FINANCIAL ACCOUNTING STANDARDS BOARD

# Memo

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| Memo No. | **Issue Summary No. 1, Supplement No. 8** |
| Issue Date | **September 5, 2014** |
| Meeting Date(s) | **PCC Meeting**<br>**September 16, 2014** |

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| Contact(s) | **Adam M Smith** | Co-Author | Ext. 424 |
| | **Elizabeth Gagnon** | Co-Author | Ext. 312 |
| | **Michael Cheng** | PCC Coordinator | Ext. 236 |
| | **Jeffrey Mechanick** | Assistant Director | Ext. 311 |

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| Project | **PCC Issue No. 13-01A, "Accounting for Identifiable Intangible Assets in a Business Combination"** |
| Project Stage | **Redeliberations** |
| Issue(s) | **Consideration of Issues Related to Non-Competition Agreements (NCA), Favorable and Unfavorable Contracts, and Contract Assets** |

## Objective of this Memo

1. The purposes of this memo are to:

   (a) Assist the PCC in assessing the following issues that were raised at its July 15, 2014 meeting:

   (i) Determining whether an NCA is part of a business combination or a separate transaction

   (ii) Differing treatment between favorable and unfavorable contracts

   (iii) Considering whether contract assets are intangible assets eligible to be subsumed into goodwill

   (b) Assist the PCC in deciding whether to reaffirm its tentative decisions made at its July 15, 2014 meeting relating to:

   (i) Disclosure

   (ii) Transition

(iii) Linkage with Accounting Standards Update No. 2014-02, *Intangibles—Goodwill and Other (Topic 350), Accounting for Goodwill*

(c) Consider the following additional issues:

(i) Whether this Issue should be reexposed

(ii) Effective date and early application.

2. Issues 1 through 3 will be discussed at the September 16, 2014 meeting if the PCC decides to pursue either Alternative B2 or Alternative A' as discussed in Issue Summary No. 1, Supplement No. 7. Issues 4 through 8 will only be discussed at this meeting if the PCC decides to pursue only Alternative B2.

## Background

3. At its July 15, 2014 meeting, the PCC was provided with additional research, analysis, and feedback from outreach on the accounting for identifiable intangible assets in a business combination (Issue Summary No. 1, Supplement No. 5). At that meeting, the PCC tentatively voted for Alternative B2, which was:

*Do not recognize the following intangible assets:*

*1. Non-competition agreements (NCA)*

*2. Customer-related intangible assets (CRI) that are not capable of being sold or licensed independently from the other assets of a business.*

*CRIs often <u>would not</u> meet the criterion for recognition. CRIs that may meet the criterion for recognition include mortgage servicing rights, commodity supply contracts, and core deposits.*

4. The PCC directed the staff to perform additional research regarding several issues that were raised at the meeting. A summary of each issue is presented below.

## Issue 1: Determining Whether an NCA Is Part of a Business Combination or a Separate Transaction

5. Paragraphs 805-10-25-20 through 25-22 of the Accounting Standards Codification requires acquirers to identify any amounts that are not part of what the acquirer and the acquiree exchanged in the business combination. These elements include settlement of preexisting relationships and other arrangements that should be accounted for in accordance with the relevant generally accepted accounting principles rather than included in the business combination accounting. The primary principle behind this guidance is that transactions entered into by or on behalf of the acquirer or primarily for the benefit of the acquirer or the combined entity, rather than primarily for the benefit of the acquiree (or its former owners) before the business combination, should be accounted for as separate transactions.

6. Paragraph 805-10-55-18 provides further implementation guidance related to determining what is part of a business combination. In making such determinations, this guidance suggests that reporting entities consider the reasons for the transaction, who initiated the transaction, and the timing of the transaction.

7. NCAs are not specifically discussed in the guidance on determining what is part of a business combination transaction and the guidance is currently interpreted differently by stakeholders. To date, however, the diversity in practice has not resulted in significantly different financial reporting outcomes.

