
FEBRUARY 14, 2001

Financial Accounting Series

EXPOSURE DRAFT (Revised)

Proposed Statement of Financial Accounting Standards

Business Combinations and Intangible Assets— Accounting for Goodwill

Limited Revision of Exposure Draft
issued September 7, 1999

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

Director of Research and Technical Activities
File Reference No. 201-R

Comment Deadline: March 16, 2001



Financial Accounting Standards Board
of the Financial Accounting Foundation

Responses from interested parties wishing to comment on the revised limited Exposure Draft must be *received* in writing by March 16, 2001. Responses received after that date will be distributed to Board members but will *not* be considered in the staff's analysis of comments that will be the basis for the Board's redeliberations. Interested parties should submit their comments by email to director@fasb.org File Reference 201-R. Those without email may send their comments to the "RTA Director-File Reference 201-R" at the address at the bottom of this page. Responses should *not* be sent by fax.

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Financial Accounting Standards Board
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<p style="text-align: center;">Notice for Recipients of This Exposure Draft</p>
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As the result of its redeliberations of the September 1999 FASB Exposure Draft of a proposed Statement, *Business Combinations and Intangible Assets*, the Board made significant changes to the proposed requirements related to goodwill but has not made significant changes to the other issues addressed in that Exposure Draft. Therefore, this limited revised Exposure Draft (proposed Statement) addresses the accounting for goodwill that after redeliberation will be included in the final Statement on business combinations and intangible assets.

The 1999 Exposure Draft would have amended APB Opinion No. 16, *Business Combinations*, to prohibit use of the pooling-of-interests (pooling) method of accounting for business combinations initiated after the issuance date of the final Statement. That Exposure Draft would have superseded APB Opinion No. 17, *Intangible Assets*, and reduced the 40-year maximum amortization period for goodwill to 20 years. It also would have replaced the 40-year maximum amortization period for intangible assets other than goodwill with a presumption that the useful economic life is 20 years or less. However, it would have required that an identifiable intangible asset that is determined to have an indefinite useful economic life and an observable market not be amortized. The 1999 Exposure Draft would not have changed the requirement in FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*, to expense the cost of certain purchased research and development assets at the date of acquisition.

During April 2000 through January 2001, the Board redeliberated those proposed requirements. As noted above, the Board made significant changes to the proposed requirements relating to goodwill, deciding that goodwill would no longer be amortized and would be tested for impairment in a manner different from how other assets are tested for impairment. In addition, the Board reconfirmed the proposals to prohibit use of the pooling method for transactions initiated after issuance of the final Statement and to not change the requirements in Interpretation 4 related to the accounting for purchased research and development assets. The Board also made modifications to the proposed requirements related to the accounting for acquired intangible assets other than goodwill. Those modifications were not deemed so significant as to require reexposure.

After the Board redeliberates the provisions in this proposed Statement, its decisions will be integrated with decisions on the other issues addressed in the 1999 Exposure Draft. The final Statement will cover the accounting for business combinations, intangible assets, and goodwill. This proposed Statement should be read in the context of the Board's decisions on those other issues. Information about the Board's tentative decisions on the issues addressed in the 1999 Exposure Draft that are not addressed in this proposed Statement can be found on the FASB web site (www.fasb.org) (Business Combinations Project—tentative decisions).

The Board invites comments on all matters in this proposed Statement and particularly on the following specific issues. Respondents need not comment on all of the issues and are encouraged to comment on additional issues. When responding to the following issues, it would be helpful if comments respond to the issues as stated, indicate any alternatives the Board should consider, and explain the reasons for the position taken.

Nonamortization of Goodwill

Issue 1: This proposed Statement would require that goodwill not be amortized in any circumstance. The carrying amount of goodwill would be reduced only if it was found to be impaired or was associated with assets to be sold or otherwise disposed of.

- a. Do you agree with the Board's conclusion that goodwill is not a wasting asset if a reporting unit is able to maintain the value of goodwill? If not, why not?
- b. Do you agree that requiring all goodwill *not* to be amortized (but to be reduced in value when it is impaired) will result in more useful financial information than requiring goodwill to be amortized in all circumstances or permitting goodwill to be amortized in certain circumstances? If not, which alternative would be preferable and why?

Paragraphs 64–84 discuss the basis for the Board's conclusions on this issue.

Goodwill Impairment Test

Issue 2: This proposed Statement would require that goodwill be tested for impairment when events or circumstances occur indicating that goodwill of a reporting unit might be impaired. A reporting unit is defined as “the lowest level of an entity that is a business and that can be distinguished, physically and operationally and for internal reporting purposes, from the other activities, operations, and assets of the entity.”

- a. Do you agree that goodwill should be tested for impairment at the reporting unit level? If not, please describe the level at which testing for impairment should occur.
- b. Is the guidance in paragraphs 10 and 11 on determining the reporting unit sufficient? If not, how should it be modified and why?
- c. In order to test goodwill for impairment at the reporting unit level, paragraph 11 states that goodwill and all other assets and liabilities of an acquired entity that will be employed in or relate to the operations of a reporting unit must be assigned to that reporting unit as of the acquisition date. What, if any, concerns do you have with that requirement? How might those concerns be addressed?

Paragraphs 71–76 discuss the basis for the Board’s conclusions on this issue.

Issue 3: This proposed Statement would require that a benchmark assessment be performed whenever a reporting unit is created or the net assets of a reporting unit are changed substantially due to an acquisition and the goodwill of that reporting unit is significant in relation to the carrying amount (book value) of its other net assets. In addition, a benchmark assessment would be performed whenever a reporting unit has been created or significantly modified by a reorganization of an entity’s reporting structure and the goodwill of that reporting unit is significant in relation to the carrying amount of its other net assets. This proposed Statement would require those benchmark assessments to be completed within one year of the date of the acquisition or at the date of the reorganization that gave rise to the benchmark assessment. Is that time frame appropriate to perform a benchmark assessment as described in paragraph 16? If not, what time frame would be appropriate and why?

Paragraphs 99–103 discuss the basis for the Board’s conclusions on this issue.

Issue 4: Paragraph 18 provides examples of events or circumstances that would require goodwill of a reporting unit to be tested for impairment. Are those indicators of potential impairment appropriate? If not, which of the examples should be modified and how? Are there additional examples that should be included? If so, please describe.

Paragraph 104 discusses the basis for the Board’s conclusions on this issue.

Issue 5: This proposed Statement would require that a goodwill impairment loss be recognized if the implied fair value of a reporting unit’s goodwill is less than its carrying amount. The implied fair value of goodwill would be determined by subtracting the fair value (with certain exceptions) of the recognized net assets of the reporting unit excluding goodwill from the

fair value of the reporting unit. (Paragraphs 12 and 13 define recognized net assets and paragraphs 20–24 provide guidance on measuring those fair values.) The process of determining the implied fair value of goodwill is similar to the process of determining the amount of goodwill that would be recognized if the reporting unit was purchased at its fair value but the purchase price allocation was restricted to the net assets, other than goodwill, recognized prior to the business combination.

- a. Do you believe that the proposed impairment test is operational and that it will adequately capture a decline in the value of goodwill? If not, please explain why not and describe an operational impairment test that would adequately capture a decline in the value of goodwill.
- b. Do you agree with the Board’s conclusion that subtracting the fair value (with certain exceptions) of recognized net assets from the fair value of the reporting unit results in an impairment test that strikes an appropriate balance between costs and benefits? If not, what alternative would you suggest and why?

Paragraphs 85–96 discuss the basis for the Board’s conclusions on this issue.

Effective Date and Transition

Issue 6: The provisions in this proposed Statement would be effective for fiscal quarters beginning after issuance of a final Statement. Neither early application nor retroactive application would be permitted. As described in paragraph 38, pro forma information would be disclosed in the period of adoption and thereafter until all periods reflect goodwill accounted for in accordance with this proposed Statement. Are those effective date and transition provisions appropriate? If not, how should they be modified and why?

Paragraphs 133–136 discuss the basis for the Board’s conclusions on this issue.

Issue 7: This proposed Statement would not require that existing goodwill be tested for impairment upon adoption of the final Statement unless an indicator of impairment exists at that date. However, this proposed Statement would require that the benchmark assessment described in paragraph 16 be performed for all existing reporting units with goodwill within six months of adoption.

- a. Should this proposed Statement require that all existing goodwill be tested for impairment upon adoption of the final Statement? If so, what time frame should be allowed for completion of those impairment tests?

- b. Is six months adequate time to complete the “transitional” benchmark assessments on existing reporting units? If not, why not and what time frame should be provided?

Paragraphs 129–132 discuss the basis for the Board’s conclusions on this issue.

Summary

This proposed Statement would establish a new accounting standard for goodwill acquired in a business combination. It would continue to require recognition of goodwill as an asset but would not permit amortization of goodwill as currently required by APB Opinion No. 17, *Intangible Assets*.

This proposed Statement would establish a new method of testing goodwill for impairment. It would require that goodwill be separately tested for impairment using a fair-value-based approach. Goodwill would be tested for impairment at a level referred to as a reporting unit, generally a level lower than that of the total entity. This proposed Statement would require that a benchmark assessment be performed in certain circumstances. That assessment would establish the methods and assumptions that would be used to test goodwill for impairment. Goodwill of a reporting unit would be tested for impairment when events and circumstances occur indicating that it might be impaired. Goodwill related to long-lived assets to be held and used would no longer be allocated to those assets when they are tested for impairment as currently required by FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*.

If the implied fair value of a reporting unit's goodwill is less than its carrying amount, goodwill would be considered impaired. The implied fair value of goodwill would be determined by subtracting the fair value (with certain exceptions) of the recognized net assets of the reporting unit (excluding goodwill) from the fair value of the reporting unit. The impairment loss would be equal to the amount by which the carrying amount of goodwill exceeds its implied fair value. Goodwill impairment losses would be aggregated and presented as a separate line item in the operating section of the income statement. This proposed Statement provides guidance for determining the amount of goodwill, if any, that would be included in the determination of the gain or loss on sale or disposal when all or a portion of a reporting unit is to be sold or otherwise disposed of.

Entities would be required to initially apply the provisions of this proposed Statement as of the beginning of the first fiscal quarter following issuance of the final Statement. Those provisions would apply not only to goodwill arising from acquisitions completed *after* the issuance date of the final Statement but also to the unamortized balance of goodwill at the date of

adoption. Income before extraordinary items and net income computed on a pro forma basis (as if goodwill had not been amortized in prior periods) would be required to be displayed for all periods presented either on the face of the income statement or in the notes to the financial statements until all periods presented reflect goodwill accounted for in accordance with the final Statement.

This proposed Statement would not require that goodwill be tested for impairment upon adoption of the final Statement unless an indicator of impairment exists at that date. However, it would require that a benchmark assessment be performed for all existing reporting units with goodwill within six months of the date of adoption. If an impairment loss was recognized as a result of that “transitional” benchmark assessment, it would be presented in the operating section of the income statement in the same manner as other impairment losses. It would not be treated as a change in accounting principle.

This proposed Statement would not apply to goodwill acquired in a combination between two or more not-for-profit organizations or to goodwill acquired in an acquisition of a for-profit enterprise by a not-for-profit organization.

Proposed Statement of Financial Accounting Standards

Business Combinations and Intangible Assets—Accounting for Goodwill

February 14, 2001

CONTENTS

	Paragraph Numbers
Standards of Financial Accounting and Reporting:	
Scope	1–2
Recording Assets Acquired and Liabilities Assumed	3–8
Initial Recognition and Measurement of Goodwill	3–4
Recognition of Acquired Identifiable Intangible Assets	5
Excess of Acquired Net Assets over Cost	6–8
Subsequent Recognition and Measurement of Goodwill	9–17
Reporting Unit	10–11
Recognized Net Assets of a Reporting Unit	12–13
Benchmark Assessment	14–17
Recognition and Measurement of an Impairment Loss	18–24
Fair Value Measurements	20–24
Fair Value of a Reporting Unit	23
Fair Value (with Certain Exceptions) of Recognized Net Assets	24
Equity Method Investments	25
Disposal of All or a Portion of a Reporting Unit	26–27
Deferred Income Taxes	28
Financial Statement Presentation	29–30
Disclosures	31–35
Effective Date and Transition	36–40
Impairment Tests at Transition	39–40
Appendix A: Background Information and Basis for Conclusions	41–141
Appendix B: Illustrations	142–147
Appendix C: Amendments to Existing Pronouncements	148–152
Appendix D: Glossary	153

Proposed Statement of Financial Accounting Standards

Business Combinations and Intangible Assets—Accounting for Goodwill

February 14, 2001

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

1. This Statement applies to all goodwill acquired in business combinations except goodwill acquired in a combination between two or more not-for-profit organizations and goodwill acquired in an acquisition of a for-profit enterprise by a not-for-profit organization.
2. This Statement does not change the accounting for an unidentifiable intangible asset recognized in an acquisition of a bank or thrift institution prescribed in paragraph 5 of FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions*.

