Knowing your options

Considerations in the application of qualitative impairment testing for FCC licenses

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At a glance

- Accounting Standards Update 2012-02, *Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment* ("ASU 2012-02"), allows companies to apply a qualitative impairment test to indefinite-lived intangibles before proceeding to a quantitative analysis. (Sometimes referred to as "Step 0.")

- As many broadcasters maintain FCC licenses as indefinite-lived assets, ASU 2012-02 presents an opportunity for broadcasters to reduce the resources used on quantitative impairment tests. However, broadcasters should be aware of the specific considerations for Step 0 tests for FCC licenses.

- Utilizing a qualitative assessment with respect to FCC licenses and other intangibles may not always be feasible. Such a determination will likely be required on a market by market basis.

- The choice to apply a Step 0 test is not a permanent election and will need to be reassessed each year.

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Background

Changes in accounting guidance related to impairment testing are expected to have an impact on the way television and radio broadcasters test their Federal Communications Commission licenses ("FCC Licenses") for impairment.

Most broadcasters have concluded that FCC Licenses are indefinite-lived assets and are typically tested for impairment individually or by market. Previous guidance issued by the Financial Accounting Standards Board ("FASB") required that indefinite-lived assets be tested for impairment on at least an annual basis using a two-step quantitative test.

Following recent amendments made by the FASB in July 2012, entities now have the option to first assess qualitative factors impacting their FCC licenses, often referred to as "Step 0", to determine whether it is more-likely-than-not that the fair value of indefinite-lived FCC license is less than its carrying amount. The result of this test can be used to determine whether it is necessary to perform the full quantitative impairment test originally required under Accounting Standards Codification 350 ("ASC 350").

As a result of these amendments, the frequency and extent of quantitative impairment testing may change for entities that own FCC licenses.

To help address uncertainties in this area, PwC offers our perspectives on how companies can implement the more-likely-than-not qualitative assessment in the testing of their indefinite-lived FCC licenses. This paper explores recent industry trends in the broadcasting industry, including:

- recent impairments recognized on public SEC registrants' FCC licenses,
- discussion of the new FASB amendment, and
- qualitative factors that entities may wish to consider when performing their qualitative assessment of indefinite-lived FCC licenses (hereinafter referred to as simply FCC licenses) for impairment testing purposes.

Qualitative impairment testing for FCC licenses

New guidance on qualitative impairment tests for indefinite-lived intangibles

In September 2011, the FASB released an amendment to FASB Accounting Standards Codification Topic 350 - Goodwill and Other Intangible Assets ("Topic 350") titled Accounting Standards Update 2011-08, Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment ("ASU 2011-08"). The objective of this amendment was to simplify how entities, both public and nonpublic, test goodwill for impairment.

The amendments in ASU 2011-08 permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350 (the more-likely-than-not threshold is defined as having a likelihood of more than 50 percent). Under the amendments in ASU 2011-08, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount.

However, ASU 2011-08 did not extend the use of the qualitative assessment to test indefinite-lived intangible assets. Hence, in July 2012, the FASB released another amendment titled Accounting Standards Update 2012-02, Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment ("ASU 2012-02"). Similar to the goodwill impairment testing guidance in ASU 2011-08, the amendments in ASU 2012-02 give an entity the option to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Topic 350 (again, the more-likely-than-not threshold is defined as having a likelihood of more than 50 percent). This amendment made testing indefinite-lived intangible asset impairment consistent with testing for goodwill impairment.

Historical quantitative approach – the Greenfield Method

Previous guidance in the FASB Accounting Standards Codification Topic 350 - Goodwill and Other Intangible Assets ("ASC 350") required an entity to test indefinite-lived intangible assets, such as FCC Licenses, for impairment, on at least an annual basis, by comparing the fair value of the asset with its carrying amount. If the carrying amount of the intangible asset exceeds its fair value, an entity should recognize an impairment loss in the amount of that excess.

In the quantitative impairment test of FCC Licenses, the Greenfield Method, a form of the Income Approach, is typically used to estimate the fair value of FCC Licenses. The Greenfield Method estimates the value of a start-up station that owns only the FCC License and assumes the station has to purchase, build, or rent all of the other assets needed to operate. The premise of the Greenfield Method is that the value of an FCC License is equivalent to a hypothetical situation in which the licensor would obtain an FCC License, incur start-up costs and losses to build up the station, and eventually reach a normalized state similar to a market participant station.

The primary assumptions used in the Greenfield Method are gross advertising revenue in the station's designated market area ("DMA"), normalized market share, normalized profit margin, estimated start-up costs, fixed asset costs and duration of ramp-up period.