8. If the PCC moves forward with an alternative for private companies wherein NCAs would not be recognized separately from goodwill in a business combination, the existing diversity in practice would result in different financial reporting outcomes. However, it is unclear from outreach how significant and/or pervasive the different financial reporting outcomes would be.

| Question for the Private Company Council |
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| Does the PCC wish to provide additional guidance to clarify if/when NCAs are part of a business combination transaction versus when they represent separate transactions? |

***Staff Analysis***

9. The staff has performed research and outreach to better understand the differing perspectives regarding whether NCAs are part of a business combination transaction or whether they represent separate transactions.

10. Some stakeholders believe that an NCA negotiated as part of a business combination is typically initiated by the acquirer to protect the interests of the acquirer and the combined entity. They point out that most NCAs do not exist prior to the business combination and exclusively cover a period of time after the business combination, only benefitting the acquirer and combined entity. As such, they believe that most NCAs initiated during negotiations for a business combination represent separate transactions under the guidance of paragraph 805-10-25-21.

11. Other stakeholders believe that non-compete clauses are typically part of a business combination transaction as they are inseparable from the transaction. They note that selling shareholders typically would not enter into an NCA absent selling the business and that the acquirer may not be willing to purchase the business without an NCA. These stakeholders believe that if the NCA could not or would not be entered into absent the business combination, it would be inappropriate to treat the NCA as a separate transaction.

12. Some stakeholders also point out that if entering into an NCA allows selling shareholders to sell their business for a more favorable price, then the NCA does not represent a separate transaction that primarily benefits the acquirer or the combined entity. Some stakeholders also note that sellers may request an NCA in certain circumstances in which it may result in a more favorable tax treatment.

13. While there is existing diversity in practice related to determining whether an NCA is part of a business combination, it is unclear how pervasive the diversity in practice is, since it does not currently result in significantly different financial reporting outcomes. For example, an acquirer might pay $10 million for a target, including an NCA with a fair value of $1 million. If the NCA is treated as part of the business combination, the allocable purchase price will be $10 million. In performing a purchase price allocation, $1 million will be allocated to the NCA and $9 million will be allocated to tangible assets,

financial assets, other intangible assets, and goodwill. If the NCA is considered a separate transaction, it will be recognized at its fair value of $1 million and the allocable purchase price for the business will be $9 million. The $9 million will be allocated to tangible assets, financial assets, intangible assets (excluding the NCA), and goodwill.

14. Some stakeholders believe that most reporting entities hold the view that NCAs with selling shareholders that are negotiated as part of a business combination should be recognized as part of the business combination and question whether there are a significant number of reporting entities and/or auditors who require NCAs to be recognized as separate transactions. However, the staff is aware of one major accounting firm whose guidance concludes that most NCAs should be accounted for as transactions separate from a business combination.

15. This diversity in practice also exists under IFRS. For example, the IFRS Discussion Group, which advises the Accounting Standards Board of Canada, discussed this issue on June 13, 2013. However, the group did not recommend that the Accounting Standards Board of Canada or the IASB take any further action because eliminating the diversity in practice would not improve financial reporting.

*Staff Recommendation*

16. The staff does not recommend that the PCC provide guidance on what is part of a business combination as part of this alternative.

17. The staff notes that PCC Issue 13-01A's scope is clearly defined as applying to intangibles acquired in a business combination. The staff believes that it would be beyond the scope of PCC Issue 13-01A to include guidance on which intangibles are part of a business combination versus which intangibles represent separate transactions.

18. While the PCC alternative would highlight an existing diversity in practice by resulting in different financial reporting outcomes, the diversity in practice was not introduced by the PCC. As such, the staff believes that if changes or clarifications are made to the guidance on determining what is part of a business combination, 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.

