For consideration by the AASB at its 12 & 13 December meeting

Agenda paper 9.1

22 October 2001

«address»

Dear «greeting»

Accounting for Intangibles
Field Testing SFAS 141 and SFAS 142

I am delighted that you have agreed to participate in the field testing of the FASB intangibles approach, as contained in SFAS 141 and SFAS 142.

To assist with this field testing I am enclosing a copy of a field testing document that outlines the key features of the FASB approach and the various aspects that we consider should be subject to field testing. We believe it is important that the various issues raised be considered in depth having particular regard to the most recent acquisition made by your company. We are most interested in how the key requirements of the Standards outlined in the attached document would be interpreted in the context of your company and the problems and issues that may arise in their application.

Any questions on the contents of the document should be directed to the project manager responsible for the project, Tony Donnelly (03 9617 7600 or tdonnelly@aasb.com.au). In due course I would be pleased to meet with you together with Tony and the AASB's Technical Director, Angus Thomson, to discuss the results of your field testing. We would also be pleased to participate in a preliminary meeting with you to discuss the anticipated approach to the field testing in more detail and also to clarify any issues you may have with the attached document or with SFAS 141 and SFAS 142.

Ideally we would like the field testing to be completed by early December. Your co-operation in this project is much appreciated by the AASB.

Yours sincerely

Keith Alfredson
Chairman
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INTANGIBLE ASSETS FIELD TESTING

DESCRIPTION

Objective

The objective of this field testing exercise is to assess the feasibility of applying the key principles of a US approach to goodwill and intangible assets in an Australian accounting context. The International Accounting Standards Board (IASB) is currently considering an approach similar to the US, and is expected to issue an Exposure Draft on Business Combinations and Intangible Assets early next year. The results of your field testing will provide input to the IASB's deliberations, and will be used by the AASB in determining whether a US approach is feasible for Australian entities. As the outcome from the IASB's deliberations will be highly influential in the development of an Australian Standard, your cooperation and assistance will provide a valuable contribution to the international resolution of this important issue.

Scope of Inquiry

Participants should consider the application of the key principles of the US approach to a recent major acquisition. The key principles of Statement of Financial Standards (SFAS) 141 "Business Combinations" and SFAS 142 "Goodwill and other Intangible Assets" are outlined in this instrument, and are accompanied by some specific implementation issues. For each of the specific issues raised, the AASB is interested in whether it would be feasible to adopt similar requirements in Australia. While the AASB is highly interested in any other significant implementation issues or concerns raised by participants, given the complexity of the US rules we are not requesting that participants directly apply SFAS 141 and SFAS 142 (and inter-related Standards). However, for those participants that are more familiar with these rules, the AASB would be interested in any detailed observations and opinions.

Materiality

Participants should focus on issues that have a material effect on the presentation and disclosure of financial information in general purpose financial reports.

Responses

The AASB would appreciate narrative/descriptive responses to the specific issues identified, in addition to any other issues that you consider important. The AASB wishes to obtain as much relevant information on this topic as is possible, including any demonstration of the financial effect of adopting the US rules would have on the balance sheets and profit and loss of Australian entities field testing the approach (ie. restated accounts). However, given the commercial sensitivity and cost of preparing such information, the AASB appreciates that this may not be possible. Any questions on the content of these documents or the field testing procedure should be directed to Tony Donnelly (03-9617-7600 or tdonnelly@aasb.com.au). Please contact Tony if you would like an electronic copy of this document in Word format.

The AASB would appreciate responses to this field testing instrument by **7 December 2001** in order to provide timely feedback to the IASB. Please return any correspondence to:

The Chairman
Australian Accounting Standards Board
Level 3, 530 Collins Street
MELBOURNE VIC 3000
kalfredson@aasb.com.au

Confidentiality

The identity of participants will be treated as confidential and will not be disclosed in either AASB, ASIC or IASB Board papers. Information provided by participants will be available to AASB staff on this project for standard-setting purposes only.