Recording Assets Acquired and Liabilities Assumed

Initial Recognition and Measurement of Goodwill

3. APB Opinion No. 16, *Business Combinations*, requires that an acquiring entity allocate the cost of an acquired entity to all of the assets acquired and liabilities assumed following the guidance in paragraph 68 of that Opinion (a process commonly referred to as the purchase price allocation). Prior to that allocation, the acquiring entity shall review the purchase consideration if other than cash to ensure that it has been valued in accordance with the requirements in paragraphs 72–76 of Opinion 16 and identify *all* of the assets acquired and liabilities assumed, including intangible assets.
4. The excess of the cost of an acquired entity over the net of the amounts assigned to identifiable assets acquired and liabilities assumed shall be recognized as an asset, referred to as **goodwill**.¹ An acquired identifiable intangible asset that does not meet the criteria in paragraph 5 of this Statement for recognition separate from goodwill shall be included in the amount recognized as goodwill.

¹ Words that appear in the glossary are set in **boldface** type the first time they are used.

Recognition of Acquired Identifiable Intangible Assets

5. An acquired identifiable intangible asset shall be recognized separately from goodwill if it meets the asset recognition criteria set forth in paragraph 63 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*,² and it meets either of the following criteria:

- a. Control over the future economic benefits of the asset results from contractual or other legal rights (regardless of whether those rights are transferable or separable from other rights and obligations).
- b. The asset is capable of being separated or divided and sold, transferred, licensed, rented, or exchanged (regardless of whether there is an intent to do so or whether a market currently exists for that asset).

An intangible asset that cannot be sold, transferred, licensed, rented, or exchanged individually meets criterion (b) if it can be sold, transferred, licensed, rented, or exchanged along with a group of related assets or liabilities. For example, although a financial institution depositor relationship cannot be transferred apart from the related deposits, it meets criterion (b) and should be recognized separately from goodwill.

Excess of Acquired Net Assets over Cost

6. In some cases, the net of the amounts assigned to identifiable assets acquired and liabilities assumed will exceed the cost of the acquired entity (*excess over cost* or *excess*) (sometimes referred to as negative goodwill). That excess shall be allocated as a pro rata reduction of the amounts that otherwise would be assigned to all of the acquired assets other than cash and cash equivalents, trade receivables, inventory, financial instruments that are required by U.S. generally accepted accounting principles (GAAP) to be carried on the balance sheet at fair value, assets to be disposed of by sale,³ and deferred tax assets.

²Paragraph 63 of Concepts Statement 5 states that an asset should be recognized when it meets the *assets* definition, has a relevant attribute measurable with sufficient reliability, and the information about it is representationally faithful, verifiable, neutral (that is, reliable), and capable of making a difference in user decisions (that is, relevant).

³Assets to be disposed of by sale include assets to be disposed of as that term is used in FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, and assets of a segment of a business being accounted for as a discontinued operation under APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*.

7. If any excess remains after reducing those assets to zero, the remaining excess shall be recognized as an extraordinary gain as described in paragraph 11 of APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. The extraordinary gain shall be recognized in the period in which the business combination is initially recognized unless the purchase price involves contingent consideration (refer to paragraph 8). If an extraordinary gain is recognized before the purchase price allocation is complete, any necessary adjustments to the amount recognized as the extraordinary gain as a result of finalizing the purchase price allocation also shall be recognized as an extraordinary item.⁴

8. If the purchase price involves contingent consideration, the amount of the excess over cost shall be recognized as a deferred credit until the consideration contingency is resolved. (Paragraphs 77–86 of Opinion 16 address contingent consideration.) When that contingency is resolved and the purchase price allocation has been adjusted to reflect the actual consideration paid, if there is any remaining excess over cost, it shall be recognized as an extraordinary gain.

Subsequent Recognition and Measurement of Goodwill

9. Goodwill shall not be amortized. Goodwill shall be tested for impairment in accordance with this Statement and not in accordance with FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. Goodwill of a **reporting unit** shall be tested for impairment when events or circumstances occur indicating that an impairment might exist. (Paragraph 18 provides examples of impairment indicators.) If an impairment indicator gives rise to both a goodwill impairment test and a test of long-lived assets for impairment (under Statement 121), the goodwill impairment test shall be performed first.⁵

⁴FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*, addresses adjustments that may be made during the purchase price allocation process and when that process should be completed.

⁵In its redeliberation of the June 2000 Exposure Draft, *Accounting for the Impairment or Disposal of Long-Lived Assets and for Obligations Associated with Disposal Activities*, the Board will consider the impact of this Statement on the impairment approach for long-lived assets to be held and used covered by that proposed Statement.

Reporting Unit

10. For purposes of applying this Statement, a reporting unit is the lowest level of an entity that is a business and that can be distinguished, physically and operationally and for internal reporting purposes, from the other activities, operations, and assets of the entity. Reporting units may be referred to as, among other things, business units, operating units, or divisions. The way a business is managed and the way an entity is organized for internal reporting purposes shall determine the reporting units of an entity. A reporting unit often will be the lowest level of an entity at which operating plans are prepared and operating profitability is measured for assessing management performance. The reporting unit level normally will be lower than the reportable operating segment (segment) level described in FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, and shall not be higher than that level.

11. In order to test goodwill for impairment at the reporting unit level, goodwill and all other assets and liabilities of an acquired entity that will be employed in or relate to the operations of a reporting unit shall be assigned to that reporting unit as of the acquisition date. The acquired assets and assumed liabilities shall be assigned in a manner that reflects management's intended use of those net assets. The methodology used to determine the amount of goodwill to assign to a reporting unit shall be reasonable and supportable. In concept, the amount of acquired goodwill to be assigned to a reporting unit would be determined in a manner similar to how the amount of goodwill to be recognized in a business combination is determined. In essence, a "purchase price" would be determined for each group of net assets assigned to a reporting unit, and that purchase price would be allocated to the recognized net assets. If the amount assigned to those net assets is less than the purchase price, the excess would be the goodwill assigned to that reporting unit.

Recognized Net Assets of a Reporting Unit

12. For purposes of applying this Statement, recognized net assets of a reporting unit include all recognized tangible and intangible assets (including fully depreciated assets that have not been written off) except goodwill and all recognized liabilities that are employed in or relate to the operations of a reporting unit. Recognized net assets shall include assets and liabilities that often are recognized as corporate items as long as those assets and liabilities relate to operations of the reporting unit (for example, environmental liabilities and pension assets and liabilities).

Those assets and liabilities shall be assigned to one or more reporting units as of the acquisition date as required by paragraph 11. Research and development assets acquired in a business combination and written off to earnings (in accordance with FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*) shall not be considered a recognized asset of a reporting unit.

13. For purposes of applying this Statement, an executory contract (such as an operating lease, purchase or sale contract, or construction contract) shall be considered a recognized asset or liability only if the amount reflected in the financial statements is based on a fair value measurement of the entire contract made subsequent to entering into the contract. For example, if the financial statements reflect an asset or liability related to a favorable or unfavorable operating lease acquired as part of a prior acquisition, that operating lease would be considered a recognized asset or liability and would be remeasured at fair value when testing goodwill for impairment. However, if the financial statements reflect prepaid rent (or rent payable) related to an operating lease, the fair value of that operating lease would *not* be considered a recognized asset (or liability). In that case, only the prepaid rent (or rent payable) would be considered a recognized asset (or liability). For purposes of testing goodwill for impairment, the carrying amount of prepaid rent, rent payable, or similar deposit balances would generally approximate fair value.

Benchmark Assessment

14. To ensure that an entity develops and documents its process for performing future impairment tests, a **benchmark assessment** as described in paragraph 16 shall be performed whenever a reporting unit is created or the net assets of a reporting unit are changed substantially due to an acquisition and the goodwill of that reporting unit is significant in relation to the carrying amount (book value) of its other net assets. A benchmark assessment also shall be performed whenever a reporting unit has been created or significantly modified by a reorganization of an entity's reporting structure and the goodwill of that reporting unit is significant in relation to the carrying amount of its other net assets. A benchmark assessment shall be completed within one year of the date of the acquisition or at the date of the reorganization that gave rise to the benchmark assessment.

15. For use in performing the benchmark assessment, the basis for and method of determining the purchase price of an acquired entity and other related factors (such as the underlying reasons for the acquisition and management's expectations related to dilution, synergies, and other financial measurements) shall be documented at the acquisition date.

16. A benchmark assessment of a reporting unit shall include the following steps:

- a. Identification and documentation of the goodwill and other recognized net assets associated with the reporting unit
- b. Identification and documentation of the key expectations related to the future performance of the reporting unit
- c. Identification and documentation of the model and key assumptions to be used to measure the fair value of the reporting unit in accordance with paragraph 23 (for example, a description of the cash flow model to be used and interest rate assumptions)
- d. Identification and documentation of the methods and key assumptions to be used to measure the recognized assets and liabilities of the reporting unit (except goodwill) in accordance with paragraph 24
- e. Measurement and documentation of the fair value of the reporting unit as of the date of the acquisition or reorganization that gave rise to the benchmark assessment
- f. Comparison of the fair value of the reporting unit and the carrying amount of its net assets (including goodwill) to determine the reasonableness of the models and key assumptions used to determine the fair value of the reporting unit and the amount of goodwill assigned to the reporting unit
 - (1) If the carrying amount of the net assets of the reporting unit (including goodwill) exceeds its fair value, the amount of goodwill assigned to the reporting unit, the model used to measure the fair value of the reporting unit, and other assumptions shall be reassessed.
 - (2) If as a result of that reassessment any of the information identified and documented in steps (a)–(c) change, the fair value of the reporting unit shall be remeasured.
 - (3) If after that reassessment and remeasurement, if any, the carrying amount of the net assets of the reporting unit (including goodwill) exceeds its fair value, goodwill shall be tested for impairment in accordance with paragraph 19.

17. In some cases, events or circumstances indicating that goodwill might be impaired may occur prior to completion of the benchmark assessment. Goodwill shall be tested for impairment when those events or circumstances occur, thus accelerating completion of steps (a)–(e) of the benchmark assessment. (Refer to paragraph 18 for examples of impairment indicators.)

Recognition and Measurement of an Impairment Loss

18. Examples of events or circumstances that would require goodwill of a reporting unit to be tested for impairment include, but are not limited to:

- a. A current-period operating or cash flow loss for a reporting unit combined with a history of operating or cash flow losses or a forecast of continuing losses
- b. A significant adverse change in one or more of the assumptions or expectations used in the most recent determination of the fair value of a reporting unit. Examples include:
 - (1) A product, technology, or service is introduced by a competitor that causes or is expected to cause a significant reduction in a reporting unit's market share for a similar product, technology, or service.
 - (2) Revenue of a reporting unit has been or is expected to be significantly lower than previously expected due to changes in technology, the loss of a customer or customer group, increased competition, or other factors.
 - (3) Operating profit or cash flows of a reporting unit have been or are expected to be significantly lower than previously expected due to unplanned cost increases, the inability to realize planned cost reductions, or other factors.
 - (4) A product or technology of a reporting unit acquired in a business combination (that does not meet the criteria for recognition separate from goodwill) has been or is expected to be replaced significantly earlier than the end of its previously estimated useful economic life, and that product or technology has no alternative use.
 - (5) A loss of key personnel has or is expected to have a significant adverse impact on a reporting unit's ability to generate revenues or develop new products, technologies, or services as planned.
 - (6) A decision is made to restructure or change the operating model of a reporting unit that represents a significant departure from the strategy assumed in the most recent determination of the fair value of a reporting unit (for example, a decision to close a plant, stop selling a product, or sell off assets or a product line).
- c. A change in legal factors or an action or assessment by a regulator that has had or is expected to have a significant adverse effect on a reporting unit
- d. 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
- e. A test of a significant asset group within a reporting unit for recoverability under Statement 121
- f. A decline in the market capitalization of an entity (or a reporting unit) below the carrying amount of its net assets (including goodwill) that is other than temporary
- g. A significant and other-than-temporary decline in the market price of the common stock of an entity (or a reporting unit)
- h. A decline in the credit rating of publicly traded debt of an entity (or a reporting unit) below investment grade.

If the factors contributing to the decline in the market price of an entity's common stock (and related impact on market capitalization) or the decline in the credit rating of an entity's publicly traded debt can be identified with events or circumstances occurring in a specific reporting unit

or units, the goodwill impairment test shall be limited to that reporting unit or units. Otherwise, if events or circumstances such as those in described in (f)–(h) occur indicating that goodwill might be impaired, goodwill of each reporting unit of the entity shall be tested for impairment.

19. Goodwill shall be considered impaired and an impairment loss recognized if the implied fair value⁶ of a reporting unit’s goodwill is less than its carrying amount. The implied fair value of goodwill shall be determined by subtracting the fair value (with certain exceptions, as explained in paragraph 24) of the recognized net assets of the reporting unit from the fair value of the reporting unit. (Paragraphs 12 and 13 define recognized net assets and paragraphs 20–24 provide guidance for measuring the fair value of the reporting unit and most recognized net assets.) The impairment loss shall be measured as the amount by which the carrying amount of goodwill exceeds its implied fair value. After an impairment loss is recognized, the adjusted carrying amount of goodwill shall be its new cost basis. Restoration of previously recognized impairment losses is prohibited.

Fair Value Measurements

20. The fair value of an asset (or liability) is the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available.

21. If quoted market prices are not available, the estimate of fair value shall be based on the best information available in the circumstances, including prices for similar assets and liabilities and the results of available valuation techniques. Examples of valuation techniques include the present value of expected future cash flows,⁷ option pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. Valuation techniques shall be consistent with the objective of measuring fair value. Those techniques shall incorporate assumptions that

⁶The fair value of goodwill can be measured only as a residual and cannot be measured directly. Therefore, this Statement includes a methodology to determine an amount that achieves a reasonable estimate of the value of goodwill (the implied fair value of goodwill) for purposes of recognizing and measuring an impairment loss.

