

FASB Emerging Issues Task Force

Issue No. 03-9

Title: Determination of the Useful Life of Renewable Intangible Assets under FASB Statement No. 142, *Goodwill and Other Intangible Assets*

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References:

FASB Statement No. 141, *Business Combinations* (FAS 141)

FASB Statement No. 142, *Goodwill and Other Intangible Assets* (FAS 142)

FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (FAS 144)

*** The alternative views presented in this Issue Summary are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination and it is ratified by the Board.**

Background

1. This Issue addresses how the pertinent factors in sub-paragraph 11(d) of FAS 142 should be evaluated in determining the useful life of an intangible asset for which a marketplace participant anticipates renewal (hereinafter referred to as "renewable intangible assets"¹). Renewable intangible assets include, but are not limited to, gaming licenses, taxicab medallions, cable franchises, airline route authorities, contracts to manage investments of mutual funds, and FCC licenses.

Measurement and Recognition Guidance

2. Paragraph B174 of FAS 141 indicates that judgment is required in determining the period over which future cash flows should be expected for purposes of determining the fair value of an intangible asset. Those estimates of future cash flows should incorporate assumptions that marketplace participants would use in making estimates of fair value, such as assumptions about future contract renewals and other benefits that might result from acquisition-related synergies. In cases in which contractual or legal rights are routinely renewed, estimates of future cash flows should extend beyond the remaining contractual or legal term.

Determination of Useful Life

3. The useful life of an intangible asset is defined under FAS 142 as "the period over which an asset is expected to contribute directly or indirectly to future cash flows." There is a direct link, therefore, between the period over which an entity estimates future cash flows from a renewable intangible asset under FAS 141 and the period over which that asset is amortized under FAS 142. As described in paragraph B44 of FAS 142, the Board concluded that "the amortization periods for intangible assets should generally reflect those useful lives and, by extension, the cash flow streams associated with them."

4. FAS 142, however, provides additional guidance for the determination of the useful life of renewable intangible assets that appears to be more limiting than the guidance in FAS 141. Paragraph 11 of FAS 142 requires an entity to assess whether certain "pertinent factors" limit the

¹ The term "renewable intangible assets" includes all intangible assets for which a marketplace participant assumes renewal or extension, regardless of whether the contract has explicit provisions that enable renewal or extension.

useful life of an intangible asset to the reporting entity (that is, whether the pertinent factors limit the period over which an asset is expected to contribute directly or indirectly to future cash flows). This Issue considers the factors listed in paragraph 11(d) and specifically addresses how an entity should evaluate whether substantial renewal costs or material modifications of the existing terms and conditions of a renewable intangible asset limit the useful life of that renewable intangible asset.

Previous Discussion

5. The Task Force previously observed that the useful life of a renewable intangible asset for amortization purposes under FAS 142 should be consistent with the period over which that asset is expected to contribute to an entity's cash flows under FAS 141. That raises the question of how the useful life under FAS 142 can be consistent with the period over which the asset is expected to contribute to an entity's cash flows if the asset's useful life is limited by a substantial renewal cost or a material modification. In response to that question, some Task Force members observed that the estimated future cash flows associated with a renewable intangible asset may, in fact, be generated by one or more intangible assets. Those Task Force members believe that the cash flows generated subsequent to an expected substantial renewal cost or material modification are generated by one or more additional intangible assets.

6. At the March 17–18, 2004 EITF meeting, the Task Force discussed an approach to evaluate how substantial renewal costs and material modifications of the existing terms and conditions of the renewable intangible asset should be evaluated in determining whether a renewable intangible asset has an indefinite life. Under that approach, an entity evaluates certain criteria (such as the probability of renewal) to determine whether the renewable intangible asset is in substance a single intangible asset. If the renewable intangible asset is in substance a single intangible asset, then the renewal costs and expected modifications (if any) of the renewable intangible asset do not limit the useful life of the intangible asset. That is, the renewal costs are not "substantial" and the expected modifications are not "material." The Task Force asked the FASB staff to further develop that approach.

