FASB Statements No. 141 & 142

The impact on intangible assets, including brands

A SPECIAL REPORT by Interbrand

FOREWORD

FASB Statements No. 141 & 142: The Impact on Intangible Assets, Including Brands

For much of the past year, many industry experts predicted deep cuts in corporate marketing budgets. However, in an Interbrand survey published in October, marketers across a wide range of industries overwhelming responded (84 percent) that their branding/marketing budgets have either not been affected by the economic slowdown or decreased only in proportion to other budgets in their organization. The rationale for this, they cite, is a strong belief in brands as measurable assets whose value should be recognized.

But it's not just marketers who have become big brand believers. Analysts, CFOs and others who rely heavily on financial statements have long said that intangible assets--including brands--are an increasingly important economic resource for many entities and are an increasing proportion of the assets acquired in many transactions.

Indeed, this new understanding regarding the value of brands and other intangible assets has contributed to the Financial Accounting Standards Board's (FASB) unanimous approval and implementation of FAS 141and FAS 142, new rules that take a very different approach to how goodwill and other intangible assets are accounted for.

Intangible assets, including brand, have long appeared on balance sheets in other parts of the world. In the U.K., balance sheet valuations arose because of the problems of accounting for goodwill on acquisitions- -the amount that was being paid for companies was becoming dramatically higher than the value of the company's net tangible assets. A study conducted by Interbrand and Citibank shows that only one third of the value of the FTSE 100 companies is accounted for by net tangible assets, and that such assets represent only one quarter of the value of top U.S. companies. What this means is that until now, up to 75 percent of a company's market capitalization has been unaccounted for. In addition, in our annual survey of 100 of "The World's Most Valuable Brands," Interbrand has determined that brand accounts for an average 37 percent of a company's market capitalization. For some brands, Apple, Coca-Cola and Nike, to name a few, this percentage is much higher, upwards of 70 percent, meaning that almost all of their intangible assets are tied up in brand.

The purpose of this document is to highlight some of the more important changes that FAS 141 and 142 will entail, with particular emphasis on the impact on brand. As the pioneers and leaders in brand valuation, Interbrand can work with you on the valuation of this critical asset, and also show you how brand value can protect and secure future earnings.

Interbrand applauds the FASB rulings because they will provide buyers and investors with greater transparency regarding the economic value of goodwill, intangible assets, and their impact on earnings. It also ensures that companies be more vigilant about protecting intangible assets and paying fair value for acquired brands, thereby avoiding costly writedowns. Interbrand believes that this is a watershed era in how FASB, the SEC, bankers, analysts, and most importantly, investors, view intangible assets and brands. They are now being recognized as principal corporate assets. Interbrand has always known this, and would welcome the chance to talk to you about ensuring that your most important intangible asset is properly accounted for...and properly protected.

ABOUT Interbrand

Interbrand (www.interbrand.com), the leading brand consultancy, combines the rigorous strategy and analysis of a management consulting practice with the entrepreneurial and creative spirit of branding and design. The company offers a comprehensive array of consulting services that guide clients in the creation, enhancement, maintenance and valuation of their most valuable asset -- their brands. Founded in 1974, Interbrand has 26 offices in 20 countries around the globe and clients from among the most respected businesses in both the traditional and new economies. Interbrand's areas of expertise include:

Brand Strategy: An independent, expert view is invaluable when assessing complex branding issues such as the design of a new brand architecture, the repositioning of an existing brand, the reinvigoration of an under-performing brand or the development of a new brand to suit a particular market need. In all of these instances, our teams of strategic consultants work in partnership with clients to produce focused and actionable solutions. The results help yield the highest return on a company's brand assets.

Brand Valuation: Stock markets increasingly confirm that brands and other intangibles are a corporation's most valuable assets. Brand valuation is a unique tool that quantifies the economic value of a brand. It is critical to marketing investments and allows management to plan and assess the impact of their strategies. The first company to ever publicly put a value on a brand, Interbrand has developed the most widely endorsed brand-valuation methodology. To date, we have valued more than 2,500 brands worldwide.

