Private Company Council

PCC Issue No. 13-01A

Title: Accounting for Identifiable Intangible Assets in a Business Combination

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Previously distributed PCC materials: Agenda Request Issue No. 1, dated February 1, 2013; Issue Summary No. 1, dated May 26, 2013; Proposed Accounting Standards Update, dated July 1, 2013

Purpose

1. This Issue Summary Supplement provides (a) a summary of the outreach activities undertaken and comments received in response to the proposed Accounting Standards Update, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination*, issued on July 1, 2013, and (b) the staff's analysis and recommendation for the primary issues identified as a result of the feedback received. This Issue Supplement should be considered in conjunction with the following discussion materials prepared for the September 30-October 1, 2013 PCC meeting:

- Issue Summary No. 1, Supplement No. 1, for PCC Issue No. 13-01B, "Subsequent Accounting for Goodwill"
- Issue Summary No. 1, Supplement No. 2, which applies to both this Issue (Issue 13-01A) and Issue 13-01B, and relates to feedback and staff analysis about (a) whether the proposed alternatives resulting from the two Issues should be linked and (b) the potential impact of the proposed alternatives on impairment testing of asset groups in Topic 360, Assets—Property, Plant and Equipment.

Background

2. At its February 12, 2013 meeting, the Private Company Council (PCC) decided to add this Issue to its agenda to explore potential alternatives within U.S. GAAP for private companies for the accounting for identifiable intangible assets acquired in a business combination. At its May 7, 2013 meeting, the PCC reached a consensus-for-exposure that would provide alternatives for private companies within U.S. GAAP related to accounting for intangible assets in a business combination.

3. 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 or (b) arise from contractual or other legal rights. The proposed Update would amend this guidance to allow a private company (that elects the alternative within U.S. GAAP) to recognize only those intangible assets arising from noncancelable 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 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 are expected to extend beyond the noncancelable contractual terms. Thus, this alternative would generally result in a private company recognizing fewer intangible assets separately from goodwill than it would presently.

4. In addition, the proposed Update would require the fair value of intangible assets that arise from noncancelable contract terms to be measured on the basis of the contract's remaining noncancelable 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) would 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.

5. While certain intangible assets would no longer be recognized separately from goodwill under this proposed alternative, the proposed Update would require that financial statements

continue to disclose the nature (but not the fair value) of all intangible assets acquired that are not recognized separately. 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.

Comment Letter Respondents by Category

6. The comment period ended on August 23, 2013. At the time this Issue Supplement was prepared, 44 comment letters had been received on the proposed Update. Respondents included:

Preparers	3
Professional Associations	14
Industry associations	6
Practitioners	20
Individuals	1
Total	**44**

7. Outreach was also performed to users of private company financial statements representing diverse user types (small and large lenders, private equity, venture capital, and other shareholders) with different background and sector specialties. User feedback is incorporated throughout this Issue Supplement.

Summary of Feedback Received

Overall Feedback

8. The majority of respondents were supportive of the objectives and the efforts that are being made by the PCC to address the specific financial reporting needs of users and preparers of private company financial statements. Many respondents supported the efforts to provide an

alternative for private companies in accounting for identifiable intangible assets in a business combination. Those respondents believe that the proposed alternative could reduce overall costs and complexity for private companies in comparison to current U.S. GAAP. Some respondents believe that the proposal does not go far enough in reducing cost and complexity for private companies because private companies will likely still need to hire third-party valuation professionals to value their intangible assets. Other respondents indicated that the proposed alternative could result in additional costs and complexities. Specific concerns are discussed throughout this Issue Supplement.

9. Some respondents, primarily the large accounting firms, expressed concerns about the significant differences the proposal would create between the financial reporting of identifiable intangible assets by private companies and public companies. Specifically, some respondents indicated concerns with limiting the value assigned to certain intangible assets because it could result in even greater measurement inconsistency than the perceived inconsistencies in practice today under the principles based application of Topic 820, Fair Value Measurements (those concerns are discussed in greater detail in paragraphs 30-32 of this Issue Supplement). Those respondents indicated that they would be supportive of the Board undertaking a more comprehensive reconsideration of the existing model for the recognition and measurement of intangible assets in a business combination. Several respondents commented on the interaction between Issues 13-01A and 13-01B. Those concerns are discussed in Issue Summary No. 1, Supplement No. 2.

Costs and Complexity and User Relevance Associated with the Proposed Alternative

10. Respondents were asked to provide feedback regarding (a) the costs and complexity of the proposed alternative in comparison to existing U.S. GAAP and (b) whether the proposed alternative would provide relevant and decision-useful information to users of private company financial statements. Specific concerns relating to those areas are discussed throughout this Issue Supplement.

Costs and Complexity Considerations

11. While most respondents believe that the proposed alternative could reduce overall costs and complexity and believe that minimal effort would be required for preparers and auditors to implement and audit the proposed amendments, many respondents question how significant the cost savings would be in comparison to existing U.S. GAAP. Under the proposed alternative, a large number of intangible assets may still need to be valued by third-party valuation professionals and then audited by auditors. Further, under common valuation approaches, many intangibles that would not be separately identified or measured under the proposed alternative, may still need to be valued, thereby minimizing potential cost savings. Other respondents indicated that the proposed alternative would likely increase complexity in some cases (for example, separating cancelable contracts from noncancelable contracts when they were previously valued as a group).

12. Other factors that respondents believe could increase costs and complexity include reduced comparability of financial statements, additional costs and complexities for private companies that apply the proposed alternative and then subsequently decide to "unwind" the accounting alternative, and training costs for preparers, valuation specialists, and auditors to understand and implement the changes included in the proposed alternative. The proposed alternative is a change from what is required under the existing guidance and therefore is deemed to increase costs and complexity specifically in the year of adoption. However, some of those costs would be expected to decline in subsequent years as the methodologies for valuing and auditing intangible assets under the revised definition evolve.

