable period. We believe the "reasonable period" referred to by the SEC staff is a relatively short period, the length of which might vary depending on the company’s particular facts and circumstances. Given occasional stock price volatility, it appears the SEC staff does not expect enterprise market capitalization to be calculated solely based on anomalous stock price fluctuations on or around the goodwill impairment assessment date. However, the SEC staff also warned that registrants should not simply ignore a recent decline in market capitalization. We believe that companies should be prepared to support any range of dates used to determine enterprise market capitalization based on company specific factors, including volatility.

**3.3.1.1 Effect of qualitative assessment on performing a market capitalization reconciliation**

A registrant’s ability to support an implied control premium when reconciling the fair values of its reporting units to the company’s overall market capitalization will become more complicated if the registrant uses the qualitative screen to test the goodwill of a reporting unit for impairment.

Although there are no GAAP requirements to reconcile the fair values of a company’s reporting units to its overall market capitalization, many companies have adopted this approach as a best practice for checking the validity of their fair value calculations. The SEC staff frequently requests that registrants perform this reconciliation to justify the resulting implied control premium. The Board acknowledged in its Basis for Conclusions that the use of the qualitative screen will result in companies applying judgment about when and how to perform the market capitalization reconciliation.

This exercise will become difficult if companies elect to apply the qualitative screen to one or more reporting units because they would no longer have current indicators of fair value to reconcile to market capitalization. While it remains to be seen whether the SEC staff will request market capitalization reconciliations, the Board concluded that a company’s inability to perform this evaluation should not be determinative with respect to its decision on whether to apply the qualitative screen. However, in certain situations some companies may want to consider performing a limited evaluation of the reasonableness
of the implied control premium by comparing the market capitalization to the sum of the fair values of
the reporting units for which Step 1 was performed in the current year plus either the carrying amounts
or the most recent fair value amounts of reporting units for which only a qualitative screen was
performed in the current year. While this approach is not as precise as a market capitalization
reconciliation in which all reporting units have current fair value calculations, it may provide information
about the reasonableness of the implied control premium for the consolidated company. If, based on this
limited analysis, the results of the market capitalization and related control premium do not reconcile,
companies should consider performing additional analyses.

If a company records an impairment charge for one or more reporting units as a result of performing the
quantitative test, it may wish to consider whether performing a full market capitalization reconciliation
would provide further evidence with respect to its overall conclusions about fair value and the related
goodwill impairment charge. Depending on the facts and circumstances, a company may conclude that
performing a full market capitalization reconciliation (including calculating the fair value of reporting
units for which it had previously only assessed qualitatively) could be useful to verify that the impairment
charge recorded was accurate. There is inherent risk in calculating a goodwill impairment using Step 2 of
the quantitative test because doing so involves using a range of estimates to allocate fair value to the net
assets of the reporting unit. Accordingly, performing a full market capitalization reconciliation of the fair
value of all reporting units can help companies verify that the value assigned to the impaired reporting
unit is appropriate.

Similarly, companies that experience a sustained decrease in share price (either in absolute terms or
relative to peers) may want to consider performing an overall market capitalization reconciliation to verify
the reasonableness of their assertions of the fair value of each of their reporting units. Depending on the
facts and circumstances, such a decrease could be identified as a significant driver of fair value that could
result in a company concluding that a quantitative market capitalization reconciliation is necessary.

### 3.3.2 Effect of deferred taxes on fair value assumptions

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<thead>
<tr>
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<tbody>
<tr>
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<tr>
<td><strong>Deferred Income Tax Considerations</strong></td>
</tr>
<tr>
<td>350-20-35-25</td>
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<tr>
<td>Before estimating the fair value of a reporting unit, an entity shall determine whether that estimation should be based on an assumption that the unit could be bought or sold in a nontaxable transaction or a taxable transaction. Making that determination is a matter of judgment that depends on the relevant facts and circumstances and must be evaluated carefully on a case-by-case basis (see Examples 1 through 2 [paragraphs 350-20-55-10 through 55-23]).</td>
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<td>350-20-35-26</td>
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<td>In making that determination, an entity shall consider all of the following:</td>
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<td>a. Whether the assumption is consistent with those that marketplace participants would incorporate into their estimates of fair value</td>
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<tr>
<td>b. The feasibility of the assumed structure</td>
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<tr>
<td>c. Whether the assumed structure results in the highest economic value to the seller for the reporting unit, including consideration of related tax implications.</td>
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In determining the feasibility of a nontaxable transaction, an entity shall consider, among other factors, both of the following:

a. Whether the reporting unit could be sold in a nontaxable transaction

b. Whether there are any income tax laws and regulations or other corporate governance requirements that could limit an entity's ability to treat a sale of the unit as a nontaxable transaction.

In EITF 02-13 (codified in ASC 350-20), the EITF addressed certain issues related to consideration of deferred taxes when performing the goodwill impairment tests. In determining the fair value of a reporting unit, the following must be considered:

- The determination of whether to estimate the fair value of a reporting unit by assuming that the unit could be bought or sold in a non-taxable transaction versus a taxable transaction in performing Step 1 of the goodwill impairment test is a matter of judgment that depends on the relevant facts and circumstances and must be evaluated on a case-by-case basis. In making that determination, an entity should consider, among other things, (1) whether the assumption is consistent with those that marketplace participants would incorporate into their estimates of fair value, (2) the feasibility of the assumed structure and (3) whether the assumed structure results in the reporting unit's highest economic value to the seller.

- An entity should use the income tax bases of a reporting unit’s assets and liabilities implicit in the tax structure assumed in its estimation of fair value of the reporting unit in Step 1. That is, an entity should use its existing income tax bases (and recalculate deferred tax balances for any difference between those income tax bases and the fair values of the assets and liabilities determined in Step 2) when a non-taxable transaction is assumed in Step 1 of the goodwill impairment test and assume new income tax bases (and new deferred tax balances) when a taxable transaction is assumed in Step 1 of the goodwill impairment test.

3.3.3 Level of future funding for pension plans considerations

When testing a reporting unit's goodwill for impairment, companies may need to request their future funding requirements information early to incorporate it into valuations. At the 2008 AICPA National Conference on SEC and PCAOB Developments, the SEC staff confirmed its view that the inclusion of updated pension information in a company's Step 2 test is appropriate even though the annual pension measurement date is required to be the end of the company's fiscal year per ASC 715.

3.3.4 Other impairment considerations

Performing the goodwill impairment test may result in certain complications that must be considered early on. For one, obtaining fair value information for all assets and liabilities of a reporting unit can be a significant undertaking that may be very time consuming. In some cases, the fair value of long-lived assets, loans, or other assets may be lower than their book values, which may lead to a greater value of implied goodwill. This may make sense if the underlying business is doing well but the assets held have declined in value. In addition, see section 3.8 for discussion about the order of impairment testing.
3.4 Cumulative translation adjustment in the goodwill impairment test

Excerpt from Accounting Standards Codification
Foreign Currency Matters – Translation of Financial Statements
Other Presentation Matters
Consideration of Cumulative Translation Adjustment in Impairment Tests
830-30-45-13
An entity that has committed to a plan that will cause the cumulative translation adjustment for an equity method investment or a consolidated investment in a foreign entity to be reclassified to earnings shall include the cumulative translation adjustment as part of the carrying amount of the investment when evaluating that investment for impairment. The scope of this guidance includes an investment in a foreign entity that is either consolidated by the reporting entity or accounted for by the reporting entity using the equity method. This guidance does not address either of the following:

a. Whether the cumulative translation adjustment shall be included in the carrying amount of the investment when assessing impairment for an investment in a foreign entity when the reporting entity does not plan to dispose of the investment (that is, the investment or related consolidated assets are held for use)

b. Planned transactions involving foreign investments that, when consummated, will not cause a reclassification of some amount of the cumulative translation adjustment.

830-30-45-14
In both cases, paragraph 830-30-40-1 is clear that no basis exists to include the cumulative translation adjustment in an impairment assessment if that assessment does not contemplate a planned sale or liquidation that will cause reclassification of some amount of the cumulative translation adjustment. (If the reclassification will be a partial amount of the cumulative translation adjustment, this guidance contemplates only the cumulative translation adjustment amount subject to reclassification pursuant to paragraphs 830-30-40-2 through 40-4.)

830-30-45-15
An entity shall include the portion of the cumulative translation adjustment that represents a gain or loss from an effective hedge of the net investment in a foreign operation as part of the carrying amount of the investment when evaluating that investment for impairment.

3.5 Frequency of goodwill impairment tests

Excerpt from Accounting Standards Codification
Intangibles – Goodwill and Other – Goodwill
Subsequent Measurement
350-20-35-28
Goodwill of a reporting unit shall be tested for impairment on an annual basis and between annual tests in certain circumstances (see paragraph 350-20-35-30). 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.
Goodwill of each reporting unit must be tested for impairment at least annually. The timing of the annual impairment test does not have to be at the end of each fiscal year. The goodwill impairment test can be performed at any time during the year as long as that measurement date is used consistently going forward. A company’s decision to apply the qualitative screen does not change the company’s annual testing date (see section 3.1.1 for guidance on the qualitative screen). Further, a company can elect to assign different measurement dates to different reporting units based on factors such as the seasonality of the business, the dates that it will be easiest to determine fair value (if necessary), and spreading out the workload if the determinations are to be performed internally. For example, a company can elect to consistently perform its annual impairment tests for Reporting Unit A in December, Reporting Unit B in September and Reporting Unit C in June.

Public companies should carefully select their annual goodwill measurement dates because quarterly reporting requirements limit the amount of time to complete the fair value determinations required. For example, if a calendar year-end public company selects 30 September or another quarter-end as its annual measurement date and subsequently experiences goodwill impairment, there may be insufficient time to complete all of the required valuation analysis prior to the date the third quarter Form 10-Q is due. As discussed in section 3.2, if Step 2 cannot be completed before the financial statements for that period are issued, an estimated impairment loss should be recognized if a goodwill impairment loss is probable and can be reasonably estimated.

Based on past practice, we have noticed that most companies adopt an annual impairment test date at the beginning of a fiscal quarter, most commonly the fourth quarter. Following this approach, companies will have the appropriate carrying amounts available as of the last day of the prior fiscal quarter and will have the full quarter to assess if they have a potential impairment (qualitative screen and/or Step 1) and complete the measurement (Step 2), if required. Further, this approach would alleviate concerns about whether indicators exist in later quarters of the fiscal year, which could occur if the impairment test was performed earlier in the year (i.e., the risk that an indicator of impairment occurred and was not detected between the completion of the annual test and the preparation of the year-end financial statements is reduced).

### 3.5.1 Changing the goodwill assessment date

Some companies might elect to change the date of the annual goodwill assessment date. In those situations, an entity should look to current SEC guidance. Section II.G.2 of the SEC’s *Current Accounting and Disclosure Issues* in the Division of Corporation Finance\(^\text{10}\), states the following about a registrant’s ability to change the annual assessment date:

> ASC 350-20 requires that goodwill be tested, at the reporting unit level, for impairment on an annual basis. An impairment test also could be triggered between annual tests if an event occurs or circumstances change. A reporting unit is required to perform the annual impairment test at the same time every year, however, nothing precludes a registrant from changing the date of the annual impairment test. If a registrant chooses to change the date of the annual impairment test, it should ensure that no more than 12 months elapse between the tests. The change in testing dates should not be made with the intent of accelerating or delaying an impairment charge. The staff will likely raise concerns if a registrant is found to have changed the date of its annual goodwill impairment test frequently.

\(^\text{10}\) Updated 30 November 2006.
Any change to the date of the annual goodwill impairment test would constitute a change in the method of applying an accounting principle, as discussed in ASC 250-10-45-1, and therefore would require justification of the change on the basis of preferability. The registrant is required by Rule 10-01(b)(6) of Regulation S-X to disclose the date of and reason for the change. The registrant is also required by Item 601 of Regulation S-K to file, as an exhibit to the first Form 10-Q or 10-QSB after the date of the change, a letter from the registrant’s independent registered public accounting firm indicating whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances. See Staff Accounting Bulletin Topic 6.G.2.b. for additional guidance.

3.6 Carrying forward of reporting unit fair value

ASU 2011-08 (effective 1 January 2012 for calendar year companies) eliminated the option to carry forward the fair value determination of a reporting unit from the prior year. Prior to the issuance of ASU 2011-08 (discussed in section 3.1.1), ASC 350 allowed companies to carry forward a detailed determination of the fair value of a reporting unit from year to year if all of the following criteria were met:

- The assets and liabilities that comprise the reporting unit have not changed significantly since the most recent fair value determination (e.g., there has not been a recent acquisition or reorganization of an entity’s reporting structure).
- The most recent fair value determination resulted in an amount that exceeded the carrying amount of the reporting unit by a substantial margin.
- Based on an analysis of events that have occurred and circumstances that have changed since the most recent fair value determination, it is remote that a current fair value determination would be less than the current carrying amount of the reporting unit (e.g., there have been no adverse changes in the key assumptions or variables used in the previous fair value computation).

As discussed in section 3.1.1, the optional qualitative assessment is less stringent than the previous rules for carrying forward a prior period’s fair value calculation.

3.7 Interim impairment test

**Excerpt from Accounting Standards Codification**

Intangibles – Goodwill and Other – Goodwill

Subsequent Measurement

350-20-35-30

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. Additionally, if the carrying amount of a reporting unit is zero or negative, goodwill of that reporting unit shall be tested for impairment on an annual or interim basis if an event occurs or circumstances exist that indicate that it is more likely than not that a goodwill impairment exists. Paragraph 350-20-35-3C(a) through (g) includes examples of such events and circumstances, and paragraph 350-20-35-8A includes additional factors to consider when the carrying amount of a reporting unit is zero or negative. Paragraphs 350-20-35-3F through 35-3G describe the process for making these evaluations.
In addition to the annual goodwill impairment test, an interim test for goodwill impairment should be completed when an event occurs or circumstances change between annual tests that would more likely than not reduce the fair value of the reporting unit below its carrying amount. ASC 350-20-35-3C provides the following list of events and circumstances to consider in determining whether an interim goodwill impairment test is necessary:

- Macroeconomic conditions (e.g., deterioration in general economy)
- Industry and market considerations (e.g., deterioration in environment in which the company operates)
- Cost factors (e.g., increases in raw materials, labor)
- Overall financial performance (e.g., negative or declining cash flows)
- Other relevant entity-specific events (e.g., changes in management or key personnel)
- Events affecting a reporting unit (e.g., change in composition of net assets, expectation of disposing all or a portion of the reporting unit)
- A sustained decrease in share price (in both absolute terms and relative to peers), if applicable

These events and circumstances were updated as part of ASU 2011-08 and are simply examples as opposed to an inclusive listing of goodwill impairment indicators. Other events and changes in circumstances may also require goodwill to be tested for impairment between annual measurement dates. Companies must test goodwill of a reporting unit for impairment after a portion of goodwill has been assigned to a business disposed of. In addition, if a specific acquisition generated synergistic goodwill that was assigned to a reporting unit that was not assigned other acquired assets, we believe that the subsequent disposal of that acquired business may be an impairment indicator of the goodwill at the reporting unit to which the synergistic goodwill was originally assigned.

