Private Company Council

PCC Issue No. 13-01A and 13-01B

Titles: "Accounting for Identifiable Intangible Assets in a Business Combination" and "Accounting for Goodwill Subsequent to a Business Combination"—Common Issues

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Previously distributed PCC materials: PCC Agenda Report, Issue No. 1, dated February 12, 2013; Issue Summary No. 1, dated May 7, 2013; Proposed Accounting Standards Updates for Issues No. 13-01A and No. 13-01B, both dated July 1, 2013; Issue Summary No. 1, Supplement No. 1 for Issue No. 13-01A, dated September 23, 2013; Issue Summary No. 1, Supplement No. 1 for Issue No. 13-01B, dated September 23, 2013

Purpose

1. This Issue Summary Supplement includes a summary of some of the common feedback in response to the Proposed Accounting Standards Updates, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination* (Issue 13-01A), and *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill* (Issue 13-01B). This Issue Supplement should be read in conjunction with Issue 13-01A, Issue Summary No. 1, Supplement No. 1, and Issue 13-01B, Issue Summary No. 1, Supplement No. 1. Issue 1 of this Issue Supplement is not relevant if the PCC decides on View D under Issue 2 of Supplement 1 for Issue 13-01A. That is, private companies would continue to be required to recognize and measure identifiable intangible assets acquired in a business combination (separate from goodwill) in accordance with Topic 805.

2. This Issue Supplement is organized as follows:
    a. Issue 1: Linkage between Issue 13-01A and Issue 13-01B

b. Potential Follow-on Issue: Impairment Tests When Grouping Long-Lived Assets

Issue 1: Linkage between Issue 13-01A and Issue 13-01B

3. The proposed Updates for Issue 13-01A and Issue 13-01B do not indicate whether the two issues should be linked (that is, if you elect one of the proposed alternatives, whether you are required to adopt the other) or are mutually exclusive (that is, the proposed alternatives could be elected independently of one another). Feedback was requested from respondents about whether an entity that elects to apply the alternative in the proposed Update on identifiable intangible assets (Issue 13-01A) should be required to apply the alternative in the proposed Update on accounting for goodwill (Issue 13-01B), and vice versa.

4. Several respondents (including three large accounting firms, the Technical Issues Committee of the AICPA's Private Companies Practice Section (TIC), and two smaller CPA firms) believe that Issue 13-01A should be linked to Issue 13-01B (but not vice versa). Under this view, if a private company elects the proposed alternative in Issue 13-01A, then that private company would be required to apply the proposed alternative in Issue 13-01B. However, if a private company elects the proposed alternative in Issue 13-01B, that private company would not be required to apply the proposed alternative in Issue 13-01A.

5. These respondents indicated that Issue 13-01A should be linked to Issue 13-01B because it would be inappropriate for the unrecognized intangible assets from the adoption of Issue 13-01A to be subsumed into goodwill and, as a result, expose the entity to a higher risk of goodwill impairment under current U.S. GAAP. By linking the adoption of Issue 13-01A with Issue 13-01B, a private company would increase its balance for goodwill but also would be able to decrease its exposure to impairment by amortizing goodwill. Plante & Moran (Issue 13-01A, CL #34, and Issue 13-01B, CL #38 noted:

> If an entity elects to follow the accounting alternative for goodwill but not the accounting alternative for identifiable intangible assets, the likely result is simply an accelerated write-off of goodwill with no resulting impact on other intangible assets. On the other hand, we believe that if an entity elects the accounting alternative for recognition, measurement, and disclosure of identifiable intangible assets acquired in a business combination, the entity should also be required to apply the proposed

accounting alternative for the subsequent measurement of goodwill in this Proposed Update. Because many of the identifiable intangible assets not recognized separately from goodwill would be amortized had the accounting alternative not been elected, we believe it would be inappropriate for those amounts to be included in goodwill subject only to an impairment test.

6. Many respondents (including two large accounting firms, five smaller accounting firms, and seven professional organizations) stated that both proposals should be linked. The reasons for linking Issue 13-01A to Issue 13-01B are discussed above. No respondent specifically described reasons to require linkage of Issue 13-01B to Issue 13-01A, however, the staff believes that some constituents support the amortization of goodwill only because, as a result of Issue 13-01A, some intangible assets with a finite life would be subsumed into goodwill.

7. A few respondents state that the proposals should not be linked. For example, the Small Business Financial and Regulatory Affairs Committee of the Institute of Management Accountants (Issue 13-01A, CL #36, and Issue 13-01B, CL #40) stated that "We see the two proposals as mutually exclusive, as proposed, and therefore the elections should be independent."

8. No respondents indicated that Issue 13-01B should be linked to Issue 13-01A only. The staff believes that this is because some of those respondents indicated that Issue 13-01B is of greater interest due to the complexities with recurring impairment testing of goodwill. Some respondents stated that changes to the accounting for goodwill are warranted without regard to any change in the accounting for identifiable intangible assets and, thus, entities should be permitted to adopt Issue 13-01B and not have to adopt Issue 13-01A. MMC Materials (Issue 13-01A, CL #2, and Issue 13-01B, CL #2) stated that "If Topic 350 is not adopted, then I would be indifferent to this proposal. Topic 350 is much more important to me."

Alternatives

9. Depending on the PCC's decisions on the alternative views presented in the Issue Supplements for Issues 13-01A and 13-01B, the PCC will need to decide whether Issue 13-01A and Issue 13-01B should be linked or mutually exclusive. For example, if the PCC were to move forward with Issue 13-01B, but not Issue 13-01A (View D in the Issue Supplement for 13-01A), no further discussion of linkage is necessary. However, if the PCC moves forward with both alternatives, linkage must be

addressed. If the PCC decides that both alternatives should move forward, the staff has identified the following three alternatives for the PCC's consideration:

View A: Election of Issue 13-01A is conditional upon the adoption of Issue 13-01B, but Issue 13-01B can be elected independent of Issue 13-01A.

