

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2014-18
December 2014

Business Combinations (Topic 805)

Accounting for Identifiable Intangible Assets in a
Business Combination

a consensus of the Private Company Council

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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CONTENTS

	Page Numbers
Summary	1–3
Amendments to the <i>FASB Accounting Standards Codification</i> ®	5–14
Background Information and Basis for Conclusions	15–24

Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The Private Company Council (PCC) added this issue to its agenda in response to feedback from some private company stakeholders indicating that the benefits of the current accounting for identifiable intangible assets acquired in a business combination may not justify the related costs. By providing an accounting alternative, this Update reduces the cost and complexity associated with the measurement of certain identifiable intangible assets without significantly diminishing decision-useful information to users of private company financial statements. Therefore, the amendments in this Update meet the overall objective of the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* for addressing the needs of private company stakeholders.

Who Is Affected by the Amendments in This Update?

The amendments in this Update, at an entity's election, apply to all entities except for public business entities and not-for-profit entities as defined in the Master Glossary of the *FASB Accounting Standards Codification*[®]. The accounting alternative applies when an entity within the scope of this Update is required to recognize or otherwise consider the fair value of intangible assets as a result of any one of the following transactions (in-scope transactions):

1. Applying the acquisition method under Topic 805 on business combinations
2. Assessing the nature of the difference between the carrying amount of an investment and the amount of underlying equity in net assets of an investee when applying the equity method under Topic 323 on investments—equity method and joint ventures
3. Adopting fresh-start reporting under Topic 852 on reorganizations.

An entity within the scope of this Update that elects to apply the amendments is subject to all of the recognition requirements within the accounting alternative. The accounting alternative, when elected, should be applied to all in-scope transactions entered into after the effective date.

What Are the Main Provisions?

An entity within the scope of this Update that elects the accounting alternative to recognize or otherwise consider the fair value of intangible assets as a result of

any in-scope transactions should no longer recognize separately from goodwill (1) customer-related intangible assets unless they are capable of being sold or licensed independently from the other assets of the business and (2) noncompetition agreements.

An entity that elects the accounting alternative in this Update must adopt the private company alternative to amortize goodwill as described in FASB Accounting Standards Update No. 2014-02, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill*. However, an entity that elects the accounting alternative in Update 2014-02 is not required to adopt the amendments in this Update.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

For entities electing this alternative, the amendments generally will result in those entities separately recognizing fewer intangible assets in a business combination when compared to entities that do not elect or are not eligible for this alternative.

Currently, an acquirer recognizes most assets acquired and liabilities assumed in a business combination at their acquisition-date fair values, including all intangible assets that are identifiable. An intangible asset is identifiable if it meets either of the following criteria:

1. It arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
2. It is separable, that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset, or liability, regardless of whether the entity intends to do so.

The accounting alternative in this Update, when elected, will continue to provide decision-useful information to the users of private company financial statements while providing a reduction in the cost and complexity associated with the measurement of certain identifiable intangible assets. Intangible assets other than customer-related intangible assets that are not capable of being sold or licensed independently from the other assets of a business and noncompetition agreements will continue to be recognized. Qualitative disclosures currently required under GAAP will continue to provide information without the undue cost and complexity associated with measuring the fair value of intangible assets not recognized under this alternative.

When Will the Amendments Be Effective?

The decision to adopt the accounting alternative in this Update must be made upon the occurrence of the first transaction within the scope of this accounting alternative in fiscal years beginning after December 15, 2015, and the effective date of adoption depends on the timing of that first in-scope transaction. If the first in-scope transaction occurs in the first fiscal year beginning after December 15, 2015, the elective adoption will be effective for that fiscal year's annual financial reporting and all interim and annual periods thereafter. If the first in-scope transaction occurs in fiscal years beginning after December 15, 2016, the elective adoption will be effective in the interim period that includes the date of that first in-scope transaction and subsequent interim and annual periods thereafter. Early application is permitted for any interim and annual financial statements that have not yet been made available for issuance.

Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–7. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Master Glossary

2. Add the following Master Glossary terms to Subtopic 805-20 as follows:

Contract Asset

An entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance).

Financial Statements Are Available to Be Issued

Financial statements are considered available to be issued when they are complete in a form and format that complies with GAAP and all approvals necessary for issuance have been obtained, for example, from management, the board of directors, and/or significant shareholders. The process involved in creating and distributing the financial statements will vary depending on an entity's management and corporate governance structure as well as statutory and regulatory requirements.

Lease

An agreement conveying the right to use property, plant, or equipment (land and/or depreciable assets) usually for a stated period of time.

Private Company

An entity other than a **public business entity**, a **not-for-profit entity**, or an employee benefit plan within the scope of Topics 960 through 965 on plan accounting.

Public Business Entity

A public business entity is a business entity meeting any one of the criteria below. Neither a **not-for-profit** entity nor an employee benefit plan is a business entity.

