Financial reporting developments
Intangibles – Goodwill and other
Accounting Standards Codification 350

Revised November 2009
To our clients and other friends

In June 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (codified primarily in ASC 350 — *Intangibles-Goodwill and Other*) which resulted in significant changes to the accounting for goodwill and other intangible assets. In December 2007, the FASB issued Statement No. 141(R), *Business Combinations* (codified primarily in ASC 805 — *Business Combinations*). The issuance of Statement 141(R) resulted in significant changes to the accounting for business combinations and has further amended the accounting for goodwill and other intangible assets.

In December 2001, we issued the First Edition of our Financial Reporting Developments publication on Goodwill and Other Intangible Assets. In February 2004, we issued the Second Edition of this publication. In August 2009, we issued the Third Edition of this publication to incorporate additional interpretive and implementation guidance issued as well as changes resulting from the issuance of Statement 141(R), FASB Statement No. 157, *Fair Value Measurements* (codified primarily in ASC 820 — *Fair Value Measurements and Disclosures*), FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51* (codified primarily in ASC 810 — *Consolidations*), FASB Statement No. 164, *Not-for-Profit Entities: Mergers and Acquisitions* and FASB Staff Position No. FAS 142-3, *Determination of the Useful Life of Intangible Assets* (codified primarily in ASC 350). We have updated the Third Edition of this publication to include the excerpts from and references to the FASB Accounting Standards Codification.

Ernst & Young professionals are prepared to help you identify and understand the issues related to the accounting for goodwill and other intangible assets.

Ernst & Young LLP

November 2009
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## I1 General provisions

### I1.1 Scope

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<td>Overview and Background</td>
</tr>
<tr>
<td>350-10-05-1</td>
</tr>
<tr>
<td>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. Subtopics 805-20 and 805-30 addresses financial accounting and reporting for goodwill and other intangibles acquired in a business combination at acquisition.</td>
</tr>
<tr>
<td>350-10-05-4</td>
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<tr>
<td>Subtopic 350-20 addresses financial accounting and reporting for goodwill subsequent to its acquisition.</td>
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<tr>
<td>350-10-05-5</td>
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<tr>
<td>Subtopic 350-30 addresses financial accounting and reporting for intangible assets acquired individually or with a group of other assets (but not those acquired in a business combination) at acquisition. It also addresses the financial accounting and reporting for intangible assets, including those acquired in a business combination, after acquisition.</td>
</tr>
<tr>
<td>Scope and Scope Exceptions</td>
</tr>
<tr>
<td>350-10-15-2</td>
</tr>
<tr>
<td>The guidance in the Intangibles—Goodwill and Other Topic applies to all entities, including business entities, mutual entities, and not-for-profit entities (NFPs).</td>
</tr>
<tr>
<td>Intangibles—Goodwill and Other — Goodwill</td>
</tr>
<tr>
<td>Overview and Background</td>
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<tr>
<td>350-20-05-1</td>
</tr>
<tr>
<td>This Subtopic addresses financial accounting and reporting for goodwill subsequent to its acquisition in a business combination and for the cost of internally developing goodwill.</td>
</tr>
<tr>
<td>350-20-05-2</td>
</tr>
<tr>
<td>Subtopic 805-30 addresses financial accounting and reporting for goodwill acquired in a business combination at acquisition.</td>
</tr>
<tr>
<td>350-20-05-3</td>
</tr>
<tr>
<td>While goodwill is an intangible asset, the term intangible asset is used in this Subtopic to refer to an intangible asset other than goodwill.</td>
</tr>
</tbody>
</table>
Scope and Scope Exceptions

350-20-15-2
The guidance in this Subtopic applies to the following transactions and activities:

a. Goodwill that an entity recognizes in accordance with Subtopic 805-30 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]

350-20-15-3
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

350-20-25-2
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

Overview and Background

350-30-05-1
This Subtopic addresses financial accounting and reporting for intangible assets (other than goodwill) acquired individually or with a group of other assets (but not those acquired in a business combination) at acquisition. This Subtopic also addresses financial accounting and reporting for intangible assets acquired in a business combination after their acquisition. Subtopic 805-20 addresses financial accounting and reporting for intangible assets acquired in a business combination at acquisition.

Scope and Scope Exceptions

350-30-15-2
While goodwill is an intangible asset, the term intangible asset is used in this Subtopic to refer to an intangible asset other than goodwill.
The guidance in this Subtopic applies to the following:

a. Intangible assets acquired individually or with a group of other assets (but not those acquired in a business combination)

b. Intangible assets (other than goodwill) that an entity recognizes in accordance with Subtopic 805-10 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.

The guidance in this Subtopic does not apply to the following:

a. [Subparagraph not used]

b. Intangible assets recognized in a combination between not-for-profit entities (NFPs), or arising from the acquisition of a for-profit business entity by an NFP

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, Statement 164 (not yet codified as of the date of this publication) 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 addresses the impairment of goodwill and intangible assets that are not amortized; while ASC 360-10 addresses the impairment of intangible assets that are amortized.
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 respective FRDs.

I1.1.1  Not-for-profit entities

Subsequent to the adoption of Statement 164, not-for-profit entities must apply the guidance in ASC 350. Therefore, goodwill and indefinite-lived intangible assets are no longer amortized; rather, they are now subject to an impairment test at least annually, as is the case for for-profit entities. Statement 164 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 Statement 142 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 value of reporting units to their fair value). If the carrying value 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 value of goodwill) must be performed by the end of the year of adoption.

See Hot Topic entitled “FASB issues Statement 164 on business combinations by not-for-profit entities” for more detailed discussion on the accounting for goodwill and intangible assets recognized in a business combination by not-for-profit entities.

I1.1.2  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 Statement 141(R) (codified primarily in ASC 805), the FASB concluded that business combinations involving only mutual entities are economically similar to combinations between

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\(^1\) 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.
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 I5.3.

See Technical Line entitled “Implications of Statement 141(R) for mutual entities” for more
detailed discussion on the accounting for goodwill and intangible assets recognized in a
business combination by mutual entities.

I1.1.3 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).

I1.2 Initial recognition and measurement of intangible assets

Excerpt from Accounting Standards Codification

<table>
<thead>
<tr>
<th>Intangibles—Goodwill and Other – Overall</th>
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<tr>
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<tr>
<td>350-10-15-3</td>
</tr>
<tr>
<td>The guidance in the Intangibles–Goodwill and Other Topic does not apply to the following transactions and activities:</td>
</tr>
<tr>
<td>a. The accounting at acquisition for intangibles and goodwill acquired in a business combination (for guidance see Topic 805)</td>
</tr>
<tr>
<td>b. [Subparagraph not used]</td>
</tr>
<tr>
<td>c. The accounting at acquisition for intangibles and goodwill acquired in a combination between not-for-profit entities (NFPs) or the acquisition of a for-profit business entity by a NFP.</td>
</tr>
</tbody>
</table>
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
The cost of a group of assets acquired in a transaction other than a business combination shall be allocated to the individual assets acquired based on their relative fair values and shall not give rise to goodwill.

350-30-25-4
Intangible assets that are acquired individually or with a group of assets in a transaction other than a business combination 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) (glossary definition). 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 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 shall be initially measured based on its fair value. The fair value of an intangible asset shall be determined based on the assumptions that market participants would use in pricing the asset. An asset that the entity does not intend to use or intends to use in a way that is not its highest and best use, such as a brand name or a research and development asset, shall nevertheless be measured at its fair value.
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 fair value as determined pursuant to the concepts in ASC 820. This includes assets that the entity does not intend to use or intends to use in a way that is not its highest and best use, such as a brand name or a research and development asset that will be shelved or abandoned after acquisition. The cost\(^2\) of a group of assets not meeting the definition of a business in ASC 805 are allocated to the individual assets based on their relative fair value. The recognition of goodwill is precluded in such asset acquisitions, as goodwill can only be recognized in accounting for 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 and assumed liabilities in the net asset group. See section B2.1 of the Business Combinations FRD for a discussion of the definition of a business and transactions that are considered business combinations. In addition, see Appendix B in our Business Combinations FRD for more detailed discussion on the accounting for asset acquisitions.

I1.3 Internally developed intangible assets

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**Recognition**

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.