User Relevance Considerations

13. Most respondents did not provide a response to questions relating to user relevance primarily because of the lack of comment letter responses from users. Of the comment letter respondents who did provide feedback about user relevance, a majority believe that the accounting alternative would provide relevant and decision-useful information to many users of private company financial statements and some respondents indicated that the proposed alternative would not result in less relevant information to users in comparison to existing U.S. GAAP. Those respondents agreed with the reasons embraced by PCC members and included in paragraph BC8 of the proposed Update, which indicates that many users of private company

financial statements do not consider many intangible assets relevant and treat them no differently than goodwill.

14. Other respondents indicated that the proposed alternative would reduce user relevance in some instances. For example, in many acquisitions, customer-related intangible assets represent the core driver of the acquisition. Thus, subsuming those intangible assets into goodwill will deprive users of relevant information and impair their ability to evaluate management's capital allocation decisions. In addition, some intangible assets are more relevant to certain industries than others.

15. Based on the outreach to users of private company financial statements performed by the staff, in summary, users have similar views when describing the attributes of intangible assets they find most relevant (for example, legally protected, separately transferable, and with discrete cash flows), but did not come to an agreement on which specific intangible types are most relevant. For example, one lender indicated that trademarks can provide decision-useful information because they can be sold or can generate income through royalty fees. However, others stated that trademarks are not relevant because they are rarely separated from an acquired entity. Some users also indicated that the identification of patents is relevant and decision-useful for similar reasons. The proposed alternative would distinguish unregistered trade names from registered trade names; however, those may not be viewed differently by users.

16. Some users, in particular lenders, indicated that information about identifiable intangible assets is useful when its value is discernable based on market factors and that recognizing intangible assets from both contractual and noncontractual cash flows can provide decision-useful information. For example, renewals of insurance policies are generally not guaranteed, however, customers historically renew. Therefore, those cash flows are not contractual, but are viewed by some users to have value. The proposed alternative would not include renewal periods, thereby reducing the amount of decision-useful information to some users of private company financial statements. One lender also stated that customer lists can be important, particularly if it is typical in an industry for customer lists to be bought and sold (for example, mortgage servicing rights). However, an equity investor indicated that it is not necessary for

customer lists or trademarks to be separately identified because their values are hard to determine.

17. Given a choice between (a) intangible assets recognized separately from goodwill and (b) intangibles subsumed to goodwill, almost all users indicated a preference for the former over the latter before considering the incremental cost of valuing such intangibles. When considering the concerns about the potential increase in cost and complexity of the proposed alternative, many of those users still prefer to recognize intangible assets separately from goodwill in comparison to subsuming all intangible assets into goodwill. Some lenders do view intangible assets differently than goodwill because lenders will use intangible assets (for example, intellectual property) as collateral. Those users indicated that unlike the assessment of goodwill impairment that is a recurring annual cost, the identification of intangible assets is a one-time cost. Overall, those users believe that Issue 13-01B (goodwill) would provide more significant cost relief to private companies than this Issue (Issue 13-01A), while still providing relevant information to users.

Issue 1: Scope

18. The proposed alternative is permitted to be applied by entities that are required to apply the acquisition method under Topic 805 except for publicly traded companies or not-for-profit entities (NFPs), as defined in the Master Glossary of the FASB Accounting Standards Codification.

19. The majority of respondents who provided comments about the scope of the proposed alternative agreed with the type of entity, transactions, and accounts that are included. Most respondents agreed that the Board and the PCC should ensure that the scope is aligned with the final definition of a *public business entity* determined by the Board and with the final Private-Company Decision Making Framework (Guide).

20. Some respondents indicated concerns about how the proposed alternative would affect financial institutions, primarily banks that engage in business combinations. Specifically, those respondents indicated that it was not clear whether the proposed alternative would allow core

deposit intangibles to be separately recognized and suggested that the Board and the PCC provide implementation guidance to clarify this. Some suggested the Board and the PCC consider whether to exclude financial institutions from the scope of the proposed alternative due to concerns that core deposits would no longer be separately recognized. Those respondents believe that the lack of a separate classification of core deposit intangible assets would not benefit users of financial statements of financial institutions.

21. Other respondents indicated that community banks typically do not frequently engage in business combinations and therefore the proposed alternative would not provide significant relief for those entities. Of the banks that do engage in business combinations, they would likely not take advantage of the proposed alternative because of differential regulatory requirements and their preference to have comparability with their peers.

22. In general, credit unions were supportive of being included in the scope of the proposed alternative. Although intangible assets do not generally represent significant assets on their financial statements, most credit unions are still required to invest significant time and resources to appropriately value separate identifiable intangible assets and believe that they could benefit by the proposed alternative.

23. A few respondents raised concerns about the accounting for subsequent sales of an intangible asset that was not recognized in an initial business combination but included in goodwill. If an intangible asset is not initially recognized, the entity would recognize a gain for the full amount of the proceeds received, since there would be no asset to derecognize upon sale. Those respondents suggested that the Board and the PCC consider whether recognition of an intangible asset should be permitted when an entity intends to sell or transfer an intangible asset shortly after acquisition.

Public Companies and Not-For-Profit Entities

24. A large majority of respondents were supportive of expanding the scope of the accounting alternative to NFPs because those entities are deemed to face some of the issues experienced by private companies. The feedback was mixed in regards to whether the proposed alternative

should be expanded to public companies. If the scope was expanded to both public companies and NFPs, the feedback was mixed regarding whether the accounting alternative should be elective or replace existing guidance. The Board has directed the staff to perform outreach to public companies and NFPs to assess whether the proposed alternative should be considered for those entities. The staff will discuss the feedback received at a future Board meeting.

