(a) *In-quota sugar-containing products* means any article classified under any of the subheadings of the HTS specified in additional U.S. note 8 to chapter 17 of the HTS that is entered under the in-quota rate of duty.

(b) *Allocated country* means a country to which an allocation of a particular quantity of sugar-containing products has been assigned.

(c) *Enter* or *Entered* means to enter, or withdraw from warehouse, for consumption.

(d) *HTS* means the Harmonized Tariff Schedule of the United States.

(e) *Participating Country* means any allocated country that USTR has determined is, and has notified the U.S. Customs Service as being, eligible to use export certificates.

(f) *USTR* means the United States Trade Representative or the designee of the United States Trade Representative.

§ 2915.3 Export certificates.

(a) To claim the in-quota rate of duty on sugar-containing products of a participating country, the United States importer must make a declaration to the United States Customs Service, in the form and manner determined by the United States Customs Service, that a valid export certificate is in effect with respect to those sugar-containing products.

(b) To be valid, an export certificate shall:

(1) Be issued by or under the supervision of the government of the participating country;

(2) Specify the name of the party to whom the certificate is issued, the product description and quantity, shipment date, and the quota year for which the export certificate is in effect;

(3) Have a distinct and uniquely identifiable number; and

(4) Be used in the quota year for which it is in effect.

Charlene Barshefsky,

United States Trade Representative.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 211

[Release No. SAB 100]

Staff Accounting Bulletin No. 100

AGENCY: Securities and Exchange Commission.

ACTION: Publication of staff accounting bulletin.

SUMMARY: This staff accounting bulletin expresses views of the staff regarding the accounting for and disclosure of certain expenses commonly reported in connection with exit activities and business combinations. This includes accrual of exit and employee termination costs pursuant to Emerging Issues Task Force (EITF) Issues No. 94–3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)*, and No. 95–3, *Recognition of Liabilities in Connection with a Purchase Business Combination*, and the recognition of impairment charges pursuant to Accounting Principles Board (APB) Opinion No. 17, *Intangible Assets*, and Statement of Financial Accounting Standards (SFAS) No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of.*

DATES: Effective November 24, 1999.

FOR FURTHER INFORMATION CONTACT: Eric Jacobsen, Paul Kepple, or Eric Casey, Office of the Chief Accountant (202–942–4400), Robert Bayless, Division of Corporation Finance (202–942–2960), Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549; electronic addresses: JacobsenE@sec.gov; KeppleP@sec.gov; CaseyE@sec.gov; BaylessR@sec.gov.

SUPPLEMENTARY INFORMATION: The statements in staff accounting bulletins are not rules or interpretations of the Commission, nor are they published as bearing the Commission's official approval. They represent interpretations and practices followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the Federal securities laws.

Dated: November 24, 1999.

Margaret H. McFarland,

Deputy Secretary.

PART 211—[AMENDED]

Accordingly, Part 211 of Title 17 of the Code of Federal Regulations is amended by adding Staff Accounting Bulletin No. 100 to the table found in Subpart B.

STAFF ACCOUNTING BULLETIN NO. 100

1. Amend Section A of Topic 2 of the Staff Accounting Bulletin Series to add new subsection 9. *Liabilities Assumed in a Purchase Business Combination.* Revise the title of Section P of Topic 5 to *Restructuring Charges*, designate the current section P as subsection 3 of Section P of Topic 5, *Income Statement Presentation of Restructuring Charges*, deleting the first paragraph under that subsection, and renumbering Questions 1, 2, and 3 in that subsection to be Questions 13, 14, and 15. Add new subsection 1. *Characteristics of an Exit Plan to Section P of Topic 5.* Add new subsection 2. *Characteristics of an Exit Cost to Section P of Topic 5.* Add new subsection 4. *Disclosures.* to Section P of Topic 5. Furthermore, add new Sections BB. *Inventory Valuation Allowances* and CC. *Impairments* to Topic 5.

TOPIC 2: BUSINESS COMBINATIONS

A. *Purchase Method*

* * * * *

8. Business Combinations Prior to an Initial Public Offering

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9. Liabilities Assumed in a Purchase Business Combination

Facts: Company A acquires Company Z in a business combination accounted for as a purchase. Company Z has recorded liabilities for contingencies such as product warranties and environmental costs.

Question: Are there circumstances in which it is appropriate for Company A to adjust Company Z's carrying value for these liabilities in the purchase price allocation?

Interpretive Response: Yes. Accounting Principles Board Opinion No. 16, *Business Combinations*, requires that receivables, liabilities, and accruals be recorded in the purchase price allocation at their fair value, typically the present value of amounts to be received or paid, determined using appropriate current market interest rates. In some cases, fair value is readily determinable from contemporaneous arms-length transactions involving substantially identical assets or liabilities, or from amounts quoted by a third party to purchase the assets or assume the liabilities. More frequently, fair values are based on estimations of the underlying cash flows to be received or paid, discounted to their present value using appropriate current market interest rates.

The historical accounting by Company Z for receivables or liabilities may often be premised on estimates of the amounts to be received or paid. Amounts recorded by Company A in its purchase price allocation may be expected to differ from Company Z's historical carrying values due, at least, to the effects of the acquirer's discounting, including differences in interest rates. Estimation of probable losses and future cash flows involves judgment, and companies A and Z may

differ in their systematic approaches to such estimation. Nevertheless, assuming that both companies employ a methodology that appropriately considers all relevant facts and circumstances affecting cash flows, the staff believes that the two estimates of undiscounted cash inflows and outflows should not differ by an amount that is material to the financial statements of Company Z, unless Company A will settle the liability in a manner demonstrably different from the manner in which Company Z had planned to do so (for example, settlement of the warranty obligation through outsourcing versus an internal service department). But the source of other differences in the estimates of the undiscounted cash flows to be received or paid should be investigated and reconciled. If those estimates of undiscounted cash flows are materially different, an accounting error in Company Z's historical financial statements may be present, or Company A may be unaware of important information underlying Company Z's estimates that also is relevant to an estimate of fair value.

The staff is not suggesting that an acquiring company should record assumed liabilities at amounts that reflect an unreasonable estimate. If Company Z's financial statements as of the acquisition date are not fairly stated in accordance with generally accepted accounting principles (GAAP) because of an improperly recorded liability, that liability should not serve as a basis for recording assumed amounts. That is, the correction of a seller's erroneous application of GAAP should not occur through the purchase price allocation. Rather, Company Z's financial statements should be restated to reflect an appropriate amount, with the resultant adjustment being applied to the historical income statement of Company Z for the period(s) in which the trends, events, or changes in operations and conditions that gave rise to the needed change in the liability occurred. It would also be inappropriate for Company Z to report the amount of any necessary adjustment in the period just prior to the acquisition, unless that is the period in which the trends, events, or changes in operations and conditions occurred. The staff would expect that such trends, events, and changes would be disclosed in Management's Discussion and Analysis in the appropriate period(s) if their effect was material to a company's financial position, results of operations or cash flows.

