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Ms. Susan M. Cospers  
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23 August 2013

**Re: Proposed Accounting Standards Update, *Accounting for Identifiable Intangible Assets in a Business Combination*, a proposal of the Private Company Council (File Reference No. PCC-13-01A)**

Dear Ms. Cospers:

As the auditor of more than 3,000 private entities, we appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Accounting for Identifiable Intangible Assets in a Business Combination*, a proposal of the Private Company Council (the proposed Update).

We strongly support providing relief to private companies under US GAAP while continuing to provide relevant information for users of private company financial statements. While we acknowledge the observation of the Private Company Council (PCC) that some users of private company financial statements believe that distinguishing certain intangible assets from goodwill may not provide decision-useful information, we challenge whether this is sufficient justification for amending the model for accounting for the acquisition of intangible assets in a business combination. We believe that any change to this model should be fundamentally consistent with conceptual underpinnings in US GAAP in addition to being convenient to apply.

When the FASB issued Statement No. 141(R), *Business Combinations* (Statement 141(R)), it debated whether identifiable intangible assets should be distinguished from goodwill. In the Basis for Conclusions to Statement 141(R), the FASB said the decision usefulness of financial statements for both private and public companies would be enhanced if intangible assets acquired in a business combination were distinguished from goodwill. In drawing that conclusion, the FASB pointed to Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, which says that "classification in financial statements facilitates analysis by grouping items with essentially similar characteristics and separating items with essentially different characteristics. Analysis aimed at objectives such as predicting amounts, timing, and uncertainty of future cash flows requires financial information segregated into reasonably homogenous groups."

We believe that an intangible asset that meets the separability criterion in US GAAP or that arises from a cancelable contractual right continues to have characteristics that distinguish it as separate and apart from goodwill. Therefore, we believe that the inclusion of such intangible assets in goodwill would diminish the decision usefulness of the reported financial information. For example, the

inclusion of such finite-lived intangible assets (e.g., a customer relationship intangible asset) in goodwill that potentially are not being amortized would diminish the representational faithfulness of those financial statements.

In addition, private companies that elect to apply the proposed Update may inappropriately realize gains on the subsequent sale of intangible assets that are initially subsumed in goodwill. For example, if a private company applying the proposed Update acquires a customer list in a business combination and later sells that customer list, the private company would recognize a larger gain on that sale than it otherwise would under current US GAAP. We believe the recognition of such gains is inconsistent with the economics of the transaction and therefore would diminish the quality of the private company's financial reporting.

Finally, we believe that recognizing intangible assets at their estimated fair values is a more faithful representation than would be provided if those intangible assets were subsumed into goodwill. We therefore do not understand how including such assets in goodwill would facilitate analysis of financial statements aimed at objectives such as predicting amounts, timing and uncertainty of future cash flows.

If the Board moves forward with this proposal, we believe that certain aspects of the proposed Update should be modified to improve its operationality and facilitate its implementation. We summarize our more significant concerns below.

### **Increase in recognition and measurement differences between business combinations and asset acquisitions and equity method investments**

The proposed Update would create recognition and measurement differences in the accounting for identifiable intangible assets in a business combination, an asset acquisition and the acquisition of an equity method investment under ASC 323, *Equity Method Investments* (ASC 323). We note that ASC 323 requires the investor to determine the acquisition-date fair value of the identifiable assets and liabilities of the investee in the same manner as a business combination under ASC 805.

We believe that the scope of the proposed Update should be expanded to include the acquisition of intangible assets in an asset acquisition and in an equity method investment under ASC 323. We do not believe there is a conceptual basis to have different recognition and measurement requirements relating the acquisition of intangible assets in these transactions and in a business combination.

### **Distinguishing noncancelable contractual rights from other legal rights**

We are concerned that the proposal would force entities to do more work to distinguish between intangible assets that arise from noncancelable contractual rights and those that arise from other legal rights because the proposed measurement requirements would differ. Under current US GAAP, companies generally do not make this distinction. What's more, distinguishing between these types of intangible assets could be challenging. For example, does an in-process research and development asset arise from contractual rights or other legal rights? We believe additional implementation guidance is necessary for companies to appropriately make this distinction.

Further, based on the examples of intangible assets included in the proposed Update, it appears that the determination of whether an intangible asset arises from other legal rights generally would depend on whether it is registered or patented. Based on our experience, companies that do not register or patent a trade secret, recipe or technology still have legal protection under the Uniform Trade Secrets Act (UTSA). Therefore, it is not clear to us whether unregistered or unpatented intangible assets that are entitled to legal protection and/or remedies under the UTSA would meet the definition of an intangible asset arising from other legal rights. As currently drafted, the proposal would seem to require that such intangible assets be subsumed in goodwill. It is unclear to us whether that was the PCC's intent and we recommend that point be clarified.

