



2012 Fall Controllershship Course
Peninsula Palo Alto Chapter of Institute of
Management Accountants

Impairments and Intangibles
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Brief Bio

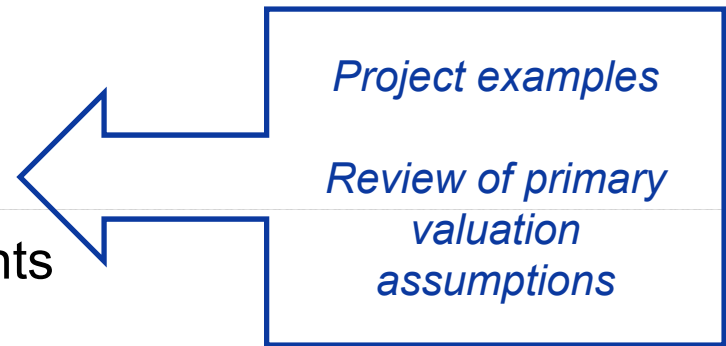
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AGENDA

- Introduction
- Background / Reference Slides
- Auditor Review Considerations
- Long-Lived Assets
- Sample SEC Issues and Comments
- Other Issues
- Q&A

- *Appendix – Presenter bio / contact information*



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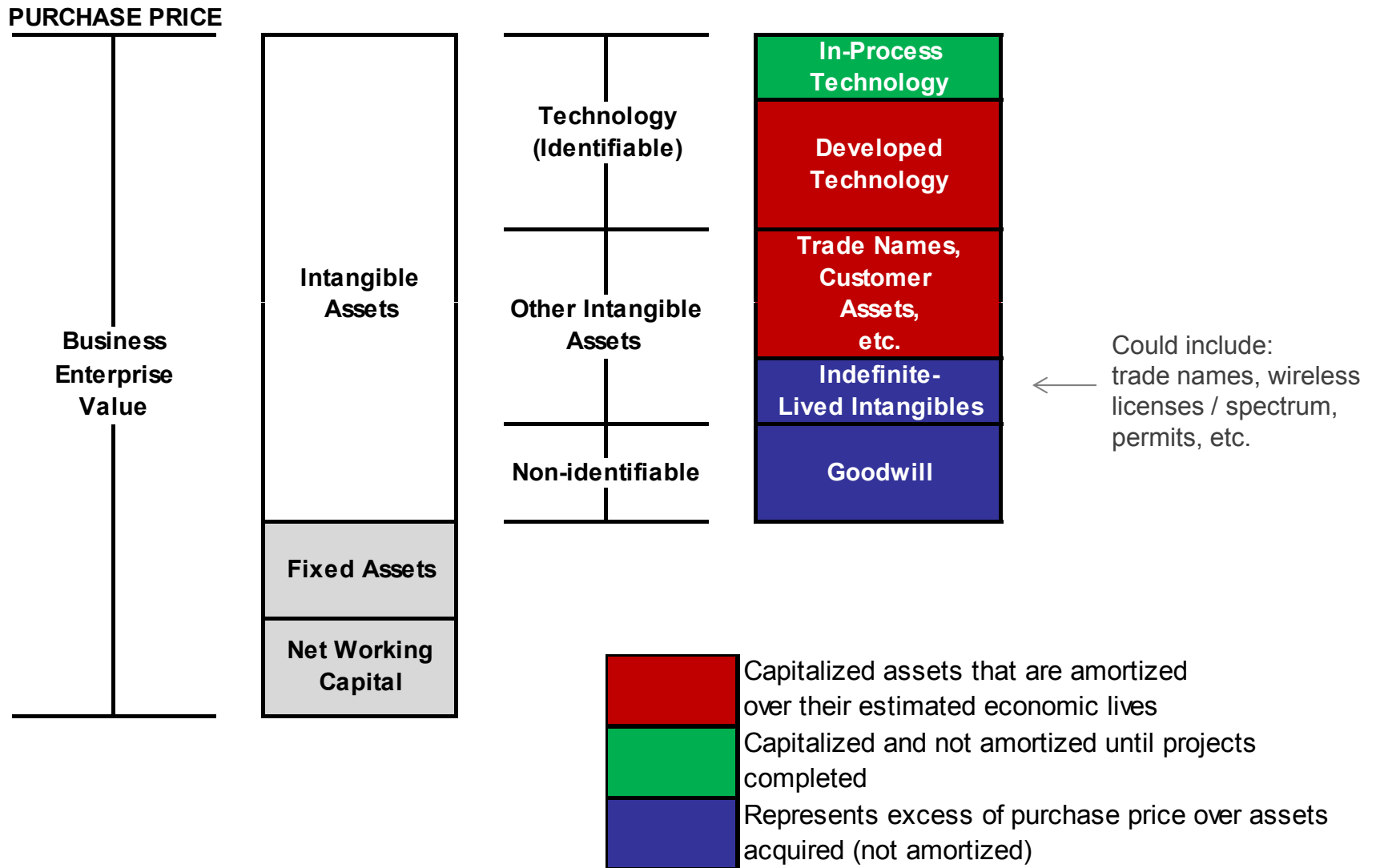
**BACKGROUND /
REFERENCE SLIDES**