In summary, the staff believes that purchase price adjustments necessary to record liabilities and loss accruals at fair value typically are required, while merely adding an additional ''cushion'' of 10 or 20 or 30 percent to such account balances is not appropriate. To arrive at those fair values, the undiscounted cash flows must be projected, period by period, based on historical experience and discounted at the appropriate current market discount rate.

* * * * *

TOPIC 5: MISCELLANEOUS ACCOUNTING

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P. *Restructuring Charges*

The term ''restructuring charge'' is not defined in the existing authoritative literature. While the events or transactions triggering the recognition [1] of what are often identified as restructuring charges vary, these charges typically result from the consolidation and/or relocation of operations, or the disposition or abandonment of operations or productive assets. Restructuring charges may be incurred in connection with a business combination, a change in an enterprise's strategic plan, or a managerial response to declines in demand, increasing costs, or other environmental factors.

Some types of restructuring charges, such as ''exit costs,'' as defined in Emerging Issues Task Force [2] (EITF) Issue No. 94–3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)* (EITF 94–3), are recognized as liabilities and charged to operations when management commits to a restructuring plan, while other types of restructuring charges contemplated by the plan may not be recognized until they are actually incurred. The circumstances in which the intended actions of management result in the recognition of a liability are identified in either EITF 94–3 or EITF Issue No. 95–3, *Recognition of Liabilities in Connection with a Purchase Business Combination* (EITF 95–3), collectively referred to as the ''Consensuses.''

1. *Characteristics of an Exit Plan*

Accrual of certain involuntary employee termination benefits and exit costs under the Consensuses requires a commitment by the company to a termination or exit plan (hereinafter collectively referred to as an exit plan) that specifically identifies all significant actions to be taken.[3] Not all plans qualify under the Consensuses as a basis for recognizing a liability for exit costs or involuntary employee termination benefits.

Facts: Prior to year end, senior management of a company approves a plan to exit certain activities and terminate employees involuntarily. Approval by the board of directors is required by the Company's policies to implement the exit plan, but is not obtained until after year end.

Question 1: Would it be appropriate for the company to accrue exit costs and involuntary employee termination benefits as of year end pursuant to the Consensuses?

Interpretive Response: No. The Consensuses do not permit accrual of exit costs or involuntary employee termination benefits prior to the date the company is committed to an exit plan by management having the appropriate level of authority (the commitment date). The staff believes that if the Company's policies require board of directors' approval, or management elects to seek board of directors' approval, the appropriate level of authority needed to commit the company under the Consensuses would be that of the board of directors. If board of directors' approval is neither required nor sought, the appropriate level of authority would be at a level below the board of directors (e.g., chief executive officer). The appropriate level of authority would be a division or branch manager if that manager can and will commit the enterprise to incur particular exit costs or involuntary employee termination benefits without additional ratification or budget authorization.

Facts: Corporate management is developing an exit plan which will include involuntary employee terminations, plant shutdowns, and

[1] The Financial Accounting Standards Board (FASB) has on its agenda currently three projects which are expected to improve existing financial reporting with regard to certain aspects of liability recognition and presentation, including the recognition or nonrecognition of constructive obligations. In the interim, pending completion of the FASB's efforts to improve financial reporting in this area, the staff is providing interpretive guidance regarding the existing accounting requirements for exit costs. The staff will reconsider the guidance provided herein upon completion of the FASB's projects.

[2] The Emerging Issues Task Force is a private sector body established by the FASB. The Commission's Chief Accountant participates in the body's deliberations.

[3] Registrants should refer to the Consensuses for their specific requirements. Registrants are reminded that they are required at the commitment date to account for those types of costs (exit, termination, etc.) falling within the scope of the Consensuses that are incurred in connection with a qualifying exit plan in accordance with the Consensuses. That is, applying the Consensuses (being Level C GAAP per AU411.16) is not optional.

asset dispositions associated with the consolidation and reduction of operations in several of its business units. Senior management of the company has set a target of reducing its North American distribution costs by 50 percent within two years. However, the exit plan is in the development stage, with only initial cost estimates having been developed. The corporate management team currently is developing the more detailed plans, significant actions, and related budgets for which individual business units and plant managers will be held accountable and be required to execute. The more detailed plans will set forth how, when, and by whom the cost reductions will be achieved.

Question 2: Does the staff believe that exit costs may be accrued prior to the completion of a more detailed exit plan?

Interpretive Response: No. The EITF set restrictive standards for plan specificity when it stated in EITF 94–3, "The exit plan *specifically identifies all significant actions* to be taken to complete the exit plan . . . *and the period of time to complete the exit plan indicates that significant changes to the exit plan are not likely* (emphasis added)." Consistent with the intent of the EITF, and to minimize the opportunities for earnings management, the staff believes that a liability for exit costs arising from a discretionary management action should be accrued only if the discretionary action is part of a comprehensive plan that has been rigorously developed and thoroughly supported.

In assessing whether an exit plan has sufficient detail, the staff would expect generally that a company's exit plan would be at least comparable in terms of the level of detail and precision of estimation to other operating and capital budgets the company prepares, such as annual business unit budgets. The absence of controls and procedures to detect, explain and, if necessary, correct variances or adjust accounting accruals would indicate that the plan lacked the authenticity and management commitment necessary for it to serve as a basis for recognizing a liability for exit costs.

The staff also believes that as a prerequisite to accruing exit costs at the commitment date, the company must be able to estimate reliably[4] the nature, timing, and amount of the exit costs associated with the significant actions it has specifically identified. Factors the staff believes should be considered when determining whether exit costs can be estimated reliably include whether:

- The estimate reflects the most likely expected outcome given all the information currently available to management;
- The exit plan identifies all significant actions expected to be taken;
- The exit plan includes an expected timetable for completing those actions;
- The plan is the one that will be used to evaluate the performance of those responsible for executing the plan and for making periodic comparisons of planned versus actual results and variances;
- *All significant actions* are documented in the plan in sufficient detail, including but not limited to details such as, geographic locations, estimated costs, expected cash flows, *etc.*;
- The components used in making the detailed calculation in the plan and arriving at the estimated liability (for example, per person costs, number of people, *etc.*) have a reasonably supportable basis; and
- The key assumptions used in developing the plan have a reasonably supportable basis.

Repeated material changes in the nature, timing, or amount of the estimated exit costs and involuntary termination benefits subsequent to the commitment date may also indicate an inability to make reliable estimates.

Facts: Company A operates five hundred retail outlets and has identified the specific location of 80 out of 100 stores which it intends to close pursuant to a store consolidation plan. The exit plan for the 80 stores identifies all significant actions and related costs in budget line item detail, such as lease termination costs, involuntary employee termination costs, store closure costs, subcontractor costs (where appropriate), *etc.* for each facility, as well as all other information specifically enumerated by the Consensuses. Management believes that the average cost to close the additional 20 stores will approximate the average cost of closing the 80 identified stores.