**The need for transition requirements for private companies that transition back to current US GAAP**

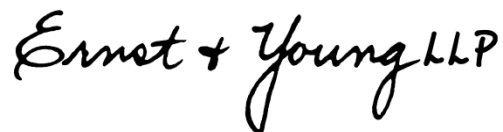
It is unclear to us how a private company that elects to apply the accounting alternative in the proposed Update would transition to US GAAP for public business entities if it later elects to or is required to apply those requirements (e.g., a company that files financial statements with the Securities and Exchange Commission in connection with an initial public offering). Because this issue is broader than this specific proposal, we believe that the Board should develop separate guidance that provides transition provisions for any private company that will transition back to current US GAAP.

Our responses to the Questions for Respondents, along with other comments about clarifications that would help make the proposed Update operational, are included in the Appendix.

\* \* \* \* \*

We would be pleased to discuss our comments with the PCC, the Board or the FASB staff at your convenience.

Very truly yours,



**Responses to the Questions for Respondents in the Proposed Accounting Standards Update, *Accounting for Identifiable Intangible Assets in a Business Combination*, a proposal of the Private Company Council**

This Appendix includes our responses to questions addressed to all respondents or specifically to auditors. We have not responded to questions addressed only to preparers or users.

**Question 1:** Please describe the entity or individual responding to this request. For example:

- a. Please indicate whether you primarily are a preparer, user, public accountant or, if other, please specify.
- b. If you are a preparer of financial statements, please indicate whether your entity is privately held or publicly held and describe your primary business and its size (in terms of annual revenue, the number of employees, or other relevant metric).
- c. If you are a public accountant, please describe the size of your firm (in terms of number of partners or other relevant metric) and indicate whether your practice focuses primarily on public entities, private entities, or both.
- d. If you are a user of financial statements, please indicate in what capacity (for example, lender, investor, analyst, or rating agency) and whether you primarily use financial statements of private entities or those of both private entities and public entities.

Ernst & Young LLP is one of the largest firms auditing both public and private entities. We currently audit more than 3,000 private entities, ranging from small start-ups and family-owned enterprises to large privately held multinational corporations.

**Question 2:** Should any types of entities be excluded from the scope of this proposed Update? Should any types of transactions or accounts be excluded, or are there any other types of transactions or accounts that should be included in the scope?

We encourage the FASB to finalize its proposal on the definition of a public business entity, which will drive the scope of the Private Company Decision-Making Framework, before concluding on whether any types of entities should be excluded from the scope of this proposed Update. We will respond in a separate comment letter on the proposed definition.

In addition, as indicated in our cover letter, we believe the scope of the proposed Update should be expanded to include the acquisition of intangible assets in an asset acquisition and the acquisition of an equity method investment under ASC 323.

**Question 3:** Should the Board expand the scope of the accounting alternative to other entities, such as publicly traded companies or not-for-profit entities? If the scope is expanded to other entities, what changes, if any, should the Board consider for the recognition, measurement, and disclosure of identifiable intangible assets acquired in a business combination? If the scope is expanded to public companies or not-for-profit entities, should the accounting alternative continue to be elective?

Because the proposed Update does not provide a conceptual basis for the accounting alternative it would provide to private companies, we do not believe the accounting alternative should be extended to public entities (see our cover letter for additional information). Further, we believe that one of the primary arguments for the proposal – the unique users of private company financial statements and their unparalleled access to management – would not extend to users of public company financial statements.

We believe that the scope of the proposed Update should be expanded to include not-for-profit entities. The primary users of not-for-profit entities' financial statements are typically donors, trustees, regulatory agencies, rating agencies and bondholders. In general, these users are concerned about an entity's ability to meet its mission and its liquidity (e.g., debt coverage and current ratios) and largely ignore the recognition, amortization and impairment of intangible assets. We believe these users generally share more of the characteristics of private company users that the proposal cites as a basis for providing the accounting alternative. We believe that, if the scope is expanded to not-for-profit entities, the accounting alternative should continue to be elective.

**Question 4:** Would the proposed amendments reduce overall costs and complexity compared with existing guidance? If not, please explain why.

