Thought Leadership Discussion

The Private Company Accounting Alternative and Intangible Asset Valuation Considerations

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Owners and managers of private companies that have completed a business combination (i.e., an acquisition) often conclude there is no need to identify or value the acquired intangible assets. This is because such private company owners and managers may believe that "no intangible assets were acquired." This statement may be true in certain acquisitions. However, it is inappropriate for a private company acquirer to ignore this financial accounting requirement without considering all of the facts and circumstances related to each acquisitive transaction. In addition, it is a common misconception that a company which has elected the private company accounting alternative is no longer subject to intangible asset valuation requirements with regard to its business acquisitions.

Introduction

According to the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 805: Business Combinations ("ASC Topic 805"), an acquirer is required to recognize—separately from goodwill—the identifiable intangible assets acquired in a business combination.

When recognizing and valuing identifiable intangible assets in a business combination, the acquirer should consider all of the target entity's assets, including the consideration of assets that are not currently presented on the target company's historical-cost-based financial statements.

Identifying and valuing intangible assets can be a complex and costly process. For many companies involved in a business combination, the benefits of separately identifying and valuing all of the acquired intangible assets do not justify the related expense.

As a result, in an effort to reduce the burden to private companies with regard to this potentially negligible benefit to financial statement users, the FASB endorsed an alternative process developed by the Private Company Council ("PCC").

The PCC concluded that intangible assets that are (1) legally protected, (2) separately transferable, and (3) capable of providing discrete cash flow are most relevant to private company financial statement users. Based on this determination, the PCC proposed an alternative reporting requirement for private companies.

According to the PCC, adoption of this accounting alternative is not expected to significantly diminish the usefulness of the information provided in private company financial statements. However, this private company accounting alternative should reduce the related expenses to the reporting entity.

The PCC Accounting Alternative

According to ASC Topic 805, an acquirer will recognize and report the fair value of the assets and liabilities acquired, including all identifiable intangible assets.

According to ASC Topic 805, an intangible asset is identifiable if it meets either of the following two criteria:

1. It arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
2. It is separable—that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset, or liability—regardless of whether the entity intends to do so.

If the private company elects the PCC accounting alternative, the acquirer will no longer be required to separately report either of the following intangible assets.

Instead, the value of these acquired intangible assets will be included in goodwill:

- Customer-related intangible assets, unless they are capable of being sold or licensed independently from the other assets of the business
- Noncompetition agreements

On December 15, 2014, the FASB issued four private company accounting alternatives under U.S. generally accepted accounting principles ("GAAP"). The private company accounting GAAP alternatives (i.e., Accounting Standards Updates or "ASUs") allow eligible private companies the option to elect the accounting alternatives.

The four elections are collectively referred to as "private company GAAP" (i.e., the PCC accounting alternative) and include the following:

1. FASB ASU No. 2014-02, Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill ("ASU 2014-02")
2. FASB ASU No. 2014-03, Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach
3. FASB ASU No. 2014-07, Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements
4. FASB ASU No. 2014-18, Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination ("ASU 2014-18")

The remainder of this discussion focuses on the application of ASU 2014-02 (Goodwill) and ASU 2014-18 (Intangible Assets) for private companies that adopt the accounting alternatives.

PCC Accounting Election Requirements

In order to qualify for the PCC accounting alternative, an entity should first qualify as a private company under the provisions of ASU 2013-12, Definition of a Public Business Entity. Subsequent to the initial proposal by the PCC, the FASB also extended the PCC accounting alternative to not-for-profits under ASU 2019-06.

Second, if an entity elects ASU 2014-18 alternative reporting of intangible assets, the entity should also adopt ASU 2014-02 regarding the amortization of goodwill.

Finally, if a PCC accounting alternative is adopted, it will be regarded as an accounting policy change for the reporting company resulting in prospective application to all future transactions after the adoption date.

If a PCC accounting alternative is adopted, it does not encompass prior transactions (i.e., it is not a retrospective accounting policy change).

