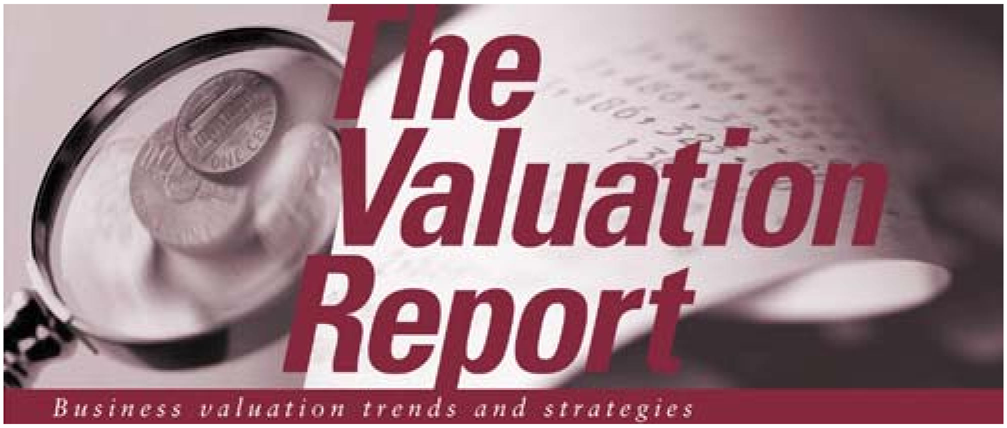

Complex Rules Dictate Accounting for Intangible Assets

In the world of mergers and acquisitions, the Financial Accounting Standards Board's (FASB) Statements of Financial Accounting Standards (SFAS) 141 and 142 certainly changed the landscape. Fair value measurement is in, pooling of interests is out…the purchase method is in, amortization is out…impairment testing is in… You get the picture.

Since their issuance, these pronouncements and their subsequent change in accounting methods have had a significant impact on financial statement reporting. For example, in 2002, AOL Time Warner announced an expected $60 billion goodwill write-off as a result of impairment testing under SFAS 142.

Yet stockholders didn't flinch because the stock price already reflected the impairment. Many valuation experts agree with the FASB's thinking: These changes improve financial reporting by making financial statements more accurately reflect fair market value.

With increased mergers and acquisition activity in the last few months, intangible assets are getting a higher level of exposure. Here's a closer look at these rulings.

About SFAS 141 and 142

SFAS 141 and 142 came about primarily because intangible assets have become much more important, as they often represent significant value to many companies. SFAS 141 deals exclusively with goodwill and intangible assets in mergers and acquisitions.

For consistency purposes, SFAS 141 requires that all business combinations be accounted for by a single method — the purchase method. SFAS 141 also requires that intangible assets be recognized as assets apart from goodwill if they arise from contractual or other legal rights or if they are "separable" from the acquired entity (i.e., capable of being sold, transferred, licensed, rented or exchanged). The pronouncement divides intangible assets into five categories:

1. Marketing-related intangible assets, such as trademarks and Internet domain names.

2. Customer-related intangible assets, such as customer lists and relationships.

3. Artistic-related intangible assets, such as literary and musical works, photographs and video.

4. Contract-related intangible assets, such as licensing, royalty, lease and franchise agreements.

5. Technology-related intangible assets, such as databases, trade secrets, computer software and patented and unpatented technologies.

SFAS 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and how these intangible assets should be accounted for upon their acquisition and beyond. This pronouncement dictates that goodwill and some intangible assets should no longer be amortized over their expected life; rather, they are subject to an annual test for impairment. Goodwill is subject to a two-step test, while other intangible assets are tested for impairment by comparing the current fair values of those assets with their recorded amounts.

The two pronouncements also require new disclosures. SFAS 141 requires disclosure of the primary reasons for an acquisition and the factors that contributed to the purchase price. And SFAS 142 requires disclosure of information about intangible assets in the years subsequent to their acquisitions — information regarding changes in the carrying amount from period to period and by class, among other details.

What They Do

According to the FASB — and many valuation experts — these new rulings improve financial reporting in several ways:

- **Better reflection of investment:** The purchase method accurately reflects the total purchase price, which allows more meaningful evaluation of subsequent performance.

- **Improved comparability:** With all business combinations accounted for using a single method, financial statement users can compare financial results more accurately.
- **More complete information:** Expanded disclosure agreements provide more information about assets and liabilities, so financial statement users can better assess changes in those assets over time, and can more intelligently assess future profitability and cash flows.

Intangible assets have always been difficult to measure. Given the focus on these types of assets due toy SFAS 141 and 142, it is vitally important to count on the expertise of a valuation professional with experience in intangible asset identification and measurement.

If you need valuation guidance regarding intangible assets, please contact our firm. We are familiar with SFAS 141 and 142 and will be happy to share our expertise with you.

What's "Intangible"?

It's no surprise that the definition of "intangible" has been the subject of much discussion. Several entities, including the International Valuation Standards Committee, came up with their own accepted definitions. But the FASB itself came up with perhaps the shortest answer, defining intangible assets as those that "lack physical substance."