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OVERVIEW OF SFAS 141 & 142

SFAS 141 "Business Combinations"
SFAS 141 addresses accounting for business combinations, including the initial identification, recognition and measurement of assets acquired in a business combination (subsequent accounting for goodwill and other intangible assets is covered by SFAS 142). SFAS 141 prohibits the "pooling-of-interests" method of accounting for business combinations, under which entities used existing carrying amounts in producing combined financial statements. SFAS 141 requires all business combinations to be accounted for using the purchase method.

The other major change introduced in SFAS 141 is to the recognition criteria for intangible assets acquired in a business combination. An intangible asset is required to be recognised separately from goodwill if that asset arises from contractual or other legal rights, or if that asset is separable. SFAS 141 provides an illustrative list of intangible assets that satisfy these criteria, which includes tradenames, licenses, databases, customer lists, customer contracts and related customer relationships, non-contractual customer relationships and order and production backlog. The transitional provisions require entities to reclassify goodwill and other intangible assets to conform with the new recognition criteria, for those acquisitions accounted for using the purchase method. SFAS 141 also includes detailed disclosure requirements, among which entities are required to state the primary reasons for acquisitions completed in that period, and a description of the factors that contributed to a purchase price that results in goodwill being recognised.

SFAS 142 "Goodwill and Other Intangible Assets"
SFAS 142 prohibits the amortisation of goodwill and introduces a two-step impairment test. This test is conducted annually, or more frequently if events or changes in circumstances indicate that goodwill might be impaired, and is carried out at the "reporting unit" level (the operating segment level of a business or one level below).

The first step in the impairment test is effectively a trigger device, which requires entities to compare the fair value of a reporting unit with its carrying amount (including goodwill). Entities are allowed to carry forward estimations of fair value if circumstances of the entity are substantially unchanged, and previous valuations exceeded the carrying amount of the unit by a substantial margin.

The second step, which measures the impairment loss (if any) to be booked, is only conducted if the carrying amount of the reporting unit exceeds its fair value, as determined by the first step. The second step requires the entity to estimate the implied fair value of goodwill, in the same manner as the amount of goodwill recognised in a business combination is determined. For example, the fair value of the reporting unit (as determined in step 1) is treated as the purchase consideration, and is allocated to the assets and liabilities of the unit (including any unrecognised intangible assets that would be recognised in an acquisition) using fair values. Any residual is deemed to be the implied fair value of goodwill. An impairment loss is recognised (and included in operating profit) to the extent that the carrying amount of goodwill exceeds its implied fair value (see Issue 4 of this document for additional description of these rules).

Unlike goodwill, other intangible assets are amortised over their useful lives, unless that life is determined to be indefinite, in which case they are not amortised but are tested for impairment only. This impairment test is conducted at least annually, and requires that the carrying value of the asset does not exceed its fair value. Intangible assets that are amortised are still tested for impairment, but in accordance with impairment rules applicable to other assets (the impairment testing of intangible assets that would be amortised under SFAS 142 is not required to be addressed by participants in this field testing exercise).

Terminology
Several key terms are defined in Appendices F of SFAS 141 and SFAS 142. These include:

> *Intangible assets* - Assets (not including financial assets) that lack physical substance.
>
> *Goodwill* - The excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. The amount recognised as goodwill includes acquired intangible assets that do not meet the criteria in paragraph 39 for recognition as assets apart from goodwill.
>
> *Fair value* - The amount at which an 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 (see section entitled "Fair Value Measurements" below).
>
> *Reporting unit* - The level of reporting at which goodwill is tested for impairment. A reporting unit is an operating segment or one level below an operating segment (as that term is defined in paragraph 10 of SFAS 131" Disclosures about Segments of an Enterprise and Related Information")

Fair Value Measurements
SFAS 142.23-25 provides guidance on determining fair value which is applicable to both reporting units and individual assets. Quoted market prices in active markets are the best evidence of fair value and should be used as the basis of measurement if available (though not necessarily for equity securities). If quoted prices are not available, estimations of fair value shall be based on the best information available, including prices for similar assets and liabilities and the results of using other valuation techniques (such as discounted cash flows or earnings multiples). While field testers may find it helpful to review this material directly, SFAS 142 generally allows preparers latitude in applying the objective of fair value measurement to their specific circumstances, based on guidance in Statement of Financial Accounting Concepts 7 "Using Cash Flow Information and Present Value in Accounting Measurements" (CON 7). Relevant excerpts from CON 7 are contained in Appendix E to SFAS 142.

