FASB STAFF POSITION

No. FAS 142-3

Title: Determination of the Useful Life of Intangible Assets

Date Posted: April 25, 2008

Objective

1. This FASB Staff Position (FSP) amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141 (revised 2007), *Business Combinations*, and other U.S. generally accepted accounting principles (GAAP).

Background

2. Paragraph 11(d) of Statement 142, which addresses the renewal or extension assumptions used to determine the useful life of a recognized intangible asset, states that the determination of the useful life shall include consideration of:

> Any legal, regulatory, or contractual provisions that enable renewal or extension of the asset's legal or contractual life without substantial cost (provided there is evidence to support renewal or extension and renewal or extension can be accomplished without material modifications of the existing terms and conditions).

3. In practice, the useful life of a recognized intangible asset under Statement 142 often is different from the period of expected cash flows used to measure the fair value of the asset in a business combination when the underlying arrangement includes renewal or extension terms. In particular, the useful life under Statement 142 usually is shorter than the period of expected cash flows used to measure the intangible asset. That difference may, for example, relate to the level of negotiations involved in renewing or extending

the terms of the underlying arrangement and/or implicit renewal or extension terms (that is, renewal or extension terms that are not explicit in the arrangement). The difference is especially pronounced for a longer-lived intangible asset for which the likelihood of renewal or extension is high but the underlying arrangement requires material modifications.

4. Constituents have asked the Board to reconsider whether a difference between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset is justified. In February 2007, the Board added this project to its agenda to address that issue. This project does not provide guidance on the measurement of recognized intangible assets. The Board agreed that the scope of this project should be limited to addressing the practice issue raised by constituents. Therefore, this project does not provide guidance on the method of amortization for a recognized intangible asset and the accounting treatment of costs incurred to renew or extend the term of a recognized intangible asset.

All paragraphs in this FSP have equal authority.
Paragraphs in bold set out the main principles.

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Scope

5. **This FSP applies to recognized intangible assets that are accounted for pursuant to Statement 142.**[1]

6. An intangible asset may be acquired individually or with a group of other assets. This FSP applies regardless of the nature of the transaction that resulted in the recognition of the intangible asset, that is, whether acquired in a business combination or otherwise.

Subsequent Measurement—Determining the Useful Life

7. **In developing assumptions about renewal or extension used to determine the useful life of a recognized intangible asset, an entity shall consider its own historical experience in renewing or extending similar arrangements; however, these assumptions should be adjusted for the entity-specific factors in paragraph 11 of Statement 142. In the absence of that experience, an entity shall consider the assumptions that market participants would use about renewal or extension (consistent with the highest and best use of the asset by market participants), adjusted for the entity-specific factors in paragraph 11 of Statement 142.**

8. Paragraph 11(d) of Statement 142 precluded an entity from using its own assumptions about renewal or extension of an arrangement where there is likely to be substantial cost or material modifications. Statement 142 included that limitation to prevent an entity from using renewal or extension terms to inappropriately lengthen the useful life of a recognized intangible asset. An underlying presumption in this FSP is that the fair value measurement guidance and impairment testing requirements of other applicable GAAP together with the disclosure requirements of this FSP would sufficiently mitigate that concern.

[1]The effective date of Statement 142 was deferred for intangible assets acquired in a combination between not-for-profit organizations or arising from the acquisition of a for-profit business entity by a not-for-profit organization until interpretive guidance related to the accounting for those transactions is issued.

9. In addition to considering the entity-specific factors in paragraph 11 of Statement 142, an entity shall consider its own historical experience in renewing or extending similar arrangements. Alternatively, if an entity lacks historical experience, it shall consider the assumptions that market participants would use consistent with the highest and best use of the asset, adjusted for the entity-specific factors in paragraph 11 of Statement 142. Accordingly, this FSP amends paragraph 11(d) of Statement 142 so that an entity will use its own assumptions about renewal or extension of an arrangement, adjusted for the entity-specific factors in paragraph 11 of Statement 142, even when there is likely to be substantial cost or material modifications.

