

FASB Emerging Issues Task Force

Issue No. 10-A

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

Document: Issue Summary No. 1, with Working Group Report No. 1

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Previously distributed EITF materials: None

Background

1. Goodwill is tested for impairment at the reporting unit level based on a two-step test. The first step, Step 1, compares the fair value of a reporting unit to its carrying amount, including goodwill. If a reporting unit's carrying amount exceeds its fair value, the second step, Step 2, of the test must be performed to measure the amount of impairment, if any.
2. Paragraph 350-20-35-39, states that assets and liabilities are assigned to a reporting unit if both of the following criteria are met:
 - a. The asset will be employed in or the liability relates to the operations of the reporting unit.
 - b. The asset or liability will be considered in determining the fair value of the reporting unit.
3. Based on past and current practice issues (for example, reporting units with negative carrying values, and significant differences in the fair value versus par amount of debt) and a recent speech by the SEC at an AICPA conference in 2009, constituents have questioned whether a reporting unit's carrying amount should be based on an Enterprise premise or on an

Equity premise. An Enterprise premise is generally considered to be the value of a reporting unit determined on the basis of the net assets (that is, assets less liabilities) of the reporting unit excluding liabilities that are part of the capital structure (referred to hereinafter as *Debt Financing*) of the reporting unit. Those liabilities generally would exclude interest-bearing debt that is not considered working capital. Accordingly, when a reporting entity has a single reporting unit and calculates its carrying amount based on an Enterprise premise, the carrying amount can also be calculated as the sum of the Debt Financing and equity of the entity. Under an Enterprise premise, Debt Financing is excluded from the liabilities assigned to a reporting unit and consequently from the fair value of the reporting unit. Excluding Debt Financing from the liabilities assigned to a reporting unit eliminates the potential for a significant difference in the fair value and the carrying amount of debt to affect the outcome of Step 1 of the goodwill impairment test. Alternatively, when a reporting unit's carrying amount is based on an Equity premise, Debt Financing, like any other liability, is available for assignment to a reporting unit.

4. Whether Debt Financing is included in or excluded from a reporting unit's carrying amount could lead to a different conclusion in Step 1 of the test and, consequently, may determine whether Step 2 of the test is performed. One example of that situation is when a significant difference exists between the carrying amount and the fair value of Debt Financing. Consider the following illustration of a reporting entity with a single reporting unit for which the fair value of its Debt Financing is significantly less than its carrying amount:

	Carrying Amount	Fair Value	Result of Step One Test
Reporting unit Enterprise Value	\$ 10,000	\$ 9,800	Fail
Less: Debt Financing	(1,500)	(1,000)	
Reporting unit Equity Value	\$ 8,500	\$ 8,800	Pass

5. The illustration presented above indicates that if an Enterprise premise was used, the reporting unit would fail Step 1 of the test, thus the reporting entity would perform Step 2 of the test to measure the amount of impairment, if any. If an Equity premise was used, the reporting unit would pass Step 1 of the test and, thus, Step 2 of the test would not be performed.

6. The following example assumes that the fair value and the carrying amount of all assets, excluding goodwill, and all liabilities, excluding Debt Financing, are equal and that the carrying amount of Debt Financing is equal to its par value, as follows:

Carrying Amount (Enterprise Premise) = \$10,000					
Assets			Liabilities plus Equity		
Current Assets	\$	2,500	Current Liabilities	\$	1,500
Fixed Assets	\$	2,000	Other Long Term Liabilities	\$	-
Intangible Assets	\$	3,000	Debt Financing	\$	1,500
Goodwill	\$	<u>4,000</u>	Equity	\$	<u>8,500</u>
Total Assets	\$	11,500	Total Liabilities plus Equity	\$	11,500

Fair Value (Enterprise Premise) = \$9,800					
Assets			Liabilities plus Equity		
Current Assets	\$	2,500	Current Liabilities	\$	1,500
Fixed Assets	\$	2,000	Other Long Term Liabilities	\$	-
Intangible Assets	\$	3,000	Debt Financing	\$	1,000
Goodwill	\$	<u>3,800</u>	Equity	\$	<u>8,800</u>
Total Assets	\$	11,300	Total Liabilities plus Equity	\$	11,300

7. Although the illustration indicates a goodwill impairment of \$200, the reporting unit passes Step 1 of the test using an Equity premise because the fair value of the Debt Financing is significantly less than its par value. The reporting unit would fail Step 1 of the test if the par value of Debt Financing was subtracted from the Enterprise Value ($\$9,800 - \$1,500 = \$8,300$).