⁷Paragraphs 42–54 and 75–88 of FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, discuss the use of present value techniques in measuring the fair value of an asset or liability.

marketplace participants would use in their estimates of fair value, including assumptions about whether an asset is being used at its highest and best use.⁸ If that information is not available without undue cost and effort, an entity may use its own assumptions.

22. Estimates of fair value shall be based on reasonable and supportable assumptions and projections. All evidence available without undue cost and effort shall be considered in developing those estimates. The weight given to the evidence shall be commensurate with the extent to which the evidence can be verified objectively. If a range is estimated for either the amount or timing of possible cash flows, the likelihood of possible outcomes shall be considered.⁹

Fair Value of a Reporting Unit

23. The fair value of a reporting unit refers to the amount at which the unit as a whole could be bought or sold in a current transaction between willing parties. Therefore, it is unlikely that the fair value of a reporting unit would be equal to the net of the fair value of the assets and liabilities of the reporting unit. The fair value of a reporting unit shall be measured using the guidance in this paragraph and paragraphs 20–22. The market capitalization of a reporting unit with publicly traded stock may not be representative of the fair value of the reporting unit as a whole.¹⁰ Therefore, the quoted market price of an individual share of stock need not be the sole measurement basis of the fair value of a reporting unit. If an acquired entity is a significant portion of a reporting unit and the technique used to value the acquisition (determine the purchase price) is consistent with the objective of measuring fair value, that same technique and underlying assumptions shall be used to measure the fair value of the reporting unit. For

⁸Highest and best use is a valuation concept that refers to the possible use, legally and physically, of an asset that is most likely to produce the greatest net return over a given period if, hypothetically, the asset were adapted to its most advantageous and valuable use, determined based on information that is readily available to the market. Absent evidence to the contrary, it is assumed that marketplace participants would use an asset at its highest and best use.

⁹Paragraph 23 of Concepts Statement 7 identifies the essential elements of a fair value measurement determined using a present value technique.

¹⁰ Many entities believe that substantial value arises from the ability to take advantage of synergies and other benefits that flow from control over another entity. Consequently, measuring the fair value of a collection of assets and liabilities that operate together in a controlled entity is different from measuring the fair value of that entity's individual equity securities. An acquiring entity often is willing to pay more for shares that give it a controlling interest than an investor would pay for a nominal number of shares. That control premium may cause the fair value of a reporting unit to exceed its market capitalization.

example, if the purchase price was based on an expected cash flow model, that cash flow model and related assumptions would be used to measure the fair value of the reporting unit.

Fair Value (with Certain Exceptions) of Recognized Net Assets

24. The recognized assets and liabilities of the reporting unit shall be measured at fair value using the guidance in this paragraph and paragraphs 20–22, unless paragraph 88 of Opinion 16 (as amended) requires use of a different measurement basis when recording an asset or liability as part of a business combination. For those assets and liabilities (for example, deferred tax assets and liabilities), the Opinion 16 measurement basis shall be used.¹¹ The tax basis of an asset or liability shall not be a factor in determining its fair value. Measurement of assets and liabilities at fair value shall incorporate techniques and assumptions consistent with those used to measure the fair value of the reporting unit. For example, if the technique used to measure the fair value of a reporting unit employs certain assumptions about the timing of future cash flows related to a significant asset of the reporting unit, those same assumptions would be used in measuring the fair value of that asset.

Equity Method Investments

25. The portion of the difference between the cost of an investment and the amount of underlying equity in net assets of an investee that represents goodwill (equity method goodwill) shall not be amortized. However, equity method goodwill shall not be tested for impairment in accordance with this Statement. Equity method investments shall continue to be tested for impairment in accordance with paragraph 19(h) of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*.

¹¹ When certain assets and liabilities measured on some basis other than fair value (in accordance with Opinion 16) are included with the net assets of the reporting unit measured on a fair value basis, the resulting total will not be a conceptually true fair value amount. Therefore, that amount is referred to herein as the fair value (with certain exceptions) of recognized net assets.

Disposal of All or a Portion of a Reporting Unit

26. If a reporting unit is to be disposed of in its entirety, goodwill of that reporting unit shall be included in the carrying amount of the net assets to be disposed of to determine the gain or loss on disposal.¹² Illustration 1 in Appendix B provides an example of that provision.

27. If a significant portion of a reporting unit is to be disposed of, goodwill of that reporting unit shall be tested for impairment. In performing that impairment test, the net assets to be disposed of shall be excluded. If the carrying amount of goodwill exceeds its implied fair value, that excess carrying amount shall be included in the carrying amount of the net assets to be disposed of to determine the gain or loss on disposal and not recognized as an impairment loss. Illustration 2 in Appendix B provides an example of that provision.

Deferred Income Taxes

28. Paragraph 30 of FASB Statement No. 109, *Accounting for Income Taxes*, states that deferred taxes are not recognized for any portion of goodwill for which amortization is not deductible for tax purposes. Paragraphs 261 and 262 of that Statement provide additional guidance for recognition of deferred taxes related to goodwill when amortization of goodwill is deductible for tax purposes. This Statement does not change the requirements in Statement 109 for recognition of deferred taxes related to goodwill.

Financial Statement Presentation

29. The aggregate amount of goodwill shall be presented as a separate line item in the statement of financial position.

30. The aggregate amount of goodwill impairment losses shall be presented as a separate line item in the operating section of the income statement unless a goodwill impairment loss is associated with a discontinued operation. A goodwill impairment loss associated with a discontinued operation shall be included (on a net-of-tax basis) within the results of discontinued

¹²For purposes of this Statement, the terms *disposal*, *disposed of*, and *disposition* refer to a disposal by sale as well as to a disposal other than by sale (for example, by abandonment, in an exchange for a similar productive asset group, or in a distribution to owners).

operations. As noted in paragraph 27, the portion of goodwill associated with net assets to be disposed of is recognized as part of the gain or loss on disposal, not as an impairment loss.

Disclosures

31. Paragraph 95 of Opinion 16 requires disclosure of general information about an acquisition in the period in which the business combination is completed. That information also shall include the primary reason for the acquisition, including a description of the factors that contributed to a purchase price that reflects a premium that results in recognition of goodwill or a discount that results in recognition of an extraordinary gain.

32. For each significant business combination (or group of individually insignificant business combinations that are significant in the aggregate) completed in the current reporting period, the following information as of the acquisition date also shall be disclosed in the notes to the financial statements if goodwill is significant in relation to the total cost of the acquired entity (or in relation to the aggregate cost of the acquired entities):

- a. The amount of acquired goodwill
- b. The amount of acquired goodwill related to each segment (for entities that are required to report segment information in accordance with Statement 131)
- c. The amount of acquired goodwill that is deductible for income tax purposes.

33. For each period for which a statement of financial position is presented, the notes to the financial statements also shall disclose the changes in the carrying amount of goodwill during the period. That disclosure shall include the amount of goodwill acquired, the amount of impairment loss recognized, and the amount of goodwill included in the gain or loss on disposal of all or a portion of a reporting unit. Entities that report segment information in accordance with Statement 131 shall provide that information for each segment and shall disclose any significant changes in the allocation of goodwill by segment.

34. For each goodwill impairment loss recognized, the following information shall be disclosed in the notes to the financial statements that include the impairment loss:

- a. A description of the facts and circumstances leading to the impairment
- b. A description of the reporting unit for which the impairment loss is recognized, the adjusted carrying amount of goodwill of that reporting unit, and the amount of the impairment loss

- c. If a recognized impairment loss is an estimate that has not yet been finalized, that fact and the reasons therefor and, in subsequent periods, the nature and amount of any significant adjustments made to the initial estimate of the impairment loss
- d. The segment to which the impaired goodwill relates (for entities that are required to report segment information in accordance with Statement 131).

35. In the period in which an excess over cost related to an acquisition is recognized as an extraordinary gain, the information required by paragraph 11 of Opinion 30 shall be disclosed in the notes to the financial statements.

Effective Date and Transition

36. The provisions of this Statement shall be initially applied (adopted) at the beginning of the first fiscal quarter following its issuance for all entities, including those that do not report on an interim basis. Earlier application is not permitted, nor is retroactive application to financial statements of prior periods (interim or annual). Goodwill arising from acquisitions completed before the date this Statement is adopted (existing goodwill) shall no longer be amortized.¹³ For acquisitions completed before the date of adoption, entities shall not change the amount of the purchase price assigned to goodwill.

37. Any unamortized deferred credit related to an excess over cost arising from acquisitions completed before the date this Statement is adopted shall be recognized as an extraordinary gain in the period of adoption. Information about that extraordinary gain shall be disclosed in accordance with paragraph 11 of Opinion 30.

38. In the period of adoption and thereafter until all periods presented reflect goodwill accounted for in accordance with this Statement, income before extraordinary items and net income computed on a pro forma basis shall be displayed for all periods presented. Those pro forma amounts shall reflect the reversal of amortization recognized in the periods presented related to goodwill, any deferred credit related to an excess over cost, and equity method goodwill. Goodwill impairment losses recognized in those prior periods shall not be increased to reflect what the losses might have been if goodwill had not been amortized. That pro forma information may be displayed either on the face of the income statement or in the notes to the

¹³Goodwill that is not being amortized in accordance with ARB No. 43, Chapter 5, "Intangible Assets," would continue not to be amortized.

financial statements. The notes to the financial statements shall disclose a reconciliation of reported earnings to the pro forma earnings reflecting adjustments for amortization of goodwill, any deferred credit, and equity method goodwill. Pro forma earnings per share may be presented either on the face of the income statement or in the notes to the financial statements.

Impairment Tests at Transition

39. A benchmark assessment (as described in paragraph 16) shall be completed within six months of the date of adoption for each reporting unit that includes goodwill (referred to as a transitional benchmark assessment). If the carrying amount of the net assets of a reporting unit (including goodwill) exceeds the fair value of a reporting unit, existing goodwill shall be tested for impairment (as required by paragraph 16(f)(3)). If events or circumstances indicating that existing goodwill might be impaired exist at or occur within six months of the date of adoption, goodwill shall be tested for impairment and completion of the transitional benchmark assessment accelerated.

40. Any impairment loss recognized upon adoption of this Statement shall be presented in the income statement in accordance with paragraph 30 of this Statement. Those impairment losses shall not be treated as a change in accounting principle. The disclosure requirements in paragraph 34 shall apply to any impairment loss recognized upon adoption of this Statement.

<p style="text-align: center;">The provisions of this Statement need not be applied to immaterial items.</p>

Appendix A

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

CONTENTS

	Paragraph Numbers
Introduction	41
Background Information	42–43
Scope	44–45
Initial Recognition and Measurement of Goodwill	46–59
Recognition of Identifiable Intangible Assets	48–54
The Nature of Goodwill	55–59
Subsequent Recognition and Measurement of Goodwill	60–104
Amortization of Goodwill	60–63
Reconsideration of Amortization Approach	64–84
Some Portion of Goodwill Is a Wasting Asset	66–67
Concerns with Testing Goodwill for Impairment	68–78
Internally Generated Goodwill	68–70
Integration of an Acquired Entity	71–76
Reporting Unit	72–76
Undiscounted Cash Flows	77–78
Decision Usefulness	79–84
Goodwill Impairment Test	85–96
Recognition of an Impairment Loss.....	85–95
Fair Value of a Reporting Unit	86–88
Recognized Net Assets of a Reporting Unit	89–95
Measurement of an Impairment Loss	96
Frequency of Impairment Test	97–104
Benchmark Assessment	99–103
Indicators of Impairment	104
Equity Method Investments.....	105–106
Disposal of All or a Portion of a Reporting Unit	107–108
Amendment of Statement 121	109–110
Financial Statement Presentation	111–113
Disclosures	114–119
Excess of Acquired Net Assets over Cost	120–127
Transition	128–132
Effective Date	133–136
Benefits and Costs	137–141

Appendix A

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

41. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

42. In August 1996, the Board added to its agenda a project on business combinations to reconsider Opinions 16 and 17. The objective of the project is to improve the transparency of the accounting for business combinations. The project focuses on the accounting for goodwill and other purchased intangible assets and the fundamental issues related to the methods of accounting for business combinations, including whether there is a need for two separate and distinct methods.

43. In September 1999, the Board issued an Exposure Draft of a proposed Statement, *Business Combinations and Intangible Assets* (the 1999 Exposure Draft). The Board received more than 200 comment letters in response to that proposed Statement and held 4 days of public hearings in February 2000 at which 43 respondents presented their views. The comment letters and public hearing testimony were considered by the Board during its redeliberations of the issues addressed in the 1999 Exposure Draft in 18 public meetings in 2000 and 2001 (including 2 educational meetings with constituent groups to discuss goodwill impairment tests). The Board met with the business combinations task force in March 2000 before beginning its redeliberations and again in November 2000 to discuss the progress of its redeliberations, primarily related to the accounting for goodwill. Board members also met with 14 companies in October and November 2000 to discuss issues related to testing goodwill for impairment. As a result of its decision to significantly change the accounting for goodwill that was proposed in the 1999 Exposure Draft, the Board decided to seek comments on that proposed change. Thus, this proposed Statement

addresses only the accounting for goodwill. After considering respondents' views on the provisions included in this proposed Statement, the Board plans to issue a final Statement that will include its decisions on using only the purchase method to account for business combinations and the accounting for acquired intangible assets, including goodwill.