10. It is common for an income approach to be used to measure the fair value of a recognized intangible asset. In determining the useful life of the asset for amortization purposes, an entity shall consider the period of expected cash flows used to measure the fair value of the recognized intangible asset, adjusted for the entity-specific factors in paragraph 11 of Statement 142. Those entity-specific factors include, but are not limited to, the entity's expected use of the asset and the entity's historical experience in renewing or extending similar arrangements.

11. For a recognized intangible asset, there might continue to be a difference between the useful life of the asset and the period of expected cash flows used to measure the fair value of the asset. However, that difference likely will be limited to situations in which the entity's own assumptions about the period over which the asset is expected to contribute directly and indirectly to the future cash flows of the entity are different from the assumptions market participants would use in pricing the asset. In those situations, it is appropriate for the entity to use its own assumptions because amortization of a recognized intangible asset should reflect the period over which the asset will contribute both directly and indirectly to the expected future cash flows of the entity.

12. Examples 1 and 2 below provide illustrative guidance for understanding and applying paragraph 11(d) of Statement 142, as amended by the provisions of this FSP. The examples and their related assumptions are illustrative only; the examples are not all-inclusive and may not represent actual situations.

Example 1

An exclusive, annually renewable technology license with a third party is acquired by an entity that has made significant progress in developing next-generation technology for digital video products. The acquiring entity believes that in two years, after it has completed developing its next-generation products, the acquired technology license will be obsolete because customers will convert to the acquiring entity's products. Market participants, however, are not as advanced in their development efforts and are not aware of the acquiring entity's proprietary development efforts. Thus, those market participants would expect the technology license to be obsolete in three years. The acquiring entity determines that the fair value of the technology license utilizing 3 years of cash flows is $10 million, consistent with the highest and best use of the asset by market participants.

To determine the useful life, the acquiring entity would consider its own historical experience in renewing or extending similar arrangements. In this case, the acquiring entity lacks historical experience in renewing or extending similar arrangements. Therefore, it would consider the assumptions that a market participant would use consistent with the highest and best use of the technology license. However, because the acquiring entity expects to use the technology license until it becomes obsolete in two years, it must adjust the market participants' assumptions for the entity-specific factors in paragraph 11 of Statement 142, specifically paragraph 11(a), which requires consideration of the entity's expected use of the asset. As a result, the technology license would be amortized over a two-year period.

Example 2

An insurance company acquired 50 customer relationships associated with contracts that are renewable annually. The acquiring entity determines that the fair value of the customer relationship asset is $10 million considering assumptions (including turnover rate) that a market participant would make consistent with the highest and best use of the asset by market participants. An income approach was used to determine the fair value of the acquired customer relationship asset.

In determining the useful life, the acquiring entity would consider its own historical experience in renewing or extending similar customer relationships. In this case, the acquiring entity concludes that its customer relationships are dissimilar to the acquired customer relationships and, therefore, the acquiring entity lacks historical experience in renewing or extending similar arrangements. Accordingly, the acquiring entity considers turnover assumptions that market participants would make about the renewal or extension of the acquired customer relationships or similar arrangements.

Without evidence to the contrary, the acquiring entity expects that the acquired customer relationships will be renewed or extended at the same rate as a market participant would expect, and no other factors would indicate a different useful life is appropriate. Thus, absent any other of the entity-specific factors in paragraph 11 of Statement 142, in determining the useful life for amortization purposes, the entity shall consider the period of expected cash flows used to measure the fair value of the asset.