PCC Accounting Alternative—Intangible Assets

Exhibit 1 summarizes the primary financial accounting differences under ASC Topic 805 and the PCC accounting alternative (i.e., ASU 2014-02 and ASU 2014-18).

As indicated in Exhibit 1, the provisions of ASU 2014-18 relate only to the consideration of customer-related intangible assets.

As a result, the adoption of this alternative does not eliminate the requirement for the acquirer to consider and report the fair value of other identifiable intangible assets acquired—which remain consistent as outlined in ASC Topic 805.

Exhibit 1
Financial Reporting Comparison
ASC 805 and the PCC Accounting Alternative

Accounting Guidance	Acquired Goodwill	Customer-Related Intangible Assets	Other Identifiable Intangible Assets
ASC Topic 805	Goodwill is not amortized but instead is tested annually for impairment	Separately recognize customer-related intangible assets, including noncompetition agreements	Report other identifiable intangible assets at fair value
PCC Accounting Alternative	Goodwill is amortized straight-line over the lesser of 10 years or the useful economic life and tested for impairment only upon the occurrence of a triggering event	Separately recognize customer-related intangible assets only if they are capable of being sold or licensed separately or arise from contractual rights (other customer-related intangible assets and noncompetition agreements are not separately recognized but instead are included as part of goodwill)	Report other identifiable intangible assets at fair value

Considerations for Electing the PCC Accounting Alternative

The election of ASU 2014-18 allows for potentially fewer intangible assets to be recognized. It does not, however, eliminate the need to consider all identifiable intangible assets. Any identifiable intangible assets that do not fall within the recognition and reporting criterion for the PCC accounting alternative are recognized under the standard criterion provided in ASC Topic 805.

Reporting entities considering the adoption of the PCC accounting alternative should carefully review the election requirements previously identified as well as the following potential issues.

Accounting Policy Change

If adopted, the PCC accounting alternative would constitute an accounting policy change that requires prospective application to all future transactions after the adoption date.

The PCC accounting alternative is only applicable to transactions that occur after the election of the alternative and cannot be retroactively applied to pre-existing intangible assets.

Intended Financial Statement User

Important considerations for a company's financial statement presentation include the requirements of those individuals or businesses that are expected to use and rely on the independently prepared (often audited) financial statements.

As a result, if the end user requirements are the ultimate determination and if that determination requires the ASC GAAP to be followed, then the company's interest or desire to elect the PCC accounting alternative may become irrelevant.

Future Public Offering

A private company electing ASU 2014-18 that ultimately undertakes a public stock offering will be required to discontinue the use of the PCC accounting alternative. Accordingly, the company will be required to recast its historical financial statements so as to comply with ASC GAAP.[1]

This recast would potentially include adjustments to goodwill and the valuation of previously unreported identifiable customer-related intangible assets and noncompetition agreements. This recast would need to be performed as of the original acquisition date. Such a recast could cause:

1. significant challenges in data gathering and
2. potential costs in excess of what were incurred at the time of the original acquisition.

PCC Accounting Alternative: ASU 2014-18

Customer-Related Intangible Assets

It is important to distinguish between (1) the customer-related intangible asset recognition criteria under the PCC accounting alternative and (2) customer-related intangible asset recognition criteria under ASC Topic 805 for public entities (or for private companies not electing the alternative).

The ASC Topic 805 criteria also apply for customer-related intangible assets may include customer lists, order or production backlog, and customer contracts and related customer relationships. ASC Topic 805 defines these customer-related intangible assets as follows:

- Customer Lists. A customer list consists of information about customers, such as their names and contact information. A customer list also may be in the form of a database that includes other information about the customers, such as their order histories and demographic information. A customer list generally does not arise from contractual or other legal rights.
- Order or Production Backlog. An order or production backlog arises from contracts such as purchase or sales orders.
- Customer Contracts and the Related Customer Relationships. If an entity establishes relations with its customers through contracts, those customer relationships arise from contractual rights. A customer relationship exists between an entity and its customer if the entity has information about the customer and regular contact with the customer, and the customer has the ability to make direct contact with the entity.

