FASB FINANCIAL ACCOUNTING STANDARDS BOARD

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Memo

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Project	**Accounting for Identifiable Intangible Assets in a Business Combination for Public Business Entities and Not-for-Profit Entities**
Issue(s)	**Project Status Update**

Purpose of This Memo

1. The purpose of this memo is to provide a summary to the Boards of the progress to date by the FASB staff on the accounting for identifiable intangible assets in a business combination project. The project is currently in the initial deliberations stage.

2. On November 5, 2014, the Board added a project to its technical agenda for public business entities (PBEs) and not-for-profit entities (NFPs) on the accounting for identifiable intangible assets in a business combination. At that time, the Board asked the staff to consider the implications of potentially subsuming certain intangible assets into goodwill. The project was added to the Board's agenda at the same meeting the Board endorsed the Private Company Council (PCC) consensus to change GAAP for private companies on the accounting for identifiable intangible assets in a business combination.

3. This memo is organized as follows:

   (a) Summary of the FASB's past projects on the accounting for identifiable intangibles in a business combination

   (b) Summary of current outreach activities and research

   (c) Staff analysis and options.

Summary of the FASB's Past Projects on the Accounting for Identifiable Intangibles in a Business Combination

4. In recent years, the FASB has considered and changed the accounting for identifiable intangible assets in business combinations multiple times. Prior to 2001, intangible assets were only recognized for transactions accounted for under the *purchase method* of accounting in Accounting Principles Board (APB) Opinion No. 16, *Business Combinations.* In practice, many acquisitions were accounted for under the *pooling of interests method* in APB 16, which did not result in the recognition of intangible assets.

5. To address the issue of identifiable intangible assets not being recognized separately from goodwill, the Board proposed new recognition criteria for identifiable intangible assets in the 1999 Exposure Draft on business combinations and intangible assets (the 1999 Exposure Draft). The Board proposed in the 1999 Exposure Draft that intangible assets should be identifiable and reliably measureable to be recognized apart from goodwill. Many respondents disagreed with these recognition criteria. Respondents to the 1999 Exposure Draft were opposed to guidance requiring that identifiable intangibles be *reliably measurable,* without defining the parameters of that term.

6. In the final FASB Statement No. 141, *Business Combinations*, the Board concluded that for an intangible asset to be separately identifiable and not subsumed into goodwill, it had to meet one of two criteria—the contractual-legal criterion (the asset arose from contractual or other legal rights) or the separability criterion (it is capable of being separated or divided from the acquired entity and sold, transferred, licensed, rented, or exchanged in combination with a related contract, asset, or liability). Workforces and acquired research and development assets without an alternate future use were exemptions to this criteria.

7. Statement 141 also eliminated the *pooling of interests method* so that all business combinations were accounted for under the *purchase method*. As a result of this change, intangible assets acquired in a business combination were recognized.

8. In 2007, the Board issued Statement No. 141 (revised 2007), *Business Combinations*, which superseded Statement 141 and changed the accounting for research and development (R&D) assets. Statement 141(R) required that the fair value of the R&D assets be recognized in a business combination regardless of whether they had any alternative future use. Those assets were subsequently tested for impairment until the completion or abandonment of the R&D project.

9. Unlike the feedback received for PBEs as noted beginning at paragraph 10 below, private company stakeholders expressed concern about the cost and complexity of estimating the fair value of certain identifiable intangible assets. In 2014, the PCC reached a consensus on an accounting alternative for identifiable intangibles assets for private companies, and the Board and the PCC issued Accounting Standards Update No. 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination.* The PCC and the Board decided that an entity within the scope of the amendments in the Update could 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.

Summary of Current Outreach Activities and Research

Outreach

10. For PBEs and NFPs, the staff performed the following outreach:

    (a) Reviewed relevant comment letter responses and bases for conclusions from previous projects on identifiable intangible assets

(b) Conducted outreach with PBE and NFP stakeholders including users, the Investor Advisory Committee (IAC), preparers, and the Not-for-Profit Advisory Committee (NAC)

(c) Performed research to obtain information about stakeholder views that took place during deliberations that led to Statements 141 and 141(R).

