FINANCIAL ACCOUNTING SERIES

EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: October 6, 2010
Comments Due: November 5, 2010

Intangibles—Goodwill and Other (Topic 350)

How the Carrying Amount of a Reporting Unit Should Be Calculated When Performing Step 1 of the Goodwill Impairment Test

a consensus of the FASB Emerging Issues Task Force

This Exposure Draft of a proposed Accounting Standards Update of Topic 350 is issued by the Board for public comment. Written comments should be addressed to:

Technical Director
File Reference No. EITF100A

Financial Accounting Standards Board
of the Financial Accounting Foundation

The *FASB Accounting Standards Codification*™ is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites individuals and organizations to send written comments on all matters in this Exposure Draft of a proposed Accounting Standards Update. Responses from those wishing to comment on the Exposure Draft must be received in writing by November 5, 2010. Interested parties should submit their comments by email to director@fasb.org, File Reference No. EITF100A. Those without email should send their comments to "Technical Director, File Reference No. EITF100A, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116." Do not send responses by fax.

All comments received constitute part of the FASB's public file. The FASB will make all comments publicly available by posting them to its website and by making them available in its public reference room in Norwalk, Connecticut.

An electronic copy of this Exposure Draft is available on the FASB's website.

Financial Accounting Standards Board
of the Financial Accounting Foundation
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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

Under Topic 350 on goodwill and other intangible assets, testing for goodwill impairment is a two-step test. An entity must assess whether the carrying amount of a reporting unit exceeds its fair value (Step 1). If it does, an entity must perform an additional test to determine whether goodwill has been impaired and to calculate the amount of that impairment (Step 2). The objective of this proposed Update is to address questions that have arisen on how to calculate the carrying amount of a reporting unit for purposes of applying Step 1 of the goodwill impairment test. The amendments in this proposed Update do not provide guidance on the measurement of the fair value of the reporting unit.

Some reporting entities calculate the carrying amount of the reporting unit using the equity premise, while others calculate the carrying amount using an enterprise premise. The equity premise generally reflects the net amount of all of the assets and liabilities assigned to the reporting unit(s) of a reporting entity (that is, the difference between total assets and total liabilities assigned to the reporting unit). An enterprise premise generally reflects the net amount of the assets and liabilities of the reporting unit, excluding liabilities that are part of the capital structure of the reporting unit.

In practice, an enterprise premise sometimes is used when an entity has reporting units with zero or negative carrying amounts resulting from the application of the equity premise. However, some entities with zero or negative carrying amounts under the equity premise have concluded that Step 1 of the test is automatically satisfied because the fair value of its reporting unit will generally be greater than zero. As a result of that conclusion, some constituents have raised concerns that Step 2 of the test is not performed despite factors indicating that goodwill may be impaired.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would affect all entities that have recognized goodwill and that either have previously applied an enterprise premise when applying Step 1 of the goodwill impairment test or have goodwill recorded in reporting units that have or may have in the future zero or negative carrying amounts.

What Are the Main Provisions?

The amendments in this proposed Update would clarify that the equity premise is the only method an entity can use for purposes of calculating the carrying amount of a reporting unit. The equity premise reflects the net amount of all of the assets and liabilities assigned to the reporting unit(s) of a reporting entity (that is, the difference between total assets and total liabilities assigned to the reporting unit). Additionally, the amendments in this proposed Update would modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity would be required to perform Step 2 of the goodwill impairment test if there are adverse qualitative factors that indicate that it is more likely than not that a goodwill impairment exists. The qualitative factors are consistent with the existing guidance and examples in paragraph 350-20-35-30, which requires that goodwill of a reporting unit 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. Lastly, any previously recognized goodwill impairment taken as a result of applying an alternative premise (that is, other than the equity premise) before adopting the amendments in this proposed Update would not be permitted to be reversed.

How Would the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

The amendments in this proposed Update would clarify that the only acceptable method of calculating the carrying amount of a reporting unit is the equity premise. As a result, current GAAP would be improved by eliminating the diversity in practice that currently exists about whether an enterprise premise also is acceptable.