8. A Working Group was formed to assist the staff in understanding the issues associated with applying both the Equity premise and the Enterprise premise and in identifying potential solutions to address those issues. The Working Group met on May 10, 2010, and the Working

Group's report from that meeting is attached as Appendix 10-AA. The Working Group was asked to provide perspectives on the various approaches but was not asked to form a Working Group recommendation.

9. Some Working Group members stated that they believe that using an Equity premise for Step 1 of the test provides an appropriate indication of goodwill impairment in most circumstances. Those Working Group members indicated that they supported directly addressing through standard-setting those circumstances in which an Equity premise does not provide an appropriate indication of goodwill impairment (for example, when the carrying amount of a reporting unit's equity is negative).

10. Other Working Group members stated that they would favor an approach that would utilize an Enterprise premise in determining how the carrying amount of a reporting unit would be calculated when performing Step 1 of the test. Under an Enterprise premise, debt financing is excluded from the liabilities assigned to a reporting unit and consequently from the fair value of the reporting unit.

11. A variant to the Enterprise premise was offered by a Working Group member was the Asset premise. Under an Asset premise, the carrying value of the reporting unit is calculated as the sum of the carrying amount of its assets less its deferred tax liabilities. The Asset premise includes deferred tax liabilities to be consistent with the treatment of deferred tax assets and for consistency with the application in determining goodwill in a business combination as a result of the iterative process between deferred tax liabilities and goodwill under Topic 350. This approach was suggested as a model because (a) it may be simpler to apply, because it avoids some of the complexities associated with assigning and valuing liabilities, (b) it is similar to how the fair value of reporting units are determined in valuations, and (c) supporters of this premise believe that the impairment of goodwill should not be influenced by changes in values of liabilities.

12. A third approach offered by some Working Group members is to calculate the carrying amount of the reporting unit on the basis of how a market participant would value the reporting

unit in a transaction. That is, the carrying amount of the reporting unit would include only those assets and liabilities that a market participant would include when pricing the reporting unit.

13. At the July 29, 2010 EITF meeting, the staff intends to obtain the Task Force's preference for an approach that more narrowly addresses anomalous situations or one that more broadly reconsiders how the carrying amount of a reporting unit is calculated when performing Step 1 of the test. This Issue Summary includes the following views to facilitate Task Force discussion of this Issue:

View A – Specify that Step 1 of the test is to be performed using an Equity premise but require that Step 2 of the test be performed when a reporting unit has a negative carrying amount.

View B – Specify that Step 1 of the test is to be performed using an Equity premise but require that Step 2 of the test be performed if qualitative factors exist that indicate that goodwill may be impaired and those factors were not taken into account in Step 1 of the test.

View C – Specify that Step 1 of the test is to be performed using an Enterprise premise.

View D – Specify that Step 1 of the test is to be performed using an Asset premise.

View E – Specify that Step 1 of the test is to be performed on the basis of how a market participant would value the reporting unit in a transaction.

14. Views A and B are more limited approaches to address specific issues identified with applying Step 1 of the test using an Equity premise, while Views C, D, and E would be broader in nature. The staff expects that additional analysis may be necessary if the Task Force favors Views C, D, or E. The potential additional analysis is discussed below in each of the proposed views. Based on the direction provided by the Task Force at its July 29, 2010 meeting, the staff expects to perform any additional analysis, including potentially reconvening the Issue 10-A Working Group, and present it at the next EITF meeting on September 16, 2010. If the Task Force reaches a consensus-for-exposure at the September meeting, there would be sufficient time to expose a proposed Update for comment, allow for redeliberations at the November 19, 2010 EITF meeting, and potentially finalize the Issue prior to the end of the year.

Scope

15. This Issue applies to reporting entities that are required to test goodwill for impairment.

Accounting Issue and Alternatives

How the carrying amount of a reporting unit should be calculated when performing Step 1 of the goodwill impairment test.

View A: Financing Debt is similar to other liabilities and should be considered for inclusion in the carrying amount of a reporting unit consistent with the guidance in paragraph 350-20-35-39 (Equity premise); however, reporting entities should apply Step 2 of the goodwill impairment test if the reporting unit has a negative carrying amount.