Additional Materials
There is a substantial amount of descriptive and interpretative materials on SFAS 141 and SFAS 142. Such descriptive material may provide a useful introduction to field testers who are not familiar with the US rules. Of course, these should only be seen as interpretations - the AASB expects field testers to reach their own views on the issues associated with these Standards. For example, the following may be helpful in forming your views:

- Ernst & Young (US) have produced a web-cast which introduces and analyses the new rules: http://webcast.ey.com/thoughtcenter/pages/programs/program_7.asp

- Keith Alfredson and Adrian Murray "Testing the boundaries of goodwill" *Company Director* (September 2001), page 17. This article is included as an attachment to the field testing instrument, and provides an overview for the impairment testing of goodwill.

If participants have difficulty in obtaining copies of SFAS 141 and SFAS 142, please contact Tony Donnelly on the details provided above.

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SPECIFIC IMPLEMENTATION ISSUES

Issue 1: Criteria for recognition of Intangible Assets separately from Goodwill

Overview of Requirements

SFAS 141.39 requires an intangible asset to be recognised as an asset apart from goodwill if it arises from:

- *contractual or other legal rights*, regardless of whether those rights are transferable or separable from the acquired entity or from other rights and obligations; or
- *separable*, that is, it is capable of being separated or divided from the acquired entity and sold, transferred, licensed, rented, or exchanged regardless of whether there is an intent to do so. An intangible asset is still considered separable if it can be sold transferred, licensed, rented, or exchanged in combination with a related contract, asset or liability.

SFAS 141.A10-A28 provides guidance on applying these principles, and includes examples of intangible assets that meet the criteria for recognition apart from goodwill (SFAS 141.A14 which lists intangible assets that meet this criteria is attached to this document). SFAS 141.61 requires entities to reclassify the carrying amounts of goodwill and intangible assets acquired as part of a business combination accounted for using the purchase method, to conform with the new recognition criteria (see Issue 5.4).

Implementation Issues

1.1 Would the application of the SFAS 141.39 criteria result in a material increase in the total value of identifiable intangible assets being recognised? What, if any, type of intangible assets would be recognised under this criteria that would not be recognised under existing Australian GAAP (eg. customer lists, order and production backlog, customer lists and non-contractual customer relationships)?

1.2 SFAS 141.35-36 requires acquired assets to be initially recorded based on their estimated fair values at date of acquisition. SFAS 141.B152 states that the FASB concluded that sufficient information should exist to reliably measure the fair value of any asset which has an underlying contractual or legal basis or is capable of being separated from the entity. Accordingly, there was no need to explicitly include reliable measurement as a recognition criterion. SFAS 141 also does not include any "where practicable" clauses to relieve the separate recognition of these intangibles.

If additional types of identifiable intangible assets are required to be recognised under the SFAS 141 requirements, is the valuation of these items likely to present a major implementation issue? Would your organisation be more likely to use independent appraisals or other external valuation resources to measure these items? (see also Issue 2.3)

1.3 With respect to recent material acquisitions, if greater value would have been attributed to identifiable intangible assets acquired in a business combination using the SFAS 141.39 criteria, would this have resulted in the recognition of negative goodwill that would not have been recognised under Australian GAAP?

Issue 2: Subsequent measurement of identifiable Intangible Assets

Overview of Requirements

SFAS 142.12 requires that a recognised intangible asset be amortized over its useful life to the reporting entity unless that life is determined to be indefinite (amortised intangibles are also required to be tested for impairment under SFAS 144, which has recently replaced SFAS 121, though this is beyond the scope of the field testing being conducted by the AASB). SFAS 142.11, and Appendix A to SFAS 142 provide guidance on determining the useful lives of intangible assets, as well as examples of how to account for specific intangible assets.