10. Proponents of View A believe that linking Issue 13-01A to Issue 13-01B provides a mechanism for assets that are finite-lived to be amortized. Further, proponents of View A believe that because Issue 13-01A would likely result in a higher goodwill balance in comparison to current U.S. GAAP, entities would be exposed to a higher risk of goodwill impairment. Therefore, by linking the adoption of Issue 13-01A to Issue 13-01B, a private company would reduce its risk for goodwill impairment by amortizing goodwill in addition to the changes made to simplify the impairment test.

11. However, proponents of View A do not believe that the election of Issue 13-01B should be linked to Issue 13-01A. Proponents of View A think that Issue 13-01B would provide a greater reduction in cost and complexity to preparers in comparison to Issue 13-01A and that reduction in cost and complexity would benefit private company preparers regardless of whether the accounting for identification of intangible assets changes. Proponents of View A believe that a change in the accounting for goodwill is supportable (based on the alternative views presented in Issue Supplement No. 1 for Issue 13-01B) even if additional intangible assets are not subsumed into goodwill.

12. Opponents of View A believe that the basis for amortizing goodwill is the inclusion of finite-lived intangibles in the goodwill balance as a result of Issue 13-01B. Thus, they believe that both alternatives should be linked (View C).

View B: No linkage

13. Proponents of View B believe that both Issue 13-01A and Issue 13-01B would result in a reduction in cost and complexity while resulting in decision-useful information for users of private company financial statements and, therefore, believe that the issues should not be required to be linked. Proponents also believe that View B could limit the number of differences within U.S. GAAP

between public companies and private companies because an entity would not be required to apply both proposals.

14. Some opponents believe that at a minimum, Issue 13-01A should be linked to Issue 13-01B for reasons included in the proponents of View A. Other opponents believe that both proposals should be linked (Issue 13-01A and Issue 13-01B, and vice versa) and are included as proponent views of View C.

View C: Must adopt both proposals

15. Proponents of View C believe that not linking both proposals would reduce the representational faithfulness of the financial statements. Those proponents state that without linking Issue 13-01A to Issue 13-01B, goodwill would increase and be at a greater risk of impairment (as discussed in View A). The FASB staff believes that proponents of View C support Issue 13-01B only because Issue 13-01A would result in the goodwill balance including finite-lived assets (whereas without the alternative, goodwill is deemed by some to be largely a non-wasting asset). Proponents also think that View C would provide the most consistency and comparability to the users of private company financial statements.

16. Opponent views to View C are included as proponent views to View A and View B.

FASB Staff Recommendation

17. The FASB staff recommends View A (the linking of Issue 13-01A to Issue 13-01B but not linking Issue 13-01B to Issue 13-01A). The staff believes that Issue 13-01A has a clear interdependency with Issue 13-01B because any change to current U.S. GAAP that would result in an entity recognizing fewer intangible assets in a business combination would result in that entity recognizing a larger amount of goodwill (because goodwill is the residual asset). Under current U.S. GAAP, goodwill is not amortized, therefore, fewer intangible assets recognized on the acquisition date would result in less amortization expense (and higher earnings) in the post-acquisition periods as compared to current U.S. GAAP.

18. The staff believes that an entity should be permitted to elect to apply Issue 13-01B without having to also apply Issue 13-01A. The staff notes that the staff recommendation included in Issue Supplement No. 1 of Issue 13-01B for the amortization of goodwill is not linked to the conclusion that goodwill would increase as a result of Issue 13-01A. The staff believes that Issue 13-01B could reduce cost and complexity for many entities and Issue 13-01B does not have a direct impact to the accounting for identification of intangible assets in Issue 13-01A.

Question 1: Which view above does the PCC support?

Potential Follow-on Issue: Impairment Tests When Grouping Long-Lived Assets

19. Some respondents noted that it is unclear what effect Issue 13-01A and Issue 13-01B would have on the long-lived asset impairment test under Topic 360 when long-lived assets are required to be grouped with other assets and liabilities of an asset group. Such assets must be grouped at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. Some respondents questioned whether an intangible asset that is subsumed into goodwill as a result of Issue 13-01A still should be considered a part of the asset group (and thus some portion of the book value of goodwill carved out for that intangible asset and included in the book value of the asset group) when that asset contributes to the cash flows of the asset group. If no such allocation is made, then the cash flows of the asset group would inappropriately include cash flows that relate to the intangible asset that is subsumed into goodwill.

20. Further, specific guidance is provided in Topic 360 about when to include goodwill in an asset group and is dependent on the relationship of goodwill to a reporting unit, which would not be relevant under the current alternative.

21. As the alternatives for intangibles and goodwill have not been finalized, it is difficult to assess how to address the effect of the alternatives on the impairment test for long-lived assets. The staff believes that the issue relating to how 13-01A and 13-01B would affect the long-lived asset impairment test under Topic 360 is a follow-on issue. If the PCC would like to address this issue, the staff would perform outreach with preparers and valuation specialists to determine how the final alternative might affect their practices for grouping long-lived assets for impairment and present the

issue to the PCC at a future meeting.

22. Depending on the PCC's decisions about the proposed alternatives and if they decide to direct the staff to perform additional research, the effect of a final alternative on the grouping of long-lived assets in an impairment test under Topic 360 could be discussed at the November 11-12, 2013 PCC meeting. This would not result in a significant timing difference between the development of the alternatives for Issues 13-01A and 13-01B and addressing this consequential amendment. The staff also notes that any decision about how Issues 13-01A and 13-01B would affect the long-lived impairment test could require re-exposure.