Certain market conditions may lead to a conclusion that one or more of those events have occurred. In remarks made at the 2008 AICPA National Conference on SEC and PCAOB Developments, the SEC staff emphasized the following indicators that it will consider when performing reviews:

- Recent operating losses at the reporting unit level
- Downward revisions to forecasts
- A decline in enterprise market capitalization below book value
- Restructuring actions or plans
- Industry trends

### 3.7.1 Market capitalization as an impairment indicator

A company’s market capitalization is considered in two ways under ASC 350-20. The first is as an indicator of possible impairment that would require an interim assessment of goodwill for impairment. The second, as discussed in section 3.3.1, is as a corroborative source of market information that is utilized to verify that the values used in Step 1 and Step 2 of the goodwill impairment analysis are reasonable. The general principle used in determining whether an interim impairment test for goodwill is required is whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Accordingly, a decline in a company’s stock price (both in absolute terms and relative to peers) and market capitalization should be considered in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Situations may arise where companies may need to consider performing an interim goodwill impairment test even though they may have recently performed their annual assessment.
A significant decline in a company’s stock price may suggest that the fair value of one or more reporting units has fallen below their carrying amounts, indicating that an interim goodwill impairment test is required. Similarly, declines in the stock prices of other companies in a reporting unit’s industry may suggest that an interim test for goodwill impairment is required. To assess whether the decline in market capitalization is an indicator requiring an interim goodwill impairment test, companies should consider the underlying reasons for the decline in the value of the securities (for example, adverse change in the business climate, an adverse action taken by a regulator, etc.), as well as the significance of the decline and the length of time the securities have been trading at a depressed value. It should not be assumed that a decline in the market price is temporary and that the stock price will recover.

3.8 Goodwill impairment test in conjunction with another asset (or asset group)

**Excerpt from Accounting Standards Codification**

<table>
<thead>
<tr>
<th>Intangibles – Goodwill and Other – Goodwill</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subsequent Measurement</td>
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<tr>
<td>350-20-35-31</td>
</tr>
<tr>
<td>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 the Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10 (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.</td>
</tr>
<tr>
<td>350-20-35-32</td>
</tr>
<tr>
<td>This requirement applies to all assets that are tested for impairment, not just those included in the scope of the Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10.</td>
</tr>
</tbody>
</table>

Because the impairment model uses the comparison of the fair value and the carrying amount of the reporting unit as the initial measure of potential impairment, ASC 360-20 requires that if an impairment test of goodwill and any other asset is required at the same time, impairment tests of all other assets (e.g., inventory, long-lived assets) should be completed and reflected in the carrying amount of the reporting unit prior to the completion of the goodwill impairment test. For example, if an impairment test under ASC 360-10 is being completed for a significant group of assets of a reporting unit that also requires a goodwill impairment test, the impairment test for the significant asset group should be completed pursuant to ASC 360-10 and the carrying amount of the asset group adjusted before completing the goodwill impairment test. The following example highlights the order of impairment testing when other assets are tested in conjunction with goodwill.
**Illustration 3-11: Order of impairment testing**

Assume that ABC Inc. has an asset group that constitutes a reporting unit and includes the following:

- Receivables
- Goodwill
- Indefinite-lived intangibles
- Inventory
- Property, plant & equipment
- Finite-lived intangibles

ABC has determined that an interim impairment test of its goodwill is warranted. ABC has also determined that its asset group must be tested for impairment. Prior to performing the goodwill impairment test, ASC 350-20 and ASC 360-10 requires the asset group and goodwill to be tested for impairment in the following order:

<table>
<thead>
<tr>
<th>First</th>
<th>Second</th>
<th>Last</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receivables</td>
<td>Property, plant and equipment</td>
<td>Goodwill</td>
</tr>
<tr>
<td>Indefinite-lived intangibles</td>
<td>Finite-lived intangibles</td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3.8.1 **Acquired entity represents only a part of the reporting unit**

When an acquired entity represents only part of the reporting unit (as is typically the case), the implied fair value of goodwill could include the appreciation of earlier acquisitions, unrecognized goodwill from prior pooling-of-interests and internally generated goodwill. In these circumstances, unrealized losses on acquisition goodwill are offset against unrecognized goodwill within the reporting unit. For example, a very successful acquisition made years ago that has appreciated would offset impairment of goodwill from a recent acquisition in the same reporting unit that has performed very poorly. The FASB acknowledges the existence of this “cushion” that is built into the impairment model. However, the FASB concluded that keeping track of acquisition-specific goodwill for impairment testing purposes would be almost impossible once an acquired company has been integrated into the acquiring company. The FASB also acknowledges that acquired goodwill may be offset or replaced by unrecorded internally generated goodwill and concluded that this was appropriate provided that the company is able to maintain the overall value of goodwill (e.g., by expending resources on advertising and customer service). However, offsetting such amounts between reporting units is not permitted.

3.9 **Identification of reporting units**

**Excerpt from Accounting Standards Codification**

**Intangibles – Goodwill and Other – Goodwill**

**Subsequent Measurement**

350-20-35-33

The provisions of Topic 280 shall be used to determine the reporting units of an entity.

350-20-35-34

A component of an operating segment is a reporting unit if the component constitutes a business or a nonprofit activity for which discrete financial information is available and segment management, as that term is defined in paragraph 280-10-50-7, regularly reviews the operating results of that component. Subtopic 805-10 includes guidance on determining whether an asset group constitutes a business. Throughout the remainder of this Section, the term *business* also includes a *nonprofit activity*. 

Financial reporting developments Intangibles – Goodwill and other
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. Paragraph 280-10-50-11 shall be considered in determining if the components of an operating segment have similar economic characteristics.

An operating segment shall be deemed to be a reporting unit if all of its components are similar, if none of its components is a reporting unit, or if it comprises only a single component.

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. In other words, 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).

An entity that is not required to report segment information in accordance with Topic 280 is nonetheless required to test goodwill for impairment at the reporting unit level. That entity shall use the guidance in paragraphs 280-10-50-1 through 50-9 to determine its operating segments for purposes of determining its reporting units.

A reporting unit is an operating segment, as that term is used in ASC 280, or one level below the operating segment (referred to as a “component”), depending on whether certain criteria are met. These criteria are discussed in detail below. An operating segment is the highest level within the company that can be a reporting unit (i.e., the operating segment level is the ceiling), and the component level is the lowest level within the company that can be a reporting unit (i.e., the component level is the floor). In addition, there may be limited cases in which a company has only one operating segment that would be its sole reporting unit. In these cases, goodwill will be tested for impairment at the entity level.

The guidance in ASC 280 states that an operating segment is not necessarily the same as a reportable segment (for which companies must disclose certain information in the segment footnote) because ASC 280 permits companies to aggregate operating segments into reportable segments if certain conditions are met. ASC 280 allows for the aggregation of multiple operating segments into a single reportable segment if either: (a) the operating segments have similar economic characteristics, as defined in ASC 280-10-50-11 or (b) the operating segments do not meet the quantitative thresholds to be reported separately, as described in ASC 280-10-50-13. For example, just because a company reports segment information on four reportable segments in the notes to its financial statements does not necessarily mean that the company has four operating segments; the company may have properly aggregated two or more operating segments into a single reportable segment. Therefore, to identify their reporting units for purposes of goodwill impairment testing, companies must first identify their operating segments and make sure that those operating segments are not aggregations of multiple operating segments as permitted by ASC 280.

The requirement to assign and then to test goodwill for impairment at the reporting unit level also applies to nonpublic companies that do not currently report segment information under ASC 280 (see section 3.19). The FASB Staff Implementation Guide on ASC 280 and our FRD, Segment reporting provide additional guidance on identifying operating segments.

The following guidance is applied to determine whether the reporting unit should be identified at the operating segment or the component level:
A component of an operating segment is a reporting unit if the component constitutes a business (as described in our FRD, *Business combinations* and discussed further below) for which discrete financial information is available and segment management regularly reviews the operating results of that component. Segment management consists of one or more segment managers.\(^{11}\)

However, two or more components within the same operating segment should be aggregated and deemed a single reporting unit if the components have similar economic characteristics.\(^{12}\)

An operating segment should be deemed to be a reporting unit if all of its components have similar economic characteristics, if none of its components is a reporting unit or if it is comprised of only a single component.

In response to questions on applying this guidance, specifically the evaluation of “similar economic characteristics”, the FASB staff issued a staff announcement at the November 2001 EITF meeting [EITF D-101 (codified primarily in ASC 350-20-55-1 through 55-9)]. See section 3.9.4 for further discussion.

### 3.9.1 The component constitutes a business or a nonprofit activity

<table>
<thead>
<tr>
<th>Excerpt from Accounting Standards Codification</th>
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<tbody>
<tr>
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</tr>
<tr>
<td><strong>Implementation Guidance and Illustrations</strong></td>
</tr>
<tr>
<td>350-20-55-3</td>
</tr>
<tr>
<td>The determination of whether a component constitutes a business or a nonprofit activity requires judgment based on specific facts and circumstances. The guidance in Section 805-10-55 should be considered in determining whether a group of assets constitutes a business or a nonprofit activity.</td>
</tr>
</tbody>
</table>

The fact that operating information (revenues and expenses) exists for a component of an operating segment does not necessarily mean that the component constitutes a business. For example, a component for which operating information is prepared might be a product line or a brand that is part of a business rather than a business in and of itself.

Section B2.1.3 of our FRD, *Business combinations*, provides guidance on the definition of what constitutes a business under ASC 805.

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\(^{11}\) For purposes of ASC 350, the term “segment manager” has the same meaning as in ASC 280. Generally, an operating segment has a segment manager who is directly accountable to and maintains regular contact with the chief operating decision maker to discuss operating activities, financial results, forecasts, or plans for the segment. The term segment manager identifies a function, not necessarily a manager with a specific title. The chief operating decision maker may also be the segment manager for certain operating segments. A single manager may be segment manager for more than one operating segment. If the characteristics in ASC 280-10-50-1 and 50-3 apply to more than one set of components of an organization but there is only one set for which segment managers are held responsible, that set of components constitutes the operating segments (ASC 280-10-50-7 and 50-8).

\(^{12}\) ASC 350-20 states that ASC 280-10-50-11 should be considered in determining if the components of an operating segment have similar economic characteristics. Refer to section 3.9.4 for further discussion of similar economic characteristics.
3.9.2 Discrete financial information

Excerpt from Accounting Standards Codification
Intangibles – Goodwill and Other – Goodwill
Implementation Guidance and Illustrations
350-20-55-4
The term discrete financial information should be applied in the same manner that it is applied in determining operating segments in accordance with paragraph 280-10-50-1. That guidance indicates that it is not necessary that assets be allocated for a component to be considered an operating segment (that is, no balance sheet is required). Thus, discrete financial information can constitute as little as operating information. Therefore, in order to test goodwill for impairment in accordance with this Subtopic, an entity may be required to assign assets and liabilities to reporting units (consistent with the guidance in paragraphs 350-20-35-39 through 35-40).

In applying the guidance in ASC 350-20-55-4, a company that produces only income statement data for a component may be required to assign assets and liabilities to that component if that component meets all of the other criteria of a reporting unit. However, it is not intended that a company assign assets and liabilities resulting in a complete GAAP balance sheet. Rather, the assigned assets and liabilities should be limited to those that are used in or relate to the operations of the component and that would be considered in determining the fair value of the reporting unit. If the assignment of assets and liabilities to the component requires an excessive amount of arbitrary allocations, this might indicate that the component is either not a business as defined by ASC 805 or it may be economically similar to another component and should be aggregated with that other component.

3.9.3 Reviewed by segment management

Excerpt from Accounting Standards Codification
Intangibles – Goodwill and Other – Goodwill
Implementation Guidance and Illustrations
350-20-55-5
Segment management, as defined in paragraphs 280-10-50-7 through 50-8, is either a level below or the same level as the chief operating decision maker. According to Topic 280, a segment manager is directly accountable to and maintains regular contact with the chief operating decision maker to discuss operating activities, financial results, forecasts, or plans for the segment. The approach used in this Subtopic to determine reporting units is similar to the one used to determine operating segments; however, this Subtopic focuses on how operating segments are managed rather than how the entity as a whole is managed; that is, reporting units should reflect the way an entity manages its operations.

3.9.4 Similar economic characteristics

Excerpt from Accounting Standards Codification
Intangibles – Goodwill and Other – Goodwill
Implementation Guidance and Illustrations
350-20-55-6
Evaluating whether two components have similar economic characteristics is a matter of judgment that depends on specific facts and circumstances. That assessment should be more qualitative than quantitative.
In determining whether the components of an operating segment have similar economic characteristics, all of the factors in paragraph 280-10-50-11 should be considered. However, every factor need not be met in order for two components to be considered economically similar. In addition, the determination of whether two components are economically similar need not be limited to consideration of the factors described in that paragraph. In determining whether components should be combined into one reporting unit based on their economic similarities, factors that should be considered in addition to those in that paragraph include but are not limited to, the following:

a. The manner in which an entity operates its business or nonprofit activity and the nature of those operations

b. Whether goodwill is recoverable from the separate operations of each component business (or nonprofit activity) or from two or more component businesses (or nonprofit activities) working in concert (which might be the case if the components are economically interdependent)

c. The extent to which the component businesses (or nonprofit activities) share assets and other resources, as might be evidenced by extensive transfer pricing mechanisms

d. Whether the components support and benefit from common research and development projects.

The fact that a component extensively shares assets and other resources with other components of the operating segment may be an indication that the component either is not a business or nonprofit activity or it may be economically similar to those other components.

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

If two operating segments have been aggregated into a reportable segment by applying the aggregation criteria in paragraph 280-10-50-11, it would be possible for one or more of those components to be economically dissimilar from the other components and thus be a reporting unit for purposes of testing goodwill for impairment. That situation might occur if an entity's operating segments are based on geographic areas. The following points need to be considered in addressing this circumstance:

a. The determination of reporting units under this Subtopic begins with the definition of an operating segment in paragraph 280-10-50-1 and considers disaggregating that operating segment into economically dissimilar components for the purpose of testing goodwill for impairment. The determination of reportable segments under Topic 280 also begins with an operating segment, but considers whether certain economically similar operating segments should be aggregated into a single operating segment or into a reportable segment.

b. The level at which operating performance is reviewed differs between this Subtopic and Topic 280. It is the chief operating decision maker who reviews operating segments and the segment manager who reviews reporting units (components of operating segments). Therefore, a component of an operating segment would not be considered an operating segment for purposes of that Topic unless the chief operating decision maker regularly reviews its operating performance; however, that same component might be a reporting unit under this Subtopic if a segment manager regularly reviews its operating performance (and if other reporting unit criteria are met).
In determining whether the components of an operating segment have similar economic characteristics, the guidance in ASC 280-10-50-11 should be considered. Operating segments often exhibit similar long-term financial performance if they have similar economic characteristics. For example, similar long-term average gross margins for two operating segments would be expected if their economic characteristics were similar. Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the objective and basic principles in ASC 280, if the segments have similar economic characteristics and if the segments are similar in each of the following areas:

- The nature of the products and services
- The nature of the production processes
- The type or class of customer for their products and services
- The methods used to distribute their products or provide their services
- If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities

In developing the guidance in EITF D-101, the FASB intended that all of the factors in ASC 280-10-50-11 be considered in making that determination. However, unlike the application of ASC 280, the FASB did not intend that every factor must be met in order for two components to be considered economically similar. In addition, the Board did not intend that the determination of whether two components are economically similar be limited to consideration of the factors described in ASC 280-10-50-11.

We believe the guidance in ASC 350-20-55-7, which clarifies that the FASB did not intend that all of the factors in ASC 280-10-50-11 must be met in order for two components to be considered economically similar, gives companies greater latitude in evaluating whether components should be aggregated. In addition, we believe that this interpretive guidance may give companies with vertically integrated operations within a single operating segment greater latitude in concluding that the components may be economically similar.

This guidance underscores the fact that components of two separate operating segments may not be aggregated into a single reporting unit. This may be troublesome for companies that report segment information based on geographic areas. Companies that report segment information based on geographic areas may decide to revisit their selection of operating segments.

