JANUARY 2015
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AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

BDO FLASH REPORT
FASB

SUBJECT:

FASB ISSUES ACCOUNTING ALTERNATIVE FOR PRIVATE COMPANIES ON INTANGIBLE ASSETS IN BUSINESS COMBINATIONS

SUMMARY:

The FASB recently issued new guidance for private companies establishing an accounting alternative for certain intangible assets acquired in a business combination. If a private company elects the alternative, it would not recognize separately from goodwill certain assets arising from customer relationships and noncompetition agreements upon acquisition. Rather, they would be subsumed into goodwill, and the goodwill would be amortized. The alternative is intended to reduce cost and complexity for private companies. The decision to elect the alternative must be made upon the occurrence of the first in-scope transaction in years beginning after December 15, 2015, with early application permitted. The standard is available here.

In addition, the FASB staff recently addressed the interaction between this option regarding certain intangible assets and the option to apply pushdown accounting under ASU 2014-17. See "January 20, 2015 Update" below.

MAIN PROVISIONS:

ASU 2014-18[1] establishes an accounting alternative for private companies.[2] The alternative relates to intangible assets that arise as a result of applying the acquisition method under Topic 805, accounting for equity method "basis differences" under Topic 323, or in connection with fresh-start accounting under Topic 852. Under the alternative, a private company would not recognize separately from goodwill the following intangible assets:

[1] *Accounting for Identifiable Intangible Assets in a Business Combination (a consensus of the Private Company Council)*

[2] Defined by the Master Glossary as *an entity other than a public business entity, a not-for-profit entity, or an employee benefit plan within the scope of Topics 960 through 965 on plan accounting.*

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a) Customer-related intangible assets unless they are capable of being sold or licensed independently from other assets of the business;
b) Noncompetition agreements.

As noted above, not all customer-related intangible assets are exempt from being separately recognized apart from goodwill. The standard cites mortgage servicing rights, commodity supply contracts, core deposits and customer information (such as names and contact details), as assets that may need to be separately recorded. The FASB concluded that intangible assets which can be independently sold or licensed are typically the most relevant to users because they frequently provide discrete cash flows, and therefore warrant separate accounting.

Further, the Board does not expect it to be costly to assess whether customer-related intangible assets meet the separation test because this assessment should be clear in most cases. For example, if the transfer of a customer relationship depends on the decisions of a customer, it would be clear that the reporting entity is not capable of selling that asset separately.

In addition, the ASU states contract assets (a concept introduced by Topic 606[3]) and leases are not customer-related intangible assets, thus, a private company electing the alternative would recognize such assets separately.

Finally, a private company that elects the alternative must also prospectively adopt the accounting alternative for amortizing goodwill established by ASU 2014-02,[4] if not already adopted. However, a private company which has previously adopted the goodwill alternative is not required to adopt the intangibles alternative in ASU 2014-18.

EFFECTIVE DATE AND TRANSITION:

Private companies are required to decide whether to elect the accounting alternative upon the occurrence of the first in-scope transaction (e.g., a business combination) in fiscal years beginning after December 15, 2015.

If the first in-scope transaction occurs in the first fiscal year beginning after December 15, 2015, the elective adoption will be effective for that fiscal year's annual financial reporting and all interim and annual periods thereafter.

If the first in-scope transaction occurs in fiscal years beginning after December 15, 2016, the elective adoption will be effective in the interim period that includes the date of that first in-scope transaction and subsequent interim and annual periods thereafter.

Early application is permitted for any interim and annual financial statements that have not yet been made available for issuance. Once elected, the accounting alternative must be applied to all in-scope transactions on a prospective basis. However, customer-related intangible assets and noncompetition agreements that exist upon adoption shall continue to be subsequently measured under Topic 350. That is, such existing intangible assets should not be subsumed into goodwill upon the adoption of ASU 2014-18.

JANUARY 20, 2015 UPDATE

Through recent informal conversations with the FASB staff, BDO understands the option not to separately recognize qualifying intangible assets under ASU 2014-18 is available in the context of pushdown accounting under ASU 2014-17.

For example, assume Company A acquired Company B, which is a business, and that both companies are private (i.e., do not meet the definition of a public business entity in the ASC Master Glossary). As an accounting policy election, Company A may elect not to record qualifying intangible assets under ASU 2014-18; the option to apply pushdown accounting is not relevant since Company A is an acquirer under Topic 805. However, Company B would have two options: as an acquiree, it would be permitted to elect pushdown accounting. If B elects to do so, it would also be permitted not to recognize qualifying intangible assets as an accounting policy election.

[3] Revenue from Contracts with Customers

[4] Accounting for Goodwill (a *consensus of the Private Company Council)*

However, this option is only available for change-in-control events occurring on or after the effective date of ASU 2014-18. For example, if Company B elects to apply push down accounting under ASU 2014-17 to its most recent change-in-control event and that event occurred before the effective date of ASU 2014-18, B would not be able to apply the guidance in ASU 2014-18 to that change-in-control event.

We further understand B's accounting policy election regarding qualifying intangible assets is independent of A's. While expected to be rare, it is possible for A and B to make conflicting elections about whether to separately recognize qualifying intangible assets under ASU 2014-18.

Furthermore, as previously mentioned, the option not to separately recognize qualifying intangible assets under ASU 2014-18 is an accounting policy election. As such, if elected, it would apply to all subsequent qualifying events and transactions, including push down accounting.