Question 3: Assuming that all other provisions of EITF 94–3 have been met, may Company A recognize a liability at the commitment date for the exit costs and involuntary termination benefits associated with all 100 stores?

Interpretive Response: No. While recognition of estimated exit costs and involuntary termination benefits for the 80 identified stores is appropriate, the staff believes that Company A has not met the requirements in EITF 94–3 for the 20 stores yet to be identified. The staff believes that all exit costs and involuntary termination benefits should be identified by specific property location and that no higher level of identification or aggregation (*e.g.,* country, region, state, county, *etc.*) is appropriate under the guidance in EITF 94–3. If and when Company A identifies the specific locations of other stores, the involuntary termination benefits, the exit costs, and the exit plan associated with those stores should be evaluated and accounted for as a new exit plan under the Consensuses rather than a revision of the exit plan for the 80 stores.

Although Company A may be unable to specifically identify significant actions to be taken to complete some parts of the exit plan (and so recognizing a liability currently under the Consensuses is not appropriate), management should consider its disclosure obligations under the Commission's rules and regulations regarding its future plans, including those obligations relating to Management's Discussion and Analysis (MD&A).

Question 4: If Company A decides not to close one of the stores in a period following the quarter in which it recognized a liability for exit costs and involuntary employee termination benefits for the 80 identified stores, may Company A leave the accrued exit costs and involuntary employee termination benefits for that store on its balance sheet in anticipation of costs expected to be incurred when other stores are identified for closing?

Interpretive Response: No. Exit costs and involuntary employee termination benefits accrued for the store should be reversed. At each balance sheet date (annual or interim), exit cost and involuntary employee termination benefits accruals should be evaluated to ensure that any accrued amount no longer needed for its originally intended purpose is reversed in a timely manner. When an exit, termination, or other loss accrual is no longer appropriate, reversal of the liability should be recorded through the same income statement line item that was used when the liability was initially recorded. Generally accepted accounting principles (GAAP) do not permit unused or excess liability accruals to be retained as general accruals, used for purposes other than that for which the liability was established initially, or returned to earnings over time and in small amounts. Furthermore, costs actually incurred in connection with an exit plan should be charged to the exit accrual only to the extent those costs

[4] See FASB Concept Statement No. 2, *Qualitative Characterisitics of Accounting Information* and FASB Concept Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, paragraph 63.

were specifically included in the original estimation of the accrual. Costs incurred in connection with an exit plan but not specifically contemplated in the original estimate of the liability for exit costs and involuntary employee termination benefits should be charged to operating expense in the period incurred, or the period that the exit cost or involuntary termination benefit qualifies for accrual under EITF 94–3, with appropriate explanation in MD&A.

Companies should have appropriate internal accounting controls with respect to exit, termination, or other loss accruals and the related expenses. These controls must ensure the company is in compliance with Section 13(b) of the Securities Exchange Act of 1934 and provide a reasonable basis for ensuring adjustments required by GAAP (increases or decreases) with respect to such liabilities are made on a timely basis.

Question 5: The Consensuses require that the exit plan begin as soon as possible after the commitment date and that the time needed to complete it indicates that significant changes in the plan (due to changing market conditions or other external factors, for example) are unlikely. What factors may indicate that an exit plan will not begin or be executed within a period of time that significant changes in the plan are unlikely?

Interpretive Response: Based on the staff's experience, a number of factors may indicate that an exit plan might not begin or be executed within a period of time that is short enough to allow a company to appropriately conclude that significant changes in the exit plan are unlikely (and consequently, that recognizing a liability pursuant to the Consensuses would not be appropriate), including:

1. Where all significant actions to be undertaken pursuant to the plan have not been identified with sufficient specificity or are not reasonably estimable,
2. Where it is likely that execution of the plan will be delayed due to events or circumstances that are reasonably likely to occur, or
3. Where a company lacks the internal controls or information needed to monitor effectively the activities being performed, compare the costs incurred to the plan, and make adjustments to the plan on a timely basis.

Facts: In the first quarter of 2000, a company develops a strategic plan to restructure four divisions during the next three years. The exit plan will be implemented one division at a time.

Question 6: May the company recognize a liability for the exit costs and involuntary employee termination benefits for all four divisions in the first quarter of 2000?

Interpretive Response: The Consensuses contemplate completion of an exit plan within a time period that indicates that significant changes in the exit plan are unlikely. In order to satisfy that condition, the staff believes that management must be able to make reasonable estimates of the exit costs and involuntary employee termination benefits, and that those estimates would not be likely to change materially within that time period. Today's dynamic and constantly changing business environment often affects a company's ability to identify exit activities to be undertaken and estimate exit costs and involuntary employee termination benefits to be incurred after the commitment date with sufficient precision and specificity to permit the accrual of those costs at the commitment date [5] under the Consensuses. Thus, the staff generally believes that the further out an exit activity is from the commitment date, the greater the risk that either all or part of the exit plan will be materially revised in response to events or circumstances that are reasonably likely to occur. Furthermore, the staff also observes that many of the illustrative examples in EITF 94–3 assume completion of significant actions within one year of the commitment date.[6] Therefore, the staff believes that a rebuttable presumption exists that the exit plan should be completed and the exit costs and involuntary employee termination benefits incurred within one year from the commitment date.

The staff recognizes, however, that an exit plan might not be completed within one year of the commitment date due to circumstances outside the company's control. Circumstances outside the company's control would include, for example, legal or contractual restrictions on the company's ability to complete the exit plan, such as existing union contracts or enacted legal restrictions concerning the length of notice required to involuntarily terminate employees. In such circumstances, management should have appropriate evidence and support for concluding that execution of its plan will not be materially affected by intervening developments and that reasonable estimates of the nature, timing, and amount of exit costs and involuntary employee termination benefits can be made so far in advance.

Facts: As of the balance sheet date, Company A's exit plan provides only that it will terminate involuntarily a certain number of employees within certain grades and classes of employees in connection with consolidation of 10 facilities in Europe. The specific grades of employees to be terminated involuntarily have not been identified at the balance sheet date. Company A has not made any announcement regarding its exit or termination plans. The involuntary termination benefits are expected to vary based on the grade and class of employee as well as the country in which the worker is employed.

Question 7: Assuming that the board of directors of Company A approves the exit and termination plans in the condition described above by year end, in the staff's view, may Company A recognize a liability at the balance sheet date for the costs it expects to incur to terminate involuntarily certain grades of employees within certain classes of employees pursuant to the Consensuses?

Interpretive Response: No. In order to recognize a liability for the cost to terminate employees involuntarily, the Consensuses require that the exit plan must specifically identify (a) the benefit formula to be used for determining individual employee involuntary termination payments, (b) the number of employees to be involuntarily terminated, and (c) the employees' job classifications or functions and locations.