- a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
- b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
- c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
- d. It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.
- e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

Amendments to Subtopic 805-20

3. Add paragraphs 805-20-05-3 through 05-4 and the new Subsection title, with a link to transition paragraph 805-20-65-2, as follows:

Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest

Overview and Background

General

805-20-05-3 The guidance in this Subtopic is presented in the following two Subsections:

- a. General
- b. Accounting Alternative.

Accounting Alternative

805-20-05-4 The Accounting Alternative Subsections of this Subtopic provide guidance for an entity within the scope of paragraph 805-20-15-2 that elects the accounting alternative for the recognition of identifiable intangible assets acquired in a business combination.

4. Add paragraphs 805-20-15-2 through 15-4, and the new Subsection title, with a link to transition paragraph 805-20-65-2, as follows:

Scope and Scope Exceptions

Accounting Alternative

805-20-15-2 A **private company** may make an accounting policy election to apply the accounting alternative in this Subtopic. The guidance in the Accounting Alternative Subsections of this Subtopic applies when a private company is required to recognize or otherwise consider the fair value of intangible assets as a result of any one of the following transactions:

- a. Applying the acquisition method (as described in paragraph 805-10-05-4)
- b. Assessing the nature of the difference between the carrying amount of an investment and the amount of underlying equity in net assets of an investee when applying the equity method of accounting in accordance with Topic 323 on investments—equity method and joint ventures
- c. Adopting fresh-start reporting in accordance with Topic 852 on reorganizations.

805-20-15-3 An entity that elects the accounting alternative shall apply all of the related recognition requirements upon election. The accounting alternative, once elected, shall be applied to all future transactions that are identified in paragraph 805-20-15-2.

805-20-15-4 An entity that elects this accounting alternative must adopt the accounting alternative for amortizing **goodwill** in the Accounting Alternative Subsections of Topic 350-20 on intangibles—goodwill and other. If the accounting alternative for amortizing goodwill was not adopted previously, it

should be adopted on a prospective basis as of the adoption of the accounting alternative in this Subtopic. For example, existing goodwill should be amortized on a straight-line basis over 10 years, or less than 10 years if the entity demonstrates that another useful life is more appropriate. However, an entity that elects the accounting alternative for amortizing goodwill is not required to adopt the accounting alternative in this Subtopic.

5. Amend paragraph 805-20-25-1 and add paragraphs 805-20-25-29 through 25-33 and the related heading and the new Subsection title, with a link to transition paragraph 805-20-65-2, as follows:

Recognition

General

> Recognition Principle

805-20-25-1 As of the acquisition date, the acquirer shall recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs 805-20-25-2 through 25-3. However, an entity (the acquirer) within the scope of paragraph 805-20-15-2 may elect to apply the accounting alternative for the recognition of identifiable intangible assets acquired in a business combination as described in paragraphs 805-20-25-29 through 25-32.

Accounting Alternative

805-20-25-29 The guidance in this Subsection applies to entities within the scope of paragraph 805-20-15-2 that elect the accounting alternative for the recognition of identifiable intangible assets acquired in a business combination.

> Identifiable Intangible Assets

805-20-25-30 An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion described in the definition of identifiable. However, under the accounting alternative, an acquirer shall not recognize separately from goodwill the following intangible assets:

- a. Customer-related intangible assets unless they are capable of being sold or licensed independently from other assets of a business
- b. Noncompetition agreements.

805-20-25-31 Customer-related intangible assets often would not meet criterion (a) in paragraph 805-20-25-30 for recognition. Customer-related intangible assets that would meet that criterion for recognition under this accounting

alternative are those that are capable of being sold or licensed independently from the other assets of a business. Examples of customer-related intangible assets are listed in paragraph 805-20-55-20. Many of the customer-related intangible assets that would meet criterion (a) for recognition also would be considered contract-based intangible assets as described in paragraph 805-20-55-31. Customer-related intangible assets that may meet that criterion for recognition include but are not limited to:

- a. Mortgage servicing rights
- b. Commodity supply contracts
- c. Core deposits
- d. Customer information (for example, names and contact information).

805-20-25-32 Contract assets, as used in Topic 606 on revenue from contracts with customers, are not considered to be customer-related intangible assets for purposes of applying this accounting alternative. Therefore, contract assets are not eligible to be subsumed into goodwill and shall be recognized separately.

805-20-25-33 A lease is not considered to be a customer-related intangible asset for purposes of applying this accounting alternative. Therefore, favorable and unfavorable leases are not eligible to be subsumed into goodwill and shall be recognized separately.