SFAS 142.16 requires that recognised intangible assets with indefinite useful lives are not amortised, but are tested for impairment at least annually. SFAS 142.17 provides guidance on the impairment testing of non-amortised intangibles, based on a comparison of the fair value of an intangible asset with its carrying amount.

Implementation Issues

2.1 SFAS 142.11 provides guidance on estimating the useful life of an intangible asset, and includes a list of pertinent factors on which an estimation of useful life may be based. Does this paragraph provide sufficient guidance for determining useful life, and were there any other specific techniques or procedures that you used to estimate useful life? Are there any other pertinent factors not included in the list that you believe to be relevant for determining useful life?

2.2 Would applying the requirements of SFAS 142.16, which prohibits indefinite useful life intangibles from being amortised, have a material effect on your financial performance in the current year (or any other year subsequent to the acquisition where that information is available)?

2.3 SFAS 142.23-25 provides guidance on determining fair value. Is this guidance sufficient for determining the fair value of non-amortised intangible assets, if any, for the purposes of impairment testing? What specific techniques would you use for determining the fair values of non-amortised intangible assets?

Issue 3: Reporting Unit

Overview of Requirements

SFAS 142.F1 defines the reporting unit, being the level at which goodwill is tested for impairment, as an operating segment or in certain circumstances one level below. Operating segment is defined in SFAS 131.10 "Disclosures about Segments of an Enterprise and Related Information" as a component of an enterprise:

"a. That engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same enterprise),

b. Whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and

c. For which discrete financial information is available."

AASB 1005 "Segment Reporting" contains similar requirements to those in SFAS 131.

SFAS 142.30 states that a component of an operating segment is a reporting unit if the component constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of that component. SFAS 142.30 also notes that an operating segment shall be aggregated and deemed a single reporting unit if the components have similar economic characteristics.

Implementation Issues

3.1 SFAS 142.30-31 provides guidance for determining reporting units. What procedures would be used to identify reporting units, and what, if any, implementation issues are likely to be encountered?

3.2 In general, would you anticipate the reporting unit to be at the segment level, or one level below?

3.3 SFAS 142.30-35 requires goodwill and acquired assets and liabilities to be assigned to reporting units using certain procedures. SFAS 142.33 states that assets and liabilities that relate to the operation of multiple reporting units (such as corporate assets) should be assigned using a reasonable, supportable and consistent methodology. What methodology would be used to assign assets and liabilities relating to multiple reporting units?

3.4 What, if any, other implementation issues are likely to be encountered when identifying reporting units and assigning net assets? How could these issues be addressed? How, if at all, could the guidance in SFAS 142.30-35 be improved?

Issue 4: **Goodwill Impairment Testing Procedures**

<u>Overview of Requirements</u>

SFAS 142.26-28 require that impairment testing be conducted annually, and whenever events or circumstances occur that would more likely than not reduce the fair value of a reporting unit below its carrying amount. SFAS 142.27 allows this fair value estimation to be carried forward from previous periods under certain circumstances. The goodwill impairment test consists of two steps:

Step 1 Compare the fair value (FV) of the reporting unit against its carrying amount (CA)

If	FV>CA	Goodwill is not impaired. No further testing required.
If	FV<CA	Go to Step 2.

Step 2 Measure impairment loss, if any, as the following:

FV of reporting unit ***less*** FV of net assets that would be recognised in a business combination (including unrecognised identifiable intangibles) 🕈	–	CA of goodwill*	=	Impairment of goodwill (if * exceeds 🕈)

These procedures are specified in SFAS 142.19-22. Guidance on specific issues, such as goodwill impairment testing when a non-controlling interest exists is provided throughout the Standards.

<u>Implementation Issues</u>

4.1 Is the guidance in SFAS 142.23-25 sufficient for reliably determining the fair value of the reporting unit? If not, how could it be improved? What techniques would be used to determine the fair value of the reporting unit?

4.2 What techniques would be used to reliably determine the fair value of net assets that would be recognised in a business combination (see also Issue 2.3)? Should additional guidance be provided on this topic?

4.2.1 What procedures would be used used to determine the fair value of unrecognised internally generated intangibles, if any, as required by Step 2 of the goodwill impairment test?