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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.
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 and related to an entity as a whole, shall be recognized as an expense when incurred.

ASC 350-30 does not change the accounting for internally developed intangible assets that was provided under APB 17. 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, for example, internally developed software.
I2  Subsequent accounting for intangible assets other than goodwill

I2.1  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 intangible assets (other than goodwill) are acquired (i.e., in a business combination, in an asset acquisition, or internally generated), the accounting treatment after the acquisition date depends on the estimated useful life of those assets 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
contractual period (i.e. the contract period existing at the acquisition date, not considering future renewal periods) of the contract in which the right was granted, irrespective of any existing renewal terms (ASC 805-20-35-2). This may represent a change from previous practice, in which renewals and extensions may have been considered in determining the useful life of a reacquired right.

- 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 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 intends not to use might contribute indirectly to future cash flows (see section I2.4).

Under ASC 350-30, 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 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 maximum 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 discussed in section I2.1.2.

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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.
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).  

The FASB also concluded that if a company performs an analysis of all pertinent factors that should be considered in determining the useful life of an intangible asset, such as those above, and finds that there is no limit on the useful life of an intangible asset, that asset should be deemed to have an indefinite life. That is, 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. Therefore, just because a precise useful life is not known does not mean that the useful life is indefinite (ASC 350-30-35-4).

### I2.1.1 Legal rights

The FASB observed that 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 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.

### I2.1.2 Renewal and extension rights

In April 2008, the FASB issued FSP 142-3 (codified primarily in ASC 350) to assist in the assessment of the useful life of an intangible asset subject to renewal or extension provisions. As a result, ASC 350-30 now 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. That is, 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; however, these assumptions are adjusted for the entity specific factors (consistent with the intended use of the asset by the entity) 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.

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4 As in determining the useful life of depreciable tangible assets, regular maintenance may be assumed but enhancements may not.
Subsequent to the exposure of FSP 142-3, constituents expressed concerns that the guidance in FSP 142-3 may lead to entities inappropriately lengthening useful lives of certain intangible assets. However, the Board believes that the fair value measurement guidance and impairment testing requirements of other applicable GAAP will mitigate concerns related to inappropriately lengthening useful lives.

Examples C1.10 and C1.11 in Appendix C provides examples for determining the useful life of an intangible asset when an entity lacks historical experience.

### I2.1.2.1 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 for amortization purposes, 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 (ASC 350-30-55-1C). 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.

### I2.1.3 Intangible assets acquired prior to the effective date of FSP 142-3

Under FSP 142-3, determining the useful life of a recognized intangible asset must be applied prospectively to intangible assets acquired after the effective date (1 January 2009 for a calendar year company). Accordingly, FSP 142-3 would not serve as a basis to change the useful life of an intangible asset that was acquired prior to its effective date.

### I2.1.4 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 other factors may need to be considered in determining the useful lives of intangible assets, including, at a minimum:

- Uncertain continuity of revenues dependent on retention of key employees,
- The “churn” rate of customers, and
- 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 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.

### 2.1.5 Considerations in determining the useful life of a customer relationship intangible

An acquired intangible asset must be amortized over its useful life, unless the useful life is indefinite (ASC 350-30-35-6). It may be difficult to support an indefinite life, except for certain classes of intangible assets where no legal, regulatory, contractual, competitive, economic, or other factors limit the useful life of an intangible asset to the reporting entity.

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 (ASC 805-20-55-25). 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. 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 12.2.1 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.

### 12.2 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 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. This supersedes APB 17, which established a maximum useful life of 40 years. 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 (except for amounts assigned to intangible assets that are acquired outside of a business combination and to be used in particular research and
development projects that have no alternative future use and are charged to expense in the period acquired in accordance with ASC 730).\(^5\)

**I2.2.1 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.

If the useful life of an intangible asset is finite, the intangible asset should be amortized over its useful life using a method of amortization that reflects the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up (ASC 350-30-35-6). If that pattern cannot be “reliably determined”, then companies should use the straight-line method. 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\(^6\) 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.

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

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\(^5\) The EITF is currently discussing the accounting for IPR&D assets acquired outside of a business combination in EITF 09-2. As of the date of this publication, the EITF has not reached a consensus-for-exposure on EITF 09-2. Until a final consensus is reached and ratified by the FASB, the tentative conclusions reached in EITF 09-2 should not be considered authoritative.

\(^6\) 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.
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.

I2.2.1 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.

I2.2.2 Residual value

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**Excerpt from Accounting Standards Codification**

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

**Subsequent Measurement**

350-30-35-8

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. APB 17 was silent as to the role of residual value in determining the amount to be amortized. Residual value 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 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.

### I2.2.3  Periodic evaluation of the estimated useful life

**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><strong>Subsequent Measurement</strong></td>
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<tr>
<td>350-30-35-9</td>
</tr>
<tr>
<td>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.</td>
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<tr>
<td>350-30-35-10</td>
</tr>
<tr>
<td>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.</td>
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<tr>
<td>350-30-35-11</td>
</tr>
<tr>
<td>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.</td>
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<tr>
<td>350-30-35-12</td>
</tr>
<tr>
<td>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.</td>
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</tbody>
</table>

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 value 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.

### 12.2.4 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 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 (ASC 360-10-35-21):

- 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.
I2 Subsequent accounting for intangible assets other than goodwill

► 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 Accounting for the Impairment or Disposal of Long-Lived Assets FRD for detailed discussion on the impairment assessment for finite-lived intangible assets.

I2.3 Intangible assets with indefinite lives

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><strong>Subsequent Measurement</strong></td>
</tr>
<tr>
<td>350-30-35-15</td>
</tr>
<tr>
<td>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.</td>
</tr>
<tr>
<td>350-30-35-16</td>
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<tr>
<td>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.</td>
</tr>
<tr>
<td>350-30-35-17</td>
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<tr>
<td>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.</td>
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<tr>
<td>350-30-35-17A</td>
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<tr>
<td>Intangible assets acquired in a business combination 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...</td>
</tr>
</tbody>
</table>

7 The term “more likely than not” refers to a level of likelihood that is more than 50 percent.
in this Section. Consistent with the guidance in paragraph 360-10-35-49, intangible assets acquired in business combination 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.

As stated in Statement 142’s basis for conclusion, 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 factors that should be considered before a determination is made that there is no limit on the useful life of an intangible asset and that the intangible asset 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.

In Statement 142’s basis for conclusions, the FASB noted that an indefinite useful life is not necessarily an infinite useful life. The useful life of an intangible asset is indefinite if no limit is placed on the end of its useful life to the reporting entity. The Board also noted that indefinite does not mean the same as indeterminate. Thus, even if the precise useful life of a finite-lived intangible asset is not determinable, the intangible asset still would have to be amortized, and the amortization period would reflect the best estimate of the useful life of that asset.

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.

I2.3.1 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. This is in contrast to the requirement in Statement 141 that the fair value of IPR&D assets be expensed on the acquisition date. These acquired assets remain indefinite-lived assets until the completion or abandonment of the associated research and development efforts.\(^8\) As discussed in section I2.3.3, during the period in which (i.e., the period prior to completion or abandonment) those acquired assets are considered indefinite

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\(^8\) 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 I2.2.
lived, they shall not be amortized but shall be tested for impairment in accordance with ASC 350-30-35-18 through 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 I2.1. 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 20. Pursuant to ASC 360-10-35-47 through 49, intangible assets acquired in a business combination that have been temporarily idled shall not be accounted for as if abandoned.

### I2.3.1.1 Examples — IPR&D assets acquired in a business combination

#### Example 1

On 01/01/X1, 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.

On the acquisition date, Pharma X determines that the fair value of the IPR&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&D asset.

On 01/06/X2, Pharma X completed Phase III clinical trials and applied for and received FDA approval to commercially market the drug. From 01/01/X1 to 01/06/X2, in accordance with ASC 350-30-35-18 through 20, Pharma X has appropriately tested the IPR&D asset for impairment annually. Pharma X has recorded no impairment loss on the IPR&D asset at the project's completion date.