Furthermore, the EITF considered notification to be an essential element obligating the employer to fulfill its commitment, giving rise to a liability. Therefore, the employees within the classifications or functions at risk of being involuntarily terminated must also be notified of the pending involuntary termination prior to the balance sheet date. The notification must include the provisions of the involuntary termination benefit formula in sufficient detail such that each employee would be able to calculate the severance benefit to be received if terminated involuntarily.

In this example, Company A has not met the notification requirements of the

[5] For purposes of EITF 95–3, the date the plan is finalized, not to exceed one year from consummation.

[6] A one-year period is also consistent with Accounting Principles Board Opinion (APB) No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (APB 30), SAB No. 93, *Accounting and Disclosures Regarding Discontinued Operations,* FASB Statement of Financial Accounting Standards No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises,* EITF Issue No. 87–11, *Allocation of Purchase Price to Assets to Be Sold* and Statement on Auditing Standards No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.*

Consensuses, nor does it appear that Company A has finalized the information called for under (a), (b), or (c) referred to above.[7]

2. *Characteristics of Exit Costs*

Under the Consensuses, an exit cost is a cost that results from a plan to exit an activity pursuant to a qualified exit plan and that meets all of the following conditions:

1. The cost is not associated with or does not benefit activities that will be continued.

2. The cost is not associated with or is not incurred to generate revenues after the commitment date.

3. The cost meets one of the following criteria:

a. It is incremental to other costs incurred in the company's conduct of its activities prior to the commitment date and will be incurred as a direct result of the exit plan; or

b. The cost will be incurred under a contractual obligation that existed prior to the commitment date and will either continue after the exit plan is completed with no economic benefit to the company or be a penalty to cancel the contractual obligation.

FASB Concept Statement No. 6, *Elements of Financial Statements* (SFAC 6), paragraphs 35 to 43 and FASB Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* (SFAS 5) provide guidance for when to recognize liabilities in general and loss contingencies in particular. Registrants should not analogize to the Consensuses for costs that are outside the scope of the Consensuses. Moreover, to fall within the scope of the Consensuses, a cost cannot be associated with or benefit continuing activities.

Facts: For existing customers of a product line or service that is to be discontinued, a company is developing a plan to transition the customers over the next year to a new product line or service.

Question 8: May the costs the company expects to incur to complete this transition be recognized as a liability for exit costs pursuant to the Consensuses as of the date the company commits to a plan to transition these existing customers?

Interpretive Response: No. The costs are being incurred in order to benefit future periods through the retention of customers, and with the expectation of generating future revenues. The staff believes that the costs to transition the customers may not be recognized as a liability for exit costs under the Consensuses and should be recognized and expensed as incurred in operating income.

Facts: A franchiser announces a franchisee cash incentive program in order to induce its franchisees to upgrade their equipment over the next year. The franchiser is not contractually obligated to make any payments to individual franchisees until the franchisees accept the offer and incur ''qualifying'' costs to upgrade their equipment, which costs are reimbursable by the franchiser.

Question 9: May the franchiser accrue the estimated cost of the incentive program at the date it announces the plan pursuant to the Consensuses?

Interpretive Response: No. The franchiser is incurring the cost in order to benefit continuing activities and with the expectation of indirect future economic benefit. Therefore, the staff believes that these are not exit costs. Furthermore, considering the definition and characteristics of a liability as provided in paragraphs 35 through 43 of SFAC 6 and SFAS 5, costs such as the above should not be accrued until the franchiser becomes contractually obligated to make such payments.

Facts: Company A licenses technology from Company B on a perpetual, exclusive basis, paying an annual royalty of 10 percent of sales. Prior to the balance sheet date, the board of directors of Company A approves a plan to renegotiate terms of the royalty arrangement. In exchange for reducing the annual royalty rate from 10 percent of all sales to 5 percent of the first $20 million in annual sales, Company A will propose to pay Company B a nonrecurring, lump-sum payment of $5 million. Although internally committed to the plan, as of the balance sheet date, Company A has not yet approached Company B regarding renegotiating the royalty terms of the technology license.

Question 10: May Company A recognize a liability at the balance sheet date pursuant to the Consensuses for its estimate of the cost to modify the royalty arrangement as well as the estimated nonrecurring, lump-sum payment by the company?

Interpretive Response: No. The lump-sum payment is outside the scope of exit costs contemplated by the Consensuses because it is being incurred to modify terms of an existing and continuing relationship. The staff does not believe that the modification of an executory contract (for example, license and royalty, purchase or sales commitments, servicing, *etc.*) represents the ''exiting'' of one contract and the initiation of a new, unrelated contract.[8] In addition, the staff notes that, although the board of directors of Company A has committed to a plan, Company B has not agreed to the terms under which it would accept modification of the royalty arrangement. Under these facts and circumstances, it does not appear to the staff that Company A would have a basis upon which to reasonably estimate the costs of changing the arrangement.

Under these facts and circumstances, the staff believes that any costs to modify the contract would not fall within the scope of the Consensuses. Furthermore, GAAP would not permit recognition of liabilities for costs associated with modifying the contract prior to their being incurred.

Facts: A company, in responding to significant staffing shortages, hires an executive search firm, agreeing to pay the firm a fixed fee for each successful recruitment. In addition, the company commits to pay the relocation costs of future employees recruited by the executive search firm.

Question 11: May the company accrue the estimated fees to be paid to the executive search firm as well as the estimated cost to relocate new employees at the date the company engages the firm and commits to the plan to pay relocation costs?

Interpretive Response: No. Such costs are being incurred to benefit continuing activities, are not necessarily incremental to other costs incurred by the company in the normal course of business, and do not represent obligations of the company at the date the company engages the executive search firm. That is, the staff believes that these costs are neither exit nor integration costs that will be incurred as a result of a purchase business combination and thus, they do not fall within the scope of the Consensuses.[9]

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[7] While recognizing a liability at the commitment date pursuant to the Consensuses would not be appropriate, registrants are reminded to consider the requirements of FASB Statement of Financial Accounting Standards No. 88, *Employers Accounting for Settlements and Curtailments of Defined Pension Plans and for Termination Benefits* and FASB Statement of Financial Accounting Standards No. 112, *Employer's Accounting for Postemployment Benefits* for those involuntary termination benefits that may be payable pursuant to pre-existing contractual arrangements (*e.g.,* union contracts) or regulatory requirements (*e.g.,* national labor laws).

[8] The staff observes that not all contract terminations are exit activities within the scope of the Consensuses. The applicability of the Consensuses depends on the particular facts and circumstances surrounding the termination.

[9] For employee relocation costs incurred relative to employees of a company acquired in a business combination accounted for under the purchase method, registrants are reminded to consider the requirements of EITF 95–3.

Rather, the fees to be paid to the executive search firm and the relocation costs should be recognized as liabilities as and when the services are provided.