6. Add paragraph 805-20-65-2 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2014-18, Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination

805-20-65-2 The following represents the transition and effective date information related to Accounting Standards Update No. 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination*:

- a. The decision to adopt the pending content that links to this paragraph must be made upon the occurrence of the first transaction that is identified in paragraph 805-20-15-2 in fiscal years beginning after December 15, 2015, and the timing of that first transaction determines the effective date of the pending content. If the first transaction occurs in the first fiscal year beginning after December 15, 2015, the pending content that links to this paragraph will be effective for that fiscal year's annual financial reporting and all interim and annual periods thereafter. If the first transaction occurs in fiscal years beginning after December 15, 2016, the pending content that links to this paragraph will be effective in the interim period that includes the date of the transaction and subsequent interim and annual periods thereafter.
- b. Customer-related intangible assets and noncompetition agreements that exist as of the beginning of the period of adoption shall continue to be

subsequently measured in accordance with Topic 350 on intangibles—goodwill and other. That is, existing customer-related intangible assets and noncompetition agreements should not be subsumed into goodwill upon adoption of the pending content that links to this paragraph.

- c. Early application is permitted for any interim and annual period before which an entity's **financial statements are available to be issued.**

7. Amend paragraph 805-20-00-1, by adding the following items to the table, as follows:

805-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contract Asset	Added	2014-18	12/23/2014
Financial Statements Are Available to Be Issued	Added	2014-18	12/23/2014
Lease	Added	2014-18	12/23/2014
Private Company	Added	2014-18	12/23/2014
Public Business Entity	Added	2014-18	12/23/2014
805-20-05-3	Added	2014-18	12/23/2014
805-20-05-4	Added	2014-18	12/23/2014
805-20-15-2 through 15-4	Added	2014-18	12/23/2014
805-20-25-1	Amended	2014-18	12/23/2014
805-20-25-29 through 25-33	Added	2014-18	12/23/2014
805-20-65-2	Added	2014-18	12/23/2014

The amendments in this Update were endorsed and approved for publication by the affirmative vote of four members of the Financial Accounting Standards Board. Messrs. Kroeker, Linsmeier, and Smith dissented.

Messrs. Kroeker, Linsmeier, and Smith dissent from the issuance of this Accounting Standards Update because they do not believe that it is appropriate to finalize an accounting recognition and measurement alternative for private entities while at the same time exploring the same accounting issues for public entities—an apparent acknowledgment that the Board has not concluded that a difference in accounting for private entities is warranted based on differences in the benefits and/or costs of the reported information to stakeholders of private

versus public entities. In the dissenting Board members' view, comparability is a vital qualitative characteristic of decision-useful information with differences in reporting for private and public entities only being justified by differences in the benefits and/or costs of the reported information for private versus public entities; otherwise, the accounting for private and public entities should remain the same.

The Private Company Decision-Making Framework (Guide) specifies the factors that need to be evaluated to justify a difference in accounting or reporting for private companies. The Guide suggests that a difference in accounting for private companies can be justified only when that difference maintains or improves the relevance of reported information for private company users while reducing costs and complexity associated with the preparation, auditing, and use of the information.

Outreach on this issue provided no evidence of differences in the relevance of identifiable intangible assets that are required to be recognized under current GAAP for users of private and public entity financial statements. Expanding the scope of findings in paragraph BC13, the dissenting Board members note that users of both private and public entity financial statements have provided mixed views about the relevance of reported information on identifiable intangible assets. Some users indicated that they generally disregard intangible assets and the associated amortization and do not consider intangible assets any differently than goodwill in their analysis. Other users indicated that, in some circumstances, they do consider the fair value and the subsequent amortization and impairment of intangible assets to be decision-useful information. Users often have similar views when describing the attributes of intangible assets they find most relevant (legally protected, separately transferable, and capable of providing discrete cash flows) but do not all agree on which specific intangible assets are most relevant. Many users note that the relevance of specific intangible assets differs from acquisition to acquisition and among industries and that, for certain acquisitions, the most relevant intangible assets could include customer-related intangible assets and/or noncompetition agreements. Based on that evidence, the dissenting Board members find no basis for justifying a difference in accounting for identifiable intangible assets for private entities. In addition, these Board members note that the Guide indicates that disclosure is never an acceptable substitute for recognition and, therefore, they also question the basis for providing a disclosure alternative for private entities within GAAP as is permitted by the amendments in this Update.

The fundamental reason why this issue was considered by the Private Company Council relates to the costs that are associated with the measurement at fair value of certain intangible assets that are required under existing guidance to be recognized separately from goodwill. The dissenting Board members believe that the measurement costs for these assets have not been demonstrated to be more significant for private entities when compared with public entities. Rather, they question whether the costs associated with the measurement of these types of intangible assets may even be greater for public entities because of the

additional scrutiny of fair values by the regulators of public business entities and their public accountants in the current environment. Therefore, they believe that this issue should not be resolved on a piecemeal basis for private entities only. Instead, they believe that the Board should address the issue at the same time for all entities (private, public business, and not-for-profit entities) to avoid the risk of having an accounting alternative in place for private entities that ultimately may be inconsistent with and overturned by future Board decisions.