In this traditional quantitative approach, each individual FCC License is tested for impairment by comparing its carrying value to its fair value. If the carrying value of the FCC License exceeds the fair value of the FCC License, the company should recognize an impairment loss in the amount of the excess.

If, after assessing the totality of events and circumstances, an entity concludes that it is not more-likely-than-not that the indefinite-lived intangible asset's carrying value is greater than its fair value, then the asset is deemed to not be impaired and the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the full quantitative impairment test by comparing the fair value with the carrying amount in accordance with Topic 350-30.

The amendments under ASU 2012-02 are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most re-cent annual or interim period have not yet been issued or, for non-public entities, have not yet been made available for issuance.

While the guidance now allows for use of the Step 0 test for FCC licenses, it is important to consider the state of the broadcast industry (see page six) in deciding whether to apply the standard (and for which markets it might be appropriate).

Qualitative factors to consider in FCC license impairment testing

In assessing whether it is more likely than not that an FCC License is impaired, an entity should assess the relevant events and circumstances that could affect the significant inputs used to determine the fair value of an FCC License.

ASU 2012-02 lists examples of events and circumstances that could be considered when performing the more-likely-than-not test, but these are fairly broad factors. FCC Licenses, however, involve additional assumptions and inputs that would not be considered in the valuation of an overall business.

As such, in addition to the factors listed in ASU 2012-02, entities may wish to also consider factors that relate more specifically to FCC Licenses, including:

- Changes to key assumptions in the Greenfield Method, including: viewership trends, market share, projected advertising revenue, ramp-up assumptions, discount rates
- Broadcast industry and market considerations, including: increased competition, shifts to digital media, changes in advertising habits, demographic trends (aging radio/ TV audiences)
- Financial performance of the subject license/market, such as declining or negative cash flows or changes to budget/long-range plans
- Macroeconomic conditions
- Legal or regulatory factors such as the recent approval for the FCC to conduct voluntary spectrum auctions
- Whether there have been any recent impairments in the entity's FCC licenses or goodwill or if the most recent quantitative impairment analysis resulted in only a small excess of fair value over carrying value
- Plans to sell or dispose of an FCC license

The examples included above are not all-inclusive, and an entity should consider other relevant events and circumstances that could affect the significant inputs used to determine the fair value of an FCC License. Entities should keep in mind that no individual example described above is intended to represent a standalone event that requires an entity to calculate the fair value of an FCC License. The events and circumstances should be considered in totality and their potential effect on significant inputs to the fair value determination should be considered when an entity determines that it is not more likely than not that the FCC License is impaired.

In the “more likely than not” determination, an entity should also consider any positive and mitigating events and circumstances that could affect the significant inputs used to determine the fair value of the FCC License, whether the entity has made any recent fair value calculation for the FCC License, and whether there have been any changes to the carrying amount of the FCC License

Entities should also keep in mind that the existence of positive and mitigating events and circumstances is not intended to represent a presumption that an entity should not perform the quantitative impairment test. Differences between individual licenses and markets need to be considered as well, as the Step 0 test will not necessarily be appropriate for every FCC License.

Complexities with the Green-field Method in Step 0 testing

While the Greenfield Method is similar to the Discounted Cash Flows method used to perform most goodwill impairment tests, there are some notable differences in assumptions.

The Discounted Cash Flows method relies primarily on assumptions that company management often has readily available, such as the company’s projections and the entity’s discount. By comparing actual results to projected performance and re-examining the company’s cost of capital, management may have a good idea of whether the reporting unit would fail an impairment test.

However, the Greenfield Method is based on the value of a hypothetical start-up station. Assumptions used in the Greenfield Method, such as a mature level of revenue, a station’s normalized market share, and projected costs to build the station often do not match the actual projections for the station. As such, these assumptions are typically not readily available or tracked by management. Actual performance of the station may or may not be a good proxy for whether assumptions in the Greenfield Method would be adjusted. Finding data for the Greenfield Method may require more in-depth market research and can be particu-larly challenging in smaller markets where there is less data available.

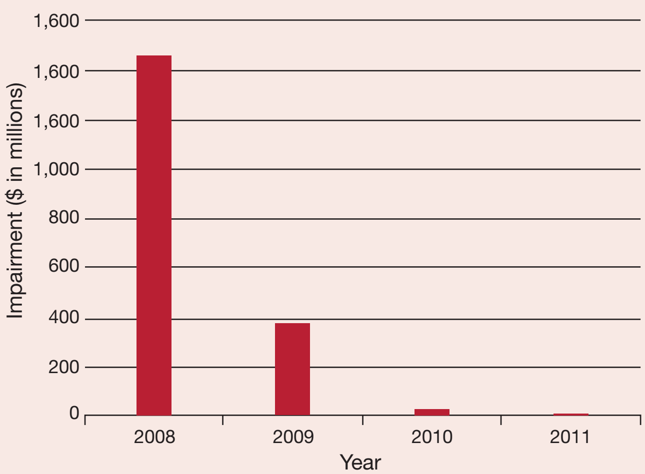
As a result, applying the Step 0 qualitative test to FCC licenses will generally require additional work compared to applying the qualitative test to goodwill.

