

Simplified accounting for private companies: Certain intangible assets

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A. General

This white paper discusses the guidance that is applicable if an entity elects the private-company intangible asset alternative, which provides alternative guidance with respect to the recognition of intangible assets related to customers and noncompete agreements (NCAs) acquired in a business combination. If a private company does not elect the intangible asset alternative, it would follow the guidance generally applicable to the recognition of intangible assets in a business combination when determining whether to recognize intangible assets related to customers and NCAs (which is discussed in Question CQ.1). Even if a private company elects the intangible asset alternative, it must still apply the guidance generally applicable to the recognition of intangible assets in a business combination when determining whether to recognize intangible assets *other than those related to customers and NCAs*.

Accounting Standards Update (ASU) 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination*, introduced the private-company intangible asset alternative to simplify the recognition of certain identifiable intangible assets by a private company in its accounting for a business combination. Under the intangible asset alternative, a private company may choose to elect an accounting policy under which it does not separately recognize the following intangible assets in the accounting for a business combination: (a) intangible assets that would otherwise arise from NCAs or (b) customer-related intangible (CRI) assets that cannot be separately sold or licensed. If the intangible asset alternative is elected, the value of these intangible assets is effectively subsumed into goodwill. A private company may elect the intangible asset alternative only if it also elects (or has already elected) the private-company goodwill alternative (see our white paper, [Simplified accounting for private companies: Goodwill](#)).

Pending change: The Financial Accounting Standards Board (FASB) has a project on its agenda, [Identifiable Intangible Assets and Subsequent Accounting for Goodwill](#), which may affect the recognition of intangible assets acquired in a business combination for all entities. At the publication date for this white paper, the project was still in process (see the [FASB's project page](#) for its status).

B. Scope

Private companies and not-for-profit entities that may elect the intangible asset alternative include entities other than the following: (a) those that meet the definition of a public business entity (PBE) as defined in the Master Glossary of the FASB's Accounting Standards Codification (ASC) or (b) employee benefit plans that fall within the scope of ASC 960, *Plan Accounting—Defined Benefit Pension Plans*, ASC 962, *Plan Accounting—Defined Contribution Pension Plans*, and ASC 965, *Plan Accounting—Health and Welfare Benefit Plans*.

Transactions other than business combinations to which the intangible asset alternative also applies are: (a) the equity method of accounting for an investment when there is a difference between its carrying amount and the private company investor's share of the investee's underlying equity in net assets and (b) the application of fresh-start reporting in a reorganization.

If elected, the intangible asset alternative applies to *all* business combinations and other in-scope transactions entered into after the date of adoption. In other words, the intangible asset alternative cannot be elected on a business combination by business combination basis.

While a private company must elect the private-company goodwill alternative if it elects the private-company intangible asset alternative, it does not have to elect the intangible asset alternative if it elects the goodwill alternative.

C. CRI assets

As mentioned earlier, when a private company elects the intangible asset alternative, it does not separately recognize in the accounting for a business combination any acquired CRI assets that cannot be separately sold or licensed from the business. It is expected that many CRI assets will not meet this recognition threshold. However, examples of CRI assets that *may* meet this threshold are: (a) core deposit intangibles (which arise from the relationships a financial institution has with its depositors), (b) mortgage servicing rights, (c) commodity supply contracts and (d) customer information (e.g., customer lists). CRI assets that will typically not meet this threshold are those that arise from expected future contracts with existing customers (e.g., customer relationships). While many CRI assets will not meet the intangible asset alternative's recognition threshold, a private company must still analyze each of its CRI assets (e.g., customer backlog, customer list) to determine whether they can be separately sold or licensed. In other words, a private company should not just assume its CRI assets are incapable of being separately sold or licensed. Among the factors that should be taken into consideration in analyzing whether the intangible asset alternative's recognition threshold is met is whether sale of the CRI asset requires input or approval from the customer. If so, it would not meet the recognition threshold. In addition, while a CRI asset that arises from an above-market (i.e., favorable) customer contract (e.g., the customer is obligated to pay an above-market price for a good) is not recognized under the intangible asset alternative unless that contract could be separately sold or licensed, a liability continues to be recognized for a below-market (i.e., unfavorable) customer contract regardless of whether the customer contract could be separately sold or licensed. As a result, a private company must still analyze each of its acquired customer contracts to determine whether it is below market.