**Evaluation:**

On 01/06/X2, Pharma X must determine the useful life of the IPR&D asset and reclassify the asset from an indefinite-lived intangible asset to a finite-lived intangible asset. Also with this reclassification, Pharma X is required to perform an impairment test (as discussed in section I2.3.1) of the IPR&D asset in accordance with ASC 350-30-35-18 through 20. Once any indicated impairment has been recorded, Pharma X amortizes the finite-lived intangible asset over its remaining estimated useful life.
Example 2
Assume the same information regarding the business combination in Example 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. On 01/06/X2, Pharma X determines that the fair value of the IPR&D asset is now $12 million.

Evaluation:
On 01/06/X2, Pharma X must record an impairment loss of $3 million. In accordance with Statement 142, Pharma X must reduce the carrying value of the IPR&D asset from $15 million to $12 million. If and when the project becomes a successful commercially viable product, Pharma X must determine the useful life of the IPR&D asset and amortize the cost of $12 million (assuming there were no other impairments) over the estimated useful life.

Example 3
Assume the same information regarding the business combination in Example 1, except that Pharma X did not receive FDA approval and rather than continuing the project, Pharma X determines that the project is no longer feasible and abandons the project.

Evaluation:
Because Pharma X decided to abandon the project and presuming 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.

I2.3.3 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 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 (ASC 350-30-35-18 through 20).

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, 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 value, 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 carrying amount 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.

I2.3.3.1 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 values of the underlying assets first being properly adjusted for impairment. See I3.8 for more discussion.

I2.3.4 Unit of accounting

<table>
<thead>
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<td><strong>Intangibles — Goodwill and Other — General Intangibles Other than Goodwill</strong></td>
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<tr>
<td><strong>Subsequent Measurement</strong></td>
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<tr>
<td>350-30-35-21</td>
</tr>
<tr>
<td>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.</td>
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<tr>
<td>350-30-35-22</td>
</tr>
<tr>
<td>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. Currently Viewing:</td>
</tr>
<tr>
<td>350-30-35-23</td>
</tr>
<tr>
<td>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:</td>
</tr>
<tr>
<td>a. The intangible assets were purchased in order to construct or enhance a single asset (that is, they will be used together).</td>
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</tbody>
</table>
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).

e. 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.

350-30-35-25
All of the following shall be included in the determination of the unit of accounting used to test indefinite-lived intangible assets for impairment:

350-30-35-26

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.
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.

ASC 350-30-35-21 through 35-27 (codified primarily from EITF 02-7) provides guidance for determining the unit of accounting when testing indefinite-lived intangible assets for impairment.

In reaching on a consensus on EITF 02-7, 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.

ASC 350-30-35-27 requires that a company that changes the way in which indefinite-lived intangible assets are used and combines as a unit of accounting for impairment testing purposes indefinite-lived intangible assets that were previously tested for impairment separately, should first test those intangible assets separately for impairment in accordance with ASC 350-30-35-18 through 20.

The following examples illustrate the determination of the unit of accounting to use in impairment testing for indefinite-lived intangible assets.
Example 1 – 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.

Evaluation:

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 reasons, 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.

Example 2 – 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 each of three countries and each of those legal entities owns 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.
Subsequent accounting for intangible assets other than goodwill

**Evaluation:**

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.

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**Example 3 – 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.

**Evaluation:**

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.
I2.3.4.1 Allocating an impairment loss to an indefinite-lived intangible asset when removing the asset from a single accounting unit

As noted in section I2.3.4, 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 if one or more of the separate indefinite-lived intangible asset 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 states that “…..questions have arisen about 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 relative historical carrying amount of the individual indefinite-lived intangible assets. If the historical carrying value 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.

Example

XYZ Corp has grouped four licenses (A, B, C and D) in an accounting unit for impairment purposes based on the requirements in EITF 02-7. 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 $225].
I2.4 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:

a. An asset that the entity will never actively use

b. 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 primarily 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. 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.

Defensive intangible assets generally were not recognized apart from goodwill for business combinations or asset acquisitions completed prior to the effective date of Statement 141(R).

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9 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.
Accounting for goodwill under
ASC 350-20

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
The two-step impairment test discussed in paragraphs 350-20-35-4 through 35-19 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 Business Combinations FRD. 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.

13.1 Measurement and recognition of goodwill impairment
Excerpt from Accounting Standards Codification
Intangibles—Goodwill and Other — Goodwill
Recognition and Measurement of an Impairment Loss
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.
The guidance in paragraphs 350-20-35-22 through 35-24 shall be considered in determining the fair value of a reporting unit.

If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, thus the second step of the impairment test is unnecessary.

If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test shall be performed to measure the amount of impairment loss, if any.

**Step 2**

The second step of the goodwill impairment test, used to measure the amount of impairment loss, compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill.

The guidance in 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 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.
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, at least annually, for impairment at the reporting unit level in accordance with ASC 350-20. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. Goodwill should not be tested for impairment under ASC 360-10. Rather, goodwill impairment is tested as follows:

► **Step 1**
  - Determine the fair value of the reporting unit.
  - Compare the fair value of the reporting unit to its carrying value, including goodwill. If the fair value exceeds the carrying value, no further work is required and no impairment loss is recognized. If the carrying value exceeds the fair value, the goodwill of the reporting unit is potentially impaired and a company then completes Step 2 in order to measure the impairment loss. It is possible that the completion of Step 2 will result in no impairment charge.

► **Step 2**
  - Calculate the implied fair value of goodwill by deducting the fair value of all tangible and intangible net assets (including unrecognized intangible assets) of the reporting unit from the fair value of the reporting unit (as determined in Step 1). In this step, companies must assign the fair value of the reporting unit to all of the reporting unit’s assets and liabilities. This assignment includes determining the fair value of any unrecognized intangible assets (including in-process research and development) of the reporting unit and any applicable corporate level assets or liabilities that had been included in the determination of the carrying value 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. The guidance included in ASC 805 is used to determine the amounts to be assigned to the assets and liabilities of the reporting unit. While this
process will be costly and time consuming, 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.

Compare the implied fair value of goodwill as determined above to the carrying value of goodwill. If the implied fair value of goodwill is less than the carrying value of goodwill, recognize an impairment loss equal to the difference (i.e., write goodwill down to the implied fair value of goodwill amount). This becomes the new carrying value of goodwill for that reporting unit that will be used in future impairment tests. The loss cannot exceed the carrying value of goodwill. Additionally, the subsequent reversal of a previously recognized impairment loss is prohibited.

Statement 141(R) 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 Business Combinations FRD for further discussion). This means that to the extent the recognition and measurement principles in ASC 805 differ from Statement 141, 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.

Statement 141(R) 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 I5.3 for the discussion regarding transition considerations related to mutual entity business combinations.

I3.1.1 Consideration of deferred income taxes in determining the carrying amount of a reporting unit

Excerpt from Accounting Standards Codification

<table>
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<td>350-20-35-7</td>
</tr>
<tr>
<td>In determining the carrying amount of a reporting unit, deferred income taxes shall be included in the carrying value 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>
</tr>
</tbody>
</table>
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.

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.

When the EITF originally deliberated EITF 02-13 (codified primarily 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 value 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 13.3.2 for further discussion pertaining to the consideration of deferred taxes in the determination of the fair value of a reporting unit.

Also, see examples C1.12 and C1.13 in Appendix C for further illustration.

I3.2 Goodwill impairment test incomplete

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).

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, either an increase or a decrease, based on the completion of the measurement should be recognized in the subsequent period.

### I3.3 Fair value measurements of a reporting unit

**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>350-20-35-22</strong></td>
</tr>
<tr>
<td>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.</td>
</tr>
<tr>
<td><strong>350-20-35-23</strong></td>
</tr>
<tr>
<td>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.</td>
</tr>
<tr>
<td><strong>350-20-35-24</strong></td>
</tr>
<tr>
<td>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.</td>
</tr>
</tbody>
</table>
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 Fair Value
Measurement FRD. In February 2008, the FASB issued FSP 157-2, which deferred the
effective date of Statement 157 (codified primarily in ASC 820) for all nonfinancial assets
and nonfinancial liabilities, except for those nonfinancial items recognized or disclosed at fair
value on a recurring basis. As a result, the effective dates of Statements 157 and 141(R)
were aligned as it pertains to nonfinancial assets and nonfinancial liabilities acquired in a
business combination and thus, deferred the use of Statement 157 principles in the fair value
measurement of a reporting unit until after the effective dates of those standards. That is,
the guidance in ASC 820 should be used to measure the fair value of a reporting for goodwill
assessment dates after 1 January 2009 for calendar year-end entities.