In the absence of evidence that costs are higher for private entities or any other compelling justification, the dissenting Board members believe that introducing an accounting alternative for private entities in GAAP through the amendments in this Update conflicts with FASB Concepts Statement No. 8, Chapter 1, *The Objective of General Purpose Financial Reporting*, and Chapter 3, *Qualitative Characteristics of Useful Financial Information*. In Concepts Statement 8, paragraph BC1.30, the Board concluded that “the objective of general purpose financial reports is the same for all entities. However, cost constraints and differences in activities among entities sometimes may lead the Board to permit or require differences in reporting for different types of entities.” Providing for differential accounting for private entities when a justification for the difference has not been established has the potential to introduce bias into the accounting and inefficiencies or inequities into the markets. In the view of the dissenting Board members, if the costs of current GAAP for identifiable intangible assets are justified by the benefits, providing this alternative for private entities hinders the comparison of private and public entities, which leads to less efficient capital allocation. Alternately, if the costs of current GAAP are not justified by the benefits, this alternative continues to require public entities to incur unjustified costs, which creates an inequity for public entities in capital markets.

Messrs. Smith and Kroeker believe, consistent with the PCC’s conclusions on customer-related intangible assets, that a considerable amount of resources is being allocated to the accounting for certain customer-related intangible assets (those that are not capable of being sold or licensed independently) and that the benefits, if any, are not justified when compared to the costs. Thus, Messrs. Smith and Kroeker believe that the Board should consider making an amendment to GAAP for all entities to provide the same alternative for customer-related intangible assets that is provided to private entities by the amendments in this Update. As an alternative to the optionality provided by this Update, Messrs. Kroeker, Linsmeier, and Smith also would consider requiring customer-related intangible assets (other than any favorable or unfavorable contractual agreements) to be included in goodwill for all entities, thus eliminating costs associated with separate accounting, particularly measurement and other related costs. However, Mr. Linsmeier would consider such a change only in the context of addressing the broader issues raised in the penultimate paragraph relating to inconsistencies in the current accounting for relationship-based intangible assets.

The dissenting Board members acknowledge that their preferred approach also may result in the need for the Board to accelerate its reconsideration of the accounting model for goodwill for both public entities and not-for-profit entities, a project that currently is on the Board's agenda. They believe that this would be a positive result because they believe that goodwill externally acquired in a business combination, as calculated today and to the extent that it is accounted for as an asset, declines in value over time. Under today's impairment accounting the decline in value of externally acquired goodwill often is not recognized because the current impairment model writes down goodwill to a lower impaired amount that considers not only existing externally acquired goodwill but also includes both internally generated goodwill existing at the date of the acquisition and goodwill created or regenerated by investments subsequent to the acquisition. The dissenting Board members see no basis for a view that goodwill should be treated as an indefinite-lived asset subject only to impairment when other similar, but more clearly observable and measurable, intangible assets that are likewise regenerated (for example, intellectual property such as patents under which cash flows are regenerated by future investment in new technology) often are treated as having finite lives and thus are amortized.

The concerns of the dissenting Board members about the relevance and costs of current guidance also are driven by their view that current accounting guidance is inconsistent for certain similar relationship-based intangible assets. For example, under current guidance, customer service capacity, new customer contracts under negotiation, and assembled work force are included in goodwill, whereas other customer relationships are recognized separately as identifiable intangible assets. Current accounting guidance also results in ascribing value as "separate assets" to customer relationships that are incapable of being realized in any manner separately and apart from the continued operations of the entity. Furthermore, the dissenting Board members note that current accounting guidance inconsistently requires entities to account for cash inflows that an entity expects to receive in the form of potential future sales. In some cases, these potential future net cash flows are separately recognized as "customer relationship intangible assets," and in other cases they are included in goodwill. In addition, the accounting can vary depending on whether the expected future sales are to certain existing customers or to other existing and all future customers. They believe that basing the accounting on these distinctions is overly complex, which makes it difficult to apply and results in arbitrary recognition and measurement decisions that limit the decision usefulness of information provided to users.

For these reasons, the dissenting Board members believe that, despite the fact that the current guidance has been in effect for only a relatively short period of time, the Board should evaluate the existing business combination guidance relating to customer-related intangible assets to determine whether complexity can be reduced for all entities while maintaining or improving the relevance of and consistency of items recognized as identifiable relationship-based intangible

assets and goodwill. Mr. Linsmeier also would find it important to consider convergence with International Financial Reporting Standards in such deliberations.

Members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the PCC's considerations in reaching the conclusions in this Update. It includes the Board's basis for endorsing the PCC's conclusions when needed to supplement the PCC's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual PCC members and Board members gave greater weight to some factors than to others.

BC2. The amendments in this Update provide guidance about an accounting alternative to recognize or otherwise consider the fair value of intangible assets as a result of any in-scope transaction. An entity within the scope of this Update that elects the accounting alternative is not required to recognize separately (a) customer-related intangible assets unless they are capable of being sold or licensed independently from the other assets of the business and (b) noncompetition agreements. An entity should continue to follow the applicable requirements in Topics 350 and 805 to account for other aspects relating to identifiable intangible assets that are not specifically referenced in this Update.

