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Accounting for Goodwill at Private versus Other Companies: Amortize, Impair, or Write Off

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Abstract: This article documents increased diversity in financial accounting practice. The Financial Accounting Standards Board (FASB) standard-setting process for the Accounting Standards Update (ASU) 2014-18 is used as documentation. The FASB ASU 2014-18 was approved by a slim margin of four to three of the FASB members. This indicates continuing controversy around accounting for goodwill that relates to the public interest goal of similar accounting for similar transactions and events. This article analyzes the content within the 52 Comment Letters submitted in response to 18 questions asked by the Private Company Council (PCC) that lead to the promulgation of the FASB ASU 2014-18. Private companies are to include non-marketable intangibles in the account goodwill that non-private companies are to continue measure and report separate from goodwill. Plus private companies are allowed to either amortize or test for impairment in measuring and reporting goodwill. Non-private companies are to test for impairment. Non-private companies do not have the option of using amortization as part of the measurement and reporting process regarding goodwill. This diversity in measuring and reporting goodwill decreases progress toward the public interest goal of comparability of financial reports. Comparability is a significant quality thought to improve decision usefulness of information.

Keywords: Accounting standard-setting process; Accounting for goodwill; Private companies; Non-private companies.

1. Introduction

For decades there has been movement toward harmonizing United States (US) Generally Accepted Accounting Principles (GAAP) with global and/or international accounting standards relative to achieving a public interest goal of increasing the decision usefulness of financial statements especially those prepared by multinational organizations. In the year 2001 the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 142 that replaced amortization with impairment as the method of measuring and reporting goodwill. In the year 2008, the International Accounting Standards Board (IASB) issued International Financial Accounting Standard (IFRS) number 3 that also eliminated amortization of goodwill and instituted the measurement and reporting practice referred to as impairment of goodwill. Harmonization appeared to be achieved. In December 2014, the FASB issued FASB ASU 2014-18 that reinstated amortization of goodwill by private companies. This is not an article about US versus non-US financial standards or standard setting. It is about US accounting standard setting relative to the public interest where some discussion of harmonizing accounting standards helps clarify the public interest focus of the article. The idea of converging accounting standards was added to the idea of harmonizing accounting standards as more organizations engaged in international transactions and events that could or should be reflected in the organization's financial statements. Harmonization and/or convergence has been hoped to increase comparability of financial statements. Part of the harmonization and/or convergence discussion has centered on public interest policies relative to principles-based versus rules-based accounting standards. The International Financial Reporting Standards (IFRS) have been characterized as being principles based. The US GAAP has been characterized as being rules based. The diversity in rules increases complexity, which is counter to the public interest goal of the information being useful. Increasing complexity decreases the ease of understanding and comparing financial information. This article documents movement away from the public interest goal of decreased complexity and increased decision usefulness as US GAAP is being promulgated that increases diversity based on whether a company is private or not-private.

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This article addresses accounting for goodwill, which includes amortization, testing for impairment, or immediate write offs by analyzing the FASB Accounting Standards Update (ASU) 2014-18 and the content within the 52 related Comment Letters submitted in response to 18 questions asked by the Private Company Council (PCC). The FASB ASU 2014-18 was approved in December 2014 by a slim margin of 4 to 3, indicating a continuing controversy around accounting for goodwill and that there will be future changes. The 3 dissenting FASB members opposed FASB ASU 2018-18 "because they do not believe that it is appropriate to finalize an accounting recognition and measurement alternative for private entities while at the same time exploring the same accounting issues for public entities."

2. Methodology

The source of the data for this article was the FASB website that contained the 52 Comment Letters submitted to the PCC (Financial Accounting Standards Board (FASB), 2014) in response to the PCC's call for comments. The PCC asked 18 questions in the call for comments. The respondents' answers to the 18 questions were tabulated. The tabulated results were analytically discussed and compared to the FASB's decisions as published in the FASB ASU 2014-18. The 18 questions were as follows in a partially summarized format:

