Notice for Recipients
of This Proposed FASB Staff Position

This proposed FASB Staff Position would amend FASB Statements No. 141, *Business Combinations*, No. 142, *Goodwill and Other Intangible Assets*, and No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, to clarify the guidance on fair value measurements that is set forth in those Statements. This proposed FSP would be effective until the reporting entity adopts FASB Statement No. 157, *Fair Value Measurements*. Upon adoption of Statement 157, the reporting entity would apply the guidance in that Statement in the circumstances addressed by this proposed FSP. This proposed FSP does not require application of the provisions of Statement 157 prior to a reporting entity's adoption of that Statement. For example, this proposed FSP does *not* address (a) whether the objective of a fair value measurement is to determine the price that would be received to sell an asset or paid to transfer a liability at the measurement date (an exit price), (b) the valuation premise used to measure the fair value of an asset (that is, in-use or in-exchange), (c) whether an adjustment for risk must be included in a fair value measurement, nor (d) any other clarifications made by Statement 157.

The Board invites individuals and organizations to send written comments on all matters in this proposed FSP. Comments are requested from those who agree with the provisions of this proposed FSP as well as from those who do not. Comments are most helpful if they identify the issues or specific paragraph or group of paragraphs to which they relate and clearly explain the issue or question. Those who disagree with provisions of this proposed FSP are asked to describe their suggested alternatives, supported by specific reasoning.

PROPOSED FASB STAFF POSITION

No. FAS 141-b, 142-e, and 144-b

Title: Fair Value Measurements in Business Combinations and Impairment Tests

Comment Deadline: November 22, 2006

Introduction

1. This FASB Staff Position (FSP) amends FASB Statements No. 141, *Business Combinations*, No. 142, *Goodwill and Other Intangible Assets*, and No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, to clarify the guidance on fair value measurements that is set forth in those Statements. This FSP is effective until the reporting entity adopts FASB Statement No. 157, *Fair Value Measurements*. Upon adoption of Statement 157, the reporting entity should apply the guidance in that Statement in the circumstances addressed by this FSP. However, the amendment to paragraph 35 of Statement 141, which clarifies the measurement attributes to be applied in a business combination, is not affected by Statement 157 and continues to apply after that Statement is adopted. The impact of Statement 157 on the paragraphs in Statements 141, 142, and 144 that are amended by this FSP is shown in the appendix (paragraphs A1–A3).

Background

2. During the process of finalizing Statement 157, the Board became aware of diversity in practice about the measurement of nonfinancial assets that are required to be measured at fair value in business combinations and impairment tests. This diversity primarily relates to the circumstances in which a reporting entity uses entity-specific assumptions, rather than the assumptions of market participants, in a fair value measurement. Diversity in practice also arose related to the appropriate measurement attribute for certain assets acquired and liabilities assumed in a business combination. The FASB staff identified certain wording in Statements 141, 142, and 144 that may have contributed to this diversity, which is described in the following paragraphs. As a result,

this FSP is intended to serve as an interim measure to clarify the current requirements for fair value measurements under those Statements until Statement 157 is adopted by the reporting entity.

Statement 141

3. Paragraph 35 of Statement 141 specifies that an acquiring entity should allocate the cost of the acquired entity to the assets acquired and liabilities assumed based on their **estimated fair values** at the date of acquisition. However, paragraph 37 provides guidance for assigning amounts to assets acquired and liabilities assumed (except goodwill) and specifies a number of measurement attributes for specific classes of assets and liabilities that are not fair value measurement attributes. For example, plant and equipment to be used is measured at the current replacement cost for similar capacity unless the expected future use of the assets indicates a lower value to the acquiring entity. Additionally, the basis for conclusions of Statement 141 (paragraph B100) acknowledges that some of the guidance for assigning amounts to assets acquired and liabilities assumed may be inconsistent with the term *fair value*. As a result, diversity in practice appears to have arisen in fair value measurements of certain assets acquired and liabilities assumed in business combinations.

Statement 142

4. Paragraph 24 of Statement 142 specifies that, if a present value technique is used to measure fair value, estimates of future cash flows used in that technique should be consistent with the objective of measuring fair value. However, the basis for conclusions of Statement 142 (paragraph B152) indicates that when cash flows are used to estimate fair value, those cash flows should be consistent with the most recent budgets and plans approved by management. That guidance appears to describe an entity-specific measurement, rather than a fair value measurement, because it does not explain that the entity’s own cash flow projections must be adjusted to the extent there is information reasonably available without undue cost and effort indicating that market participants would use different assumptions. As a result, diversity in practice appears to have arisen in (a) the initial measurement of intangible assets acquired with a group of assets (but not

those acquired in a business combination) and (b) the measurement of goodwill and indefinite-lived intangible assets in impairment tests under Statement 142.