I3.3.1 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. When a registrant performs a goodwill impairment test, whether the test is an interim or annual test, the registrant should reconcile the fair value of the reporting unit(s) to the registrant’s stock price and market capitalization.

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 rigors 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 an appropriate reason 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.

I3.3.2 Effect of deferred taxes on fair value assumptions

Excerpt from Accounting Standards Codification

<table>
<thead>
<tr>
<th>Intangibles—Goodwill and Other — Goodwill</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred Income Tax Considerations</td>
</tr>
</tbody>
</table>

350-20-35-25
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]).

350-20-35-26
In making that determination, an entity shall consider all of the following:

a. Whether the assumption is consistent with those that marketplace participants would incorporate into their estimates of fair value

b. The feasibility of the assumed structure

c. Whether the assumed structure results in the highest economic value to the seller for the reporting unit, including consideration of related tax implications.

350-20-35-27
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 primarily 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.

See examples C1.12 and C1.13 in Appendix C for further illustration.

### I3.3.3 Level of future funding for pension plans considerations

When determining the fair value of a reporting unit, 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.

### I3.3.4 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 I3.8 for discussion about the order of impairment testing.
I3.4 Treatment of cumulative translation adjustment in the goodwill impairment test

A question arises as to how a company should consider the cumulative translation adjustment (CTA) in the assessment of goodwill impairment when foreign entities comprise all or part of the reporting unit.

For example, assume that the assets, liabilities and equity of a reporting unit are as follows:

- **Assets**: $50
- **Liabilities**: (20)
- **Net assets**: $30
- **Paid-in-capital and retained earnings**: (35)
- **Cumulative translation adjustment**: 5
- **Total equity**: $(30)

Should the “carrying amount” of the reporting unit be the net amount of recorded assets and liabilities based on current exchange rates (i.e., $30 in the preceding example), or is the “carrying amount” the equity of the reporting unit excluding the effect of the CTA (i.e., $30 + $5 = $35 in the preceding example)?

We believe that ASC 830 provides analogous guidance. ASC 830-30-40-1 is clear that no basis exists to include the CTA in an impairment assessment if that assessment does not contemplate a planned sale or liquidation that will cause reclassification of some amount of the CTA. Therefore, we believe that only if the company has committed to a plan that will cause the CTA for the reporting unit to be reclassified to earnings should the CTA be included as part of the carrying amount of the reporting unit (i.e. the “carrying amount” of the equity) when testing goodwill of the reporting unit for impairment. Thus, in the preceding example, the carrying value of the reporting unit would be considered $30 (i.e. the “carrying amount” of the net assets at current exchange rates) unless the reporting unit was “held for disposal” under a plan that will ultimately result in the CTA for the reporting unit being reclassified to earnings.

I3.5 Frequency of goodwill impairment tests

**Excerpt from Accounting Standards Codification**

<table>
<thead>
<tr>
<th>Intangibles—Goodwill and Other – Goodwill</th>
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</thead>
<tbody>
<tr>
<td><strong>Subsequent Measurement</strong></td>
</tr>
<tr>
<td><strong>350-20-35-28</strong></td>
</tr>
<tr>
<td>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.</td>
</tr>
</tbody>
</table>
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 fair value measurement required in Step 1 of the impairment test can be performed at any time during the year as long as that measurement date is used consistently going forward. 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 obtain the required fair values, 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 the required valuation analysis prior to the date the third quarter Form 10-Q is due. As stated earlier, 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.

We encourage companies to adopt an annual impairment test date at the beginning of a fiscal quarter, preferably the fourth quarter. Following this approach, companies will have the appropriate carrying values 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 (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).

### I3.5.1 Changing the goodwill assessment date

For varied reasons, 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:

> SFAS 142 [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

\(^\text{10}\) Updated 30 November 2006.
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.

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 paragraph 4 of SFAS 154 [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.

I3.6 Carrying forward of reporting unit fair value

Excerpt from Accounting Standards Codification

<table>
<thead>
<tr>
<th>Intangibles—Goodwill and Other — Goodwill</th>
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</thead>
<tbody>
<tr>
<td>Subsequent Measurement</td>
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<tr>
<td>350-20-35-29</td>
</tr>
</tbody>
</table>

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

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

b. The most recent fair value determination resulted in an amount that exceeded the carrying amount of the reporting unit by a substantial margin.

c. Based on an analysis of events that have occurred and circumstances that have changed since the most recent fair value determination, the likelihood that a current fair value determination would be less than the current carrying amount of the reporting unit is remote.
The annual impairment test does not necessarily require a new determination of the fair value of each reporting unit every year. Companies may carry forward a detailed determination of the fair value of a reporting unit from year to year if all of the following criteria are 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. ASC 350-20 does not specify what is meant by a “substantial margin.” We believe that “substantial margin” should be considered in light of the volatility of valuations in that particular reporting unit’s industry. For example, if a reporting unit is in an industry characterized by relatively stable valuations over time, a margin of fair value over carrying value of, say, 20% may be considered substantial. However, if a reporting unit is in an industry characterized by volatile and/or wide-ranging valuations, a “substantial margin” may be much higher (e.g., 50% or more). Each case depends on the relevant facts and circumstances.

► 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).

### 13.7 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. Examples of such events or circumstances include the following:

a. A significant adverse change in legal factors or in the business climate
b. An adverse action or assessment by a regulator
c. Unanticipated competition
d. A loss of key personnel
e. A more-likely-than-not expectation that a reporting unit or a significant portion of a reporting unit will be sold or otherwise disposed of
The testing for recoverability under the Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10 of a significant asset group within a reporting unit

Recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit.

In addition, paragraph 350-20-35-57 requires that goodwill be tested for impairment after a portion of goodwill has been allocated to a business to be disposed of.

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 value, such as:

- A significant adverse change in legal factors or in the business climate.
- An adverse action or assessment by a regulator.
- Unanticipated competition.
- A loss of key personnel.
- A more likely than not expectation that a reporting unit or a significant portion of a reporting unit will be sold or otherwise disposed of.
- A significant asset group within a reporting unit is tested for recoverability under ASC 360-10.
- A subsidiary that issues separate GAAP financial statements and is a component of a reporting unit recognizes a goodwill impairment loss.

The above 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

I3.7.1 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 I3.3.1, 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. While a decline in stock price and market capitalization (whether or not below book value of the entire entity) is not specifically cited in ASC 350-20 as a circumstance requiring an interim goodwill impairment test, a company’s stock price 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 only 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.

I3.7.2 Reporting units with a negative carrying amount

At the 31 October 2002 EITF Agenda Committee Meeting, the Agenda Committee contemplated whether to add an issue to the EITF’s agenda to address whether a single reporting unit entity that has a negative carrying amount passes Step 1 of the goodwill impairment test, assuming its fair value is zero or greater. Constituents raised concerns that such situations would never result in the recognition of a goodwill impairment even if one existed because a reporting unit with a negative carrying amount would always pass the Step 1 test. After consideration, the Agenda Committee recommended that this issue not be added to the EITF’s agenda based of the guidance in paragraph 19 of Statement 142 [ASC 350-20-35-6], which states that “if the fair value of a reporting unit exceeds its
carrying amount, goodwill of the reporting unit is considered not impaired.” Based on the EITF’s Agenda Committee decision, we believe that no goodwill impairment would be recognized for a single reporting unit that has a negative carrying amount and fair value of at least zero or greater.

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

**Excerpt from Accounting Standards Codification**

**Intangibles—Goodwill and Other — Goodwill**

**Subsequent Measurement**

350-20-35-31

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.

350-20-35-32

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.