In general, we believe the proposed amendments would achieve the PCC's objective of reducing overall costs compared with existing guidance. However, we do not believe this objective would be met when an intangible asset is measured using a multi-period excess earnings method (MPEEM).

Under the MPEEM, the estimate of the intangible asset's fair value starts with the prospective financial information associated with a collection of assets rather than a single asset. Contributory asset charges are then typically deducted from the net cash flows for the collection of the associated assets to isolate the excess earnings attributable to the intangible asset being valued. The contributory asset charge is a deduction for the contribution of supporting assets (e.g., working capital, fixed assets, customer relationships, trade names) as required by market participants to the generation of the prospective cash flows attributable to the particular asset being valued. Therefore, under the MPEEM, intangible assets that would otherwise not be recognized (e.g., a noncontractual customer relationship) or would be measured on a basis other than ASC 820 would now be required to be measured at fair value under ASC 820 in order to determine the contributory asset charge. As a result, the intended relief would not be achieved.

**Question 5:** Do you agree that the accounting alternative for the recognition and measurement of intangible assets acquired in a business combination would provide relevant and decision-useful information to users of private company financial statements? If not, what accounting alternative, if any, would provide more relevant information to users?

We believe that intangible assets that would be separately recognized and would continue to be measured under ASC 820 would continue to provide relevant, decision-useful information to users of private company financial statements. However, we would challenge whether intangible assets that would be subsumed into goodwill under the proposal would provide relevant and decision-useful information for users. For example, assume a private company elects the accounting alternative and an acquired customer list intangible asset is subsumed into goodwill. Under current US GAAP, the customer list would have been separately recognized and amortized on an accelerated basis over its useful life. If the private company elects this accounting alternative but not the goodwill alternative, today's avoided amortization expense would be recorded as a goodwill impairment charge (assuming there were no changes in the company's cash flows during the useful life of the customer list). It's not clear to us how this would provide meaningful information to the users of the private company financial statements.

**Question 6:** Do you agree that for contractual intangible assets, recognition and measurement should be limited to the noncancelable term of the contract? If so, do you agree with the proposed definition of a noncancelable contractual term? Do you agree that market participant expectations about the potential renewal or cancellation of the contract should not be factored into the measurement? Do you foresee any increase in cost and complexity or other difficulties in applying this alternative recognition and measurement principle? If yes, would additional implementation guidance address those difficulties?

Refer to the section "Distinguishing noncancelable contractual rights from other legal rights" in our cover letter.

In addition, the wording in paragraph ASC 805-20-25-31 of the proposed Update is somewhat unclear and appears to be similar to the definition of a noncancelable lease term in ASC 845, *Leases*. Since we understand that the Board has proposed removing the definition of a noncancelable lease term from the Master Glossary as part of its proposal on accounting for leases, it is unclear to us why that definition was used as a starting point for the proposed Update.

We also believe that it would be helpful to provide additional background (e.g., implementation guidance, discussion in the Basis for Conclusions) on the principles underlying the definition of noncancelable. For example, while we understand that the situations described in paragraph 805-20-25-31(b) and (c) would be rather common, it is unclear to us in what circumstances paragraphs (a) or (d) would arise. Additional context could help facilitate implementation of the proposed Update.

**Question 7:** Do you agree that intangible assets arising from other legal rights should continue to be measured at fair value considering all market participant expectations, consistent with Topic 820? If not, what accounting alternative for measurement do you recommend?

We agree that the measurement basis for intangible assets arising from other legal rights should continue to be fair value considering all market participant expectations, consistent with Topic 820.

**Question 8:** Do you agree that an entity should disclose the nature of identifiable intangible assets that are not recognized separately as a result of applying the amendments in this proposed Update? If not, please explain why.

We agree that an entity should disclose the nature of identifiable intangible assets that are not recognized separately as a result of applying the amendments in this proposed Update.

**Question 9:** For identifiable intangible assets that are recognized separately as a result of applying the amendments in this proposed Update, do you agree that the amendments should not require any other additional recurring disclosures and that entities should be required to comply with disclosure requirements in relevant Topics, as applicable (for example, Topic 350, Intangibles—Goodwill and Other, and Topic 805)? If not, what additional disclosures should be required and please explain why.

For identifiable intangible assets that are recognized separately as a result of applying the amendments in this proposed Update, we do not believe that any other additional recurring disclosures are necessary. Further, we agree that an entity should comply with disclosure requirements in relevant Topics, such as Topic 350 and Topic 805.

**Question 10:** Do you agree that the proposed Update should be applied on a prospective basis? Should retrospective application be permitted?