## Issue 2: Treatment of Favorable and Unfavorable Customer Contracts

19. Some concerns were raised at the July PCC meeting regarding the potential disconnect between treatment of favorable and unfavorable customer contracts. Under current GAAP, favorable and unfavorable contracts are measured as the lesser of the following two amounts:

    (a) The amount by which the contract is favorable or unfavorable from the perspective of the acquirer when compared with pricing for current market transactions for the same or similar items

    (b) The amount of any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavorable.

20. As an example, consider a customer contract with three years remaining in its term that is favorable to an acquiree. The contract might be expected to generate an additional $1 million in excess profit over the three-year term as its terms differ from current market prices. However, if the counterparty to the contract can cancel the contract by paying $200,000, the fair value of the favorable contract would be $200,000.

21. Since liabilities are outside of the scope of PCC Issue 13-01A, unfavorable contracts would continue to be recognized as liabilities, while favorable customer contracts could be subsumed into goodwill if they are not capable of being sold independently from the other assets of a business.

| **Question for the Private Company Council** |
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| Does the PCC wish to scope favorable contracts out of PCC Issue 13-01A? |

### *Staff Analysis*

22. The staff notes that favorable and unfavorable customer contracts are occasionally recognized in purchase accounting under current GAAP, especially in certain industries and in circumstances in which one party to a contract has significantly more power to negotiate favorable terms. However, for most companies and in most industries, favorable and unfavorable customer contracts are fairly uncommon. The most common

favorable and unfavorable contracts are above-market and below-market leases, which would not be affected by Alternative B2, which focuses only on customer-related intangibles and NCAs.

23. In the staff's outreach to stakeholders, users were generally interested in the recognition of loss-making or onerous contracts. They believe that information on these liabilities was useful in understanding the business combination.

24. Similar to perspectives on intangible assets in general, user views were mixed with regard to favorable contract intangibles. However, generally users were interested in favorable contracts only if they were capable of being sold or licensed separately from the other assets of a business. If a favorable contract could not be transferred and could only be fulfilled by the acquirer in a business combination, users were generally supportive of subsuming its value into goodwill.

*Staff Recommendation*

25. The staff does not recommend scoping favorable contracts out of the PCC alternative considering the following:

    (a) Recognition of favorable and unfavorable customer contracts are uncommon under existing GAAP. Customer contracts and customer relationships are typically recognized, but they are generally considered to be "at market", and therefore do not fall under the favorable/unfavorable contract guidance.

    (b) Stakeholders in the staff's outreach were interested in fair value information about onerous or loss-making contracts but generally did not find information on favorable contracts to be useful unless the contract could be sold independently of the other assets of a business.

    (c) Subsuming a significant favorable contract into goodwill would not necessarily create issues with subsequent impairment. PCC Issue 13-01B allows reporting entities to choose a life for goodwill that is less than 10 years and the staff believes that significant favorable contracts with a life shorter than 10 years would indicate a shorter life should be used.

## Issue 3: Consideration of Whether Contract Assets Are Intangible Assets Eligible to Be Subsumed into Goodwill

26. Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, defines a contract asset 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).

27. The definition of a contract asset is a new term defined in the Master Glossary of the Codification and will be used in Topic 606 once the guidance in Update 2014-09 becomes effective. This issue considers whether contract asset is within the scope of this PCC Issue 13-01A.

| **Question for the Private Company Council** |
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| Does the PCC want to include contract assets as defined in Update 2014-09 within the scope of PCC Issue 13-01A? |

*Staff Analysis*

28. Update 2014-09 distinguishes between a contract asset and a receivable based on whether the receipt of the consideration is conditional on something other than the passage of time. A contract asset and a receivable both represent the entity's right to consideration. Update 2014-09 indicates that an entity shall assess a contract asset for impairment in accordance with Topic 310, Receivables.