For purposes of the intangible asset alternative, CRI assets do not include: (a) leases or (b) contract assets as that term is used in ASC 606, *Revenue from Contracts with Customers* (see Question CQ.2). As a result, intangible assets related to leases and contract assets should be separately recognized (as otherwise required) and should not be subsumed into goodwill.

For guidance on valuing and amortizing CRI assets when the application of the intangible asset alternative still results in the recognition of a CRI asset, see Sections 10.6.4 and 10.6.5.2 of our publication, *A guide to accounting for business combinations* ([our business combinations guide](#)).

CQ.1 *What is the difference between the recognition criterion for CRI assets under the intangible asset alternative and the general recognition criteria for CRI assets in ASC 805, Business Combinations?*

When a private company elects the alternative, it only recognizes CRI assets that are capable of being sold or licensed separate from the other assets of the business. When a private company does not elect the alternative, it must apply the general recognition criteria for identifiable intangible assets in ASC 805. Those criteria, only one of which must be met, are focused on the following: (a) the separability of the asset and (b) the contractual-legal nature of the asset. For additional information about recognizing intangible assets related to customer contracts under the general recognition criteria in ASC 805, see Sections 10.6, 10.8 and 10.9 of [our business combinations guide](#).

One significant difference between the alternative's and ASC 805's recognition criteria is that the alternative's recognition criterion does not consider whether the CRI asset is contractual or legal in nature. Whether a CRI asset is contractual or legal in nature is not a determining factor in considering whether it should be recognized when a private company elects the alternative. As a result, it is possible that some (perhaps even many) CRI assets that meet the contractual-legal criterion will be subsumed into goodwill under the alternative because they cannot be sold or licensed separate from other assets of the business. Additional discussion about contractual-legal CRI assets is provided in the next two questions.

Another significant difference between the alternative's and ASC 805's recognition criteria is that the separability criterion under ASC 805 requires an intangible asset to be capable of being sold or licensed *either* on its own or combined with a related contract, identifiable asset or liability. In contrast, the

recognition criterion under the alternative requires an intangible asset to be capable of being sold or licensed on its own *without any other assets of the business*. There is no allowance under the alternative (as there is under ASC 805's separability criterion) to consider whether the intangible asset can be sold with a related contract, identifiable asset or liability. As a result, a CRI asset may meet ASC 805's separability criterion, but not meet the alternative's recognition criterion.

CQ.2 *Why did the FASB exclude contract assets from the scope of the intangible asset alternative (indicating that such assets should continue to be recognized as otherwise appropriate)?*

The contract assets excluded from the scope of the alternative are those that meet the following definition included in the Master Glossary of the Codification: "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)." Contract asset, as used in the capacity of ASC 606, has a meaning that is very different from the meaning of a contractual-legal CRI asset (see the previous question). One key attribute of a contract asset is that it relates to goods or services already transferred to the customer. Another key attribute of a contract asset is that it is expected to eventually convert into accounts receivable once the entity has an unconditional right to consideration for its performance. Both of these attributes do not exist in most contractual-legal CRI assets. While use of similar terminology (contract asset vs. contractual-legal CRI asset) has justifiably caused some confusion, it is clear that contractual-legal CRI assets are subject to the scope of the alternative and should be evaluated to determine whether they can be sold or licensed separate from other assets of the business. Only if that is the case should those assets be recognized. Otherwise, they should be subsumed into goodwill.

CQ.3 *Should contractual-legal CRI assets (e.g., backlog, above-market customer contracts) continue to be recognized if a private company elects the intangible asset alternative?*

Whether contractual-legal CRI assets should be recognized when a private company elects the alternative depends on whether they can be sold or licensed separate from other assets of the business. The fact that there is an underlying contract does not automatically mean that an intangible asset should be recognized under the alternative. In other words, whether there is a contract underlying the CRI asset is not a determining factor in considering whether an intangible asset should be recognized under the alternative.