FASB Staff Recommendation

25. Since the majority of the respondents agreed with the scope of the proposed alternative, the staff recommends that the PCC reaffirm the current scope of the proposed alternative (since the decision regarding the extension of the alternative to NFPs or public business entities will be addressed by the Board separately). However, the staff notes that the scope should be updated to match the final scope of the Guide in order to align it with the definition of a public business entity, when completed. The staff believes that the concerns raised about the relevance of core deposit intangible assets for financial institutions are similar to concerns raised about the relevance of some intangible assets to other industries (for example, technology companies that are concerned that unpatented technology would no longer be recognized under the proposed alternative). Therefore, the staff believes that those concerns are not unique to financial institutions or core deposit intangible assets. If some intangible assets are relevant to a primary user of a private company's financial statements, an entity can choose not to apply the proposed alternative and recognize identifiable intangible assets in accordance with Topic 805.

Question 1: Does the PCC agree with the staff recommendation to reaffirm that the proposed alternative would be available to any entity that is required to apply the acquisition method under Topic 805 except for public business entities and NFPs?

Issue 2: How intangible assets acquired in a business combination (separate from goodwill) should be identified, recognized, and measured.

Feedback

26. Overall feedback on Issue 2 is discussed in paragraphs 8-17 of this Issue Supplement. This section includes feedback about specific aspects of the proposed alternative.

Distinguishing Noncancelable Contract Terms from Cancelable Contract Terms

27. Respondents indicated specific concerns relating to the distinction between contractual rights with noncancelable contract terms and contractual rights with cancelable contract terms. Some respondents noted that the break-out of contracts between those that are cancelable and those that are noncancelable could add costs and complexity in comparison to existing U.S. GAAP. For example, the FASB staff's outreach indicates that many companies do not have contract terms that are uniform for all contracts. Even if their contracts have similar terms, they often have different start and end dates. Thus, some constituents raised concerns that the proposed alternative would require them to potentially value customer contracts on an individual basis or to group contracts (which could require a detailed analysis of their contractual relationships to determine the groupings) as opposed to valuing the customer relationship based on aggregated revenues using historical attrition rates. PricewaterhouseCoopers, LLP (CL#11) included the following remarks:

> It may be more difficult to separate the value of certain identifiable intangible assets when those assets relate closely to and significantly affect the value of contractual or legal intangible assets and are valued together today. This may be the case where assets arising solely from noncancelable contractual terms or other legal rights- such as patents and trademarks – must be separated from the value of unpatented technology, databases, and knowhow that would not be recognized apart from goodwill under the proposal.

28. Some respondents highlighted that the determination of what is noncancelable for some contracts could be subjective. Thus, the determination could require legal interpretation or result in the need for additional implementation guidance. Crowe Horwath, LLP (CL#37) put it this way:

> One area we believe could require significant effort to implement and audit without a corresponding benefit is the portion of the proposed standard that involves the analysis required to determine which intangibles are contractual versus non-contractual and the determination of the remaining contractual life of specific contracts.

29. Some respondents challenged criterion (a) of the definition of a noncancelable contractual term under paragraph 805-20-25-30 of the proposed Update. A few respondents suggested the Board and PCC clarify the definition of a noncancelable asset included under paragraphs 805-20-25-31(a) through 25-31(d). Those respondents stated that the definition should take into consideration the acquirer's intent because otherwise valuation inconsistencies could arise in cases in which an acquirer would cancel the contract immediately after the business combination since that contract would have already been recorded as a noncancelable contract.

Measurement of Identifiable Intangible Assets That Arise from Contractual Rights That Are Noncancelable

30. The proposed alternative indicates that identifiable intangible assets that arise from contractual rights would be measured using the fair value measurement principles of Topic 820 except that the measurement would only consider market participant assumptions about the remaining noncancelable contract term and, therefore, would not consider any potential contractual renewals or cancellations that ordinarily would be considered in determining the fair value of that contract.

31. Some respondents indicated that this aspect of the proposed alternative may add complexity because of the creation of a new measurement methodology for contractual intangible assets that would represent neither cost nor fair value. In addition, they questioned the usefulness of the information derived from the application of the proposed alternative because they believe that the new measurement methodology would create inconsistencies and comparability issues and ultimately would not properly reflect the value of such intangible assets. Crowe Horwath, LLP (CL#37) put it this way:

> We believe that the "almost fair value" amounts…. does not justify the effort because limiting the life of the contract to the remaining noncancelable contractual term does not reflect the fair value of the intangible asset, or in some cases the economics of the transaction, and therefore significantly limits the usefulness to financial statement users.

32. Concerns also were raised that the proposed alternative would not decrease costs and complexity when intangible assets are measured using certain valuation methodologies such as

the multi-period excess earnings method (MPEEM). The MPEEM is the most commonly used valuation approach for an entity's primary asset and is also used to assess the overall reasonableness of a valuation. MPEEM requires the estimation of the fair value of all supporting tangible and intangible assets, including intangible assets that are not recognized separately from goodwill (for example, assembled workforce under current U.S. GAAP). If additional intangible assets that do not meet the noncancelable-contractual or other legal rights criterion will be subsumed into goodwill, they may still need to be valued to perform the MPEEM. For example, if a brand or technology is deemed to be an entity's primary asset (and thus valued under a MPEEM), noncontractual customer relationships would need to be valued to appropriately apply the MPEEM. Thus, those respondents argue that the proposed alternative would not provide cost and complexity relief to private companies or their auditors because either the unrecognized intangibles would still have to be valued or the new methodologies would have to be developed to replace the MPEEM. HDH Advisors LLC (CL#29) said the following:

> The proposed guidance could complicate any appraisals performed using a MPEEM, as all intangible assets (whether or not meeting the legal criterion) must be fair valued as part of such analysis in order to calculate contributory asset charges.

Other Legal Rights

33. Some respondents stated that determining intangible assets that arise from other legal rights could be challenging. For example, a trade secret, a recipe, or technology that is not registered may be entitled to legal protection. Those respondents stated that the proposed alternative is not clear about whether those intangible assets would be subsumed into goodwill.