The amendments in this proposed Update would improve the application of the goodwill impairment test by requiring entities with reporting units with zero or negative carrying amounts to perform Step 2 if there are adverse qualitative factors that indicate that goodwill is more likely than not impaired. Previously, some entities with zero or negative carrying amounts satisfied Step 1 because the reporting unit's carrying amount would likely never exceed its fair value under the equity premise. As a result, goodwill impairments may be reported sooner than under current practice.

When Would the Amendments Be Effective?

For public entities, the amendments in this proposed Update would be effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption would not be permitted.

For nonpublic entities, the amendments in this proposed Update would be effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Nonpublic reporting entities would be able to early adopt the proposed amendments using the effective date for public reporting entities.

Upon adoption of the amendments, a reporting entity with reporting units with carrying amounts that are zero or negative would be required to assess whether the reporting unit's goodwill is more likely than not to be impaired. If the entity determines that the goodwill of one or more of its reporting units is more likely than not to be impaired, the reporting entity would be required to perform Step 2 of the goodwill impairment test for those unit(s). Any resulting goodwill impairment would be recorded as a cumulative-effect adjustment to beginning retained earnings in the period of adoption. Any subsequent goodwill impairments occurring after the initial adoption of the amendments would be included in earnings as required by Section 350-20-35.

How Do the Proposed Provisions Compare with International Financial Reporting Standards (IFRS)?

The proposed provisions will provide guidance requiring the use of the equity premise and would affect when Step 2 of the goodwill impairment test is performed in certain situations. Entities that follow IFRS use a different impairment model under IAS 38, *Intangible Assets,* which is a single-step goodwill impairment test.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Do you agree that the equity premise should be the only permissible methodology for Step 1 of the goodwill impairment test? If not, why not?

Question 2: Do you agree with the qualitative factors that have been provided for reporting units with zero or negative carrying amounts to consider in determining whether it is more likely than not that a goodwill impairment exists? If not, why not? Are there additional factors that also should be included?

Question 3: Do you need more guidance on how to determine if it is more likely than not that goodwill is impaired at transition? If so, please describe what may be helpful with that determination.

Question 4: For reporting entities that have used an enterprise premise to calculate the carrying amount of a reporting entity for Step 1 of the goodwill impairment test, do you believe that applying the amendments in this proposed Update would result in different conclusions about the need to perform Step 2? If so, please describe such scenarios.

Question 5: Do you agree with the proposed effective dates for public and non-public entities? Are they operational? If not, why not?

Amendments to the *FASB Accounting Standards Codification*™

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–3 as a result of this proposed Update. In some cases, not only are the amended paragraphs shown but also the preceding and following paragraphs are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Subtopic 350-20

2. Add paragraph 350-20-35-8A and amend paragraphs 350-20-35-4, 350-20-35-6 through 35-7, and 350-20-35-30, with a link to transition paragraph 350-10-65-2, as follows:

Intangibles—Goodwill and Other—Goodwill

Subsequent Measurement

> 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).

> 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 carrying amount of a reporting unit shall be calculated as the difference between the total assets and total liabilities assigned to the reporting unit in accordance with paragraph 350-20-35-39.

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

350-20-35-6 If the carrying amount of a reporting unit is greater than zero and its fair value ~~of a reporting unit~~ exceeds its carrying amount, goodwill of the reporting unit is considered not impaired~~, thus~~; thus, the second step of the impairment test is unnecessary. If the carrying amount of the reporting unit is zero or negative, the guidance in paragraph 350-20-35-8A must be followed.

350-20-35-7 In determining the carrying amount of a reporting unit, deferred income taxes shall be included in the carrying ~~value~~amount of the reporting unit, regardless of whether the fair value of the reporting unit will be determined assuming it would be bought or sold in a taxable or nontaxable transaction.

350-20-35-8 If the carrying amount of a reporting unit exceeds its fair value the second step of the goodwill impairment test shall be performed to measure the amount of impairment loss, if any.