State of the broadcast industry

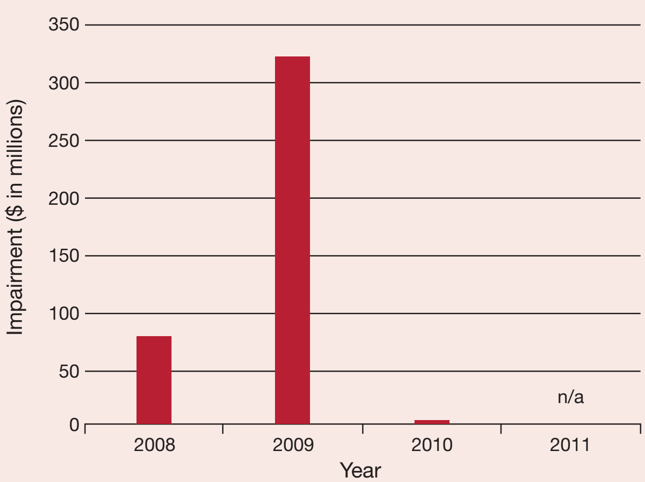
From 2006-2011, the radio and television industry suffered from a multitude of factors stemming from the global financial crisis. The broadcast television industry was impacted by increased competition for diminished advertising budgets, the introduction of popular alternative media formats and a mandated transition to digital transmission. During the same time period, the broadcast radio industry was impacted as companies focused advertising efforts on maintaining a television presence, the increasing prevalence of online and satellite radio, and overall industry consolidation.

These challenges contributed to large, well-established broadcast companies realizing recent impairment losses in their FCC Licenses, as indicated in the following graphs[1]:

Broadcast Television FCC License Impairments



Broadcast Radio FCC License Impairments



A closer look at current trends in different industry sub-segments according to the PwC Global Entertainment and Media Outlook: 2012-2016 helps provide a perspective around the consideration for application of qualitative impairment for FCC licenses:

TV broadcasting industry outlook

While every broadcast market is unique, the television broadcast industry as a whole in the US hit a bottom in 2009. Since 2009, the industry has experienced slow growth which is expected to continue in the near-term as the industry rebounds from the financial crisis, albeit with continued competition and consolidation.

The television broadcasting industry is expecting a recovery in revenues aided by higher, renegotiated retransmittal fees. In addition, new content is expected to attract increased advertising budgets.

Despite these growth prospects, television broadcast companies are wary of future competition for advertising budgets from other mediums, increasing number of cable subscribers and continued popularity of alternative media formats.

Radio broadcasting industry outlook

The radio broadcasting industry as a whole also reached a low in 2009. While a slow recovery seems to be underway, the industry is not expected to reach the peak levels seen in 2006 in the near future.

Decreasing unemployment is the main factor contributing to the growth of the industry, as listeners are expected to spend more time at work and in their cars where they tend to listen to the radio.

Despite these growth prospects, radio broadcasters are wary of competition for limited advertising budgets, increasing competition from online streaming formats and the potential market share gains of satellite radio companies.

Overall considerations

While the overall recovery in the TV and radio broadcast industries in the US since 2009 may provide some comfort with applying a Step 0 test, it is important to consider market-by-market performance and expectations in assessing television and radio FCC licenses.

[1]Data is per a search of public companies in the US Radio, Television, and Entertainment industries with enterprise values greater than $100 million.

Conclusion

Television and radio broadcast entities are beginning to rebound with the economy; however, they are facing potential risks that could affect the value of their FCC Licenses going forward.

The recent accounting trends may ultimately drive a fundamental shift in the way financial statement preparers and valuation advisors approach the testing of FCC Licenses. While the recent FASB amendment in ASU 2012-02 may help save time and cost for some filers, it may not be appropriate for every entity or FCC license.

Consideration of the assumptions underlying the Greenfield Method, industry risks, company specific factors, and economic conditions, amongst other qualitative factors noted above, should be made when assessing whether an FCC License is more-likely-than-not to be impaired. The most appropriate approach will depend on individual circumstances, which will likely continue evolving with the industry.

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