34. Some respondents think that additional costs would result from entities needing to take a closer look to make the distinction between noncancelable contractual rights and other legal rights since (a) current U.S. GAAP does not make that distinction and (b) the proposed measurement requirements would differ. In addition, some respondents stated that the exclusion of unregistered technologies and trademarks would generate inconsistencies in the accounting treatment of intangible assets whose characteristics are slightly different on paper but whose

economic substance would not be different (for example, unpatented technology versus patented technology, and registered trademarks versus unregistered trademarks).

<u>Measurement of Identifiable Intangible Assets Arising from Other Legal Rights</u>

35. The majority of respondents supported the measurement of intangible assets arising from other legal rights (but are not contractual) at acquisition-date fair value incorporating all market participant expectations consistent with Topic 820. Those respondents stated that recognizing intangible assets at their estimated fair value provides a faithful representation of their value and intangible assets arising from other legal rights often have discrete cash flows associated with them (for example, patents). In addition, some intangible assets that arise from legal rights are not typically renewed and thus would not change existing valuations for those assets (for example, patents). 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 valuation process.

36. A few respondents disagreed with the measurement approach for other legal rights because they believe that Topic 820 is inherently complex. Accordingly, they suggested that the Board consider simplifying that guidance for all entities regardless of whether they are private or public companies. The respondents who disagreed also stated that nonfinancial assets and liabilities not measured on a recurring basis, such as intangible assets, should be exempted from the application of Topic 820. They explained that fair value measurements prescribed by Topic 820 are costly for preparers and provide limited value to users due to the fact that the relevance of fair value measurements diminishes in periods after a business combination because the carrying amount of the intangibles no longer matches their fair value.

Alternatives

37. Given the concerns raised about the proposed alternative, the staff has identified five alternative views for the PCC's consideration relating to the separate identification of intangible assets in a business combination.

38. A few respondents suggested that a better alternative to the one proposed would be to subsume all intangible assets into goodwill (View B in this Issue Supplement). They believe that this approach would provide private companies with the relief they requested and would not negatively impact the relevance of the information provided to users because many users indicated that they do not consider intangible assets or goodwill to be relevant factors in their decisions. The AICPA Private Companies Practice Section Technical Issues Committee (TIC) (CL#39) said the following:

> TIC's preferred alternative is to adopt an "all or nothing" approach to the recognition of identified intangibles, which would provide an option to subsume all identified intangibles into goodwill at the acquisition date.

39. Another alternative suggested was to limit the recognition and measurement guidance to identifiable intangible assets that have noncancelable contractual terms or other legal rights <u>and</u> meet the separability criterion. This alternative could provide a higher level of relief to private companies compared to the one currently proposed because certain complex intangible assets, such as contractual and noncancelable customer relationships, would no longer need to be separately measured. However, many of the complexities highlighted in this Issue Supplement, for example the use of the MPEEM approach, would still exist under such an alternative. Therefore, the staff did not include this as an alternative.

View A—Retain Proposals: *Recognize separately from goodwill identifiable intangible assets that arise from contractual rights with noncancelable contractual terms or that arise from other legal rights. Identifiable intangible assets that arise from contractual rights would be measured using the fair value measurement principles of Topic 820 except that the measurement would only consider market participant assumptions about the remaining noncancelable term and would not consider any potential contractual renewals or cancellations.*

40. Proponents believe that View A could reduce the cost and complexity of preparing financial statements while continuing to provide decision-useful information about intangible assets acquired in a business combination. Proponents believe that intangible assets that have legally protected rights and that could generate discrete cash flows, such as patented technology,

registered trademarks, and contractual customer-based intangibles that are noncancelable, are relevant to private company financial statement users. While proponents acknowledge that this alternative may not result in as significant a reduction in costs as would View B, they believe that it would reduce unnecessary cost and complexity related to valuing intangible assets that are either separable or contractual that have cancelable contract terms, that may have little relevance to users. View A would require most customer relationship intangible assets to be subsumed into goodwill, which most users believe 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. For those users who find relevance in such intangible assets, proponents believe that the disclosure of the nature of unrecognized identifiable intangible assets, would continue to provide the desired information without the undue cost and complexity associated with valuing them. Most users of private company financial statements could obtain further information from management about those intangible assets, if necessary, through their ability to access management.

41. Proponents believe that intangibles that meet the contractual/legal criterion are more relevant to users of private company financial statements than intangibles that are only separable because those intangible assets are supported by legal rights and therefore considered more akin to tangible assets by users of private company financial statements. In comparison to existing U.S. GAAP, proponents believe that View A would narrow the number of intangible assets recognized by recognizing some but not all contractual/legal intangible assets. Proponents believe that View A would result in an outcome that most closely meets the attributes of the intangibles that users find most relevant; namely, intangibles that are legally protected and contractual intangibles that can generate cash flows that can be more reliably estimated than some of the contractual intangible assets that are recognized under existing guidance.

42. Proponents also believe that the measurement method under View A would be more relevant to users than measuring the fair value of the entire contractual relationship including potential renewal terms. That measurement method could significantly reduce the subjectivity, and therefore the complexity, of valuing highly judgmental intangible assets. For example, while a customer contract would continue to be recognized up to the value attributed to its

noncancelable term, the related customer relationships attributed to the potential renewals of the contract, or to expectations of future contracts (such as future purchase orders), would not be recognized separately from goodwill. Proponents also believe that ongoing costs of testing intangible assets (excluding goodwill) for impairment may be reduced because View A would generally result in fewer intangible assets being separately recognized.