7. At the June 30–July 1, 2004 EITF meeting, the Task Force discussed how substantial costs and material modifications should be evaluated for determining whether a renewable intangible asset is in substance a single asset. The Task Force generally agreed that a renewable intangible asset is in substance a single asset if renewal is reasonably assured. Further, the Task Force generally agreed that an entity should evaluate substantial costs and material modifications when evaluating whether renewal is reasonably assured.

8. The Task Force discussed the meaning of substantial costs, and generally agreed that the costs that an entity should evaluate are those expected renewal costs that the entity would not otherwise incur if the contract was not subject to renewal. The Task Force discussed whether the timing of the cash flows should be a factor in the determination of whether the renewal costs are substantial. Further, the Task Force noted that paragraph B60 of FAS 142 requires an entity to evaluate significance by comparing those expected renewal costs to the fair value of the renewable intangible asset as of the date the asset is acquired. The Task Force also discussed the meaning of material modification.

9. The Task Force was not asked to reach a consensus but directed the FASB staff to further develop the meaning of substantial costs and material modification for the Task Force's consideration.

Current Discussion

10. The FASB staff believes that some of the difficulty associated with defining *substantial costs* and *material modifications* is due to combining the term "substantial" with the term "costs" as well as combining the term "material" with the term "modification." The FASB staff believes that it is useful to first reach an agreement on the meaning of renewal costs and modifications for purposes of applying paragraph 11(d) of FAS 142. Those definitions will serve as a basis for additional discussions about the meaning of "substantial" and "material." Therefore, this Supplement discusses the definition for renewal costs and modifications (Issue 1) separately from the discussion of the definitions for substantial (Issue 2) and material (Issue 3).

11. At the last meeting, the Task Force generally agreed that a substantial cost or material modification could result in a useful life for a renewable intangible asset that is shorter than the period of expected cash flows used to value the asset. However, some Task Force members believe that the period of amortization of those assets should be consistent with the period in which the assets are expected to contribute to the entity's cash flows. In order to reconcile the requirement that a substantial cost and/or a material modification limits the useful life of a renewable intangible asset with the notion that the period of amortization should be consistent with the cash flow period, those Task Force members have supported the concept that a renewable intangible asset that is subject to a substantial cost or a material modification and is expected to contribute to an entity's cash flows in periods beyond the renewal period is, in essence, comprised of more than one asset.

12. Other Task Force members believe that a renewable intangible asset is comprised of one asset and therefore disagree that a renewable intangible asset that is subject to a renewal cost and/or a material modification is, in essence, comprised of more than one asset. Those Task Force members believe that the useful lives of those renewable intangible assets do not need to be consistent with the period over which the entity projects that the asset will contribute to its cash flows. Because of those differences of opinion, this Supplement specifically sets forth a reconsideration of this issue—the useful life of a renewable intangible asset that is expected to contribute to an entity's cash flows beyond the period in which a substantial cost or a material modification is expected to occur (Issue 4).

Issue 1: The meaning of a *renewal cost* and a *modification of the terms and conditions* pursuant to paragraph 11(d) of FAS 142.

13. At the June 30–July 1, 2004 EITF meeting, some Task Force members supported the notion that the types of costs and modifications that should be evaluated under paragraph 11(d) of FAS 142 are those expected costs and modifications that an entity would not expect to incur if the intangible asset was perpetual. In supporting that notion, those Task Force members observed that paragraph 11(d) of FAS 142 states that an entity can assume renewal of the intangible asset if renewal can be accomplished *without* substantial costs and provided renewal can be

accomplished without a material modification of the terms and conditions that existed at the acquisition date. That is, the types of costs and modifications that should be evaluated under paragraph 11(d) of FAS 142 are those incremental costs and modifications that an entity would reasonably expect to be necessary in order to achieve renewal.

