FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Memo

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Purpose **Update for ASAF on FASB Activities Related to the Post-Implementation Review of Statement 141(R) and Accounting for Goodwill after a Business Combination**

Purpose of This Memo

1. This paper provides an update on the following FASB activities:

   (a) The results of the Post-implementation Review (PIR) of FASB Statement No. 141(revised 2007), *Business Combinations*

   (b) The FASB's response to the Statement 141(R) PIR

   (c) The Private Company Council's (PCC) alternative for the subsequent measurement of goodwill

   (d) The FASB's project on the subsequent measurement of goodwill for public business entities and not-for-profit entities.

PIR of Statement 141(R)

2. In May 2013, the Financial Accounting Foundation (FAF), which has oversight responsibility for the FASB, completed its PIR of Statement 141(R) (now included in Topic 805, Business Combinations).[1] The FAF Trustees' objectives for the reviews are to determine whether a standard is accomplishing its stated purpose, evaluate its

[1] Click here for the FAF's report and click here for the FASB's response letter.

implementation and continuing compliance costs as well as its related benefits, and provide recommendations to improve the standard-setting process.

3. The PIR team, through research and outreach with various stakeholders, reached the following conclusions:

(a) Statement 141(R) resolved some of the practice issues associated with the purchase method of accounting for business combinations, but some important practice issues related to business combination accounting remain unresolved. Statement 141(R) established recognition and measurement requirements for the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. It also established principles to guide disclosure of information to enable users of financial statements to evaluate the nature and effects of business combinations. Statement 141(R) is converged in many areas with IFRS 3, *Business Combinations*.

(b) Overall, Statement 141(R)'s principles and requirements are understandable and generally can be applied as intended. The following requirements represent the areas that stakeholders, especially preparers for small-to-medium entities, have the most difficulty applying:

   (i) Measuring assets acquired and liabilities assumed using the fair value requirements in FASB Statement No. 157, *Fair Value Measurements* (now included in Topic 820, Fair Value Measurement)

   (ii) Measuring the fair value of contingent consideration

   (iii) Determining whether a transaction is a business combination or an asset purchase.

(c) Investors generally find the information resulting from the application of Statement 141(R) useful in understanding and analyzing most business combination transactions. However, some review participants question the reliability or decision-usefulness of the reported information for business combinations that (i) include assets and liabilities that are difficult to measure at fair value, (ii) result in a bargain purchase, or (iii) in substance may be asset purchases.

(d) Statement 141(R) introduced more complexity and costs to the accounting for business combinations than the FASB anticipated. Much of the complexity relates to the application of Statement 157's measurement requirements. The costs relate to the extensive external valuation expertise being sought by both preparers and auditors of financial statements. Smaller entities may face additional costs for timely access to external resources.

(e) Statement 141(R) achieved improvements in the relevance and completeness of business combination information. Improvements in the areas of comparability, reliability, and representational faithfulness of that information were not fully achieved in large part because of the fair value measurement requirements.

The FASB's Response to the Statement 141(R) PIR

4. As a part of its response to the PIR, the FASB highlighted several projects on its agenda that could address many of the concerns raised in the PIR. The relevant projects and the status of those projects are as follows:

(a) Clarifying the Definition of a Business, including guidance for partial sales or transfers and the corresponding acquisition of partial interests in a nonfinancial asset or assets—The FASB is expected to begin deliberations on this project later in 2014.

(b) PCC project related to separately identifying intangible assets acquired in a business combination—The PCC is evaluating alternatives that would reduce the identifiable intangible assets recognized separately from goodwill. The alternatives currently being considered by the PCC focus primarily on the recognition of fewer customer relationships and noncompete agreements.

(c) Emerging Issues Task Force (EITF) Issue No. 12-F, "Pushdown Accounting"—The EITF reached a consensus-for-exposure in March 2014 that an acquired entity should have an option to apply pushdown accounting in its separate financial statements upon the occurrence of an event in which an acquirer obtains control of the acquired entity. The EITF is expected to review comment letter responses and redeliberate the proposed FASB Accounting Standards Update, *Business Combinations (Topic 805): Pushdown Accounting*, in September 2014.

(d) Accounting for Financial Instruments—Impairment—This project considers issues related to purchased financial assets with an explicit expectation of credit losses at acquisition. The FASB's project on impairment is in process and deliberations are expected to be completed later in 2014.

5. In addition, in response to concerns raised about the use of Statement 157 to measure the assets and liabilities acquired in a business combination, the FASB highlighted that the FAF was about to begin a PIR on Statement 157. Statement 157, issued in September 2006, provides a single definition of fair value, establishes a framework for measuring fair value, and expands disclosures about fair value. The Statement 157 PIR was completed in February 2014 and concluded that the framework for measuring fair value within GAAP generally achieves its purpose.[2] The Statement 157 PIR reached the following conclusions:

(a) Information resulting from the application of Statement 157 generally provides investors with decision-useful information, the most useful of which appears to be the description of the inputs and valuation technique(s) used to measure fair value. Some stakeholders indicated that the volume and extent of disclosures may be beyond the needs of most investors and other users of financial statements, yet some stakeholders believed additional disclosures would be helpful, particularly around the distribution of unobservable inputs.

(b) Certain requirements remain difficult to apply, particularly for entities such as employee benefit plans, not-for-profit organizations, and private companies. Those difficulties relate to valuations requiring significant use of judgment, the absence of observable markets for the assets being valued, inconsistent application of measurement and disclosure requirements across entities, and resource constraints.