Disclosures

13. **For a recognized intangible asset, an entity shall disclose information that enables users of financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity's intent and/or ability to renew or extend the arrangement.**

14. In addition to the required disclosures in paragraphs 44 and 45 of Statement 142, an entity shall disclose the following, where applicable:

a. The entity's accounting policy on the treatment of costs incurred to renew or extend the term of a recognized intangible asset
b. In the period of acquisition or renewal, the weighted-average period prior to the next renewal or extension (both explicit and implicit), by major intangible asset class
c. For an entity that capitalizes renewal or extension costs, the total amount of costs incurred in the period to renew or extend the term of a recognized intangible asset for each period for which a statement of financial position is presented, by major intangible asset class.

15. AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties,* provides guidance on when an entity is required to provide disclosures about an estimate. In determining whether disclosures about an estimate are required, the criterion in paragraph 13(b) of SOP 94-6 shall be considered met if the effect of a change in either (a) the useful life or (b) the expected likelihood of renewal or extension of an intangible asset would be material to the financial statements, either individually or in aggregate by major intangible asset class.

Effective Date and Transition

16. This FSP shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited.

17. The guidance for determining the useful life of a recognized intangible asset in paragraphs 7–11 of this FSP shall be applied prospectively to intangible assets **acquired** after the effective date. The disclosure requirements in paragraphs 13–15 shall be applied prospectively to all intangible assets **recognized** as of, and subsequent to, the effective date.

The provisions of this FSP need not be applied to immaterial items.

This FSP was adopted by the affirmative votes of six members of the Financial Accounting Standards Board. Mr. Young dissented.

Mr. Young dissents from this FSP because he believes it will not improve financial reporting. Mr. Young believes that the approach in the FSP is conceptually flawed. Statements 141(R) and 142 require initially recognizing an intangible asset at fair value. However, because this FSP does not address the accounting treatment of costs to renew or extend the term of a recognized intangible asset, it does not explicitly prohibit capitalizing renewal costs into the carrying amount of the recognized intangible asset. If the initial fair value measurement was done properly, it would have reflected the expected renewal costs; therefore, capitalizing them is inappropriate. Mr. Young believes that initial and subsequent measurement is inconsistent with one another and will not reflect the underlying economics. One might argue that the renewal adds value to the intangible asset, but that treatment is not consistent with other acquired intangible assets. For example, costs expended to extend the life of goodwill or increase the value of a trademark cannot be capitalized.

Under the provisions of this FSP, a contractual intangible asset need not have an explicit renewal provision in the contract or agreement to be considered renewable. Therefore, virtually any purchased contractual intangible can be considered renewable. Because this FSP does not address the accounting treatment of costs to renew or extend the term of a renewable intangible asset, the current practice of capitalizing those costs not only will continue but will be applied to many more previously ineligible intangible assets. Mr. Young believes that capitalization of those costs is inconsistent with the treatment of internally developed intangible assets and should have been prohibited by the FSP. Separating purchased intangibles from similar internally developed intangibles will be

difficult, and one can expect costs attributable to internally developed intangible assets to be capitalized as part of renewals of purchased intangible assets.

Mr. Young believes that the outcome of this FSP will be a greater ability of preparers to avoid volatility in earnings, increased carrying amounts of assets of little value to investors, and less transparency in financial reporting.

Members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
George J. Batavick
G. Michael Crooch
Thomas J. Linsmeier
Leslie F. Seidman
Lawrence W. Smith
Donald M. Young

Appendix

AMENDMENTS TO STATEMENT 142

A1. Statement 142 is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

a. Paragraph 11, as amended:

> The accounting for a recognized intangible asset is based on its **useful life** to the reporting entity. An intangible asset with a finite useful life is amortized; an intangible asset with an indefinite useful life is not amortized. The useful life of an intangible asset to an entity is the period over which the asset is expected to contribute directly or indirectly to the future cash flows of that entity.[9] The estimate of the useful life of an intangible asset to an entity shall be based on an analysis of all pertinent factors, in particular, the following factors with no one factor being more presumptive than the other:
>
> a. The expected use of the asset by the entity.
> b. The expected useful life of another asset or a group of assets to which the useful life of the intangible asset may relate.
> c. Any legal, regulatory, or contractual provisions that may limit the useful life.
> d. ~~Any legal, regulatory, or contractual provisions that enable renewal or extension of the asset's legal or contractual life without substantial cost (provided there is evidence to support renewal or extension and renewal or extension can be accomplished without material modifications of the existing terms and conditions)~~ The entity's own historical experience in renewing or extending similar arrangements (consistent with the intended use of the asset by the entity), regardless of whether those arrangements have explicit renewal or extension provisions. In the absence of that experience, the entity shall consider the assumptions that market participants would use about renewal or extension (consistent with the highest and best use of the asset by market participants), adjusted for entity-specific factors in this paragraph.
> e. The effects of obsolescence, demand, competition, and other economic factors (such as the stability of the industry, known technological advances, legislative action that results in an uncertain or changing regulatory environment, and expected changes in distribution channels).
> f. The level of maintenance expenditures required to obtain the expected future cash flows from the asset (for example, a material level of required maintenance in relation to the carrying amount of the asset may suggest a very limited useful life).[10]

It is common for an income approach to be used to measure the fair value of an intangible asset. In determining the useful life of the intangible asset for amortization purposes, an entity shall consider the period of expected cash flows used to measure the fair value of the intangible asset adjusted as appropriate for the entity-specific factors in this paragraph.

If no legal, regulatory, contractual, competitive, economic, or other factors limit the useful life of an intangible asset to the reporting entity, the useful life of the asset shall be considered to be indefinite. The term *indefinite* does not mean infinite. Appendix A includes illustrative examples of different intangible assets and how they should be accounted for in accordance with this Statement, including determining whether the useful life of an intangible asset is indefinite.

b. Paragraph 44:

For intangible assets acquired either individually or as part of a group of assets (in either an asset acquisition or business combination), the following information shall be disclosed in the notes to the financial statements in the period of acquisition:

a. For intangible assets subject to amortization:
    (1) The total amount assigned and the amount assigned to any major **intangible asset class**
    (2) The amount of any significant residual value, in total and by major intangible asset class
    (3) The weighted-average amortization period, in total and by major intangible asset class
b. For intangible assets *not* subject to amortization, the total amount assigned and the amount assigned to any major intangible asset class
c. The amount of research and development assets acquired in a transaction other than a business combination and written off in the period and the line item in the income statement in which the amounts written off are aggregated~~.~~
d. For intangible assets with renewal or extension terms, the weighted-average period prior to the next renewal or extension (both explicit and implicit), by major intangible asset class.

This information also shall be disclosed separately for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively if the aggregate fair values of intangible assets acquired, other than goodwill, are significant.

c. Paragraph 45:

The following information shall be disclosed in the financial statements or the notes to the financial statements for each period for which a statement of financial position is presented:

a. For intangible assets subject to amortization:
    (1) The gross carrying amount and accumulated amortization, in total and by major intangible asset class
    (2) The aggregate amortization expense for the period
    (3) The estimated aggregate amortization expense for each of the five succeeding fiscal years
b. For intangible assets *not* subject to amortization, the total carrying amount and the carrying amount for each major intangible asset class
c. The entity's accounting policy on the treatment of costs incurred to renew or extend the term of a recognized intangible asset
d. For intangible assets that have been renewed or extended in the period for which a statement of financial position is presented:
    (1) For entities that capitalize renewal or extension costs, the total amount of costs incurred in the period to renew or extend the term of a recognized intangible asset, by major intangible asset class
    (2) The weighted-average period prior to the next renewal or extension (both explicit and implicit), by major intangible asset class
~~c~~e. The changes in the carrying amount of goodwill during the period showing separately:
    (1) The gross amount and accumulated impairment losses at the beginning of the period
    (2) Additional goodwill recognized during the period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with Statement 144
    (3) Adjustments resulting from the subsequent recognition of deferred tax assets during the period in accordance with paragraphs 30 and 30A of Statement 109, as amended
    (4) Goodwill included in a disposal group classified as held for sale in accordance with Statement 144 and goodwill derecognized during the period without having previously been reported in a disposal group classified as held for sale
    (5) Impairment losses recognized during the period in accordance with this Statement
    (6) Net exchange differences arising during the period in accordance with FASB Statement No. 52, *Foreign Currency Translation*
    (7) Any other changes in the carrying amounts during the period
    (8) The gross amount and accumulated impairment losses at the end of the period.