Scope

BC3. The PCC and the Board decided that the scope of this Update should be consistent with the scope of the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies*. Therefore, the scope of this Update includes all entities except public business entities and not-for-profit entities. The PCC and the Board acknowledge that users of financial statements, such as regulators and lenders, may request that an entity not apply the accounting alternative even if the entity is otherwise eligible. The PCC and the Board also acknowledge that if an entity that elects this accounting alternative is subsequently subject to public business entity reporting requirements, it may be required to recast prior periods as if the accounting alternative had not been elected.

BC4. To achieve comparability among entities that elect to apply the accounting alternative, the PCC and the Board decided that the recognition requirements within this Update should be applied together and not individually. That is, adoption of the accounting alternative requires an entity to no longer recognize both certain customer-related intangible assets and noncompetition agreements. The PCC and the Board also decided that the accounting alternative, if elected, should apply to all in-scope transactions entered into after the date of adoption.

Background Information

BC5. Under Topic 805, an acquirer recognizes assets acquired and liabilities assumed in a business combination at their acquisition-date fair values, including all intangible assets that are identifiable. According to the definition in the Master Glossary, an asset is identifiable if it meets either of the following criteria:

1. It arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
2. It is separable, that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset, or liability, regardless of whether the entity intends to do so.

BC6. The PCC added this issue to its agenda on February 12, 2013, in response to feedback from private company stakeholders indicating that the benefits of the current accounting for identifiable intangible assets acquired in a business combination often do not justify the related costs. While feedback was mixed, outreach with users of private company financial statements illustrated that the recognition and measurement of certain identifiable intangible assets separately from goodwill in a business combination does not always provide decision-useful information. Although many users acknowledged that they consider some intangible assets separately in their analysis, some indicated that many intangible assets that currently are recognized separately are not considered any differently than goodwill. Users also noted that the relevance of separately recognized intangible assets diminishes in periods after a business combination because the carrying amounts of the intangible assets no longer represent their fair values. In addition, the PCC received input from private company stakeholders through various channels¹ indicating concerns about the cost and complexity of estimating the fair value of certain identifiable intangible assets.

BC7. The feedback indicated that the fair value of some identifiable intangible assets is relevant to some users of private company financial statements. Many users suggested that intangible assets that are legally protected and that can be sold or can generate discrete cash flows, such as technology, are the most relevant. Some users, particularly lenders, indicated that intangible assets are most relevant when their cash flows can be reliably estimated or they can be sold in liquidation.

¹This input was received through (a) private company roundtables conducted by the Board, (b) written submissions to the Blue-Ribbon Panel on Standard Setting for Private Companies and the Financial Accounting Foundation's Plan to Establish the Private Company Standards Improvement Council, and (c) the Private Company Financial Reporting Committee.

BC8. Some users indicated that information about customer-related intangible assets is not decision useful because those assets generally are not transferable or separable from the entity and because their values depend on too many variables that may be overly subjective. Many users stated that noncompetition agreements are important to a business combination but that the fair value of noncompetition agreements was not decision useful.

BC9. On May 7, 2013, the PCC reached a consensus to propose an elective accounting alternative for private companies to account for identifiable intangibles in a business combination. The Board endorsed the decisions by the PCC and, on July 1, 2013, issued an Exposure Draft, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination*, that described an accounting alternative that would limit the separate recognition to intangible assets with noncancelable contractual terms or other legal rights. The proposed alternative was intended to reduce the cost and complexity of preparing financial statements while continuing to provide decision-useful information about intangible assets acquired in a business combination.

BC10. The PCC discussed the feedback received from the 44 comment letters on the Exposure Draft at its October 1, 2013 meeting. Many respondents supported the efforts to provide an alternative for private companies in accounting for identifiable intangible assets in a business combination. Those respondents stated that the proposed alternative could reduce overall costs and complexity for private companies in comparison to existing GAAP. Some respondents indicated specific concerns about the distinction between contractual rights with noncancelable contract terms and contractual rights with cancelable contract terms. The breakout of contracts between those that are cancelable and those that are not could potentially add costs and complexity when compared to existing GAAP. Some respondents also pointed out that the distinction between patented (a legal right) technology and unpatented technology may be difficult to make, because many technologies include a mixture of patents, unpatented technology, trade secrets, and know-how.

BC11. Under the Exposure Draft's proposed amendments, in measuring the identifiable intangible assets that arise from contractual rights, an entity would have considered only market participant assumptions about the remaining noncancelable contract term and would not have considered any potential contractual renewals or cancellations that under existing GAAP ordinarily would have been considered in determining the fair value. Some respondents indicated that this aspect of the alternative may add complexity because of the creation of a new measurement methodology that would represent neither cost nor fair value. They also questioned the usefulness of the information derived from applying the proposed alternative because, in their view, the new measurement methodology would create inconsistencies and comparability issues and ultimately would not properly reflect the value of such intangible assets. Respondents also stated that additional costs would result from entities needing to distinguish between noncancelable contractual rights and other legal rights. As

a result, some respondents indicated that the different measurement guidance for other legal rights and intangible assets that arise from contractual rights with noncancelable contractual terms would generate more complexity and inconsistencies in the measurement process.