When a private company elects ASU 2014-18, it is required to recognize separately from goodwill those customer-related identifiable intangible assets that are "capable of being sold or licensed ***independently*** from other assets of the business." [emphasis added] As indicated previously, when a private company does not elect the PCC alternative, the company is required to recognize intangible assets based on the standard criteria provided under ASC Topic 805.

The intangible asset's contractual or legal nature is not a recognition criterion under the PCC accounting alternative. As a result, it is possible for a customer-related intangible asset to meet the ASC Topic 805 contractual-legal criterion and still be subsumed into goodwill. This would occur if the intangible asset is not capable of being sold or licensed independently from other assets of the business.

Additionally, the separability criterion of ASC Topic 805 requires that an intangible asset is capable of being "sold, transferred, licensed, rented, or exchanged, either individual or together with related contract, identifiable asset or liability."

Under the PCC accounting alternative, the recognition criterion requires an intangible asset to be "capable of being sold or licensed ***independently*** from other assets of the business." [emphasis added] As a result, it is possible for a customer-related intangible asset to meet the ASC Topic 805 recognition criterion but not meet the PCC accounting alternative recognition criterion.

The FASB initially indicated that it did not expect many customer-related intangible assets to meet the recognition criterion under the PCC accounting alternative. However, the FASB did provide examples of customer-related intangible assets that may meet the recognition criterion under the PCC accounting alternative (i.e., they are able to be sold or licensed independently).

These PCC recognition customer related-intangible assets include, but are not limited to, the following:

- Mortgage servicing rights
- Commodity supply contracts
- Core deposits
- Customer information (i.e., customer lists)

Noncompetition Agreements and the PCC Alternative for Intangible Assets

A noncompetition agreement is a legal contract that prohibits or restricts one party from competing against another party. A noncompetition agreement in place as part of a business combination would (1) meet the contractual-legal criterion under ASC Topic 805 and (2) be considered an identifiable intangible asset.

However, if a private company elects the PCC accounting alternative, then noncompetition agreements are not recognized separately from goodwill.

Identifiable Intangible Assets Required in the PCC Accounting Alternative

As previously discussed, private companies that adopt the PCC accounting alternative are not required to recognize:

1. customer-related intangible assets that are not capable of being sold or licensed independently from the other assets of a business and
2. noncompetition agreements separately from goodwill.

All other identifiable intangible assets will continue to be recognized based on the criterion provided in ASC Topic 805.

The following discussion provides examples of identifiable intangible assets that are *not excluded* in the PCC accounting alternative and, therefore, may still require a fair value determination in a business combination. In other words, all identifiable intangible assets not specifically excluded in the PCC accounting alternative should be considered, analyzed, and reported according to the ASC GAAP.

Since the election of the PCC accounting alternative does not eliminate all intangible asset reporting requirements in a business combination, it is important to recognize many of the identifiable intangible assets to be considered.

FASB considers intangible assets to be identifiable if they meet either:

1. the contractual-legal criterion or
2. the separability criterion.

ASC Topic 805 provides a nonexhaustive list of intangible assets that the FASB considers as having characteristics that meet either of the criteria.

These intangible assets generally fall into the following categories:

- Marketing-related intangible assets
- Customer-related intangible assets
- Artistic intangible assets
- Contract-related intangible assets
- Technology-related intangible assets

An acquirer should assess identifiable intangible assets based on the specific facts and circumstances of the target business and its industry (e.g., certain intangible assets may be unique to specific industries). For example, the health care/health sciences industry may include identifiable intangible assets unique to that industry, such as certificates of need, contracts with insurers, operating licenses, and physician/provider contracts.