### Additional observations

Some constituents have noted that two operating segments may have been aggregated into a reportable segment by applying the aggregation criteria in ASC 280-10-50-11, and have inquired about whether one or more of the components of those operating segments can be reporting units. The FASB staff believes it would be possible for one or more of those components to be economically dissimilar from the other components and thus be a reporting unit for purposes of testing goodwill for impairment. In particular, the FASB staff believes that that situation might occur when an entity’s operating segments are based on geographic areas. The following points need to be considered in addressing this question:

- The determination of reporting units under ASC 350-20 begins with the definition of an operating segment in ASC 280-10-50-1 and considers disaggregating that operating segment into economically dissimilar components for the purpose of testing goodwill for impairment. The

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13 This staff announcement summarized the FASB staff’s understanding of the Board’s intent with respect to the determination of whether a component of an operating segment is a reporting unit. This guidance is now codified in ASC 350-20 and is discussed in sections 3.9.1 through 3.9.4.
determination of reportable segments under ASC 280 also begins with an operating segment, but considers whether certain economically similar operating segments should be aggregated into a single operating segment or into a reportable segment.

The level at which operating performance is reviewed differs between ASC 280 and ASC 350 – it is the chief operating decision maker who reviews operating segments and the segment manager who reviews reporting units (components of operating segments). Therefore, a component of an operating segment would not be considered an operating segment for ASC 280 purposes unless the chief operating decision maker regularly reviews its operating performance; however, that same component might be a reporting unit under ASC 350-20 if a segment manager regularly reviews its operating performance (and if other reporting unit criteria are met).

Implicit in the FASB’s guidance is the fact that identifying the reporting unit begins with the definition of an operating segment. ASC 280 allows for the aggregation of two operating segments into a single reportable segment if the aggregation criteria in ASC 280-10-50-11 are met. If a company has a reportable segment under ASC 280 that consists of aggregated operating segments, it must first look through the aggregated reportable segment to identify operating segments.

In summary, reporting units will vary depending on the level at which performance of the operating segment is reviewed, how many businesses are included in the operating segment, and the economic similarity of those businesses. The FASB believes that defining the reporting unit one level below the operating segment level (i.e., the component level) is appropriate and aligns with how operating results are regularly reviewed to make decisions about resource allocation and to assess segment performance. However, the FASB also noted that even though segment management might review the operating results of a number of business units, components with similar economic characteristics should be aggregated into one reporting unit because the benefit of goodwill is shared by components of an operating unit that have similar economic characteristics. Because of this sharing of benefits, allocating goodwill among those components would be arbitrary and unnecessary for the purpose of testing goodwill for impairment.

We believe that identifying the reporting units is one of the more difficult and judgmental processes in applying ASC 350-20. Therefore, we believe that companies should document their selection of reporting units and the basis for that selection (and retain that documentation).

The following example illustrates how the concepts described above would be applied.
RS = The reportable segments included in the ASC 280 segment disclosures. This company has two reportable segments (RS1 and RS2).

OS = The operating segments under ASC 280. This company has three operating segments (OS1, OS2, and OS3). In applying ASC 280, the company determined that OS1 and OS2 have similar economic characteristics and meet the criteria for aggregation in ASC 280-10-50-11. Therefore, OS1 and OS2 qualified for aggregation into RS1. OS3 meets the quantitative thresholds in ASC 280 to be reported separately and has not been aggregated with any other operating segment and is therefore the same as reportable segment RS2.

C = The components of the company. This company has seven components (C1, C2, C3, C4, C5, C6 and C7) that are one level below the operating segments.

Identifying the reporting units

- Determining the reporting units of the company begins at the operating segment level (OS1, OS2 and OS3). ASC 350-20 does not allow the aggregation of OS1 and OS2 as permitted under ASC 280 for the purpose of determining the reportable segment.

- The company will apply the reporting unit criteria in ASC 350-20 to the components to determine if the reporting unit should be identified one level below the operating segment. Each component will be evaluated to determine if: (a) it is a business (as defined in ASC 805), (b) discrete financial information is available and (c) the operating results are regularly reviewed by the segment manager(s). If the components of a specific operating segment meet these criteria, they might be deemed to be separate reporting units. However, if they have similar economic characteristics (which is a matter of judgment based on individual facts and circumstances), these components must be aggregated into one reporting unit.

For example, assume C5, C6 and C7 each are businesses for which discrete financial information is available, and segment (OS3) management regularly reviews their individual operating results. If C5, C6 and C7 all have dissimilar economic characteristics, then there would be three reporting units within OS3 as each of the components would be a reporting unit. If C5 and C6 have similar economic characteristics, but C7 does not have similar economic characteristics to C5 and C6, then there would be two reporting units within OS3: (1) C5 and C6 combined, and (2) C7. If C5, C6 and C7 all have similar economic characteristics, the reporting unit would be the operating segment (OS3).

- Components of different operating segments may not be aggregated even if they have similar economic characteristics. As such, if C2 and C3 had similar economic characteristics, they could not be aggregated because C2 and C3 are components of different operating segments.

Conclusions

- The company will have at least three reporting units based on the fact that three operating segments have been identified.

- The company can have as many as seven reporting units (the number of components). The number will depend on how many components meet the reporting unit criteria and, if so, the number of potential components that must be aggregated based on similarity of economic characteristics, which is based on judgment.

- The company will not have more than seven reporting units. Even if levels exist below the components that meet the reporting unit criteria, ASC 350-20 prohibits identifying the reporting unit more than one level below the operating segment.
In general, we do not believe that identifying multiple reporting units below the operating segment level would otherwise call into question a company’s disclosure of reportable segments under ASC 280, provided that the company appropriately applied the provisions of that guidance. A key distinction between an operating segment and a component is the level of review of the operating results of each. The CODM reviews the results of an operating segment, while a segment manager reviews the results of a component. A segment manager is normally directly accountable to and maintains regular contact with the CODM (ASC 280-10-50-7 and 50-8). However, based on recent activities by the SEC staff, the SEC staff is often skeptical that registrants properly identify operating segments under ASC 280. The SEC continues to emphasize segment disclosures and the application of ASC 280 during its review process. The SEC staff comments generally focus on: (1) the identification of operating segments, (2) the aggregation or combination of operating segments and (3) the impact of changes to operating segments on reporting units and the related assessment of goodwill for impairment. In some cases, the SEC has insisted upon restatement, indicating that segment reporting may represent an area of increased financial reporting risk.

Further, because the CODM generally can obtain and review the results of any level within the organization, clearly identifying which level of operating results that the CODM reviews can be difficult. ASC 350-20 does not require a company to disclose the identity or number of its reporting units. However, if the SEC staff reviews a company’s segment reporting, management should be prepared to justify why its component reporting units are not operating segments for which segment disclosures must be made.

### 3.10 Assigning assets acquired and liabilities assumed to reporting units

#### Excerpt from Accounting Standards Codification

**Intangibles – Goodwill and Other – Goodwill**

**Subsequent Measurement**

350-20-35-39

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 preceding 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.

To test goodwill for impairment at the reporting unit level, assets acquired and liabilities assumed should be assigned to a reporting unit as of the date of acquisition. The purpose of this assignment process is to establish the “carrying amount” of the reporting units so that Step 1 of the goodwill impairment test (i.e., the comparison of the carrying amount of a reporting unit to its fair value) can be performed.

Both of the following criteria should be met for an acquired asset or assumed liability to be assigned to a reporting unit:

- The asset will be employed in or the liability relates to the operations of a reporting unit, and
- The asset or liability will be considered in determining the fair value of the reporting unit.
ASC 350-20 does not require the assignment of all assets acquired and liabilities assumed to a reporting unit; only those meeting the above criteria should be assigned. Further, the Board noted that another objective of the process is to assign to a reporting unit all of the assets and liabilities that would be necessary for the reporting unit to operate as a business. For example, acquired cash or marketable securities that are unrelated to any reporting unit and its working capital requirements, but are general corporate assets of the acquired company, need not be assigned to a reporting unit. In addition, an entity’s debt may be at the corporate level and/or reside at a subsidiary.

An entity’s estimate of a reporting unit’s fair value should include assigned debt if that debt:

- Relates to the operations of the reporting unit, and
- Is likely to be transferred in the event the reporting unit is sold.

As a result, absent the situations noted above, we believe that in applying the provisions in ASC 350-20-35-39, an entity would not typically assign general corporate debt to its reporting units.

Also, the assets and liabilities assigned need not constitute a complete GAAP balance sheet. Further, while ASC 350-50 refers to acquired assets and assumed liabilities, assets and liabilities that are generated or originated by a company should also be assigned to reporting units based on the criteria above.

3.10.1 Determining the manner in which the carrying amount of a reporting unit is determined (equity versus enterprise)

Some constituents have questioned the manner in which a reporting unit’s carrying amount should be determined (i.e., under an “equity” premise or an “enterprise” premise). ASU 2010-28 (codified in ASC 350-20) addressed the issue of when to perform Step 2 of the goodwill impairment test for reporting units with zero or negative carrying amounts (see section 3.1.2 for further information). In the Basis for Conclusions to ASU 2010-28, the FASB noted that the EITF evaluated different approaches for calculating the carrying amount of reporting units. Eventually, the EITF decided not to prescribe how a reporting unit’s carrying amount should be determined. However, the Task Force observed that the manner in which the fair value and carrying amount of the reporting unit is determined should be consistent.

When a reporting unit’s carrying amount is based on an equity premise, all liabilities (including debt) are available for assignment to the reporting unit. Conversely, when a reporting unit’s carrying amount is based on the enterprise premise, debt is excluded from the liabilities assigned to the reporting unit. When the carrying amount of debt approximates its fair value, using either premise would not have an impact on Step 1 of the goodwill impairment test. In addition, when no debt has been assigned to the reporting unit, the carrying amount of the reporting unit will be same under either premise.

Furthermore, in circumstances where the carrying amount of an asset or liability equals its fair value, its assignment to a reporting unit will have an equal effect on both the carrying amount and the fair value of the reporting unit. However, the carrying amount of an asset or liability will often differ from its fair value. As a result, the selection of either the equity or enterprise premise or the decision to assign certain assets and liabilities to a reporting unit may affect the outcome of Step 1 of the goodwill impairment test.

3.10.2 Assignment of a contingent consideration asset or liability

Often the consideration transferred in a business combination may include a contingent consideration arrangement. ASC 805 states that an acquirer should recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree. That arrangement may represent an asset or liability.
When determining whether or not to assign a contingent consideration asset or liability to a reporting unit, the criteria in ASC 350-20-35-39 should be considered. If the reporting unit is obligated to pay or has the right to receive the contingent consideration, we believe the contingent consideration asset or liability would generally be assigned to that reporting unit. In addition, it may be appropriate to assign a contingent consideration arrangement to a reporting unit even if the reporting unit is not the legal counterparty to the arrangement. This may arise if the reporting unit includes the business acquired and a market participant would assume that obligation or right if the reporting unit was sold in a transaction.

### 3.11 Assets or liabilities used in multiple reporting units

**Excerpt from Accounting Standards Codification**

**Intangibles – Goodwill and Other – Goodwill**

**Subsequent Measurement**

350-20-35-40

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 assigned 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 assignment based on payroll expense might be used. A reasonable allocation method may be very general. For use in making those assignments, the basis for and method of determining the fair value of the acquiree and other related factors (such as the underlying reasons for the acquisition and management’s expectations related to dilution, synergies, and other financial measurements) shall be documented at the acquisition date.

Some assets or liabilities may be employed in or related to the operations of multiple reporting units. The methodology used to determine the amounts to assign to each reporting unit in these cases should be reasonable, supportable and 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 assigned according to the benefit received by the different reporting units or based on the relative fair values of the reporting units. For example, pension obligations may be assigned on a pro rata basis based on the payroll expense of the reporting units. The assignment method used for particular assets and liabilities should be applied consistently. The basis for and method of determining the fair value of the acquiree and other related factors (such as the underlying reasons for the acquisition and management’s expectations related to dilution, synergies and other financial measurements) in assigning assets and liabilities to multiple reporting units should be documented at the acquisition date.

### 3.11.1 Assets or liabilities accounted for at the corporate level

ASC 350-20 also requires the assignment of all applicable assets and liabilities that may be accounted for at the corporate level, including environmental liabilities using the criteria noted in section 3.11. Additionally, when assets or liabilities do not meet the criteria in section 3.11 and are not included in the carrying amount of the reporting unit, they should be treated consistently in determining the fair value of the reporting unit (Step 1) and (if necessary) in determining the implied fair value of the reporting unit’s goodwill (Step 2). See section 3.1 for discussion of the goodwill impairment test.
For example, if the fair value of the reporting unit is determined based on discounted future cash flows of the reporting unit on an unleveraged (or debt-free) basis (a common enterprise valuation methodology), the debt associated with the reporting unit should be treated consistently (i.e., excluded) in determining the carrying amount of the reporting unit so that the comparison of those values is meaningful. On the other hand, if the debt relates to the operations of the reporting unit and would be considered in determining its fair value (e.g., if a property assigned to the reporting unit secures a mortgage), the company should include the debt in both the determination of the fair value and the carrying amount of the reporting unit. See previous discussion at section 3.10.1.

The goal of such assignment is to ensure that comparisons of the fair value to the carrying amount of reporting units are on an “apples-to-apples” basis. Therefore, this assignment requires the company to understand how items such as debt, accounts receivable, accounts payable, inventories, accrued liabilities and other working capital items are treated in the valuation of the reporting unit so that those items are treated consistently in assigning assets and liabilities to reporting units. Another objective of this exercise is to assign to the reporting units all of the assets and liabilities that would be necessary for that reporting unit to operate as a business. Therefore, to the extent that corporate items are reflected in the fair 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. Therefore, that type of liability should generally be included in determining the fair value of the reporting unit.

The FASB acknowledges that the requirement to assign corporate level assets and liabilities could be considered inconsistent with ASC 280, which requires that the reported segment include only those assets that are included in the measure of the segment’s assets that is used by the chief operating decision maker. Therefore, goodwill and other assets may not be included in reported segment assets. ASC 350-20 does not literally require that goodwill and all other related assets and liabilities assigned to reporting units for the purpose of testing goodwill for impairment be included in a company’s reported segment assets. Rather, the assignment process is simply a method of identifying the reporting unit to which assets and liabilities relate and determining the consolidated company’s carrying amount of reporting units. However, even though an asset may not be included in reported segment assets, the asset or liability should be assigned to the reporting unit for the purpose of the goodwill impairment test in accordance with the guidance discussed above.

This assignment process does not impact a parent company’s cost basis in its subsidiaries, nor does it require the subsidiary to change its basis in any assets or liabilities used for external reporting purposes (i.e., the guidance does not require “push down” accounting in the separate financial statements of subsidiaries). However, the bases of the reporting unit’s assets and liabilities used for goodwill impairment tests should reflect the parent’s bases.
Assigning goodwill to reporting units

Excerpt from Accounting Standards Codification

Intangibles — Goodwill and Other — Goodwill

Subsequent Measurement

350-20-35-41
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 paragraphs 350-20-35-42 through 43.

350-20-35-42
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. That is:

a. An entity would determine the fair value of the acquired business (or portion thereof) to be included in a reporting unit—the fair value of the individual assets acquired and liabilities assumed that are assigned to the reporting unit. Subtopic 805-20 provides guidance on assigning the fair value of the acquiree to the assets acquired and liabilities assumed in a business combination.

b. Any excess of the fair value of the acquired business (or portion thereof) over the fair value of the individual assets acquired and liabilities assumed that are assigned to the reporting unit is the amount of goodwill assigned to that reporting unit.

c. [Subparagraph not used]

350-20-35-43
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.

350-20-35-44
This Subtopic 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) shall be allocated to a reporting unit for purposes of testing for impairment if it meets the criteria in paragraph 350-20-35-39.