We agree that the proposed Update should be applied prospectively. Because retrospective application likely would result in remeasuring a previously recognized intangible asset based on the remaining contractual term as of the date of acquisition, we believe retrospective application would result in unnecessary cost and complexity. Further, it is unclear to us why a private company would want to apply the accounting alternative on a retrospective basis. Therefore, we do not believe retrospective application should be permitted.

**Question 11:** When should the alternative accounting method be effective? Should early application be permitted?

Because adoption of the proposed Update would be elective, we believe that an effective date in the first period after issuance of a final standard would be appropriate. Further, we would support permitting early application.

**Question 12:** For preparers and auditors, how much effort would be needed to implement and audit the proposed amendments?

We believe that this question is difficult to answer broadly because the effort needed to implement and audit the proposed amendments would depend on the facts and circumstances of a particular transaction.

**Question 14:** If an entity elects the accounting alternative in this proposed Update, should that entity also be required to apply the PCC's proposed accounting alternative for the subsequent measurement of goodwill (in Topic 350)? Alternatively, if an entity elects the accounting alternative in Topic 350 for goodwill, should that entity also be required to adopt the accounting alternative in this proposed Update? (No decisions have been reached by the Board and the PCC about this question.)

We believe that the proposed Update and the accounting alternative in Topic 350 for goodwill should be linked so that an entity that elects either accounting alternative would be required to adopt the other. We believe that not doing so would diminish the representational faithfulness of the financial statements. For example, if a private company were to elect this accounting alternative but not the goodwill alternative, the goodwill balance would likely include finite-lived intangible assets (for example, a noncontractual customer relationship intangible asset) that would not be amortized. As further discussed in our response to Question 5, any subsequent goodwill impairment charge likely would not be as meaningful because that impairment charge could relate to an unrecognized intangible asset.

In addition, if a private company were to elect this accounting alternative but not the goodwill alternative, the private company would be required to test its goodwill for impairment on an annual basis. If the private company were to fail Step 1 of the goodwill impairment test and have to proceed to Step 2, in determining the fair value of the reporting unit, the private company could not avail itself of the relief provided in this proposal. It seems inconsistent to us that an intangible asset that was not originally recognized or measured on a basis other than ASC 820 would now be subject to the requirements of ASC 805.

**Question 15:** The scope of this proposed Update uses the term publicly traded company from an existing definition in the Master Glossary. In a separate project about the definition of a nonpublic entity, the Board is deliberating which types of business entities would be considered public and would not be included within the scope of the Private Company Decision-Making Framework. The Board and PCC expect that the final definition of a public business entity resulting from that project would be added to the Master Glossary and would amend the scope of this proposed Update. The Board has tentatively decided that a public business entity would be defined as a business entity meeting any one of the following criteria:

- a. It is required to file or furnish financial statements with the Securities and Exchange Commission.
- b. It is required to file or furnish financial statements with a regulatory agency in preparation for the sale of securities or for purposes of issuing securities.



- c. It has issued (or is a conduit bond obligor) for unrestricted securities that can be traded on an exchange or an over-the-counter market.
- d. Its securities are unrestricted, and it is required to provide U.S. GAAP financial statements to be made publicly available on a periodic basis pursuant to a legal or regulatory requirement.

Do you agree with the Board's tentative decisions reached about the definition of a public business entity? If not, please explain why.

We will answer this question in our upcoming comment letter on the FASB's Proposed Accounting Standards Update, *Definition of a Public Business Entity*.

\* \* \* \* \*

#### Other recommendations

- ▶ We recommend striking the words "or cancellation" in the following sentence in paragraph ASC 805-20-30-25: "However, the measurement of the intangible asset only shall consider market participant assumptions about the remaining noncancelable term of the contract, and therefore not consider market participant expectations about the potential renewal or cancellation of the contract." We believe the intent of the PCC was to consider the potential cancellation of the contract in the recognition of an acquired intangible asset.
- ▶ We believe that paragraph ASC 805-20-55-61(c) could imply that an IPR&D asset arises from contractual rights rather than other legal rights. It is unclear to us whether this was the PCC's intent. Refer to the section "Distinguishing noncancelable contractual rights from other legal rights" in our cover letter for further information.
- ▶ As described in paragraph ASC 805-20-55-59, we agree that an intangible asset should be recognized if it is identifiable and arises from other legal rights that are enforceable. Therefore, we recommend the following change (in **bold**) to paragraph ASC 805-20-25-30: "...b. Other legal rights **that are enforceable.**"