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Background & Reference Slides

Overview of Purchase Price Allocation Principles (ASC 805)



Background & Reference Slides

Impairment Testing Overview

	Long-Lived Assets Tangibles & Intangibles	Indefinite-Lived Intangibles	Goodwill
Primary Guidance	<p>ASC 360 Accounting for the Impairment or Disposal of Long-Lived Assets</p> <p>Formerly SFAS 144</p> <p>ASC 350-30 (primarily -35)</p>	<p>ASC 350 Goodwill and Other Intangible Assets</p> <p>Formerly SFAS 142</p> <p>ASU 2012-02 (issued 7/12) Qualitative Testing</p>	<p>ASC 350 Goodwill and Other Intangible Assets</p> <p>Formerly SFAS 142</p> <p>ASU 2011-08 (issued 9/11) Qualitative Testing</p>
Focus	Test recoverability of long-lived assets; determine impairment if needed	Fair value test Indefinite-lived intangibles carried at lower of fair value or carrying value	Fair value test Goodwill carried at lower of fair value or carrying value
Testing	Event based	At least annually; event based if triggered	At least annually; event based if triggered

Background & Reference Slides

Impairment Testing Overview (continued)

Other Guidance

- ASC 820, *Fair Value Measurements and Disclosures* (formerly SFAS 157)

- Other
 - AICPA Accounting and Valuation Guide – Testing Goodwill for Impairment (draft issued 11/4/11)
 - AICPA Accounting and Valuation Guide – “IPR&D Practice Aid” (draft issued 11/18/11)
 - Appraisal Foundation Monographs
 - *Identification of Contributory Assets and Calculation of Economic Rents* (issued 2010)
 - *Valuation of Customer-Related Assets* (draft issued in 6/12)
 - SEC speeches

Background & Reference Slides

Impairment Testing Overview (continued)

- **“Order” of Impairment Testing**

- Difference – typical engagement sequence vs. measurement if multiple assets are tested for impairment (and are likely impaired)

- **If multiple assets are tested for impairment at the same time:**

1. Test other assets (e.g., accounts receivable and inventory) under applicable guidance and **indefinite-lived intangible assets**
2. Long-lived assets
3. Goodwill

Carrying values are adjusted, if necessary for the result of each test prior to performing the next test



**AUDITOR REVIEW
CONSIDERATIONS**



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Auditor Review Considerations

Collaboration and consensus among **management, auditors** (both audit and valuation teams), and **external valuation specialists** is key

- **Especially key for ASC 360 long-lived assets testing**
- Audit team questions (“tie-out” / PBC) and Valuation team questions (theory, methodologies, and valuation-specific assumptions)
- Firm and reviewer-specific considerations and preferences
- Consensus between local audit team vs. “National” standards group
- Well reasoned approaches + high quality documentation needed
 - Qualitative + quantitative
 - **Qualitative – understanding of “story” and why conclusion makes sense**

Engage in planning discussions as early as possible



LONG-LIVED ASSETS



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Long-Lived Assets *Overview and General Observations*

- Guidance in ASC 360 – “clear as mud” (client’s comment)
- Assumptions more subject to interpretation in audit review vs. goodwill test or purchase price allocations – **early discussions with auditors are key!**
- Best illustrated through examples (each reviewed by a different Big Four auditor)