Because the impairment model uses the comparison of the fair value and the carrying value 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 value 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 value 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.
Example

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

| Receivables | Inventory               |
| Goodwill    | Property, plant & equipment |
| Nonamortizing intangibles | Amortizing 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>Step 1</th>
<th>Step 2</th>
<th>Step 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receivables</td>
<td>Property, plant and equipment</td>
<td>Goodwill</td>
</tr>
<tr>
<td>Nonamortizing intangibles</td>
<td>Amortizing intangibles</td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

I3.8.1 Acquired entity represents only a part of the reporting unit

When an acquired entity represents only part of the reporting unit (the typical case), the implied fair value of goodwill could include the appreciation of earlier purchase acquisitions, unrecognized goodwill from prior pooling-of-interests and internally generated goodwill. Thus, this approach has the impact of offsetting unrealized losses on acquisition goodwill 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.
I3.9  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 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.

350-20-35-35
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.

350-20-35-36
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.

350-20-35-37
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).

350-20-35-38
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, 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 I3.19). The FASB Staff Implementation Guide on Statement 131 and our Segment Reporting FRD (SCORE Retrieval File No. BB0698) 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 the Business Combinations FRD 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.\(^{11}\)

\(^{11}\) 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).
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.\textsuperscript{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 I3.9.4 for further discussion.

**I3.9.1 The component constitutes a business**

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<tr>
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<td><strong>Intangibles – Goodwill and Other – Goodwill</strong></td>
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<td><strong>Implementation Guidance and Illustrations</strong></td>
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<tr>
<td><strong>350-20-55-3</strong></td>
</tr>
<tr>
<td>The determination of whether a component constitutes a business 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.</td>
</tr>
</tbody>
</table>

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

As discussed in section B2.1.3 of our Business Combinations FRD, the definition of what constitutes a business is significantly broader under ASC 805 than it was previously under EITF 98-3. As a result of the broadened definition of a business, the number of reporting units could increase if previous components that did not qualify as a “business” under EITF 98-3 now qualify under the definition in ASC 805. Entities that previously concluded that a component did not qualify as a reporting unit solely because the definition of a business was not met, must reevaluate their reporting units. We believe that this analysis should be performed in conjunction with the adoption of Statement 141(R) (ASC 805), rather than as of the annual impairment assessment date. In addition, if it is determined that additional reporting units exists, we believe that entities should perform an impairment test similar to the requirement when a portion of a reporting unit is disposed of as discussed in section I3.15.

\textsuperscript{12} ASC 35-20 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 I3.9.4 for further discussion of similar economic characteristics.
Transition Example

XYZ Co. (the Company) has a calendar year-end with an annual goodwill assessment date of 1 October 2008. The Company has identified three operating segments in accordance with ASC 280. The Company’s operating segments; clothing division, accessories division and sporting goods division, all have multiple components.

Clothing division:

The Company evaluates the organization of the clothing division and determines that the operating segment is made up of three components. A product manager, who reports to the segment manager, manages each component, and the segment manager regularly reviews the results of each component.

Component 1 produces and sells pants. The component has discrete financial information that is reviewed regularly by segment management. The Company determines that the pants component meets the definition of a business under EITF 98-3 because there are no missing elements and the pant component, if sold, can continue normal operations and sustain its revenue stream.

Component 2 produces and sells shirts. Discrete financial information is available and is regularly reviewed by segment management. Similar to the pant component, the shirt component meets the definition of a business under EITF 98-3 and if sold, can continue normal operations and sustain its revenue stream. The pants and shirts are produced in the same factory and have a similar manufacturing process. In addition, both are economically similar.

Component 3 produces shoes in a facility dedicated to the production of shoes and the production process is different from the pants and shirts. Shoe production is new to the Company and was a result of an acquisition of a development stage company in 2007. The development stage company patented a new technology that allows shoes to resist water. The component does not meet the definition of a business under EITF 98-3 because outputs are missing. Segment management regularly reviews discrete financial information.

The Company determines that the clothing operating segment consists of one reporting unit. The reporting unit consists of the aggregation of the pants and shirts components as they are economically similar. The shoe component does not meet the criteria to be deemed a reporting unit because it does not constitute businesses independently. As a result, it is incorporated with the pants and shirts component.
On 1 January 2009, XYZ Co. adopts Statement 141(R) (ASC 805), and as a result, reevaluates their reporting units. Based on the new definition of what constitutes a business in ASC 805, the Company determined, based on relevant facts and circumstances, that the shoe component now constitutes a business. Although the unit has no outputs (that is, a final product or customers), the unit has inputs (fixed assets, employees and intellectual property) and processes (strategic and operation processes for researching and developing a product) that are capable of being managed for the purpose of generating some form of return. Under ASC 805, the fact that the shoe component currently does not generate a return is not relevant to the determination of whether the set is a business.

As a result, the Company now concludes that the clothing division now has two reporting units; the combined pants and shirts reporting unit and the shoe reporting unit.

If an entity determines that it now has more reporting units based on the broadened definition of a business, the entity would be required to reassign any previously assigned goodwill to those reporting units in accordance with ASC 350-20-35-41 through 35-43 as discussed in section I3.12. That reassignment process, which is similar to a fair value assignment, must be performed consistent with the guidance in ASC.

When reconsidering reporting units, the guidance in ASC 350-20 that allows two or more components of an operating segment to be aggregated and deemed a single reporting unit if the components have similar economic characteristics should be considered (see discussion in section I3.9.4).

### I3.9.2 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.

### I3.9.3 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.

### I3.9.4 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.

**350-20-55-7**

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 and the nature of those operations

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

c. The extent to which the component businesses 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 may be economically similar to those other components.

350-20-55-8

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.

350-20-55-9

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:

a. The nature of the products and services
b. The nature of the production processes
c. The type or class of customer for their products and services
d. The methods used to distribute their products or provide their services
e. 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, clarifying 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 than initially thought based solely on the reference to the guidance in ASC 280-10-50-11. For example, just because gross profit margins may vary

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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 I3.9.1 through I3.9.4.
significantly between components does not necessarily mean that those components cannot 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.

### I3.9.5 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 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 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 280-10-50-1). 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).

I3.9.6  Example — Identification of reporting units
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. 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, in our example, because C2 and C3 are components of different operating segments, they may not be aggregated.

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
I3 Accounting for goodwill under ASC 350-20

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 or reportable segments for which segment disclosures must be made.

I3.10 Assigning assets acquired and liabilities assumed to reporting units

Excerpt from Accounting Standards Codification

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<tr>
<td>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:</td>
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<tr>
<td>a. The asset will be employed in or the liability relates to the operations of a reporting unit.</td>
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<tr>
<td>b. The asset or liability will be considered in determining the fair value of the reporting unit.</td>
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<tr>
<td>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.</td>
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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 value” of the reporting units so that Step 1 of the goodwill impairment test (i.e., the comparison of the carrying value of a reporting unit to its fair value) can be completed each year, or more frequently if goodwill impairment indicators arise.

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 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 (1) relates to the operations of the reporting unit and (2) 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.
I3.11  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. 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.

I3.11.2  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 I3.11. Additionally, when assets or liabilities do not meet the criteria in section I3.11 and are not included in the carrying value 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 I3.1 for discussion of the two-step 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 value 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 value of the reporting unit.

The goal of such assignment is to ensure that comparisons of the fair value to the carrying value 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 value 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 Statement 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.
### I3.12 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 (ASC 350-20-35-43). 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.
### I3.12.1 Example – Goodwill assigned to more than one reporting unit using “with and without” method

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.

<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><strong>Fair value of:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<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>

**Direct method:**

Assign 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>Fair value of acquired business</td>
<td>$ 33</td>
<td>$ 17</td>
</tr>
<tr>
<td>(or portion thereof)*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair value of net assets to be assigned</td>
<td>(20)</td>
<td>(15)</td>
</tr>
<tr>
<td>(from above)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goodwill assigned to reporting units</td>
<td>$ 13</td>
<td>$ 2</td>
</tr>
</tbody>
</table>

**Indirect method:**

Assign 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>RU 1</th>
<th>RU 2</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fair value of reporting unit after acquisition</strong></td>
<td>$ 95</td>
<td>$ 80</td>
</tr>
<tr>
<td><strong>Fair value of reporting unit prior to acquisition</strong></td>
<td>(62)</td>
<td>(63)</td>
</tr>
<tr>
<td><strong>Fair value of acquired business or asset group</strong>*</td>
<td>33</td>
<td>17</td>
</tr>
<tr>
<td><strong>Fair value of net assets to be assigned</strong></td>
<td>(20)</td>
<td>(15)</td>
</tr>
<tr>
<td>(from above)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Goodwill assigned to reporting unit</strong></td>
<td>$ 13</td>
<td>$ 2</td>
</tr>
</tbody>
</table>
I3.12.2 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.