1. Are you primarily a preparer, user, public accountant or, if other, please specify?
2. Should any types of entities, transactions or accounts in the proposed scope be excluded?
3. Should the FASB consider expanding the scope of the accounting alternative to other entities, such as publicly traded companies or not-for-profit entities?
4. Would the proposed amendments reduce overall costs and complexity compared with existing guidance?
5. Do you agree that the accounting alternative for goodwill would provide relevant and decision-useful information to users of private company financial statements?
6. Do you agree with the PCC's decision to amortize goodwill on a straight-line basis over the life of the primary asset acquired in a business combination, not to exceed 10 years?
7. Do you agree that goodwill accounting for under this alternative should be tested for impairment at the entity-wise level?
8. Do you agree that goodwill accounted for under this alternative should be tested for impairment only upon the occurrence of a triggering event that would indicate that the fair value of the entity may be below its carrying amount?
9. Should the assessment of triggering events be performed consistently with how entities currently assess for goodwill impairment between annual tests?
10. Do you agree with the alternative one-step method of calculating goodwill impairment loss as the excess of the carrying amount of the entity over its fair value?
11. Do you agree with the disclosure requirements of the proposed Update, which largely are consistent with the current disclosure requirements in FASB Accounting Standards Codification (ASC) Topic 350?
12. How much effort would be needed to implement and audit the proposed amendments?
13. Do you agree that goodwill existing as of the effective date should be amortized on a straight-line basis prospectively over its remaining useful life not to exceed 10 years?
14. When should the alternative accounting method be effective? Should early application be permitted?
15. How much effort would be needed to implement and audit the proposed amendments?
16. Would the proposed amendments result in less relevant information?
17. If an entity elects the accounting alternative, should the entity also be required to apply ASC Topic 850?
18. Do you agree with the FASB's tentative definition of a public business entity?

3. Results and Discussion

3.1. Respondents

The first question in the call for Comment Letters from potential respondents asked whether the respondent was primarily a preparer, user, or public accountant. Table 1 summarizes the Respondents' profiles, and shows that public accountants submitted 48 percent of the Comment Letters, and non-public accountants submitted 52 percent, though they did not explicitly declare their status as either preparers or users. While the respondents prepare and use financial information and reports, public accountants are the major separately identifiable group. While comparing the accountants' and non-accountants' responses is out of scope for this study, opinions did not appear to vary between these groups.

Table-1. Respondents Profiles

Respondent Type	Percent	Number
Non-Public Accountants	52%	27
Public Accountants	48%	25
Total	100%	52

3.2. Scope and Definitions

The major controversy with FASB ASU 2014-18 is not the "accounting alternative" available to private companies electing to implement a modification of ASC Topic 805 to account for identifiable intangible assets in a business combination. The major controversy is that different measurement and reporting methods for similar transactions and events are promulgated by the FASB based on whether the organization is private or not private. Size of the organization is not the defining variable for different measurement and reporting. Whether an organization is domestic or multinational is the defining variable. It is just whether the organization is private or not private. According to the accounting alternative, intangible assets that are not "capable of being sold or licensed independently" should be included in goodwill even if these assets can be identified and measured. Non-private and private companies electing not to implement the amendment must measure and report these non-marketable intangible assets (e.g., customer-related intangible assets, noncompetition agreements) using the GAAP standard prior to FASB ASU 2014-18, wherein these assets are reported separately from goodwill. Only 15 percent of the respondents opposed the alternative method (see Table 2), based on the fact that the accounting alternative was only available to private companies when these respondents felt that this should be available to all types of companies. Since FASB 2014-18 concluded that the accounting alternative "reduces the cost and complexity associated with the measurement of certain identifiable intangible assets without significantly diminishing decision-useful information," the debate continues as to why the alternative is not available to non-private companies. The net result will be fewer intangible asset accounts when the non-marketable intangible assets accounts are no longer reported separately, and included in goodwill.

Table-2. Accounting Alternative to Include Non-marketable Intangible Assets in Goodwill

Comment Letter Question	Agree	Disagree	Neither agree or disagree	FASB 2014-18 Guidance
2. Private companies and/or proposed transactions and/or events excluded	15%	31%	54%	No
3. Not-for-profit and public companies included	44%	23%	33%	No

Comment Letter Question 2 asked respondents whether any of the specified transactions and accounts for private companies should be excluded. The FASB decision was consistent with 85 percent of the respondents who did not think that any of the specified transactions or accounts for private companies should be excluded.

Comment Letter Question 3 was whether "non-private" (e.g., non-profits, publicly traded) companies should have the same treatment as private companies (see Table 2): 23 percent responded that non-private companies should be excluded, and 44 percent responded that non-private companies should be offered the alternative method (i.e., amortization). Many of the 33 percent of respondents who neither agreed nor disagreed suggested that not-for-profits should be included with private companies. The PCC could have broken this question into two questions asking specifically about non-profits, and whether to include public companies. Several comments recommended including credit unions with private companies. The FASB decided exclude non-private companies from the scope.