Testing goodwill for impairment at the reporting unit level requires that all goodwill be assigned to one or more reporting units as of the date of acquisition. All goodwill must be assigned to a reporting unit, regardless of its source. For example, even goodwill that arises from applying push down accounting [pursuant to SAB Topic 5-J (codified primarily in ASC 805-50-S99-1)] and ASC 852 must be assigned to a reporting unit.
If goodwill from an acquisition is to be assigned to more than one reporting unit, ASC 350-20 requires the methodology used be reasonable, supportable and applied in a consistent manner. Goodwill should be assigned to the reporting units that are expected to benefit from the synergies of the combination even though other assets or liabilities of the acquired company may not be assigned to those reporting units. 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.

In addition to a methodology that is reasonable and supportable, the methodology used should be consistent with the objectives of ASC 350-20-35-42 when goodwill is assigned to more than one reporting unit at the acquisition date.

We believe that if all of the assets and liabilities of an acquired business are assigned to a specific reporting unit, then the goodwill associated with that acquisition should also be assigned to that reporting unit, unless it is clear that some other reporting unit is expected to benefit from the acquisition. If a reporting unit is expected to benefit from the acquisition even though it was assigned no assets or liabilities of the acquired company, then the “with and without approach” is the best assignment method. However, this approach requires determining the fair value of the reporting unit(s) of the acquiring company benefited by the acquisition and may not be cost beneficial. In many circumstances, the acquirer’s purchase price calculation may include assumptions about synergistic benefits that the acquiring company expects; in that case, the amount of goodwill to assign to the reporting units benefited may be derived from the purchase price calculation. Other reasonable and supportable methods (other than the “with and without” method) may be appropriate, depending on the facts and circumstances. However, the assignment method chosen should not result in an immediate impairment of the acquired goodwill.

The following example illustrates the assignment of goodwill to more than one reporting unit using both the “direct” and “with-and-without” methods.

<table>
<thead>
<tr>
<th>Illustration 3-13: Goodwill assigned to more than one reporting unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assume that Company A completes the acquisition of Company B for consideration transferred of $50 million. The fair value of the net working capital acquired is $8 million, the fair value of the acquired identifiable tangible and intangible assets is $27 million and goodwill is $15 million. The acquisition is to be integrated into two of Company A’s reporting units. There is no synergistic goodwill attributable to other reporting units.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Acquired net assets to be assigned to:</th>
<th>RU 1</th>
<th>RU 2</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net working capital</td>
<td>$ 5</td>
<td>$ 3</td>
<td>$ 8</td>
</tr>
<tr>
<td>Tangible and intangible net assets</td>
<td>15</td>
<td>12</td>
<td>27</td>
</tr>
<tr>
<td>Net assets to be assigned</td>
<td>$ 20</td>
<td>$ 15</td>
<td>$ 35</td>
</tr>
</tbody>
</table>

| Analysis - direct method: |

Using the direct method, Company A assigns goodwill to the reporting units based on the difference between the fair value of the net assets and the fair value of the acquired business (or portion thereof) to be assigned to the reporting units.

<table>
<thead>
<tr>
<th>RU 1</th>
<th>RU 2</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 33</td>
<td>$ 17</td>
<td>$ 50</td>
</tr>
<tr>
<td>$(20)</td>
<td>(15)</td>
<td>(35)</td>
</tr>
<tr>
<td>$ 13</td>
<td>$ 2</td>
<td>$ 15</td>
</tr>
</tbody>
</table>
**Analysis - indirect ("with-and-without") method:**

Using the “with-and-without” method, Company A assigns goodwill to the reporting units based on the difference between the fair value of the net assets to be assigned and the fair value of the acquired business (or portion thereof). However, the fair value of the acquired business (or portion thereof) is determined using a “with and without” method.

<table>
<thead>
<tr>
<th></th>
<th>RU 1</th>
<th>RU 2</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of reporting unit after acquisition</td>
<td>$95</td>
<td>$80</td>
<td>$175</td>
</tr>
<tr>
<td>Fair value of reporting unit prior to acquisition</td>
<td>(62)</td>
<td>(63)</td>
<td>(125)</td>
</tr>
<tr>
<td>Fair value of acquired business or asset group*</td>
<td>33</td>
<td>17</td>
<td>50</td>
</tr>
<tr>
<td>Fair value of net assets to be assigned (from above)</td>
<td>(20)</td>
<td>(15)</td>
<td>(35)</td>
</tr>
<tr>
<td>Goodwill assigned to reporting unit</td>
<td>$13</td>
<td>$2</td>
<td>$15</td>
</tr>
</tbody>
</table>

* In this example, the sum of the fair values of the acquired businesses or asset groups equals the purchase price. In other circumstances, this may not be the case due to synergies and other characteristics related to the relationship between the businesses. In those cases, a reasonable and supportable method (e.g., a prorate allocation) should be used to assign any excess goodwill remaining after this allocation process.

### 3.12.1 Entity level goodwill

In certain circumstances, goodwill recognized relates to the company as a whole instead of particular reporting units. For example, goodwill that arises when a company applies push-down accounting or excess reorganization value recognized pursuant to ASC 852 often relates to the company as a whole. In those circumstances, the net assets would have been adjusted to their fair values, and an assignment method might be based on the relative excess of fair value of the reporting units over the net assets of the reporting units. An assignment method based on the relative fair values of all reporting units might be appropriate provided that it does not result in an immediate goodwill impairment charge.

### 3.12.2 Assignment of goodwill to reporting units for a mining entity

In 2004, the EITF addressed the issue of whether an entity in the mining industry should assign goodwill to a reporting unit that consists of an individual operating mine. Constituents raised questions because assigning goodwill to an operating mine results in a day-two impairment of any assigned goodwill due to the fact that the fair value of the reporting unit consists primarily of mineral deposits, which is a depleting asset. The EITF reached a consensus that goodwill should be assigned to a reporting unit which includes an operating mine. The EITF acknowledged that the assignment of goodwill to an individual operating mine likely will result in an eventual goodwill impairment due to the depleting nature of the primary asset of the reporting unit and could result in a day-two goodwill impairment. However, the EITF agreed that the guidance in ASC 350 was clear—goodwill should be assigned to reporting units and an individual operating mine may constitute a reporting unit. As a result, the EITF agreed to discontinue discussion of this issue and removed it from its agenda.

### 3.12.3 Delay in assignment of goodwill

As noted above, goodwill should be assigned, as of the acquisition date, to one or more reporting units that are expected to benefit from the synergies of the business combination. In certain situations, a company may be unable to determine the fair values to be assigned to all of the acquired identifiable assets and assumed liabilities for some time after the business combination and may utilize all or a substantial portion of the measurement period allowed by ASC 805 to finalize the initial accounting for the business combination. See our FRD, *Business combinations* for more information on the measurement period.
If the fair value of the identifiable assets acquired and liabilities assumed are determined only provisionally at the end of the current reporting period, ASC 350-20-50-1 recognizes that an entity may not have completed the assignment of goodwill to the reporting units. However, prior to finalization of the accounting for a business combination, an entity might be able to provisionally assign some or all of the goodwill. Neither the guidance in ASC 350 nor the Basis for Conclusions in FAS 142 addressed the assignment of provisional goodwill. However, we believe that the assignment of goodwill should not be delayed because the accounting for the business combination is incomplete. Because ASC 350 has specific disclosure requirements and ASC 280 requires companies that report segment information to provide information about goodwill in total and for each reportable segment, we believe that provisionally determined goodwill should be assigned at the end of a reporting period. Once the accounting for the business combination is finalized, the provisional amounts assigned should be reassessed and adjustments to the goodwill that was provisionally assigned should be made as necessary.

In addition, there is required disclosure of situations where a portion of goodwill has not yet been assigned to a reporting unit as of the date of a company's financial statements. If an acquisition closes shortly before the company's year-end, the company may not have sufficient time to complete its acquisition accounting and/or assignment of goodwill to reporting units. The company should ensure that all goodwill is assigned to the reporting units before it performs its next annual impairment test. However, if it is determined that impairment indicators exist, we believe this goodwill must be assigned to a reporting unit and tested for impairment.

3.12.4 Impairment testing of recently acquired goodwill

There is no requirement to test goodwill for impairment on the date of acquisition. In addition, paragraph BC382 of the Basis for Conclusions on Statement 141(R) states that:

“The Boards acknowledged that overpayments are possible and, in concept, an overpayment should lead to the acquirer’s recognition of an expense (or loss) in the period of the acquisition. However, the Boards believe that in practice any overpayment is unlikely to be detectable or known at the acquisition date. That is, the Boards are not aware of instances in which a buyer knowingly overpays or is compelled to overpay a seller to acquire a business. Even if an acquirer thinks it might have overpaid in some sense, the amount of overpayment would be difficult, if not impossible, to quantify. Thus, the Boards concluded that in practice it is not possible to identify and reliably measure an overpayment at the acquisition date. Accounting for overpayments is best addressed through subsequent impairment testing when evidence of a potential overpayment first arises.”

We believe that this guidance suggests that an entity should test the acquired goodwill (whether provisionally determined or final) for impairment if impairment indicators exist. In addition, if the goodwill assessment date follows shortly after an acquisition, a goodwill impairment test should be performed irrespective of the status of the accounting for the business combination.

3.12.4.1 Impairment testing in a subsequent period

If the completion of the accounting for a business combination and the final assignment of goodwill to the reporting units occur in a period subsequent to the acquisition and the amount of goodwill recognized provisionally is different from the final amount, an issue arises if an impairment test was performed on the provisionally recognized goodwill in the previous period. The issue is whether or not the previous impairment assessment should be updated. Neither ASC 805 nor ASC 350 addresses whether a company performs the impairment test prospectively or whether it retrospectively performs the impairment test at the previous assessment date (date the provisionally determined goodwill was tested). We believe that if an entity tested goodwill that was determined provisionally, that impairment test should be retrospectively updated to account for the change in the goodwill balance, similar to the accounting for
qualifying measurement period adjustments under ASC 805. We believe that this view is supported by paragraph BC399 of the Basis of Conclusions to FAS 141(R) which states, in part:

“…..adjustments during the measurement period following a business combination are more analogous to Type I subsequent events (AU Section 560, Subsequent Events) than to changes in estimates. The effects of events that occur after the end of an accounting period but before the financial statements for that period are issued that provide evidence of a condition that existed at the date of the financial statements are reflected in financial statements as of that date. Similarly, the effects of information that first becomes available during the measurement period that provides evidence of conditions or circumstances that existed at the acquisition date should be reflected in the accounting as of that date.”

Because an acquirer is required to retrospectively adjust, as of the acquisition date, amounts preliminarily recognized in a business combination, we believe that it is appropriate to retrospectively update any goodwill impairment test performed on provisionally determined amounts.

**Illustration 3-14: Impairment of goodwill during the measurement period**

Consider the following facts:

- Company A acquired Company B on 1 August 20X0
- Company A included Company B in RU1, one of its 3 existing reporting units
- Prior to the acquisition of Company B, RU1 had existing goodwill of $8 million
- Company A’s annual goodwill assessment date is 1 October 20X0
- The accounting for the business combination was incomplete as of 1 October 20X0
- Preliminary goodwill recognized in the acquisition of Company B is $10 million, all of which was assigned to RU1
- From the date of acquisition through 1 October 20X0, the market value of RU1 declined

The assessment of goodwill for impairment as of 1 October 20X0 resulted in Company A recognizing a goodwill impairment charge of $6 million for RU1 leaving a goodwill balance of $12 million. On 1 February 20X1, Company A recognized a qualifying measurement period adjustment that increased the acquisition goodwill by $1 million.

**Analysis**

Company A is required to retrospectively adjust, as of the acquisition date, amounts recognized preliminarily in a business combination. As a result, Company A should update the goodwill impairment test as of 1 October 20X0 to account for the increased goodwill balance. In doing so, Company A should record any resulting adjustment to the previously recognized goodwill impairment charge retrospectively as of 1 October 20X0.

If the qualifying measurement period adjustment reduced the acquisition goodwill by $1 million, Company A would also update its goodwill impairment test as of 1 October 20X0 and record any resulting adjustment to the previously recognized goodwill impairment charge retrospectively as of 1 October 20X0.
3.12.5 Impact on segment disclosure

The requirement to assign all goodwill to reporting units does not mean that goodwill must be added to the measure of reportable segment assets for purposes of reporting segment information in accordance with ASC 280 unless the company actually assigns goodwill for internal reporting purposes. ASC 280 requires disclosure of segment assets based on information provided to the CODM in assessing performance and allocating resources. The requirement to assign all goodwill to reporting units in accordance with ASC 350-20 does not change the ASC 280 disclosure requirement. However, companies must disclose the carrying amount of goodwill along with any changes in that carrying amount by reportable segment. See section 4.3 further discussion.

3.13 Changes in a company's reporting structure

3.13.1 Reorganization

<table>
<thead>
<tr>
<th>Excerpt from Accounting Standards Codification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intangibles – Goodwill and Other – Goodwill</td>
</tr>
<tr>
<td>Subsequent Measurement</td>
</tr>
<tr>
<td>350-20-35-45</td>
</tr>
<tr>
<td>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 350-20-35-39 through 35-40 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 (see paragraphs 350-20-35-51 through 35-57).</td>
</tr>
<tr>
<td>350-20-35-46</td>
</tr>
<tr>
<td>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.</td>
</tr>
</tbody>
</table>

Under ASC 350-20, assets and liabilities and goodwill must be reassigned to reporting units when a company reorganizes its reporting structure such that the composition of one or more of its reporting units is changed. The assets (excluding goodwill) and liabilities of the affected reporting units should be reassigned using the guidance in ASC 350-20-35-39 and 35-40. However, goodwill should be reassigned to the affected reporting units using a relative fair value approach similar to that used when a portion of a reporting unit is disposed of. That is, the goodwill is assigned to the businesses in the reporting units based on their relative fair values and then follows the businesses into the new reporting unit in the reorganization. The FASB concluded that reorganizing a reporting unit is similar to the sale of a business within a reporting unit, and therefore, the same methodology should be used to assign goodwill in a reorganization. To the extent that reporting units are being divided in the reorganization, the relative fair value approach will need to be applied. However, this model is not necessary in cases in which reporting units are merely being combined into a new reporting unit. In this case, we believe that the goodwill of the existing reporting units is simply combined in the new reporting unit.
Illustration 3-15: Goodwill assigned to a new reporting unit

Assume that Company A currently has three reporting units: RU1, RU2, and RU3. Company A reorganizes its reporting structure and transfers portions of RU1, RU2, and RU3 into a newly formed reporting unit, RU4. Relevant amounts per reporting unit are as follows:

<table>
<thead>
<tr>
<th></th>
<th>RU 1</th>
<th>RU 2</th>
<th>RU 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair values</td>
<td>$100</td>
<td>$40</td>
<td>$60</td>
<td>$200</td>
</tr>
<tr>
<td>Goodwill</td>
<td>30</td>
<td>10</td>
<td>20</td>
<td>60</td>
</tr>
<tr>
<td>Fair value of transferred operations</td>
<td>20</td>
<td>10</td>
<td>10</td>
<td>50</td>
</tr>
<tr>
<td>Relative fair value transferred</td>
<td>20%</td>
<td>50%</td>
<td>25%</td>
<td></td>
</tr>
</tbody>
</table>

Analysis:

Because goodwill is required to be assigned based on relative fair value, assignment of goodwill to RU4 is as follows:

<table>
<thead>
<tr>
<th></th>
<th>RU 1</th>
<th>RU 2</th>
<th>RU 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill (prior to reassignment)</td>
<td>$30</td>
<td>$10</td>
<td>$20</td>
<td>$60</td>
</tr>
<tr>
<td>Relative fair value transferred</td>
<td>20%</td>
<td>50%</td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td>Goodwill assigned to RU4</td>
<td>6</td>
<td>5</td>
<td>5</td>
<td>16</td>
</tr>
</tbody>
</table>

The following represents the fair values as well as the beginning and ending goodwill balances for each reporting unit:

<table>
<thead>
<tr>
<th></th>
<th>RU 1</th>
<th>RU 2</th>
<th>RU 3</th>
<th>RU 4</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair values</td>
<td>$80</td>
<td>$20</td>
<td>$45</td>
<td>$55</td>
<td>$200</td>
</tr>
<tr>
<td>Goodwill (prior to reassignment)</td>
<td>$30</td>
<td>$10</td>
<td>$20</td>
<td>$0</td>
<td>$60</td>
</tr>
<tr>
<td>Goodwill assigned to RU4</td>
<td>(6)</td>
<td>(5)</td>
<td>(5)</td>
<td>16</td>
<td>0</td>
</tr>
<tr>
<td>Goodwill (after reassignment)</td>
<td>$24</td>
<td>$5</td>
<td>$15</td>
<td>$16</td>
<td>$60</td>
</tr>
</tbody>
</table>

3.14 Goodwill impairment testing by a subsidiary for standalone reporting

Excerpt from Accounting Standards Codification

Intangibles – Goodwill and Other – Goodwill

Subsequent Measurement

350-20-35-47

Subsidiary goodwill might arise from any of the following:

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

c. Goodwill arising from the business combination in which a subsidiary was acquired that the parent pushed down to the subsidiary’s financial statements.
350-20-35-48

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 (GAAP) shall be accounted for in accordance with this Subtopic. 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 (see paragraph 350-20-35-3C(f)). Only if goodwill of that higher-level reporting unit is impaired would a goodwill impairment loss be recognized at the consolidated level.