BC12. As a result of the feedback received on the Exposure Draft, the PCC and the Board ultimately decided to perform additional outreach to develop additional alternatives. The additional research included an alternative to subsume all intangible assets into goodwill and an alternative that would recognize separately from goodwill only intangible assets that are capable of being sold or capable of generating separate and discrete cash flows.

BC13. Users of private company financial statements, including lenders and equity investors, had mixed views about the usefulness of information on the fair value of intangible assets. Some users indicated that they generally disregard intangible assets and the associated amortization and do not consider intangible assets any differently than goodwill in their analysis. Other users indicated that they do consider the information, fair value, and subsequent impairments of intangible assets to be decision-useful information in some circumstances. Users often had similar views when describing the attributes of intangible assets they find most relevant (legally protected, separately transferable, and capable of providing discrete cash flows) but did not all agree on which specific intangible assets are most relevant. Many users noted that the relevance of intangible assets differed from acquisition to acquisition and among industries.

BC14. After reviewing the feedback, the PCC asked the FASB staff to conduct further research and analysis on (a) recognizing and measuring separately from goodwill only those intangible assets in a business combination that are capable of being sold or licensed independently from other assets of the business as well as (b) alternatives focusing solely on types of customer-related intangible assets that may not warrant recognition and measurement separate from goodwill. Although many stakeholders agreed with the general principle of separately recognizing only intangible assets that are capable of being sold or licensed independently from the other assets of a business, many of these stakeholders raised concerns that such a principles-based alternative could involve significant costs and complexities in determining (and supporting in an audit) which intangibles met the criteria for recognition and which did not. Because customer-related intangible assets and noncompetition agreements are the intangible assets that typically are not capable of being sold or licensed independently from the other assets of a business, those stakeholders stated that the alternative should focus on those intangible assets. They also pointed out that customer-related intangible assets and noncompetition agreements are among the most subjective and difficult intangible assets to measure and that their value is disregarded by many users. Some PCC and Board members also stated that customer-related intangible assets are similar to and often inseparable from assembled workforce, which is already subsumed into goodwill. Furthermore, some stakeholders stated that reflecting a gain in the income statement

associated with bargain purchases does not provide relevant information and point out that no longer separately recognizing certain customer-related intangible assets and noncompetition agreements could reduce the number of transactions (or the amount) that result in the recording of a bargain purchase gain. Some stakeholders did not support an alternative focused only on customer-related intangible assets and noncompetition agreements because, in their view, it would not reduce costs enough to warrant an accounting alternative.

BC15. The PCC considered allowing entities not to recognize any intangible assets separately from goodwill on the basis that such an alternative would lead to a significant reduction in cost and complexity of preparing financial statements. However, there were also a number of significant follow-on accounting issues that would have arisen in an alternative that subsumed all intangible assets into goodwill, including developing a new model for testing goodwill for impairment, addressing how to account for subsequent sales of intangible assets and businesses, possibly introducing complexities in impairment testing for long-lived tangible assets, determining how to account for certain internally-generated intangible assets that are recognized before a business combination, and properly defining which intangible assets should be eligible for subsuming into goodwill. Ultimately, the PCC and the Board determined that certain intangible assets are relevant to many financial statement users and, therefore, should continue to be recognized separately from goodwill. In addition, the PCC and the Board determined that subsuming all intangible assets into goodwill could misrepresent the economics of an acquisition by grouping dissimilar items with different useful lives, risks, and cash flows. Some PCC and Board members also stated that subsuming all intangible assets into goodwill, including those that often provide relevant information, would be inconsistent with the Private Company Decision-Making Framework.

BC16. On the basis of input from users, preparers, and public accountants of private company financial statements, the PCC developed this accounting alternative that introduces an alternative method for accounting for identifiable intangible assets in a business combination. An entity within the scope of this Update can elect not to recognize (a) customer-related intangible assets unless they are capable of being sold or licensed independently from the other assets of a business and (b) noncompetition agreements. The PCC and the Board noted that although the post-implementation review of FASB Statement No. 141 (revised 2007), *Business Combinations*, concluded that the Statement's principles and requirements are understandable and generally can be applied as the Board intended, the report found that the Statement introduced more complexity and costs to accounting for a business combination than were expected, especially for small and medium-sized entities. The PCC and the Board concluded that this alternative will, for private companies, avoid the unnecessary costs and complexity encountered when measuring certain customer-related intangible assets and noncompetition agreements. Furthermore, because customer-related intangible assets and noncompetition

agreements often do not meet the typical characteristics of intangible assets that users find most relevant (legally protected, separately transferable, and capable of providing discrete cash flows), the PCC and the Board concluded that this alternative will not result in a significant reduction in decision-useful information.

Recognition

BC17. The PCC and the Board decided that an entity within the scope of this Update can elect not to separately identify and recognize (a) customer-related intangible assets that are not capable of being sold or licensed independently from the other assets of a business and (b) noncompetition agreements. Customer-related intangible assets often will not meet the criterion for recognition. Customer-related intangible assets that may meet the criterion for recognition include mortgage servicing rights, commodity supply contracts, core deposits, and customer information (for example, names and contact information).