Scope

44. The 1999 Exposure Draft applied to all acquired goodwill. This Statement excludes from its scope goodwill acquired in combinations between two or more not-for-profit organizations and goodwill acquired in an acquisition of a for-profit enterprise by a not-for-profit organization. Because it currently has a project on its agenda addressing issues related to combinations of not-for-profit organizations, the Board decided that it would be appropriate to include the accounting for goodwill and other intangible assets related to those combinations in that project. The Board noted that goodwill arising from those types of combinations would be accounted for in the same manner as goodwill arising from business combinations unless distinguishing characteristics or circumstances are identified that would justify different accounting treatment.

45. The Board decided that this Statement should not change the accounting for an unidentifiable intangible asset recognized in an acquisition of a bank or thrift institution that is prescribed in Statement 72. The Board noted that that Statement does not refer to the unidentifiable intangible asset as goodwill and concluded that it would not be appropriate to account for that intangible asset as if it were goodwill without a full reconsideration of the issues associated with that industry, which would be beyond the issues addressed in this Statement.

Initial Recognition and Measurement of Goodwill

46. This Statement affirms the Board's conclusion in the 1999 Exposure Draft that goodwill meets the assets definition in FASB Concepts Statement No. 6, *Elements of Financial Statements*, and the asset recognition criteria in Concepts Statement 5. Most respondents to the 1999 Exposure Draft agreed with that conclusion. Generally, those in agreement said that goodwill is an asset because consideration is paid for it and future benefits are expected from it in conjunction with the future benefits expected from other assets. Many of those respondents referred to goodwill as a special type of asset—one that cannot be separated from the other net assets of an entity.

47. As proposed in the 1999 Exposure Draft and consistent with the requirements of Opinion 16, this Statement requires that goodwill be measured as the excess of the cost of an acquired entity over the net of the amounts assigned to identifiable assets acquired and liabilities assumed. Few respondents to the 1999 Exposure Draft commented on that requirement or suggested alternative measurement approaches. As it did prior to issuing the 1999 Exposure Draft, the Board noted that an acquiring entity should make every effort to (a) measure the purchase consideration accurately, (b) record the fair values rather than the book values of net assets acquired, and (c) ensure that all intangible assets meeting the separate recognition criteria in paragraph 5 of this Statement are recognized so that those items are not included in the amount recognized as goodwill.

Recognition of Identifiable Intangible Assets

48. The 1999 Exposure Draft proposed that acquired identifiable intangible assets that cannot be reliably measured should be included in the amount recognized as goodwill. Identifiable intangible assets that are reliably measurable would have been required to be separately recognized in the financial statements under the provisions of the 1999 Exposure Draft. Although Opinions 16 and 17 have similar requirements for identifying and recognizing intangible assets, the Board observed that that guidance has been of limited usefulness, since relatively few intangible assets have been recognized under those Opinions. Thus, one of the Board's objectives in this project was to make the recognition criteria for intangible assets in Opinions 16 and 17 more operational so that more intangible assets would be recognized separately from goodwill.

49. Respondents to the 1999 Exposure Draft were asked to comment on (a) whether the Board's conclusion that various intangible assets can be measured separately from goodwill with a degree of reliability sufficient to meet the asset recognition criteria is appropriate and (b) whether some classes or types of intangible assets are more reliably measurable than others. Most respondents agreed that many intangible assets acquired in a business combination can be identified separately from goodwill and that various intangible assets are reliably measurable. However, some questioned whether it is appropriate to recognize all intangible assets separately, and many questioned their ability to reliably measure some of those identifiable intangible assets.

Others said measurement of individual intangible assets at their fair values is possible but questioned the cost effectiveness of those measurements.

50. Respondents generally concurred that the proposed requirements would meet the Board's objective of requiring more intangible assets to be recognized separately from goodwill. However, some respondents questioned that objective given the subjective nature of intangible asset valuations. A number of respondents suggested that many intangible assets, including goodwill, should be recognized as a single asset and that only intangible assets that can be sold separately or that have distinct future cash flows should be recognized separately from goodwill. However, other respondents maintained that distinguishing between identifiable intangible assets and goodwill is meaningful to users of financial statements (users).

51. Respondents' views on which intangible assets should be recognized separately varied. A number of approaches were suggested for distinguishing between goodwill and other acquired intangible assets. Respondents also urged the Board to clarify the term *reliably measurable*. The Board discussed the approaches suggested by respondents and decided to modify the proposed requirements to achieve more consistent application. The Board decided that an identifiable intangible asset should be recognized separately from goodwill if it meets the asset recognition criteria in paragraph 63 of Concepts Statement 5 and if either (a) control over the future economic benefits of the asset results from contractual or other legal rights or (b) the intangible asset is capable of being separated or divided and sold, transferred, licensed, rented, or exchanged.

52. The Board presumes that an intangible asset that meets either criterion (a) or (b) also meets the asset recognition criteria in Concepts Statement 5, including the criterion that requires that the asset be measurable with sufficient reliability. The Board believes that if an acquired identifiable intangible asset has an underlying contractual or legal basis or if it is capable of being separated from the entity, sufficient information should exist to measure that intangible asset reliably. Furthermore, while the fair value determination for an intangible asset may lack the precision of similar determinations for other assets on the balance sheet, it provides information that is more representationally faithful than that which would be provided if that asset were simply subsumed into goodwill on the grounds of measurement difficulties.

53. This Statement does not permit an identifiable intangible asset to be recognized separately from goodwill if it meets the asset recognition criteria but does not meet either of the criteria described in paragraph 5. However, the Board believes that the revised criteria will result in greater disaggregation and recognition than would have occurred under the 1999 Exposure Draft as well as under Opinions 16 and 17. That is because requiring recognition on the basis of either underlying contractual or other legal-based rights or separability provides a clearer distinction between the amounts that should be assigned to goodwill and other intangible assets. The Board also observed that application of the new requirements should result in greater comparability between entities.

54. The Board noted that many of its constituents believe an item is not an asset if it is not separable. However, the assets definition in Concepts Statement 6 does not include separability as a necessary characteristic. Thus, even though certain intangible assets do not meet the criteria for recognition separate from goodwill, they do meet the assets definition—as does goodwill.

The Nature of Goodwill

55. The 1999 Exposure Draft included the following description of the six components of goodwill:

- Component 1—The excess of the fair values over the book values of the acquired entity’s net assets at the date of acquisition.
- Component 2—The fair values of other net assets that were not recognized by the acquired entity. They may not have been recognized because they failed to meet the recognition criteria (perhaps because of measurement difficulties), because of a requirement that prohibited their recognition, or because the entity concluded that the costs of recognizing them separately were not justified by the benefits.
- Component 3—The fair value of the “going concern” element of the acquired entity’s existing business. The going-concern element represents the ability of the established business to earn a higher rate of return on an assembled collection of net assets than would be expected if those net assets had to be acquired separately. That value stems from the synergies of the net assets of the business, as well as from factors related to market imperfections. Such factors include the ability to earn monopoly profits and barriers to market entry—either legal or because of transaction costs—by potential competitors.
- Component 4—The fair value of the expected synergies from combining the acquiring entity’s and acquired entity’s net assets and businesses. Those synergies are unique to each combination, and different combinations would produce different synergies and, hence, different values.
- Component 5—Overvaluation of the consideration paid by the acquiring entity stemming from errors in valuing the consideration tendered. Although the purchase price in an all-cash

transaction would not be subject to measurement error, the same may not necessarily be said of a transaction involving shares of the acquiring entity's stock. For example, if the number of shares being traded daily is small relative to the number of shares issued in the combination, imputing the current market price to all of the shares issued to effect the combination may produce a higher value than those shares would produce if they were sold for cash and the cash then used to effect the combination.

- Component 6—Overpayment or underpayment by the acquiring entity. Overpayment might occur, for example, if the price is driven up in the course of bidding for the acquired entity, while underpayment may occur in the case of a distress sale or fire sale.

56. The Board continues to believe that the following analysis of those components is useful in understanding the nature of goodwill. The first two components, both of which relate to the acquired entity, conceptually are not part of goodwill. The first component is not an asset in and of itself but instead reflects gains that were not recognized by the acquired entity on its net assets. As such, it is part of those assets rather than part of goodwill. The second component also is not part of goodwill conceptually but instead primarily reflects intangible assets that might be separately identified and recognized as individual assets.

57. The fifth and sixth components, both of which relate to the acquiring entity, also are not conceptually part of goodwill. The fifth component is not an asset in and of itself or even part of an asset but, rather, is a measurement error. The sixth component also is not an asset but, rather, conceptually represents a loss (in the case of overpayment) or a gain (in the case of underpayment) to the acquiring entity. Thus, neither of those components is conceptually part of goodwill.

58. The 1999 Exposure Draft noted that the third and fourth components are conceptually part of goodwill. The third component relates to the acquired entity and reflects the excess assembled value of the acquired entity's net assets. It represents the preexisting goodwill that was either internally generated by the acquired entity or acquired by it in a prior business combination. The fourth component relates to the acquired entity and acquiring entity jointly and reflects the excess assembled value that is created by the combination, which reflects the synergies that are expected from combining their businesses. The Board described the third and fourth components collectively as "core goodwill."

59. As a practical matter, the Board acknowledged that it generally is not possible to separate the fifth and sixth components from the measurement of core goodwill, given the current state of the art of measurement. Similarly, it also generally is not possible to separate all of the first and second components from core goodwill because fair values for some tangible and intangible assets either may not be available or may not be measurable with sufficient reliability. However, as the 1999 Exposure Draft proposed, this Statement calls for efforts to avoid subsuming the fifth component into the amount initially recognized for goodwill, and includes provisions for eliminating the fifth and sixth components by testing goodwill for impairment.

Subsequent Recognition and Measurement of Goodwill

Amortization of Goodwill

60. The 1999 Exposure Draft proposed that goodwill be amortized over its useful economic life and that the amortization period should not exceed 20 years. Respondents' views on that proposed requirement varied. Some respondents agreed with the Board that goodwill should be amortized like other assets; others favored not amortizing goodwill but testing it for impairment; still others suggested that goodwill be written off immediately.

61. In considering the possible accounting alternatives, the Board affirmed its view that goodwill should not be written off immediately. Having reconfirmed that goodwill is an asset that meets the recognition criteria, the Board noted that it would be difficult to justify an immediate write-off of goodwill when it has just been recognized as an asset. If goodwill had been worthless on the date of acquisition, it never should have been recognized rather than recognized first as an asset and subsequently written off.

62. Many respondents that expressed support for the requirement to amortize goodwill stated that although amortization was not necessarily their first preference, they were willing to accept the proposed requirement given the proposed method of displaying goodwill amortization in the income statement. Many respondents, however, stated that they did not agree with the proposal to place an arbitrary limit of 20 years on the goodwill amortization period.

63. When it issued the 1999 Exposure Draft, the Board believed that not all goodwill declines in value and that goodwill that does decline in value rarely does so on a straight-line basis.

Because many respondents stated that straight-line amortization of goodwill over an arbitrary period does not reflect economic reality and does not provide useful information, the Board decided to reconsider its decision to require amortization of goodwill.

Reconsideration of Amortization Approach

64. As part of its reconsideration of the proposed amortization approach, the Board sought input from its constituents. Two groups of constituents met with the Board to discuss their proposed approaches to accounting for goodwill, under which goodwill would not be amortized but would be tested for impairment. Based on those presentations, informal discussion with Board members, and additional research, the FASB staff developed a general approach to testing goodwill for impairment (general impairment approach).

65. During October and November 2000, Board and staff members discussed that general impairment approach with 14 companies in a variety of industries to gather input on how it might be implemented. Those field visits also included a discussion of the methods currently used by companies to value potential acquisitions, analyze the subsequent performance of acquisitions, test goodwill for impairment, and determine the amount of goodwill to write off when an acquired business is subsequently sold or disposed of. Field visit participants offered suggestions to change and improve the general impairment approach. After those field visits were completed and the findings summarized, the Board reconsidered its reasons for concluding in the 1999 Exposure Draft that a nonamortization approach was not appropriate for goodwill.

Some Portion of Goodwill Is a Wasting Asset

66. The 1999 Exposure Draft noted that, conceptually, some of what is recognized as goodwill may have an indefinite useful economic life that could last as long as the business is considered a going concern. However, the Board concluded that some of what is recognized as goodwill might have a finite useful economic life partly because goodwill is measured as a residual and may include components (representing assets or elements of assets) that are wasting assets and therefore should be amortized. Prior to issuing the 1999 Exposure Draft, the Board considered the discernible-elements approach that would have required amortization of the wasting portion of goodwill and nonamortization of the nonwasting portion (that is, the portion with an indefinite useful economic life). However, the Board concluded that segregating the portion of recognized

goodwill that might not be a wasting asset from the portion that is a wasting asset would not be practicable.