	Example #1	Example #2	Example #3	Example #4
Company's Industry	Life sciences	Communications equipment / technology	Marketing and technology services	Telecom services provider
Assets Tested For Impairment	Long-lived assets (primarily fixed assets)	Long-lived assets (fixed assets; intangible assets including technology, customer relationships, and trade names) Goodwill Capitalized software (ASC 985)	Long-lived assets (intangible assets; nominal fixed assets) Goodwill	Long-lived assets (primarily fixed assets; minor intangible assets) Indefinite-lived intangible asset (licenses / spectrum)
Reporting Unit Details	Entire company (one reporting unit)	One of several reporting units	One of many reporting units (country-specific operations)	Entire company (one reporting unit)

Long-Lived Assets *Recoverability Test Overview*

- Impairment test focuses on recoverability vs. fair value.
 - Carrying value of **long-lived asset / asset group** is compared to the sum of projected **undiscounted cash flows** (“UCF”)
 - Includes only cash flows that are directly associated with and that are expected to arise as a result of the use and eventual disposition of the asset group
 - Cash flows are projected over the remaining useful life of the **primary asset** of the asset group
 - If UCF < carrying value, impairment needs to be measured and determined
- **Event-driven** (not an annual test like for goodwill)
- *Items in blue discussed in further detail in forthcoming slides*

Long-Lived Assets

Asset Group and Primary Asset

■ Asset group guidance

- Assets are grouped at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities
- However, an impairment loss – if any – only impacts the carrying amounts of long-lived assets
- Likely consists of fixed assets, intangible assets, and working capital
- *Example: ASC 360-10-55-36; transportation industry*

■ Primary asset

- Principal long-lived asset being depreciated or amortized that is the most significant component asset from which the asset group derives its cash-flow generating capacity
- Cannot be land or an indefinite-lived intangible asset

Long-Lived Assets

Asset Group and Primary Asset (continued)

Asset Group Examples

	Example #1	Example #2	Example #3	Example #4
Company's Industry	Life sciences	Communications equipment / technology	Marketing and technology services	Telecom services provider
Asset Group Included	Fixed assets Working capital Other LT assets/ liabilities	Intangible assets - Developed technology - Customer relationships - Trade names Fixed assets Other LT assets/ liabilities Working capital Capitalized software Included in Recoverability Test but tested for impairment separately under ASC 985	Intangible assets - Developed technology - Customer relationships Fixed assets Other LT assets/ liabilities	Fixed assets Other intangible assets - Nominal subscriber base Licenses / spectrum Indefinite-lived; included in Recoverability Test but tested for impairment separately
Primary Asset	Fixed assets	Capitalized software	Customer relationships	Fixed assets

Long-Lived Assets

When to Test for Impairment – “Triggering Events”

- ASC 360-10-35-21 lists the following examples of events or changes in circumstances that could indicate that the carrying amount of a long lived asset / asset group may not be recoverable:
 - A significant decrease in the market price of a long-lived asset (asset group)
 - A significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition
 - A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator
 - An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset (asset group)
 - A current-period operating or cash flow loss combined with a history of operating or cash flow losses or projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group)
 - A current expectation that, more likely than not, a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life. The term more likely than not refers to a level of likelihood that is more than 50 percent.

- Not an all-inclusive list

Long-Lived Assets *Undiscounted Cash Flows*

- Includes only cash flows that are directly associated with and that are expected to arise as a result of the *use* and *eventual disposition* of the asset group
- Cash flows are projected over the remaining useful life of the primary asset of the asset group
- Entity uses its *own assumptions* of asset use (not market participant since this is *not* a fair value test)
- Excludes interest and generally determined on a pre-tax basis
- Cash flows based on existing service potential
 - Includes maintenance-related expenses
 - Excludes future capital expenditures that would increase service potential; future R&D
- Consider proceeds related to potential sale of assets at end of period
- Consider of use of probability-weighted approach
 - May be appropriate if there are alternative courses of action

Long-Lived Assets

Undiscounted Cash Flows (continued)