350-20-35-49

If testing at the consolidated level leads to an impairment loss, that loss shall be recognized at that level separately from the subsidiary's loss.

ASC 350-20 requires that goodwill reported in separate GAAP financial statements issued by a subsidiary be tested for impairment by the subsidiary. That is, the subsidiary should test all goodwill on its books as if the subsidiary was a stand-alone entity in accordance with the provisions of ASC 350-20. This requirement applies to both public and non-public subsidiaries issuing separate GAAP financial statements. Goodwill at a subsidiary can arise from acquisitions made prior to the company becoming a subsidiary of the parent, from applying push-down accounting when the parent acquired the subsidiary and from acquisitions made after the company became a subsidiary of the parent.

If the subsidiary is required to recognize a goodwill impairment in its stand-alone financial statements, that impairment is not recognized in the parent company's financial statements (i.e., the impairment is not "pushed up" to the higher level of consolidation). The parent company should, however, consider whether a goodwill impairment loss recognized at the subsidiary level indicates that the goodwill of the reporting unit or units in which the subsidiary resides should be tested. That is, if the impairment of goodwill at the subsidiary level indicates that it is more likely than not that the fair value of the affected reporting unit(s) is below their carrying amount, the goodwill in that reporting unit(s) should be tested for impairment. If the impairment test of reporting unit goodwill at the consolidated level results in the recognition of an impairment loss, that loss should be recognized in the consolidated financial statements and would not change the amount of goodwill impairment recognized in the subsidiary financial statements. The difference between the impairment loss recognized at the subsidiary level and an impairment loss reported by the consolidated parent, if any, will result in a recurring consolidating adjustment.

Similarly, a goodwill impairment loss recognized by a parent is not “pushed down” to the subsidiary. Rather, the subsidiary will apply ASC 350-20 in its own stand-alone financial statements. However, if the parent recognizes a goodwill impairment loss in the reporting unit(s) that includes a separate reporting subsidiary, that subsidiary should consider if a goodwill impairment indicator exists with respect to its goodwill.
### Disposal of all or a portion of a reporting unit

<table>
<thead>
<tr>
<th>Excerpt from Accounting Standards Codification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intangibles – Goodwill and Other – Goodwill</td>
</tr>
<tr>
<td><strong>Subsequent Measurement</strong></td>
</tr>
<tr>
<td>350-20-35-51</td>
</tr>
<tr>
<td>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.</td>
</tr>
<tr>
<td>350-20-35-52</td>
</tr>
<tr>
<td>When a portion of a reporting unit that constitutes a business (see Section 805-10-55) 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.</td>
</tr>
<tr>
<td>350-20-35-53</td>
</tr>
<tr>
<td>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.</td>
</tr>
<tr>
<td>350-20-35-54</td>
</tr>
<tr>
<td>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.</td>
</tr>
<tr>
<td>350-20-35-55</td>
</tr>
<tr>
<td>That situation might occur when the acquired business is operated as a standalone entity or when the business is to be disposed of shortly after it is acquired.</td>
</tr>
<tr>
<td>350-20-35-56</td>
</tr>
<tr>
<td>Situations in which the acquired business is operated as a standalone entity are expected to be infrequent because some amount of integration generally occurs after an acquisition.</td>
</tr>
<tr>
<td>350-20-35-57</td>
</tr>
<tr>
<td>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 350-20-35-3A through 35-19 using its adjusted carrying amount.</td>
</tr>
</tbody>
</table>

The goodwill of a reporting unit that is to be disposed of in its entirety should be included as part of the carrying amount of the net assets to be disposed of in determining the gain or loss on disposal. When some but not all of a reporting unit is disposed of, some of the goodwill of the reporting unit should be assigned to the portion of the reporting unit being disposed of, if that portion constitutes a business. ASC 805 provides guidance in determining whether a group of assets constitutes a business.

The assignment of goodwill should be based on the relative fair values of the portion of the reporting unit being disposed of (i.e., the business) and the portion of the reporting unit remaining. This approach requires a determination of the fair value of both the business to be disposed of and the business (or businesses) within the reporting unit that will be retained. Following the assignment, the goodwill of the remaining reporting unit should be tested for impairment even though it may be between annual impairment test dates.
This relative fair value approach should not be used when the business to be disposed of was never integrated into the reporting unit after its acquisition (e.g., a business operated as a stand-alone business or a business that is to be disposed of shortly after acquisition). In that case, the current carrying amount of the acquired goodwill should be included in the carrying amount of the business to be disposed of because the rest of the reporting unit never realized the benefits of the acquired goodwill. The FASB notes that it believes this situation would be rare because some amount of integration usually follows an acquisition.

An issue arises when a business or reporting unit is disposed of that includes the net assets and operations of a prior acquisition, but a portion of the goodwill arising from that acquisition (i.e., the synergistic goodwill) had been assigned to a reporting unit that was not disposed of. In that scenario, part of the cost basis of that prior acquisition remains recorded as goodwill in the reporting unit retained even though all of the operations and net assets of that prior acquisition were disposed. In this case, we believe that the company should consider whether the reporting unit to which that synergistic goodwill was assigned has experienced a goodwill impairment indicator because the benefit that gave rise to the assignment of goodwill is now disposed of.

3.15.1 Change in parent’s ownership interest results in loss of control

Under ASC 810-10, when a company that has a controlling interest loses control either through a sale of its interest or other means described in that guidance, the company derecognizes the assets and liabilities of the company, including goodwill. The carrying amount of the net assets of the company being derecognized, including goodwill, is used in computing the gain or loss on sale. The goodwill derecognized is no longer assigned to a reporting unit for purposes of impairment testing.

3.15.2 Assigning goodwill to a business transferred in a common control transaction

Often, an entity will transfer a business to another entity (receiving entity) in a common control transaction. If the transferred business is part of a larger reporting unit at the consolidated entity level and the parent has not previously pushed down the goodwill to the transferred business, questions arise in practice regarding the amount of goodwill that should be assigned to the transferred business.

Depending on the facts and circumstances, we believe the following two options may be used to assign goodwill to the transferred business:

1. The first option is similar to that described in section 3.15, which requires that the goodwill of the reporting unit be assigned to the transferred business based on the relative fair values of the retained portion of the reporting unit and the transferred business on the date of transfer.

2. The second option is to apply the historical cost approach using the guidance in ASC 805-50-30-5 and assign the specifically identified goodwill value from the original acquisition of the transferred business.

The receiving entity in the common control transaction will record the transferred goodwill at the ultimate parent’s historical cost in accordance with ASC 805-50-30-5, potentially resulting in a difference between the goodwill assigned to the transferred business and the goodwill recorded by the receiving entity.

Companies should determine the appropriate assignment method based on the specific facts and circumstances. As discussed above, the remaining goodwill is tested for impairment under ASC 350-20.

3.15.3 Assignment of goodwill in a spin-off

3.15.3.1 Accounting by parent

When an entity spins-off a reporting unit(s) or a component(s) of a reporting unit that constitutes a business as defined under ASC 805, goodwill of the reporting unit should be assigned to the business being spun-off. That is, any goodwill assigned to the business being spun-off would be derecognized from the parent’s balance sheet. Goodwill should be assigned to the business being spun-off using the relative fair value approach discussed in section 3.15.
3.15.3.2 Accounting by spun-off entity

Goodwill recognized in the spin-off entity’s balance sheet may differ from the amount assigned by the parent based on the relative assignment process. While the parent’s accounting follows the relative fair value approach, the stand-alone financial statements of the spin-off entity has to account for goodwill using a “historical goodwill concept”. Under this concept, any acquisition-specific goodwill related to a previous acquisition of an entity that would be included in the spin-off would be presented in the stand-alone financial statements of the business being spun-off. The stand-alone entity would be required to identify its reporting units and perform a goodwill impairment test for all prior periods. The goodwill impairment test at the stand-alone level may yield an impairment charge that was not required to be recognized at the parent level.

Illustration 3-16: Assignment of goodwill in a spin-off

On 1 January 20X8 Company A acquires Company B for consideration transferred of $200 million. The fair value of the identifiable net assets acquired is $160 million and goodwill is $40 million. Company B will be placed in reporting unit RU3. RU3 also includes the net assets ($100) and goodwill ($20) of Company C, which was acquired by Company A on 1 January 20X6. As part of the Company B acquisition, Company A’s two other reporting units (RU1 and RU2) are expected to benefit from the synergies of the combination. As such, Company A assigns goodwill of $30 to RU3, $6 to RU2 and $4 to RU3. Assume that prior to the acquisition, RU1 and RU2 had no goodwill recorded. In addition, none of the acquired assets and assumed liabilities was assigned to RU1 or RU2.

<table>
<thead>
<tr>
<th></th>
<th>RU 1</th>
<th>RU 2</th>
<th>RU 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net assets (excluding goodwill)</td>
<td>$60</td>
<td>$50</td>
<td>$260$1</td>
<td>$370</td>
</tr>
<tr>
<td>Goodwill</td>
<td>6</td>
<td>4</td>
<td>50$2</td>
<td>60</td>
</tr>
<tr>
<td>Total net assets</td>
<td>$66</td>
<td>$54</td>
<td>$310</td>
<td>$430</td>
</tr>
</tbody>
</table>

On 1 January 20X1, Company A decides to spinoff Company B. As of 1 January 20X1, the fair value of RU3 was $350 ($245 related to Company B and $105 related to Company C).

Analysis

Accounting by parent

In determining the amount of goodwill to derecognize, Company A should use the relative fair value approach. As such, Company A should derecognize goodwill of $35 (($245/$350) x $50) associated with the spin-off of Company B. Note that none of the goodwill assigned to RU1 and RU2 is considered in determining the amount of goodwill to derecognize. The remaining goodwill balance in RU3 should be tested for impairment in accordance in ASC 350-20-35-57.

Accounting by spun-off entity (Company B)

The stand-alone financial statements of the spun-off entity (Company B) would include goodwill of $40 million. Because Company B has to account for the goodwill using the historical goodwill concept, the $40 acquisition-specific goodwill related to Company A’s acquisition of Company B on 1 January 20X8 would be presented in the stand-alone financial statements of Company B.

1 Company B’s net assets (excluding goodwill) of $160 plus Company C’s net assets (excluding goodwill) of $100.
2 Company B’s goodwill of $30 ($40 less $10 assigned to RU1 and RU2) plus Company C’s goodwill of $20.
3.16 **Goodwill impairment testing when a noncontrolling interest exists**

**Excerpt from Accounting Standards Codification**

<table>
<thead>
<tr>
<th>Intangibles – Goodwill and Other – Goodwill</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subsequent Measurement</td>
</tr>
<tr>
<td>350-20-35-57A</td>
</tr>
<tr>
<td>If a reporting unit is less than wholly owned, the fair value of the reporting unit and the implied fair value of goodwill shall be determined in the same manner as it would be determined in a business combination accounted for in accordance with Topic 805 or an acquisition accounted for in accordance with Subtopic 958-805. Any impairment loss measured in the second step of the goodwill impairment test shall be attributed to the parent and the noncontrolling interest on a rational basis. If the reporting unit includes only goodwill attributable to the parent, the goodwill impairment loss would be attributed entirely to the parent. However, if the reporting unit includes goodwill attributable to both the parent and the noncontrolling interest, the goodwill impairment loss shall be attributed to both the parent and the noncontrolling interest.</td>
</tr>
<tr>
<td>350-20-35-57B</td>
</tr>
<tr>
<td>If all or a portion of a less-than-wholly-owned reporting unit is disposed of, the gain or loss on disposal shall be attributed to the parent and the noncontrolling interest.</td>
</tr>
</tbody>
</table>

Under ASC 805, when a company initially acquires a controlling, but less than 100%, interest in another company, the acquiring company recognizes the assets acquired, liabilities assumed and any noncontrolling interest at fair value (with limited exception) and recognizes goodwill to the extent that the consideration transferred exceeds amounts assigned to the net identifiable assets acquired.

If a reporting unit is less than wholly-owned, the fair value of the reporting unit and the implied fair value of its goodwill shall be determined in the same manner as it would be determined in a business combination pursuant to ASC 805. Any goodwill impairment that results from applying step two of the goodwill impairment model should be attributed to the controlling and noncontrolling interests on a rational basis.

While the allocation of earnings to the controlling and noncontrolling interests will often be as straightforward as multiplying earnings by the relative ownership percentages, that approach will not be appropriate for allocating goodwill impairment. Particular care must be taken when a premium is paid to obtain control of an entity. And, as a result, the controlling and noncontrolling interests’ bases in acquired goodwill will not be proportional to ownership interests because the control premium is allocated only to the controlling interest.

The following is an example of allocating a goodwill impairment charge between a controlling and noncontrolling interest:
Illustration 3-17: Allocation of a goodwill impairment charge to the noncontrolling interest

XYZ Corp acquires 90% of the equity interest in ABC Corp for $400 million. XYZ Corp determines the fair value of the noncontrolling interest of ABC Corp is $40 million. The fair value of the identifiable net assets determined under ASC 805 is $300 million. XYZ Corp determined that ABC Corp should be in a new reporting unit because ABC Corp is not economically similar to any of its other reporting units. On the acquisition-date, the following was determined:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of consideration transferred</td>
<td>$400</td>
</tr>
<tr>
<td>Fair value of noncontrolling interest</td>
<td>40</td>
</tr>
<tr>
<td>Total fair value</td>
<td>440</td>
</tr>
<tr>
<td>Fair value of identifiable net assets</td>
<td>(300)</td>
</tr>
<tr>
<td>Goodwill recognized</td>
<td>140</td>
</tr>
<tr>
<td>Goodwill attributable to controlling interest</td>
<td>130</td>
</tr>
<tr>
<td>Goodwill attributable to noncontrolling interest</td>
<td>10</td>
</tr>
<tr>
<td>1 The fair value of the noncontrolling interest was determined by subtracting the consideration transferred by XYZ Corp from the total fair value of ABC Corp. Note that the fair value of the noncontrolling interest is not proportionate to the ownership interest because of the control premium paid by XYZ Corp.</td>
<td></td>
</tr>
<tr>
<td>2 The goodwill of $130 attributable to the controlling interest is calculated as follows: (($400) - (90% x $300)).</td>
<td></td>
</tr>
<tr>
<td>3 The goodwill of $10 attributable to the noncontrolling interest is calculated as follows: (($40) - (10% x $300)).</td>
<td></td>
</tr>
</tbody>
</table>

One year after the acquisition, a new company opened for business that directly competes with the newly acquired reporting unit of XYZ Corp. Due to this new competition, revenues of the newly formed reporting unit declined. As a result, the fair value of the reporting unit falls to $380 million. For this example, assume no indicators of impairment were evident prior to XYZ Corp's annual assessment. In addition, no other impairment under ASC 360-10 is required to be recognized. The effects of taxes have been ignored.