Corporate Identity: A well-orchestrated corporate branding system is an invaluable communications tool in today's complex world and does more than just identify a business or organization -- it acts as an indication and endorsement of quality, value and reliability. A corporation's established assets, all visible points of public contact, differentiate it from competitors. Interbrand believes that corporate identity is a powerful strategic weapon, one that promotes an understanding of the corporate purpose and differentiates corporations and their products in an increasingly competitive marketplace.

Naming: A name is the foundation of a successful brand and can be an asset of enormous value. Effective names project the personality of a product, service or company and should inspire the quality and integrity of what they represent. Successful brand names also should be relevant, pronounceable, memorable and free of negative connotations. Interbrand pioneered the field of name development and has developed thousands of effective, motivating names for scores of industries around the world.

Packaging: Packaging puts a face to the name of a brand. The right design can leave an indelible impression, encouraging an initial purchase and fostering the emotional link that underlies consumer loyalty. A package must be a powerful selling tool in itself, standing out from the clutter on a shelf. A brand's packaging must instantly communicate its positioning and product benefits, and reinforce that message after the purchase so that the brand becomes a mainstay on the consumer's shopping list.

Research: All decisions involve some level of risk. Clearly defining and quantifying that risk is the key to effective decision- making. Interbrand uses research extensively and commissions both qualitative and quantitative studies for clients. From the choice of a new name or package design to the repositioning of an existing brand, or the introduction of a new one, our experts help clients avoid expensive mistakes through research.

3D/Environmental Design: Environments are one of the best opportunities a brand, corporation or institution has for communicating its identity. By developing an environment consistent with the brand message, a brand can provide its customers with a predictable and familiar experience in all locations -- from retail environments and tradeshows to the corporate environment. Interbrand's environmental design practices employ state-of-the-art technologies to design brand environments in a three-dimensional world, including the design of interactive media and virtual environments.

FASB Fast Facts

On July 20, 2001, the FASB issued two new accounting standards, Statement No. 141, Business Combinations, and Statement No. 142, Goodwill and Other Intangible Assets. The highlights include the following:

Elimination of Pooling-of-Interests

Pooling-of-interests method is eliminated. Purchase accounting is required for all business combination transactions initiated after June 30, 2001.

Nonamortization of Goodwill

Goodwill created in purchase accounting transactions closing after June 30, 2001 will not be amortized.

Goodwill existing prior to June 30, 2001 will continue to be amortized until the final standard is adopted.

Goodwill must be allocated to reporting units and subject to an annual impairment test. The impairment test is a two-step process that begins with the comparison of the fair value of a reporting unit to its carrying amount. If the fair value is less than its carrying amount, then in step-two, the fair value must be allocated, similar to a purchase price allocation, to all of the reporting units assets and liabilities. If after the allocation process, the carrying amount of goodwill is greater than its fair value, an impairment must be recorded.

Identifiable Intangible Assets

Identifiable intangible assets that are deemed to have a finite life will continue to be amortized over their useful lives. Identifiable intangible assets that are deemed to have an indefinite life, one that extends "beyond a foreseeable horizon," will not be amortized. Identifiable intangible assets that have a finite life will continue to assessed for impairment in accordance with the standard on the impairment of long-lived assets. An intangible asset with an indefinite life will be required to use a one-step impairment test, which requires an impairment to be recorded if the carrying amount of the identifiable intangible is in excess of its fair value.

Effective Date and Transition

The effective date for FASB Statement No. 141 was June 30, 2001. This standard is applied on a prospective basis. FASB Statement No. 142 is effective for all fiscal years beginning after December 15, 2001. A transitional impairment test is required within the first six months of adoption. If an impairment loss arises from this transitional test it should be reported as a change in accounting principle.

Interbrand FASB 141 & 142 Decision Tree

Is the Asset in question acquired?

- No → **Organic Asset**
  - Stop, no transaction
- Yes ↓

Is there any recognized Goodwill?

- No → **Tangible**
  - Stop, no transaction
- Yes ↓

- Does it arise from Contractual/ Legal rights?
- Or -
- Is it capable of being separated from the acquired entity and sold, transferred, licensed, rented or exchanged?

- No: it is Goodwill → **Goodwill**
  - This excludes brands
  - All goodwill must be assigned to a reporting unit and allocated appropriately. Goodwill values will no longer be allowed to be amortized. Instead impairment tests on goodwill values will be evaluated annually if circumstances warrant a revision
- Yes: it is an intangible asset ↓

What is its useful life?