Statement 144

5. Under Statement 144, an impairment loss is recognized only if the carrying amount of a long-lived asset (asset group) is not recoverable **and** exceeds its fair value. The carrying amount of a long-lived asset (asset group) is not recoverable if it exceeds **the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset (asset group)**. However, an impairment loss is measured as the amount by which the carrying amount of a long-lived asset (asset group) exceeds its **fair value**. Paragraph 17 of Statement 144 specifies that estimates of future cash flows used to test **recoverability** of a long-lived asset (asset group) should incorporate the entity's own assumptions about its use of the asset (asset group). The assumptions used in developing those estimates should be reasonable in relation to the assumptions used in developing other information used by the entity for comparable periods, such as internal budgets and projections, accruals related to incentive compensation plans, or information communicated to others. Paragraph 24 of Statement 144 specifies that, if a present value technique is used to measure **fair value**, estimates of future cash flows used in that technique should be consistent with the objective of measuring fair value. Assumptions that market participants would use in their estimates of fair value should be incorporated whenever that information is available without undue cost and effort. Otherwise, the entity may use its own assumptions. As a result of the differing guidance for (a) assessing recoverability, which incorporates an entity's own assumptions in the cash flow projections, and (b) measuring an impairment, which reflects market participant assumptions if available without undue cost and effort, diversity in practice appears to have arisen in the measurement of long-lived assets (asset groups) in impairment tests under Statement 144.

FASB Staff Position

Fair Value Measurements under Statements 141, 142, and 144

6. If a present value technique is used in a fair value measurement under Statements 141, 142, or 144, estimates of future cash flows shall be consistent with the objective of measuring fair value, as defined in those Statements. Therefore, the measurement shall reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability. Those assumptions shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing those assumptions, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop its assumptions shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions (for example, the reporting entity may have unique attributes that will enable it to realize cash flows that differ from those that could be reasonably expected by others in the marketplace).

Amendments to Statement 141

7. Certain of the measurement attributes for specific classes of assets acquired and liabilities assumed in a business combination (as described in paragraph 37 of Statement 141) are not fair value measurement attributes. This FSP amends paragraph 35 of Statement 141 to clarify that it is not intended to suggest that **all** assets acquired or liabilities assumed in a business combination be measured at fair value. However, for items that are required to be measured at fair value in a business combination (for example, intangible assets that meet the criteria for recognition apart from goodwill), it is not appropriate to analogize to other non-fair-value measurement attributes that may apply to different classes of assets and liabilities under paragraph 37 of Statement 141.

8. For a variety of reasons, an acquirer may determine that certain assets acquired in a business combination will not be used in the entity's ongoing operations. However, some of those assets may be expected to provide defensive value, principally by improving the prospects for the holder's own assets by removing competing products or technologies

from the marketplace. For example, an acquired technology may be held (locked up) by the reporting entity because it would compete with the reporting entity's own commercialized technology. If there is information that is reasonably available without undue cost and effort indicating that market participants would use the acquired technology, rather than lock it up (for example, the reporting entity is aware that market participants do not have similar commercialized technology), the reporting entity's own data shall be adjusted to reflect that information in a fair value measurement. If there is no information that is reasonably available without undue cost and effort indicating that market participants would use different assumptions, then a fair value measurement of the acquired technology would be based on the reporting entity's own assumptions. In those circumstances, a fair value measurement of the acquired technology that will be locked up would include the defensive value that is expected to be provided by that acquired technology.

9. In other circumstances, an acquired asset may be held for disposal other than by sale. For example, an acquiring entity might intend to abandon internal-use billing software that is acquired in a business combination after a transition period during which the acquiree's billing activities are migrated to the acquirer's own billing software.[1] If information is reasonably available without undue cost and effort indicating that market participants would use the acquired billing software for its remaining economic life, rather than the limited transition period, the reporting entity's own data shall be adjusted to reflect that information in a fair value measurement. If no information is reasonably available without undue cost and effort indicating that market participants would use different assumptions, then a fair value measurement of the acquired billing software would be based on the reporting entity's own assumptions. In those circumstances, a fair

[1] Paragraph A14(e)(2) of Statement 141 clarifies that computer **software** is an intangible asset. Intangible assets acquired in a business combination that meet the criteria in Statement 141 for separate recognition apart from goodwill are measured at their estimated fair values. In contrast, computer **hardware** is not an intangible asset and would be measured in a business combination pursuant to the guidance in paragraph 37(d)(1) of Statement 141, which specifies that plant and equipment to be used are measured at their current replacement cost for similar capacity unless the expected future use of the assets indicates a lower value to the acquiring entity. Accordingly, the measurement of acquired computer hardware in a business combination is not subject to the guidance in this FSP.

value measurement of the acquired billing software would reflect its use for only the period of transition.