29. When an entity performs first by satisfying a performance obligation before a customer performs by paying the consideration, the entity has a contract asset—a right to consideration from the customer in exchange for goods or services transferred to the customer. In many cases, that contract asset is an unconditional right to consideration—a receivable—because only the passage of time is required before payment of that consideration is due. However, in other cases, 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. The distinction between a contract asset and a receivable was made in Update 2014-09 because doing so provides users of financial statements with relevant information about the risks associated with the entity's rights in a contract. That is because although both would be subject to credit risk, a contract asset also is subject to other risks, for example, performance risk.

30. If an entity has recognized 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 or IFRS 9).

31. The Basis for Conclusions in Update 2014-09 indicates (paragraph BC63) that a contract asset would meet the definition of a financial asset in accordance with IFRS 9 and the staff does not believe that a contract asset is a customer-related intangible asset.

32. Unlike intangible assets that are either amortized over its useful life or indefinite lived, contract assets will generally eventually become a receivable and the entity will have an unconditional right to cash for that asset. Update 2014-09 requires that a contract asset is reclassified as a receivable when the entity's right to consideration is unconditional other than the passage of time. Therefore, the staff believes that it would be inappropriate to classify a contract asset as a customer-related intangible asset at the acquisition date when the asset will eventually be reclassified as a receivable.

*Staff Recommendation*

33. The staff believes that contract assets are not customer-related intangible assets and that they should not be eligible to be subsumed into goodwill under the proposed alternative. However, as there is the potential for confusion, the staff recommends that the PCC explicitly state that contract assets are not within the scope of PCC Issue 13-01A and are not eligible to be subsumed into goodwill.

## Issue 4: Disclosure

34. At its July 15, 2014 meeting, the PCC tentatively decided that an entity would be required to disclose the nature of intangible assets that are not recognized separately from goodwill as a result of applying the accounting alternative. To enhance those disclosures, the PCC tentatively decided not to prescribe specific disclosures for entities to include in their financial statements. However, the PCC tentatively decided to include some examples of the types of disclosures an entity may consider. Examples include:

    (a) Attrition rate

    (b) Length of non-compete agreements

    (c) Contractual or non-contractual CRIs

    (d) Contract terms.

35. This list is not intended to be all-inclusive. The examples are intended only to illustrate the objective of the disclosures. This issue considers whether the PCC would like to reaffirm its tentative decision about disclosure.

| Question for the Private Company Council |
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| Does the PCC want to reaffirm its tentative decision that an entity would be required to disclose the nature of identifiable intangible assets that are not recognized separately from goodwill? |

*Staff Analysis*

*Alternative 1: No Additional Disclosure*

36. Proponents of Alternative 1 believe that no additional disclosure is necessary because Alternative B2 that was decided by the PCC would not result in a significant change to GAAP and the current disclosure requirements in Topic 805 would result in sufficient disclosures about intangible assets that do not require separate recognition. Paragraph 805-30-50-1 states:

> Paragraph 805-10-50-1 identifies one of the objectives of disclosures about a business combination. To meet that objective, the acquirer shall

> disclose all of the following information for each business combination that occurs during the reporting period:
>
> a. A qualitative description of the factors that make up the goodwill recognized, such as expected synergies from combining operations of the acquiree and the acquirer, <u>intangible assets that do not qualify for separate recognition</u>, or other factors. [Emphasis added.]

37. Proponents believe that additional qualitative disclosure of intangible assets that would no longer be recognized would result in boilerplate information that is unlikely to provide decision-useful information to users. Proponents also believe that if disclosure of those intangible assets is important to users, then the value of those intangible assets should be recognized in the financial statements.

38. Opponents of Alternative 1 believe that existing disclosures do not provide sufficient information to users about intangible assets that are no longer recognized. The feedback indicated that some users of financial statements do find information about CRIs and NCAs to be useful.

*Alternative 2: Disclose about the nature of intangible assets that are not recognized separately from goodwill as a result of applying Alternative B2*

39. Under Alternative 2, the PCC would reaffirm its tentative decision that an entity would be required to disclose the nature of identifiable intangible assets acquired but not recognized under Alternative B2. To enhance those disclosures, the final standard would not prescribe specific disclosures for entities to include in their financial statements. However, examples that demonstrate the types of disclosures an entity may consider would include:

    (a) Attrition rate

    (b) Length of non-compete agreements

    (c) Contractual or non-contractual CRIs

    (d) Contract terms.

