

# To the Point

FASB – final guidance

The new guidance may allow some companies to avoid performing a costly fair value calculation for indefinite-lived intangible assets each year.

## Qualitative impairment test added for indefinite-lived intangibles

### What you need to know

- ▶ The FASB is giving companies the option to perform a qualitative impairment assessment for their indefinite-lived intangible assets that may allow them to skip the annual fair value calculation.
- ▶ The qualitative assessment is similar to the screen companies can use to determine whether they must perform the two-step goodwill impairment test.
- ▶ To perform a qualitative assessment, a company must identify and evaluate changes in economic, industry and company-specific events and circumstances that could affect the significant inputs used to determine the fair value of an indefinite-lived intangible asset.
- ▶ The guidance is effective for annual and interim impairment tests performed for fiscal years beginning after 15 September 2012. Early adoption is permitted.

### Overview

The Financial Accounting Standards Board (FASB or Board) issued final guidance adding an optional qualitative assessment for determining whether an indefinite-lived intangible asset is impaired. The guidance in Accounting Standards Update (ASU) 2012-02<sup>1</sup> is similar to last year's goodwill guidance,<sup>2</sup> which allows companies to perform a qualitative assessment to test goodwill for impairment.

Until now, companies have had to calculate the fair value of their indefinite-lived intangible assets annually. If the carrying amount of an indefinite-lived intangible asset exceeds its fair value, an impairment charge must be recorded.

The guidance in the ASU gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not (a likelihood of more than 50%) that an indefinite-lived intangible asset is impaired. If a company determines that it is more likely than not that the fair value of such an asset exceeds its carrying amount, it would not need to calculate the fair value of the asset in that year. However, if a company concludes otherwise, it must calculate the fair value of the asset, compare that value with its carrying amount and record an impairment charge, if any.

## Key considerations

The ASU gives companies the option to consider relevant events and circumstances that may affect the fair value of an indefinite-lived intangible asset. Companies will need to consider whether and, if so, how much those events and circumstances could have affected the significant inputs they use to determine the fair value of the assets.

The ASU focuses on significant inputs used to determine fair value because there are many types of indefinite-lived intangible assets, and diverse factors could affect the fair value for each asset. The goodwill guidance, by contrast, directs companies to assess events and circumstances that could affect the fair value of a reporting unit.

The events and circumstances to be considered in a qualitative assessment for an indefinite-lived intangible asset include the majority of those identified for the qualitative assessment for goodwill. The Board decided that the factors used to determine the useful life of an intangible asset should also be considered.

The ASU's list of events and circumstances that could affect significant inputs used to determine the fair value of the indefinite-lived intangible asset includes:

- ▶ Cost factors, such as increases in raw materials, labor or other costs that have a negative effect on future expected earnings and cash flows
- ▶ Financial performance, such as negative or declining cash flows, or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods
- ▶ Legal, regulatory, contractual, competitive, economic, political, business or other factors
- ▶ Other relevant entity-specific events, such as changes in management, key personnel, strategy or customers, contemplation of bankruptcy, or litigation
- ▶ Industry and market considerations, such as a deteriorating operating environment, increased competition, a decline in market-dependent multiples or metrics (in both absolute terms and relative to peers) or a change in the market for an entity's products or services due to obsolescence, demand, competition or other economic factors
- ▶ Macroeconomic conditions, such as a deterioration in general economic conditions, limited access to capital, foreign exchange rate fluctuations or other equity and credit market developments

The qualitative assessment for an indefinite-lived intangible asset focuses on the events and circumstances that could affect the significant inputs used in the fair value measurement of the asset.

None of these events and circumstances by itself would indicate that it is more likely than not that an indefinite-lived intangible asset is impaired. In its qualitative assessment, a company also should consider positive or mitigating events and circumstances that may affect the significant inputs used to determine the fair value of an indefinite-lived intangible asset. A company would then evaluate the significance of each of the identified events and circumstances to these inputs.

The ASU also updates how companies consider whether to perform an interim impairment evaluation of an indefinite-lived intangible asset. Based on the new guidance, companies will consider the relevant events and circumstances listed above as well as offsetting positive evidence to determine whether it is more likely than not that the asset is impaired. Under previous guidance, companies performed an interim impairment test if the existence of negative events and changes in circumstances indicated that an indefinite-lived intangible asset might be impaired.

The Board stated in its Basis for Conclusions that evaluating these events and circumstances may be challenging for certain indefinite-lived intangible assets. For example, in-process research and development assets are subject to significant uncertainties such as regulatory approval that are out of a company's control. These assets were not excluded from the scope of the ASU because the qualitative assessment is optional, and there may be circumstances when using the assessment would be appropriate. Given the importance of unobservable inputs and the complexity of the fair value calculation for certain assets, the Board believes that companies will have to use significant judgment in applying the qualitative assessment.

The ASU also states that if an entity has a recent fair value calculation for an indefinite-lived intangible asset, it should consider the difference between that fair value and the current carrying amount. However, the Board acknowledged that the more time that has passed since the last quantitative assessment, the more difficult it could be for a company to conclude that an indefinite-lived intangible asset is not impaired based solely on qualitative factors.

Both negative and positive evidence should be evaluated to determine whether it is more likely than not that the asset is impaired.

### How we see it

Companies that have indefinite-lived intangible assets whose fair values have recently exceeded their carrying amounts by significant margins are likely to use the screen to avoid performing a costly fair value calculation. Companies that recently recognized an impairment or don't have a significant margin between the carrying amount and fair value of their indefinite-lived intangible asset may find it challenging to apply the screen.

Like the goodwill standard, the guidance exempts nonpublic companies from having to disclose quantitative information about the significant unobservable inputs used in a subsequent fair value measurement that is categorized within Level 3 of the fair value hierarchy. That's because the Board concluded that most users of nonpublic companies' financial statements already have general knowledge of a significant impairment loss and the underlying reasons before the financial statements are finalized. Public companies, which in last year's ASU were provided this relief for disclosures related to goodwill impairment losses, are not provided similar relief in this ASU and therefore must make these disclosures for impairment losses recognized for indefinite-lived intangible assets.

## How we see it

The qualitative assessment will require companies to apply substantial judgment to evaluate the effect of events and circumstances on the significant inputs used to determine an asset's fair value.

To apply the screen, companies will have to design processes and controls to identify and evaluate positive and negative changes that could affect the significant inputs used to determine the fair value of these assets.

## Effective date

The guidance is effective for annual and interim impairment tests performed for fiscal years beginning after 15 September 2012. Early adoption is permitted, even by companies whose impairment testing dates have passed if they have not yet issued their most recent financial statements or made them available for issuance.

### Endnotes:

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- <sup>1</sup> ASU 2012-02, *Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment*.
- <sup>2</sup> ASU 2011-08, *Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment*.

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