Question 12: May the company accrue as an exit cost at the balance sheet date an asset impairment in accordance with the Consensuses for facilities it expects to close or dispose of?

Interpretive Response: No. The Consensuses address recognition of liabilities associated with exit plans and not recognition of losses associated with asset impairments. That is, the recognition of losses on asset impairments, even in connection with exit plans, does not fall within the scope of the Consensuses. The closure and disposition or abandonment of a registrant's own long-lived assets, such as manufacturing plants, not constituting a business segment in accordance with APB 30, would be accounted for in accordance with SFAS 121, with any losses on asset impairment being charged to operating income.[10]

3. *Income Statement Presentation of Restructuring Charges*

Facts: Because restructuring charges typically do not relate to ''a single separate major line of business or class of customer,'' [11] they do not qualify for presentation as losses on the disposal of a discontinued operation. Additionally, since the charges are not both unusual and infrequent [12] they are not presented in the income statement as extraordinary items.

Question 13. * * *
Question 14. * * *
Question 15. * * *

4. *Disclosures*

Beginning with the period in which the exit plan is committed to, the Consensuses require disclosure, in *all* periods, *including interim* periods, until the exit plan is completed, of the following:

1. The amount of involuntary termination benefits accrued and charged to expense and their income statement classification.

2. The number of employees to be terminated.

3. A description of the employee group(s) to be terminated.

4. The actual amount of involuntary termination benefits paid and charged against the liability and the number of employees actually terminated pursuant to the exit plan.

5. Where the activities that will not be continued are significant to the enterprise's revenue or operating results or if the exit costs recognized at the commitment date are material:

a. A description of the major actions comprising the exit plan, activities that will not be continued, including the method of disposition, and the anticipated date of completion.

b. A description of the type and amount of exit costs recognized as liabilities and their income statement classification.[13]

c. A description of the type and amount of exit costs paid and charged against the liability.

d. The revenue and net operating income or losses from activities that will not be continued if those activities have separately identifiable operations for all periods presented.

6. The amount of any adjustment(s) to the liability account and whether the corresponding entry was recorded as an adjustment of the cost of an acquiree or included in the determination of net income for the period.

7. Where an acquirer has not finalized the plan to exit an activity or involuntarily terminate (relocate) employees of the acquiree as of the balance sheet date, a description of any unresolved issues, the types of additional liabilities that may result in a change to the purchase price allocation, and how any adjustments will be reported.[14]

Question 16: What specific disclosures about restructuring charges has the staff requested to fulfill the disclosure requirements of the Consensuses and Management's Discussion and Analysis (MD&A)?

Interpretive Response: The staff often has requested greater disaggregation and more precise labeling when exit and involuntary termination costs are grouped in a note or income statement line item with items unrelated to the exit plan.[15] For the reader's understanding, the staff has requested that discretionary, or decision-dependent, costs of a period, such as exit costs, be disclosed and explained in MD&A separately. Also to improve transparency, the staff has requested disclosure of the nature and amounts of additional types of exit costs and other types of restructuring charges [16] that appear quantitatively or qualitatively material, and requested that losses relating to asset impairments be identified separately from charges based on estimates of future cash expenditures.

The staff frequently reminds registrants that in periods subsequent to the commitment date that material changes and activity in the liability balances of each significant type of exit cost and involuntary employee termination benefits (either as a result of expenditures or changes in/reversals of estimates) should be disclosed in the footnotes to the interim and annual financial statements and discussed in MD&A. In the event a company recognized liabilities for exit costs and involuntary employee termination benefits relating to multiple exit plans, the staff believes presentation of separate information for each individual exit plan that has a material effect on the balance sheet, results of operations or cash flows generally is appropriate.

For material exit or involuntary employee termination costs related to an acquired business, the staff has requested disclosure in either MD&A or the financial statements of—

a. When the registrant began formulating exit plans for which accrual may be necessary,

b. The types and amounts of liabilities recognized for exit costs and involuntary employee termination benefits and included in the acquisition cost allocation, and

c. Any unresolved contingencies or purchase price allocation issues and the types of additional liabilities that may result in an adjustment of the acquisition cost allocation.

The staff has noted that the economic or other events that cause a registrant to consider and/or adopt an exit plan or

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[10] Where an acquirer intends, at the consummation date, to dispose of certain of an acquiree's long-lived assets, registrants are reminded to consider the requirements of APB 16, EITF Issue No. 87–11, and EITF Issue No. 90–6 in allocating the purchase price to and subsequently accounting for such assets held for disposal.

[11] See APB 30, paragraph 13.

[12] See APB 30, paragraph 20.

[13] Registrants should refer to EITF Issue No. 96–9, *Classification of Inventory Markdowns and Other Costs Associated with a Restructuring* for additional comments as to income statement presentation. For example, the staff believes that inventory writedowns should be classified in the income statement as a component of cost of goods sold.

[14] Registrants are reminded of the requirements in FASB Statement No. 38, paragraph 4(b) and SAB Topic 2–A (7). The staff believes that the allocation period should not extend beyond the minimum reasonable period necessary to gather the information that the registrant has arranged to obtain for purposes of the estimate, and in any event usually should not exceed one year.

[15] EITF 94–3 requires that the effect of recognizing a liability for exit costs should be presented in income from continuing operations and not net of taxes. Refer to EITF 94–3 for additional guidance regarding the income statement presentation.

[16] Examples of common components of exit costs and other types of restructuring charges which should be considered for separate disclosure include, but are not limited to, involuntary employee terminations and related costs, changes in valuation of current assets such as inventory writedowns, long term asset disposals, adjustments for warranties and product returns, leasehold termination payments, and other facility exit costs, among others.

that impair the carrying amount of assets, generally occur over time. Accordingly, the staff believes that as those events and the resulting trends and uncertainties evolve, they often will meet the requirement for disclosure pursuant to the Commission's MD&A rules prior to the period in which the exit costs and liabilities are recorded pursuant to GAAP. Whether or not currently recognizable in the financial statements, material exit or involuntary termination costs that affect a known trend, demand, commitment, event, or uncertainty to management, should be disclosed in MD&A. The staff believes that MD&A should include discussion of the events and decisions which gave rise to the exit costs and exit plan, and the likely effects of management's plans on financial position, future operating results and liquidity unless it is determined that a material effect is not reasonably likely to occur. Registrants should identify the periods in which material cash outlays are anticipated and the expected source of their funding. Registrants should also discuss material revisions to exit plans, exit costs, or the timing of the plan's execution, including the nature and reasons for the revisions.

The staff believes that the expected effects on future earnings and cash flows resulting from the exit plan (for example, reduced depreciation, reduced employee expense, *etc.*) should be quantified and disclosed, along with the initial period in which those effects are expected to be realized. This includes whether the cost savings are expected to be offset by anticipated increases in other expenses or reduced revenues. This discussion should clearly identify the income statement line items to be impacted (for example, cost of sales; marketing; selling, general and administrative expenses; *etc.*). In later periods if actual savings anticipated by the exit plan are not achieved as expected or are achieved in periods other than as expected, MD&A should discuss that outcome, its reasons, and its likely effects on future operating results and liquidity.