A distinction is that an assembled workforce is typically not considered an identifiable intangible asset to be separately reported in a business combination transaction. As a result, any value attributed to an assembled workforce in a business combination is typically subsumed into goodwill.

However, the fair value measurement of an assembled workforce may be required in order to estimate the fair value of another identifiable intangible asset valued by reference to certain valuation methods.

Additionally, an employment contract between an individual employee and the employer generally meets the contractual-legal criterion and, therefore, may be valued separately from goodwill.

Marketing-Related Intangible Assets

Marketing-related intangible assets are assets that are primarily used in the marketing or promotion of products and services of the entity.

ASC Topic 805 provides the following examples of marketing-related intangible assets:

- Trademarks, service marks, trade names, collective marks, and certification marks
- Trade dress (unique color, shape, package design)
- Newspaper mastheads
- Internet domain names

A noncompetition agreement would generally be considered a marketing-related intangible asset according to ASC Topic 805. However, if a company adopts the PCC accounting alternative, it will not be required to recognize noncompetition agreements separately from goodwill.

Customer-Related Intangible Assets

If a private company adopts the PCC accounting alternative, customer-related intangible assets that are not capable of being sold or licensed independently from other assets of a business are subsumed into goodwill. If the customer-related intangible asset is capable of being sold or licensed independently from other assets of a business, then it may be recognized and valued separately from goodwill.

Even after electing the PCC accounting alternative, a private company should analyze each of the acquired customer-related intangible assets and should not automatically assume they are incapable of being sold or licensed independently of other assets.

Artistic-Related Intangible Assets

According to ASC Topic 805, artistic-related intangible assets arise from contractual or legal rights such as those provided by copyright. The copyright holder can transfer a copyright in whole through an assignment or in part through a licensing agreement.

If an acquirer acquires multiple copyrights, the acquirer can recognize any related assignments or license agreements as a single asset if they have similar useful lives.

ASC Topic 805 provides the following examples of artistic-related intangible assets:

- Plays, operas, ballets
- Books, magazines, newspapers, other literary works
- Musical works such as compositions, song lyrics, advertising jingles
- Pictures, photographs
- Video and audiovisual material, including motion pictures or film, music videos, television programs

Contract-Related Intangible Assets

According to ASC Topic 805, contract-based intangible assets represent the value of rights that arise from contractual arrangements.

ASC Topic 805 provides the following examples of contract-based intangible assets:

- License, royalty, standstill agreements
- Advertising, construction, management, service or supply contracts
- Operating lease agreements of a lessor
- Construction permits
- Franchise agreements
- Operating and broadcast rights
- Servicing contracts such as mortgage servicing contracts
- Employment contracts that are favorable
- Use rights such as drilling, water, air, timber cutting, and route authorities

Technology-Related Intangible Assets

ASC Topic 805 provides the following examples of technology-based intangible assets:

- Patented technology
- Computer software and mask works
- Unpatented technology
- Databases, including title plants
- Trade secrets, such as secret formulas, processes, recipes

Impact on Goodwill

Any intangible assets that are not individually recognized under the PCC accounting alternative or under ASC Topic 805 are subsumed into goodwill. In addition, if a private company adopts ASU 2014-18, it is also required to adopt ASU 2014-02.

The PCC accounting alternative under ASU 2014-02 allows private companies to amortize goodwill acquired in a business combination transaction on a straight-line basis (1) over 10 years or (2) over a shorter period if the company can demonstrate a more appropriate useful life.

Allowing private companies to amortize goodwill is one of the most significant differences between ASC GAAP and the PCC accounting alternative for private companies. The amortization of goodwill is

prohibited under ASC GAAP. Instead, goodwill is tested at least annually for impairment. Amortizing goodwill can have impacts on a company's financial statements and financial ratios.

Another difference between ASC GAAP and the PCC accounting alternative is the frequency of goodwill impairment testing. Under ASC GAAP, goodwill impairment testing is required at least annually, or more frequently under certain circumstances.

