Goodwill impairment update

December 12, 2017
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Agenda

How did we get here?

Overview of ASU 2017-04

Practice considerations/observations
How did we get here?

**APB 17**
- Amortize goodwill over 40 years or less

**SFAS 142 (2001)**
- Two-step goodwill impairment test
- Step 1, Test for potential impairment
- Step 2, Hypothetical purchase price allocation to determine impairment

**ASU 2011-18 (Qualitative Assessment)**
- If MLTN that CA not greater than FV, skip Step 1

**ASU 2014-02 (Private Company Alternative for Goodwill)**
- If elected, amortize goodwill over 10 year period (or less if appropriate)

**ASU 2017-04**
- Eliminate Step 2 of the goodwill impairment test
Overview of ASU 2017-04

<table>
<thead>
<tr>
<th>Current guidance</th>
<th>ASU 2017-04</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicators of impairment at an interim date require a quantitative test for goodwill impairment</td>
<td>No change</td>
</tr>
<tr>
<td>Optional Step 0 allows qualitative assessment of whether it is more likely than not that goodwill is impaired (annual test only)</td>
<td>No change</td>
</tr>
<tr>
<td>Step 1 of the goodwill impairment test identifies potential impairment</td>
<td>Single-step test identifies and measures impairment</td>
</tr>
<tr>
<td>Step 2 of the goodwill impairment test measures the impairment</td>
<td>Eliminated</td>
</tr>
<tr>
<td>Qualitative assessment identifies impairment for reporting units with zero or negative carrying amounts. When impairment is identified, perform Step 2 to measure the impairment</td>
<td>Replaced. Entities must disclose the amount of goodwill allocated to each reporting unit with zero or negative carrying amounts and the related reportable segment</td>
</tr>
</tbody>
</table>
Overview of ASU 2017-04 (continued)

Example 1: How to apply the ASU to non-deductible goodwill

Company X performs a goodwill impairment test for a reporting unit at December 31, 2016. The reporting unit has the following characteristics.

- Net assets (excluding goodwill and deferred income taxes): $60; tax basis is $35
- Goodwill: $40
- Net deferred tax liabilities: $10
- Total carrying amount: $90 ($60 + $40 - $10)\(^2\)
- Fair value: $80

Using market participant assumptions, Company X concludes that fair value should be based on selling the reporting unit in a nontaxable transaction.

The carrying amount of the reporting unit ($90) exceeds the fair value ($80). Company X records a goodwill impairment loss of $10, and reduces the carrying amount of goodwill to $30 ($40 - $10).

Company X does not perform the legacy Step 2 to measure goodwill impairment.

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1 Based on Example 1 in ASU 2017-04
2 IAS 36, Impairment of Assets.
Overview of ASU 2017-04 (continued)

Example 2: How to apply the ASU to deductible goodwill

Company Y performs a goodwill impairment test for Reporting Unit Z at December 31, 20X6 and determines that its carrying amount exceeds fair value by $100. Because Company Y’s goodwill is tax deductible, a simultaneous equation is required to determine the deferred tax asset and additional adjustment to goodwill (not shown here). Assuming a 40% tax rate, the goodwill impairment charge is $167 and is partially offset by a deferred tax benefit of $67.

<table>
<thead>
<tr>
<th></th>
<th>Carrying amount</th>
<th>Fair value</th>
<th>Initial impairment</th>
<th>Adjustment for equation</th>
<th>Carrying amount after impairment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill</td>
<td>$ 400</td>
<td>$ 400</td>
<td>$ (100)</td>
<td>$ (67)</td>
<td>$ 233</td>
</tr>
<tr>
<td>Deferred Taxes</td>
<td>$ 200</td>
<td>$ 200</td>
<td></td>
<td>$ 67</td>
<td>$ 267</td>
</tr>
<tr>
<td>Other Net Assets</td>
<td>$ 400</td>
<td>$ 400</td>
<td></td>
<td></td>
<td>$ 400</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$ 1,000</strong></td>
<td><strong>$ 1,000</strong></td>
<td><strong>$ 900</strong></td>
<td><strong>$ (100)</strong></td>
<td><strong>$ 900</strong></td>
</tr>
</tbody>
</table>

3 Based on Example 2A in ASU 2017-04
**Overview of ASU 2017-04 (continued)**

**Private Company Adoption**
An entity that adopted the private company alternative for goodwill, but not for subsuming intangible assets into goodwill, may adopt this ASU without demonstrating that the accounting change is preferable.

<table>
<thead>
<tr>
<th>Effective dates and transition</th>
<th>Applying the ASU</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Prospectively for annual and interim periods in fiscal years beginning after:</strong></td>
<td></td>
</tr>
<tr>
<td>December 15, 2019</td>
<td>Public business entities that file with the SEC</td>
</tr>
<tr>
<td>December 15, 2020</td>
<td>Public business entities that do not file with the SEC</td>
</tr>
<tr>
<td>December 15, 2021</td>
<td>Entities that are not public business entities</td>
</tr>
<tr>
<td><strong>Early adoption</strong></td>
<td>Permitted for goodwill impairment tests with measurement dates after January 1, 2017</td>
</tr>
</tbody>
</table>

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Practice considerations/observations

**Regulators/auditors scrutiny**
- Increased focus on Step 1?
- Increased focus on process/controls

**Potential valuation implications**
- Zero/negative carrying amount reporting units
- Situations where step 2 indicated no impairment

**Potential preparer implications**
- Early adoption – why not?
- Anything missed by not having a Step 2 test?
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