I3.12.3 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 allocation 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 Statements 142 was clear—goodwill should be allocated 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.

I3.12.4 Delay in assignment of goodwill
As noted above, goodwill should be assigned to one or more reporting units as of the acquisition date; however, 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 (ASC 350-20-50-1). 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. Because the acquisition just closed, there should be no material accounting consequence associated with delaying the assignment of goodwill to reporting units even if the company performs its annual goodwill impairment test at or near year-end. However, the fair value of the reporting unit used in the goodwill impairment test should be comparable to the carrying value used. That is, if the acquired goodwill, assets and liabilities are not included in the carrying value of the reporting unit because they have not yet been assigned to the reporting units, the fair value of the reporting unit should
not include any value associated with the acquired business. Additionally, the company should ensure that all goodwill is assigned to the reporting units before it performs its next annual impairment test.

I3.12.5 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 value of goodwill along with any changes in that carrying value by reportable segment (ASC 350-20-50-1). See section I4.3 further discussion.

I3.13 Changes in a company’s reporting structure
I3.13.1 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>
</tbody>
</table>

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 reassigned 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).

| 350-20-35-46 |

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.

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.

I3.13.1.1 Example — 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>RU1</th>
<th>RU2</th>
<th>RU3</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>20</td>
<td>15</td>
<td>55</td>
</tr>
<tr>
<td>Relative fair value transferred</td>
<td>20%</td>
<td>50%</td>
<td>25%</td>
<td></td>
</tr>
</tbody>
</table>

Evaluation:

Because goodwill is required to be assigned based on relative fair value, allocation of goodwill to RU 4 is as follows:

<table>
<thead>
<tr>
<th></th>
<th>RU1</th>
<th>RU2</th>
<th>RU3</th>
<th>RU4</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 (after reassignment)</td>
<td>24</td>
<td>5</td>
<td>15</td>
<td>16</td>
<td>60</td>
</tr>
</tbody>
</table>

Goodwill was assigned to RU4 as follows:

<table>
<thead>
<tr>
<th></th>
<th>RU1</th>
<th>RU2</th>
<th>RU3</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</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>
I3.14 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 350-20-35-30(g)). 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 an impairment of the goodwill 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 value, 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 320-20 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.

### I3.15 Disposal of All or a Portion of a Reporting Unit

**Excerpt from Accounting Standards Codification**

**Intangibles – Goodwill and Other – Goodwill**

**Subsequent Measurement**

350-20-35-51

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.

350-20-35-52

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.

350-20-35-53

The amount of goodwill to be included in that carrying amount shall be based on the relative fair values of the business to be disposed of and the portion of the reporting unit that will be retained. For example, if a business is being sold for $100 and the fair value of the reporting unit excluding the business being sold is $300, 25 percent of the goodwill residing in the reporting unit would be included in the carrying amount of the business to be sold.
However, if the business to be disposed of was never integrated into the reporting unit after its acquisition and thus the benefits of the acquired goodwill were never realized by the rest of the reporting unit, the current carrying amount of that acquired goodwill shall be included in the carrying amount of the business to be disposed of.

That situation might occur when the acquired business is operated as a standalone entity or when the business is to be disposed of shortly after it is acquired.

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.

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 350-20-35-4 through 35-19 using its adjusted carrying amount. 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 interesting 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 allocation of goodwill is now disposed.

I3.15.1 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 value of the net assets is used in computing the gain or loss on sale. The goodwill attributable to the sold interest is deconsolidated and no longer assigned to a reporting unit for purposes of impairment testing.

I3.15.2 Contribution of assets or equity interest in a common control transaction

There is no specific guidance on the accounting by the contributing entity when a contribution of assets or equity interests is made which constitute a business and is part of a larger reporting unit at a consolidated entity level. Goodwill may have not been assigned at the contributed entity level; therefore, an appropriate method to allocate goodwill to the contributed entity needs to be made by the parent.

We believe there are two options which can be used to allocate the goodwill. These options are as follows:

► The first option is similar to that described above which requires the goodwill of the reporting unit be allocated to the contributed entity based on the relative fair values of the retained portion of the reporting unit and the contributed entity on the date of contribution.

► The second option is using the guidance in ASC 805-50-30-5, and record the specifically identified original goodwill value of the contributed business from the original acquisition that generated such goodwill.

The receiving entity in the common control transaction will record goodwill based on historical cost, potentially resulting in a difference between the goodwill allocated to the contributed entity and the goodwill recorded by the receiving entity.

Companies should determine the appropriate allocation method based on the specific facts and circumstances. As discussed above, the remaining goodwill is tested for impairment under ASC 350-20.
I3.15.3 Allocation of goodwill in a spin-off

When an entity spins-off a reporting unit(s) or a component(s) of a reporting that constitutes a business as defined under ASC 805, goodwill of the reporting unit should be allocated to, and included in, the business being spun-off. That is, any goodwill allocated to the business being spun-off would be derecognized from the parents balance sheet. Goodwill should be allocated to the business being spun-off using the relative fair value approach discussed in section I3.15.

Goodwill recognized in the spin-off entity's balance sheet may differ from the amount allocated by the parent based on the relative allocation process. While the parent’s accounting follows the relative fair value approach, the stand-alone financial statements of the spun-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 business may yield an impairment charge that was not required to be recognized at the parent level.

I3.16 Goodwill impairment testing when a noncontrolling interest exists

Excerpt from Accounting Standards Codification

Intangibles—Goodwill and Other — Goodwill

Subsequent Measurement

350-20-35-57A
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. 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.

350-20-35-57B
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.

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 (ASC 350-20-35-57A). 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 in this instance because a premium is often 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:

### I3.16.1 Allocation of a goodwill impairment charge to the noncontrolling interest

**Example**

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 2</td>
</tr>
<tr>
<td>Goodwill attributable to noncontrolling interest</td>
<td>$ 10 3</td>
</tr>
</tbody>
</table>

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.
2. The goodwill of $130 attributable to the controlling interest is calculated as follows: \([($400) - (90\% \times $300)]\).
3. The goodwill of $10 attributable to the noncontrolling interest is calculated as follows: \([($40) - (10\% \times $300)]\).
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>
<th>(in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of reporting unit</td>
<td>$380</td>
</tr>
<tr>
<td>Carrying amount of reporting unit</td>
<td>440</td>
</tr>
<tr>
<td>Passed / (Failed)</td>
<td>(60)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Step 2:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of reporting unit</td>
<td>$380</td>
</tr>
<tr>
<td>Fair value of 100% identifiable net assets</td>
<td>300</td>
</tr>
<tr>
<td>Implied goodwill</td>
<td>80</td>
</tr>
<tr>
<td>Carrying amount of goodwill</td>
<td>140</td>
</tr>
<tr>
<td>Impairment loss</td>
<td>(60)</td>
</tr>
<tr>
<td>Goodwill impairment loss attributable to the controlling interest</td>
<td>$56</td>
</tr>
<tr>
<td>Goodwill impairment loss attributable to the noncontrolling interest</td>
<td>$4</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: 
\[\frac{130}{140} \times 60\]

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: 
\[\frac{130}{140} \times 60\]

I3.16.2 Goodwill generated prior to 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.

I3.16.3 Allocation 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 values 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).

After the provisions of ASC 810 are adopted, although the total goodwill balance is not adjusted, for impairment testing purposes goodwill should be reallocated between the controlling and noncontrolling interests based on the changes in ownership interests.

To illustrate this concept, 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). If Parent acquires an additional 10% interest in Subsidiary, the consolidated amount of goodwill does not change, but the goodwill balance is reallocated 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).

I3.17 Tax effects of goodwill impairments

See section T11a08 in our Accounting for income taxes FRD for discussion on the tax implications pertaining to the impairment of identifiable intangible assets and goodwill.