Under the PCC accounting alternative, it is only necessary to test goodwill for impairment when a triggering event occurs as defined by the FASB.

Such triggering events may include (but are not limited to) the following:

1. Deterioration in general economic conditions
2. Deterioration in industry or market conditions
3. Increased costs that have a negative impact on earnings and cash flow
4. Deterioration of financial performance
5. Changes in key personnel or customers
6. Bankruptcy
7. Litigation
8. Disposing of all or a portion of an entity (or reporting unit)
9. A sustained decrease in share price (in absolute terms or in comparison to peers)

The elimination of the required annual impairment test can be another cost saver for companies electing the PCC accounting alternative. Once elected, the accounting alternative applies to all existing goodwill and to all goodwill recognized in future transactions within the scope of the PCC alternative.

Example of an Intangible Asset Not Excluded under the PCC Accounting Alternative

Once an acquirer determines that it is necessary to recognize an intangible asset in a business combination, that asset's fair value should be measured.

The FASB defines fair value as the "amount at which an asset (or liability) could bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale."

In estimating the fair value of an intangible asset, an analyst will consider the three generally accepted intangible asset valuation approaches: (1) the cost approach, (2) the market approach, and (3) the income approach. Within each valuation approach, multiple methods may be considered.

The valuation approaches and methods ultimately applied are based on the analyst's judgement and on the facts and circumstances of each engagement. A detailed description of the generally accepted valuation approaches and methods for estimating the fair value of intangible assets is beyond the scope of this discussion.

There are a significant number of potential identifiable intangible assets that are not excluded when electing the PCC accounting alternative. One example is a company's trade name.

The following example illustrates one valuation method that can be used to value a trademark and trade name. The following example assumes that a private company has made an acquisition and has identified the target company's trade name as an identifiable intangible asset under ASC Topic 805. Even though the acquirer has elected to report under the PCC accounting alternative, it will still need to measure and report the fair value of the acquired trademark and trade name.

The example also includes certain considerations, factors, and components of a business which may impact the underlying value of a trade name. The example is not intended to be the exclusive or preferred method of valuation.

The facts and circumstances of each assignment should help an analyst to identify an appropriate valuation method, as well as the most relevant (i.e., important) factors to consider, related to the trade name subject to analysis.

Trade Name Overview

The following example provides an overview of certain considerations and analysis regarding the value of a trade name with an indefinite life. A trade name is the name under which a company performs its business and is marketed and known by the general public. This name may or may not be the same as a company's legal name.

A trade name may also function as a company's trademark, and in many instances the two are not necessarily separable from the other. Trade names and trademarks may have different registration requirements and legal considerations, but that consideration is beyond the scope of this discussion.

Valuation Overview

The following trade name valuation example applies the so-called relief from royalty ("RFR") method. The RFR method is a market approach method. This

method estimates the value of an intangible asset based on the premise that if the company did not own the trade name, it would need to license the name at a reasonable royalty rate in order to receive a comparable level of earnings.

The royalty expense savings (or the relief from the required license royalty) due to current ownership of the trade name can then be analyzed to estimate the value of the trade name intangible asset.

The first step in the RFR method is to identify guideline sale or license transactions. This is generally accomplished by developing an appropriate search criterion and utilizing publicly available transaction databases (illustrated in step 1 below).

Once a group of comparable sale or license transactions is identified (often called comparable uncontrolled transactions, or "CUTs"), the data may be used to calculate various pricing metrics or royalty rates (illustrated in step 2 below).

The analyst can then compare (1) the comparable sale or licensing transaction intangible assets to (2) the subject company intangible asset. The analyst may consider relevant factors expected to affect value. Based on this comparison, the analyst selects pricing metrics or royalty rates to apply to the subject company (illustrated in step 3 below).

Finally, the selected pricing metrics are applied to the subject company earnings measure (typically revenue) to estimate an indicated license or royalty savings (illustrated in step 4 below). The estimated relief from royalty payments can then be converted to an indicated value using a present value factor.

