



# ACCOUNTING POLICY & PRACTICE



VOL. 7, NO. 25

**SPECIAL REPORTS**

DECEMBER 9, 2011

Reproduced with permission from Accounting Policy and Practice Special Reports, 7 APPR 962, 12/09/2011. Copyright © 2011 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

## **FASB Amends Goodwill Impairment Testing Rules**

BY P.J. PATEL, CFA, VALUATION RESEARCH CORPORATION

The Financial Accounting Standards Board amended Accounting Standards Codification (ASC) Topic 350 by introducing a qualitative assessment that may be used prior to performing step one of the two-step goodwill impairment test. An entity may first qualitatively assess whether it is more likely-than-not that the fair value of a reporting unit is less than its carrying amount. If it is determined that the fair value of a reporting unit is more likely-than-not less than its carrying amount the company would then perform the two-step goodwill impairment test described in ASC 350. The amendments are described in Accounting Standards Update or ASU 2011-08 which is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after Dec. 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before Sept. 15, 2011. The ASU is the Board's response to concerns from private companies about the cost and complexity of the quantitative impairment test. The ASU applies to all entities,

*P.J. Patel, Sr. Vice President, specializes in the valuation of businesses and intangible assets, including brands, in-process R & D, software, and patents for financial reporting purposes at Valuation Research Corporation.*

both public and nonpublic, that have goodwill in their financial statements.

**Amended Testing Methodology.** The ASU amends the current two-step goodwill impairment test by allowing companies to first assess qualitative factors to determine whether it is more likely-than-not that the fair value of a reporting unit is less than its carrying amount. This assessment is the basis for determining whether it is necessary to perform the two-step goodwill impairment test described in ASC 350. The more likely-than-not threshold is defined as having a likelihood of more than 50 percent. If, after a review of the qualitative factors, it is determined that the fair value of the reporting unit does not clear this threshold, the company would proceed to step one of the two-step goodwill impairment test described in ASC 350.

The ability to perform a qualitative test existed in ASC 350 prior to the current ASU, though in a different form. The prior standards allowed the fair value of a reporting unit to be carried forward from a prior year if certain criteria were met. In practice, the application of this exception was limited. Additionally, the ASU provides examples of events and circumstances that an entity should consider when making the more likely-than-not evaluation. Further, under the amendments in the ASU, an entity is no

longer permitted to carry forward its detailed calculations of a reporting unit's fair value from a prior year. The amendments do not change the current guidance for testing of other indefinite-lived intangible assets for impairment.

**Qualitative Events/Circumstances.** The ASU provides a new list of events and circumstances to consider. The list supersedes the prior list of factors in ASC 350. Examples of such events and circumstances include the following:

- macroeconomic conditions such as a deterioration in general economic conditions, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets;
- industry and market considerations such as a deterioration in the environment in which an entity operates, an increased competitive environment, a decline in market-dependent multiples or metrics (consider in both absolute terms and relative to peers), a change in the market for an entity's products or services, or a regulatory or political development;
- cost factors such as increases in raw materials, labor, or other costs that have a negative effect on earnings and cash flows;
- overall 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;
- other relevant entity-specific events such as changes in management, key personnel, strategy, or customers, contemplation of bankruptcy; or litigation;
- events affecting a reporting unit such as a change in the composition or carrying amount of its net assets, a more likely-than-not expectation of selling or disposing all, or a portion, of a reporting unit, the testing for recoverability of a significant asset group within a reporting unit, or recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit; and
- if applicable, a sustained decrease in share price (consider in both absolute terms and relative to peers).

The FASB adds that the list above is not all-inclusive. The Board continues, "an entity shall consider the extent to which each of the adverse events and circumstances identified could affect the comparison of a reporting unit's fair value with its carrying amount. An entity should place more weight on the events and circumstances that most affect a reporting unit's fair value or the carrying amount of its net assets. An entity also should consider positive and mitigating events and circumstances that may affect its determination of whether it is more likely-than-not that the fair value of a reporting unit is less than its carrying amount. If an entity has a recent fair value calculation for a reporting unit it also should include in its consideration the difference between the fair value and the carrying amount in reaching its conclusion about whether to perform the first step of the goodwill impairment test.

---

# In This Issue

“While the qualitative test may initially appear to be a less expensive option, it may result in higher costs if the company spends additional time and expense in audit review. Now companies will be able to rely more on management’s ability to assess qualitatively whether goodwill is impaired, particularly in situations where a recent fair value calculation shows a significant excess exists between the reporting unit’s

fair value and its carrying amount. In our view, for reporting units where a nominal excess exists between its fair value and carrying amount, as well as for public companies which are subject to additional external scrutiny, it may be appropriate, and ultimately more time and cost effective, to complete a fair value calculation.”