I3.18 Goodwill related to equity method investments

Excerpt from Accounting Standards Codification

Investments—Equity Method and Joint Ventures – Overall

Subsequent Measurement

323-10-35-13

A difference between the cost of an investment and the amount of underlying equity in net assets of an investee shall be accounted for as if the investee were a consolidated subsidiary. Paragraph 350-20-35-58 requires that the portion of that difference that is recognized as goodwill not be amortized. Paragraph 350-20-35-59 explains that equity method goodwill

Financial reporting developments Intangibles – Goodwill and other ASC 350
shall not be reviewed for impairment in accordance with paragraph 350-20-35-58. However, equity method investments shall continue to be reviewed for impairment in accordance with paragraph 323-10-35-32.

Intangibles—Goodwill and Other — Goodwill

Subsequent Measurement

350-20-35-58

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.

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 should not be tested for impairment under the provisions of ASC 350-20. Instead, the carrying value 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.

A loss in value of an investment which is other than a temporary decline should be recognized. Evidence of a loss in value might include, but would not necessarily be limited to, absence of an ability to recover the carrying amount of the investment or inability of the investee to sustain an earnings capacity which would justify the carrying amount of the investment. A current fair value of an investment that is less than its carrying amount may indicate a loss in value of the investment. However, a decline in the quoted market price below the carrying amount or the existence of operating losses is not necessarily indicative of a loss in value that is other than temporary. All are factors to be evaluated (ASC 323-10-35-32).
When Statements 141(R) and 160 were issued, questions were raised regarding the application of the equity method of accounting. The FASB never made an explicit decision to change the accounting for equity-method investments. However, because ASC 323 refers to the guidance for business combinations and consolidations in accounting for equity method investments, it was unclear whether the accounting for equity-method investments changed as a result. Questions include, but not limited to, how the equity-method investment should be assessed for impairment (a practice issue that existed prior to the issuance of Statements 141(R) and 160). In November 2008, the EITF reached a final consensus on EITF 08-6 (codified primarily in ASC 323). The EITF concluded that the equity method investment as a whole should be assessed for other-than-temporary impairment in accordance with APB 18, and that none of the individual assets underlying the equity method investment should be individually assessed for impairment at the investor level.

EITF 08-6 was effective on a prospective basis for transactions in an investee’s shares occurring in fiscal years, and interim periods within those fiscal years, beginning on or after 15 December 2008. While not explicitly discussed by the EITF, we believe the consensus on impairments also would be applied prospectively such that any impairments recognized prior to the effective date would not be affected.

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 value of the investee might be impaired. See section E3.64, “Treatment of basis differences upon impairment”, in our accounting manual for further discussion.

**I3.19 Impairment testing for nonpublic entities**

<table>
<thead>
<tr>
<th>Excerpt from Accounting Standards Codification</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Intangibles—Goodwill and Other — Goodwill</strong></td>
</tr>
<tr>
<td>Subsequent Measurement</td>
</tr>
<tr>
<td>350-20-35-60</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—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.

I3.20 Goodwill resulting from a subsidiaries acquisition of an entity

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

For example, the operations of Subsidiary A are included, in its 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. Subsidiary A, however, should recognize $100 million of goodwill in its separate financial statements and assigns that goodwill to its reporting units in accordance with ASC 350-20.

I3.21 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 (805-740-25-8 and 25-9). See our Accounting for income taxes for detailed discussion on the accounting for tax deductible goodwill.
I4  Financial statement presentation and disclosure requirements

I4.1  Financial statement presentation

I4.1.1  Goodwill

Excerpt from Accounting Standards Codification

Intangibles – Goodwill and Other – Goodwill

Other Presentation Matters

350-20-45-1
The aggregate amount of goodwill shall be presented as a separate line item in the statement of financial position.

350-20-45-2
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.

350-20-45-3
A goodwill impairment loss associated with a discontinued operation shall be included (on a net-of-tax basis) within the results of discontinued operations.

Presentation of Financial Statements – Discontinued Operations

Relationships

205-20-60-4
For guidance on reporting a goodwill impairment loss associated with a discontinued operation, see paragraph 350-20-45-3.

I4.1.2  Intangible assets other than goodwill

Excerpt from Accounting Standards Codification

Intangibles – Goodwill and Other – General Intangibles Other than Goodwill

Other Presentation Matters

350-30-45-1
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.

350-30-45-2
The amortization expense and impairment losses for intangible assets shall be presented in income statement line items within continuing operations as deemed appropriate for each entity.
Paragraphs 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.

I4.1.2 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 the 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.

I4.1.2 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.
I4.2 Disclosure requirements related to goodwill and intangible assets

I4.2.1 Intangible assets 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 or business combination), 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 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 in the aggregate for individually immaterial business combinations that are material collectively if the aggregate fair values of intangible assets acquired, other than goodwill, are significant.
I4.3 Other general disclosure requirements

I4.3.1 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.
I4.3.2 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.
When Statement 141(R) was issued, it amended the goodwill disclosures in Statement 142 to converge the level of detail in the goodwill reconciliation to that required by the IASB (that amended guidance is included in ASC 350). As such, 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. The issue arises has to how to account for goodwill acquired prior to the adoption of Statement 142. That is, how should the accumulated amortization recognized prior of the adoption of Statement 142 be presented in the goodwill reconciliation required by ASC 350-20-50-1. We believe that beginning gross goodwill amount should be presented net of any amortization recognized prior to the adoption of Statement 142.

### I4.4 Disclosures surrounding impairment

#### I4.4.1 Goodwill impairment

**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, 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 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.
I4.4.1.1 SEC observations relating to goodwill impairment disclosures

The SEC staff frequently asks for supplemental information about:

► Details of the goodwill impairment analysis for each reporting unit, including how reporting units are identified, how assets, liabilities and goodwill are allocated to reporting units, and how the fair value of the each reporting unit was estimated

► 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 goodwill is less than its carrying amount

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 following:

► 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 allocated 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

► The significant assumptions and estimates used in determining the fair value of reporting units with a goodwill impairment

Registrants should provide robust disclosures that satisfy the requirements 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 and the method used to determine the fair value of the associated reporting unit.

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 following:

► 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.
I4.4.2 Intangible assets other than goodwill impairment

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.
I5 Effective date, transition, and transitional disclosures

I5.1 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.

I5.2 Not-for-profit entities
When Statement 164 was issued, it amended Statement 142 to make Statement 142 applicable to not-for-profit entities. That amended guidance is included in ASC 350. Therefore, goodwill and indefinite-lived intangible assets previously recognized by not-for-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.

Statement 164 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.

I5.3 Mutual entities

Excerpt from Accounting Standards Codification

Business Combinations – Overall

Recognition

805-10-25-11

An acquirer sometimes obtains control of an acquiree without transferring consideration. The acquisition method of accounting for a business combination applies to those combinations. Such circumstances include any of the following:

a. The acquiree repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control.

b. Minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting interest.

c. The acquirer and acquiree agree to combine their businesses by contract alone. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously. Examples of business combinations achieved by contract alone include bringing two businesses together in a stapling arrangement or forming a dual-listed corporation.