16. Proponents of View A believe that Subtopic 350-20 requires the use of an Equity premise. They refer to paragraphs 350-20-35-22 and 35-23 which indicate that 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 due to the value arising from control. Proponents of View A believe that the reference to the value of equity securities implies that the goodwill impairment test was intended to be applied using an Equity premise.

17. Furthermore, proponents of View A believe that the question was indirectly answered during the October 31, 2002 EITF Agenda Committee meeting. The Agenda Committee Report indicates that the Agenda Committee addressed whether it would ever be appropriate for a reporting entity with a single reporting unit to exclude an asset or a liability from that reporting unit. The Agenda Committee indicated that, in its view, if a reporting entity has only one reporting unit, all of the reporting entity's assets and liabilities should be included in that reporting unit. Proponents of View A believe that the Agenda Committee's view supports an Equity premise. Opponents of View A note that the Agenda Committee's view is not authoritative.

18. Some opponents of View A agree with the observation that the guidance requires the use of an Equity premise, but do not agree with the conclusions reached by the Agenda Committee. These opponents observe that entities that have multiple reporting units are required to assess whether Financing Debt or other assets and liabilities should be assigned to a specific reporting unit. They believe the same analysis should apply to a single reporting unit entity. For example, an environmental liability related to a previously sold business that was retained by the seller may not be related to the operations of the reporting unit; thus, some believe it fails to meet the second criteria of paragraph 350-20-35-39 for assignment to the reporting unit. In that regard, opponents of View A assert there is not a common answer, but, rather, that it will depend on the facts and circumstances as to whether a liability is assigned to a reporting unit. These opponents believe that if the current guidance is applied consistently for single or multiple reporting unit structures, then it would effectively solve this practice issue.

19. Other opponents of View A argue that in certain situations, the adherence to an Equity premise with the assignment of Financing Debt to a reporting unit might result in a shielding of goodwill in Step 1 of the test (for example, when the fair value of a debt is significantly different from the par amount, as illustrated above). Those opponents observe that there are situations in which the recorded goodwill is impaired but, as a result of the inclusion of debt within the carrying amount of the reporting unit, the reporting entity is unable to proceed to Step 2 of the test.

20. Proponents of View A observe that Step 1 was designed as a screening mechanism. Thus, they claim the test was not designed to replicate a one-step test of goodwill. Those proponents highlight examples in which the Step 1 screen might be viewed to shield a goodwill impairment, but point out that this was contemplated by the model. One such example is when an intangible asset contributes to the fair value of the reporting unit, yet has no carrying value. This could cause the reporting unit to pass Step 1 even in circumstances in which the underlying goodwill is impaired (if Step 2 were performed). Another example is when deferred income taxes are required to be included in the carrying amount of the reporting unit, even though the fair value of the reporting unit is measured assuming a sale structure as a taxable transaction. .

View B: Financing Debt is similar to other liabilities and should be considered for inclusion in the carrying amount of a reporting unit consistent with the guidance in paragraph 350-20-35-39 (Equity premise); however, entities should apply Step 2 of the goodwill impairment test if qualitative factors exist that indicate that it is more likely than not that a goodwill impairment may exist and those factors are not captured by the quantitative test under Step 1.

21. Proponents of View B believe that this approach addresses the concern that reporting units that may have a goodwill impairment may pass Step 1 of the test because of the limitations of the quantitative test while using an Equity premise. This view would add a qualitative test to Step 1 so that reporting entities would need to consider whether anomalous situations exist within the quantitative test under Step 1 that may be masking a potential impairment.

22. Proponents support including examples of factors that might trigger Step 2 of the test to make the principle more operational and understandable. Those factors might include:

- a. A reporting unit that has a nominal or negative carrying amount
- b. A reporting unit that has liabilities whose fair values differ significantly from their carrying amounts
- c. A reporting unit whose carrying amount includes deferred taxes and the reporting unit's fair value is based on an assumed taxable transaction structure.