10. This FSP amends Statement 141 as follows: [Added text is underlined and deleted text is ~~struck out~~.]

a. Paragraph 35:

Following the process described in paragraphs 36–46 (commonly referred to as the purchase price allocation), an acquiring entity shall allocate the cost of an acquired entity to the assets acquired and liabilities assumed based on their respective measurement attributes~~estimated fair values~~ at the date of acquisition (refer to paragraph 48). The measurement attributes that shall be used in this allocation for specific classes of assets and liabilities are set forth in paragraph 37. Prior to that allocation, the acquiring entity shall (a) review the purchase consideration if other than cash to ensure that it has been valued in accordance with the requirements of paragraphs 20–23 and (b) identify all of the assets acquired and liabilities assumed, including intangible assets that meet the recognition criteria in paragraph 39, regardless of whether they had been recorded in the financial statements of the acquired entity.

b. Paragraph 36:

Among other sources of relevant information, independent appraisals and actuarial or other valuations may be used as an aid in determining the amounts assigned to those ~~estimated fair values of~~ assets acquired and liabilities assumed that are required under paragraph 37 to be measured at their estimated fair values. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. If quoted market prices are not available and a present value technique is used, estimates of future cash flows shall be consistent with the objective of measuring fair value. Therefore, the measurement shall reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability. Those assumptions shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing those assumptions, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop its assumptions shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.[11a] The tax basis of an asset or liability shall not be a factor in determining its estimated fair value ~~(Opinion 16, paragraph 87)~~.

[11a] FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, discusses the essential elements of a present value measurement (paragraph 23) and provides reasons why an entity's estimates of cash flows might differ from those used by marketplace participants (paragraph 32).

Amendment to Statement 142

11. This FSP amends Statement 142 as follows:

a. Paragraph 24:

If quoted market prices are not available, the estimate of fair value shall be based on the best information available, including prices for similar assets and liabilities and the results of using other valuation techniques. A present value technique is often the best available technique with which to estimate the fair value of a group of net assets (such as a reporting unit). If a present value technique is used to measure fair value, estimates of future cash flows used in that technique shall be consistent with the objective of measuring fair value. Therefore, the measurement shall reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset (or a group of net assets, such as a reporting unit). Those assumptions shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing those assumptions, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop its assumptions shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions. ~~Those cash flow estimates shall incorporate assumptions that marketplace participants would use in their estimates of fair value. If that information is not available without undue cost and effort, an entity may use its own assumptions. Those c~~Cash flow estimates shall be based on reasonable and supportable assumptions and shall consider all available evidence. The weight given to the evidence shall be commensurate with the extent to which the evidence can be verified objectively. If a range is estimated for the amounts or timing of possible cash flows, the likelihood of possible outcomes shall be considered. Concepts Statement 7 discusses the essential elements of a present value measurement (paragraph 23), provides examples of circumstances in which an entity's cash flows might differ from the market cash flows (paragraph 32), and discusses the use of present value techniques in measuring the fair value of an asset or a liability (paragraphs 39–54 and 75–88). Appendix E of this Statement incorporates those paragraphs from Concepts Statement 7.

Amendment to Statement 144

12. This FSP amends Statement 144 as follows:

a. Paragraph 24:

If a present value technique is used, estimates of future cash flows shall be consistent with the objective of measuring fair value. ~~Assumptions that market participants would use in their estimates of fair value shall be incorporated~~

~~whenever that information is available without undue cost and effort.[14] Otherwise, the entity may use its own assumptions.~~ Therefore, the measurement shall reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset (or asset group). Those assumptions shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing those assumptions, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop its assumptions shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.[14]

[14] Concepts Statement 7 discusses the essential elements of a present value measurement (paragraph 23) and provides reasons why an entity's estimates of cash flows might differ from those used by marketplace participants (paragraph 32). Appendix E incorporates those paragraphs.