11. PBE user feedback:

(a) Most users preferred current GAAP to any of the proposed alternatives.

(b) Many users had concerns about any potential changes to simplify the accounting for intangible assets in a business combination.

(c) Many users highlighted that certain intangible assets are inherently difficult (and costly) to value.

(d) Some users felt that fair value and historical cost provide relevant information, but others indicated that the value of some intangible assets does not provide decision-useful information because of the subjectivity and questionable reliability of the valuations and the varying relevance of some intangible assets to different industries.

(e) Unlike users of private company financial statements, most users felt they generally did not have access to management, making it difficult to obtain information outside of the financial statement disclosures.

12. Overall, the feedback from IAC members was mixed:

(a) Some members noted that users of PBE financial statements generally place limited reliance on the value of intangible assets separately from goodwill, some intangible assets (such as customer relationships) can be difficult to separately value and are often ignored by many analysts, and intangible assets typically represent a minor component of an acquisition.

(b) IAC members stated that some intangible assets can be relevant depending on the industry that the performance of an impairment analysis is perceived as promoting management accountability, and the potential recording of an impairment charge can be an indicator of management's success.

13. PBE preparer feedback:

    (a) Most preparers did not consider the one-time cost of determining the fair value of intangible assets acquired to be significant in the context of a business combination.

    (b) Preparers generally feel that users do not have a specific focus on the intangible assets recorded outside of potential impairment.

    (c) Some preparers are interested in the existence of intangible assets owned by a target and use those assets in estimating cash flows of the target.

14. NFP feedback:

    (a) For NFPs that do engage in business combinations (many do not), respondents, including members of the NAC, generally believe that any changes to recognition of intangible assets made for private companies also should apply to NFPs.

Research

15. Paragraph B171 of Statement 141(R) states the following:

> Some respondents doubted their ability to reliably measure the fair values of many intangible assets. They suggested that the only intangible assets that should be recognized separately from goodwill are those that have direct cash flows and those that are bought and sold in observable exchange transactions. The FASB rejected that suggestion. Although the fair value measures of some identifiable intangible assets might lack the precision of the measures for other assets, the FASB concluded that the information that will be provided by recognizing intangible assets at their estimated fair values is a more faithful representation than that which would be provided if those intangible assets were subsumed into goodwill. Moreover, including finite-lived intangible assets in goodwill that is not being amortized would further diminish the representational faithfulness of financial statements

16. The Post-Implementation Review (PIR) Report on Statement 141R indicated that both private companies and PBEs, particularly smaller PBEs, struggled with the measurement of intangible assets at fair value because that measurement can be complex. As a result, costs are being incurred to hire external valuation specialists to estimate the fair value of intangibles and auditors to test those values. Per the PIR Report, users of both public and private company financial statements found the identification of separate intangibles useful, but noted that inconsistent application of FASB Statement No. 157, *Fair Value*

Measurements, to the measurement of such intangibles resulted in a lack of comparability and reliability. In response to the PIR Report, the FASB staff performed outreach and analyses to understand the specific concerns of stakeholders and whether there are any cost-effective solutions to address those concerns.

17. Historically, many academic studies have found a decline in the relevance of accounting information and attributed that decline to the economy becoming more intangible asset-based while accounting recognizes few intangible assets outside of a business combination. Statement 141, which required the recognition of the fair value of intangible assets acquired in a business combination, was issued in large part because of some of this research. However, surveys of financial statement users are mixed in terms of whether the recognition of intangible assets in a business combination provides useful information, primarily due to the subjectivity involved in valuing intangibles as well as how quickly the information becomes irrelevant and not useful for future analysis. Surveys of users generally indicate that there is a desire to know the value attributed to intangible assets at acquisition when they are meaningful to a company's future prospects and if those intangible assets can be monetized. Other academic research supports recognition of internally generated intangible assets (that is, intangible assets created internally rather than acquired in a business combination). These studies particularly point to research and development as creating an asset that should be recognized on an entity's balance sheet. However, users have mixed views about this also, because they observe that research and development spending does not always translate into asset value.