- Finite → **Finite Intangible/Brand**
  - All intangible assets must be assigned to a reporting unit and allocated appropriately. Finite intangible asset values will be amortized by its useful life. The useful life of the asset should be evaluated each year to determine whether events and circumstances warrant a revision to the useful life

  Accounting Transaction:

Balance Sheet: Intangible value, net	1/expected life
Income Statement: Depreciation expense	(1/expected life)
- Indefinite ↓

Is there any impairment?

- No → **Indefinite Intangible/Brand with no Impairment**
  - All intangible assets must be assigned to a reporting unit and allocated appropriately. Indefinite intangible asset values will not be amortized.

  No Accounting Transaction (except in Year 1)
- Yes → **Indefinite Intangible/Brand with Impairment**
  - All intangible assets must be assigned to a reporting unit and allocated appropriately. Indefinite intangible asset values will not be amortized. Instead impairment tests on goodwill values will be evaluated annually if circumstances warrant a revision

  Accounting Transaction:

Balance Sheet: Intangible value,net	Carrying value (net of change)
Income Statement: Impairment charge	(Impairment loss)

DETAILED ANALYSIS – FAS 141

In June 2001, the FASB issued FAS 141 and FAS 142, two pronouncements with profound ramifications, particularly on the accounting for the effects of mergers and acquisitions. FAS 141 largely impacts the manner in which the acquisition itself is reflected in the financial statements of the parties to the business combination on the date of acquisition, while FAS 142 largely impacts the treatment of intangible assets recognized in light of a business combination in financial statements for periods following the business combination.

According to FAS 141, all business combinations initiated after June 30, 2001 must now be accounted for under the purchase method. Business combinations include those with non-corporate entities but not roll-ups and the like. In purchase accounting, the acquiring company will be treated as though it purchased the net assets of the target at fair market value (FMV) on the date of acquisition. Furthermore, in calculating FMV, most often net present value (NPV) is deemed to be the best valuation method.

Intangible assets resulting from a business combination that either arise from contractual or legal rights or are capable of being transferred from the acquired entity must be recognized as assets apart from goodwill. Examples of intangible assets that meet the criteria for recognition apart from goodwill include:

* Marketing Related: Such as trademarks, trade names and mastheads; trade dress (unique color, shape, or package design); Internet domain names
* Customer Related: Such as customer lists and relationships;
* Creative Type: Such as plays, books, literary rights, musical works and artistic recordings; video and audiovisual material, including motion pictures, music videos, television programs
* Contract-Based: Such as licensing agreements, leases and operating rights; advertising, construction, management, service or supply contracts; franchise agreements; broadcast rights; employment contracts
* Technology Based: Such as patents, unpatented technology, computer software, databases and trade secrets; formulas and recipes.

With regard to the term “brand” and “brand name,” these are often used as synonyms for trademarks and tradenames. This is not the case, however, with regard to FAS 141. Here, brand refers to a group of complementary assets such as the trademark (or service mark) and its related tradename, visual representation, advertising, formulas, recipes, and technological expertise (which may or may not be patented). Given that a whole host of intangibles together may form “brand,” FAS 141 allows companies to recognize, as a single asset apart from goodwill, a group of complementary intangible assets commonly referred to as a brand if the assets that make up that group have similar useful lives.

DETAILED ANALYSIS – FAS 142

FAS 142 was issued as a complement to FAS 141, and governs the treatment, either with amortization expense or with tests for write-off due to impairment, of intangible assets recognized as results of business combinations.

Under FAS 142, intangible assets are put into two groups, those subject to amortization and those not subject to amortization. In essence, an intangible asset with an indefinite useful life is not amortized while all others are amortized. In many instances, trademarks, and brands in the broader sense of the asset, will not be amortizable. However, if a company has decided to phase out the brand, for example, in four years, the carrying amount of the brand would then be amortized over its then remaining useful life.

While FAS 142 provides a number of criteria to determine useful life, the first, the expected use of the intangible asset by the company, is by far the most important of all. Residual value, essentially a price expected to be received when the intangible asset will be discarded will, most likely, be considered to be zero, and the method of allocating the intangible asset's cost will be straight line unless a better pattern can be shown.