CQ.4 *What does it mean to say that a CRI asset can be sold or licensed separate from other assets of the business?*

When assessing whether a CRI asset can be sold or licensed separate from other assets of the business, a private company should first evaluate whether the CRI asset can be sold or licensed, and if it can, then evaluate whether it can be sold or licensed separate from other assets of the business.

When considering whether a CRI asset can be sold or licensed, the private company should evaluate whether there are any restrictions on selling the CRI asset. For example, the private company should consider whether it is precluded from selling a customer contract or customer information. Consider a situation in which a customer contract explicitly indicates that the private company cannot sell the contract or that it cannot sell the contract without obtaining the customer's approval. In either of those situations, the CRI asset is not capable of being sold or licensed. As a result, a CRI asset should not be recognized for the customer contract under the intangible asset alternative. Consider another situation in which a private company informs its customers when they sign up on the private company's website that their information may be sold to third parties, but gives them the ability to opt out of their information being sold. In this situation, only the customer information for those customers who did not opt out should be considered capable of being sold or licensed by the private company.

When considering whether a CRI asset can be sold or licensed *separate from other assets of the business*, the private company should evaluate whether the CRI asset is dependent on other assets of the business. In other words, the private company needs to determine whether another party would be

able to use or benefit from the CRI asset without other assets of the business. Consider two situations in which a private company acquires order backlog in a business combination. In the first situation, the private company acquires order backlog for the custom manufacture of industrial equipment. If the private company concludes that another party would not be able to fulfill that order backlog without the use of patented intellectual property or specialized processes or knowledge not available in the marketplace, then the private company would conclude that the CRI asset for the order backlog cannot be sold or licensed *separate from other assets of the business*. As a result, the order backlog would not be recognized separately (i.e., it would be subsumed into goodwill). In the second situation, the private company acquires order backlog for generic dry cleaning services. If the private company concludes that another party would be able to fulfill that order backlog because it has the capabilities to do so with its own dry cleaning equipment or because others in the marketplace have the capabilities to do so, then the private company would conclude that the CRI asset for the order backlog can be sold or licensed *separate from other assets of the business*. As a result, the order backlog would be recognized as a separate intangible asset (assuming there are no restrictions on selling or licensing the backlog).

One type of evidence that may exist to corroborate that a CRI asset can be sold or licensed separate from other assets of the business is an exchange transaction in which the same or similar CRI asset was sold on its own.

CQ.5 *What are examples of CRI assets that can be sold or licensed separate from other assets of the business?*

ASC 805-20-25-31 lists CRI assets that *may* be capable of being sold or licensed separate from other assets of the business. Included on this list are mortgage servicing rights, commodity supply contracts, core deposit intangibles (which arise from the relationships a financial institution has with its depositors) and customer information. Whether these CRI assets are capable of being sold or licensed separate from other assets of the business depends on the facts and circumstances. A private company should not assume that these assets meet the criterion for separate recognition. Each CRI asset needs to be analyzed to determine whether it can be sold or licensed separate from other assets of the business (see the previous question). We believe this analysis will typically show that these CRI assets can be sold or licensed separate from other assets of the business, with the exception of customer information (e.g., a customer list) that cannot be sold without customer approval (see the previous and next questions).

CQ.6 *How are the recognition of intangible assets for customer relationships and customer information (e.g., customer lists) interrelated?*

In practice, the application of the general recognition criteria for CRI assets in ASC 805 has not typically resulted in the recognition of a separate customer list intangible asset when related customer relationship intangible assets are recognized. Given that many customer relationship intangible assets will be subsumed into goodwill under the alternative, if a private company elects the alternative, it will be necessary to determine whether a separate customer list intangible asset should be recognized. If a customer list can be sold or licensed separate from other assets of the business, and it is determined to be material, it must be recognized under the alternative. In this situation, the fair value of the customer list should not be subsumed into goodwill with the related customer relationship intangible assets.

