

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

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Purpose

1. The purpose of this document is to clarify the Asset premise, which is the basis of View D in Issue Summary No. 1, for determining both the carrying value of a reporting unit and its fair value for purposes of Step 1 of the goodwill impairment test.

Determining the Carry Value of a Reporting Unit

2. Under the Asset premise, the carrying value of the reporting unit is calculated as the sum of the carrying amounts of its assets less its deferred tax liabilities. The Asset premise includes deferred tax liabilities in order 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, *Intangibles - Goodwill and Others*.

Determining the Fair Value of a Reporting Unit

3. To perform Step 1 of the impairment test using the Asset premise, the fair value of the reporting unit is determined by calculating its base enterprise value and then adding back all liabilities included in that enterprise value calculation. A business enterprise value (sometimes

referred to as total invested capital) as determined by an income or market approach is typically understood to be the combined fair value of working capital, fixed assets, and intangible assets including goodwill. Other liabilities are generally not included in this valuation. For purposes of this Issue Summary, this valuation is referred to as the "base enterprise valuation." Because the Asset premise uses the base enterprise valuation as its starting point, this method avoids some of the complexities associated with defining an Enterprise premise (View C of Issue Summary No. 1). For example, in applying View C, an entity may need to adjust the base enterprise valuation for non-working capital liabilities, such as legal contingencies, pension obligations, or environmental liabilities. Because the Asset premise starts with the base enterprise valuation value, which valuation experts typically determine consistently, the Asset premise potentially avoids some of the complexities of the Enterprise premise which might be necessary if View C was applied.

Example of Calculating Carrying Value and Fair Value of Reporting Unit

4. Assume the reporting unit's carrying amounts are as follows:

Carrying Amount			
Assets		Liabilities plus Equity	
Current Assets	\$ 2,500	Working capital liabilities	\$ 1,500
Fixed Assets	\$ 2,000	Deferred tax liabilities, net	\$ 500
Intangible Assets	\$ 3,000	Debt Financing	\$ 1,500
Goodwill	\$ 4,000	Equity	\$ 8,000
Total Assets	\$ 11,500	Total Liabilities plus Equity	\$ 11,500

Fair Value ⁽¹⁾			
Assets		Liabilities plus Equity	
Current Assets	\$ 2,500	Working capital liabilities ⁽²⁾	\$ 1,500
Fixed Assets	\$ 2,000		
Intangible Assets	\$ 3,000	Debt Financing	\$ 1,000
Goodwill	\$ 3,800	Equity	\$ 8,800
Total Assets	\$ 11,300	Total Liabilities plus Equity	\$ 11,300

(1) The fair value has been determined based on the assumption of a taxable transaction. If the determination of fair value is based on the assumption of a nontaxable transaction, then the valuation may need to be adjusted for the related tax considerations. This complexity, however, is present regardless of the premise (Asset, Equity, or Enterprise) that is used.

(2) Working capital liabilities may include accounts payable, accrued employee compensation, and other liabilities that are included in determining the fair value of the reporting unit based on the base enterprise valuation.

5. The company determines that its base enterprise value is \$9,800. The fair value of working capital liabilities is \$1,500. The Asset premise would be computed as follows:

Asset Premise

Carrying Amount

Total Assets	\$11,500
Less: Deferred tax liabilities	(500)
Carrying amount based on an Asset premise	\$11,000

Fair Value

Fair value based on an Enterprise premise	\$9,800
Add: Liabilities included in fair value of reporting unit based on an Enterprise premise	1,500
Fair value based on an Asset premise	\$11,300

Under Case 1, Step 1 is passed because the fair value of the reporting unit, \$11,300, exceeds its carrying value, \$11,000. Under the Enterprise premise, Step 1 is passed because the enterprise value of \$9,800 exceeds its carrying value of \$9,500. Under the Equity premise, Step 1 is passed because the equity value of \$8,800 exceeds its carrying value of \$8,000.