4.3 What issues, if any, arise in impairment testing goodwill of a reporting unit which has a minority interest? How would you determine the fair value of the reporting unit without reflecting fair value attributable to a minority interest (as may be required by SFAS 142.38)?

4.4 Are the indicators of potential impairment in SFAS 142.28 appropriate? How frequently is applying this approach likely to result in impairment tests being conducted between annual tests? How could the indicators of impairment be improved, if at all?

Issue 5: Other Issues

5.1 SFAS 142.18 states that goodwill should not be amortised, but should be tested for impairment at the reporting unit level using a two step impairment test.

5.1.1 Do you believe that the US impairment test is operational, and that it will adequately capture a decline in the value of goodwill?

5.1.2 Do you think that requiring all goodwill not to be amortised, but to be tested for impairment using a procedure based on SFAS 142 would provide more useful financial information compared to requiring goodwill to be amortised in some or all circumstances?

5.1.3 If an approach based on SFAS 142 would provide more useful financial information to users, does this justify the additional costs that may be incurred in applying SFAS 142?

5.2 In general, do you believe that any additional costs in applying rules consistent with SFAS 141 and SFAS 142 would be justified by the provision of superior information for decision making purposes, to users of general purpose financial reports? How, if at all, could the US approach be adapted to better achieve this aim?

5.3 Do you believe that applying rules consistent with SFAS 141 and SFAS 142 would result in the disclosure of commercially sensitive information that would have the potential to adversely affect your business? If so, how could these issues be overcome while still providing the same level of useful information to users?

5.4 The transitional provisions of SFAS 141.61 require entities to reclassify goodwill and other intangible assets from acquisitions completed before the introduction of the Standard, in order to comply with the new criteria for recognition of intangible assets separately from goodwill. Are there any issues that would prevent these and other rules in SFAS 141 and SFAS 142 from being applied to acquisitions completed before the application of the Standard? To what extent would it be practicable to require reclassification of goodwill and other intangible assets acquired from past business combinations (ie. acquisitions completed within 2,5 or 10 years)?

[Participants should note that the US Emerging Issues Task Force is planning to discuss clarification of this issue, which may result in the issuance of criteria limiting the transitional requirement to reclassify certain intangible assets separately from goodwill. Under the proposed clarification, intangible assets will only be required to be reclassified separately from goodwill when (1) the asset meets the recognition criteria in SFAS 141.39, (2) the asset has been assigned an amount equal to its measured fair value at the date that the business combination was initially recorded, and (3) separate general ledger or other accounting records have been maintained for the asset]

EXTRACT FROM SFAS 141 "BUSINESS COMBINATIONS"

A14. The following are examples of intangible assets that meet the criteria for recognition as an asset apart from goodwill. The following illustrative list is not intended to be all-inclusive, thus, an acquired intangible asset might meet the recognition criteria of this Statement but not be included on that list. Assets designated by the symbol**+** are those that would be recognized apart from goodwill because they meet the contractual-legal criterion[30]. Assets designated by the symbol***** do not arise from contractual or other legal rights, but shall nonetheless be recognized apart from goodwill because they meet the separability criterion. The determination of whether a specific acquired intangible asset meets the criteria in this Statement for recognition apart from goodwill shall be based on the facts and circumstances of each individual business combination.

a. Marketing-related intangible assets
1. Trademarks, tradenames+
2. Service marks, collective marks, certification marks+
3. Trade dress (unique color, shape, or package design) +
4. Newspaper mastheads+
5. Internet domain names+
6. Noncompetition agreements+

b. Customer-related intangible assets
1. Customer lists*
2. Order or production backlog+
3. Customer contracts and related customer relationships+
4. Noncontractual customer relationships*

c. Artistic-related intangible assets
1. Plays, operas, ballets+
2. Books, magazines, newspapers, other literary works+
3. Musical works such as compositions, song lyrics, advertising jingles+
4. Pictures, photographs+
5. (5) Video and audiovisual material, including motion pictures, music videos, television programs+

d. Contract-based intangible assets
1. Licensing, royalty, standstill agreements+
2. Advertising, construction, management, service or supply contracts+
3. Lease agreements+
4. Construction permits+
5. Franchise agreements+
6. Operating and broadcast rights+
7. Use rights such as drilling, water, air, mineral, timber cutting, and route authorities+
8. Servicing contracts such as mortgage servicing contracts+
9. Employment contracts+

e. Technology-based intangible assets
1. Patented technology+
2. Computer software and mask works+
3. Unpatented technology*