67. The 1999 Exposure Draft proposed that an identifiable intangible asset that could not be reliably measured should be recognized as part of goodwill. As noted previously, the Board decided to change that proposed treatment to require that only intangible assets that do not have an underlying contractual or other legal base or are not capable of being separated and sold, transferred, licensed, rented, or exchanged be recognized as part of goodwill. An identifiable intangible asset that does not meet the asset recognition criteria in Concepts Statement 5 also would have to be recognized as part of goodwill. (As discussed in paragraph 53, the Board believes that application of those criteria should result in more recognition and reporting uniformity in the identifiable intangible assets that are recognized separately from goodwill.) In addition, the intangible assets that would be recognized as part of goodwill using the revised criteria generally would be “goodwill like” in nature—that is, of the type that can be renewed or regenerated. The Board concluded that by revising the criteria for separating identifiable intangible assets from goodwill, the portion of recognized goodwill that might be wasting would be smaller than it would have been using the criteria in the 1999 Exposure Draft. Thus, Board members viewed nonamortization of all goodwill as potentially more appropriate than it would have been under the 1999 Exposure Draft. However, the Board still needed to overcome its concerns with testing goodwill for impairment and develop an operational impairment test.

Concerns with Testing Goodwill for Impairment

Internally generated goodwill

68. In the 1999 Exposure Draft, the Board concluded that it would not be feasible to rely solely on impairment tests as a means of measuring goodwill subsequent to its acquisition. Unlike many other assets that are tested for impairment, goodwill does not have a set of cash flows uniquely associated with it. Instead, the cash flows associated with acquired goodwill usually become intermingled with those associated with internally generated goodwill because entities generally enter into business combinations to reduce costs and achieve synergies, which entail integrating the acquired entity with the acquiring entity.

69. In its reconsideration of the goodwill impairment issue, the Board assessed to what extent it would be appropriate to allow the accounting model to compensate for the fact that acquired goodwill might be replaced by internally generated goodwill. Many respondents noted that the current accounting model does not permit recognition of internally generated intangible assets, including goodwill. They also noted that a good portion of a company's value may be related to those unrecognized intangible assets. Respondents mentioned the growing disparity between the market capitalization of many companies and their book values as strong evidence of that unrecognized value. Board members concluded that it is appropriate to assume that acquired goodwill is being replaced by internally generated goodwill provided an entity is able to maintain the overall value of goodwill (for example, by expending resources on advertising and customer service).

70. The Board noted that the anomalies that result from the differences in how acquired goodwill and internally generated goodwill are accounted for also justify a departure from the current model of accounting for goodwill subsequent to an acquisition on an acquisition-specific basis. The Board observed that an entity often has internally generated goodwill and goodwill-like assets that are not recognized on its balance sheet. Thus, it would be infrequent that the value of the actual (recognized and unrecognized) goodwill and goodwill-like assets of an entity would be less than the amount portrayed as goodwill in its balance sheet even if the value of the goodwill associated with a specific acquisition declined subsequently. This point was significant to some Board members in agreeing to accept a nonamortization approach and depart from the normal acquisition-specific model for testing goodwill for impairment.

Integration of an acquired entity

71. Prior to issuing the 1999 Exposure Draft, the Board's discussions of goodwill impairment tests generally centered on testing goodwill specific to an acquisition. The Board concluded that keeping track of acquisition-specific goodwill for impairment purposes was considered almost impossible once an acquired entity was integrated with the acquiring entity. The Board considered the alternative—testing goodwill at the combined entity (total company) level to be unacceptable. The Board learned in its field visits that synergies occur below the acquiring entity level and that management is held accountable for acquisitions at a lower level. In addition,

Board members noted that the higher the level of review, the more difficult it would be to develop a robust impairment test and the less confident investors would be with the results of the impairment tests. The Board considered further the fact that an acquired entity is often integrated with a part of the acquiring entity and concluded that, in those cases, goodwill should be tested for impairment in conjunction with more than just the assets of the acquired entity. The Board concluded that, in most cases, it is appropriate to test goodwill for impairment in the aggregate at a level higher than that of the acquired entity and lower than that of the combined entity.

Reporting unit

72. The Board initially considered testing goodwill at the reportable operating segment (segment) level (as defined in Statement 131), based on the presumption that that level generally is the lowest reporting level that captures all of the goodwill of a specific acquisition. However, field visit participants informed the Board that they often allocate goodwill below the segment level—for example, to operating or business unit levels.

73. After considering the views of field visit participants and others, the Board concluded that this Statement should permit some flexibility in the level at which goodwill is tested for impairment and that it should allow the level to differ as appropriate from company to company and industry to industry. Thus, the Board decided to refer to the appropriate level of review as the reporting unit—allowing for a structure that should reflect the way a business is managed and the way an entity is organized for internal reporting purposes.

74. A reporting unit is defined in this Statement as the lowest level of an entity that is a business and that can be distinguished, physically and operationally and for internal reporting purposes, from the other activities, operations, and assets of the entity. The Board envisions that a reporting unit generally will be at a level somewhere between a segment and an asset group (as that term is used in Statement 121). However, the Board acknowledges that for some entities, a reporting unit will be the same as a segment and that for narrowly focused entities, the entity as a whole may be one reporting unit.

75. Goodwill by its nature will be associated with the operations of an entity at different levels—possibly different levels within the same overall entity. For example, acquired Entity B

is operated as a stand-alone business and is not integrated with acquiring Entity A. Entity B, the new international division of Entity A, would be a reporting unit for purposes of testing goodwill for impairment. Recently acquired Entity C is integrated with the domestic division of Entity A, which consists of several business units. One of those business units produces a similar product as Entity C; therefore, Entity C is combined with the operations of that business unit, which meets the definition of a reporting unit. Goodwill from the acquisition of Entity C would be tested for impairment along with the previously existing goodwill of that reporting unit. Thus, the goodwill arising from the acquisitions of Entities B and C would be tested for impairment at different reporting levels—Entity B at the division level and Entity C at the business unit level. The Board’s intent was that a reporting unit would be the level of internal reporting that reflects the way an entity manages its business or operations and to which goodwill naturally would be associated.

76. It was important to the Board that the impairment test be performed at a level at which information about the operations of an entity and the assets and liabilities that support those operations are documented for internal reporting purposes (as well as possibly for external reporting purposes). That approach reflects the Board’s belief that the information an entity reports for internal use will naturally reflect the way the overall entity is managed. Therefore, the Board did not intend the concept of a reporting unit and the requirement to test goodwill for impairment at that level to create a new internal reporting level. The Board believes that information entities currently generate about their operations, such as cash flows by business unit for planning purposes, would be used in measuring the fair value of a reporting unit. Similarly, information about the underlying assets and liabilities currently reported by an entity, such as a balance sheet for each division, would be used to identify and measure the recognized net assets of a reporting unit.

Undiscounted cash flows

77. Prior to issuing the 1999 Exposure Draft, the Board discussed testing goodwill for impairment using an undiscounted cash flow method similar to that required for long-lived assets in Statement 121. The Board concluded at that time that a similar method would not be

appropriate for goodwill because the cash flows in question could continue for many years—longer than most other assets.

78. Another reason the Board decided to consider not using an undiscounted cash flow method to test goodwill for impairment is that constituents generally agreed with the 1999 Exposure Draft proposal that intangible assets that are not being amortized should be excluded from the scope of Statement 121. The 1999 Exposure Draft would have required that the fair value of an intangible asset not being amortized be tested for impairment on an annual basis and that an impairment loss be recognized if the carrying amount of the intangible asset exceeded its fair value. That proposed fair value impairment test would have differed from the impairment test used for all other assets. Thus, the Board decided to continue to pursue an approach that would exclude nonamortized intangible assets—including goodwill—from the scope of Statement 121 and to test for impairment using a fair-value-based approach.

Decision Usefulness

79. As discussed above, the Board concluded in the 1999 Exposure Draft that amortizing goodwill was a more appropriate method of accounting for goodwill than not amortizing goodwill and testing it for impairment or writing it off immediately. However, the 1999 Exposure Draft proposed that goodwill amortization expense should be separated from other items on the income statement to make the accounting for goodwill more transparent. The Board noted the anomalous accounting between acquired goodwill and internally generated goodwill and that goodwill is different from other assets. The Board concluded that those differences justified displaying charges associated with goodwill differently, particularly because goodwill may be a nonwasting asset in part and because measures of its amortization and impairment may be less precise than other measures of income items.

80. The Board further acknowledged constituents' assertions that many users assess goodwill charges differently than other income items, in some cases eliminating them from their analysis of earnings per share. The Board therefore concluded that a more transparent display would facilitate the analyses of those users but would not impair the analyses of users that do not assess those charges differently.

81. During its field visits, the Board learned that in addition to the many analysts that ignore goodwill amortization expense in their analyses, many companies ignore goodwill amortization expense in measuring operating performance for internal reporting purposes but hold management responsible for the amount invested in an acquired entity (including goodwill). A number of field visit participants noted, for example, that in measuring return on net assets, management would include goodwill in the denominator (asset base) but would exclude the amortization expense from the numerator (operating earnings). Thus, Board members accepted that not only is goodwill amortization expense in many cases not considered by users of financial statements, it also may not be used by management for purposes of decision making.

82. Upon reconsideration of those issues, the Board concluded that an acceptable impairment test could be developed based on an aggregate view of goodwill and that nonamortization of goodwill coupled with a fair-value-based impairment test would result in more representationally faithful and decision-useful financial information.

83. The Board then considered whether it was appropriate to permit entities to amortize acquired goodwill in certain circumstances. The Board was doubtful that it could develop operational criteria to identify the circumstances in which goodwill should be amortized. The Board agreed that if it were to permit both nonamortization and amortization of goodwill (a mixed approach), entities effectively would have a free choice as to which method to use to account for goodwill, resulting in a significant potential for noncomparable financial reporting among entities. The Board further noted that accounting for all acquired goodwill in the same manner is consistent with its fundamental conclusion that not amortizing goodwill and testing it for impairment in conjunction with all of the net assets of a reporting unit—including goodwill from other acquisitions—would result in more representationally faithful financial reporting.

84. Board members concluded that not amortizing goodwill in all circumstances would provide information that is more useful to investors than adopting a mixed approach under which goodwill would be permitted to be amortized in some circumstances. The Board observed that adopting a nonamortization approach for all goodwill would not mean goodwill would never be written down or that it would only be written down in large amounts. Board members noted that if the carrying amount of goodwill of a reporting unit cannot be maintained, the impairment test

would accommodate both periodic and irregular write-downs of goodwill to reflect that decline in value. For example, an entity might acquire a mature business that is considered a “cash cow” and is not expected to grow. Rather, the acquired entity is expected to generate cash flows for a defined period of time as it winds down its operations and eventually ceases to operate. The Board acknowledged that if that acquired business is operated as a separate reporting unit, that reporting unit would recognize goodwill impairment losses on a regular basis until its goodwill is reduced to zero, presumably when operations cease.

Goodwill Impairment Test

Recognition of an Impairment Loss

85. The Board concluded that, in concept, the objective of a fair-value-based impairment test should be to determine the best estimate of the fair value of goodwill, which would be compared with its carrying amount to determine whether goodwill is impaired. The Board acknowledged that it is not possible to directly measure the fair value of goodwill, noting that goodwill is measured as a residual amount at acquisition. The Board concluded that a method similar to the method of allocating the purchase price to the net assets acquired would need to be used to measure the value of goodwill subsequent to acquisition. Thus, the Board decided that the net assets of a reporting unit should be subtracted from the fair value of that reporting unit to determine the implied fair value of goodwill.

Fair value of a reporting unit

86. During its redeliberations on the accounting for goodwill, the Board considered various methods of testing goodwill for impairment, including methods based on market capitalization, discounted cash flow, residual income valuation, cash flow return on investment, and economic value added. Board members generally agreed that each of those methods could be used to determine the fair value of a reporting unit and that companies should be permitted to use a valuation method with which they are familiar, providing that the result is consistent with the objective of fair value.

87. However, the Board concluded that if a reporting unit has publicly traded stock, the ability of a controlling shareholder to benefit from synergies and other intangible assets that arise from control might cause the fair value of a reporting unit as a whole to exceed its market

capitalization. Therefore, in those few instances in which a reporting unit has publicly traded stock, market capitalization need not be used as the sole indicator of fair value. The Board acknowledges that the assertion in paragraph 23 that the market capitalization of a reporting unit may not be representative of the fair value of the reporting unit as a whole can be viewed as inconsistent with the definition of fair value in FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Those Statements maintain that “if a quoted market price is available, the fair value is the product of the number of trading units times that market price.” However, the Board believes that measuring the fair value of a collection of assets and liabilities that operate together to produce cash flows is different from measuring the fair value of that entity’s individual equity securities and that an entity often is willing to pay more for shares that give it a controlling interest than an investor would pay for a nominal number of shares. Thus, consideration of the impact of a control premium when control is known to exist in measuring the fair value of a reporting unit is appropriate, whereas it is not for a noncontrolling position in equity securities.

88. The Board noted that in most instances quoted market prices for a reporting unit would not be available and thus would not be used to measure the fair value of a reporting unit. The Board concluded that a valuation technique used to measure the fair value of a reporting unit should capture the five elements outlined in paragraph 23 of Concepts Statement 7 and should result in a valuation that yields results similar to a discounted cash flows method. The Board also noted that, consistent with Concepts Statement 7, the fair value measurement should reflect estimates and expectations that marketplace participants would apply.