Sample Recoverability Test Undiscounted Cash Flows Framework	For the fiscal years ending March 31,						
	2013	2014	2015	2016	2017	2018	
1) Revenue							
2) Operating expenses EBITDA							Maintenance-level
3) (less) / plus: Change in net working capital							
4) (less): Maintenance capital expenditures							
5) plus: Disposal / salvage value							
6) Cash flows							
Sum of undiscounted cash flows	("A")						
7) Compares to Subject Asset Group carrying value	("B")						
Difference -- UCF vs. carrying value						If A < B, impairment exists	

Long-Lived Assets

Undiscounted Cash Flows (continued)

Undiscounted Cash Flow Test Comments

	Example #1	Example #2	Example #3	Example #4
Company's Industry	Life sciences	Communications equipment / technology	Marketing and technology services	Telecom services provider
Test Framework	Probability-weighted approach	Most likely estimate (one scenario)	Most likely estimate (one scenario)	Probability-weighted approach
Primary Asset	Fixed assets	Capitalized software	Customer relationships	Fixed assets
Results	No impairment indicated	Impairment indicated	Impairment indicated	No impairment indicated
Qualitative Considerations (For Passing Examples)	<ul style="list-style-type: none"> - Overall market cap - Reconciliation of cash flow assumptions to entire entity 			<ul style="list-style-type: none"> - No impairment of indefinite-lived asset also tested - Overall market cap considerations

Long-Lived Assets

Determining Asset Impairment

- Asset impairment is an area where we have seen differences in practice and focus (and what is accepted in audit reviews) vs. examples in formal guidance
- **Guidance:**
 - Asset group is impaired by amount its carrying value exceeds its fair value
 - Fair value for asset group considers *market participant* assumptions which may be different from Recoverability Test *entity-specific* assumptions
 - Practical considerations; entity not precluded from using its own assumptions as long as there is no information indicating that market participants would use different assumptions
 - To determine fair value, UCF framework on previous page needs to be adjusted to reflect taxes, other cash flow adjustments (e.g., impact of depreciation/amortization), and present value considerations
 - Impairment then allocated on a pro-rata basis to the asset group's long-lived assets
 - **An asset cannot be impaired lower than its fair value**
- **In Practice:**
 - **Focus on estimating fair value of individual assets**

Long-Lived Assets

Determining Asset Impairment (continued)

Determining Asset Impairment -- Comments

	Example #2	Example #3	Example #4
Company's Industry	Communications equipment / technology	Marketing and technology services	Telecom services provider
Asset Impairment Models	<p>Fair value models for individual intangible assets</p> <ul style="list-style-type: none"> - Developed technology (Excess Earnings) - Customer relationships (Distributor Method) - Trade names (Relief-From-Royalty Method) <p>Fair value model for valuation of fixed assets (Cost Approach)</p>	<p>Allocation of impairment fair value to developed technology and customer relationships</p> <p>Fixed asset value assessed to be at floor value so was not adjusted</p>	<p>While impairment was not indicated as part of the Recoverability Test, we had discussed and had started work on valuing the fixed assets in the event the Recoverability Test failed</p> <p>Fair value model for valuation of fixed assets (Cost Approach)</p>
Asset Impairment Results	<p>Some intangible assets impaired (nominal, since many have been amortizing for several years)</p> <p>No fixed asset impairment</p>	Significant asset impairment (almost 90% of long-lived asset carrying value impaired)	NA
Qualitative Considerations	Considered relative values of intangible and fixed assets vs. goodwill	Considered very poor performance of business – full goodwill impairment indicated	<ul style="list-style-type: none"> - No impairment of indefinite-lived asset also tested - Overall market cap considerations; operations trends

Sample SEC Issues and Comments

■ Global Impairment Issues

- Disclose methodology and key assumptions used to test for impairment, as well as the basis for selecting those key assumptions
- Disclose the specific facts and circumstances that gave rise to impairments
- Disclose any assets or reporting units for which impairment charges are reasonably likely to occur in the next 12 to 24 months
- Provide sensitivity analysis

■ Intangible Asset-Specific Issues

- Disclose key assumptions that drive the fair value determination when utilizing a discounted cash flow analysis, within critical accounting policy
- Describe the method used to isolate the cash flows associated with the intangible asset (i.e., how were asset groups determined)
- Describe qualitatively and quantitatively the significant estimates and assumptions used in the valuation methods