An intangible asset other than goodwill not subject to amortization must be tested annually for impairment (for brand this would mean recalculating its brand value), or even more frequently if there is evidence that its fair market value has depreciated appreciably. Furthermore, intangible assets subject to amortization that undergo impairment testing without loss recognition should, most likely, revisit their amortization periods. In any event, the useful life of any intangible asset should be should be revisited at least each reporting period.

The recalculation of useful lives and testing for impairment losses is compulsory for the first accounting period beginning after December 15, 2001. Because most companies report financial statements on a calendar year basis, they will have to recalculate useful lives of all assets on their balance sheet and recognize impairment loss, if any, on any intangible assets, effective January 1, 2002. That remeasurement is optimally reflected in the first interim financial statement issued as of the transition date, but in no event can it be reflected later than the financial statement for a period ending six months after the transition. This means that for calendar-year companies, the change to these new rules and the January 1, 2002 revaluations can be reflected no later than in their quarterly reports for the three months ended June 30, 2002.

Goodwill will no longer be amortized for any past or present acquisition. Since no intangible assets were recognized for pooling-type acquisitions initiated prior to July 1, 2001, and FAS 142 does not require a complete restatement of financial statements for prior accounting treatments, but only possibly remeasurements of old intangible assets already on the balance sheet, 2002 and later financial statements will still reflect differences due to prior acquisition having been treated as purchases or as poolings.

DETAILED ANALYSIS – IMPAIRMENT

An entity must test its indefinite-lived intangible assets for impairment as of the beginning of the fiscal year in which FAS 142 is adopted. The amounts used in the transitional impairment test should be measured as of the beginning of the fiscal year. A two-stage approach is applied to impairment testing. First, a comparison needs to be made of the fair value of the intangible asset with its carrying amount. If the carrying amount exceeds the fair value then an impairment loss is recognized in an amount equal to the difference

Any subsequent impairment losses resulting from events or circumstances that occur after the first day of the fiscal year in which FAS 142 is adopted should be reported as a component of income from continuing or discontinued operations, as appropriate.

All recognized goodwill that exists on the date that FAS 142 is adopted (after completing the reclassifications between goodwill and intangible assets) should cease being amortized and should be tested for impairment (i.e., a transitional goodwill impairment test). At the date that FAS 142 is initially applied, an entity should establish its reporting units based on its reporting structure on that date.

The testing and amount of impairment loss are done on a reporting unit basis. A reporting unit is, in essence, the smallest part of the business for which separate financial statements can be generated and which is subject to management review. For example, if following the acquisition of a number of brands, one brand of one subsidiary suffers suffers value impairment, a loss in the value of that one subsidiary's brand must be recognized even if the brands of the other purchased subsidiaries have appreciated in value. This is considerably different from U.K. GAAP, in which impairment loss testing and recognition are based upon the intangible assets of the entire acquisition, not that of an individual reporting unit. Once reporting units are identified, an entity will need to assign its assets (excluding goodwill) and liabilities to those reporting units. All existing goodwill that is recognized in an entity's balance sheet at the date that FAS 142 is adopted also should be assigned to one or more reporting units.

In assigning existing goodwill to reporting units, an entity should consider the sources of that goodwill and the reporting units to which the related acquired net assets were assigned. FAS 142 also states that the guidance on assigning newly acquired goodwill to reporting units may be useful in assigning existing goodwill to reporting units. The purpose of this identification and assignment process is to establish the basis for future impairment testing.

IMPLICATIONS OF FAS 141 & 142

Now that FAS 141 and 142 have taken effect, companies that may have acquired brands prior to June 30, 2001, or that are involved in ongoing transactions, should perform the following tasks:

1. Identify the value of brands acquired and separate these values from goodwill;
2. Check for suspected impairment of any goodwill or intangible assets, including brands;
3. Establish the amount of any impairment by reference to the fair value of brands previously acquired with a comparison of the carrying value;
4. Assess whether the acquired brands fall into the category of finite life (amortizable), or indefinite life (non-amortizable), and revise amortization schedules
5. Establish the value of separately identifiable intangible assets, including brands, which are part of current ongoing transactions

Other repercussions owing to FAS 141 and 142 could fall to companies who have overpaid on acquisitions by forcing them to write down goodwill. According to FAS 142, companies must routinely check the goodwill and other intangible assets (including brands) on their books to determine if the businesses they bought will generate enough return to justify the price. If the goodwill or intangible asset is considered impaired, they must take a one-time writeoff. Already, AOL Time Warner, AT&T and Viacom Inc. may collectively have to write down as much as $1 trillion of goodwill created when they overspent on acquisitions.