4. Databases, including title plants*
5. Trade secrets, such as secret formulas, processes, recipes.+

Marketing-Related Intangible Assets

A15. Marketing-related intangible assets are those assets that are primarily used in the marketing or promotion of products or services. Trademarks are words, names, symbols, or other devices used in trade to indicate the source of the product and to distinguish it from the products of others. A service mark identifies and distinguishes the source of a service rather than a product. Collective marks are used to identify the goods or services of members of a group, and certification marks are used to certify the geographic origin or other characteristics of a good or service. In the United States and other countries, trademarks, service marks, collective marks, and certification marks may be protected legally through registration with governmental agencies, continuous use in commerce, or by other means. If registered or otherwise provided legal protection, a trademark or other mark is an intangible asset that meets the contractual-legal criterion for recognition apart from goodwill. Otherwise, a trademark or other mark shall be recognized apart from goodwill only if the separability criterion is met, which would normally be the case.

A16. The terms *brand* and *brand name* often are used as synonyms for trademarks and tradenames. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as the trademark (or service mark) and its related tradename, formulas, recipes, and technological expertise (which may or may not be patented). This Statement does not preclude an entity from recognizing, as a single asset apart from goodwill, a group of complementary intangible assets commonly referred to as a brand if the assets that make up that group have similar useful lives.

A17. An Internet domain name is a unique alphanumeric name that is used to identify a particular numeric Internet address. Registration of a domain name associates the name with a designated computer on the Internet for the period the registration is in effect. Those registrations are renewable. Registered domain names shall be recognized as an intangible asset apart from goodwill because they meet the contractual-legal criterion.

Customer-Related Intangible Assets

Customer lists

A18. A customer list consists of information about customers such as their name and contact information. A customer list also may be in the form of a database that includes other information about the customers such as their order history and demographic information. A customer list does not generally arise from contractual or other legal rights. However, customer lists are valuable and are frequently leased or exchanged. Therefore, an acquired customer list would meet the separability criterion for recognition apart from goodwill. An acquired customer list would *not* meet that criterion, however, if the terms of confidentiality or other agreements prohibit an entity from selling, leasing, or otherwise exchanging information about its customers.

Order or production backlog

A19. If an acquired order or production backlog arises from contracts such as purchase or sales orders, it meets the contractual-legal criterion for recognition apart from goodwill (even if the purchase or sales orders were cancelable).

Customer contracts and related customer relationships

A20. If an entity establishes relationships with its customers through contracts, those customer relationships would arise from contractual rights. Therefore, customer contracts and the related customer relationships are intangible assets that meet the contractual-legal criterion. This Statement requires that those intangible assets be recognized as assets apart from goodwill even if confidentiality or other contractual terms prohibit the sale or transfer of the contract separately from the acquired entity.

Noncontractual customer relationships

A21. If a customer relationship does not arise from a contract, this Statement requires that the relationship be recognized as an intangible asset apart from goodwill if it meets the separability criterion. Exchange transactions for the same asset or a similar type of asset provide evidence of separability of a noncontractual customer relationship and might also provide information about exchange prices that should be considered when estimating its fair value. For example, relationships with depositors are frequently exchanged with the related deposits and, thus, meet the criteria for recognition as an intangible asset apart from goodwill.

Artistic-Related Intangible Assets

A22. Artistic-related intangible assets meet the criteria for recognition apart from goodwill if the assets arise from contractual rights or legal rights such as those provided by copyright. In the United States for example, copyrights are granted by the government for the life of the creator plus 50 years. Copyrights can be transferred either in whole through assignments or in part through licensing agreements. In determining the fair value of an intangible asset protected by copyright, consideration shall be given to the existence of any assignments or licenses of the acquired copyrights. This Statement does not preclude an acquiring entity from recognizing a copyright intangible asset and any related assignments or license agreements as a single intangible asset for financial reporting purposes if their useful lives are similar.