43. Opponents believe that View A does not result in enough cost relief for private companies compared to current U.S. GAAP, because they believe that View A would still result in identifiable intangible assets being recognized, even if fewer than in existing guidance, and therefore would continue to require extensive involvement of external valuation professionals and auditors. In addition, opponents of View A believe that excluding from the recognition criteria intangible assets that are separable would take away important information from users of private company financial statements, because such intangibles could have discrete cash flows and may be sold separately from the acquired entity and some intangible assets may be more relevant to a particular industry (for example, unpatented technology).

44. Opponents believe that View A could increase complexity in comparison to existing U.S. GAAP consistent with the views from respondents to the proposed Update highlighted in this Issue Supplement. Having a split valuation model that separates measuring legal rights from noncanceleable contractual rights could create more complexity and result in a lack of comparability between those intangible assets. Opponents believe that implementation issues and audit concerns could arise as a result of having to distinguish between contracts with cancelable terms and those with noncancelable terms, because there could be significant judgment involved in such a bifurcation, as discussed above.

45. Opponents believe that View A would not reflect the economics of the transaction or strategic rationale for entering into an acquisition or may not reflect the business model of the acquired entity. In some industries (for example, software), unpatented technology and in-process research and development may be the primary motive for entering into the transaction, which would imply that considerable value should be assigned to those assets. By not reflecting that information in the financial statements, valuable information could be taken away from

users. View A would create diversity for intangible assets with the same (or similar) economic profile (unpatented technology versus patented technology).

46. Opponents believe that the proposals would not be practical for identifiable intangible assets that have short-term contracts. For example, many customer contracts have cancellation provisions (without cause) for 30 to 90 days. In such cases, some would conclude that the useful life of a contract would be a quarter of the fiscal year. Therefore, an acquisition occurring more than 90 days prior to the end of a fiscal year could ultimately result in fully expensing the assets in the same period.

47. Opponents believe that View A could increase complexity because an entity may need to value individual customer contracts and determining a value over a specific contract life may require more discrete asset identification. In addition, the measurement may vary between entities based on the number of years remaining in a contract for the same or similar assets. Opponents believe that factoring renewals into the measurement may be appropriate in some instances in which renewals are highly likely. In addition, opponents note that View A would still require more effort than the incremental benefit because it would still require that valuation techniques are applied to a portion of the intangible assets. If using MPEEM for valuation, all intangible assets may still need to be fair valued as part of the analysis in order to calculate contributory asset charges. For example, if the primary asset is separately identified, such as customer relationships that are contractual and noncancelable. Opponents believe that the measurement would not result in a true fair value and therefore may limit the usefulness to users and would not take into account management’s intent for utilization of the assets post combination.

View B—No Intangibles Approach: *A private company would not recognize any intangible assets separately from goodwill.*

48. Under View B, a private company would not recognize any intangible asset in a business combination separately from goodwill. The amount recognized as goodwill would represent the

excess of the purchase price over the fair value of the acquired tangible net assets. Goodwill would therefore need to be re-characterized as Goodwill and Other Intangible Assets.

49. Proponents of View B argue that users of financial statements generally disregard the accounting effects of most intangible assets and, therefore, subsuming all intangibles into goodwill would not reduce usefulness of financial statements. Further, proponents believe that View B would significantly reduce cost and complexity because most private companies would no longer need assistance from outside valuation professionals for the valuation of intangible assets. View B also would eliminate the judgment element that is currently necessary in valuing intangible assets, which proponents believe can result in different fair values for economically similar intangibles.

50. Proponents also believe that if private companies are given an alternative, the alternative should be meaningful enough to easily distinguish it from the accounting for public companies. Proponents indicated that users would be better served if private company recognition exceptions are kept straight-forward (as in View B) so users can quickly identify and analyze the differences, as opposed to trying to understand the nuances between two different recognition principles that results in information that is not comparable and differences that are not identifiable.

51. Proponents believe that View B would provide relief to private companies that have users that disregard intangible assets in their analysis and do not require separate recognition of intangible assets. Similar to View A, under View B, users would obtain information from the disclosures about the nature of the acquired intangibles and, if needed, ask management to provide specific information about such intangibles (cash flows, fair value, or otherwise).

52. Proponents of View B also acknowledge the concerns raised by stakeholders that indicate that the narrower definition of “identifiable” under View A may not reduce costs in comparison to current guidance. Proponents believe that View A may introduce unnecessary complexity, especially for preparers and auditors when evaluating which intangibles are cancelable or noncancelable, and which are noncancelable or legal. Furthermore, proponents of View B

believe that even the potentially lower costs expected under View A are not justifiable since they believe that reporting intangibles separately from goodwill does not provide decision-useful information to users of private company financial statements.

53. Opponents believe that View B would lead to a gross misrepresentation of intangible assets because dissimilar items with different useful lives, different risks, and different cash flows would be grouped together in one line item that would not be a faithful representation of the underlying economic phenomena. Opponents also refer to FASB Concepts Statement No. 5. *Recognition and Measurement in Financial Statements of Business Enterprises*, which states that "analysis at objectives such as predicting amounts, timing and uncertainty of cash flows requires financial information segregated into reasonably homogeneous groups." Moreover, when there is a sale of an intangible asset (or a group of assets), an entity's gain or loss calculation would not capture the carrying amount of the assets, leading to overstated gains or understated losses (except when the intangible sold constitutes a business, in which case a relative portion of the goodwill would be allocated to the carrying amount of the business sold). Opponents acknowledge the significant cost relief that would be provided under View B, but believe that grouping of dissimilar assets and not conveying the value of certain important intangible assets separately from goodwill could diminish the usefulness of private company financial statements.

54. Opponents of View B (similar to opponents of View A), believe that separately recognizing all or some identifiable intangibles from goodwill is more representationally faithful than allocating intangibles to goodwill. Allocating all intangibles to goodwill would diminish, not improve, the usefulness of financial statements. Opponents highlight that some intangible assets are relevant to many financial statement users and, therefore, should continue to be recognized separately from goodwill. This is consistent with the PCC's decision to reject the no intangibles approach alternative at its May 2013 meeting. Moreover, opponents believe that including finite-lived intangible assets in goodwill that is not being amortized would further diminish the usefulness of subsequent financial statements.