CQ.7 *Should a customer relationship intangible asset be recognized under the intangible asset alternative when the target has a history of entering into contracts with a customer (even though no contracts with the customer exist at the acquisition date)?*

Under the general recognition criteria for CRI assets in ASC 805, if the target has a history of entering into contracts with a customer, but has no contracts with the customer at the acquisition date, a customer relationship intangible asset exists because the target has a history of entering into contracts with the customer (which satisfies the contractual-legal criterion) (see Section 10.6.2 of [our business combinations guide](#)). Whether a customer relationship intangible asset should be recognized under the alternative in this situation depends on whether the customer relationship can be sold or licensed separate from other

assets of the business. Given that there is no underlying contract for this customer relationship at the acquisition date, it is unlikely that there is a customer relationship that could be sold or licensed. However, an analysis still needs to be performed to reach that conclusion in a specific set of facts and circumstances. While a customer relationship intangible asset likely does not exist in this situation, a customer information intangible asset may exist. Additional discussion on customer information intangible assets is provided in the three preceding questions.

CQ.8 *Does a private company still have to recognize a liability for a below-market (i.e., unfavorable) customer contract if it elects the intangible asset alternative?*

Yes. The alternative only applies to CRI assets, not customer-related liabilities. As such, a private company that elects the alternative must analyze all its customer contracts to determine whether they are in an above-market or below-market position. Those that are in a below-market position must be recognized as liabilities. Those that are in an above-market position must be analyzed to determine whether they can be sold or licensed separate from other assets of the business. A private company cannot net customer-related liabilities against CRI assets subsumed into goodwill.

CQ.9 *Given that paragraph BC17 of ASU 2014-18 indicates that “[c]ustomer-related intangible assets often will not meet the criterion for recognition,” is it appropriate to forgo the analysis of customer contracts and the identification of CRI assets when accounting for a business combination? In other words, is it acceptable to assume that a private company has not acquired any CRI assets that should be recognized when it has elected the intangible asset alternative?*

No. If a private company elects the alternative, it must still analyze its customer contracts to determine which are in an above-market position (and subject to the alternative) and which are in a below-market position resulting in recognition of a liability (see the previous question). Once the private company has identified its above-market customer contracts and all other CRI assets it acquired, it must evaluate whether each of those assets can be sold or licensed separate from other assets of the business. While the statement made in paragraph BC17 of ASU 2014-18 about the frequency with which intangible assets will meet the alternative’s recognition criterion may be true in a general sense, it is not appropriate for a private company to assume that generality applies in its situation and ignore the specific facts and circumstances surrounding the particular CRI assets it acquired in a business combination.

CQ.10 *Given that paragraph BC21 of ASU 2014-18 indicates that “it is inappropriate to classify a contract asset as a customer-related intangible asset at the acquisition date when the contract asset will eventually be reclassified as a receivable,” should a backlog intangible asset not be classified as a CRI asset (which would make it ineligible to be subsumed into goodwill under the intangible asset alternative) because it will eventually lead to a receivable?*

No. A contract asset arises as a result of the entity transferring goods or services to the customer for which it does not have the unconditional right to receive payment. With respect to a backlog intangible asset, the entity has not yet transferred the related goods or services to the customer. As a result, an order backlog intangible asset is a CRI asset and not a contract asset. As a CRI asset, a private company that has elected the alternative must evaluate a backlog intangible asset to determine whether it can be sold or licensed separate from other assets of the business.

CQ.11 *How should a private company evaluate noncontractual customer relationships for recognition under the intangible asset alternative?*

As with any CRI asset, the private company should determine whether the noncontractual customer relationships can be sold or licensed separate from other assets of the business. In general, noncontractual customer relationships typically cannot be sold or licensed separate from other assets of the business because they represent expected future sales from customers (e.g., future sales from a walk-up customer base).

CQ.12 *Can a private-company lessor apply the intangible asset alternative to its leases?*

No. The alternative specifically excludes leases from its scope. As a result, CRI assets related to leases should be recognized as otherwise required by ASC 805 and should not be subsumed into goodwill.