14. The FASB staff considered whether renewal costs and modifications should be analyzed net of directly associated cash flows that are expected to offset such costs and modifications. For example, a casino may reasonably expect that it will be required to build an additional hotel in order to obtain renewal, but that the cost of the hotel will be offset by increased cash inflows from lodging, gambling, and other services as a result of the additional hotel. However, the Task Force previously discussed that fact pattern and rejected the notion that costs or modifications should be evaluated net of directly associated cash flows that are expected to offset such costs or modifications. The Task Force concluded that determining whether a cash outflow or a change in the terms and conditions that are necessary in order to achieve renewal is economical, is not an appropriate evaluation for determining whether such outflows or changes should limit the useful life of a renewable intangible asset.

15. Accordingly, the following are proposed definitions for the types of costs and modifications that should be considered, exclusive of any directly associated cash flows that an entity would reasonably expect to offset such costs or modifications, for purposes of evaluating paragraph 11(d) of FAS 142:

Renewal costs. Costs that an entity reasonably would expect to incur that it would not otherwise incur if the renewable intangible asset was perpetual rather than renewable.²

Modifications of the terms and conditions existing at acquisition. Changes to the terms and conditions that an entity reasonably would expect to occur that it would not otherwise expect to occur if the renewable intangible asset was perpetual rather than renewable (it is not necessary to define modifications if the Task Force supports View C on Issue 3).

² Renewal costs can be either assets or expenses.

16. In order to develop an expectation about whether renewal can be accomplished without renewal costs or modifications, an entity should evaluate the facts and circumstances that it considered in determining the fair value of the asset, including:

- a. *Terms and conditions of the intangible asset.* An entity should evaluate the terms and conditions existing at acquisition associated with the renewable intangible asset. An agreement may explicitly require an entity to incur certain renewal costs or state that certain terms and conditions are subject to negotiation at renewal.
- b. *History of renewal costs and modifications.* An entity should evaluate whether the asset or similar assets that are observable in the marketplace have a history of renewal costs and/or modifications. As observed by the Board in paragraph B43 of FAS 142, past history (and industry practice) often provides evidence about whether a renewable intangible asset is renewed without renewal costs and modifications.
- c. *Exposure to substantive negotiation.* An entity should evaluate whether the renewable intangible asset is exposed to substantive negotiation in order to achieve renewal. In its evaluation of whether it is exposed to substantive negotiation in order to achieve renewal, an entity should consider the following, among other things: (a) the availability of alternative resources (such as substitute products, suppliers, or customers) from the perspective of both parties to the renewable intangible asset, (b) the stability of the industry and parties to the asset, (c) the dependency on technology subject to technological advances, (d) the potential legislative actions that could result in uncertainty or changing regulatory environment, and (e) the likelihood that the parties will perform pursuant to the agreement.

Issue 2: The factor(s) that should be considered in determining whether a renewal cost is "substantial."

17. Paragraph B60 of FAS 142 provides the following guidance for evaluating whether renewal costs are substantial:

The Board noted that whether the cost of renewal is substantial should be determined based on the relationship of the renewal cost to the fair value of the intangible asset at the time it is acquired.

18. Application of paragraph B60 of FAS 142 will produce a ratio that an entity will then need to evaluate in order to determine whether the cost of renewal is substantial. The FASB staff observes that the fair value of the intangible represents the present value of the future cash flows expected to be derived from the asset. In order to properly calculate the ratio, the numerator (renewal costs) should also be discounted to present value.

19. The FASB staff believes that the Task Force should not quantify an amount at which that ratio should be considered substantial. Accordingly, the FASB staff believes that the Task Force does not need to further address the determination of whether renewal costs are substantial.

20. If the renewal costs are substantial there is no need to determine whether a material modification would occur. If the renewal costs are not substantial, then the entity would need to evaluate whether an intangible asset can be renewed without material modifications to existing terms and conditions.