Recognized net assets of a reporting unit

89. The Board considered which of the following net asset amounts should be subtracted from the fair value of the reporting unit to determine the implied fair value of goodwill: (a) the fair value of recognized net assets (excluding goodwill), (b) the fair value of *both* recognized *and* unrecognized net assets (excluding goodwill), (c) the book value of recognized net assets (excluding goodwill), and (d) the book value of recognized net assets (excluding goodwill) adjusted for any known differences between book value and fair value. The Board concluded that subtracting the fair value of *both* recognized *and* unrecognized net assets would result in a

number closest to the fair value of goodwill. However, the Board considered the cost of identifying the unrecognized net assets and determining their fair values in addition to the cost of determining the fair values of the recognized net assets and concluded that those costs outweigh the benefits of that method.

90. The Board acknowledged that subtracting the fair value of only *recognized* net assets (excluding goodwill) from the fair value of the reporting unit would result in a residual amount that includes more than acquired goodwill. That is, the residual amount also would include the fair value of unrecognized internally generated goodwill and other intangible assets (generated both before and after an acquisition) and the fair value of any unrecognized acquired goodwill and other intangible assets related to prior business combinations accounted for by the pooling method. The Board referred to the above amounts as adding “cushion” or “noise” to the estimate of the implied fair value of goodwill. The Board was not as concerned about the cushion resulting from unrecognized internally generated goodwill as it was about the cushion arising from other unrecognized assets of the reporting unit because the latter confuses different types of assets (while the former does not). The Board noted that if the *book value* of recognized net assets was subtracted, the cushion also would include the unrecognized increase (or decrease) in the fair value of the reporting unit’s recognized tangible and intangible net assets.

91. The Board concluded that subtracting the fair value of recognized net assets (excluding goodwill) would result in the next best estimate of the implied fair value of goodwill, even though it would comprise a cushion attributable to the fair value of the *unrecognized* net assets. Even though that choice has its associated costs, after considering the remaining two choices—subtracting the book value or adjusted book value of recognized net assets—both of which comprise more cushion than a fair value amount, the Board believes that subtracting the fair value of recognized net assets strikes an acceptable balance between costs and benefits. The Board observed that the process of determining the implied fair value of goodwill is similar to the process of determining the amount of goodwill that would be recognized if the reporting unit was purchased at its fair value but the purchase price allocation was restricted to the net assets, other than goodwill, recognized prior to the business combination.

92. The Board concluded that in measuring the fair value of the recognized assets and liabilities of a reporting unit, the guidance in Concepts Statement 7 should be followed. Thus, if a price for an asset or liability or an essentially similar asset or liability can be observed in the marketplace, that price is its fair value measurement. When observable marketplace amounts are not available, Concepts Statement 7 describes an expected present value technique that is useful in estimating the fair value of an asset or liability. An expected present value technique uses the sum of probability-weighted present values in a range of estimated cash flows adjusted for risk, all discounted using the same interest rate convention. The Board believes that such a technique is a more effective measurement tool than the traditional present value approach, especially in situations in which the timing or the amount of estimated cash flows is uncertain, as is the case in measuring nonfinancial assets and liabilities.

93. The Board considered whether there should be exceptions to the use of a fair value measurement for the recognized net assets of a reporting unit, because the amounts initially assigned to certain assets and liabilities acquired in a business combination are not measured on a present value basis (for example, deferred tax liabilities) or are measured on a basis that would not be consistent with the fair value measurement guidance in Concepts Statement 7 (for example, pension obligations). The Board observed that if this Statement required those types of assets and liabilities to be measured at fair value (using the guidance in paragraphs 20–22 of this Statement) in determining the fair value of the recognized net assets of a reporting unit, an impairment loss might result due solely to the different measurement bases. Therefore, the Board decided that recognized assets and liabilities of a reporting unit should be measured at fair value *unless* Opinion 16 would require a different measurement basis if the assets and liabilities were acquired in a business combination. The Board accepted that in situations in which the measurement basis for an asset or liability of a reporting unit is other than fair value, referring to the amount of recognized net assets to be subtracted from the fair value of the reporting unit as the fair value of recognized net assets would not be appropriate. Therefore, this Statement refers to that amount as the fair value (with certain exceptions) of recognized net assets.

94. In order to make operational an approach that incorporates the values of the recognized assets and liabilities, the Board concluded that all of the assets and liabilities of an acquired entity (including goodwill) that will be used in the operations of a reporting unit would have to be

allocated to that reporting unit as of the acquisition date. During its field visits, the Board learned that many companies do not allocate certain liabilities, such as pension and environmental liabilities, below the corporate or entity level. The Board believes that to the extent those liabilities relate to one or more reporting unit or units, they should be included in the determination of the fair value (with certain exceptions) of the recognized net assets of that unit or units.

95. The Board acknowledged that the requirement in this Statement to assign what some view as corporate assets and liabilities to reporting units could be considered inconsistent with the requirements in Statement 131. For purposes of display and disclosure of information about assets by segment, entities are required by Statement 131 to include in reported segment assets only those assets that are included in the measure of the segment's assets that is used by the chief operating decision maker. Thus, goodwill and other assets and liabilities may not be included in reported segment assets. This Statement, however, requires that goodwill and all other related assets and liabilities be assigned to reporting units for purposes of testing goodwill for impairment. This Statement also requires that the amount of goodwill in each segment be disclosed in the notes to the financial statements.

Measurement of an Impairment Loss

96. The Board concluded that if the implied fair value of goodwill of a reporting unit is less than the carrying amount of that goodwill, an impairment loss equal to that difference should be recognized. This requirement is consistent with the method of measuring an impairment loss associated with long-lived assets in accordance with Statement 121.

Frequency of Impairment Test

97. The Board discussed with field visit participants whether goodwill should be tested for impairment on an annual basis or whenever events or circumstances occur indicating that goodwill might be impaired. While some field visit participants agreed with the concept behind annual impairment tests, many noted that given the complexity of the proposed impairment approach—particularly the requirement to measure the recognized assets and liabilities at their fair values (with certain exceptions)—an annual requirement would be onerous. In addition, participants observed that an annual impairment test would not always accelerate the recording of

impairment losses; some noted that events indicating impairment might occur more often than once a year. Others noted that an annual impairment test would be inconsistent with the current impairment model for other long-lived assets.

98. The Board concluded that goodwill should be tested for impairment whenever events or circumstances indicating impairment occur and not on an annual basis because an impairment loss should be recognized in the period in which it occurs. In addition, the Board acknowledged that management often reviews the operating performance of reporting units on a regular basis; therefore, a requirement for an annual impairment test might be redundant and thus would involve unnecessary time and expense.

Benchmark Assessment

99. The Board believes it is important for an acquiring entity to develop and document its process for performing goodwill impairment tests any time a significant change is made to the assets and liabilities of a reporting unit. Therefore, the Board agreed that a benchmark assessment should be performed in conjunction with most significant acquisitions, regardless of how much goodwill arises from that acquisition. For similar reasons, the Board agreed that a benchmark assessment should be performed in conjunction with a reorganization of an entity's reporting structure.

100. A benchmark assessment involves identifying the valuation model to be used, documenting key assumptions, and measuring the fair value of the reporting unit. The Board acknowledged that some costs would be associated with performing a benchmark assessment. However, it concluded that a benchmark assessment is necessary to ensure that an entity has identified and documented all key assumptions and tested the outputs of the selected valuation model for reasonableness prior to testing goodwill for impairment.

101. The Board concluded that measuring the fair value of the reporting unit as part of the benchmark assessment would provide management with an opportunity to assess whether the amount of goodwill assigned to the reporting unit is reasonable by comparing the fair value of the reporting unit with its carrying amount (book value). If, as part of that assessment, the fair value of the reporting unit was found to be less than its carrying amount, the entity would have an

opportunity to reassess the goodwill allocation, the selected valuation model, and the assumptions underpinning the initial valuation.

102. The Board concluded that if, after that reassessment, the fair value of the reporting unit is still less than its carrying amount, goodwill should be tested for impairment. The Board observed that although the purpose of a benchmark assessment is not to test for impairment, ignoring the fact that the fair value of a reporting unit is below its carrying amount would not be appropriate. However, the Board believes that recognition of an impairment loss as a result of a benchmark assessment should occur infrequently if an acquired entity is integrated with a reporting unit that has no goodwill from prior business combinations. The Board noted that in those situations unless an overpayment occurs, it would be very unlikely that the acquired goodwill would be impaired shortly after an acquisition.

103. The Board decided to permit entities up to one year after the acquisition date to complete a benchmark assessment, consistent with the maximum time permitted to complete a purchase price allocation. Because a benchmark assessment due to an acquisition might not be completed until one year after an acquisition, the Board believes it is important that the acquiring entity document key information concurrent with an acquisition. Thus, the Board concluded that the basis for and the method of determining the purchase price of an acquired entity and other related factors should be documented at the acquisition date. The Board believes that information will be essential in performing the benchmark assessment of the reporting unit or units into which an acquired entity is integrated.

Indicators of Impairment

104. The 1999 Exposure Draft included examples of events and circumstances that would give rise to a goodwill impairment test (in addition to the examples in Statement 121). The Board reviewed and revised those examples to reflect its decision that goodwill should be tested for impairment at the reporting unit level. Paragraph 18 of this Statement includes the revised examples of events or circumstances that require an entity to test goodwill in one or more reporting units for impairment. The Board affirmed that the list of impairment indicators is not meant to be an exhaustive list and that an individual event, as well as a series of events, might give rise to an impairment test. The Board concluded that management should continually

monitor for the existence of a circumstance or the occurrence of an event or series of events indicating that goodwill is impaired. That is, it is not appropriate to consider only once a year whether such circumstances exist or events have occurred. The Board also concluded that the impairment test should be performed when such an event or circumstance occurs, not at some later date.

Equity Method Investments

105. Under Opinion 18, an investor is required to use the equity method of accounting if its investment in voting stock gives it the ability to exercise significant influence over operating and financial policies of the investee. The investor's cost and the underlying equity in net assets of the investee often differ, and Opinion 18 requires that that difference be accounted for as if the investee were a consolidated subsidiary. An investor is therefore required to complete a purchase price allocation, which often results in identification of part of the difference as goodwill. (However, that amount is not reported as goodwill in the investor's statement of financial position.) The Board reasoned that goodwill associated with equity method investments (equity method goodwill) should be accounted for in the same manner as goodwill arising from a business combination. Thus, the Board concluded that equity method goodwill should not be amortized.

106. Equity method investments are tested for impairment in accordance with Opinion 18 and it is the equity investment as a whole that is tested for impairment, not the underlying net assets. Because equity method goodwill is not separable from the related investment, the Board concluded that that goodwill should not be tested for impairment in accordance with this Statement. Thus, equity method goodwill is exempt from the impairment provisions of this Statement.

Disposal of All or a Portion of a Reporting Unit

107. The 1999 Exposure Draft proposed that when goodwill is associated with assets to be sold or otherwise disposed of, some amount of goodwill should be included in the cost of the assets disposed of. The June 2000 FASB Exposure Draft, *Accounting for the Impairment or Disposal of Long-Lived Assets and for Obligations Associated with Disposal Activities*, proposed guidance for associating assets to be disposed of with related goodwill. That Exposure Draft proposed that

goodwill generally should be allocated to assets to be disposed of on a pro rata basis using the relative fair values of the acquired long-lived assets and identifiable intangible assets at the acquisition date. The Board observed that that guidance was based on the current acquisition-specific model of accounting for goodwill subsequent to an acquisition. Thus, the Board considered whether that guidance was appropriate given its fundamental decision to move to a model that considers the reporting unit to be the unit of account for goodwill after an acquisition.

108. The Board concluded that because the reporting unit is the unit of account for goodwill, goodwill cannot be identified or associated with an asset group at a level lower than the reporting unit, other than in an arbitrary manner. However, the Board realized that when a significant portion of a reporting unit is to be disposed of, it is necessary to determine whether the net assets of the reporting unit that remain after the disposition can support the carrying amount of goodwill. Thus, the Board concluded that goodwill should be tested for impairment (excluding the assets to be disposed of) in those circumstances. If the implied fair value of reporting unit goodwill is determined to be less than its carrying amount, the excess of the carrying amount of goodwill over its implied fair value should be included in the carrying amount of the net assets to be disposed of. The Board also observed that when a reporting unit is to be disposed of in its entirety, all of that reporting unit's goodwill should be included in the carrying amount of its net assets.

Amendment of Statement 121

109. Statement 121 requires that goodwill associated with a long-lived asset be combined with that asset's carrying value when testing that long-lived asset (or group of assets) for impairment. Having decided that goodwill should be tested for impairment at the reporting unit level under this Statement, the Board needed to address whether Statement 121 should continue to apply to goodwill associated with assets to be held and used and whether it should be used for purposes of testing those assets for impairment. The Board observed that if the asset group being tested for impairment is also a reporting unit, goodwill does not need to be tested for impairment with the asset group under Statement 121 because it would be tested for impairment under the provisions of this Statement. The Board clarified that in those circumstances goodwill would be tested for impairment (and any impairment loss recognized) before the other long-lived assets are tested for impairment.