40. This list is not intended to be all-inclusive. The examples are intended only to illustrate the objective of the disclosures.

41. Proponents of Alternative 2 believe that disclosure of information about the nature of identifiable intangible assets acquired but not recognized would provide financial statement users with sufficient information about non-separately recognized intangible assets that would serve as a signal to alert financial statement users to the existence of intangible assets that are subsumed into goodwill. Proponents believe that disclosure of information by private companies could help some users to identify items that could require further discussion with management without significant costs to preparers.

42. Opponents of Alternative 2 question the relevance of additional disclosure. If some intangible assets do not warrant separate recognition on the face of the financial statements, there should not be a need for incremental disclosures about those assets. Opponents believe that such disclosures would add complexity and costs (particularly, disclosures that might require estimates, such as attrition rate) that may defeat one of the goals of the project, which is to reduce costs and complexity.

*Staff Recommendation*

43. The staff recommends that the PCC reaffirm its tentative decision about disclosure (that is, Alternative 2). The staff believes that disclosure of information about the nature of CRIs and NCAs that are acquired but not recognized could provide financial statement users with sufficient information about non-separately recognized intangible assets that would serve as a signal to alert financial statement users to the existence of intangible assets that are subsumed into goodwill. CRIs and NCAs are a critical element to some business combinations and the staff believes that disclosure of information about NCAs and CRIs could help some users to identify items that could require further discussion with management without significant costs to preparers.

## Issue 5: Transition

44. At its July 15, 2014 meeting, the PCC tentatively decided that if elected, the alternative should be applied prospectively for all business combinations entered into after the effective date with no option to apply retrospective application. An entity would continue to recognize and measure intangible assets that exist as of the beginning of the period of

adoption in accordance with Topic 350. This issue considers whether the PCC would like to reaffirm its tentative decision about transition.

| **Questions for the Private Company Council** |
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| Does the PCC want to reaffirm its tentative decision that if elected, the alternative should be applied prospectively for all business combinations entered into after the effective date with no option to apply retrospective application?<br><br>Does the PCC want to reaffirm its tentative decision that if elected, an entity would continue to recognize and measure intangible assets that exist as of the beginning of the period of adoption in accordance with Topic 350? |

*Staff Analysis*

*Potential methods of prospective recognition*

45. To help identify the most appropriate method of prospective recognition for intangible assets that exist at the beginning of the period of adoption, the FASB staff has identified the following Alternatives to account for separately-recognized intangible assets existing as of the beginning of the period of adoption:

*Alternative A: Continue to recognize and measure intangible assets that exist as of the beginning of the period of adoption in accordance with Topic 350 (PCC's tentative decision).*

*Alternative B: Any intangible asset that exists as of the beginning of the period of adoption would no longer be separately recognized and would be subsumed into goodwill.*

46. The primary differences between Alternative A and Alternative B relate to subsequent measurement. Under Alternative A, any existing intangible asset would continue to be amortized (except for indefinite lived intangible assets) and subject to the impairment test under Topic 350. Under Alternative B, pending the PCC's decision to link PCC Issue 13-01A with Update 2014-02, an entity would either:

(a) Subsequently measure and account for goodwill by amortizing goodwill on a straight-line basis over a 10-year period, or less than 10 years if the entity demonstrates that another useful life is more appropriate. The entity would also be subject to a simplified impairment test.

(b) Elect not to apply Update 2014-02, and continue to recognize goodwill in accordance with existing GAAP; which means goodwill would be subject to an annual impairment test and would not be amortized (pending the Board's decisions in its project on accounting for goodwill for PBEs and NFPs).