23. Proponents of View B support requiring that Step 2 be performed only when it is more likely than not that a goodwill impairment may exist rather than automatically requiring a reporting entity to perform Step 2 if qualitative factors exist. These proponents believe that automatically requiring Step 2 when a qualitative factor is present would be burdensome to preparers and in many situations may not be necessary. For example, a reporting entity may have a negative carrying amount but may not necessarily be suffering financial or operational difficulties. Such a situation could occur because the reporting entity recently completed a highly leveraged recapitalization transaction. Another example may be that the reporting unit benefits from the deferred tax shield in Step 1 but after considering the effect of that shield the reporting entity may conclude that it is not likely that an impairment exists. Accordingly,

proponents of View B believe that this approach provides a principles-based solution for addressing the concerns raised by this Issue while balancing operational and cost versus benefit concerns.

24. Opponents of View B are concerned with the operability of such an approach, particularly due to the subjectivity associated with determining what quantitative factors may trigger the need to perform Step 2 of the test. These opponents are concerned that not every qualitative factor may be readily apparent when considering the quantitative test under Step 1, which may increase the risk of unidentified impairments.

View C: Financing Debt is always excluded from the liabilities assigned to a reporting unit and consequently from the fair value of a reporting unit when performing Step 1 of the goodwill impairment test (Enterprise premise).

25. Proponents of View C believe that testing goodwill for impairment should be capital structure¹ neutral. That is, they believe that the capital structure of a reporting unit and the amount of leverage² within the capital structure are not relevant to the fair value measurement.

26. Proponents of View C also believe that the guidance in Subtopic 350-20 requires an Enterprise premise because debt does not relate to the "operations" of a business and, therefore, should always be excluded from the liabilities assigned to that reporting unit and from that reporting unit's measured fair value. They believe that debt, like equity, is a form of financing the operations of a business, but not part of the operations of the business.

27. Proponents of View C observe that further guidance may need to be developed regarding which types of debt should be excluded from the carrying amount as well as what other liabilities, if any, should be excluded from the carrying amount (for example, non-operating liabilities) (that is, Debt Financing). One suggestion made at the Working Group meeting was to use the concepts from the Board's financial statement presentation project to make this

¹ The percent of debt versus the percent of equity.

² Ratio of debt to total capital (that is, debt and equity combined).

determination. That is, assets or liabilities that would be either operating or investing activities should be included in the valuation and those assets or liabilities that are included in financing activities would be excluded. However, there may be some concern with pursuing that approach since the FASB's financial statement presentation project is not yet completed and is subject to change.

28. Opponents of View C believe that an Enterprise premise is not appropriate for all reporting entities, for example, financial institutions and insurance companies, because interest-bearing liabilities used to finance the reporting entity's assets are an integral part of their business. Most of the Working Group members agreed that an Enterprise premise was not the most appropriate method for Step 1 of the test for financial institutions, insurance companies, and other entities whose business model is to manage a net margin between assets and liabilities. If the Task Force were to choose to pursue a View C approach, an alternative approach would likely need to be developed for those types of entities.

View D: Modify Step 1 of the goodwill impairment test so that it is based on an Asset premise, that is, only a reporting unit's assets (less any deferred tax liabilities) are considered when performing the test.

29. Proponents of View D believe that given the difficulty with determining which liabilities to exclude from the carrying amount of the reporting unit discussed under View C, the Asset premise is a simpler method to apply because all liabilities other than deferred tax liabilities are excluded from determining the carrying amount of the reporting unit. In other words, as currently required, deferred income taxes related to the reporting unit would be included in the carrying value of the reporting unit's assets, regardless of whether the fair value of the reporting unit will be determined assuming it would be bought or sold in a taxable transaction. Most members of the Working Group noted that there generally were no issues associated with determining which assets should be included in a reporting unit but, rather, that determining which liabilities should be included was more complicated and fact specific. These proponents note that this model would result in a better comparison of the reporting unit's carrying amount and fair value.

30. Opponents of View D believe that an Asset premise is not appropriate for all reporting entities, for example, financial institutions and insurance companies, because interest-bearing liabilities used to finance the reporting entity's assets are an integral part of their business. Most of the Working Group members agreed that an Asset premise was not the most appropriate method for Step 1 of the test for financial institutions, insurance companies, and other entities whose business model is to manage a net margin between assets and liabilities. If the Task Force were to choose to pursue a View D approach, an alternative approach would likely need to be developed for those types of entities.

View E: Assets and liabilities of a reporting unit should be included in its carrying amount if market participants would take into account those assets or liabilities when measuring the fair value of the reporting unit.