One key way to avoid both overpayment and writedowns is to conduct brand valuations pre-acquisition. Again, with brand accounting for an average of 37 percent of a company's market cap (and in some cases much more), performing brand valuations prior to acquisitions can ensure that a significant part of your acquired business is properly valued.

An intangible asset not subject to amortization must be tested annually for impairment (for brand this would mean recalculating its brand value), or even more frequently if there is evidence that its fair market value has depreciated appreciably. Furthermore, intangible assets subject to amortization that undergo impairment testing without loss recognition should, most likely, revisit their amortization periods. In any event, the useful life of any intangible asset should be should be revisited at least each reporting period.

The new standards will require companies to fully understand the strategy of their acquisitions, making sure that they allocate the assets and liabilities acquired to the right reporting units and that the reporting units are in sync with their strategy. The workload for companies will obviously increase as a result of this standard, as in the annual requirement to review for impairment.

Also at issue is whether companies have the capability internally to accurately determine the fair values of the assets and liabilities acquired to their reporting units or whether they will have to retain external experts. Quoted market prices are the best indication of fair value. However, market values are not always available, particularly where assets being measured exhibit different natures, scope or size. Brands by their very nature are unique and incomparable, and would require a specific methodology for determining fair value.

SUMMARY

Why Interbrand and Brand Valuation?

As the world's leading brand consultancy, and as pioneers and leaders in brand valuation, we have valued more than 2,500 brands worldwide. Interbrand can work with you on separating your brand from goodwill, performing brand valuations and conducting regular impairment reviews. In addition, Interbrand's brand valuation starts with the entire value of the company, establishes a value for intangibles, and bifurcates the values of brands and that of goodwill. The net benefit to you is that this method provides you with valuations of not just your brand(s), but also of goodwill and your remaining tangible assets.

Importantly, your brand is the one intangible asset for which it is most difficult to determine fair market value, and whose value you can least afford to lose. Interbrand uses a proprietary methodology for calculating the fair market value of your brand, using a present value of future cash flows calculation that is the best way to incorporate market assumptions.

And, because Interbrand is not a public accounting firm, we do not offer audits, tax return preparation and other similar services, which would entail conflict of interest. This conforms to recent pressure that accounting firms not provide consulting services to clients that they audit. These new rules require expert brand valuation consult to help companies deal with purchase price allocations and impairment provisions quickly, consistently and optimally. Implementation of the new guidelines as they apply to past and future transactions will most certainly face intense scrutiny by the SEC. Expert opinion and supporting argumentation will be required in order to satisfy the regulators that a detailed analysis and rigorous assessment has been conducted to justify a brand's classification under "indefinite life."

Finally, Interbrand can show you how brand value can protect and secure future earnings. Indeed, our ranking of The World's Most Valuable Brands, as published annually by *BusinessWeek*, shows a clear and strong correlation between brand value and shareholder value.

The World's Most Valuable Brands by Interbrand, as featured annually in *BusinessWeek* magazine.

About Interbrand Brand Valuation

The Interbrand approach is framed by a series of analyses that begin the process of enlightenment: comparing the value of intangible assets to other tangible assets; comparing these values over time; analyzing brand value across parts of the business, and understanding the impact on brand value of marketing expenditure and other brand initiatives.

Interbrand can also recommend other applications for brand valuation. Some include:

Mergers and Acquisitions
- Marketing due diligence on acquired brands
- Marketing due diligence on target acquisitions
- Marketing due diligence on IPOs, divestitures
- Recommend fair value on acquisitions

Marketing Strategy
- Recommend appropriate investment by brand, market, customer segment, product and channel
- Recommend optimal brand architecture
- Recommend brand stretch opportunities
- Recommend potential licensing, co-branding or joint venture agreements

Corporate Strategy
- Brand portfolio optimization
- Customer portfolio optimization
- Manage risk associated with brand or corporate identity changes
- Understand in what markets and consumer segments brand creates value
- Lower taxes

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