Sample SEC Issues and Comments (continued)

- ☑ *Sample SEC comment: “In light of the impairment losses on property, plant and equipment recognized in the most recent year and the nature of long-lived impairment testing, please tell us your consideration of disclosing the methods, assumptions and estimates underlying your long-lived asset impairment measurements and the uncertainties associated with the measurements in your discussion of critical accounting estimates.”*

- ☑ *Sample SEC comment: “We see your history of losses. Tell us whether you have long-lived assets you believe are at risk for impairment based on your most recent testing. If so, please expand the related critical accounting policy disclosure in future filings to more specifically describe the nature of the assets at risk, the methods and key assumptions on which you based your evaluation and the degree of uncertainty associated with key assumptions.”*

- ☑ *Sample SEC comment: We note that indefinite-lived intangible assets account for a significant portion of your total assets. We also note that revenues, operating income and segment income have declined in recent quarters due to the negative impact of the current economic environment. We note that you performed your annual impairment test as of the end of the fiscal year and concluded that these assets were not impaired. Tell us whether you performed subsequent interim impairment tests. If you did not, tell us why, addressing the factors in ASC 360-10-35-21. You should discuss in your critical accounting estimates the factors you considered in determining why no interim impairment testing under ASC 350 was required.”*

■ Indefinite-Lived Intangible Assets

- Fair value test
- Recently issued Accounting Standards Update (“ASU”) – 2012-02 (issued in 7/12)
 - Permits entities to consider qualitative factors to assess whether a quantitative test for impairment is necessary
 - Effective for years beginning after 9/15/12; early adoption permitted
 - Similar concepts as ASU-2011-08 for goodwill
- Caution when assuming an indefinite-life for an asset as part of the purchase price allocation process – future impairment considerations
 - Consider long vs. indefinite life
 - *Examples: Recent Compaq trade name impairment; winery acquisition*

■ IFRS Considerations

- IAS 36, Impairment of Assets
- Different framework vs. U.S. ASC guidance
 - Assessment of value at cash-generating unit (“CGU”) level; typically includes goodwill
 - Determination of Recoverable Amount (higher of value in use vs. fair value less costs to sell)
 - If Recoverable Amount < CGU carrying value, impairment exists. Difference = impairment loss
 - Impairment loss allocated (no “Step 2” goodwill testing) – first to reduce goodwill until it is 0, then pro-rata to other CGU assets (though floor for each asset is its recoverable amount)



QUESTIONS?



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Appendix -- Speaker Background / Contact Information

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Current Responsibilities

Josette Ferrer is the founder and a Managing Director of Clairerent Advisors. Since 1993, Josette has been assisting clients with the valuation intangible assets, intellectual property, stock options, of closely held businesses and business interests, debt instruments, capital equipment / fixed assets, and other assets.

Experience

Prior to founding Clairerent Advisors in 2010, Josette was the U.S. Practice Leader of Marsh's Valuation Services Group (formerly Kroll's Valuation Services Practice). Her career includes serving as the Managing Director in charge of the San Francisco Valuation Services Group of WTAS, Inc. ("WTAS"), a former subsidiary of HSBC Group. At WTAS, Josette's responsibilities included developing and overseeing all technical, operational, marketing functions for the SF valuation team. Prior to WTAS, Josette was a director with Huron Consulting Group and a senior manager at Arthur Andersen LLP.

While Josette has extensive experience serving clients in many industries, areas of specialty include high technology, early stage ventures, telecommunications, service companies, consumer products, manufacturing, and financial services companies. Her clients have ranged from small, emerging businesses to Fortune 500 companies. Josette has been a guest speaker for a wide variety of forums, including Financial Executives International ("FEI"), the Institute of Management Accountants ("IMA"), the Practicing Law Institute ("PLI"), the San Francisco Bar Association, Santa Clara University, BIOCOM, and various venture capital roundtables, and has also published an article related to the valuation of intellectual property for the PLI.

Education and Affiliations

- B.S. in Business Administration, University of California, Berkeley
- Member, Fair Value Forum
- Board Member, SF Chapter, Financial Executives International
- ProVisors