Simplifying Accounting for Intangible Assets Acquired in a Business Combination

The Financial Accounting Standards Board (FASB) ended 2014 by issuing a fourth accounting alternative available to private companies that allows them to simplify their accounting by recognizing fewer intangible assets in a business combination. Private companies making an accounting policy election to apply the accounting alternative under Accounting Standards Update (ASU) No. 2014-18, Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination, may exclude certain intangible assets from separate recognition in a business combination. The alternative is available to all entities except public business entities and not-for-profit entities.

Recognition

Under current generally accepted accounting principles (GAAP), an acquirer is required to recognize assets acquired and liabilities assumed in a business combination at their acquisition-date fair values, including intangible assets that are identifiable, i.e., separable or arising from contractual or other legal rights.

Under the accounting alternative, a private company will not recognize separately from goodwill the following intangible assets:

- Customer-related intangible assets (CRIs) unless they are capable of being sold or licensed independently from the other assets of a business
- Noncompete agreements (NCA)

Examples of CRIs capable of being sold or licensed independently from other assets of a business include mortgage servicing rights, commodity supply contracts, banking core deposits and customer information, e.g., names and contact information. FASB has determined contract assets, as used in recently issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), are not customer-related intangible assets eligible to be subsumed into goodwill and should be recognized separately. Likewise, a lease is not a customer-related intangible asset for purposes of applying the accounting alternative. Therefore, favorable and unfavorable leases are not eligible to be subsumed into goodwill and should be recognized separately.

In most cases, adoption of the accounting alternative will result in entities recognizing fewer intangibles other than goodwill, easing the third-party appraisal expense for these acquirers and reducing complexity in accounting for business combinations.

Linkage to Goodwill Alternative

An entity electing the intangible asset accounting alternative also must adopt the private company alternative to amortize goodwill provided in ASU No. 2014-02, Intangibles – Goodwill and Other (Topic 350): Accounting for Goodwill. If the entity did not previously adopt the accounting alternative for amortizing goodwill, it should be adopted on a prospective basis as of the adoption of the accounting alternative for intangible assets. However, an entity electing the accounting alternative for amortizing goodwill is not required to adopt accounting alternative for intangible assets.

Disclosures

While entities adopting the alternative no longer will recognize certain intangible assets separately from goodwill in a business combination, those entities will be required to provide qualitative disclosures currently required under U.S. GAAP. This includes a qualitative description of the nature of intangible assets acquired and not separately recognized. An entity will not be required to disclose the fair value of intangible assets acquired and not separately recognized.
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**Transition**

The alternative is available to all entities, except public business entities and not-for-profit entities, required to recognize or otherwise consider the fair value of intangible assets resulting from any of the following:

- Applying the acquisition method under Topic 805
- Adopting fresh-start reporting under Topic 852 on reorganizations
- Assessing the nature of the difference between the carrying amount of an investment and the amount of underlying equity in net assets of an investee when applying the equity method under Topic 323, Investments – Equity Method and Joint Ventures

A private company must make the decision to adopt the accounting alternative upon the occurrence of the first transaction within the scope of the accounting alternative 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 adoption will be effective for that fiscal year and all periods thereafter. If the first in-scope transaction occurs in fiscal years beginning after December 15, 2016, the adoption will be effective in the interim period that includes the date of that first in-scope transaction and all periods thereafter.

Early adoption is permitted for any annual and interim period for which an entity’s annual financial statements have not yet been made available for issuance. The accounting alternative, when elected, should be applied to all in-scope transactions entered into after the effective date. Customer-related intangible assets and NCAs existing as of the beginning of the period of adoption should not be subsumed into goodwill but should continue to be subsequently measured in accordance with Topic 350.

**Considerations for Electing Alternative**

As with all accounting alternatives available to private companies, entities considering the intangible asset alternative should first carefully evaluate the feasibility of applying the alternative if they expect to become a public business entity in the near future. Private companies that become public business entities after electing any of the private company alternatives would have to retrospectively apply the public entity accounting and reporting requirements to all prior periods presented, which could be both challenging and costly.

Contact your BKD advisor for more information about the intangible asset alternative and other private company initiatives.

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