Staff Analysis and Options

18. At its January 22, 2014, meeting, the FASB discussed alternatives for accounting for identifiable intangible assets in business combinations for public business entities and NFPs. The following is a summary of the three primary views of how identifiable intangible assets acquired in a business combination should be accounted for. The FASB is still considering these alternatives and the results of the staff research, and has not yet made a decision.

19. View A—All intangibles subsumed into goodwill:

(a) Key elements include the following:

(1) No intangibles recognized in a business combination separately from goodwill

(2) Required disclosure of the nature (but not fair value) of identifiable, but not separately recognized, intangible assets.

(b) The PCC determined that View A was not a viable alternative for private companies at a subsequent meeting, and the FASB is focusing the PBE and NFP discussion on customer-related intangibles and noncompete agreements (see view B).

20. View B—Only intangibles capable of being sold or licensed independently from other assets of the business recognized separately:

(a) All intangibles would be subsumed into goodwill and other intangible assets except those that are capable of generating cash flows separate and distinct from a business. Subsequent to the January 22, 2014, FASB meeting, the PCC considered four subviews of View B, as follows:

(1) View B1—Intangible assets only would be separately recognized if they were capable of being sold or licensed independently from other assets of a business.

(2) View B2 (the PCC alternative)—Change limited to noncompetition agreements (NCA) and customer-related intangibles (CRI). NCAs would not be separately recognized and CRIs only would be recognized if they are capable of being sold or licensed independently from other assets of a business.

(3) View B3—Change limited to CRIs: Similar to View B2, but limited to CRIs.

(4) View B4—Narrower definition of contractual CRIs. This alternative consists of narrowing the guidance on when a CRI meets the contractual/legal criterion for recognition provided in paragraph 805-20-55-25 to exclude ongoing customer relationships associated with purchase-order-based or at-will customers.

(b) Proponent views include the following:

(1) Consistent with the accounting treatment for assembled workforce under current GAAP.

(2) CRIs and NCAs are typically not capable of being sold individually, licensed to third parties, or otherwise capable of generating cash flows independent of a business.

(3) The value of CRIs and NCAs is often disregarded by many users so a qualitative description of those assets may suffice.

(4) CRIs and NCAs are among the most subjective and difficult intangible assets to value.

(c) Opponent views include the following:

(1) Disclosure of the nature of intangible assets often does not provide decision-useful information.

(2) The value of intangible assets that cannot be sold or otherwise generate cash flows independent from the business may still provide decision-useful information for some industries.

(3) This option may not significantly reduce cost or complexity.

21. View C—No change to GAAP:

(a) Key elements include the following:

(1) Continue to recognize intangible assets acquired in a business combination separately from goodwill on the date of acquisition. Those intangibles may include CRIs, customer contracts, trade names, brands, technology, patents, publishing rights, software, trade secrets, and in-process R&D (IPR&D). A company would recognize these intangible assets at their acquisition-date fair values in accordance with Topic 805, Business Combinations.

(b) Proponent views include the following:

(1) Separately recognizing all identifiable intangibles from goodwill is more representationally faithful than allocating all or some intangibles to goodwill.

(2) The "primary" asset, or the asset that is the main reason for the acquisition, should be recognized at fair value. Because that primary asset can be an

intangible asset, the relevance of financial reporting would be reduced if the model does not require recognition of those assets.

(3) They do not feel significant costs are incurred that are associated with the valuation of intangibles recognized in a business combination. They observe that the costs are incurred only on the acquisition date.

(4) There do not appear to be significant practice issues associated with current GAAP. The FASB staff has not received any technical inquiries related to these issues in the last three years.

(c) Opponent views include the following:

(1) The benefits of separate recognition do not justify the costs.

(2) Some users disregard the fair value of intangible assets.