110. However, in some cases, a reporting unit may consist of multiple asset groups. The Board observed that in those situations an event might occur that requires an impairment test of some, but not all, long-lived assets of that reporting unit. That same event might or might not require an impairment test of reporting unit goodwill. Therefore, the Board considered whether in those circumstances some portion of goodwill should continue to be allocated to the asset group as currently required by Statement 121. The Board concluded that because the reporting unit is the unit of account for goodwill, the reporting unit *is* the lowest level of assets with which goodwill can be associated; therefore, goodwill is not associated with lower-level asset groups. Based on that view, the Board decided that there is no need to allocate or otherwise associate reporting unit goodwill with asset groups when those assets are tested for impairment. The Board noted however, that it may need to provide some guidance in its forthcoming impairment Statement on how to adjust cash flow projections for goodwill when testing long-lived assets for recoverability.

Financial Statement Presentation

111. The 1999 Exposure Draft proposed that goodwill should be aggregated and presented as a separate line item in the statement of financial position. Respondents agreed that presenting goodwill separately in the statement of financial position provides useful information. The Board decided to retain that requirement, noting that separating goodwill from other assets in the statement of financial position is even more important under a nonamortization model.

112. The Board also reconsidered the proposed requirement in the 1999 Exposure Draft to present goodwill impairment losses (combined with goodwill amortization expense) on a net-of-tax basis as a separate line item in the income statement. The Board noted that the special income statement treatment proposed in the 1999 Exposure Draft was aimed at making goodwill amortization expense more transparent. That decision was due in part to the differing views about whether amortization of goodwill faithfully represents the consumption or diminution of goodwill and about the nature of goodwill. Therefore, the special display provisions were designed primarily for goodwill amortization expense—not goodwill impairment losses.

113. Because this Statement does not permit amortization of goodwill, the Board only needed to consider how goodwill impairment losses should be displayed in the income statement. The

Board discussed whether goodwill impairment losses should be presented in the income statement in the same manner as any other impairment loss (as a component of pretax operating income) or in accordance with the special display provisions proposed in the 1999 Exposure Draft. The Board decided to report a goodwill impairment loss recognized under a nonamortization model in the same manner as an impairment loss recognized on other assets. The Board therefore concluded that goodwill impairment losses should be reported as a component of income from operations (before income taxes) unless the goodwill impairment loss is associated with a discontinued operation—in which case it would be included within the results of the discontinued operation.

Disclosures

114. The Board needed to reconsider all of the goodwill disclosure requirements proposed in the 1999 Exposure Draft because they were based on a model that would have required amortization of goodwill. The Board consulted with a group of financial statement users before reaching its conclusions on what information about goodwill should be disclosed in the notes to the financial statements if goodwill is to be tested for impairment rather than amortized. The Board decided to replace the 1999 Exposure Draft requirement to disclose the underlying elements of goodwill with a requirement to disclose information about why the entity entered into the acquisition and why it was willing to pay a purchase premium that resulted in the recognition of goodwill. The Board believes that information will be useful to users in assessing the potential of future impairment losses and the types of events that might give rise to recognition of those losses.

115. The Board considered whether entities should be required to disclose information about goodwill on a disaggregated basis and, if so, at what level. The Board concluded that disaggregated information about goodwill in the period of acquisition is useful because goodwill normally will be tested at a level lower than the entity as a whole. However, the Board decided to require disclosure of the amount of acquired goodwill associated with each segment rather than with each reporting unit. The Board observed that information about acquired goodwill at a level lower than the segment level would be of little value to users because they would not have access to performance data (earnings and cash flow information) at that lower level.

116. The Board also considered whether entities should be required to provide information about the methods and key assumptions that would be used in measuring the fair value of a reporting unit and the types of events that would likely give rise to a goodwill impairment test. That information might be used to make informed judgments about the timing and amount of potential future impairment losses. However, the Board realized that without access to information about past cash flows or earnings at the reporting unit level, the suggested disclosures would be of little benefit to users in making those judgments. In addition, the Board noted that information about methods and assumptions could be useful only if changes to those methods and assumptions are disclosed almost continuously. The Board decided not to require disclosure of that information and observed that disclosure of the reasons for making the acquisition and paying a premium would provide users with information that could assist them in understanding the types of events that might result in future impairment losses.

117. The Board concluded that in the years subsequent to an acquisition, entities should provide information about changes in the carrying amount of goodwill and the reasons for those changes. The Board observed that that information might be best disclosed in a tabular reconciliation format but does not believe that it is appropriate to specify a particular disclosure format. Entities that present segment information in accordance with Statement 131 should disclose the segment to which the impaired goodwill relates.

118. In its discussions on what information should be disclosed when a goodwill impairment loss is recognized, the Board considered the disclosures required by Statement 121 when an impairment loss is recognized for a long-lived asset or group of assets. The Board agreed to require disclosure of similar information when a goodwill impairment loss is recognized—including the facts and circumstances leading to the impairment of goodwill, such as the events or series of events that gave rise to the impairment test. The Board noted that it would be important for users to understand whether the impairment loss was due to external factors or events that should have been within management's control and whether the loss was related to a recently acquired entity.

119. The Board concluded that when an impairment loss is recognized, information should be disclosed at the reporting unit level as well as at the segment level. That information should

include a description of the reporting unit for which the loss is recognized, the adjusted carrying amount of reporting unit goodwill, and the amount of the impairment loss. The Board observed that when an impairment loss is recognized, disclosure of information about goodwill at the reporting unit level would be helpful both in assessing the magnitude of the loss recognized and in assessing the amount of potential future impairment losses.

Excess of Acquired Net Assets over Cost

120. Sometimes the amounts assigned to the net assets acquired in a business combination exceed their cost; that excess is commonly referred to as negative goodwill and is referred to herein as the *excess over cost* or *excess*. The 1999 Exposure Draft proposed that the excess be used to reduce on a pro rata basis the amounts assigned to intangible assets that do not have an observable market. After those intangible assets had been reduced to zero, any remaining excess would have been used to reduce on a pro rata basis the amounts recognized for the remaining intangible assets and depreciable nonfinancial assets. Any excess remaining after those assets had been reduced to zero would have been recognized as an extraordinary gain.

121. Respondents offered little support for the proposed treatment of the excess—particularly the requirement to record an extraordinary gain (if an excess remained after reducing certain assets). Respondents asserted that recognizing any gain on a purchase transaction cannot be justified conceptually. They generally favored recognizing the remaining excess as a deferred credit that would be amortized in a manner similar to goodwill—as is done in current practice. Some respondents stated that they were willing to accept the proposed treatment of the remaining excess as a compromise because an excess rarely remains.

122. A number of respondents also disagreed with the proposed requirement to allocate the excess to specified acquired assets—especially given the emphasis in the 1999 Exposure Draft on initially recording assets and liabilities at their fair value. Most of those respondents suggested that the entire excess should be recognized as a deferred credit; however, a few respondents suggested that the excess should be recognized as a component of equity or as a contingent liability.

123. The Board reaffirmed its belief that an excess rarely would remain if the valuations inherent in the purchase price allocation process are done properly. Therefore, the Board concluded, as it

did in the 1999 Exposure Draft, that if an excess remains after the initial allocation of the purchase price to acquired net assets, accurate and thorough remeasurements should be performed to verify that the consideration paid and all of the identifiable assets and liabilities obtained in the combination have been properly valued and recognized. In deciding how to account for an excess that remains after that valuation and allocation process, the Board considered the changes it had made to the separate recognition criteria for intangible assets.

124. The Board noted that the purchase price is the fair value of the acquired business because it is the result of a transaction between a willing buyer and a willing seller. Board members reaffirmed their belief that in most cases the excess is due to measurement errors in the purchase price allocation process. Therefore, Board members concluded that, as proposed in the 1999 Exposure Draft, the excess should be used to adjust the amounts initially assigned to certain assets. However, the Board observed that based on the revised criteria for separate recognition of intangible assets, many intangible assets with “soft” measures would not be reported separately. That is because the fair values of identifiable intangible assets that meet the separate recognition criteria are presumably more reliably measurable than those of intangible assets that do not meet those criteria. Thus, the more goodwill-like intangible assets would be prohibited from being separately recognized. Therefore, the Board concluded that the excess need not be allocated first to certain intangible assets before it is allocated to other acquired assets.

125. Based on suggestions from respondents, the Board also decided to change the mix of assets to be reduced. The Board concluded that the excess should be allocated on a pro rata basis to all acquired assets *except* cash and cash equivalents, trade receivables, inventory, financial instruments that are required to be carried on the balance sheet at fair value, assets to be disposed of by sale, and deferred tax assets. The Board concluded that those assets should be excluded from the allocation of the excess because (with the exception of deferred tax assets) their fair values are more certain than those of other assets. The Board also observed that not excluding those assets potentially would result in ordinary gain recognition in the near term as those assets are realized.

126. The Board then addressed how to account for any remaining excess once certain assets are reduced to zero. The Board reaffirmed its view that any remaining excess represents either an

unrecognizable obligation or a bargain purchase. The Board observed that accounting for the excess as an unrecognizable obligation would require recognizing a credit balance that does not meet U.S. GAAP recognition criteria or the definition of a liability and that would be reduced only when, if ever, it is determined that the related outlays have been incurred. Because of the inherent difficulties in making those determinations and because entities would not be permitted to recognize those obligations in any other circumstance, the Board concluded that the only practical approach would be to recognize the excess as an extraordinary gain as proposed in the 1999 Exposure Draft. The Board noted that extraordinary treatment is appropriate to highlight the fact that an excess exists and to reflect the unusual nature and infrequent occurrence of the item. In response to the concerns with gain recognition related to an acquisition, the Board noted that regardless of how the excess is accounted for it results in gain recognition. The only difference would be when that gain would be recognized—immediately or in the future.

127. This Statement requires the excess to be recognized as an extraordinary gain in the period in which the business combination is recognized initially unless the purchase price involves contingent consideration. In that instance, the amount of the excess over cost is to be recognized as a deferred credit until the contingency is resolved. The Board believes that recognition of an extraordinary gain should be deferred when contingent consideration exists because the initial purchase price (excluding the contingent amount) could be below the fair value of the net assets (giving rise to an excess over cost). A resolution of the contingency resulting in additional consideration could significantly change that result. Thus, recognizing an extraordinary gain related to that excess when the business combination is recognized initially could result in recognition of an extraordinary gain that may be reversed (partially or fully) if and when the contingent consideration is paid.

Transition

128. Prior to issuance of this Statement, entities may have goodwill recognized on their books that is being accounted for under ARB No. 43, Chapter 5, “Intangible Assets,” and Opinion 17. Goodwill being accounted for under ARB 43 is either a type (a) intangible asset that is being amortized (with no limit on the length of the amortization period) or a type (b) intangible asset that is not being amortized. Goodwill being accounted for under Opinion 17 is being amortized over a period of up to 40 years. The Board concluded that because existing goodwill is no

different from future goodwill, all goodwill should no longer be amortized upon adoption of this Statement. Board members observed that if amortization of existing goodwill were to continue after this Statement is adopted, financial statements would suffer from the noncomparability the Board was concerned about in discussing whether to adopt a mixed approach for goodwill. In addition, the Board noted that to be operational the goodwill impairment provisions in this Statement will need to apply to existing goodwill as well as to future goodwill. Most important, the Board observed that nonamortization of goodwill in conjunction with testing for impairment is the most representationally faithful method of accounting for goodwill and that a nonamortization approach should be applied in all circumstances.

129. Having decided that existing goodwill should no longer be amortized upon adoption of this Statement, the Board addressed whether existing goodwill should be tested for impairment concurrent with the change in accounting from amortization to nonamortization. The Board observed that existing goodwill is currently subject to the limited impairment guidance in Opinion 17 and ARB 43. Many companies currently test goodwill for impairment on an undiscounted basis, similar to the method Statement 121 requires entities to use to test long-lived assets for impairment. Thus, it is possible that existing goodwill that is not impaired under current U.S. GAAP would be impaired if the impairment provisions in this Statement were applied at the date of adoption.

130. Board members observed that requiring goodwill in each reporting unit to be tested for impairment upon adoption of this Statement would be both costly and difficult—particularly determining the fair value (with certain exceptions) of the underlying net assets of each reporting unit. Thus, for cost-benefit reasons the Board concluded that, absent an impairment indicator, existing goodwill should not be required to be tested for impairment upon adoption of this Statement. However, if circumstances exist at the date of adoption or arise thereafter indicating that existing goodwill of a reporting unit might be impaired, goodwill should be tested for impairment—even if the circumstance relates to an event or events occurring prior to issuance of this Statement. The Board observed that the requirement in this Statement that goodwill be tested for impairment when events or circumstances occur indicating that goodwill might be impaired would be effective upon adoption of this Statement. Therefore, entities should begin looking for impairment indicators when this Statement is adopted.

131. The Board agreed that although entities would not be required to test existing goodwill for impairment, entities should be required to perform a transitional benchmark assessment within six months of the date that this Statement is adopted. As part of that transitional benchmark assessment, entities would be required to compare the fair value of each existing reporting unit having goodwill with the carrying amount of its net assets (including goodwill). If the fair value of the reporting unit is less than its carrying amount, an impairment test of the goodwill of that reporting unit would be required at that time. The Board believes that the transitional benchmark assessment will not be overly burdensome, thus striking an acceptable balance between costs and benefits. The Board acknowledged that because this Statement does not require that all existing goodwill be tested for impairment, the potential exists for impairment losses related to existing goodwill to go unrecognized until events or circumstances indicating impairment occur.