The staff often finds that, because of the discretionary nature of exit plans and the components thereof, presenting and analyzing material exit and involuntary termination charges in tabular form, with the related liability balances and activity (*e.g.*, beginning balance, new charges, cash payments, other adjustments with explanations, and ending balances) from balance sheet date to balance sheet date, is necessary to explain fully the components and effects of significant restructuring charges. The staff believes that such a tabular analysis aids a financial statement user's ability to disaggregate the restructuring charge by income statement line item in which the costs would have otherwise been recognized, absent the restructuring plan (for example, cost of sales; selling, general, and administrative; *etc.*).

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A.A. * * *

B.B. *Inventory Valuation Allowances*

Facts: Accounting Research Bulletin No. 43 (ARB 43), Chapter 4, Statement 5, specifies that: ''A departure from the cost basis of pricing the inventory is required when the utility of the goods is no longer as great as its cost. Where there is evidence that the utility of goods, in their disposal in the ordinary course of business, will be less than cost, whether due to physical obsolescence, changes in price levels, or other causes, the difference should be recognized as a loss of the current period. This is generally accomplished by stating such goods at a lower level commonly designated as market.''

Footnote 2 to that same chapter indicates that ''In the case of goods which have been written down below cost at the close of a fiscal period, such reduced amount is to be considered the cost for subsequent accounting purposes.''

Lastly, Accounting Principles Board Opinion No. 20, *Accounting Changes*, provides ''inventory obsolescence'' as one of the items subject to estimation and changes in estimates under the guidance in paragraphs 10–11 and 31–33 of that standard.

Question: Does the write-down of inventory to the lower of cost or market, as required by ARB 43, create a new cost basis for the inventory or may a subsequent change in facts and circumstances allow for restoration of inventory value, not to exceed original historical cost?

Interpretive Response: Based on ARB 43, footnote 2, the staff believes that a write-down of inventory to the lower of cost or market at the close of a fiscal period creates a new cost basis that subsequently cannot be marked up based on changes in underlying facts and circumstances.[17]

C.C. *Impairments*

Standards for recognizing and measuring impairment of the carrying amount of long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used are found in Statement of Financial Accounting Standards No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* (SFAS 121). Additional guidance related to goodwill impairment is also provided in Accounting Principles Board (APB) Opinion No. 17, *Intangible Assets* (APB 17). The FASB currently has active projects addressing both SFAS 121 and APB 17 issues. The staff will reconsider the guidance provided below upon completion of those projects.

Facts: Company X has mainframe computers that are to be abandoned in six to nine months as replacement computers are put in place. The mainframe computers were placed in service in January 19X0 and were being depreciated on a straight-line basis over seven years. No salvage value had been projected at the end of seven years and the original cost of the computers was $8,400. The board of directors, with the appropriate authority, approved the abandonment of the computers in March 19X3 when the computers had a remaining carrying value of $4,600. No proceeds are expected upon abandonment. Abandonment cannot occur prior to the receipt and installation of replacement computers, which is expected prior to the end of 19X3. Management had begun reevaluating its mainframe computer capabilities in January 19X2 and had included in its 19X3 capital expenditures budget an estimated amount for new mainframe computers. The 19X3 capital expenditures budget had been prepared by management in August 19X2, had been discussed with the company's board of directors in September 19X2 and was formally approved by the board of directors in March 19X3. Management had also begun soliciting bids for new mainframe computers beginning in the fall of 19X2. The mainframe computers, when grouped with assets at the lowest level of identifiable cash flows, were not impaired on a ''held and used'' basis throughout this time period. Management had not adjusted the original estimated useful life of the computers (seven years) since 19X0.

Question 1: Company X proposes to recognize an impairment charge under SFAS 121 for the carrying value of the mainframe computers of $4,600 in March 19X3. Does Company X meet the requirements in SFAS 121 to classify the mainframe computer assets as ''to be disposed of?''

Interpretive Response: No. SFAS 121, paragraph 15, provides that when management, having the authority to approve the action, has committed to a plan to dispose of the assets, whether by

[17] See also disclosure requirements for inventory balances in Rule 5–02–6 of Regulation S–X.

sale or abandonment, the assets to be disposed of should be reported at the lower of carrying amount or fair value less cost to sell. The staff believes that registrants must also consider the criteria in APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (APB 30), paragraph 14, and Emerging Issues Task Force Issue No. 94–3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)* (EITF 94–3) to determine whether a plan is sufficiently robust to designate the assets as assets to be disposed of. APB 30 and EITF 94–3 require a plan to have the following characteristics:

- Prior to the date of the financial statements, management having the appropriate level of authority approves and commits the enterprise to a formal plan of disposal, whether by sale or abandonment;
- The plan specifically identifies all major assets to be disposed of, significant actions to be taken to complete the plan, including the method of disposition and location of those activities, and the expected date of completion;
- There is an active program to find a buyer if disposal is to be by sale;
- Management can estimate proceeds to be realized on disposal;
- Actions required by the plan will begin as soon as possible after the commitment date; and
- The period of time to complete the plan indicates that significant changes to the plan are not likely.

The staff believes that a necessary condition of a plan to dispose of assets in use is that management have the current ability to remove the assets from operations. For example, the staff believes that the above fact pattern would not qualify as a plan of disposal under SFAS 121 in March 19X3 because the mainframe computer assets cannot be taken out of service and abandoned prior to installing the new, but not yet available, mainframe computers. The operational requirement to continue to use the assets is indicative that the assets are still held for use. The staff does not intend this guidance to mean that assets to be sold must be removed from service in order to be designated as assets held for disposal. Rather, the company must be able to remove the assets from service upon identification of a buyer or receipt of an acceptable bid, but the assets can otherwise remain in service provided the criterion in SFAS 121 has been met. If a buyer is found and an acceptable offer is received, but the assets must be retained by the seller for some period due to ongoing operational needs, the criterion for ''to be disposed of'' treatment has not been met.

The staff also believes that an active program to find a buyer exists only if the marketing effort commenced promptly after the commitment date and continued unabated until the sale was accomplished.

Question 2: Would the staff accept an adjustment to write down the carrying value of the computers to reflect a ''normalized depreciation'' rate for the period from March 19X3 through actual abandonment (*e.g.*, December 19X3)? Normalized depreciation would represent the amount of depreciation otherwise expected to be recognized during that period without adjustment of the asset's useful life, or $1,000 ($100/month for ten months) in the example fact pattern.