Issue 3: The factor(s) that should be considered in determining whether a modification is "material."

View A: The determination of whether a modification is material should be based on a comparison of the expected cost (net present value of the change in cash outflows) or the expected benefit (net present value of the change in cash inflows) resulting from the modification in relationship to the fair value of the asset at time it is acquired.

21. View A proponents observe the symmetry between the definition of a renewal cost and the definition of a modification and therefore believe that the determination of whether a modification is material should be symmetrical with the determination of whether a renewal cost is substantial. Accordingly, View A proponents believe that the determination of whether a modification is material should be based on a comparison of the expected cost (net present value of the change in cash outflows) or the expected benefit (net present value of the change in cash inflows) resulting from the modification to the fair value of the asset at the time it is acquired.

They also believe that, in order to be consistent with the evaluation of whether renewal costs are substantial, costs should be aggregated for purposes of performing the comparison; similarly, modification benefits should be aggregated and evaluated separately from modification costs. View A proponents believe that the Task Force should not quantify an amount at which that ratio should be considered material.

22. View A proponents acknowledge the difficulties in performing a quantitative assessment of whether modifications are material, but observe that many other critical elements of the financial statements, including loan loss and insurance reserves, depreciation and asset impairments, and the value of acquired in-process research and development and other intangibles, require the use of valuation and estimation techniques. View A proponents also believe that the information necessary to perform the analysis should be available from the cash flow models used to value renewable intangible assets under the income approach under FAS 141.

23. Opponents of View A believe that an entity cannot reasonably estimate the timing, nature, or magnitude of a future modification and, as a result, the quantitative effect of a modification is not reasonably estimable. Therefore, opponents believe View A is not operational.

View B: The determination of whether a modification is material should be based on judgment with consideration of the relevant facts and circumstances that exist when the intangible asset is acquired.

24. View B proponents believe that the determination of whether a modification is material should be based on judgment with consideration of the relevant facts and circumstances that exist when the intangible asset is acquired. The following factors, among others, should be considered when making the determination:

- a. The relationship of the cost or benefit of the modification to the fair value of the asset at the time it is acquired
- b. The change in the entity's key financial metrics (such as revenues, costs, margin, and net income) that result from the modification

- c. The extent to which the modification is expected to change the risks and rewards associated with owning the asset.

View C: The determination of whether a modification is material should be based on the extent to which the counterparty is limited in its ability to modify the existing agreement.

25. Proponents of View C believe that an entity cannot reasonably estimate the timing, nature, or magnitude of future modifications, and therefore disagree with the definition of modification proposed under Issue 1. Instead, they believe that for an entity to conclude that renewal can be accomplished without a material modification of the terms and conditions that existed at the acquisition date, the counterparty to the renewable intangible asset should be limited in its ability to modify the existing agreement by legal, regulatory, or contractual provisions. If the counterparty is limited, then the entity must determine whether the maximum allowable modifications to the agreement are material based on the specific facts and circumstances. The entity should consider, among other factors, the change in the entity's key financial metrics that result from the maximum allowable modifications and the extent to which the maximum allowable modifications would change the risks and rewards associated with owning the asset.

26. An entity cannot assert that the intangible asset can be renewed without material modifications to existing terms and conditions if (a) the maximum allowable modifications are material, or (b) the counterparty is not limited in its ability to modify the agreement (for example, all terms and conditions are subject to renegotiation upon a renewal), or (c) the counterparty can subjectively elect not to extend the agreement.

27. An entity should not be precluded from determining that renewal can be achieved without material modification if renewal is subject to achievement of requirements that are objectively determinable (for example, a broadcaster must comply with FCC regulations during the contract period) and achievement of those requirements is reasonable.

Issue 4: The useful life of a renewable intangible asset that is expected to contribute to an entity's cash flows beyond the period in which a substantial cost or a material modification is expected to occur.