55. Opponents also think that View B could result in a significant lack of comparability (a) between public company financial statements and private company financial statements and/or

(b) among private companies (that is, a private company that chooses to apply the proposed alternative and a private company that chooses not to apply the proposed alternative). Opponents believe that there is uncertainty about whether some industries will avail themselves of the proposed alternative (for example, some technology companies) given the feedback that indicates that users of private company financial statements do find information about some intangible assets to be decision-useful (for example, patented or unpatented technology).

View C: *Subsume only customer related intangibles ("CRI") assets into goodwill.*

56. Another alternative (View C) the PCC could consider is for an entity to subsume only CRIs (that is, backlog, contracts, lists, relationships) into goodwill. Under View C, an entity would continue to recognize and measure identifiable intangible assets acquired in a business combination (separate from goodwill) in accordance with existing guidance in Topic 805. However, CRIs would be subsumed into goodwill. Proponents of View C highlight that outreach indicates that many users of private company financial statements stated that information about customer relationships is not decision-useful because those assets are generally not transferable or separable from an entity, and because their values depend on variables that may be subjective. In addition, proponents believe that determining the appropriate useful life and pattern of amortization for CRIs can be challenging. Proponents also believe that View C could benefit entities in which CRI is the primary asset and therefore the use of the MPEEM would not be necessary. Proponents also note that View C would not result in entities having to make a distinction between unpatented technology and patented technology, which was an area of concern indicated by respondents about the proposed alternative. Proponents highlight that if information about CRIs is important to users, entities would still have the option to comply with current U.S. GAAP under Topic 805.

57. Opponents acknowledge that View C could reduce costs for entities in which CRI is the primary asset. However, opponents of View C think that if a CRI is the primary asset, information about CRIs would most likely provide relevant information to users of private company financial statements. Opponents believe that information about customer relationships is relevant because some users of private company financial statements indicated that customers

generally stay with the same bank or renew their insurance policies; therefore, those intangibles may represent an important asset to a bank or an insurance company. Those users indicated that in those instances, customer relationships can be relevant whether they are contractual or noncontractual. In addition, opponents believe that View C could result in similar concerns about cost and complexity as indicated in this Issue Supplement, primarily relating to measurement, and question how significant the cost savings of View C would be. If CRI is the primary asset, the MPEEM may not be necessary; however, auditors and valuation specialists would likely need to develop another approach to gain comfort with the reasonableness of the overall valuation. In addition, entities will still likely need to hire a valuation specialist to perform a valuation for the intangible assets that are required to be separately recognized.

View D—Status quo: *Continue to require recognizing and measuring identifiable intangible assets acquired in a business combination (separate from goodwill).*

58. Under View D, a private company's intangible assets acquired in a business combination would continue be recognized separately from goodwill on the date of acquisition. Such intangibles, among others, may include customer relationships, customer contracts, trade names, brands, technology, patents, publishing rights, software, trade secrets, and IPR&D. A private company would recognize all assets acquired and liabilities assumed in a business combination at their acquisition-date fair values in accordance with Topic 805, including intangibles that meet the criteria for an intangible asset to be identifiable. Therefore, an acquirer must determine the fair value of certain intangibles even if those intangibles were not previously reported in the acquired entity's pre-acquisition financial statements (for example, customer relationships). Identifiable intangibles, both finite and indefinite-lived, must be recognized separately from goodwill.

59. Proponents of View D believe that separately recognizing all identifiable intangibles from goodwill is more representationally faithful than allocating all or some intangibles to goodwill, which is consistent with the principle basis for the existing requirement to recognize intangibles separately from goodwill. When the current guidance was first introduced, the FASB specifically cited Concepts Statement 5, which states that "analysis aimed at objectives such as predicting

amounts, timing, and uncertainty of future cash flows requires financial information segregated into reasonably homogenous groups." Based on that principle, and since goodwill would no longer be amortized, the Board concluded that intangibles that are identifiable (which was defined in a broad manner), should be separately recognized from goodwill. At the time, the FASB defined "identifiable" broadly because it believed that history of individual exchange transactions was not the only evidence of separability. Proponents acknowledge that the fair value estimates for some intangible assets might lack the precision of the fair value measurements for other assets. However, they also believe that the financial information that will be provided by recognizing all intangible assets at their fair values is more representationally faithful than that which would be provided if those intangible assets were subsumed into goodwill on the basis of measurement difficulties.

60. Opponents of View D have views consistent with those of proponents of View A, View B, and View C, and believe that the benefits of the current accounting for identifiable intangible assets acquired in a business combination do not justify the related costs. In addition, some users of private company financial statements indicated that they view many intangible assets as being no different than goodwill. Therefore, opponents of View D believe that an alternative that would reduce cost and complexity for private companies relating to identification of intangible assets in a business combination is warranted.

View E—*The FASB staff will conduct additional research on other potential alternatives*

61. Under View E, the staff would conduct additional research to develop other potential alternatives for the PCC's consideration of this Issue. The staff would present that research, along with other potential alternatives, to the PCC at a future meeting. Proponents of View E believe that Views A through D in this Issue Supplement are not viable alternatives to address this Issue for reasons indicated above within this Issue Supplement. Proponents of View E believe that the benefits of the current accounting for identifiable intangible assets acquired in a business combination do not justify the related costs and additional research should be conducted in light of some of the concerns received from respondents about the proposed alternative. Proponents acknowledge the linkage between Issue 13-01A and Issue 13-01B, however, they

believe that private company stakeholders can benefit from a reduction in cost and complexity relating to Issue 13-01B regardless of whether the accounting for intangible assets changes. Proponents believe that the PCC can make a decision on Issue 13-01B while deferring any decision on Issue 13-01A to a future meeting.