BC18. The PCC and the Board concluded that assessing whether a customer-related intangible asset is capable of being sold or licensed independently from the other assets of a business will not be costly to reporting entities that adopt this alternative because it generally is clear that most customer-related intangible assets do not meet the criterion for recognition. The examples of customer-related intangible assets that may meet the criterion for recognition (mortgage servicing rights, commodity supply contracts, core deposits, and customer information) represent relationships and information that often can be sold to third parties without input from the customer or their agreement to the transfer. If the transfer of a customer relationship is dependent on the decisions of a customer, it would be clear that a reporting entity is not capable of selling that customer-related intangible asset separately from the other assets of the business. Furthermore, the PCC and the Board noted that private companies generally are aware of whether their customer-related intangible assets can be sold and transferred to another entity even if the private company has no intention of selling the customer-related intangible assets.

BC19. The PCC and the Board chose not to require an assessment of whether a noncompetition agreement is capable of being sold or licensed separately from the other assets of a business because, in their view, noncompetition agreements will seldom, if ever, meet the criteria for recognition. Some concerns were raised, however, that while many reporting entities and public accountants consider noncompetition agreements to be part of most business combinations, to other reporting entities and public accountants, most noncompetition agreements represent transactions separate from a business combination. Noncompetition agreements are not specifically discussed in the guidance on determining what is part of a business combination transaction. To date, however, the diversity in practice has not resulted in significantly different financial reporting outcomes. As a result, the PCC and the Board decided not to provide additional guidance to clarify whether noncompetition agreements are

part of a business combination. The PCC and the Board concluded that this accounting alternative is clearly defined as applying to intangible assets acquired in a business combination. While acknowledging that this alternative may highlight an existing diversity in practice by resulting in different financial reporting outcomes, the PCC and the Board concluded that if changes or clarifications are made to the guidance on determining what is part of a business combination transaction, such changes should apply to all reporting entities rather than just private companies adopting this alternative and could be examined in a separate project by the Board.

BC20. The PCC and the Board concluded that under this alternative favorable customer contracts are eligible to be subsumed into goodwill because they are intangible assets. However, unfavorable customer contracts would continue to be recognized because they represent liabilities and therefore are not within the scope of this Update. Customer contracts and relationships are typically recognized, but the concept of “at market” is a broad range and customer contracts generally are considered to fall within the range that is considered “at market.” Therefore, most customer contracts do not fall under the favorable-unfavorable contract guidance. Because user feedback generally indicated that many users did not believe that the fair value of customer contracts was decision useful unless the contract could be sold separately from the other assets of a business, the PCC and the Board concluded that it was appropriate to subsume favorable customer contracts into goodwill. It also noted that subsuming a significant favorable contract into goodwill will not necessarily create subsequent impairment issues. FASB Accounting Standards Update No. 2014-02, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill*, allows reporting entities to choose a life for goodwill that is less than 10 years. The PCC and the Board concluded that significant favorable contracts with a life shorter than 10 years may justify a shorter useful life for goodwill. As a result, the PCC and the Board concluded that favorable customer contracts will be included within the scope of this Update.

BC21. The PCC and the Board decided that contract assets as defined in the Master Glossary and used in Topic 606, Revenue from Contracts with Customers, are not considered intangible assets eligible to be subsumed into goodwill and therefore are not within the scope of this Update. In certain situations, an entity satisfies a performance obligation but does not have an unconditional right to consideration, for example, because it first needs to satisfy another performance obligation in the contract. That leads to recognition of a contract asset. Once an entity has an unconditional right to consideration, it should present that right as a receivable separately from the contract asset and account for it in accordance with other guidance (for example, Topic 310, Receivables). As a result, the PCC and the Board concluded that it is inappropriate to classify a contract asset as a customer-related intangible asset at the acquisition date when the contract asset will eventually be reclassified as a receivable.

Disclosure

BC22. The PCC and the Board concluded that the current disclosure requirements in Topic 805 will result in sufficient disclosures about intangible assets that do not require separate recognition. This includes a qualitative description of intangible assets that do not qualify for separate recognition. The PCC noted that requiring additional qualitative disclosure would likely result in boilerplate information that is unlikely to provide decision-useful information to users. The PCC also expressed concern that any cost savings associated with not separately recognizing certain intangible assets would be offset by the costs of providing additional qualitative or quantitative disclosures.

Transition

BC23. The PCC and the Board decided that if an entity elects the accounting alternative, the entity should apply the amendments in this Update prospectively for all in-scope transactions entered into after the effective date with no option to apply them retrospectively. The PCC and the Board considered but rejected retrospective application because the different recognition principles could be overly burdensome for preparers to apply retrospectively and may not provide sufficient benefits to users to justify the costs to preparers.