28. Some Task Force members have supported the notion that the useful life of a renewable intangible asset should be consistent with the period in which the asset is expected to contribute to the entity's cash flows. That is, if an entity expects that a renewable intangible asset will contribute to its cash flows indefinitely, then the intangible asset is an indefinite-lived intangible asset. Those Task Force members believe that if the entity expects continued cash flows, then any expected cost or modification is not substantial or material. That view was previously discussed and rejected by the Task Force.

29. The Task Force concluded that determining whether the cash flows are expected to continue is not an appropriate evaluation for determining whether a renewable intangible asset is indefinite. As a result, the Task Force asked the FASB staff to further develop the definitions and guidance on the application of "substantial costs" and "material modifications." Inherent in that request, and generally supported by the Task Force, is the notion that a substantial cost or material modification could result in a useful life for a renewable intangible asset that is shorter than the period of expected cash flows used to value the asset.

30. To address the concern that the value of a renewable intangible asset may be amortized over a period that was shorter than the period in which it is expected to contribute to an entity's cash flows, some Task Force members asked the FASB staff to evaluate whether a renewable intangible asset is, in essence, comprised of more than one asset. That is, the cash flows (and value) attributed to the contract period would be recognized as a contract asset and the cash flows (and value) attributed to periods beyond the contract asset would be recognized as one or more intangible assets. The contract asset would be amortized over the remaining period of the contract. The FASB staff proposed that the "non-contract" asset would be amortized when the asset was renewed. Clearly, the Task Force could consider other amortization periods and methods for the "non-contract" asset.

31. To address concerns raised by Task Force members related to the "more than one asset" approach, this Supplement asks the Task Force to conclude whether a renewable intangible asset that is expected to contribute to an entity's cash flows beyond the period in which a substantial cost or a material modification is expected to occur should be (a) accounted for as a single asset and amortized over a period that is shorter than the period in which the asset is expected to contribute to an entity's cash flows or (b) accounted for as more than one asset.

View A: A renewable intangible asset that is expected to contribute to an entity's cash flows beyond the period in which a substantial cost or a material modification is expected to occur should be accounted for as a single asset and amortized over the shorter of the useful life of the asset or up to the period in which a substantial renewal cost or material modification is expected to occur.

32. View A proponents believe that it is inconsistent to value a renewable intangible asset as one asset under FAS 141 and subsequently determine that the asset is in substance more than one asset under FAS 142. Therefore, they believe that a renewable intangible asset that is expected to contribute to an entity's cash flows beyond the period in which a substantial cost or a material modification is expected to occur should be accounted for as a single asset.

33. Proponents of View A believe also that the guidance in FAS 142 indicates that the pertinent factors identified in paragraph 11 of FAS 142 place important limits on the determination of an intangible asset's useful life. They believe that if the Board intended for the determination of useful life to be based solely on the period over which a renewable intangible asset could continue to produce net cash inflows, regardless of the magnitude of the "pertinent factors" described under paragraph 11 of FAS 142, none of the criteria pertinent to the determination of useful life in paragraph 11 would be relevant. Therefore, View A proponents believe that an entity should amortize a renewable intangible asset over the shorter of the useful life of the asset or up to the period in which a substantial renewal cost or material modification is expected to occur.

View B: A renewable intangible asset that is expected to contribute to an entity's cash flows beyond the period in which a substantial cost or a material modification is expected to occur should be accounted for as a more than one asset.

34. Proponents of View B believe that the purpose of the evaluation of the terms "substantial cost" and "material modification" is to identify whether renewal gives rise to an asset that has dissimilar risks and rewards of ownership or dissimilar cash flows as compared to a hypothetically identical intangible asset that is perpetual. They believe that a renewable intangible asset that is not subject to either a substantial cost or a material modification is in substance a single asset. On the other hand, a renewable intangible asset that is subject to either a material modification or a substantial cost and that generates cash flows subsequent to a material modification and/or a substantial cost does so because the renewable intangible asset is comprised of more than one asset.