31. Proponents of View E do not believe in prescribing a specific method for determining which assets and liabilities should be included in the carrying amount of a reporting unit for testing impairment. These proponents believe that a reporting entity should first determine how a market participant would value the reporting unit. That fair value measurement would then be used to determine which assets and liabilities employed in the reporting unit should be included in the carrying amount for purposes of performing Step 1 of the test. These proponents believe that this approach is consistent with paragraph 350-20-35-22, which states that "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." These proponents cite paragraph B116 of the basis for conclusions for FASB Statement No. 142, *Goodwill and Other Intangible Assets*, where the Board noted that the objective of the assignment process should be to ensure that the assets and liabilities that are assigned to a reporting unit are the same net assets that are considered in determining the fair value of the unit. Because a market participant's view must be considered when measuring fair value, View E proponents believe that this alternative is consistent with both (a) the requirements to measure fair value and (b) the objective of the assignment process.

32. Opponents of View E believe that such an approach would result in an unnecessary yet significant change to the goodwill impairment model to address the limited situations that this Issue is attempting to address. They also note the example described in View A for which the tax structure of the transaction (and consequently its valuation premise) is not considered when determining whether deferred tax assets or liabilities would be included in the reporting unit's carrying amount. The Task Force previously made that decision understanding that its conclusion could potentially result in a goodwill impairment shield, and these opponents question what information has changed that would trigger a reassessment of that conclusion.

33. Opponents of View E also point out that under this approach it may be difficult to determine what assets and liabilities a market participant might purchase, and the composition of those assets and liabilities could change each time a goodwill impairment test is performed.

Recurring Disclosures

34. Because each of the above approaches for performing Step 1 of the test would increase the likelihood of identifying goodwill impairments and should address the anomalous situations that raised this Issue, the staff does not believe that any additional recurring disclosures is warranted.

Transition Method and Disclosures

35. Because both Step 1 and Step 2 of the goodwill impairment test often involve using valuation techniques that require projecting future cash flows to measure fair value, the staff believes that retrospective application of any of the approaches would require significant estimates of cash flows and fair values and that it may not be possible to objectively distinguish information about those estimates that: (a) provides evidence of circumstances that existed on the dates at which those amounts would be recognized, measured, or disclosed under retrospective application, and (b) would have been available when the financial statements for that prior period were issued. Thus, applying any of the above views on a retrospective basis may be impracticable as discussed in paragraph 250-10-45-9.

36. Accordingly, the staff recommends that transition on this Issue be applied in a similar manner as was required for FASB Statement No. 142, *Goodwill and Other Intangible Assets*.

The adoption of the Statement 142 required an impairment loss recognized as a result of a transitional goodwill impairment test to be recognized as the effect of a change in accounting principle by recording the cumulative effect of the change to beginning retained earnings in the period of adoption. The staff notes that Statement 142 provided entities with an extended period to complete the transitional impairment test because of the significance of the change to practice in testing goodwill for impairment and the related valuation considerations involved. The staff does not believe that those circumstances exist today given that entities have been performing the goodwill impairment tests for almost 10 years. As such, the staff recommends that any cumulative effect adjustment required as a result of adopting this guidance be recorded in the first reporting period in the initial period of adoption (for example, first quarter financial statements for a calendar year entity).

37. The staff expects that this Issue may affect a number of reporting entities with a single reporting unit when there is a significant difference between the fair value and the carrying amount of their Debt Financing. However, whether or not early adoption should be allowed is dependent upon how the Task Force resolves this Issue.

International Convergence

38. The International Financial Reporting Standards goodwill impairment test in International Accounting Standard 36, *Impairment of Assets* (IAS 36), is different from U.S. GAAP in several respects; including the level at which impairment is tested, how fair value may be measured, and the manner in which a goodwill impairment is calculated. Additionally, the impairment model for goodwill pursuant to IAS 36 is a one-step model that requires an impairment to be recognized when the recoverable amount of the cash generating unit is less than its recoverable amount. The Board considered a one-step impairment test in its deliberations of Statement 142, however, it determined that a two-step test was more appropriate primarily due to cost versus benefit concerns raised by constituents. Given the pervasiveness of the differences between U.S. GAAP and IFRS, the staff does not believe convergence can be achieved solely through this Issue.