47. While Alternative B would present intangible assets consistently on a comparative basis, Alternative A would result in less cost for a private company and would also provide more relevant information for users. Under Alternative A, preparers would not need to evaluate the potential effect of a change in the subsequent accounting for goodwill and the time and effort to change the accounting. In addition, the current amortization period for those intangible assets could be more appropriate than amortizing over a 10-year period (or the period over which goodwill is amortized) and could more appropriately reflect the economics of the transaction.

*Staff Recommendation*

48. The staff recommends the PCC reaffirm its tentative decision that an entity would apply the proposed alternative prospectively for all business combinations entered into after the effective date. A retrospective approach would require a private entity to restate all past intangibles and goodwill balances, along with the related amortization and impairment charges. That approach may be impracticable because of the retrospective judgments that would be necessary for such restatements (for example, restating goodwill impairment based on the changes to accounting for identifiable intangibles that would change the previously recognized goodwill amounts). A prospective approach in which the differential accounting treatment would only apply to new business combinations after the effective date could be more appropriate. Retrospective application would most likely result in additional effort and cost to be incurred by preparers.

## Issue 6: Linkage with Accounting Standards Update No. 2014-02, *Intangibles—Goodwill and Other (Topic 350), Accounting for Goodwill*

49. At its July 15, 2014 meeting, the PCC tentatively decided that the election of the accounting alternative for PCC Issue 13-01A would require the adoption of the private company accounting alternative for goodwill as provided in Update 2014-02. This issue considers whether the PCC would like to reaffirm its tentative decision about linkage.

| Question for the Private Company Council |
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| Does the PCC want to reaffirm its tentative decision that the election of the accounting alternative for PCC Issue 13-01A would require the adoption of the private company accounting alternative for goodwill as provided in Update 2014-02? |

*Staff Analysis*

50. The staff has identified the following alternatives for consideration:

*Alternative A: Election of Issue 13-01A requires the adoption of Update 2014-02.*

51. Proponents of Alternative A believe that linking PCC Issue 13-01A to Update 2014-02 provides a mechanism for assets that are finite-lived to be amortized. Further, proponents of Alternative A believe that because PCC Issue 13-01A would likely result in a higher goodwill balance in comparison to existing GAAP, entities would be exposed to a higher risk of goodwill impairment. Therefore, by linking the adoption of PCC Issue 13-01A to Update 2014-02, a private company would reduce its risk for goodwill impairment by amortizing goodwill (which would include intangible assets that are not recognized).

*Alternative B: Election of PCC Issue 13-01A does not require the adoption of Update 2014-02.*

52. Proponents of Alternative B believe that both PCC Issue 13-01A and Update 2014-02 independently would result in a reduction in cost and complexity for private companies while resulting in decision-useful information for users of private company financial statements and, therefore, believe that PCC Issue 13-01A and Update 2014-02 should not be linked. Proponents also believe that Alternative B could limit the number of differences within GAAP between private companies and PBEs because an entity would not be required to apply both alternatives.

*Staff Recommendation*

53. The staff recommends that the PCC reaffirm its tentative decision (Alternative A) that the election of the accounting alternative for PCC Issue 13-01A would require the adoption of the private company accounting alternative for goodwill as provided in Update 2014-02. The staff believes that by linking the adoption of PCC Issue 13-01A to Update 2014-02, a private company would reduce its risk for goodwill impairment by amortizing goodwill (which would include intangible assets that are not separately recognized).

## Issue 7: Whether PCC Issue 13-01A should be reexposed

54. The PCC should consider whether to reexpose PCC Issue 13-01A based on the changes to the proposed alternative as a result of the decisions reached at the July 15, 2014 meeting in addition to the questions above.

| Question for the Private Company Council |
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| Does the PCC believe that PCC Issue 13-01A should be reexposed? |

*Staff Analysis*

55. According to the staff analysis, reexposure is generally required when there has been a substantive change to the scope or to the primary recognition, measurement, or disclosure principles. The intention of a reexposure is to allow constituents to have an opportunity to raise issues or concerns not previously considered by the PCC. The need to issue a revised exposure draft is a matter of judgment, taking into consideration various factors, including:

(a) The extent to which decisions reached during redeliberations of an exposure draft result in a substantive change to the guidance proposed in the exposure draft on which respondents commented (individually and/or in the aggregate).