Interpretive Response: No. Whether the mainframe computers are viewed as ''to be disposed of'' or ''held and used'' at March 19X3, there is no basis under SFAS 121 to write down an asset to an amount that would subsequently result in a ''normalized depreciation'' charge through the disposal date. For an asset that meets the requirements to be classified as ''to be disposed of'' under SFAS 121, paragraph 15 of that standard requires the asset to be valued at the lower of carrying amount or fair value less cost to sell. For assets that are classified as ''held and used'' under SFAS 121, an assessment must first be made as to whether the asset is impaired. Paragraph 6 of SFAS 121 indicates that an impairment loss should be recognized only if the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset(s) grouped at the lowest level of identifiable cash flows. If an impairment loss is to be recognized for an asset to be ''held and used,'' it is measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset. The staff would object to a write down of long-lived assets to a ''normalized depreciation'' value as representing an acceptable alternative to the approaches required in SFAS 121.

The staff also believes that registrants must continually evaluate the appropriateness of useful lives assigned to long-lived assets, including identifiable intangible assets and goodwill.[18] In the above fact pattern, management had contemplated removal of the mainframe computers beginning in January 19X2 and, more formally, in August 19X2 as part of compiling the 19X3 capital expenditures budget. At those times, at a minimum, management should have reevaluated the original useful life assigned to the computers to determine whether a seven year amortization period remained appropriate given the company's current facts and circumstances, including ongoing technological changes in the market place. This reevaluation process should have continued at the time of the September 19X2 board of directors' meeting to discuss capital expenditure plans and, further, as the company pursued mainframe computer bids. Given the contemporaneous evidence that management's best estimate during much of 19X2 was that the current mainframe computers would be removed from service in 19X3, the depreciable life of the computers should have been adjusted prior to 19X3 to reflect this new estimate. The staff does not view the recognition of an impairment charge to be an acceptable substitute for choosing the appropriate initial amortization or depreciation period or subsequently adjusting this period as company or industry conditions change. The staff's view applies also to selection of, and changes to, estimated residual values. Consequently, the staff may challenge impairment charges for which the timely evaluation of useful life and residual value cannot be demonstrated.

Question 3: Although the carrying amount of goodwill related to assets to be held and used must be assessed for impairment in conformity with SFAS 121, paragraph 107 of that standard observes that cost of goodwill that is not identified with impaired assets (*i.e.,* ''enterprise level'') continues to be accounted for under APB 17. Companies are required by paragraph 31 of APB 17 to evaluate continually whether events and circumstances warrant revised estimates of useful lives or recognition of a charge-off of carrying amounts. APB 17 does not specify a particular quantitative methodology for measuring the existence or extent of an impairment. What methodologies are acceptable for determining impairment of ''enterprise level'' goodwill under APB 17?

Interpretive Response: Several methodologies have evolved for measuring impairment of enterprise level goodwill under APB 17. These

[18] See APB 17, paragraph 31, and SFAS 121, paragraph 6 and footnote 1.

methodologies appear to fall within three general categories: market value method, undiscounted cash flows methods, and discounted cash flows methods. A market value method compares the enterprise's net book value to the value indicated by the market price of its equity securities; if net book value exceeds market capitalization, the excess carrying amount of goodwill is written off. Cash flow methods employ forecasts of the enterprise's future cash flows, with comparison of the enterprise's net book value to (a) aggregate cash flow, or (b) the present value of those cash flows. The staff has observed variations in practice with respect to when a registrant will recognize an impairment of the carrying amount of enterprise goodwill depending on which of these methods is applied, how an enterprise's capitalization will be considered in cash flow forecasts, and how the discount rate is selected.

Regardless of the method used and the diversity in application of some of those methods, the staff believes that the evaluation of enterprise level goodwill cannot occur at a level which does not include all of the operations which benefit directly from that acquired intangible. If an acquired business has been managed as a separate business unit, the business unit may be the appropriate level to evaluate the related goodwill. In contrast, if the acquired business has been fully integrated into the registrant's operations, evaluation of the purchased goodwill would be appropriate only at the level of the registrant as a whole.

Question 4: A registrant's method of assessing and measuring the impairment of enterprise level goodwill under APB 17 is an accounting policy subject to APB Opinion No. 22, *Disclosure of Accounting Policies* (APB 22).[19] What disclosures would the staff expect regarding the method selected?

Interpretive Response: Until diversity in practice is reduced, a company that reports material amounts of unamortized cost of goodwill or that recognizes material amounts of goodwill amortization should describe the manner in which the carrying amount of enterprise level goodwill is assessed for recoverability and how and when any impairment would be measured. Materiality is to be assessed based on the relationship of the unamortized asset balance to other financial position measurements (including shareholders' equity) or of the relationship of the amortization expense to income statement measurements.

The staff believes that the policy adopted by the company, and the description of that policy included in the financial statements, should be explicit and refer to objective, rather than discretionary, factors. The staff would expect the following to be addressed:

- What conditions would trigger an impairment assessment of the carrying amount of enterprise level goodwill;
- What method—market value, discounted or undiscounted cash flows—would be used to measure an impairment;
- How the method would be implemented, including how interest charges would be considered in the assessment, how the discount rate would be selected, and other significant aspects of the policy.

When there is a change in the method used to assess the carrying value of goodwill, the Commission's rules[20] require a preferability letter from the company's auditors. The staff does not believe that it would be appropriate to rely on the guidance in SFAS 121 concerning impairments of long-lived assets to justify preferability of changes in the method of evaluating impairment of the carrying amount of enterprise level goodwill. For example, a company that previously changed from an undiscounted cash flow method to assess recoverability of enterprise level goodwill to a method that uses discounted cash flow could not justify a change back to an undiscounted cash flow method by reference to SFAS 121. The staff believes that, generally, a discounted cash flows approach is preferable to an undiscounted cash flows approach and a market value approach is preferable to using a discounted cash flows approach, assuming that market value is reliably determinable.

The staff believes that an impairment triggered by a change in accounting policy should be treated as a change in accounting principle inseparable from a change in estimate.[21] The impairment charge should be presented as a change in estimate within operating income (or loss) and not as the cumulative effect of a change in accounting principle.

Facts: Company A acquires 100 percent of Company B in a purchase business combination, with Company B becoming a wholly owned subsidiary of Company A. The acquisition cost of $1,000 is pushed down to Company B's financial records, resulting in an allocation of $300 to fixed assets, $600 to goodwill, and $100 to other net assets. The fixed assets are composed entirely of four manufacturing facilities.

Two years after the acquisition, Company A commits to a reorganization plan that calls for the relocation of Company B's manufacturing operations to facilities separately owned and operated by Company A. Company B's line of products will continue to be marketed. There will be no reduction in the level of output of Company B's products as a result of the relocation, nor will there be any diminution in expected profitability in future years. That level of profitability is expected to recover the remaining cost of the unamortized goodwill. Company A has committed to dispose of the manufacturing facilities of Company B and has met all of the criteria necessary to classify those assets as ''to be disposed of'' under SFAS 121. Company A expects to realize $200 in net proceeds from the sale of the four manufacturing facilities. The current carrying amounts for the facilities and goodwill are $280 and $480, respectively, which are not impaired on a ''held and used'' basis.

