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## ***Making Sense of FASB 142, Goodwill and Other Intangibles and Fair Value Reporting***

For those accountants here in the United States who have spent their entire accounting careers being beat over the head with the highly conservative historical cost basis accounting standards that have been the hallmark of the Financial Accounting Standards Board since its inception, FASB 142 can be a challenge, if not a nightmare. No longer does one simply value the assets acquired in a merger or acquisition and then anything paid beyond that value, assign it to goodwill and amortize that asset over its useful life. You must now, at least on an annual basis, “test” any recorded goodwill for impairment. What is impairment? How is it measured?

First, let us define intangible assets, including goodwill, which is best described by the International Accounting Standards Board as “...assets that manifest themselves by their economic properties; they do not have physical substance; they grant rights and privileges to their owner; and usually generate income for their owner. Intangible assets can be categorized as arising from: Rights; Relationships; Grouped Intangibles; or Intellectual Property.” What then, is goodwill if it falls under the classification of an intangible asset? Goodwill, for the purpose of FASB 142, is defined as: the excess of the cost of an acquired entity over the net of amounts assigned to assets acquired and liabilities assumed. Further, goodwill for GAAP purposes includes all amounts that fail the criteria of an identified intangible asset; this is why it is important to understand the definition of not only goodwill, but also intangible assets.

Now that we have a brief understanding of what goodwill and intangible assets are, how do we now if goodwill, or for that matter, an intangible asset has been impaired? Seems like a far-fetched concept and in reality, it is. First, a value must be placed on the intangible asset in question, which requires performing a valuation of the asset. Guess what? Every valuation analyst will tell you, including me, that valuing an asset or an entity is not an exact science and if your company were to hire several valuation analysts to value the same intangible asset, you will get different values from each. Now you know why CFO's were and still are, leery of the implementation of any of the new fair value standards coming down from the Financial Accounting Standards Board. Let us get back to the real question of this paragraph, how does one know that an intangible asset (which by definition cannot be seen or touched), is impaired? Simple, you value the division or subsidiary as a separate entity as if you were going to sell it and if the value that is derived is lower than the goodwill recorded on your books, you have impairment and the goodwill must be adjusted to reflect this impairment. If the value derived is higher, you have no impairment and you make no adjustments to the recorded goodwill. It seems simple, but this is how an intangible is tested for impairment.

The difficult part of the equation lies in the determination of the value of the intangible in question. Remember my quote from above? Valuation is not an exact science and if you were to hire several valuation analysts to value the exact same asset, you will get different values from each. This is not a joke and not an overstatement. There are countless methods and variations of these methods when valuing business concerns-discounted cash flows, capitalization of income, asset value, etc. Then there is the question as to the standard of value to use: Fair Market Value, Fair Value, Liquidation Value, Etc., hence the release of FASB

157, Fair Value Measurements. In this standard, the FASB defines for us what standard should be used when valuing an asset or entity for financial reporting in the United States, which is called ***fair value***.

The FASB defines Fair Value as:” *...the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.*” They then go on to describe a Fair Value Hierarchy when determining “market participants”:

- Level 1-Inputs are observable market inputs that reflect quoted prices for identical assets or liabilities in active markets the reporting entity has the ability to access at the measurement date
- Level 2-Inputs are observable market inputs other than quoted prices for identical assets or liabilities in active markets the reporting entity has the ability to access at the measurement date
- Level 3-Inputs are unobservable market inputs; for example, inputs derived through extrapolation or interpolation that are not able to be corroborated by observable market data.

This standard of value, which is not fair market value, but instead is based on an exit price and not necessarily what the asset or liability may be sold for in an arms-length transaction. This standard is based on the assumption of a hypothetical transaction from the perspective of the holder or owner of the asset or liability and therefore, is an exit price. Think things are getting complicated?, they indeed are.

What does this mean for the controller or CFO for publically traded companies? Get ready for migration towards International Financial Reporting Standards, which are based on fair value reporting rather than historically based reporting standards. In fact, the Securities and Exchange Commission, which we all know controls financial reporting for publically traded companies in the US, has already taken measures to adopt the International Accounting Standards as the financial reporting standards for publically traded companies in the US and this is why we are seeing the FASB in the US moving towards fair value reporting. Get ready, its coming and soon.

You best bet is to familiarize yourself with the IASB (International Accounting Standards Board) and its standards or either hire outside consulting to get your company ready for the complete turn-around in financial reporting standards. There are many books written on the subject; my particular favorite, “Valuation for Financial Reporting”, written by Michael J. Mard, James R. Hitchner, and Steven D. Hyden, is readily available online or at bookstores. Another good reference is the AICPA IPR&D practice aid (In Process Research & Development). Although this practice aid was written for the software, electronic devices and pharmaceutical industries, it is widely accepted as best practices related to defining and accounting for, disclosing, valuing, and auditing assets acquired to be used in research and development activities. This practice aid can be acquired through the AICPA at [cpa2biz.com](http://cpa2biz.com).

If you would like to speak with one of our professionals concerning any issues regarding FASB 142 or other recent FASB fair value based standards, please email me at [ahartcpa.com](mailto:ahartcpa.com).

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