BC24. Under this accounting alternative, an entity should continue to recognize and measure customer-related intangible assets and noncompetition agreements that exist as of the beginning of the period of adoption in accordance with Topic 350, Intangibles—Goodwill and Other. The PCC and the Board considered requiring any intangible asset that exists as of the beginning of the period of adoption to no longer be separately recognized and, therefore, to be subsumed into goodwill. However, the PCC and the Board concluded that because the cost of initially measuring the fair value of those customer-related intangible assets and noncompetition agreements has already been incurred, continuing to recognize and measure them separately will not result in significant additional costs.

BC25. The decision to adopt the accounting alternative in this Update must be made upon the occurrence of the first transaction within the scope of this accounting alternative in fiscal years beginning after December 15, 2015, and the effective date of adoption depends on the timing of that first in-scope transaction. If the first in-scope transaction occurs in the first fiscal year beginning after December 15, 2015, the elective adoption will be effective for that fiscal year's annual financial reporting and all interim and annual periods thereafter. If the first in-scope transaction occurs in fiscal years beginning after December 15, 2016, the elective adoption will be effective in the interim period that includes the date of that first in-scope transaction and subsequent interim and annual periods thereafter. The PCC and the Board decided to permit early adoption so that companies can take advantage of the accounting alternative as soon as possible.

Linkage to Accounting Alternative in Accounting Standards Update No. 2014-02

BC26. The PCC and the Board decided that if an entity elects the accounting alternative in this Update, the entity must adopt the private company accounting alternative for amortizing goodwill as described in Update 2014-02. If the accounting alternative for amortizing goodwill was not adopted previously, it should be adopted on a prospective basis as of the adoption of the accounting alternative in this Update. However, an entity that elects the accounting alternative in Update 2014-02 is not required to adopt the accounting alternative in this Update.

BC27. The PCC and the Board considered not linking this accounting alternative to the accounting alternative described in Update 2014-02. Independently, each issue will result in a reduction in cost and complexity for private companies while still resulting in decision-useful information for users of private company financial statements. However, the adoption of this accounting alternative will result in intangible assets that are wasting in nature being subsumed into goodwill. The PCC and the Board concluded that it would not be appropriate to subsume finite-lived intangible assets into goodwill unless goodwill is amortized. In addition, the adoption of this accounting alternative likely will result in a higher goodwill balance than would result under current GAAP; therefore, entities will be exposed to a higher risk of goodwill impairment. By linking the adoption of this accounting alternative to the accounting alternative described in Update 2014-02, a private company will reduce its risk for goodwill impairment by amortizing goodwill (which would include intangible assets that are not recognized separately).

Effect on User-Relevance and Cost under the Private Company Decision-Making Framework

BC28. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. The Private Company Decision-Making Framework provides considerations for the PCC and the Board in making user-relevance and cost-benefit evaluations for private companies under the existing conceptual framework. The Private Company Decision-Making Framework is a tool to help the Board and the PCC identify differential information needs between users of public company financial statements and users of private company financial statements and to identify opportunities to reduce the relatively greater cost and complexity of preparing financial statements for private companies in accordance with GAAP. The PCC's and the Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because

there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC29. The PCC and the Board concluded that this accounting alternative, if elected, will continue to provide decision-useful information to the users of private company financial statements, while reducing the cost and complexity associated with the measurement of certain identifiable intangible assets. Intangible assets other than customer-related intangibles that are not capable of being sold or licensed independently from other assets of a business and noncompetition agreements will continue to be recognized separately from goodwill. Although the input from private company stakeholders was mixed, the PCC determined that intangible assets that are legally protected, separately transferable, and capable of providing discrete cash flows are those that users typically find most relevant. For users who find relevance in intangible assets that are no longer recognized as a result of adopting this accounting alternative, the PCC and the Board concluded that qualitative disclosures currently provided under Topic 805 will continue to provide the desired information without the undue cost and complexity associated with measuring the intangible assets. The Private Company Decision-Making Framework indicates that lenders and other creditors are most concerned about the financial statements amounts and notes that affect the reported amount of cash, liquidity, and cash flows from operations available to service debt. The PCC and Board believe that not recognizing noncompetition agreements and limiting the recognition of customer-related intangible assets to those that can be sold or licensed independently of other assets of a business focus the cost of determining identifiable intangible assets on those intangible assets that have potential to provide relevant information on potential cash flows to service debt.

BC30. Because fewer intangibles will be recognized separately in a business combination, this accounting alternative will reduce the cost and complexity of measuring intangible assets acquired in a business combination and, therefore, reduce the cost and complexity of preparing financial statements.

BC31. The PCC and the Board concluded that, overall, this accounting alternative for identifiable intangible assets acquired in a business combination is responsive to the needs of private companies and their stakeholders. The PCC and the Board also concluded that the alternative recognition guidance will continue to provide relevant information to the users of private company financial statements, while providing a reduction in the cost and complexity associated with the measurement of certain identifiable intangible assets. Therefore, this Update meets the overall objective of the Private Company Decision-Making Framework for addressing the needs of private company stakeholders.