[2] Click here for the FAF's report and click here for the FASB's response letter.

(c) Some stakeholders believe that the changes made to financial reporting and operating practices to implement Statement 157 were significant, but the PIR team acknowledged that some of the changes may be attributable to changes in the regulatory and economic environment or may be amplified by the global financial crisis of 2008.

(d) The ongoing costs to comply with Statement 157 are considered significant by some stakeholders. Those costs are not exclusively a result of the Statement 157 requirements, but also relate to regulatory environment factors arising after the issuance of Statement 157. Typically, the size of the preparer or practitioner is inversely related to its concerns about the costs related to Statement 157.

(e) Overall, Statement 157 achieved its expected benefits as it adequately resolved the issues underlying its stated need, and it generally provides users with decision-useful information. However, for employee benefit plans, not-for-profit organizations, or private companies, some investors think that the fair value information resulting from the application of Statement 157 does not provide relevant or meaningful information.

6. The FASB also noted in its response to the Statement 141(R) PIR that IFRS 3 and Statement 141(R) are the products of a FASB-IASB joint project, and the IASB was beginning a PIR of IFRS 3.

The PCC's Alternative for Accounting for Goodwill

7. FASB Accounting Standards Update No. 2014-02, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill*, is an alternative for private companies developed by the PCC in response to feedback from private company stakeholders that the accounting for the subsequent measurement of goodwill is costly and complex and provides limited benefits to private company users.

8. Under the PCC's alternative for private companies, a private company can elect to amortize goodwill over 10 years. A private company also can elect to amortize goodwill over less than 10 years if it demonstrates that another useful life is more appropriate. In

addition, the PCC decided that a private company should make an accounting policy election to perform its impairment testing of goodwill at the entity level or the reporting unit level. Under current GAAP, impairment testing is required to be performed at the reporting unit level. The policy election also allows a private company to test goodwill for impairment only when a triggering event occurs that indicates the fair value of an entity (or a reporting unit) may be below its carrying amount. In testing goodwill for impairment, a private company continues to have the option to first assess qualitative factors to determine whether a quantitative impairment test is necessary. If that qualitative test indicates that it is more likely than not that goodwill is impaired, the entity is required to perform the quantitative test to compare its fair value with its carrying value (or the fair value of the reporting unit with the carrying value of the reporting unit).

9. The PCC further simplified the goodwill impairment test by eliminating step two of the quantitative test, which requires the application of a hypothetical purchase price allocation to calculate the goodwill impairment amount. Under the PCC alternative, the goodwill impairment amount, if any, is the excess of the entity's (or the reporting unit's) carrying amount over its fair value. Goodwill should not be reduced below zero.

10. The disclosures required for private companies that elect the alternative are similar to those in existing GAAP. However, a private company that elects the accounting alternative is not required to present changes in goodwill in a tabular reconciliation.

The Alternatives for Accounting for Goodwill for Public Business Entities and Not-for-Profits

Background

11. On November 25, 2013, the FASB added a project to its technical agenda to evaluate potential alternatives for the subsequent measurement of goodwill for public business entities and not-for-profit entities. The project was added to the FASB's agenda at the same meeting in which the FASB endorsed the PCC recommendation for private companies to be able to elect to amortize goodwill.

Alternatives

12. The FASB is considering the following alternatives for the subsequent measurement of goodwill:

    (a) Amortization of goodwill over its expected useful life, not to exceed a specified number of years, with a simplified impairment test upon the occurrence of triggering events

    (b) A direct write-off of goodwill to either equity or the profit and loss statement at the acquisition date

    (c) A simplified impairment test without amortization (for example, the use of a one-step impairment test or testing for impairment at a level higher than the reporting unit level).

Summary of Outreach

13. The FASB staff performed a significant amount of outreach with financial statement users; preparers; auditors; other standards setters, including the IASB and the ASBJ; and others about accounting for goodwill after a business combination.

14. Many, but not all, of the preparers in the FASB staff's outreach indicated concerns over the cost and complexity of the goodwill impairment test. However, preparers had different views about whether they prefer the impairment model or another model, such as amortization or a direct write-off of goodwill. Some of those that favor goodwill amortization were supportive primarily because they believe it would reduce cost and complexity, not because they thought it would provide better information to users of financial statements.

15. All users of public company financial statements that the staff spoke to said goodwill amortization would not provide relevant information and indicated that they would make an adjustment to earnings for goodwill amortization. While a direct write-off also would not provide relevant information, some users were open to the idea of a direct write-off over amortization primarily because it would not require an adjustment to an entity's reported results each reporting period.

16. While some users, particularly lenders, were indifferent about the model for the subsequent measurement of goodwill, many users, particularly credit rating agencies and equity analysts, noted that impairment charges do provide some relevant information from a qualitative perspective.

Status

17. At the Board meeting on March 26, 2014, the FASB staff updated the FASB on the results of research and outreach about accounting for goodwill after a business combination. The FASB made no decisions at the meeting. Several FASB members commented that they were interested in understanding the results of the IASB's PIR of IFRS 3 before deciding whether to make improvements to GAAP in this area. The FASB instructed the staff to monitor the status of the IASB's PIR. The FASB staff plans to discuss the project with the FASB after the IASB provides information about the results of its PIR.