The FASB ASC Glossary definition of private companies specifically excludes non-profit and public business companies, though the FASB definition of public business companies continues to be under revision. Comment Letter Question 18 asked respondents whether they agreed with the FASB's tentative decision regarding the definition of a public business entity. Essential to the application of FASB ASU 2014-18 is the definition of a private company. The FASB ASC Glossary defines a private company as "an entity other than a public business entity, a not-for-profit entity, or an employee benefit plan." The tentative definition of a pubic business entity is:

> A public business entity would be defined as a business entity meeting any one of the following criteria: a. It is required to file or furnish financial statements with the Securities and Exchange Commission. b. It is required to file or furnish financial statements with a regulatory agency in preparation for the sale of securities or for purposes of issuing securities. c. It has issued (or is a conduit bond obligor) for unrestricted securities that can be traded on an exchange or an over-the-counter market. d. Its securities are restricted, and it is required to provide U.S. GAAP financial statements to be made publicly available on a periodic basis pursuant to a legal or regulatory requirement.

Table 3 reports the responses, showing that only 19 percent agreed, eight percent disagreed, and the remaining 73 percent did not agree or disagree as they were waiting on a finalized decision from the FASB. Though only eight percent agreed with the FASB's tentative definition, the FASB included it in FASB ASU 2014-18.

FASB ASU 2014-18 stipulates that private companies electing to implement the accounting alternative must also implement FASB ASU 2014-02, which allows them to amortize goodwill, while all others must use a process to test for impairment of goodwill. The call for Comment Letters after publication of FASB ASU 2014-02 in January 2014 included questions related to the accounting amendments therein. The main controversy surrounds the definition of private versus public companies.

Table-3. Public Business Company Defined

Comment Letter Question	Agree	Disagree	Neither agree or disagree	FASB 2014-18 Guidance
18. Tentative decision regarding definition of a public business company	19%	8%	73%	Included

3.3. Accounting Treatment for Goodwill

Amortization of goodwill is an option to adjusting goodwill based on estimated impairment or the direct write off of goodwill. Amortization is available only to private companies per the amendment to FASB ASC Topic 350 from FASB ASU 2014-02. Not-for-profit and public companies must measure goodwill using the impairment method or direct write off.

3.3.1. Amortization

Table 4 reports the results from Comment Letter questions 4 and 15, which concern costs or complexity associated with amortization. Question 4 asked about the costs and complexity of using amortization versus impairment testing. Sixty three percent of the respondents felt that the costs and complexity would decrease. The FASB agreed. Question 15 asked about the effort to implement or audit amortization. Fifty percent of the respondents felt that the process would not be more difficult.

Table-4. Availability of Accounting Alternative for Goodwill including Non-marketable Intangible Assets

Comment Letter Question	Agree	Disagree	Neither agree or disagree	FASB 2014-18 Guidance
4. Amortization reduces costs and complexity	63%	10%	27%	No
15. Only a little effort needed to implement and audit amortization	50%	8%	42%	Not specifically mentioned

Table 5 reports the results from questions 5 and 16, which asked whether amortization provides relevant and decision-useful information. Over 50 percent of the respondents agreed that it does. Only 15 percent agreed that the proposed amendments would not result in less relevant information, and 77 percent did not include opinions about this. The FASB approved a method consistent with the opinion that amortization provides relevant and decision-useful information.

Table-5. Amortization Relevance and Decision-Usefulness

Comment Letter Question	Agree	Disagree	Neither agree or disagree	FASB 2014-18 Guidance
5. Amortization provides relevant decision-useful information	52%	8%	40%	Yes
16. Amortization will result in less relevant information for users	15%	8%	77%	No

Table 6 reports the results for questions 6 and 13, which asked whether straight-line amortization should apply for ten or fewer years. In the tabulation process, these two questions were divided. Suggestions included that the time line should be 15 years, as is for the Internal Revenue Service (IRS). With the differences in financial accounting, using a maximum of ten years, and the IRS, using a maximum of 15 years, deferred taxation could potentially result in additional complexity. Twenty five percent of the respondents agreed with a time line of 10 or fewer years; about 25 percent suggested that 15 or fewer years would reduce complexity. Companies using 15 years for tax reporting and ten years for financial reporting will have to manage the complexity of measuring and reporting the difference in deferred taxes in the financial statements.