35. Opponents of View B believe that it is inconsistent to value a renewable intangible asset as one asset under FAS 141 and subsequently determine that the asset is in substance more than one asset under FAS 142. View B opponents also believe that there are practical implications of applying View B in practice, such as (a) determining how to bifurcate the cash flows into more than one asset and (b) determining the period in which the additional asset(s) should be placed into service.

Issues Previously Considered Under Issue 03-9, Issue Summary No. 1 and Its Supplements

36. At the March 17–18, 2004 EITF meeting, after considering numerous issues under Issue Summary No. 1 and its related Supplements, the Task Force directed the FASB staff to address the issue of determining whether a renewable intangible asset is in-substance a single indefinite-lived intangible asset. The FASB staff believes that this Issue Summary addresses the primary practice issues related to determining the useful lives for renewable intangible assets. Accordingly, the FASB staff recommends that the Task Force discontinue its discussions of the Issues presented under Issue Summary No. 1 and its related Supplements.

Exhibit 03-9A

APPLICATION EXAMPLES

The following examples illustrate the application of the proposed definitions of renewal costs and modifications and the alternative views associated with determining whether a modification is material.

Example 1 – Cable Franchise Right

On September 1, 20X2, Company A acquired from Company B a cable franchise right issued by a local franchising authority. The franchise right permits Company A to provide cable services to subscribers in the franchise area through December 31, 20X5, and enables five-year renewals that are subject to negotiation. The procedures for negotiating renewal are governed by federal law under the Cable Communications Policy Act of 1984 (the Cable Act). Under the Cable Act, the local franchising authority can require the cable operator to provide services, facilities, and equipment necessary to meet the future cable-related needs and interests of the community. While the Cable Act does not guarantee the renewal for the franchisee, a franchisee whose past performance and proposal for future performance meet the standards established by the Cable Act should be granted renewal. A franchising authority that follows Cable Act procedures and develops an appropriate administrative record may deny renewal if the operator's service has been unsatisfactory in the past or if the operator is unwilling (or unable) to promise to provide the services, facilities, and equipment necessary to meet the future cable-related needs and interests of the community. The cable franchise right had been renewed by Company B on four previous occasions, and the local franchising authority historically requested Company B to provide services, facilities, and equipment necessary to meet the community's cable-related needs and interests.

The local franchising authority has indicated that it will require Company A to upgrade its cable system in order for Company A to obtain a renewal of the cable franchise right. In addition, the franchise agreement existing at the date of acquisition required the franchisee (Company B) to provide a capital grant to fund PEG access equipment and facilities in 20X1. Due to growth in the local community to be served by Company A, Company A reasonably expects that in order to achieve future renewals the local franchising authority will continue to require Company A to provide incremental capacity and capital support for public, educational, and governmental (PEG) channels.

Company A acquired the cable franchise right with the intention of upgrading the cable system in order to remain competitive with digital satellite service that is available in the franchise area. Company A, however, does not believe that the incremental capacity and capital support for PEG channels is necessary to remain competitive and would not incur those costs unless required to do so to achieve renewal. Company A does not anticipate any additional costs or changes in the terms and conditions of the contract.

Step 1 – Identification of Renewal Costs

Cable system upgrade. The cable system upgrade will result in a change in cash outflows and, therefore, should be evaluated to determine if it is a renewal cost. The existing franchise agreement requires that Company A periodically upgrade its cable system to integrate advancements in technology as may be required to meet the needs and interests of the community. While Company A's expectation to upgrade the cable system is designed to assist it in remaining competitive with digital satellite service, the upgrade also meets the needs and interest of the community. In this case, Company A is able to make its planned upgrades under the existing terms and conditions of the franchise agreement. Accordingly, Company A concludes that the cost associated with the system upgrade is not a renewal cost.