Appendix 10-AA

FASB Emerging Issues Task Force

Issue No: 10-A

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

Document: Working Group Report No. 1*

Date Prepared: June 1, 2010

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Dates Issue Previously Discussed: None

Previously Distributed EITF Materials: None

Purpose

1. The purpose of this document is to summarize the discussion of this Issue at the EITF Issue 10-A Working Group meeting held on May 10, 2010. The Working Group was assembled to (a) explore certain concerns that have been raised relating to the application of Step 1 of the goodwill impairment test and (b) assist the staff with (i) understanding how practice has interpreted existing accounting literature and (ii) exploring how the goodwill impairment testing requirements could be improved. This Working Group Report also sets forth related staff observations.

Background

2. Members of the Working Group represented accounting and valuation firms. Many of the Working Group members also are members of the AICPA Impairment Task Force. Two SEC staff members participated as observers.

Working Group Discussion

3. The Working Group discussed nine questions, which are discussed in the following paragraphs.

Defining the Premise

Question 1: Do you agree with the definitions of the Enterprise premise and the Equity premise presented in Working Group Discussion Document No. 1? If not, how would you propose to change them?

4. Working Group members discussed three methods for determining the carrying value of reporting units when performing Step 1 of the goodwill impairment test. In addition to the Enterprise premise and the Equity premise, which were defined in Discussion Document No. 1, the Asset premise was introduced. Under an Asset premise, the carrying value of the reporting unit is calculated as the sum of the carrying amount of its assets less its deferred tax liabilities. The Asset premise includes deferred tax liabilities to be consistent with the treatment of deferred tax assets and for consistency with the application in determining goodwill in a business combination as a result of the iterative process between deferred tax liabilities and goodwill under Topic 350. This approach was suggested as a model because (a) it may be simpler to apply, as it avoids some of the complexities associated with assigning and valuing liabilities, (b) it is similar to how the fair value of reporting units are determined in valuations, and (c) supporters of this premise believe that the impairment of goodwill should not be influenced by changes in values of liabilities. Under the Asset premise, the carrying amount of the reporting unit's total assets (including goodwill) would be compared to the fair value of those assets. The Working Group discussed the Asset premise and some members noted that it would be easier to apply than the Enterprise premise since liabilities other than deferred tax liabilities would not be assigned to reporting units.

5. Most of the Working Group members stated that they did not believe that the Enterprise or Asset premises would be appropriate for all reporting entities, such as financial institutions and insurance companies, because interest-bearing liabilities, such as liabilities used to finance the reporting entity's assets, are an integral part of the business model for those reporting entities. In

other words, the business model for those entities is designed to manage the net margins between assets and liabilities.

6. One observer from the SEC noted that the question of using the Enterprise premise or the Equity premise was raised in a speech with nonfinancial institutions in mind; thus, the determination of which premise is appropriate may not be the same for different industries.

7. There was general agreement that, if the Enterprise premise is prescribed, it could be difficult to determine which liabilities should be assigned to a reporting unit when calculating a reporting entity's carrying amount. For example, whether a pension liability should be included in the carrying value of a reporting unit under the Enterprise premise (that is, is it a working capital liability or a long-term financing liability). A suggestion was made to consider using the principle developed by the joint FASB/IASB project on financial statement presentation to determine which liabilities are for working capital (operating) and which are for financing.

8. Working Group members also noted that when a reporting entity has multiple reporting units, often all of the reporting entity's liabilities are not assigned to a reporting unit. However, for a single reporting unit, generally all of the reporting entity's liabilities are assigned to a reporting unit.

9. Some Working Group members believe that the criteria in paragraph 350-20-35-39 can be difficult to apply. Paragraph 350-20-35-39 states:

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 the reporting unit.
- b. The asset or liability will be considered in determining the fair value of the reporting unit.

Question 2: Do you believe that guidance to clarify these terms and, in particular, the definition of which liabilities should be excluded when using the Enterprise premise is necessary? If so, what should be clarified and how?

10. As described above, Working Group members discussed the assignment of liabilities to reporting units and generally agreed that it was the most challenging part of the task. Given that difficulty along with how important it is to be able to assign liabilities to the performance of the goodwill impairment test, there was general consensus that further clarification was needed. However, the Working Group did not reach a viewpoint on how to best accomplish that objective.

Staff Observation: If the Task Force were to conclude that the Enterprise premise is the appropriate methodology, further guidance may be needed. For example, on how to categorize liabilities as either working capital or financing for purposes of calculating a reporting unit's carrying amount using an Enterprise premise and how that model would be applied by certain reporting entities, such as financial institutions and other reporting entities for which financing is an integral part of the operating strategy.