CQ.13 *How does the intangible asset alternative affect the recognition of a bargain purchase gain in a business combination?*

Consider a situation in which a private company acquires 100% of a target for \$100 million. Assume that the net assets acquired consist of the following:

- Tangible assets whose fair values total \$120 million
- CRI assets whose fair values total \$20 million
- Liabilities whose fair values total \$30 million

Further assume that the CRI assets cannot be sold or licensed separate from other assets of the business. If the private company has *not* elected the alternative, the identifiable net assets acquired would be measured at \$110 million. If the private company has elected the alternative, the identifiable net assets acquired would be measured at \$90 million (as the CRI assets of \$20 million would not be separately recognized).

Based on this discussion and the discussion in Sections 12.1 and 12.2 of our [business combinations guide](#), the effects of electing and not electing the alternative in this situation are summarized in the following table:

	Alternative is elected	Alternative is <i>not</i> elected
Consideration transferred	\$100,000,000	\$100,000,000
Identifiable net assets acquired	90,000,000	110,000,000
Goodwill (bargain purchase gain)	\$10,000,000	(\$10,000,000)

In this situation, election of the alternative results in goodwill when a bargain purchase gain would have otherwise resulted. This outcome is an appropriate reflection of how the alternative should be applied and its effects on the recognition of a bargain purchase gain.

CQ.14 *Does a private company's election of the intangible asset alternative mean it no longer has to perform valuations (or have valuations performed) for purposes of accounting for a business combination?*

No. Clearly, a private company that elects the alternative and does not have any CRI assets that meet the recognition criterion should not value and separately recognize those CRI assets in the accounting for the business combination. However, the private company must consider what other assets and liabilities it acquired that should be recognized at fair value in the accounting for the business combination (e.g., other intangible assets, inventory, property, plant and equipment). Section 10.9.1 of [our business combinations guide](#) lists and discusses several types of intangible assets that may need to be recognized (and, as a result, valued) in connection with a business combination. To the extent the private company acquires any other assets or liabilities that must be recognized at fair value, it will have to perform valuations for those assets or liabilities or hire a valuation specialist to perform those valuations. For example, if the private company acquires a trademark and a patent, it will need to estimate their fair values for purposes of recognizing them in the accounting for the business combination regardless of whether it has elected the alternative.

CQ.15 *When valuing other assets acquired in the business combination, will it be necessary to estimate the fair value of CRI assets that are being subsumed into goodwill under the intangible asset alternative?*

Depending on the nature of the CRI assets being subsumed into goodwill and the nature of the other assets being valued, as well as the valuation methods being used to measure these assets, it may be necessary to perform a high-level valuation of the CRI assets that are being subsumed into goodwill.

For example, contributory asset charges (CACs) are often used in the multi-period excess earnings method (MPEEM), which is an income approach valuation method that may be used to estimate the fair value of certain assets. A common CAC used in the MPEEM relates to an entity's assembled workforce. Under ASC 805, an entity does not recognize an intangible asset for an assembled workforce. However, if the MPEEM is used to value an acquired asset such as intellectual property or a license, the value of the assembled workforce acquired is typically estimated for purposes of applying a CAC in the MPEEM because the assembled workforce is a contributory asset to the cash flows of the intellectual property or license. In a similar sense, a CRI asset being subsumed into goodwill under the alternative may need to be valued and treated as a CAC in the MPEEM. This may be necessary when dealing with the valuation of technology or a brand acquired in a business combination, but may not be necessary in a business combination in which minimal intangible assets were acquired. If a CAC for CRI assets subsumed into goodwill under the alternative were inappropriately excluded from the MPEEM, this may result in overvaluing the intangible asset whose fair value is being estimated.

For another example, when a private company acquires technology assets and uses the relief from royalty (RFR) method to value those assets, it may be necessary to value the CRI assets subsumed into goodwill to help determine if the royalty rates and values for the technology assets can be supported by the profit margin of the target and the returns generated by the other tangible and intangible assets.

When valuing a CRI asset subsumed into goodwill under the alternative for purposes of valuing another asset using the MPEEM or RFR method, it may be appropriate to perform the valuation at a high level instead of performing a detailed quantitative analysis.