350-20-35-8A If the carrying amount of a reporting unit is zero or negative, the second step of the impairment test shall be performed to measure the amount of impairment loss, if any, when it is more likely than not that a goodwill impairment exists. In considering whether it is more likely than not that a goodwill impairment exists, an entity shall evaluate whether there are adverse qualitative factors, including the examples provided in paragraph 350-20-35-30(a) through (g).

> When to Test Goodwill for Impairment

350-20-35-28 Goodwill of a reporting unit shall be tested for impairment on an annual basis and between annual tests in certain circumstances (see paragraph 350-20-35-30). The annual goodwill impairment test may be performed any time during the fiscal year provided the test is performed at the same time every year. Different reporting units may be tested for impairment at different times.

350-20-35-29 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.

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. <u>Additionally, goodwill of a reporting unit with a zero or negative carrying amount shall be tested for impairment between annual tests if an event occurs or circumstances change to indicate that it is more likely than not that a goodwill impairment exists.</u> 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
f. 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
g. Recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit.

In addition, paragraph 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.

> Assigning Acquired Assets and Assumed Liabilities to a Reporting Unit

350-20-35-39 For the purpose of testing goodwill for impairment, acquired assets and assumed liabilities shall be assigned to a reporting unit as of the acquisition date if both of the following criteria are met:

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

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

3. Add paragraph 350-10-65-2 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2010-XX, *Intangibles—Goodwill and Other (Topic 350): How the Carrying Amount of a Reporting Unit Should Be Calculated When Performing Step 1 of the Goodwill Impairment Test*

350-10-65-2 The following represents the transition and effective date information related to Accounting Standards Update No. 2010-XX, *Intangibles—Goodwill and Other (Topic 350): How the Carrying Amount of a Reporting Unit Should Be Calculated When Performing Step 1 of the Goodwill Impairment Test:*

a. For **public entities,** the pending content that links to this paragraph shall be effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted.
b. For **nonpublic entities,** the pending content that links to this paragraph shall be effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Nonpublic reporting entities may elect to early adopt the pending content that links to this paragraph using the effective date for public entities in (a).
c. Upon adoption of the pending content that links to this paragraph, a reporting entity must assess whether it is more likely than not that a goodwill impairment exists for each reporting unit with a zero or negative carrying amount. If it is more likely than not that a goodwill impairment exists, the second step of the goodwill impairment test shall be performed (using the date of adoption for purposes of this step) to measure the amount of impairment loss, if any.
d. Any previously recognized goodwill impairment recognized before adopting the pending content that links to this paragraph shall not be reversed.
e. The pending content that links to this paragraph shall be adopted by recording a cumulative-effect adjustment to beginning retained earnings in the period of adoption.

The amendments in this proposed Update were approved for publication by the unanimous vote of the five members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
Thomas J. Linsmeier
Leslie F. Seidman
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this proposed Update. It includes the Board's basis for ratifying the Task Force conclusions when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information

BC2. Section 350-20-35 provides guidance that states that Step 2 of the goodwill impairment test should be performed when the carrying amount of the reporting unit exceeds its fair value. However, there is diversity in practice regarding how the carrying amount should be calculated. Some reporting entities calculate the carrying amount of the reporting unit using the equity premise, while others calculate the carrying amount using an enterprise premise. In practice, an enterprise premise sometimes is used when an entity has reporting units with zero or negative carrying amounts resulting from the application of the equity premise. However, some entities using the equity premise with reporting units with zero or negative carrying values have concluded that Step 1 of the test automatically is satisfied because the fair value of its reporting unit generally will be greater than zero. As a result of that conclusion, Step 2 of the test is not performed despite factors indicating that goodwill may be impaired.

Basis for Conclusions

BC3. During the discussion of this Issue, Task Force members evaluated different approaches to address this Issue. Some members of the Task Force stated that they were not in favor of an approach that required a Step 2 analysis to be performed solely because a reporting unit has a zero or negative carrying amount and there are no indicators that a goodwill impairment exists. One Task Force members stated that they preferred requiring reporting entities with a single reporting unit to assign assets and liabilities to the reporting unit in the same way in which they are assigned by reporting entities with multiple reporting units rather than changing the Step 1 analysis for certain entities. Both of these approaches were ultimately not favored by the Task Force.