Test for impairment

<table>
<thead>
<tr>
<th>Step 1:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of reporting unit</td>
</tr>
<tr>
<td>Carrying amount of reporting unit</td>
</tr>
<tr>
<td>Passed / (Failed)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Step 2:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of reporting unit</td>
</tr>
<tr>
<td>Fair value of 100% identifiable net assets</td>
</tr>
<tr>
<td>Implied goodwill</td>
</tr>
<tr>
<td>Carrying amount of goodwill</td>
</tr>
<tr>
<td>Impairment loss</td>
</tr>
<tr>
<td>Goodwill impairment loss attributable to the controlling interest</td>
</tr>
<tr>
<td>Goodwill impairment loss attributable to the noncontrolling interest</td>
</tr>
</tbody>
</table>

1 Step 1 of the goodwill impairment test failed as the carrying amount exceeded the fair value of the reporting unit.  
2 The impairment loss is attributed based on the relative interest of the goodwill on the acquisition date. The goodwill impairment loss of $56 attributable to the controlling interest is calculated as follows: [($130/$140) x $60].  
3 The impairment loss is attributed based on the relative interest of the goodwill on the acquisition date. The goodwill impairment loss of $4 attributable to the noncontrolling interest is calculated as follows: [($10/$140) x $60].
3.16.1 Goodwill generated prior to the effective date of the guidance in ASC 810

If a reporting unit includes goodwill that is attributable only to a parent’s basis in a partially-owned subsidiary for which acquisition accounting was completed pursuant to Statement 141, any goodwill impairment charge (whether recognized before or after the provisions of ASC 810 are adopted) would be attributed entirely to the parent.

Because a business combination achieved in stages and accounted for under Statement 141 (and APB 16) followed step acquisition accounting (that is, the noncontrolling interest was not initially measured at fair value), it is inappropriate to determine the noncontrolling interest’s basis in any goodwill recognized using its relative ownership in the subsidiary. Given the prohibition on retroactively applying the guidance in ASC 805, the goodwill recognized by the controlling interest should continue to be respected, even after the provisions of ASC 805 and ASC 810 are adopted. This is because the noncontrolling interest does not have a basis in the goodwill arising from acquisitions accounted for under Statement 141 or APB 16, if the goodwill becomes impaired after the provisions of ASC 810 are adopted, the entire impairment charge would be allocated to the controlling interest.

3.16.2 Assignment of goodwill upon change in parent’s ownership interest

ASC 810 requires that changes in a parent’s ownership interest in a subsidiary while the parent retains its controlling financial interest are to be accounted for as equity transactions. Neither gains nor losses on those transactions are recognized in net income, and the carrying amounts of the subsidiary’s assets (including goodwill) and liabilities should not be changed. In accounting for such transactions under ASC 810, the carrying amount of the noncontrolling interest should be increased/decreased to reflect the change in the noncontrolling interest’s ownership in the subsidiary’s net assets (that is, the amount attributed to the additional noncontrolling interests should reflect its proportionate ownership percentage in the subsidiary’s net assets acquired).

For impairment testing purposes goodwill should be reassigned between the controlling and noncontrolling interests based on the changes in ownership interests. See below for an illustration of this concept:

<table>
<thead>
<tr>
<th>Illustration 3-18:</th>
<th>Allocation of a goodwill impairment charge upon change in parent’s ownership interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assume Parent acquires 80% of Subsidiary. The business combination is accounted for under ASC 805 and $100 of goodwill is recognized ($80 attributable to Parent and $20 attributable to the noncontrolling interest, assuming no control premium).</td>
<td></td>
</tr>
</tbody>
</table>

**Analysis**

If Parent acquires an additional 10% interest in Subsidiary, the consolidated amount of goodwill does not change, but the goodwill balance is reassigned between Parent and the noncontrolling interest based on the revised percentage ownership interest (that is, $90 would be attributable to the Parent and $10 attributable to the noncontrolling interest).

3.17 Tax effects of goodwill impairments

See section 11.8 in our FRD, Income taxes for discussion on the tax implications pertaining to the impairment of identifiable intangible assets and goodwill.
3.18 Goodwill related to equity method investments

**Excerpt from Accounting Standards Codification**

<table>
<thead>
<tr>
<th>Intangibles – Goodwill and Other – Goodwill</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Subsequent Measurement</strong></td>
</tr>
<tr>
<td><strong>350-20-35-58</strong></td>
</tr>
<tr>
<td>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 323-10-35-13 (equity method goodwill) shall not be amortized.</td>
</tr>
</tbody>
</table>

**350-20-35-59**

However, equity method goodwill shall not be reviewed for impairment in accordance with this Subtopic. Equity method investments shall continue to be reviewed for impairment in accordance with paragraph 323-10-35-32.

ASC 323-10-35-13 requires that an equity method investor account for the difference between its cost basis in the investee and the investor’s interest in the underlying net book value of the investee as if the investee was a consolidated subsidiary. The portion of the difference between the cost of the investment and the amount of the underlying equity in the net assets of the equity method investee that is recognized as goodwill (referred to as “equity method goodwill”) is no longer amortized under ASC 350-20. The equity method goodwill is the remainder after the allocation of the excess to the underlying net assets (e.g., property, plant and equipment, intangible assets), as in a purchase price allocation. However, the balance of equity method goodwill shall not be tested for impairment under the provisions of ASC 350-20. Instead, the carrying amount of the investment should continue to be tested for impairment in accordance with ASC 323-10-35-32. The FASB concluded that goodwill associated with equity method investments should be accounted for in the same manner as goodwill arising from a business combination. The FASB also reasoned, however, that because the equity method goodwill is not separable from the related investment, that goodwill should not be tested for impairment under ASC 350-20.

When applying ASC 323, the equity investment as a whole is reviewed for impairment and not the underlying net assets or goodwill.

Goodwill on the investee’s balance sheet is subjected to the ASC 350-20 requirements in the investee’s separate financial statements. However, a question arises whether an equity method investor should recognize its portion of an equity method investee’s goodwill impairment charge or not (i.e., whether goodwill impairment charges are “flowed through” or treated in the same manner as goodwill impairment charges recognized by consolidated subsidiaries). We believe that the investor should recognize its share of any impairment losses recognized by the investee. Further, if an equity investee recognizes a goodwill impairment loss, the investor should consider whether its carrying amount of the investee might be impaired. See section E3.4.4 in our Accounting Manual chapter, *Equity method investments* for further discussion.

3.19 Impairment testing for nonpublic entities

**Excerpt from Accounting Standards Codification**

<table>
<thead>
<tr>
<th>Intangibles – Goodwill and Other – Goodwill</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Subsequent Measurement</strong></td>
</tr>
<tr>
<td><strong>350-20-35-60</strong></td>
</tr>
<tr>
<td>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—i.e., if in fact that level meets the definition of a reporting unit.</td>
</tr>
</tbody>
</table>
When the FASB originally deliberated Statement 142, and having decided that the determination of reporting units should be linked to segment reporting, it considered whether to make an exception or provide additional guidance for entities that are not required to present segment information. The FASB concluded that although nonpublic entities are not required to follow the segment disclosure requirements now codified in ASC 280, those entities should not be exempt from testing goodwill for impairment at the reporting unit level. The FASB 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.

### 3.20 Goodwill resulting from a subsidiary’s acquisition of an entity

A consolidated subsidiary that acquires another business in a business combination should reflect all of the goodwill resulting from the acquisition in its separate financial statements, regardless of the amount of goodwill that the parent assigns to the reporting unit in which the subsidiary resides.

**Illustration 3-19: Goodwill resulting from an acquisition by a subsidiary**

Assume the operations of Subsidiary A are included, in their entirety, in Reporting Unit 1 of the Parent. Subsidiary A acquires Target and the acquisition results in goodwill of $100 million. The Parent believes that synergies related to the acquisition will benefit both Reporting Unit 1 and Reporting Unit 2 and, therefore, assigns $80 million of the acquired goodwill to Reporting Unit 1 and $20 million to Reporting Unit 2.

**Analysis**

Subsidiary A should recognize $100 million of goodwill in its separate financial statements and assign that goodwill to its reporting units in accordance with ASC 350-20.

### 3.21 Deferred income taxes

**Excerpt from Accounting Standards Codification**

**Intangibles – Goodwill and Other – Goodwill**

**Subsequent Measurement**

350-20-35-61

Paragraph 805-740-25-3 through 25-4 states that deferred income taxes are not recognized for any portion of goodwill for which amortization is not deductible for income tax purposes. For guidance on recognition of deferred income taxes related to goodwill when amortization of goodwill is deductible for tax purposes, see paragraphs 805-740-25-6 through 25-9.

ASC 740 states that deferred taxes are not recognized for any portion of goodwill for which amortization is not deductible for tax purposes. However, deferred taxes are recognized for certain portions of goodwill that are deductible for tax purposes (ASC 805-740-25-8 and 25-9). See our FRD, *Income taxes* for further information on the accounting for tax-deductible goodwill.
4 Financial statement presentation and disclosure requirements

4.1 Financial statement presentation

**Excerpt from Accounting Standards Codification**

<table>
<thead>
<tr>
<th>Intangibles — Goodwill and Other – Goodwill</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Other Presentation Matters</strong></td>
</tr>
<tr>
<td>350-20-45-1</td>
</tr>
<tr>
<td>The aggregate amount of goodwill shall be presented as a separate line item in the statement of financial position.</td>
</tr>
<tr>
<td>350-20-45-2</td>
</tr>
<tr>
<td>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.</td>
</tr>
<tr>
<td>350-20-45-3</td>
</tr>
<tr>
<td>A goodwill impairment loss associated with a discontinued operation shall be included (on a net-of-tax basis) within the results of discontinued operations.</td>
</tr>
</tbody>
</table>

**Presentation of Financial Statements – Discontinued Operations**

<table>
<thead>
<tr>
<th>Relationships</th>
</tr>
</thead>
<tbody>
<tr>
<td>205-20-60-4</td>
</tr>
<tr>
<td>For guidance on reporting a goodwill impairment loss associated with a discontinued operation, see paragraph 350-20-45-3.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Intangibles – Goodwill and Other – General Intangibles Other than Goodwill</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Other Presentation Matters</strong></td>
</tr>
<tr>
<td>350-30-45-1</td>
</tr>
<tr>
<td>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.</td>
</tr>
<tr>
<td>350-30-45-2</td>
</tr>
<tr>
<td>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.</td>
</tr>
<tr>
<td>350-30-45-3</td>
</tr>
<tr>
<td>Paragraphs 350-30-35-9 through 35-12 and 350-30-35-15 through 35-17 require that an intangible asset be tested for impairment when it is determined that the asset shall no longer be amortized or shall 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.</td>
</tr>
</tbody>
</table>
4.1.1 Balance sheet presentation

ASC 350 requires that the aggregate amount of goodwill be presented as a separate line item in the balance sheet. In deliberating Statement 142, the FASB concluded that goodwill was sufficiently different from other assets to require that it be displayed separately on the balance sheet.

ASC 350 also requires that, at a minimum, the aggregate balance of intangible assets (excluding goodwill) be shown as a separate line item on the balance sheet. This does not preclude the presentation of individual intangible assets or classes of intangible assets as separate line items. In addition, Regulation S-X, Rule 5-02 requires separate presentation in the balance sheet of each class of intangible asset that is in excess of five percent of total assets.

Companies should continue to appropriately classify intangible assets as either current or non-current as required by ASC 210. We believe that there will be limited circumstances in which an intangible asset will be classified as current (e.g., a production backlog that will be completed and delivered within one year). Additionally, we believe that the practice of reclassifying the amount of the coming year’s amortization of an intangible asset to current assets is inappropriate.

4.1.2 Income statement presentation

Goodwill impairment losses should 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 should be included within the results of discontinued operations. Any portion of goodwill assigned to net assets disposed of (as discussed in Chapter 3) should be recognized as part of the gain or loss on disposal of those assets and not with other goodwill impairment losses.

The amortization expense related to intangible assets being amortized and any impairment loss related to intangible assets should be presented within continuing operations in the income statement line items deemed appropriate for the reporting company. Amortization expense is not required to, but may be, separately reported on the face of the income statement. Alternatively, amortization expense may be included in the income statement line item to which it relates. If the underlying intangible asset is used in the operations of the company, we believe that the related amortization expense should be included in the determination of operating income. If not reported separately in the income statement, total amortization expense for the period is required to be disclosed in the notes to the financial statements.

4.2 Disclosure requirements

4.2.1 Intangible asset disclosures in period of acquisition

**Excerpt from Accounting Standards Codification**

**Intangibles – Goodwill and Other – General Intangibles Other than Goodwill**

**Disclosure**

350-30-50-1

For intangible assets acquired either individually or as part of a group of assets (in either an asset acquisition, a business combination, or an acquisition by a not-for-profit entity), all of the following information shall be disclosed in the notes to financial statements in the period of acquisition:

a. For intangible assets subject to amortization, all of the following:

   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 in a transaction other than a business combination or an acquisition by a not-for-profit entity and written off in the period and the line item in the income statement in which the amounts written off are aggregated.

d. For intangible assets with renewal or extension terms, the weighted-average period before the next renewal or extension (both explicit and implicit), by major intangible asset class.

This information also shall be disclosed separately for each material business combination or acquisition by a not-for-profit entity or in the aggregate for individually immaterial business combinations or acquisitions by a not-for-profit entity that are material collectively if the aggregate fair values of intangible assets acquired, other than goodwill, are significant.

4.2.2

Goodwill

**Excerpt from Accounting Standards Codification**

**Intangibles – Goodwill and Other – Goodwill**

**Disclosure**

350-20-50-1

The changes in the carrying amount of goodwill during the period shall be disclosed, showing separately (see Example 3 [paragraph 350-20-55-24]):

a. The gross amount and accumulated impairment losses at the beginning of the period

b. Additional goodwill recognized during the period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with paragraph 360-10-45-9

c. Adjustments resulting from the subsequent recognition of deferred tax assets during the period in accordance with paragraphs 805-740-25-2 through 25-4 and 805-740-45-2

d. Goodwill included in a disposal group classified as held for sale in accordance with paragraph 360-10-45-9 and goodwill derecognized during the period without having previously been reported in a disposal group classified as held for sale

e. Impairment losses recognized during the period in accordance with this Subtopic

f. Net exchange differences arising during the period in accordance with Topic 830

g. Any other changes in the carrying amounts during the period

h. The gross amount and accumulated impairment losses at the end of the period.

Entities that report segment information in accordance with Topic 280 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.
A reconciliation of the carrying amount of goodwill at the beginning of the period to the carrying amount at the end of the period is required. This disclosure requirement has been modified to include the gross amount and any accumulated impairment losses at the beginning of the period. This requirement, in fact, indicates that beginning goodwill should be shown gross, net of any previous impairments, and should represent the gross goodwill acquired in a previous business combination.