PEG capital and capacity. The PEG capital and capacity will result in a change in cash outflows and therefore should be evaluated to determine if it is a renewal cost. The existing franchise agreement does not require Company A to make any additional capital payments but requires Company A to make available six PEG channels. Due to the growth in Company A's franchise area, Company A reasonably expects that the local franchise authority will require additional capital and an increase in the number of available PEG channels. Company A would not provide the local franchising authority with the incremental capital or PEG channels unless required to do so in order to achieve renewal. Accordingly, Company A concludes that the cost associated with the incremental PEG capital and capacity is a renewal cost given that it would not incur the costs if the franchise right was perpetual.

Step 2 – Evaluation of Whether Renewal Costs are Substantial

Company A should compare the net present value of the expected cost associated the incremental PEG capital and capacity to the fair value of the franchise right to determine whether the cost is substantial.

If the cost is substantial, Company A should conclude that the renewable intangible asset is subject to substantial renewal cost and does not need to identify whether the modifications exist.

Assuming that the renewal cost is not substantial, Company A should identify whether the intangible asset can be renewed without a modification of the existing terms and conditions.

Step 3 – Identification of Modifications of the Existing Terms and Conditions

The changes to the existing contractual terms and conditions that Company A expects will be necessary to achieve future renewals include the cable system upgrade and incremental PEG capital and capacity. The change requiring Company A to upgrade the system is not a modification given that Company A would reasonably expect to incur the system upgrade cost if the franchise right was perpetual. On the other hand, Company A would not provide

the local franchising authority with the incremental capital or PEG channels unless required to do so in order to achieve renewal. Therefore, the change to the contractual terms and conditions imposed by the local franchising authority requiring Company A to provide incremental PEG capital and capacity is a modification given that the change would not occur if the franchise right was perpetual.

Step 4 - Evaluation of Whether Modifications are Material

View A: Company A should compare the net present value of the expected cost associated with the incremental PEG capital and capacity to the fair value of the franchise right to determine whether the modification is material.

View B: Company A should evaluate whether cost associated with the incremental PEG capital and capacity is material based on the relevant facts and circumstances. In reaching that conclusion, Company A should evaluate, among other factors, the magnitude of that modification in relationship to the fair value of the asset at the date it is acquired, the change in Company A's key financial metrics, and the extent to which the modification is expected to change the risks and rewards associated with owning the asset.

View C: Company A should evaluate whether the local franchising authority is limited in its ability to modify the franchise agreement by legal, regulatory, or contractual provisions. If the local franchising authority is limited in its ability to modify the franchise agreement, Company A should evaluate whether the maximum allowable modifications to the agreement are material based on the specific facts and circumstances. The entity should consider, among other factors, the change in the entity's key financial metrics that result from the maximum allowable modifications and the extent to which the maximum allowable modifications would change the risks and rewards associated with owning the asset.

If the local franchising authority is not limited in its ability to modify the franchise agreement, Company A cannot assert that the intangible asset can be renewed without material modifications to existing terms and conditions.

Company A's performance must meet the standards established by the Cable Act in order to attain renewal. If Company A believes that those requirements are objectively determinable and believes it is reasonable that it will comply with those requirements, Company A should not be precluded from reaching a determination that it is not subject to a material modification.

Example 2 – Network Affiliation Agreement

Company C operates a television station. On September 1, 20X2, Company C acquired a network affiliation agreement from Company D under which Company C will operate the station as an affiliate of a major network broadcasting company. The network affiliation agreement is renewable every 2 years and has been renewed or extended on 15 previous occasions. While the relationship has remained in place for over 30 years, due to the evolution of the industry many of the terms and conditions (for example, those governing the delivery of programming and pricing) have been subject to modification over time. Company C reasonably expects that it will be

required to increase its local programming for the foreseeable future (which will require an increased cash outflows to secure the programming) but will receive an increase in revenue sharing from local advertising to offset those costs. Company C does not anticipate any additional costs or changes in the terms and conditions of the contract.