132. The Board concluded that an impairment loss recognized as the result of a transitional benchmark assessment should be presented as a component of operating income, in the same manner that all impairment charges would be presented. The Board noted that the impairment loss will be based on fair value estimates that reflect market conditions as of the date the loss is measured. In some cases, goodwill may be impaired because of a series of events that occurred both before and after the date this Statement is adopted. In those cases, it is not possible to determine the amount of the impairment loss related to current and past reporting periods. Thus, the Board concluded that a goodwill impairment loss recognized as the result of a transitional benchmark assessment should be presented as a component of operating income, not as a change in accounting principle. The Board noted that FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, and Statement 121 (for assets held and used) include a similar transition approach for impairment losses recognized upon adoption of those Statements.

Effective Date

133. The Board noted that because nonamortization of goodwill results in financial statements that are more representationally faithful, it would be important for this Statement to become effective as soon as possible after issuance. The Board also noted that for comparability reasons, amortization of all existing goodwill should stop within the same interim (three month) reporting period following issuance of this Statement. The Board, therefore, concluded that all entities should initially apply this Statement at the beginning of the first fiscal quarter following its

issuance. Entities that do not report on an interim basis would be required to adopt this Statement as if they did report on a quarterly basis.

134. The Board observed that little additional cost would be associated with having the nonamortization provisions effective upon this Statement's issuance. Therefore, the Board concluded that there was no need to delay the effective date. The Board acknowledged that it would take entities time to perform the transitional benchmark assessment, so it agreed to provide entities up to six months to complete that assessment. However, if an event or circumstance occurs shortly after the date of adoption indicating that existing or newly acquired goodwill might be impaired, the entity would be required to test goodwill of the affected reporting unit at that time. That required impairment test would accelerate completion of the transitional benchmark assessment for that reporting unit.

135. Consistent with its decision that all entities should adopt this Statement within the three-month period following its issuance to aid in the comparability of financial statements, the Board concluded that entities should not be permitted to adopt this Statement early or apply it on a retroactive basis to prior-period financial statements. However, because many entities will adopt this Statement in the middle of their fiscal year, the Board agreed that it would be useful to include income statement information in the period of adoption as if an entity had stopped amortization of goodwill at the beginning of the annual reporting period. The Board therefore concluded that entities should display income before extraordinary items and net income on a pro forma basis (as if existing goodwill had not been amortized in all periods presented) until all periods presented reflect goodwill accounted for in accordance with this Statement. The Board noted that the pro forma information could be presented either on the face of the income statement or in the notes to the financial statements. The Board agreed that entities should adjust prior-period income amounts only for goodwill amortization expense and not consider the impact the impairment provisions might have had on prior-period information. The Board reasoned that requiring entities to determine the impact of the impairment provisions on prior periods would not be cost beneficial. The Board noted that the pro forma amounts also should reflect the reversal of amortization of any deferred credit related to an excess over cost and amortization of equity method goodwill.

136. Because this Statement changes the criteria for recognizing intangible assets separately from goodwill, the Board considered whether entities should be required to reassess the intangible assets currently recognized separately and possibly reclassify intangible assets that do not meet the new criteria as goodwill and vice versa. For example, some entities may have an assembled workforce recognized as a separate intangible asset, which would not be permissible under the new criteria. Conversely, some entities may have subsumed in existing goodwill certain intangible assets that would be recognized separately under the new criteria.¹⁴ The Board noted that it would be fairly straightforward to identify existing intangible assets that do not meet the new criteria for recognition separate from goodwill but that it would not be so straightforward to identify intangible assets that were subsumed in goodwill. The Board concluded that it would not be appropriate to require the reassessment in one direction but not the other and that, therefore, this Statement should not permit a reassessment of the current amounts recognized for existing goodwill (and other intangible assets). The Board noted that although entities may have aggregated goodwill and intangible assets as one amount for reporting purposes, existing goodwill would have to be disaggregated from that amount for presentation in subsequent statements of financial position if information exists on how the purchase price was initially allocated to goodwill and other intangible assets.

Benefits and Costs

137. The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including preparers, auditors, and users of financial information. In fulfilling that mission, the Board endeavors to determine that a proposed standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. Although the costs to implement a new standard may not be borne evenly, investors and creditors—both present and potential—as well as others benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

¹⁴ Entities might not have adhered strictly to the purchase price allocation requirements in Opinion 16 because the amortization requirements in Opinion 17 are the same for goodwill and other acquired intangible assets.

138. The Board believes that the requirements in this Statement will result in an improvement in financial reporting. The Board believes that the changes in how goodwill is initially recognized and subsequently accounted for will provide investors with greater transparency with respect to the economic value of goodwill and the amount and timing of its impact on earnings.

139. The Board believes that the benefits of recording goodwill charges on the income statement only when goodwill is impaired rather than on a systematic basis over an arbitrary period of time exceed the costs associated with the impairment test required by this Statement. The Board reached conclusions on several issues related to the impairment test after weighing the costs and benefits of the possible choices.

140. The Board observed that entities were required to test goodwill for impairment under Opinion 17 and that there are costs associated with that impairment test as well. Because Opinion 17 contained little guidance on how to test goodwill for impairment, a lack of consistency exists from entity to entity as to how goodwill was tested for impairment. In addition, some or a portion of goodwill was required to be tested for impairment in conjunction with related assets in accordance with Statement 121. Therefore, in some instances goodwill was being tested for impairment under more than one method. This Statement requires that all entities test goodwill for impairment only in accordance with the provisions of this Statement, which will result in financial statements that are more comparable.

141. The Board has sought to reduce the costs of applying this Statement and facilitate transition to its requirements by not requiring that entities test existing goodwill for impairment upon adoption of this Statement or on an annual basis (absent an impairment indicator). The Board also struck a compromise between costs and benefits in choosing, when testing goodwill for impairment, to require that only the *recognized* assets and liabilities of a reporting unit be used to determine the implied fair value of goodwill. The Board's decision to allow up to six months after the date this Statement is adopted to complete the transitional benchmark assessment also should reduce costs and facilitate transition.

Appendix B

ILLUSTRATIONS

142. The following examples illustrate the application of the provisions of this Statement related to the accounting for goodwill when all or a portion of a reporting unit is sold or otherwise disposed of (paragraphs 26 and 27). The following is a summary of the assumed facts used in both examples.

143. ABC Company (ABC) designs, manufactures, and distributes three separate products. Each of those products is managed as a separate business unit, and each also is a separate reporting unit for purposes of goodwill impairment testing. The carrying amount of the recognized net assets of ABC by reporting unit are shown below as of December 31, 2001:

ABC Company
Net Assets by Business Unit (Reporting Unit) (\$000s)

	<u>Business Unit A</u>	<u>Business Unit B</u>	<u>Business Unit C</u>
Assets excluding goodwill	\$400	\$100	\$ 500
Goodwill	<u>500</u>	<u>400</u>	<u>800</u>
Total assets	900	500	1,300
Liabilities	<u>(200)</u>	<u>(15)</u>	<u>(400)</u>
Net assets	<u>\$700</u>	<u>\$485</u>	<u>\$ 900</u>

Illustration 1—Accounting for Goodwill When a Reporting Unit Is Sold or Otherwise Disposed Of

144. In January 20X2, ABC sold business unit A for \$1,000. Paragraph 26 states that if an entire reporting unit is to be disposed of, goodwill of that reporting unit should be included in the carrying amount of the net assets to be disposed of to determine the gain or loss on disposal. Therefore, ABC would recognize a \$300 gain on the sale of that reporting unit (\$1,000 less \$700).¹⁵

¹⁵As described in paragraph 18(d) of this Statement, ABC would be required to test goodwill for impairment when it became more-likely-than-not that business unit A would be sold or otherwise disposed of. This example assumes that the impairment test was performed and that the \$500 carrying amount of goodwill was *not* impaired.

Illustration 2—Accounting for Goodwill When a Portion of a Reporting Unit Is Sold or Otherwise Disposed Of

145. Also in January 20X2, ABC decided that it would continue to design, market, and distribute product B, but it would outsource the manufacturing of that product to another entity. ABC thus sold the facility and related assets used in the production of product B (with a carrying amount of \$75) to that other entity for \$110. Those assets were a significant portion of the total assets of reporting unit B. Therefore, in accordance with paragraph 27, ABC would test goodwill of reporting unit B for impairment based on the fair value of that reporting unit and its recognized net assets, excluding the net assets to be disposed of.¹⁶ If the carrying amount of goodwill exceeds its implied fair value, that excess carrying amount would be included in the carrying amount of the net assets of reporting unit B to be disposed of to determine the gain or loss on disposal.

146. In order to test goodwill for impairment, ABC determines the fair value of reporting unit B after the sale (\$410) and the fair value (with certain exceptions) of the recognized net assets (excluding goodwill) remaining in reporting unit B after the sale (\$35). A summary of the results of that goodwill impairment test follows:

Fair value of reporting unit B after the sale	\$410
Less: Fair value (with certain exceptions) of recognized net assets (excluding goodwill)	<u>35</u>
Implied fair value of goodwill	375
Less: Carrying amount of goodwill	<u>(400)</u>
Excess of the carrying amount of goodwill over its implied fair value	<u><u>\$ (25)</u></u>

147. The implied fair value of goodwill is less than its carrying amount. In accordance with paragraph 27, the excess carrying amount (\$25) would be included in the carrying amount of the net assets sold. The gain on sale of those net assets would be determined as follows:

Carrying amount of net assets sold	\$ 75
Carrying amount of goodwill associated with assets sold	<u>25</u>
Combined carrying amount of net assets sold	100
Sale proceeds	<u>110</u>
Gain on sale	<u><u>\$ 10</u></u>

¹⁶As described in paragraph 18(d) of this Statement, ABC would be required to test goodwill for impairment when it became more-likely-than-not that the manufacturing assets of business unit B would be sold or otherwise disposed of. This example assumes that the impairment test was performed and that the \$400 carrying amount of goodwill was *not* impaired.

Appendix C

AMENDMENTS TO EXISTING PRONOUNCEMENTS

148. This appendix includes only the amendments to various pronouncements that differ significantly from the proposed amendments in the September 1999 Exposure Draft, *Business Combinations and Intangible Assets*.

149. APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, is amended as follows:

- a. Footnote 9 to paragraph 19(b) is replaced by the following:

Investors shall not amortize goodwill associated with equity method investments made after the effective date of FASB Statement No. XXX, *Business Combinations and Intangible Assets*.
- b. The following sentence is added to the end of paragraph 19(m):

If that retroactive adjustment is due to an investment that is made after the effective date of FASB Statement No. XXX, *Business Combinations and Intangible Assets*, no goodwill related to the investment (including goodwill related to step purchases made prior to the effective date of Statement XXX) shall be amortized in determining the amount of the adjustment.
- c. The last sentence of paragraph 19(n) is replaced by the following:

However, if the investor is unable to relate the difference to specific accounts of the investee, including identifiable intangible assets, the difference shall be considered to be goodwill and not be amortized in accordance with Statement XXX.

150. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, is amended as follows:

- a. Paragraph 29 is replaced by the following:

FASB Statement No. XXX, *Business Combinations and Intangible Assets*, provides guidance on the accounting for acquired intangible assets including goodwill. Paragraph 9 of that Statement states that goodwill shall not be amortized and shall be tested for impairment when events or circumstances occur indicating that an impairment might exist. For rate-making purposes, a regulator may permit an enterprise to amortize purchased goodwill over a specified period. In other cases, a regulator may direct an enterprise not to amortize goodwill or to write off goodwill.

- b. Paragraph 30 is replaced by the following:

If the regulator permits all or a portion of goodwill to be amortized over a specific time period as an allowable cost for rate-making purposes, the regulator's action provides reasonable assurance of the existence of a regulatory asset (paragraph 9). That regulatory asset would then be amortized for financial reporting purposes over the period during which it will be allowed for rate-making purposes. Otherwise, goodwill shall not be amortized and shall be tested for impairment in accordance with Statement XXX.

151. FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, is amended as follows:

- a. In the first sentence of paragraph 3, , and goodwill related to those assets is deleted.
b. Paragraph 12 is deleted.

152. The first sentence of paragraph 9 of FASB Interpretation No. 9, *Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or a Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method*, as amended by FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking and Thrift Institutions*, is replaced by the following:

Paragraph 9 of FASB Statement No. XXX, *Business Combinations and Intangible Assets*, states that goodwill shall not be amortized and shall be tested for impairment in accordance with that Statement.

Appendix D

GLOSSARY

153. This appendix contains definitions of certain terms used in this Statement.

Benchmark assessment

The process of documenting key factors and assumptions and measuring a reporting unit to produce information that will serve as the basis for testing goodwill for impairment. A benchmark assessment also includes a comparison of the fair value of a reporting unit to its carrying amount to assess the reasonableness of the assumptions and model underlying the fair value measurement.

Goodwill

The excess of the cost of an acquired entity over the net of the amounts assigned to identifiable assets acquired and liabilities assumed. The amount recognized as goodwill may include one or more acquired identifiable intangible assets that do not meet the criteria in this Statement for recognition separate from goodwill.

Reporting unit

The lowest level of an entity that is a business and that can be distinguished, physically and operationally and for internal reporting purposes, from the other activities, operations, and assets of the entity.