### Intangible assets other than goodwill

#### Excerpt from Accounting Standards Codification

**Intangibles – Goodwill and Other – General Intangibles Other than Goodwill**

**Disclosure**

350-30-50-2

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

- **a.** For intangible assets subject to amortization, all of the following:
  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 entity’s accounting policy on the treatment of costs incurred to renew or extend the term of a recognized intangible asset

- **d.** For intangible assets that have been renewed or extended in the period for which a statement of financial position is presented, both of the following:
  1. For entities that capitalize renewal or extension costs, the total amount of costs incurred in the period to renew or extend the term of a recognized intangible asset, by major intangible asset class
  2. The weighted-average period before the next renewal or extension (both explicit and implicit), by major intangible asset class.

350-30-50-4

For a recognized intangible asset, an entity shall disclose information that enables users of financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity’s intent or ability (or both intent and ability) to renew or extend the arrangement.
Disclosures surrounding impairment

Impairment of goodwill

Excerpt from Accounting Standards Codification

Intangibles – Goodwill and Other – Goodwill

Disclosure

350-20-50-2

For each goodwill impairment loss recognized, all of 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 or nonprofit activities, 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 (see paragraphs 350-20-35-18 through 35-19), that fact and the reasons therefore and, in subsequent periods, the nature and amount of any significant adjustments made to the initial estimate of the impairment loss.

350-20-50-3

The quantitative disclosures about significant unobservable inputs used in fair value measurements categorized within Level 3 of the fair value hierarchy required by paragraph 820-10-50-2(bbb) are not required for fair value measurements related to the financial accounting and reporting for goodwill after its initial recognition in a business combination.

SEC observations relating to goodwill impairment analysis and disclosures

The SEC staff frequently asks for supplemental information including:

- Details of the goodwill impairment analysis for each reporting unit, including how reporting units are identified and how assets, liabilities and goodwill are assigned to reporting units

- Sensitivity analyses regarding material assumptions used in assessing recoverability of goodwill, and how changes in those assumptions might affect the outcome of the goodwill impairment test

- Details of the company’s analysis of events that occurred since the latest annual goodwill impairment assessment and whether those events suggest that the fair value of a reporting unit is less than its carrying amount

- The reconciliation of the aggregate fair values of the reporting units to the registrant’s market capitalization (see section 3.3.1 for further information)

- The type of events that could result in a future goodwill impairment
In addition, the SEC staff often asks registrants to provide more robust disclosures of accounting policies for goodwill impairments and the actual details of any recognized goodwill impairments. These comments have asked for more discussion of:

- The accounting policies relating to the goodwill impairment tests, including when the two-step impairment test is performed, identification of reporting units and how goodwill is assigned to reporting units, and how the implied fair value of goodwill is derived in the second step
- The facts and circumstances leading to an impairment
- How the fair value of each reporting was estimated and the significant assumptions and estimates used in its determination of the fair value of reporting units
- Reporting units with material amounts of goodwill that is “at risk” (i.e., there is a reasonable possibility that the reporting unit might fail a future Step 1 impairment test)

Registrants should provide robust disclosures that satisfy the requirements of ASC 350-20-50-2. When the SEC staff believes that the factors resulting in a goodwill impairment have not been satisfactorily disclosed, the SEC staff frequently requests additional information as to the factors and circumstances leading to the impairment.

Even if no impairment is identified in a particular reporting period, registrants should disclose their accounting policy related to goodwill impairment testing. The SEC staff frequently issues comments when these disclosure requirements are not met or the disclosures are not clear and meaningful. At a minimum, the disclosures should include:

- The annual assessment date and a description of when an interim test is required (e.g. whenever events or circumstances make it more likely than not that an impairment may have occurred, such as a significant adverse change in the business climate or a decision to sell or dispose of the reporting unit).
- A description of how the estimated fair value of a reporting unit is determined and the significant assumptions used in that analysis.

Although detailed information such as the fair value or carrying amount of reporting units is not required by GAAP, the SEC believes that meaningful information about the potential for a future goodwill impairment should be included in MD&A. The SEC staff frequently asks registrants to provide in MD&A disclosures about the possible future impairment of goodwill. For each reporting unit that may have a material amount of goodwill “at risk”, the SEC staff expects a registrant’s MD&A to disclose:

- The percentage by which the fair value of each reporting unit exceeds its carrying amount at the date of the last impairment test
- The amount of goodwill assigned to the reporting unit
- A qualitative discussion of key assumptions that drive the fair value of the reporting unit (i.e., the SEC staff encourages, but does not require, disclosure of the key numerical assumptions or a quantitative sensitivity analysis)
- Uncertainties surrounding key assumptions
- Events that could have a negative effect on the fair value of the reporting unit

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14 If a registrant does not have any reporting units that are at risk of failing the Step 1 goodwill impairment test, that fact should be disclosed in MD&A.
A reporting unit may be “at risk” of failing Step 1 of the impairment test if it had a fair value that is not substantially in excess of its carrying amount at the assessment date. While no bright-lines exist to determine whether or not the fair value was not substantially in excess of the carrying amount and thus a reporting unit’s goodwill is considered at risk, the SEC staff has stated that it expects a registrant to apply judgment when making those disclosures.

4.3.2 Impairment of intangible assets other than goodwill

**Excerpt from Accounting Standards Codification**

Intangibles — Goodwill and Other — General Intangibles Other than Goodwill

*Disclosure*

350-30-50-3

For each impairment loss recognized related to an intangible asset, all of the following information shall be disclosed in the notes to 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 Topic 280.
5 Effective date, transition, and transitional disclosures

5.1 Effective date

The guidance in ASC 350 is effective for fiscal years beginning after 15 December 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.

The guidance included in ASU 2011-08 on performing a qualitative assessment to test goodwill for impairment (discussed in section 3.1.1.1) is effective for fiscal years beginning after 15 December 2011. Early adoption is permitted.

5.2 Not-for-profit entities

When ASC 958 was issued, it amended ASC 350 to make it applicable to not-for-profit entities. Therefore, goodwill and indefinite-lived intangible assets previously recognized by not-profit-entities are no longer amortized; rather, they are now subject to an impairment test at least annually, as is the case for for-profit entities.

ASC 958 must be applied prospectively to mergers for which the merger date is on or after the beginning of an initial reporting period beginning on or after 15 December 2009 and to acquisitions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 15 December 2009.

5.3 Mutual entities

ASC 805 provides transition guidance for mutual entities with goodwill or intangible assets acquired in business combinations accounted for using the purchase method under APB 16 or Statement 72. The transition guidance in ASC 805 is similar to that in Statement 141 and Statement 147.

Upon the adoption of the guidance in ASC 805, mutual entities should evaluate the unamortized balances of intangible assets recognized in a business combination completed prior to the effective date of the guidance in ASC 805 (1 January 2009 for calendar year entities) and:

- Reclassify unamortized balances of intangible assets that do not meet the ASC 805 criteria for recognition apart from goodwill into goodwill. For example, any unamortized balance related to a value assigned to an assembled workforce should be reclassified to goodwill.

- Reclassify unamortized balances of intangible assets that meet the ASC 805 criteria for recognition apart from goodwill but that have been aggregated in the goodwill balance for financial reporting purposes as separate identifiable intangible assets.

- If certain identifiable intangible assets are classified on the balance sheet with goodwill because of similar useful lives, those intangible assets should be reclassified and shown separately if they (i) meet the ASC 805 recognition criteria and have been (ii) identified, (iii) separately valued and (iv) separately accounted for in an entity’s general ledger or other accounting records.
Intangibles — Goodwill and other

Illustration 5-1: Core deposit intangible asset group with goodwill and separate accounting records maintained

In recording the acquisition of a bank, the acquiring entity identified the core deposit intangible (CDI) asset as an acquired intangible asset, estimated its fair value at the date of acquisition, determined its useful life and recognized deferred taxes related to that asset. The acquiring entity combined the CDI asset and goodwill into a single amount for external reporting purposes and the total amount was recorded in a single account in the general ledger account labeled “goodwill and other intangible assets.” However, separate subsidiary ledgers (in the form of spreadsheets) were maintained for goodwill and for the CDI asset to which periodic amortization and impairment charges were posted.

Analysis

The acquirer should reclassify the carrying amount of the CDI asset to a separate balance sheet account, other than goodwill, as of the adoption date of the guidance in ASC 350. The CDI asset meets the recognition criteria in ASC 805, its fair value was measured at the date of acquisition and separate accounting records were maintained for that asset. After the adoption of the guidance in ASC 350, the separate CDI asset should continue to be amortized over its remaining useful life.

Illustration 5-2: Core deposit intangible asset group with goodwill and separate accounting records were not maintained

Assume the same facts as in Illustration 5-1, except that the acquiring entity decided to recognize the CDI asset and goodwill as a single asset labeled goodwill on the balance sheet and to amortize the combined asset over its estimated composite useful life of 15 years. The acquiring entity reasonably concluded that the financial reporting results produced by amortizing the combined amount recognized as goodwill over its composite useful life would not be materially different from the results that would have been produced had the CDI asset been recognized and accounted for separately from goodwill. At the date the combination was completed, the acquiring entity recorded the amounts assigned to goodwill and to the CDI asset in a single general ledger account. In subsequent periods, accounting records were maintained only for the combined asset. The acquiring entity has, however, retained in its accounting records supporting the initial recording of the business combination that includes information about the estimated fair value of the acquired CDI asset and its useful life.

Analysis

The acquiring entity cannot change the amount of the purchase price assigned to goodwill because, in this case, while the acquirer had identified and estimated the fair value of the CDI asset at the date the business combination was initially recorded, separate accounting records (such as a separate general ledger account or spreadsheet) were not maintained for that asset.

5.3.1 Transitional intangible asset impairment testing for mutual entities

The guidance in ASC 805 requires that mutual entities perform a transitional goodwill impairment test of all goodwill and that this test should be completed within the first year of adoption. Mutual entities are required to complete Step 1 (determining and comparing the fair value of the reporting unit’s carrying amount) of the transitional impairment test within six months of adopting the guidance in ASC 350. If Step 1 of the goodwill impairment test is failed in any of the reporting units, thereby indicating a potential impairment, the entity should complete Step 2 of the test for that reporting unit as soon as possible, but no later than the end of the fiscal year of adopting the guidance in ASC 350.
If Step 1 of the transitional goodwill impairment test has been completed and it is necessary for the entity to complete Step 2, the entity should disclose in its interim period financial statements the reportable segment or segments that might recognize a goodwill impairment loss and the period in which the potential loss will be measured.

An impairment loss recognized because of the transitional impairment test should be recognized as the cumulative effect of a change in accounting principle. Conversely, an impairment loss that does not result from the transitional impairment test should be reflected as a separate line item on the income statement within continuing operations on a pretax basis.

Mutual entities should perform Step 1 of the goodwill impairment test for each reporting unit that is assigned a material amount of goodwill. When evaluating materiality, entities should consider whether a complete impairment of that assigned goodwill in any period (interim or annual) could be material to the financial statements of that period. In some cases, it may be obvious that the fair value of the reporting unit far exceeds its carrying amount. In those instances, the level of rigor in estimating the fair value of the reporting unit may be less than if such a difference is not apparent.

To the extent that the fair value of a reporting unit does not obviously far exceed its carrying amount, we encourage entities to perform a thorough transitional impairment test. This is to ensure that any impairment loss related to the adoption of the guidance in ASC 350 is appropriately recognized as the cumulative effect of a change in accounting principle and to ensure that the entity has a “feel” for the amount of any cushion (i.e., excess of the reporting unit’s fair value over its carrying amount) in each reporting unit.

In addition to completing the transitional goodwill impairment test, a mutual entity must also perform the first of the annual goodwill impairment tests for each reporting unit in the year that it adopts the guidance in ASC 350. Thus, a mutual entity will need to perform the impairment test twice in the year of adoption. The annual goodwill impairment test can be performed at any time during the year as long as that measurement date is used consistently going forward. The transitional goodwill impairment test may not be considered the first year’s annual goodwill impairment test unless the entity designates the beginning of its fiscal year as the date for its annual impairment test.
A Summary of important changes

The following highlights important changes to this Financial reporting developments publication since the December 2011 edition:

Chapter 3: Subsequent accounting for goodwill

› Section 3.4 was updated to include an excerpt from the ASC on considerations of when to include cumulative translation adjustment in goodwill impairment test.
## Differences between US GAAP and IFRS