D. Assets arising from NCAs

With respect to NCAs, the intangible asset alternative does not provide guidance on when an NCA should be accounted for as part of the business combination or separate from the business combination. While this question has arisen historically and there is some diversity on how it has been treated in practice, the accounting implications were often not significant because the preexisting guidance typically resulted in the recognition of an intangible asset both when an NCA was accounted for as part of the business combination, as well as when an NCA was accounted for separate from the business combination. However, under the intangible asset alternative, treating an NCA as part of the business combination does not result in the recognition of a separate intangible asset (i.e., its value is subsumed into goodwill). We believe an intangible asset alternative under which a private company can elect to not separately recognize the intangible assets that would otherwise arise from NCAs with selling shareholders is an indication that those NCAs should be considered part of the business combination for accounting purposes when a private company elects the intangible asset alternative. In other words, if a private company elects the intangible asset alternative, it *should not* conclude that NCAs with selling shareholders should be accounted for separate from the business combination.

Additional information related to determining what is and is not part of the business combination for accounting purposes is provided in Chapter 13 of [our business combinations guide](#).

E. Disclosures

A private company's policy related to its accounting for CRI assets and NCAs acquired in a business combination should be disclosed in accordance with ASC 235-10-50. In addition, if a private company

elects the intangible asset alternative, it should provide the disclosures related to a change in accounting principle as appropriate under ASC 250-10-50.

There are no incremental disclosure requirements associated with the intangible asset alternative. However, a private company that elects the intangible asset alternative should be mindful of the preexisting requirement discussed in ASC 805-30-50-1(a) to *qualitatively* describe the factors that make up goodwill, which includes intangible assets that are not separately recognized. A private company does not need to estimate the fair value of NCA intangible assets and CRI assets subsumed into goodwill for this purpose.

F. Effective date and transition

A private company is permitted to make a first-time election to apply the intangible asset alternative at any time without having to perform a preferability assessment (as otherwise required by ASC 250, *Accounting Changes and Error Corrections*).

The intangible asset alternative should be applied prospectively, starting with the first business combination or other transaction within its scope (see Section B) that occurs after it is first elected. Any previously recognized NCA intangible assets or CRI assets should continue to be recognized and measured in accordance with preexisting guidance. In other words, these preexisting intangible assets should not be subsumed into goodwill upon election of the intangible asset alternative.

F.1 Considerations related to the election of the intangible asset alternative

A private company may elect the intangible asset alternative only if it also elects (or has already elected) the private-company goodwill alternative (which is discussed in our white paper, [Simplified accounting for private companies: Goodwill](#)). If a private company has not already elected the goodwill alternative when it elects the intangible asset alternative, the goodwill alternative would be applied on a prospective basis in the period the intangible asset alternative is elected.

Before electing the private-company intangible asset and goodwill alternatives, a private company should carefully consider whether doing so makes sense in its facts and circumstances. For example, many of the anticipated benefits resulting from election of these alternatives could be negated or offset if there is a reasonable possibility that the entity will go public or be acquired by a PBE in the future. If a private company goes public or is acquired by a PBE after it has elected the intangible asset and goodwill alternatives, the private company would have to discontinue those elections and retrospectively apply U.S. generally accepted accounting principles applicable to PBEs. In other words, the private company would have to retrospectively undo the accounting under *both* alternatives. The ramifications of doing so involve the performance of prior-year impairment test(s) using the goodwill impairment model applicable to PBEs, reversing goodwill amortization and valuing, recognizing and amortizing intangible assets for NCAs and CRI assets previously subsumed into goodwill. Given that many of the anticipated benefits of electing the intangible asset and goodwill alternatives could be negated or offset by the ramifications of later discontinuing the use of those alternatives, a private company should carefully consider whether electing the alternatives makes sense in its facts and circumstances.

A private company should discuss the effects of electing the intangible asset and goodwill alternatives with the users of its financial statements to understand whether the private company's election of the alternatives is acceptable to those users. The users who should be considered in this regard include investors, lenders and regulators, among others. Thoughtful consideration also should be given to upcoming or potential changes in the users of its financial statements and the willingness of any potential new users of the financial statements to accept financial statements in which the intangible asset and goodwill alternatives have been applied.

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