Effective Date and Transition

13. This FSP shall be effective for financial statements issued for fiscal years beginning after December 15, 2006, and interim periods within those fiscal years. Earlier adoption is encouraged. This FSP shall be applied prospectively as of the beginning of the interim or annual period in which it is initially applied. This FSP is effective until the reporting entity adopts Statement 157. Upon adoption of Statement 157, the reporting entity should apply the guidance in that Statement in the circumstances addressed by this FSP.

Alternative Views

14. Three Board members object to the issuance of this proposed FSP because they believe it does not represent a sufficient improvement in financial reporting prior to the

application of Statement 157. Those Board members acknowledge that Statements 141, 142, and 144 contain guidance that is inconsistent with respect to the use of an entity's own assumptions. However, they believe this proposed FSP represents an incremental, piecemeal change to measuring fair value, in that it does not specify (a) whether fair value is an entry or exit price, (b) how to establish the premise for a fair value measurement (that is, in-use or in-exchange), (c) whether a risk premium must be included, and (d) other important clarifications included in Statement 157. Therefore, the resulting measurements might not be fair value, as that term is defined in Statement 157. Those Board members would prefer that entities be afforded the time prior to the effective date of Statement 157 to understand the clarified objective of fair value measurements and the related implementation guidance and make any changes to conform to the new fair value guidance concurrently, for all items within its scope.

15. Moreover, the Board is currently reconsidering the provisions of Statements 141 and 142 as part of its business combinations project. The Board also has been asked to reconsider the provisions of Statement 144 as part of a future convergence project. The possibility of additional changes resulting from those efforts could add to the costs and confusion of imposing an interim change at this time.

Appendix

Impact of Statement 157 on the Paragraphs in Statements 141, 142, and 144 That Are Amended by This FSP

A1. Paragraph 35 of Statement 141, as amended by this FSP, is not affected by the guidance in Statement 157. The portions of paragraph 36 and its related footnote 11a of Statement 141, as amended by this FSP, that are deleted upon adoption of Statement 157 are as follows: [Deleted text is ~~struck out~~.]

a. Paragraph 36:

> Among other sources of relevant information, independent appraisals and actuarial or other valuations may be used as an aid in determining the amounts assigned to those assets acquired and liabilities assumed that are required under paragraph 37 to be measured at their estimated fair values. ~~Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. If a present value technique is used, estimates of future cash flows shall be consistent with the objective of measuring fair value. Therefore, the measurement shall reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability. Those assumptions shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing those assumptions, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop its assumptions shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.[11a]~~ The tax basis of an asset or liability shall not be a factor in determining its estimated fair value.

~~[11a] FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, discusses the essential elements of a present value measurement (paragraph 23) and provides reasons why an entity's estimates of cash flows might differ from those used by marketplace participants (paragraph 32).~~

A2. Paragraph 24 of Statement 142, as amended by this FSP, is deleted upon adoption of Statement 157 as follows:

a. Paragraph 24:

~~If quoted market prices are not available, the estimate of fair value shall be based on the best information available, including prices for similar assets and liabilities and the results of using other valuation techniques. A present value technique is often the best available technique with which to estimate the fair value of a group of net assets (such as a reporting unit). If a present value technique is used to measure fair value, estimates of future cash flows used in that technique shall be consistent with the objective of measuring fair value. Therefore, the measurement shall reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset (or a group of net assets, such as a reporting unit). Those assumptions shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing those assumptions, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop its assumptions shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions. Cash flow estimates shall be based on reasonable and supportable assumptions and shall consider all available evidence. The weight given to the evidence shall be commensurate with the extent to which the evidence can be verified objectively. If a range is estimated for the amounts or timing of possible~~

~~cash flows, the likelihood of possible outcomes shall be considered. Concepts Statement 7 discusses the essential elements of a present value measurement (paragraph 23), provides examples of circumstances in which an entity's cash flows might differ from the market cash flows (paragraph 32), and discusses the use of present value techniques in measuring the fair value of an asset or a liability (paragraphs 39 54 and 75 88). Appendix E of this Statement incorporates those paragraphs from Concepts Statement 7.~~

A3. Paragraph 24 and its related footnote 14 of Statement 144, as amended by this FSP, are deleted upon adoption of Statement 157 as follows:

a. Paragraph 24:

~~If a present value technique is used, estimates of future cash flows shall be consistent with the objective of measuring fair value. Therefore, the measurement shall reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset (or asset group). Those assumptions shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing those assumptions, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop its assumptions shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.~~[14]

~~[14] Concepts Statement 7 discusses the essential elements of a present value measurement (paragraph 23) and provides reasons why an entity's estimates of cash flows might differ from those used by marketplace participants (paragraph 32). Appendix E incorporates those paragraphs.~~