62. Opponents of View E believe that the FASB staff has considered viable approaches to address how intangible assets in a business combination should be identified and those approaches are included within this Issue Supplement. Opponents note that the staff has considered other alternatives that would result in the recognition of some intangible assets, but fewer than under current U.S. GAAP, and encountered similar concerns about cost and complexity as indicated throughout this Issue Supplement. Opponents of View E also believe that Issue 13-01A has an interdependency with Issue 13-01B. Thus, the PCC should make a decision on both Issues at the same time because any exceptions or expedients to the initial recognition of intangibles for private companies could increase the goodwill amount recognized on the acquisition date.

FASB Staff Recommendation

63. Given the concerns raised by respondents relating to the proposed alternative (View A), the staff does not believe that the overall reduction in cost and complexity is significant in comparison to existing U.S. GAAP, and could even increase for certain transactions. For example, separating patented technology from unpatented technology or the potential complexity and data needs associated with assessing noncancelable terms of customer contracts and the valuation of those contracts. Some respondents indicated that they support the proposed alternative because it would eliminate the valuation of the identifiable intangible assets that are most difficult to measure (for example, non-contractual customer relationships). However, given the complexities raised by respondents about the use of MPEEM and other valuation methods, in many cases those intangible assets would still need to be valued and, therefore, would not result in a substantial reduction in cost and complexity. In addition, View A would result in some identifiable intangible assets that some users find relevant to be subsumed into goodwill (for example, contractual intangible assets that have a high likelihood of renewal, unregistered trade names, and unpatented technology). Therefore, the staff does not recommend View A.

64. At its May 2013 meeting, the PCC considered an alternative that would have required separate recognition when a contractual/legal intangible asset is also separable. Specifically, this alternative would have required that the contractual/legal intangible asset has a history of observable transactions evidencing the sale, transfer, or exchange of the same or similar intangible asset. The PCC decided against this alternative because it concluded that the alternative would have significantly limited the number of intangible assets recognized, hence it would have resulted in certain relevant contractual/legal intangibles being subsumed into goodwill. It was concluded that this alternative would have resulted in the loss of valuable information for users because it would have excluded intangible assets that are contractual but not separable (certain contractual customer relationships), or contractual and separable but for which there is no history of observable transactions for the same or similar asset (for example, certain patented technology for which there is no history of transactions). Therefore, the staff did not include this alternative in this Issue Supplement. In addition, that view would result in many of the concerns about complexity of valuation as indicated in the feedback section of this Issue Supplement.

65. The PCC also considered an alternative that would have required separate recognition for intangible assets that meet the contractual-legal criterion regardless of whether they were noncancelable. The PCC decided against this alternative because of the view that the existing definition of contractual-legal is too broad in light of the overall objective to reduce cost and complexity while achieving a narrower focus on intangibles that users of private company financial statements find most relevant. For example, under the existing definition, a customer contract and the related customer relationship meet the contractual-legal criterion even if a contract does not exist at the acquisition date, as long as the entity has a practice of establishing contracts with its customers, as described in paragraph 805-20-55-25 of the Codification. Therefore, the staff did not include this alternative in this Issue Supplement.

66. The staff does not recommend View C because while View C may reduce costs in some instances (primarily in cases in which the CRI is the primary asset), the reduction in costs may not justify the reduction in the benefit to users of private company financial statements. The

staff believes that if a CRI is the primary asset, information about CRI's would be beneficial to users and, in many cases, more beneficial than other intangible assets that would still be required to be separately identified and measured under Topic 805.

67. As a result of the concerns about cost and complexity with an alternative that would result in the separate identification of some intangible assets but not all, the staff believes that the PCC should strongly consider View B, View D, and View E in this Issue Supplement. The staff believes that View B would result in the most significant reduction in cost and complexity of preparing financial statements for private companies. However, when considering the feedback from some users of private company financial statements that indicates that some identifiable intangible assets do provide decision-useful information depending on the type of user, industry, and other factors, and that given a choice between (a) intangible assets recognized separately from goodwill or (b) intangibles subsumed to goodwill, almost all users indicated a preference for the former over the latter before considering the incremental cost of valuing such intangibles. Therefore, the staff does not believe that View B would result in decision-useful information to users of private company financial statements and does not recommend View B.

68. The staff believes that if the PCC decides on View D and not to make a change to the accounting for identifiable intangible assets, private companies would still benefit from a reduction in cost and complexity if they elect to apply Issue 13-01B relating to the accounting for goodwill. While the staff believes that the PCC should strongly consider View D, the staff also believe that if the PCC confirms its decision relating to amortization of goodwill as discussed in Issue 13-01B, Supplement No. 1, View B could be a viable alternative in situations in which a private company's users would not require a separate breakout of intangible assets and do not find relevance in goodwill or intangible assets. In those instances, View B could maximize relief for those private companies without compromising user needs. If information about intangible assets is important to users, entities would still have the option to comply with Topic 805. However, the staff does not believe that View B is a viable alternative if the PCC decides on the direct write-off approach to goodwill as discussed in Issue 13-01B Supplement No. 1.

69. In light of the concerns received from respondents, the staff recommends View E (additional research). The staff has considered other alternatives that would result in the recognition of some intangible assets, but fewer than under current U.S. GAAP, and encountered similar concerns about cost and complexity as indicated in this paragraph and throughout this Issue Supplement. However, additional research could allow the staff to determine whether there are any other viable alternatives that can address the cost/benefit concerns of private company stakeholders for this Issue. If the PCC does not choose View E, the staff recommends View D to not make a change to the accounting for identifiable intangible assets. The staff believes that private companies would still benefit from a reduction in cost and complexity if they elect to apply Issue 13-01B relating to the accounting for goodwill.

Question 2: Which View does the PCC prefer?