The following example applies the RFR method to measure the value of the trade name.

Select Sample of Guideline Transactions (Step 1)

Exhibit 2 presents a summary of the selected license transactions that the analyst determined were comparable to the subject trade name intangible asset. In this example, the subject company is a regional propane distributer.

Transaction Pricing Metrics (Step 2)

Exhibit 2 presents two royalty rate calculation methods: (1) royalties based on a percent of gross revenue and (2) royalties based on a dollar amount per 10,000 gallons of propane sales.

The analyst determined that a royalty rate based on gross revenue is appropriate to apply in the analysis. Accordingly, the analyst calculated the implied revenue royalty rate for the group of transactions as summarized in Exhibit 3.

Comparison to the Subject Company (Step 3)

The analyst identified the primary characteristics for comparison between the subject company and the identified transactions, as summarized in Exhibit 4. Based on the facts and circumstances of the subject company (including discussions with management), the analyst completed the characteristic adjustment summary and selected a royalty rate to apply in the RFR method analysis.

Fair Value Measurement (Step 4)

Based on the selected royalty rate of 0.40 percent of revenue, Exhibit 5 presents an example of an RFR

Exhibit 2
Search for CUT Arm's-Length License Royalty Rates

License Effective Date	Gross Revenue Royalty Rate Range		Volume ($/10,000 gallons) Royalty Rate Range		License Term	License Territory	License Exclusivity
	Low	High	Low	High			
4/1/2006			$ 100.00	$ 100.00	2-Year Initial Term	Worldwide	Exclusive
11/2/2000			$ 50.00	$ 70.00	15 Years	North America	Nonexclusive
1/1/2013	0.55%	0.55%			Indefinite	NA	Multi-Exclusivity
2/2/1999	0.33%	0.33%			5 Years	Michigan, Indiana, Ohio, Illinois, Worldwide	Multi-Exclusivity

Exhibit 3
Implied Royalty Rate Range for the Guideline License Transactions

	Gross Revenue Royalty Rate Range		Volume ($/10,000 gallons) Royalty Rate Range	
	Low	High	Low	High
Guideline Royalty Rate Range	0.33%	0.55%	$ 50.00	$ 100.00
2021 Projected Subject Company ($000 revenue or gallons/10,000)	$ 55,500	$ 55,500	2,600	2,600
Annual Royalty Estimate ($000)	183	305	130	260
Implied Revenue Royalty Rate			0.23%	0.47%

Exhibit 4
Primary Trademark and Trade Name Characteristics for Comparison Purposes

Trademark and Trade Name Characteristics	Adjustment
Age (subject company name over 20 years)	↑
Quality (considered similar to competitor offerings)	--
Profitability (similar within the industry)	--
Market Share (average among competitors)	--
Name Recognition (well perceived and recognized)	↑
Geographic Restriction (well known, but limited to its current markets)	↓
Business Reliance on Name for Growth (not considered to be a primary factor)	--

Characteristic Summary		
↑	↓	--
2	1	4

0.40% Selected

Exhibit 5
Illustrative RFR Method Fair Value Measurement Analysis

Valuation Variables:			2021 $000	2022 $000	2023 $000	2024 $000	2025 $000	2026 $000	2027 $000	*Terminal $000*
			Projected Year Ending December 31,							
	Annual Revenue Growth		*NA*	*7.4%*	*6.5%*	*6.1%*	*4.2%*	*3.0%*	*2.4%*	*1.5%*
	Projected Company Revenue		55,500	59,600	63,500	67,400	70,200	72,300	74,000	*75,100*
Multiplied by:	Selected Market-Derived Royalty Rate		0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	*0.40%*
Equals:	Projected Annual Royalty Expense Relief		222	238	254	270	281	289	296	*300*
Minus:	Income Taxes @ 21%		(47)	(50)	(53)	(57)	(59)	(61)	(62)	*(63)*
Equals:	Projected Annual Royalty Expense Relief - After Tax		175	188	201	213	222	228	234	*237*
	Discounting Periods (mid-year convention)		0.500	1.500	2.500	3.500	4.500	5.500	6.500	
Multiplied by:	Present Value Factor	13.5%	0.939	0.827	0.729	0.642	0.566	0.498	0.439	
Equals:	Present Value of Interim Royalty Expense Relief		165	156	146	137	126	114	103	