<table>
<thead>
<tr>
<th>Guidance</th>
<th>US GAAP</th>
<th>IFRS</th>
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</table>
| Subsequent accounting for intangible assets | Intangible assets are subsequently accounted for at cost, less accumulated amortization and any impairment losses. | Intangible assets are subsequently accounted for at:  
  - Cost less accumulated amortization and any impairment losses; or  
  - Fair value (if an active market exists) less accumulated amortization and any impairment loss (referred to as the revaluation model). |
| Level of assessment and recognition and measurement of an impairment loss – indefinite-lived intangible assets | **Level of Assessment for Impairment Testing**  
Indefinite-lived intangible assets separately recognized should be assessed for impairment individually unless they operate in concert with other indefinite-lived intangible assets as a single asset (i.e., the indefinite-lived intangible assets are essentially inseparable).  
Indefinite-lived intangible assets may not be combined with other assets (e.g., finite-lived intangible assets or goodwill) for purposes of an impairment test.  
**Recognition and Measurement of an Impairment Loss**  
An impairment loss is recognized for the excess of the carrying amount of the indefinite-lived intangible asset over its fair value. | **Level of Assessment for Impairment Testing**  
If the indefinite-lived intangible asset does not generate cash flows that are largely independent of those from other assets or groups of assets, then the indefinite-lived intangible asset should be tested for impairment as part of the cash generating unit (CGU) to which it belongs, unless certain conditions are met.  
**Recognition and Measurement of an Impairment Loss**  
An impairment loss is recognized for the excess of the carrying amount of the indefinite-lived intangible asset over its recoverable amount (higher of fair value less costs to sell and value in use). |
| Acquisition of an assembled workforce in an asset acquisition | An assembled workforce that is acquired as part of an asset acquisition should be recognized as an intangible asset. For intangible assets that are acquired individually or within a group of assets, the FASB observed that the asset recognition criteria in Concepts Statement 5 are met even though the contractual-legal criterion or separability criterion has not been met.  
ASC 805 precludes the recognition of an assembled workforce in a business combination. | An assembled workforce that is acquired as part of an asset acquisition generally is not recognized as an intangible asset because the entity usually has insufficient control over the expected future economic benefits of that assembled workforce.  
IFRS 3(R) precludes the recognition of an assembled workforce as a separate acquired asset in a business combination. |
<table>
<thead>
<tr>
<th>Guidance</th>
<th>US GAAP</th>
<th>IFRS</th>
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</thead>
<tbody>
<tr>
<td>Assignment of goodwill</td>
<td>Goodwill is assigned to a reporting unit, which is an operating</td>
<td>Goodwill is allocated to a CGU or group of CGUs which represents the</td>
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<td>segment or one level below an operating segment (component).</td>
<td>lowest level within the entity at which goodwill is monitored for</td>
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<td>internal management purposes and cannot be</td>
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<td>larger than an operating segment as defined in IFRS 8, Segment</td>
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<td>Reporting. IAS 36 defines a CGU as the smallest identifiable group of</td>
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<td>assets that generates cash inflows that are largely</td>
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<td>independent of the cash inflows from other assets or group of assets.</td>
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<td>Qualitative impairment evaluation – goodwill</td>
<td>Companies may first assess qualitative factors to determine whether</td>
<td>No similar optional qualitative assessment exists. Each CGU (or</td>
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<td>it is more likely than not that the fair value of a reporting unit</td>
<td>group of CGUs) must be</td>
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<td>is less than its carrying amount. If a company concludes</td>
<td>tested annually for impairment.</td>
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<td>that is the case, it must perform Step 1 of the goodwill impairment</td>
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<td>test. If it concludes otherwise, it can stop.</td>
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<td>Method of determining and calculating</td>
<td>Two-step goodwill impairment test is performed as follows:</td>
<td>One-step goodwill impairment test is performed at the CGU level.</td>
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<tr>
<td>impairment loss – goodwill</td>
<td><strong>Step 1:</strong> The fair value of the reporting unit is compared with its</td>
<td>The CGU's (or group of CGUs) carrying amount, including</td>
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<td>carrying amount. If the carrying amount of the reporting unit</td>
<td>goodwill, is compared to its recoverable amount (higher of fair</td>
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<td>exceeds its fair value, then step 2 is performed to measure the</td>
<td>value less cost to sell and value in use). Value in use is defined</td>
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<td>amount of impairment loss, if any.</td>
<td>as the present value of the future cash flows expected to be</td>
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<td><strong>Step 2:</strong> The goodwill impairment loss is the amount by which the</td>
<td>derived from an asset or CGU. Any impairment loss (amount by which</td>
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<td>carrying amount of the goodwill exceeds the implied fair value of</td>
<td>the CGU’s carrying amount, including goodwill, exceeds its recoverable</td>
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<td>the goodwill determined by assigning the fair value of the</td>
<td>amount) is allocated first to reduce goodwill to zero, then, subject</td>
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<td>reporting unit to all of the assets and liabilities of that unit</td>
<td>to certain limitations, the carrying amount of other assets in the</td>
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<td>(including any unrecognized intangible assets) as if the reporting</td>
<td>CGU are reduced pro rata based on the carrying amount of each asset.</td>
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<td>unit had been acquired in a business combination. The amount of the</td>
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<td>impairment loss is limited to the carrying amount of the goodwill.</td>
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<td>Guidance</td>
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<td>IFRS</td>
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<tr>
<td>Impairment of goodwill recognized in an acquisition of less than 100% of the acquiree</td>
<td>In a business combination, ASC 805 requires entities to measure noncontrolling interest at fair value. When a noncontrolling interest exists in the reporting unit, any goodwill impairment loss is allocated to the controlling and noncontrolling interest on a rational basis.</td>
<td>IFRS 3(R) permits an acquirer to measure the noncontrolling interest components that are present ownership interests and entitle their holders to a proportionate share of the acquiree’s net asset in the event of liquidation either at fair value, including goodwill, or at the noncontrolling interest's proportionate share of the fair value of the acquiree’s identifiable net assets, exclusive of goodwill. All other components of noncontrolling interest are measured at fair value unless another measurement basis is required by IFRS. Noncontrolling interest measured at fair value When a noncontrolling interest exists in the CGU, any goodwill impairment loss is allocated to the controlling and noncontrolling interest either on a rational basis or on the same basis as that on which profit or loss is allocated (generally based on relative ownership interests). Noncontrolling interest measured at its share of the fair value of the acquiree’s net identifiable assets The recoverable amount of the CGU includes goodwill attributable to both the controlling and noncontrolling interests. However, because the entity measured noncontrolling interest at its share of the fair value of the acquiree’s net identifiable assets, the carrying amount of the CGU includes goodwill attributable only to the controlling interest. Therefore, the carrying amount of the goodwill allocated to the CGU is grossed up to include the goodwill attributable to the noncontrolling interest. The adjusted carrying amount of the CGU is then compared to the recoverable amount to determine whether the CGU is impaired. Any goodwill impairment loss is allocated to the controlling and noncontrolling interest either on a rational basis or on the same basis as that on which profit or loss is allocated (generally based on relative ownership interests). However, because goodwill is recognized only to the extent of the controlling interest, only the goodwill impairment loss allocated to the controlling interest is recognized.</td>
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<tr>
<td>Reversal of loss</td>
<td>Reversal of impairment losses not permitted (except for assets held for sale).</td>
<td>Reversal of impairment losses required if recoverable amount increases, except for goodwill.</td>
</tr>
</tbody>
</table>
Examples – Accounting for intangible assets other than goodwill

The following examples are provided in ASC 350-30-55, as amended. Each of the following examples describes an acquired intangible asset, the facts and circumstances surrounding the determination of its useful life, and the subsequent accounting based on that determination. In practice, judgment will be required in making these determinations. The facts and circumstances unique to each acquired intangible asset will need to be considered.

**Illustration C-1: 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 with the best estimate being 18 months.

**Analysis**

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 ASC 360-10.

**Illustration C-2: 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 five 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 five years.

**Analysis**

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 ASC 360-10.
### Illustration C-3: 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.

**Analysis**

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 ASC 360-10.

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### Illustration C-4: 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.

**Analysis**

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 the rules applicable to indefinite-lived intangible assets (i.e., an annual comparison of fair value to carrying amount).

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### Illustration C-5: Acquired broadcast license, no assumed renewal

Assume the same facts as in Illustration C-4, except that 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.

**Analysis**

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 the rules applicable to indefinite-lived intangible assets. 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 ASC 360-10.
Illustration C-6: 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.

Analysis

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 the rules applicable to indefinite-lived intangible assets.

Illustration C-7: 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 provide evidence that the trademarked product will generate cash flows for the acquiring entity for an indefinite period of time.

Analysis

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 the rules applicable to indefinite-lived intangible assets.

Illustration C-8: 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.

Analysis

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 the rules applicable to indefinite-lived intangible assets.
Illustration C-9: 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.

Analysis

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 the rules applicable to indefinite-lived intangible assets. 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 ASC 360-10.

Illustration C-10: Acquired technology license that renews annually

An exclusive, annually renewable technology license with a third party is acquired by an entity that has made significant progress in developing next-generation technology for digital video products. The acquiring entity believes that in two years, after it has completed developing its next-generation products, the acquired technology license will be obsolete because customers will convert to the acquiring entity’s products. Market participants, however, are not as advanced in their development efforts and are not aware of the acquiring entity’s proprietary development efforts. Thus, those market participants would expect the technology license to be obsolete in three years. The acquiring entity determines that the fair value of the technology license utilizing 3 years of cash flows is $10 million, consistent with the highest and best use of the asset by market participants.

Analysis

In ASC 350-30-35-3(d), the acquiring entity would consider its own historical experience in renewing or extending similar arrangements. In this case, the acquiring entity lacks historical experience in renewing or extending similar arrangements. Therefore, it would consider the assumptions that a market participant would use consistent with the highest and best use of the technology license. However, because the acquiring entity expects to use the technology license until it becomes obsolete in two years, it must adjust the market participants’ assumptions for the entity-specific factors in ASC 350-30-35-3, specifically item (a), which requires consideration of the entity’s expected use of the asset. As a result, the technology license would be amortized over a two-year period. The technology license would be reviewed for impairment under ASC 360-10.
Illustration C-11: Acquired customer relationship

An insurance company acquired 50 customer relationships operating under contracts that are renewable annually. The acquiring entity determines that the fair value of the customer relationship asset is $10 million, considering assumptions (including turnover rate) that a market participant would make consistent with the highest and best use of the asset by market participants. An income approach was used to determine the fair value of the acquired customer relationship asset.

Analysis

In applying ASC 350-30-35-3, the acquiring entity would consider its own historical experience in renewing or extending similar customer relationships. In this case, the acquiring entity concludes that its customer relationships are dissimilar to the acquired customer relationships and, therefore, the acquiring entity lacks historical experience in renewing or extending similar arrangements. Accordingly, the acquiring entity considers turnover assumptions that market participants would make about the renewal or extension of the acquired customer relationships or similar arrangements. Without evidence to the contrary, the acquiring entity expects that the acquired customer relationships will be renewed or extended at the same rate as a market participant would expect, and no other factors would indicate a different useful life is appropriate. Thus, absent any other of the entity-specific factors in ASC 350-30-35-3, in determining the useful life for amortization purposes, the entity shall consider the period of expected cash flows used to measure the fair value of the asset. The customer relationships would be reviewed for impairment under ASC 360-10.

Illustration C-12: Trade name held for defensive purposes

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

Analysis

Because Entity A does not intend to actively use the acquired trade name, but intends to hold the rights to the trade name to prevent others from using it, the trade name meets the definition of a defensive intangible asset.
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Annual goodwill assessment date – the date at which a reporting unit performs the annual impairment test as required by ASC 350.

Asset group – the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities (ASC 360-10-15-4).

Business – an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. Additional guidance on what a business consists of is presented in ASC 805-10-55-4 through 55-9.

Common control transactions – transactions in which the entities involved are controlled by the same parent or group of entities.

Component of an operating segment – a component of an operating segment is a reporting unit if the component constitutes a business (as defined in ASC 805) for which discrete financial information is available and segment management (as defined in ASC 280) regularly reviews the operating results of that component (ASC 350-20-35-33 through 35-36). ASC 805-10 includes guidance on determining whether an asset group constitutes a business.

Control premium – the amount an investor will pay to acquire control of a company, typically an amount higher than the current market value of the company. The amount above the market price that the investor offers for the shares is known as the control premium.

Controlling interest – the equity in a subsidiary that is attributable, directly or indirectly, to a controlling shareholder.

Defensive intangible asset – an acquired intangible asset in a situation in which an entity does not intend to actively use the asset but intends to hold (i.e., lock up) the asset to prevent others from obtaining access to the asset.

Deferred tax asset – the deferred tax consequences attributable to deductible temporary differences and carryforwards. A deferred tax asset is measured using the applicable enacted tax rate and provisions of the enacted tax law. A deferred tax asset is reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized (ASC Master Glossary).

Deferred tax liability – the deferred tax consequences attributable to taxable temporary differences. A deferred tax liability is measured using the applicable enacted tax rate and provisions of the enacted tax law (ASC Master Glossary).

Discontinued operations – operations of a business that have been sold, abandoned, or otherwise disposed of. Accounting regulations require that continuing operations be reported separately in the income statement from discontinued operations, and that any gain or loss from the disposal of a segment (an entity whose activities represent a separate major line of business or class of customer) be reported along with the operating results of the discontinued segment.
Discrete financial information — operating segment results for a reporting segment that include income statement data for that segment.

Equity method goodwill — the portion of the difference between the cost of an investment and the amount of underlying equity in net assets of an investee that is recognized as goodwill in an equity method investment. (ASC 350-20-35-58).

Finite life — the useful life of an asset that has legal, regulatory, contractual, competitive, economic or other factors limiting the useful life of the intangible asset to the reporting entity.

Goodwill — an asset representing the future economic benefits arising from other assets acquired in a business combination or an acquisition by a not-for-profit entity that are not individually identified and separately recorded. For ease of reference, this term also includes the immediate charge recognized by not-for-profit entities in accordance with paragraph 958-805-25-29 (ASC Master Glossary).

Implied fair value of goodwill — the fair value of goodwill at the reporting unit level, determined on a residual basis by subtracting the sum of the fair values of individual asset categories (tangible and intangible) from the indicated fair value of the reporting unit.

Income approach15 — the income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts.

Indefinite useful life — the useful life of an asset with no legal, regulatory, contractual, competitive, economic or other factors limiting the useful life of the intangible asset to the reporting entity. The term indefinite does not mean infinite (ASC 350-30-35-1 through 35-3).

Intangible assets — assets (not including financial assets) that lack physical substance. (The term intangible assets is used to refer to intangible assets other than goodwill.) (ASC Master Glossary)

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 (ASC Master Glossary).

Internally developed intangible asset — intangible assets which are not acquired externally as part of a business combination, an acquisition by a not-for-profit entity or other asset acquisition.

15 ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS, revised the definition of the income approach as follows: “Valuation techniques that convert future amounts (for example, cash flows or income and expenses) to a single current (that is, discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.” This revised definition is effective for interim and annual periods beginning after 15 December 2011 for public companies and for annual periods beginning after 15 December 2011 for nonpublic companies. Early adoption is permitted.
Market participant\(^6\) – buyers and sellers in the principal (or most advantageous) market for the asset or liability that are:

- Independent of the reporting entity; that is, they are not related parties
- Knowledgeable, having a reasonable understanding about the asset or liability and the transaction based on all available information, including information that might be obtained through due diligence efforts that are usual and customary
- Able to transact for the asset or liability
- Willing to transact for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so (ASC Master Glossary)

Mutual entity – 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 entities, credit unions, and farm and rural electric cooperatives are examples of mutual entities (ASC Master Glossary).

Noncontrolling interest – the portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. A noncontrolling interest is sometimes called a minority interest (ASC Master Glossary).

Nontaxable transaction – a business combination that results in the acquiree’s tax basis of the acquired assets and liabilities assumed being carried over to the acquirer.

Not-for-profit entity – an entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

- Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
- Operating purposes other than to provide goods or services at a profit
- Absence of ownership interests like those of business entities.
- Entities that clearly fall outside this definition include the following:
  - All investor-owned entities
  - Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans (ASC 958-10-15).

\(^6\) ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS, revised the definition of market participants as follows: “Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

a. They are independent of each other, that is, they are not related parties, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms

b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary

c. They are able to enter into a transaction for the asset or liability

d. They are willing to enter into a transaction for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so.”

This revised definition is effective for interim and annual periods beginning after 15 December 2011 for public companies and for annual periods beginning after 15 December 2011 for nonpublic companies. Early adoption is permitted.
Operating segment – a component of a public entity that has all of the following characteristics:

- It 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 public entity).
- Its operating results are regularly reviewed by the public entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance.
- Its discrete financial information is available (ASC 280-10-50-1).

Reliably determined – a method of amortization can be reliably determined if there is a relatively high level of confidence that a pattern of asset consumption will not deviate significantly from that used in measurement.

Reorganization value – the value attributed to the reconstituted entity, as well as the expected net realizable value of those assets that will be disposed before reconstitution occurs. Therefore, this value is viewed as the fair value of the entity before considering liabilities and approximates the amount a willing buyer would pay for the assets of the entity immediately after the restructuring (ASC Master Glossary).

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 (also known as a component) (ASC Master Glossary).

Research and development – research is planned search or critical investigation aimed at discovery of new knowledge with the hope that such knowledge will be useful in developing a new product or service (referred to as product) or a new process or technique (referred to as process) or in bringing about a significant improvement to an existing product or process. Development is the translation of research findings or other knowledge into a plan or design for a new product or process or for a significant improvement to an existing product or process whether intended for sale or use. It includes the conceptual formulation, design, and testing of product alternatives, construction of prototypes, and operation of pilot plants.

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

Segment management – generally, an operating segment has a segment manager who is directly accountable to and maintains regular contact with the chief operating decision maker to discuss operating activities, financial results, forecasts, or plans for the segment. The term segment manager identifies a function, not necessarily a manager with a specific title (ASC 280-10-50-7 through 50-8).

Subsidiary goodwill – all goodwill recognized by a public or nonpublic subsidiary in its separate financial statements that are prepared in accordance with generally accepted accounting principles (ASC 350-20-35-48).

Taxable transaction – a business combination that results in the tax basis of the acquired assets and liabilities assumed being remeasured at fair value, and thus creating a taxable event.

Unit of account17 – that which is being measured by reference to the level at which an asset or liability is aggregated (or disaggregated) (ASC Master Glossary).

Useful life – the period over which an asset is expected to contribute directly or indirectly to future cash flows (ASC Master Glossary).

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17 ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS, revised the definition of unit of account as follows: “The level at which an asset or liability is aggregated and disaggregated in a Topic for recognition purposes.” This revised definition is effective for interim and annual periods beginning after 15 December 2011 for public companies and for annual periods beginning after 15 December 2011 for nonpublic companies. Early adoption is permitted.
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