Issue 3: Recurring Disclosure

70. Under the proposed alternative, an entity would be required to disclose qualitatively the nature of identifiable intangible assets acquired but not recognized as a result of applying the accounting alternative. For intangibles that are recognized after applying the accounting alternative, a private company would follow the disclosure requirements in the relevant Codification Topics (for example, Topic 805; Topic 350, Intangibles—Goodwill and Other; and Topic 820).

Feedback

71. The majority of respondents agreed with the required additional disclosure to provide qualitative information about the nature of identifiable intangible assets acquired but not recognized as a result of applying the proposed alternative. Those respondents indicated that the disclosures would provide financial statements users with sufficient information about non-separately recognized intangible assets that would work as a signal to alert financial statement users to the existence of intangible assets that are subsumed into goodwill. Most users of private company financial statements could obtain further information from management about those intangible assets if necessary through their ability to access management.

72. A few respondents questioned the relevance of the proposed additional disclosure. If non-contractual, contractual and cancelable, and non-legal intangible assets do not warrant separate recognition on the face of the financial statements, there should not be a need for disclosures about those assets. Other respondents expressed concern that the provision of such disclosures would add complexity and require private companies to likely involve third-party valuation experts to assist them with the identification of the additional intangible assets. This may defeat one of the goals of the proposed alternative, which is to reduce costs and complexity for private companies. A few respondents requested that the Board and the PCC clarify the periods in which the additional disclosures should be provided.

73. Nearly all respondents agreed that the proposed alternative should not require any other additional recurring disclosures for identifiable intangible assets that are recognized separately as a result of applying the proposed alternative.

FASB Staff Recommendation

74. If the PCC chooses View A, View B, or View C under Issue 2 of this Issue Supplement, the staff recommends that the PCC reaffirm its tentative decision that the proposed alternative would require an entity to disclose qualitatively the nature of identifiable intangible assets that are not recognized separately from goodwill as a result of applying the proposed alternative. Disclosures would be required in the period of acquisition and annually thereafter. For identifiable intangible assets that are recognized separately from goodwill, entities would continue to follow the disclosure requirements in applicable topics. The Guide indicates that the PCC should consider whether there will be sufficient disclosure in the notes necessary to facilitate a user's review and to allow a user to identify appropriate follow-up questions to present to management (the red-flag approach) when the user deems it necessary to do so. The staff believes that disclosure of qualitative information about intangible assets that are not recognized would provide useful information to users and help them identify items that could require further discussion with management without significant costs to preparers.

Question 3: Does the PCC agree with the staff recommendation about recurring disclosure?

Issue 4: Transition

75. The proposed Update indicates that the proposed alternative would be effective prospectively for all business combinations entered into during fiscal years, and interim periods within those years, beginning on or after the effective date.

Feedback

76. Nearly all respondents agreed that the proposed alternative should be applied on a prospective basis. Many respondents did not agree with the option of retrospective application due to cost and complexity considerations. However, a few respondents acknowledged that a retrospective application should be permitted on an elective basis for preparers and users who prefer consistent presentation of intangible assets in comparative financial statements. In addition, those respondents stated that retrospective application may not be practical unless an entity also adopts the PCC proposal on accounting for goodwill (Issue 13-01B).

FASB Staff Recommendation

77. The staff recommends that 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. The staff believes that 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). Accordingly, the staff believes that a prospective approach, in which the differential accounting treatment would only apply to new business combinations after the effective date, would be more appropriate. The staff acknowledges the concerns of some stakeholders who may prefer the option of retrospective application in order to achieve comparability. However, the proposed alternative is intended to reduce costs and complexity

while improving the relevance of information to users. Given the additional effort and cost that would be incurred with retrospective application, the staff does not recommend that retrospective application be permitted.

Question 4: Does the PCC agree with the staff recommendations for transition?

Issue 5: Effective date and early application

78. The proposed Update did not indicate an effective date for the proposed alternative but does indicate that that early application would be permitted.

Feedback

79. The majority of respondents indicated that the proposed alternative should become effective within a short period of time after final issuance. Some suggested that the proposed alternative should be effective for fiscal years beginning after December 15, 2013, while others recommended that the proposed alternative should be effective for fiscal years beginning after December 15, 2014. 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. Whether an accounting change after the effective date can be made will be discussed separately.

FASB Staff Recommendation

80. The staff recommends that private companies should be able to apply the alternative, if they elect to do so, for the accounting for intangible assets in a business combinations entered into during fiscal years, and interim periods within those years, beginning on or after December 15, 2014, with early application permitted. The staff believes that if the proposed alternative is final before the end of 2013, private companies and their auditors would have almost 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 2015 (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. The staff believes that 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.

Question 5: Does the PCC agree that the proposed alternative should be effective for business combinations entered into during fiscal years, and interim periods within those years, beginning on or after December 15, 2014, with early application permitted?

Issue 6: Whether the proposed Update should be revised and reexposed.

81. The PCC should consider whether to reexpose this Issue based on the changes to the proposed alternative as a result of the decisions reached on the questions above. 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 constituents 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.

After considering those factors, if the PCC decides not to move forward with the separate identification of intangible assets in a business combination, but to propose that all intangible assets be subsumed into goodwill (View B) or to subsume only CRI assets into goodwill (View C), the staff believes that exposure of a revised exposure draft is warranted.

82. The FASB staff notes that if reexposure is required, the summary of comments from the re-exposed proposed Update and a final alternative could be proposed to the PCC at its January 2014 meeting. If the Board were to endorse the proposed alternative, the final Update could be issued shortly thereafter (approximately within 60 days). That would enable entities that choose to elect early adoption to take advantage of the relief in their 2013 financial statements if the financial statements have not yet been issued (as calendar-year private company financial statements are often not issued until April or May).

Question 6: Does the PCC believe that the proposed Update should be reexposed?