Contract-Based Intangible Assets

A23. Contract-based intangible assets represent the value of rights that arise from contractual arrangements. Customer contracts (refer to paragraph A20) are one particular type of contract-based intangible asset. Contracts to service financial assets are another. While servicing is inherent in all financial assets, it becomes a distinct asset or liability only when (a) contractually separated from the underlying financial assets by sale or securitization of the assets with servicing retained or (b) through the separate purchase and assumption of the servicing. If mortgage loans, credit card receivables, or other financial assets are acquired in a business combination with servicing retained, this Statement does not require recognition of the inherent servicing rights as an intangible asset because the fair value of the servicing intangible asset is considered in the measurement of the fair value of the acquired financial asset. However, a contract representing an acquired servicing asset is an intangible asset that shall be recognized apart from goodwill.

A24. If the terms of a contract give rise to a liability or commitment (which might be the case if the terms of an operating lease or customer contract are unfavorable relative to market prices), that liability or commitment shall be recognized as required by paragraph 37(k) of this Statement.

Technology-Based Intangible Assets

A25. Technology-based intangible assets relate to innovations or technological advances. As stated in paragraphs A26-A28, the future economic benefits of those assets are often protected through contractual or other legal rights. Thus, many technology-based intangible assets meet the contractual-legal criterion for recognition apart from goodwill.

Computer software and mask works

A26. If computer software and program formats are protected legally such as by patent or copyright, they meet the contractual-legal criterion for recognition apart from goodwill. Mask works are software permanently stored on a read-only memory chip as a series of stencils or integrated circuitry. Mask works may be provided legal protection; for example, in the United States mask works qualify for protection under the Semiconductor Chip Protection Act of 1984. Acquired mask works protected under the provisions of that Act or other similar laws or regulations also meet the contractual-legal criterion for recognition apart from goodwill.

Databases, including title plants

A27. Databases are collections of information, often stored in electronic form (such as on computer disks or files). An acquired database that includes original works of authorship is entitled to copyright protection and, if so protected, meets the contractual-legal criterion for recognition apart from goodwill. However, a database often includes information created as a consequence of an entity's normal operations, such as a customer list or specialized information such as a title plant, scientific data, and credit information. Databases that are not protected by copyright can be (and often are) exchanged in their entirety or in part. Alternatively, they can be (and often are) licensed or leased to others. Thus, even if the future economic benefit of a database does not arise from legal rights, it meets the separability criterion for recognition as an asset apart from goodwill.

Trade secrets, such as secret formulas, processes, recipes

A28. A trade secret is "information, including a formula, pattern, compilation, program, device, method, technique, or process, that (1) drives independent economic value, actual or potential, from not being generally known . . . and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.[30] If the future economic benefit of an acquired trade secret is protected legally, such as by the Uniform Trade Secrets Act or other laws and regulations, that asset meets the contractual-legal criterion for recognition as an asset apart from goodwill. Otherwise, a trade secret would be recognized as an asset apart from goodwill only if the separability criterion was met, which is likely to be the case.

Footnotes to SFAS 141 referenced above

[27] As described in paragraph A18, some of the intangible assets identified on that list as meeting the separability criterion should not be recognized apart from goodwill if terms of confidentiality or other agreements prohibit the acquiring entity from selling, leasing, or otherwise exchanging the asset.

[28] In some cases, the terms of an operating lease might be unfavorable relative to market prices. Paragraph 37(k) of this Statement states that a portion of the purchase price be assigned to such as unfavorable leases.

[29] The intangible assets designated by the symbol + also might meet the separability criterion. However, separability is not a necessary condition for an asset to meet the contractual-legal criterion.

[30] M. Simensky and B. Lanning, *The New Role of Intellectual Property in Commercial Transactions* (New York: John Wiley & Sons, 1998), page 293.