BC4. The Task Force reached a consensus to require that (a) the carrying amount of a reporting unit be calculated on an equity basis and that (b) reporting entities with reporting units that have a zero or negative carrying amount perform Step 2 of the goodwill impairment test if there are adverse qualitative factors that indicate that it is more likely than not that a goodwill impairment exists. The qualitative factors are consistent with the existing guidance in paragraph 350-20-35-30, which requires that goodwill of a reporting unit 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.

BC5. The Task Force believes this consensus limits the burden on reporting entities because it does not automatically require Step 2 of the impairment test to be performed but addresses situations in which it is more likely than not a goodwill impairment exists.

Scope

BC6. The Task force concluded that the amendments in this proposed Update should apply to all entities that have recognized goodwill and either previously have applied an enterprise premise when applying Step 1 of the goodwill impairment test or have goodwill recorded in reporting units that have or may have in the future zero or negative carrying amounts.

Effective Date and Transition

BC7. The Task Force decided that the amendments in this proposed Update would be effective for fiscal years, and interim periods within those years, beginning after December 15, 2010, for public reporting entities. For nonpublic reporting entities, the amendments would be effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption would not be permitted for public reporting entities; however, nonpublic reporting entities could early adopt the proposed amendments using the effective date for public reporting entities.

BC8. In reaching that decision, the Task Force discussed the timeliness of education cycles and whether nonpublic entities will become aware of and have time to implement the proposed amendments before their effective date. Some Task Force members noted that while some nonpublic entities may not become aware of the proposed amendments before the effective date, other nonpublic entities may want to adopt at the same time as public reporting entities. Task Force members also observed that many users of nonpublic entity financial statements do not put emphasis on the reported amount of goodwill or related impairments.

BC9. The Task Force decided that the effect of initially adopting the amendments in this proposed Update should be recorded as a cumulative-effect adjustment to beginning retained earnings. The Task Force also indicated that it would be impractical to retrospectively apply the proposed amendments.

BC10. The Task Force decided to require reporting entities with reporting units whose carrying amounts are zero or negative to perform Step 2 of the impairment test if it is more likely than not that a goodwill impairment exists. This will ensure that potential existing impairments were identified upon adoption of the amendments.

Benefits and Costs

BC11. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC12. For certain entities, Step 2 of the goodwill impairment test would be required to be performed upon adoption. However, the Task Force believes that by only requiring the Step 2 analysis to be performed when it is more likely than not that a goodwill impairment exists, costs to implement are minimized. The Task Force believes that the cost of performing Step 2 for those reporting units is outweighed by the benefit of identifying reporting units whose goodwill is impaired but may have been unrecognized previously as a result of the operation of Step 1 of the existing impairment test.

Amendments to the XBRL Taxonomy

The following elements are proposed additions to the XBRL U.S. GAAP Financial Reporting Taxonomy. They reflect the amendments to the disclosure and presentation requirements of the Accounting Standards Codification and would be used in association (tagged) with the appropriate reported values in the SEC filer XBRL exhibit.

Individuals and organizations commenting on the amendments in this proposed Update should consider the usefulness, appropriateness, and completeness of these elements for entities required to include an XBRL exhibit with their SEC filings. Respondents also should consider the context of the elements in the current XBRL U.S. GAAP Financial Reporting Taxonomy.

Standard Label[†]	**Definition**	**Codification Reference**
Accounting Standards Update 2010-XX [Member]	Accounting Standards Update 2010-XX, Intangibles—Goodwill and Other (Topic 350): How the Carrying Amount of a Reporting Unit Should Be Calculated When Performing Step 1 of the Goodwill Impairment Test	350-10-65-1(b)

[†]The Standard Label and the Element Name are the same (except that the Element Name does not include spaces). If they are different, the Element Name is shown in *italics* after the Standard Label.