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REPORT

GOODWILL

Recent Developments in Goodwill Impairment Testing

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Goodwill impairment testing continues to evolve, most recently through Emerging Issues Task Force (EITF) issue 10-A and a new Financial Accounting Standards Board (FASB) project to consider qualitative assessment of the likelihood of goodwill impairment. In EITF 10-A, ''When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts,'' the FASB provided comments on how to handle goodwill impairment testing for reporting units with zero or negative carrying amounts. The goodwill impairment assessment project, for which the comment period ended June 6, 2011, may add a qualitative assessment to the current two-step goodwill impairment test. Both EITF 10-A and the goodwill impairment assessment project may help reduce the complexity of goodwill impairment testing.

Background. EITF 10-A resulted from questions pertaining to whether a reporting unit's carrying amount should be based on an enterprise value (EV) premise or an equity level value premise. Although this is a significant issue on its own, especially in situations where the fair value of debt differs from its book value, this issue was further magnified in situations where the carrying value of equity was zero or negative. In these instances, the method for calculating the carrying value would result in different conclusions in a step 1 test; either goodwill impairment is indicated and step 2 is needed or no goodwill impairment is indicated. The EV is commonly defined as debt plus equity, or total assets less debt-free current liabilities adjusted for deferred taxes. The enterprise level test is completed by comparing the carrying value of the enterprise with its fair value. Conversely, the equity level test is completed by comparing the carrying value of the equity with its fair value. While there are advantages to each method, we believe the EV level to be the most appropriate for determining

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whether goodwill impairment may be indicated, because it is neutral to the reporting unit's capital structure, it is an entity level test for an entity level asset and therefore provides a better measure of whether goodwill is impaired.

Whether debt is included in a reporting unit's carrying amount can lead to different step 1 conclusions, depending on how debt is accounted for—its carrying value, its fair value or the current obligation—which then impacts whether the second step of the goodwill impairment test is performed. The EITF did not reach a consensus on which method for calculating the carrying value was appropriate, and decided not to mandate an approach. However, the method used to determine the fair value of the reporting unit should be consistent with the manner in which its assets and liabilities are included in determining the carrying amount of the reporting unit. Regardless of the method used to calculate the carrying amount, a reporting unit with zero or negative carrying amount must perform step 2 of the goodwill impairment test, if qualitative factors indicate it is ''more-likely-than-not'' that goodwill impairment exists.

EITF 10-A became effective for public companies for interim and annual reporting periods in fiscal years beginning after Dec. 15, 2010. The effective date is deferred for nonpublic entities to all reporting periods in fiscal years beginning after Dec. 15, 2011.

New Goodwill Project. The FASB has started a new project, ''Goodwill Impairment Assessments,'' which proposes a qualitative assessment to the existing goodwill impairment test. The qualitative assessment would determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying value. If an entity determines that it is more likely than not that the fair value is less than its carrying amount, then performing the two-step impairment test may be unnecessary. If an entity concludes impairment may exist, it would be required to perform the first step of the two-step impairment test. It should be noted, the ability to qualitatively assess a reporting unit for goodwill impairment prior to commencing a fair value based test already exists, but FASB hopes to put increased emphasis on it with this project by using a 'more-likely-than-not' threshold as well as further expanding on the criteria that need to be reviewed.

The FASB proposal includes the following examples of events and circumstances which may indicate that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount:

a) Macro-economic conditions such as a significant deterioration in general economic conditions, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets;

b) Industry and market considerations such as a sustained deterioration in the environment in which an entity operates, an increased competitive environment, a decline in market-dependent multiples of metrics, a significant change in the market for an entity's products or services, or an adverse regulatory development;

c) Cost factors such as a significant increase in raw materials, labor, or other costs that adversely affect earnings;

d) Overall financial performance such as a significant decline in actual or planned revenue or earnings, or sustained negative cash flows;

e) Other relevant entity-specific events such as changes in management, key personnel, strategy, or customers, contemplation of bankruptcy; or litigation;

f) Events affecting a reporting unit such as a change in the 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

g) If applicable, a sustained decrease (both absolute and relative to its peers) in share price.

The Board proposed an effective date of fiscal years beginning after Dec. 15, 2011. The FASB is preparing an Exposure Draft with a comment period ending June 6, 2011.

Conclusion. EITF 10-A and the goodwill impairment assessment projects help reduce the cost and complexity of testing goodwill for impairment. EITF 10-A, removes the odd circumstance where an entity with zero or negative carrying value avoids goodwill impairment. Meanwhile, the insertion of the qualitative assessment puts further emphasis on the ability to first qualitatively review a reporting unit for impairment prior to the undertaking of a fair value based test.

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