The nature of the historical modifications has not resulted in significant changes to the underlying economics, the overall value of the intangible asset, or the fundamental nature of the right—the right to air network programming and earn a share of advertising revenue thereon. Further, many of the modifications have been made in order to adapt the relationship to fit the needs of both the network affiliate and the network broadcasting company in light of the changing business environment.

Step 1 – Identification of Renewal Costs

Programming. The expected need to acquire local programming will result in a change in cash outflows and, therefore, should be evaluated to determine if it is a renewal cost. The existing network affiliation agreement requires Company C to purchase a certain amount of local programming. Due to market changes, Company C reasonably expects that the network broadcasting company will require Company C to purchase additional local programming. Company C, however, is unable to change the programming mix absent a change in the network affiliation agreement. Accordingly, Company C concludes that the incremental cost associated with acquiring additional local programming is a renewal cost given that it would not incur the costs if the affiliation agreement was perpetual.

Advertising. The expected increase in advertising revenue will result in a change in cash inflows and, therefore, should not be evaluated to determine if it is a renewal cost.

Step 2 – Evaluation of Whether Renewal Costs are Substantial

Company C should compare the net present value of the expected cost associated with adding the incremental local programming to the fair value of the network affiliation agreement to determine whether the cost is substantial.

If the cost is substantial, Company C should conclude that the renewable intangible asset is subject to substantial renewal cost and does not need to identify whether the modifications exist.

Assuming that the renewal cost is not substantial, Company C should identify whether the intangible asset can be renewed without a modification of the existing terms and conditions.

Step 3 – Identification of Modifications of the Existing Terms and Conditions

The existing network affiliation agreement specifies Company C's mix of local and network programming and share of advertising revenue. Due to market changes, Company C reasonably expects its mix of local to network programming and share of revenue to change. Company C, however, would not be able to change its mix of local to network programming

or share of advertising revenue absent a change in the network affiliation agreement. Accordingly, Company C concludes that change in the contractual terms associated with programming and advertising is a modification since the change would not occur if the network affiliation agreement was perpetual.

Step 4 – Evaluation of Whether Modifications are Material

View A: Company C should compare the net present value of the incremental cash outflows associated with acquiring the local programming to the fair value of the network affiliation agreement. Company C should separately compare the net present value of the incremental cash inflows associated with receiving an increase in revenue from advertising to the fair value of the network affiliation agreement.

View B: Company C should evaluate whether cost associated with the acquiring local programming is material based on the relevant facts and circumstances. In reaching that conclusion, Company C should evaluate, among other factors, the magnitude of that modification in relationship to the fair value of the asset at the date it is acquired, the change in Company C's key financial metrics, and the extent to which the modification is expected to change the risks and rewards associated with owning the asset. Company C should perform a similar evaluation to determine whether the cash inflows associated with the increase in revenue sharing from local advertising is material.

View C: Company C should evaluate whether the network broadcasting company is limited in its ability to modify the affiliation agreement by legal, regulatory, or contractual provisions. If the network broadcasting is limited in its ability to modify the franchise agreement, Company C should evaluate whether the maximum allowable modifications to the agreement are material based on the specific facts and circumstances. The entity should consider, among other factors, the change in the entity's key financial metrics that result from the maximum allowable modifications and the extent to which the maximum allowable modifications would change the risks and rewards associated with owning the asset.

If the network broadcasting company is not limited in its ability to modify the network affiliation agreement, Company C cannot conclude that the intangible asset can be renewed without material modifications to existing terms and conditions. In this case, the network broadcasting company is not limited in its ability to modify the network affiliation agreement and, therefore, Company C cannot conclude that the intangible asset can be renewed without material modifications to existing terms and conditions.