Overview of Decisions Reached on PCC Issue No. 1, "Accounting for Identifiable Intangible Assets in a Business Combination and Subsequent Accounting for Goodwill"

The Private Company Council (PCC) proposes alternatives for private companies related to the accounting for intangible assets acquired in a business combination, and the accounting for goodwill

Date of Meeting: May 7, 2013

The PCC reached a consensus-for-exposure to provide alternatives for private companies[1] within U.S. GAAP related to (a) accounting for intangible assets in a business combination, and (b) accounting for goodwill. The PCC's decisions are subject to FASB endorsement and public comment.

Accounting for intangible assets acquired in a business combination

Under current U.S. GAAP, an acquirer of a business is required to identify and recognize separately from goodwill the fair value of intangible assets that (a) are separable,[2] or (b) arise from contractual or other legal rights. The PCC decided that a private company (that elects the alternative within U.S. GAAP) would recognize only those intangible assets arising from noncancellable contractual terms or those arising from other legal rights. Otherwise, an intangible asset would not be recognized separately from goodwill even if it is separable. For instance, a private company 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 extend beyond the noncancellable contractual terms. As a result, this alternative would generally result in a private company recognizing fewer intangible assets separately from goodwill than it would presently.

In addition, the PCC decided that the fair value of intangible assets that arise from noncancellable contract terms should be measured on the basis of the contract's remaining noncancellable term regardless of whether market participants would consider potential contractual renewals in determining fair value. The fair value of intangible assets that arise from other legal rights that are noncontractual (for example, a registered trade name) should continue to be recognized at fair value in accordance with Topic 820, Fair Value Measurement, incorporating all expectations of market participants about such intangible assets.

While certain intangible assets would no longer be recognized separately from goodwill under this proposed alternative, the PCC decided that financial statements should continue to disclose the nature (but not the fair value) of all intangible assets acquired that are identifiable. This proposed alternative recognition guidance for intangible assets would be applied prospectively for all business combinations entered into after the effective date, which is yet to be determined.

Accounting for goodwill

To an acquiring entity, goodwill represents the residual asset in a business combination after recognizing all identifiable assets and liabilities of an acquired entity. Under current U.S. GAAP, goodwill is not amortized but is subject to impairment testing at least annually. The PCC decided that a private company (that elects the alternative within U.S. GAAP) should amortize goodwill over the useful life of the primary asset acquired in a business combination, not to exceed 10 years. A primary asset is the most significant long-lived asset acquired in the business combination.

The PCC also decided that goodwill should be tested for impairment only when a triggering event occurs that would more likely than not reduce the fair value of an entity below its carrying amount. Goodwill should be tested for impairment at the entity-wide level as compared to the current requirement to test at the reporting unit level. In testing goodwill for impairment, a private company would continue to have the option to first assess qualitative factors to determine whether step one of

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[1] Nonpublic entities as defined in Topic 715, Compensation—Retirement Benefits, excluding not-for-profit entities as defined in the Master Glossary of the Codification.

[2] Separable means that an acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset, or liability.

the test is necessary. If necessary, step one of the goodwill impairment test would still require that the entity compare its fair value to its carrying amount.

The PCC further simplified the goodwill impairment test by eliminating step two of the current impairment test, which requires the application of a hypothetical purchase price allocation to calculate the goodwill impairment amount. Under the PCC's proposal, the goodwill impairment amount would represent the excess of the entity's carrying amount over its fair value as calculated in step one of the test. Goodwill would not be reduced below zero.

The PCC decided not to prescribe new disclosure requirements for goodwill. A private company would follow the applicable disclosure requirements in current U.S. GAAP related to goodwill and intangible assets. The alternative goodwill accounting guidance for private companies would be applied prospectively for all goodwill generated from business combinations entered into after the effective date, which is yet to be determined. Goodwill existing as of the effective date would be amortized prospectively over its remaining useful life (not to exceed 10 years) or 10 years if remaining useful life cannot be reliably estimated.