	$000
Sum of Present Value of Interim Royalty Expense Relief	947
Present Value of Terminal Royalty Expense Relief	868
Total Present Value of Royalty Expense Relief	1,815
Fair Value Measurement ($000, rounded)	**1,820**

Calculation of Terminal Value	$000
Terminal After-Tax Royalty Expense Relief	237
Divided by: Direct Capitalization Rate	12%
Terminal Value of Royalty Expense Relief	1,978
Present Value Factor	0.439
Present Value of Terminal Royalty Expense Relief	868

method valuation analysis for the identified trade name.

The RFR method summarized above includes a number of underlying assumptions and analyses that are beyond the scope of this discussion. A summary of some of the primary considerations included in the previous calculations includes the following:

- Projected annual revenue provided by company management
- Utilization of the market-derived royalty rate (0.40 percent)
- Estimated income tax rate (21.0 percent)
- Present value discount rate (13.5 percent based on the company's estimated weighted average cost of capital or "WACC")
- Application of a terminal value based on the illustrative assumption indefinite useful economic life for the trade name.
- Terminal value direct capitalization rate (12.0 percent based on the company's estimated 13.5 percent WACC less the estimated long-term growth rate of 1.5 percent)

As presented in Exhibit 5, the RFR method measures the fair value for the trade name, using the assumptions and factors previously described, of approximately $1.8 million.

Summary and Conclusion

ASC Topic 805 requires that identifiable intangible assets acquired in a business combination transaction are to be recognized and reported separately from goodwill.

The PCC accounting alternative provides an exception for qualified companies. The PCC alternative does not require the recognition of (1) customer-related intangible assets that are not capable of being sold or licensed independently from other assets of the business and (2) noncompete agreements.

However, the election of the PCC accounting alternative does not exempt private companies from recognizing all other identifiable intangible assets (e.g., trade names, leases, contract assets, software, etc.) based on the criterion provided in ASC Topic 805.

If a private company elects the PCC accounting alternative under ASU 2014-18, it should also adopt the requirements of goodwill reporting outlined in ASU 2014-02. This requirement allows private companies to amortize goodwill acquired in a business combination on a straight-line basis over 10 years (or fewer years) and potentially reduces the frequency of impairment tests. Impairment tests are required only as a result of a triggering event rather than on at least an annual basis.

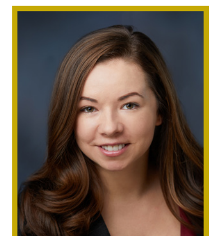
Before a private company elects the PCC accounting alternative, the company owners and managers may need to consider the additional effects and ramifications beyond an expected benefit of reduced acquisition-related costs and financial reporting requirements. Such considerations may include the requirements of the users of the financial statements, the potential for future conditions requiring the restatement of historical accounting for acquisitions, and the continuing need to measure the fair value of identifiable intangible assets not specifically excluded as a result of the accounting election.

Note:

1. Brian H. Marshall, "Simplified Accounting for Private Companies: Certain Intangible Assets," National Professional Standards Group (June 2020).

Sources:

1. FASB Accounting Standards Codification, Business Combinations (Topic 805).
2. FASB Accounting Standards Update No. 2014-18, Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination (December 2014).
3. FASB, "Extending Private Company Accounting Alternatives on Certain Identifiable Intangible Assets and Goodwill to Not-For-Profit Entities" (May 30, 2019).
4. FASB Accounting Standards Update No. 2014-02, Intangibles—Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment (January 2017).



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