(b) Whether stakeholders have had sufficient opportunity to fully consider the implications of the change and communicate their views on the change (for example, through comment letters and constituent outreach activities during redeliberations).

(c) Whether the decision making of the Board or the PCC would benefit from additional input on the change, considering the extent to which such input would provide new information not previously considered by the Board or the PCC prior to redeliberations.

(d) The time that has lapsed since issuance of the exposure draft and the effect of economic, regulatory, or other changes during the intervening period on the arrangements that are the subject of the exposure draft.

56. The proposed Update would have provided a private company with an alternative to recognize only those intangible assets arising from contractual rights with noncancellable contractual terms or those arising from other legal rights. As a result, an intangible asset would not be recognized separately from goodwill even if it were transferrable or separable. For instance, a private company under the proposed Update would not recognize the fair value of customer-related intangible assets that are noncontractual, such as customer lists or those arising from customer relationships that are expected to extend beyond the noncancelable contractual terms.

*Staff Recommendation*

57. Overall, the FASB staff believes that that Alternative B2 would generally result in a private company recognizing more intangible assets separately from goodwill than it would under the alternative in the proposed Update. The staff believes that Alternative B2 could result in a substantive change to the guidance proposed in the exposure draft on which respondents commented in some situations. The staff also believes the PCC should consider the lapse of time between the issuance of the proposed Update (July 2013) and the tentative decisions reached to date. After considering those factors, if the PCC decides to move forward with Alternative B2, the staff believes that exposure of a revised exposure draft is warranted.

## Issue 8: Effective Date and Early Application (only applicable if PCC Issue 13-01A is not reexposed)

58. The proposed Update did not indicate an effective date for the proposed alternative but does indicate that early application would be permitted. This issue considers the effective date of the amendments in proposed Update and whether the PCC would like to reaffirm its tentative decision that early adoption should be permitted.

59. The majority of respondents indicated that the proposed Update should become effective within a short period of time after final issuance. Some respondents indicated that the effective date should be one year after issuance to provide private companies with sufficient time to prepare and understand the implications of the changes given that they will not have the benefit of learning from public companies. Nearly all respondents were supportive that early application should be permitted.

| Questions for the Private Company Council |
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| Does the PCC believe that a proposed alternative should be effective for business combinations entered into in the first annual period beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016? If not, what effective date does the PCC suggest?<br><br>Does the PCC wish to affirm its tentative decision that a proposed alternative should permit early adoption for any annual or interim period for which the entity's annual or interim financial statements have not yet been made available for issuance? |

*Staff Analysis*

60. The staff believes the PCC should decide whether private companies should be able to apply the alternative, if elected, to account for intangible assets in a business combination entered into in the first annual period beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. Early application should be permitted for any annual or interim period for which the entity's annual or interim financial statements have not yet been made available for issuance. If the proposed alternative is finalized before the end of 2014, private companies and their auditors would have approximately two years from issuance before the issuance of a calendar year private company's financials to implement the new guidance, but also

provide an opportunity for those that wish to be able to apply the guidance earlier. Making the guidance effective in 2016 (for calendar year companies) acknowledges the fact that private companies and their auditors often do not learn about new guidance until later in the year and that the final standard may be issued while their resources are focused on year-end close and other matters. For entities that prefer to elect to apply the proposed alternative before the effective date, a benefit is that they will have the option of early adoption.

*Staff Recommendation*

61. The staff recommends that private companies should be able to apply the alternative, if elected, to account for intangible assets in a business combination entered into in the first annual period beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. Early application should be permitted for any annual or interim period for which the entity's annual or interim financial statements have not yet been made available for issuance.