Interpretation of Existing Guidance

Question 3: Do you interpret existing accounting guidance to require either the Enterprise premise or the Equity premise, or is it unclear? Why?

11. Although some Working Group members stated that they believe that the Equity premise is generally used in practice, some Working Group members noted that the guidance is not clear. Thus, Working Group members generally agreed that the existing accounting guidance should be clarified.

12. Some Working Group members stated that they believe that existing accounting literature allows a reporting entity the flexibility to determine the most appropriate premise for Step 1 of the test and that a reporting entity should consider using an Enterprise premise if that premise would provide a better indication of goodwill impairment than an Equity premise. Those

Working Group members reference, among other things, an SEC staff member speech at the 2009 AICPA National Conference on Current SEC and PCAOB Developments that suggested that an enterprise premise may be appropriate under certain circumstances when performing Step 1 of the goodwill impairment test.

Staff Observation: As a result, it appears that there is a need to clarify the accounting guidance regarding which alternative is appropriate, including whether there are situations in which different premises should be used.

Question 4: If following an Equity premise, do you believe that existing guidance requires all of a reporting entity's liabilities to be assigned to a reporting unit? Does your view change if the reporting entity has a single reporting unit versus multiple reporting units? Why?

13. Generally, members of the Working Group acknowledged and agreed that they believe that the guidance does not require that all liabilities must be assigned to a reporting unit when there are multiple reporting units. However, Working Group members stated that liabilities are fully assigned when there is a single reporting unit; based on the EITF Agenda Committee decision on October 31, 2002.

14. Several Working Group members believe that it should be possible that some liabilities would not be assigned to the reporting unit even when there is only one reporting unit (for example, an environmental liability related to a sold business that is not related to the remaining business). Several Working Group members indicated that they believe that the concept should be reconsidered.

Staff Observation: It appears that the concept of assigning all liabilities to a reporting unit when the reporting entity only has one reporting unit should be reconsidered.

Alternatives

Question 5: What are your views on the following alternatives assuming that any method could be used?

Alternative A – Compare the carrying value of the reporting unit to its fair value using an Enterprise premise.

Alternative B – Compare the carrying value of the reporting unit to its fair value using an Equity premise.

Alternative B1 – Same as Alternative B except require Step 2 of the goodwill impairment test when the carrying value of the reporting unit is less than or equal to zero. This view would address situations in which Step 2 is not performed because the reporting unit's carrying value is negative. Opponents of this view note that a carrying value of \$1 would pass Step 1 (assuming the fair value of the reporting unit was greater than \$1), whereas, a carrying value of zero would fail and require Step 2. Thus, they do not believe that this is an appropriate result when goodwill may be impaired in both situations. Some opponents of this alternative prefer Alternative B2.

Alternative B2 – Same as B1 except also require Step 2 of the goodwill impairment test if the carrying amount of debt is significantly higher than its fair value primarily due to the entity's credit risk. This alternative addresses the concerns that Alternative B1 draws a bright line on when to perform Step 2 even though similar situations may exist for reporting units that have slightly positive carrying values. Proponents of this alternative believe that it provides a more principles based approach for assessing when Step 2 should be performed.

Alternative C – Do not prescribe a premise for Step 1 of the goodwill impairment test; perform the Step 1 phase of the test on the basis of how market participants would measure the fair value of the reporting unit.

15. The staff observed that there was not significant support for any of the alternatives presented. However, Working Group members stated that they did not support Alternatives B1

and B2 because Working Group members generally did not believe that the principle should be based upon whether a reporting unit's equity has a positive carrying value.

16. Alternatives B1 and B2 were generally viewed as quick fixes without underlying principles to address the underlying question of whether the Enterprise premise or the Equity premise should be used to screen for potential goodwill impairments. In addition, several members of the Working Group stated that they thought Alternative B2 would be too difficult to implement, especially for a reporting entity that does not have publicly traded debt to assess its own credit.

Staff Observation: Working Group members generally agreed that the EITF should consider a goodwill impairment model that would accommodate reporting entities across industries.

Question 6: Are there other alternatives that accomplish the objective of identifying goodwill impairment other than by requiring annual valuations of the reporting units' assets and liabilities (that is, Step 2 of the goodwill impairment test)?