See Technical Line entitled “Implications of Statement 141(R) for mutual entities” for more detailed discussion on the accounting for goodwill and intangible assets recognized in a business combination by mutual entities.
## Appendix A: Abbreviations used in this publication

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>FASB Accounting Standards Codification</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASC 205</td>
<td>FASB ASC Topic 205, Presentation of Financial Statements</td>
</tr>
<tr>
<td>ASC 210</td>
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### Appendix A: Abbreviations used in this publication

#### Financial reporting developments

#### Intangibles — Goodwill and other ASC 350

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<tr>
<td>Development Costs</td>
<td>Development costs are expensed as incurred unless addressed by a separate standard. Development costs related to computer software developed for external use are capitalized once technological feasibility is established in accordance with specific criteria (ASC 985). In the case of software for internal use, only those costs incurred during the application development stage (as defined in ASC 350-40) may be capitalized.</td>
<td>Development costs are capitalized when technical and economic feasibility of a project can be demonstrated in accordance with specific criteria. Some of the state criteria include: demonstrating technical feasibility, intent to complete the asset, and ability to sell the asset in the future, as well as others. There is no separate guidance addressing computer software development costs.</td>
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<tr>
<td>Advertising Costs</td>
<td>Advertising and promotional costs are either expensed as incurred or expensed when the advertising takes place for the first time (policy choice). Direct response advertising may be capitalized if the specific criteria in ASC 720-35 are met.</td>
<td>Advertising and promotional costs are expensed as incurred. A prepayment may be recognized as an asset only when payment for the goods or services is made in advance of the entity's having access to the goods or receiving the services.</td>
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<tr>
<td>Revaluation</td>
<td>Revaluation is not permitted.</td>
<td>Revaluation to fair value of intangible assets other than goodwill is a permitted accounting policy elections for a class of intangible assets. Because revaluation requires reference to an active market for the specific type of intangible, this is relatively uncommon in practice.</td>
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<td>Method of Determining Impairment – Goodwill</td>
<td>Two-step approach requires a recoverability test to be preformed first at the reporting unit level (carrying amount of the reporting unit is compared to the reporting unit fair value). If the carrying amount of the reporting unit exceeds its fair value, then impairment testing must be performed.</td>
<td>One-step approach requires that an impairment test be done at the cash generating unit (CGU) level by comparing the CGU's carrying amount, including goodwill, with its recoverable amount.</td>
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Appendix B: Differences between US GAAP and IFRS

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<th>Guidance</th>
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<tr>
<td>Impairment Loss Calculation – Goodwill</td>
<td>The amount by which the carrying amount of goodwill exceeds the implied fair value of the goodwill within its reporting unit.</td>
<td>Impairment loss on the CGU (amount by which the CGU's carrying amount, including goodwill, exceeds its recoverable amount) is allocated first to reduce goodwill to zero, then the carrying amount of other assets in the CGU are reduced pro rata, based on the carrying amount of each asset.</td>
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<tr>
<td>Impairment Loss Calculation – Indefinite Life Intangible Assets</td>
<td>The amount by which the carrying value of the asset exceeds its fair value.</td>
<td>The amount by which the carrying value of the asset exceeds its recoverable amount.</td>
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<tr>
<td>Reversal of Loss</td>
<td>Prohibited for all assets to be held and used.</td>
<td>Prohibited for goodwill. Other long-lived assets must be review annually for reversal indicators. If appropriate, loss may be reversed up to the newly estimated recoverable amount, not to exceed the initial carrying amount adjusted for depreciation.</td>
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<tr>
<td>Allocation of Goodwill</td>
<td>Goodwill is reported at the reporting unit level which is an operating segment or one level below an operating segment (component).</td>
<td>Goodwill is allocated to a cash-generating unit (CGU) or group of CGUs which represents the lowest level within the entity at which the goodwill is monitored for internal management purposes and cannot be larger than an operating segment as defined in IFRS 8, Operating Segments.</td>
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Appendix C: Examples — Accounting for intangible assets other than goodwill

C1   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.

C1.1   Example 1 — An acquired customer list
A direct-mail marketing company acquired the customer list and expects that it will be able to derive benefit from the information on the acquired customer list for at least one year but for no more than three years with the best estimate being 18 months.

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.

C1.2   Example 2 — An acquired patent that expires in 15 Years
The product protected by the patented technology is expected to be a source of cash flows for at least 15 years. The reporting entity has a commitment from a third party to purchase that patent in 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.

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.

C1.3   Example 3 — An acquired copyright that has a remaining legal life of 50 years
An analysis of consumer habits and market trends provides evidence that the copyrighted material will generate cash flows for approximately 30 more years.

The copyright would be amortized over its 30-year estimated useful life following the pattern in which the expected benefits will be consumed or otherwise used up and reviewed for impairment under ASC 360-10.
C1.4  Example 4 – An acquired broadcast license that expires in five years

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

The broadcast license would be deemed to have an indefinite useful life because cash flows are expected to continue indefinitely. Therefore, the license would not be amortized until its useful life is deemed to be no longer indefinite. The license would be tested for impairment in accordance with the rules applicable to indefinite-lived intangible assets (i.e., an annual comparison of fair value to carrying value).

C1.5  Example 5 – The broadcast license in example 4

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

Because the broadcast license can no longer be renewed, its useful life is no longer indefinite. Thus, the acquired license would be tested for impairment in accordance with 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.

C1.6  Example 6 – An acquired airline route authority from the United States to the United Kingdom that expires in three years

The route authority may be renewed every five years, and the acquiring entity intends to comply with the applicable rules and regulations surrounding renewal. Route authority renewals are routinely granted at a minimal cost and have historically been renewed when the airline has complied with the applicable rules and regulations. The acquiring entity expects to provide service to the United Kingdom from its hub airports indefinitely and expects that the related supporting infrastructure (airport gates, slots and terminal facility leases) will remain in place at those airports for as long as it has the route authority. An analysis of demand and cash flows supports those assumptions.
Because the facts and circumstances support the acquiring entity's ability to continue providing air service to the United Kingdom from its U.S. hub airports indefinitely, the intangible asset related to the route authority is considered to have an indefinite useful life. Therefore, the route authority would not be amortized until its useful life is deemed to be no longer indefinite and would be tested for impairment in accordance with the rules applicable to indefinite-lived intangible assets.

C1.7 Example 7 — An acquired trademark that is used to identify and distinguish a leading consumer product that has been a market-share leader for the past eight years

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

The trademark would be deemed to have an indefinite useful life because it is expected to contribute to cash flows indefinitely. Therefore, the trademark would not be amortized until its useful life is no longer indefinite. The trademark would be tested for impairment in accordance with the rules applicable to indefinite-lived intangible assets.

C1.8 Example 8 — A trademark that distinguished a leading consumer product that was acquired 10 years ago

When it was acquired, the trademark was considered to have an indefinite useful life because the product was expected to generate cash flows indefinitely. During the annual impairment test of the intangible asset, the entity determines that unexpected competition has entered the market that will reduce future sales of the product. Management estimates that cash flows generated by that consumer product will be 20 percent less for the foreseeable future; however, management expects that the product will continue to generate cash flows indefinitely at those reduced amounts.

As a result of the projected decrease in future cash flows, the entity determines that the estimated fair value of the trademark is less than its carrying amount, and an impairment loss is recognized. Because it is still deemed to have an indefinite useful life, the trademark would continue to not be amortized and would continue to be tested for impairment in accordance with the rules applicable to indefinite-lived intangible assets.
C1.9  Example 9 — A trademark for a line of automobiles that was acquired several years ago in an acquisition of an automobile company

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

Because the useful life of that acquired trademark is no longer deemed to be indefinite, the trademark would be tested for impairment in accordance with 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.

C1.10  Example 10 - An 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.

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.
C1.11 Example 11 – An 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.

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.

C1.12 Example 12 – A 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.

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.
Appendix D: Glossary

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, formerly Statement 144, Paragraph 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).

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 (lock up) the asset to prevent others from obtaining access to the asset.

Deferred tax asset — the deferred tax consequences attributable to the deductible temporary differences and carryforwards. A deferred tax asset is measure 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.

Deferred tax liability — the deferred tax consequences attributable to taxable temporary differences. A deferred tax liability is measure using the applicable enacted tax rate and provisions of the enacted tax law.

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 net equity in net assets of an investee that is recognized as goodwill in an equity method investment. Equity method goodwill shall not be reviewed for impairment (ASC 350-20-35-59).

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

Goodwill—the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. The amount recognized as goodwill includes acquired intangible assets that do not meet the criteria in ASC 805 for recognition as an asset apart from goodwill.

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 approach—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.)

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.

Internally developed intangible asset—intangible assets which are not acquired externally as part of a business combination or other asset acquisition.

Market participant—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 820)

**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.

**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.

**Non-taxable 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.

**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.
Other-than-temporary decline — an other-than-temporary decline shall be considered to have occurred if it is probable that the investor will be unable to recover the carrying amount of the investment.

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.

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).

Research and development asset — 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 (subsidiary goodwill). Subsidiary goodwill shall be tested for impairment at the subsidiary level using the subsidiary’s reporting units. (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 account** – that which is being measured by reference to the level at which an asset or liability is aggregated (or disaggregated).

**Useful life** – the period over which an asset is expected to contribute directly or indirectly to future cash flows.
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