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January 2002

Tackling the Implementation of SFAS 141 & 142

Now that companies have begun to implement SFAS 141, *Business Combinations*, and SFAS 142, *Goodwill and Other Intangible Assets*, a number of concerns have surfaced. Valuation Research has helped many companies work through the complex issues involved in the application of SFAS 141 & 142. In this article, we will be discussing two such issues: 1) treatment of intangible assets with indefinite lives, and 2) the effect of FAS 109 rules for deferred taxes on SFAS 141 & 142.

TREATMENT OF INDEFINITE-LIVED INTANGIBLES

In addition to testing goodwill for impairment, Step One of the impairment test should involve a test of the intangible assets with indefinite lives. Even if it has been determined that there is no goodwill impairment, one cannot assume that impairment does not exist among the indefinite-lived intangible assets. In the course of an engagement that we completed for a major media company, we had to determine the appropriate method to be used to test an indefinite-lived intangible asset (in this case, a broadcast license) for impairment. The question was whether to test the indefinite-lived intangible asset against an undiscounted cash flow test under SFAS 144 (formerly 121) or against a fair value test.

Like goodwill, indefinite-lived intangible assets shall not be amortized and must be tested annually for impairment (and when impairment is suspected) against the standard of fair value. If market pricing data is not available, a fair value estimate should be based on the best information available, such as prices for similar assets or by using a present value technique.

It is important to note that companies who have intangibles other than goodwill on their books and operate on a calendar-year basis will have an earlier impairment test deadline to meet for those assets than they do for goodwill. The transition period allowed for goodwill extends to six months. Companies with other intangibles must resolve the accounting for intangibles by the end of their first interim period (i.e. quarter). To account for intangibles, companies must:

- **Reassess the remaining useful life on each intangible asset**
- **Adjust the amortization accordingly**
- **For indefinite-lived intangibles, complete the impairment test vs. fair value**

SFAS 109 CONSIDERATIONS

Another issue that has come up in the course of SFAS 142 engagements is compliance with SFAS 109 rules for deferred taxes. SFAS 142 does not change the requirements in SFAS 109 for

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Tackling the Implementation of SFAS 141 & 142 *(continued)*

recognition of deferred income taxes related to goodwill and intangible assets. SFAS 142 specifically refers to Paragraph 30 of SFAS 109 which states that, "Deferred income taxes are not recognized for any portion of goodwill for which amortization is not deductible for income tax purposes." Paragraphs 261-262 of SFAS 109 offer additional guidance for recognition of deferred income taxes related to goodwill when amortization of goodwill is deductible for tax purposes.

The general tax rule, that stock deals result in non-deductible goodwill and asset deals result in the acquisition of amortizable intangibles for tax purposes, remains the same. Treating stock deals as asset deals for tax purposes upon the special elections provided under the Internal Revenue Code also remains the same. Thus, the following rules apply for goodwill and intangible assets depending on whether they are amortizable for tax purposes.

	Amortizable	Nonamortizable
Intangibles with indefinite lives	Deferred taxes No tax rate benefit	No deferred taxes
Intangibles with definite lives	Deferred taxes	No deferred taxes Tax rate detriment

In addition, any impairment of goodwill or identifiable intangibles will create or adjust temporary differences at the time of the impairment. The restatement of the fair market value represents the new book basis to be compared with the tax basis. Note the following circumstances:

- Where there is impairment of goodwill or identifiable intangibles that have not been amortized for tax purposes, the reduction in the book basis should create a deferred tax asset. This deferred tax asset, similar to a restructure reserve, anticipates the future tax deduction on the sale of the goodwill or identifiable intangible at a fair market amount less than the tax basis.
- Where there is an impairment of goodwill or identifiable intangibles that have been amortized for tax purposes, the deferred tax accounts will be adjusted to reflect the new temporary differences.

We will continue to keep you informed on issues related to SFAS 141 & SFAS 142. For more information, contact your Valuation Research representative or Alfred King at 609/243-7013. VR

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