Table-6. Amortize Goodwill using Straight line over 10 versus 15 or Fewer Years

Comment Letter Question	Agree	Disagree	Neither agree or disagree	FASB 2014-18 Guidance
6. Amortize using straight line not to exceed 10 years	25%	25%	50%	Yes
6b. Amortize using straight line not to exceed 15 years.	23%	2%	75%	No
13. Amortize over remaining useful life not to exceed 10 years	25%	27%	48%	Yes
13b. Amortize over remaining useful life not to exceed 15 years	19%	4%	77%	No

3.3.2. Impairment Testing

Table 7 summarizes the responses from questions 7 – 10, which ask about impairment testing, that is, whether a one-step test of impairment should be used if there is a triggering event. Fifty percent or more of the respondents said yes, and the FASB agreed.

Table-7. Testing for Impairment of Goodwill

Comment Letter Question	Agree	Disagree	Neither agree or disagree	FASB 2014-18 Guidance
7. Test for impairment at entity-wide level	50%	12%	38%	Yes
8. Test for impairment if there is a triggering event	52%	4%	44%	Yes
9. Triggering events noted in the proposal are appropriate	50%	2%	40%	Yes
10. Agrees with one step method of calculating impairment	58%	2%	40%	Yes

The dissenting FASB members stated, “under today’s impairment accounting, the decline in value of externally acquired goodwill often is not recognized because the current impairment model writes down goodwill to a lower impaired amount that considers not only existing externally acquired goodwill but also includes both internally generated goodwill existing at the date of the acquisition and goodwill created or regenerated by investments subsequent to the acquisition. The dissenting Board members see no basis for a view that goodwill should be treated as an indefinite-lived asset.”

3.3.3. Write Offs

Historically, guidance for accounting for goodwill discussed impairment testing and direct write offs upon acquisition, preferring the former and discouraging the latter. The FASB ASU 2014-18 amendment revisits the issue, again discouraging direct write offs. Discouraging is not the same as not allowing.

3.4. Remaining Questions

The remaining questions deal with disclosure, prospective implementation, early application, the implementation of topics 805 and 350, and write offs for goodwill. Question 11 asked about disclosure requirements, and only 8 percent of respondents disagreed with the recommendations. FASB adopted the proposed disclosure requirements, though the dissenting members felt that “disclosure is never an acceptable substitute for recognition.” Question 12 asked whether implementation should be prospective. As 56 percent of the respondents agreed, the FASB adopted prospective implementation. Question 14 asked if early application should be allowed. Since 58 percent of respondents agreed, this was included as an option. Comment letter question 17 asked whether Topic 805 and the proposed changes in FASB 2014-18 (Topic 350) should be implemented simultaneously. While the FASB indicated that these should be implemented at the same time 37 percent of respondents agreed, 19 percent disagreed with the remainder not taking a stand.

4. Conclusion

The FASB ASU 2014-18 amended the FASB ASC Topic 805 by increasing diversity relative to accounting for goodwill. The third method of amortization was added to the preferred method of impairment and the discouraged (but allowed) direct write-off method. Increasing diversity in the measuring and reporting of goodwill is a step away from the public interest goal of decision-useful information founded in the quality of being able to compare financial reports developed using similar methods to measure and report similar transactions and events. The FASB ASU 2014-18 also allows an accounting alternative allowing the inclusion of non-marketable assets in the goodwill account for private companies that is not allowed for non-private companies. The dissenting FASB members stated “that this issue should not be resolved on a piecemeal basis for private entities only [as] … the issue [should be addressed] at the same time for all entities (private, public business, and not-for-profit entities) to avoid the risk of having an accounting alternative in place for private entities that ultimately may be inconsistent with and overturned by future Board decisions.” FASB ASU 2014-18 also validates FASB ASU 2014-02, which granted private companies the option of amortizing goodwill instead of testing for impairment, which non-private companies use per FASB ASC Topic 350. The review reported in this article of the tabulated 52 Comment Letters submitted to the PCC prior to the final publication of FASB ASC 2014-18 sheds light on the controversy surrounding the measurement and reporting for goodwill. Illuzzi (2015) commented on what she refers to the FASB “preferability” rules as related to the goodwill alternative. She concluded the “new private company financial reporting alternatives have given financial statement preparers many issues to consider” (Illuzzi, 2015). While the FASB uses due process in the establishment of accounting standards, FASB ASC 2014-18 only partially reflects the preferences of the people who and organizations that formally submitted comments on the proposed content. Without an adopted definition of what constitutes a public business entity, there appears to be on-going diversity and potential future changes in financial accounting for goodwill.

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