17. Other than the Asset premise discussed above, some Working Group members suggested that the carrying value of the reporting unit should be determined on the basis of how market participants would value that reporting unit. In other words, assets and liabilities should be assigned to a reporting unit from a market participant perspective rather than from how management uses them. That approach would redefine how the carrying value of reporting units would be determined. In addition, Working Group members noted that this approach would have the reporting units being valued differently from the way in which management is using the related assets and liabilities.

18. Some Working Group members suggested adding qualitative factors to the quantitative factors to indicate when Step 2 in the goodwill impairment test is required, such as when the fair value of the reporting unit's debt from the holder's perspective is significantly lower than its carrying value.

Question 7: International Accounting Standard 36, *Impairment of Assets*, provides for a one-step goodwill impairment test. While the impairment model and unit of accounting under IAS 36 differ from U.S. GAAP, some constituents believe that a one-step impairment model is superior to a two-step approach. The FASB considered whether to require a one-step test during its deliberations of FASB Statement No. 142, *Goodwill and Other Intangible Assets*, but ultimately decided against that approach due to cost-benefit concerns. Should the Task Force reconsider whether to require a one-step impairment test for goodwill? Why?

19. The Working Group briefly discussed this topic and there was general support for continuing with a two-step model versus moving toward a model similar to IFRS. Working Group members observed that if such a change were to be made, those efforts would be better addressed by the Board rather than the EITF.

Staff Observation: In the absence of the Board adding a comprehensive project to its agenda to address asset impairments, it appears that Working Group members supported retaining the current two-step goodwill impairment model over moving to a one-step model similar to IFRS.

Question 8: Deferred taxes are required to be included in the carrying value of a reporting unit at book value regardless of the tax structure assumed in the valuation of the reporting entity. That guidance may result in a shield if the reporting unit has a significant net deferred tax liability position. That situation could also increase the likelihood of an impairment if the reporting unit is in a significant deferred tax asset position. That guidance can result in situations in which the carrying value and fair value of a reporting unit in Step 1 of the goodwill impairment test are not on an "apples-to-apples" basis. Do you believe that the Task Force should reconsider this guidance? Why? Are there operability concerns relating to requiring an entity to consider the likely tax structure of a hypothetical transaction?

20. Working Group members acknowledged that the required treatment of deferred taxes in an impairment test has the potential to create an impairment shield when net deferred liabilities are

included in the carrying value of a reporting unit and increases the likelihood of failing Step 1 of the goodwill impairment test when net deferred tax assets are included in the carrying value of a reporting unit.

21. Working Group members pointed out that if the determination of the reporting unit was determined based on market participant assumptions, then this concept may need to be revisited.

Staff Observation: If the Task Force determines that the carrying value of the reporting unit should be based on market participant assumptions, then the treatment of deferred taxes in calculating the carrying value should be revisited.

Other

Question 9: If the Task Force selects the Enterprise premise, are there certain industries or situations in which an Equity premise (for example, financial services industry) is generally used such that an Enterprise premise would be difficult to use?

22. See discussion under Question 1.

Question 10: If the Task Force selects the Equity premise, are there situations (other than when the carrying value of the reporting unit is less than or equal to zero or there is a significant difference between the carrying value and fair value of debt) that also result in illogical conclusions?

23. Working Group members noted two other situations that can create impairment "shields." The first situation relates to including deferred tax assets and liabilities in the carrying value of the reporting unit regardless of the tax structure assumed in the valuation. This potential shield is due to the guidance in paragraph 350-20-35-7 (originally issued as EITF Issue No. 02-13, "Deferred Income Tax Considerations in Applying the Goodwill Impairment Test in FASB Statement No. 142"), which is addressed by Question 8 above. The second situation relates to Topic 805 (originally issued as FASB Statement No. 141 (revised 2007), *Business Combinations*), which requires noncontrolling interests to be measured at fair value to determine

the carrying amount of acquired assets and liabilities versus FASB Statement No 141, *Business Combinations*, which required noncontrolling interests to be measured at historical cost.

Staff Observation: The staff noted that some Working Group members stated that the EITF should consider the effect these "shields" may have on the goodwill impairment analysis.

Other Observations:

24. Most Working Group members agreed that the situation in which the comparison of a negative or zero carrying amount versus a positive equity value for a reporting unit arose the most frequently in entities with single reporting units.