Entities that report segment information in accordance with Statement 131 shall provide the above information about goodwill in total and for each reportable segment and shall disclose any significant changes in the allocation of goodwill by reportable segment. If any portion of goodwill

has not yet been allocated to a reporting unit at the date the financial statements are issued, that unallocated amount and the reasons for not allocating that amount shall be disclosed.

Illustration 1 in Appendix C provides an example of those disclosure requirements.

d. Paragraph A1:

[For ease of use, only the two added examples are shown.]

Example 10

An acquired technology license that renews annually. An exclusive, annually renewable technology license with a third party is acquired by an entity that has made significant progress in developing next-generation technology for digital video products. The acquiring entity believes that in two years, after it has completed developing its next-generation products, the acquired technology license will be obsolete because customers will convert to the acquiring entity's products. Market participants, however, are not as advanced in their development efforts and are not aware of the acquiring entity's proprietary development efforts. Thus, those market participants would expect the technology license to be obsolete in three years. The acquiring entity determines that the fair value of the technology license utilizing 3 years of cash flows is $10 million, consistent with the highest and best use of the asset by market participants.

In applying paragraph 11(d), the acquiring entity would consider its own historical experience in renewing or extending similar arrangements. In this case, the acquiring entity lacks historical experience in renewing or extending similar arrangements. Therefore, it would consider the assumptions that a market participant would use consistent with the highest and best use of the technology license. However, because the acquiring entity expects to use the technology license until it becomes obsolete in two years, it must adjust the market participants' assumptions for the entity-specific factors in paragraph 11 of Statement 142, specifically paragraph 11(a), which requires consideration of the entity's expected use of the asset. As a result, the technology license would be amortized over a two-year period. The technology license would be reviewed for impairment under Statement 144.

Example 11

An acquired customer relationship. An insurance company acquired 50 customer relationships operating under contracts that are renewable annually. The acquiring entity determines that the fair value of the customer relationship asset is $10 million, considering assumptions (including turnover rate) that a market participant would make consistent with the highest and best use of the

asset by market participants. An income approach was used to determine the fair value of the acquired customer relationship asset.

In applying paragraph 11(d), the acquiring entity would consider its own historical experience in renewing or extending similar customer relationships. In this case, the acquiring entity concludes that its customer relationships are dissimilar to the acquired customer relationships and, therefore, the acquiring entity lacks historical experience in renewing or extending similar arrangements. Accordingly, the acquiring entity considers turnover assumptions that market participants would make about the renewal or extension of the acquired customer relationships or similar arrangements. Without evidence to the contrary, the acquiring entity expects that the acquired customer relationships will be renewed or extended at the same rate as a market participant would expect, and no other factors would indicate a different useful life is appropriate. Thus, absent any other of the entity-specific factors in paragraph 11, in determining the useful life for amortization purposes, the entity shall consider the period of expected cash flows used to measure the fair value of the asset. The customer relationships would be reviewed for impairment under Statement 144.

e. Paragraph C2:

[For ease of use, only the portions of this paragraph that have been affected by this FSP have been reproduced.]

In accordance with paragraphs 45 and 47, the following disclosures would be made by Theta Company in its December 31, 20X3 financial statements relating to acquired intangible assets and goodwill. Theta Company has two reporting units with goodwill—Technology and Communications—which also are reportable segments. Theta Company did not incur costs to renew or extend the term of acquired intangible assets during the period ending December 31, 20X3.