

Heads Up

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It's Not Complicated

Simplifying Private-Company Accounting for Intangible Assets in a Business Combination

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Introduction

On December 23, 2014, the FASB issued [ASU 2014-18](#),¹ which provides alternative accounting for a private company² that recognizes or considers the fair value of identifiable intangible assets (1) in a business combination, (2) as part of an investment accounted for under the equity method, or (3) upon the adoption of fresh-start accounting. The accounting alternative is effective prospectively upon the first eligible transaction entered into in an annual period beginning after December 15, 2015 (with early adoption permitted), and will apply to all future transactions after the adoption date. The alternative will help private companies reduce the cost and complexity of accounting for a business combination and other eligible transactions because many customer-related intangible (CRI) assets and all noncompete agreements (NCAs) would not be recognized separately and would be subsumed into goodwill.

Key Provisions of the ASU

Under current U.S. GAAP, an entity must recognize and measure at fair value on the date of acquisition intangible assets that meet either the contractual-legal criterion or the separability criterion described in the definition of "identifiable" in the *FASB Accounting Standards Codification* (ASC) Master Glossary. Under the alternative in ASU 2014-18, which applies to assets acquired in a business combination, to investments accounted for under the equity method, and upon fresh-start accounting, a private company would be required to separately recognize CRI assets only if they are capable of being sold or licensed independently from the other assets of the business. In addition, a private company that elects to adopt this alternative will no longer separately recognize NCAs that arise within the scope of the ASU. Accordingly, it would potentially recognize fewer intangible assets and, correspondingly, recognize more goodwill.

Editor's Note: Favorable customer contracts are intangible assets and are therefore within the scope of the ASU, whereas unfavorable contracts are recognized as liabilities and outside its scope. Contract assets³ and leases are also excluded from the ASU's scope. ASC 805-20-25-31 (added by the ASU) provides examples of CRI assets that may meet the criteria for separate recognition apart from goodwill, which include but are not limited to mortgage servicing rights, commodity supply contracts, core deposits, and customer information (e.g., names and contact information).

¹ FASB Accounting Standards Update No. 2014-18, *Accounting for Identifiable Intangible Assets in a Business Combination* — a consensus of the Private Company Council.

² An entity other than a "public business entity," a "not-for-profit entity," or an employee benefit plan within the scope of ASC 960 through ASC 965 on plan accounting. (For titles of ASC references, see Deloitte's *"Titles of Topics and Subtopics in the FASB Accounting Standards Codification."*)

³ FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers*, defines a contract asset as an "entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance)."

Effective Date and Transition

An entity that elects to adopt the accounting alternative would apply the guidance prospectively to the first eligible transaction within the scope of the ASU that occurs in an annual period beginning after December 15, 2015 (with early adoption permitted) and all transactions thereafter. Upon adoption of the alternative, an entity would continue to measure existing CRI assets and NCAs in accordance with ASC 350 and should not reclassify or subsume them into goodwill.

If an entity elects the alternative in ASU 2014-18, it is also required to adopt the alternative accounting in ASU 2014-02 for goodwill.

In addition, if an entity elects the alternative, it is also required to adopt the alternative accounting in ASU 2014-02⁴ for goodwill. However, an entity that elects to adopt the goodwill alternative does not need to adopt the guidance in ASU 2014-18. Further, ASU 2014-18 does not require an entity to provide any incremental disclosures beyond those required by ASC 805.

Editor's Note: An entity electing the alternative needs to consider the potential impact on its accounting if it plans to or may otherwise become subject to the reporting requirements of a public business entity. Currently, there is no guidance on how an entity would make the transition from using a private-company alternative to applying public business entity requirements and it is generally expected that an entity would need to recast its prior-period financial statements as if it had not applied the alternative. As the amount of time between each use of the alternative increases, it may become increasingly difficult for an entity to retrospectively adjust the fair value of identifiable assets subsumed into goodwill since the information it would need to determine the fair value of the assets may no longer be available.

⁴ FASB Accounting Standards Update No. 2014-02, *Accounting for Goodwill* — a consensus of the Private Company Council.

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