Question 5: Is it appropriate to recognize an impairment loss of $560 ($280+$480 − $200) based on the excess of the carrying amount of goodwill and fixed assets over net sales proceeds?

Interpretive Response: No. An impairment loss can be recognized only for the $80 loss ($280 − $200) on the sale of the facilities. Paragraph 123 of SFAS 121 indicates that goodwill related to assets to be disposed of by an entity should be accounted for under the provisions of APB 17, paragraph 32, which states:

''Ordinarily goodwill and similar intangible assets cannot be disposed of apart from the enterprise as a whole. However, a large segment or separable group of assets of an acquired company or the entire acquired company may be sold or otherwise liquidated, and all or a portion of the unamortized cost of the goodwill recognized in the acquisition should be included in the cost of the assets sold.''

In the above fact pattern, the staff believes that the operations and business of Company B, which supported the initial premium resulting in the recognition of goodwill, were not diminished by the disposition of solely physical facilities. The underlying operations, customer relationships, future revenue streams, and business outlook remained intact and, as a result, the staff believes that it is inappropriate to treat the disposition of manufacturing

[19] See also APB Opinion No. 12, *Omnibus Opinion—1967,* regarding disclosure requirements for depreciable assets.

[20] See Rule 10–01(b)(6) of Regulation S–X.

[21] See paragraph 32 of APB Opinion No. 20, *Accounting* Changes.

facilities as if the business itself had been disposed of. The staff would object to the allocation of goodwill to the disposed manufacturing facilities.

Paragraph 19 of SFAS 121 requires disclosure of the results of operations of assets held for disposal. If revenues attributable to assets to be disposed of, that remain in operation for some period of time prior to their disposal, cannot be segregated because substantially the same revenues will continue after the assets are disposed of, the amount of the benefit from suspending depreciation, in accordance with SFAS 121, paragraph 16, should be disclosed. The effect associated with assets held for disposal should be discussed in Management's Discussion and Analysis (MD&A), if material.

Facts: Assume the same fact pattern as for Question 5, except that the four manufacturing facilities will be shut down, but not disposed of or abandoned. The four manufacturing facilities do not meet the criteria necessary to be classified as ''to be disposed of'' under SFAS 121 but are impaired on a ''held and used'' basis under SFAS 121. Company A intends to retain the four facilities in case the need arises in the future for further manufacturing capacity.

Question 6: Would the staff object to the company's proposal to recognize an impairment loss based on the excess of the carrying amount of goodwill and fixed assets over fair value?

Interpretive Response: Yes. Paragraph 12 of SFAS 121 specifies:

''If an asset being tested for recoverability was acquired in a business combination accounted for using the purchase method, the goodwill that arose in that transaction shall be accounted for as part of the asset grouping * * * in determining recoverability. If some but not all of the assets acquired in that transaction are being tested, goodwill shall be allocated to the assets being tested for recoverability on a pro rata basis using the relative fair values of the long-lived assets and identifiable intangibles acquired at the acquisition date unless there is evidence to suggest that some other method of associating the goodwill with those assets is more appropriate.''

In the above fact pattern, the staff believes that it is inappropriate to allocate the carrying amount of the goodwill balance to the four facilities being evaluated for impairment. In this instance, the goodwill that existed at the time Company B was acquired principally was the result of a customer base, marketing activities, existing product lines and new products being developed. It did not relate to the fixed assets but, rather, the ongoing operations of the business, which have not been reduced in any way. The goodwill represents the inherent value of the going concern element of Company B and the ability of the entity to generate a return in excess of the return that could be generated on the acquired assets individually, all of which are still in place. The staff contrasts this scenario with one where facilities are eliminated in conjunction with a subsequent decision to abandon the product or business line housed in those facilitites. If the revenue producing activity and the facilities had been acquired in a business combination giving rise to recognition of goodwill, a portion of goodwill should be allocated to the facilities based on their relative fair value, unless another allocation method is more appropriate.

Question 7: Has the staff expressed any views with respect to company-determined estimates of cash flows used for assessing and measuring impairment of assets under SFAS 121?

Interpretive Response: In providing guidance on the development of cash flows for purposes of applying the provisions of SFAS 121, paragraph 9 of that standard indicates that estimates of expected future cash flows should be the best estimate based on reasonable and supportable assumptions and projections. Additionally, paragraph 9 indicates that all available evidence should be considered in developing estimates of expected future cash flows and that the weight given to the evidence should be commensurate with the extent to which the evidence can be verified objectively.

The staff recognizes that various factors, including management's judgments and assumptions about the business plans and strategies, affect the development of future cash flow projections for purposes of applying SFAS 121. The staff, however, cautions registrants that the judgments and assumptions made for purposes of applying SFAS 121 must be consistent with other financial statement calculations and disclosures and disclosures in MD&A. The staff also expects that forecasts made for purposes of applying SFAS 121 be consistent with other forward-looking information prepared by the company, such as that used for internal budgets, incentive compensation plans, discussions with lenders or third parties, and/or reporting to management or the board of directors.

For example, the staff has reviewed a fact pattern where a registrant developed cash flow projections for purposes of applying the provisions of SFAS 121 using one set of assumptions and utilized a second, more conservative set of assumptions for purposes of determining whether deferred tax valuation allowances were necessary when applying the provisions of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes.* In this case, the staff objected to the use of inconsistent assumptions.

In addition to disclosure of key assumptions used in the development of cash flow projections, the staff also has required discussion in MD&A of the implications of assumptions. For example, do the projections indicate that a company is likely to violate debt covenants in the future? What are the ramifications to the cash flow projections used in the impairment analysis? If growth rates used in the impairment analysis are lower than those used by outside analysts, has the company had discussions with the analysts regarding their overly optimistic projections? Has the company appropriately informed the market and its shareholders of its reduced expectations for the future that are sufficient to cause an impairment charge? The staff believes that cash flow projections used in the impairment analysis must be both internally consistent with the company's other projections and externally consistent with financial statement and other public disclosures.

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PENSION BENEFIT GUARANTY CORPORATION

29 CFR Parts 4011 and 4022

Disclosure to Participants; Benefits Payable in Terminated Single-employer Plans

AGENCY: Pension Benefit Guaranty Corporation.

ACTION: Final rule.

SUMMARY: This rule amends the appendix to the Pension Benefit Guaranty Corporation's regulation on Benefits Payable in Terminated Single-Employer Plans by adding the maximum guaranteeable pension benefit that may be paid by the PBGC with respect to a plan participant in a single-employer pension plan that terminates in 2000. This rule also amends the PBGC's regulation on Disclosure to Participants by adding information on 2000 maximum guaranteed benefit