Agenda Item VI

FASB Statement No. 142, *Goodwill and Other Intangible Assets*
Paragraphs B137-B146

When to test goodwill for impairment

B137. After discussions with field visit participants, the Board proposed in the 2001 Exposure Draft that goodwill be tested for impairment whenever events occur or circumstances change indicating potential impairment (an events-and-circumstances approach) and not on an annual basis. The Board acknowledged that management often reviews the operating performance of reporting units on a regular basis; therefore, a requirement for an annual impairment test might be redundant and thus might involve unnecessary time and expense.

B138. The 1999 Exposure Draft included examples of events and circumstances that would give rise to a goodwill impairment test (in addition to the examples in Statement 121). The Board revised those examples to reflect its decision that goodwill should be tested for impairment at the reporting unit level. The 2001 Exposure Draft included the revised examples of events or circumstances that would require an entity to test goodwill in one or more reporting units for impairment (impairment indicators). The Board affirmed that the list of impairment indicators is not meant to be exhaustive and that an individual event, as well as a series of events, might give rise to the need for an impairment test.

B139. Most respondents agreed with the Board's conclusion in the 2001 Exposure Draft to test goodwill for impairment using an events-and-circumstances approach. Most of those respondents stated that such an approach would be cost-effective because it would generally result in testing goodwill for impairment less frequently than once a year and because the fair value of each reporting unit would not have to be determined annually. However, respondents expressed concern that because the proposed list of impairment indicators included events that occur often in the common course of business, goodwill impairment tests would be required more frequently than is feasible. Respondents offered a number of suggestions for ways to reduce the frequency of an impairment test under an events-and-circumstances approach, including requiring the impairment test only if two or more indicators are present and using the indicators as a guide for testing instead of as a mandatory requirement to test for impairment.

B140. Some respondents disagreed with the proposal that goodwill be tested for impairment using only an events-and-circumstances approach, preferring that goodwill be tested for impairment annually. Attestors noted that under an annual approach, they would be able to provide positive assurance about whether goodwill is impaired, rather than negative assurance that no event occurred or circumstance changed that would require an impairment test. Other respondents noted that an annual approach would result in more consistent application and comparable financial statements and would reduce the subjectivity of and second-guessing about the timing of an impairment charge.

B141. The Board noted that although most respondents supported the proposed events-and-circumstances approach, the concerns that were expressed with the list of impairment indicators suggest that such an approach might not be operational. That is, even if the list of impairment indicators was revised, the revised list still might not be applied or interpreted consistently—thereby undermining the integrity of the impairment model itself. Furthermore, if goodwill was tested for impairment on an annual basis, the recognition of an impairment loss would be less dependent on the subjective interpretation of the performance of reporting units. In addition, Board members observed that goodwill impairments generally do not occur suddenly but occur as a result of a series of events that might not be captured by a list of impairment indicators. An annual test would provide a safety net for impairments that arise as the result of a series of events.

B142. A principal reason that the Board concluded not to propose an annual test in the 2001 Exposure Draft was the cost associated with the proposed impairment test. Having decided to reduce the cost of the impairment test by adding a screen for potential impairment and also to decrease in many cases the number of reporting units, the Board observed that the cost of an annual impairment test would be lower than under the 2001 Exposure Draft, thereby making an annual approach more feasible.

B143. The Board acknowledged that an annual test would entail some cost to preparers because fair value determinations will have to be made for each reporting unit. However, for most entities, the most labor-intensive and potentially expensive part of the process relates to assigning goodwill and net assets to reporting units and establishing the model and key assumptions that will be used to measure the fair value of each reporting unit. Board members observed that those costs will be incurred whether goodwill is tested for impairment annually or on an events-and-circumstances basis. Thus, once the initial fair value of each reporting unit has been determined, the incremental costs associated with annual testing generally will be much lower than those one-time costs.

B144. The Board concluded that the incremental cost of an annual impairment test can be justified because of the benefit to users of financial statements in the form of positive assurance that the carrying amount of goodwill is not overstated. Annual testing would also enhance comparability between entities, since every entity would be testing goodwill for impairment with the same frequency.

B145. Integral to the Board's decision that goodwill should be tested for impairment annually was the view that an annual requirement should not call for a "fresh start" effort in determining the fair value of each reporting unit every year. That is, many entities should be able to conclude that the fair value of a reporting unit is greater than its carrying amount without actually recomputing the fair value of the reporting unit. That conclusion could be supported if the last fair value determination exceeded the carrying amount by a substantial margin and nothing had happened since the last fair value determination that would make the likelihood that the current fair value of the reporting unit would be less than its current carrying amount remote. However, if a recent acquisition, divestiture, or reorganization affected a reporting unit, the fair value of the reporting unit would need to be remeasured for purposes of impairment testing.

B146. The Board noted that testing annually for goodwill impairment would not negate the need for management to be aware of events occurring or circumstances changing between annual tests indicating potential impairment. Should there be such an event or circumstance, an entity would be required to test goodwill for impairment at that time and not wait until the next annual test. Board members observed that when an impairment indicator arises toward the end of an interim reporting period, an entity might not be able to complete the goodwill impairment test before its financial statements are issued. The Board concluded that it would be appropriate for an entity to recognize its best estimate of that impairment loss in those circumstances.