Business Issue

Recently the FASB issued an Accounting Standards Update¹ to permit private companies to amortize goodwill acquired in a business combination, and to apply a simplified goodwill impairment model. This change is intended to help reduce reporting complexity for private companies; however, private companies should carefully consider this alternative, especially for those considering an initial public offering.

The goodwill alternative

Under this alternative, a private company can elect to amortize goodwill on a straight-line basis over a maximum period of 10 years. An amortization period of fewer than 10 years can be used if the company can demonstrate that another useful life is more appropriate based on facts and circumstances.

Impairment of goodwill is assessed only upon the occurrence of triggering events, but it may be assessed at either the entity level or the reporting unit level under this alternative. Further, private companies continue to have the option to first assess qualitative factors to determine whether a quantitative impairment test is necessary. However, if a quantitative impairment test is required, a one-step impairment test, rather than a two-step impairment test, would be performed. This one-step impairment test is easier to apply because it does not require a hypothetical purchase price allocation to isolate the change in goodwill.

The goodwill alternative is a policy election, and applies to all existing goodwill and goodwill generated in future business combinations for fiscal years beginning after December 15, 2014. Early adoption is permitted.

Note that the alternative does not apply to other indefinite-lived intangibles, such as franchise rights. Other indefinite-lived intangibles will still require an annual impairment analysis.

Are you eligible? You may be surprised...

The goodwill alternative is available to private companies. However, some companies that consider themselves to be private may not be eligible for this alternative due to the FASB’s new definition of a “public company.”²

The new definition may result in more companies being considered “public,” for example:

- If a company is required to file financial statements with the SEC
- If stand-alone financial statements of a subsidiary of a public company are included in a parent’s SEC filing
- If a company (i) has securities that are not subject to transfer restrictions and (ii) is required to prepare US GAAP financial statements and make them publicly available on a periodic basis

Thus, it is expected that the goodwill alternative will provide the most benefit to private companies with no public filing requirements.

¹ ASU No. 2014-02, Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill, issued in January 2014
² ASU No. 2013-12, Definition of a Public Business Entity, An Amendment to the Master Glossary
The table below provides a high level summary of key considerations in applying the alternative:

<table>
<thead>
<tr>
<th>Pros</th>
<th>Risks</th>
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<tbody>
<tr>
<td>• Reduced costs of compliance</td>
<td>• Additional costs in later periods if company must “unwind” the alternative in later periods (e.g., if a company goes public)</td>
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<tr>
<td>• Reduced complexity</td>
<td>• Key financial statement users may not accept the alternative</td>
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<td>• Lower likelihood of impairment due to amortization of goodwill</td>
<td>• Additional amortization expense</td>
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<td>• Favorable income tax effects</td>
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**Our insight**

The change from an annual goodwill impairment test to a trigger-based test, as well as the change from a two-step impairment test to a one-step test, will reduce the costs and complexity of financial reporting for private companies that carry goodwill on their balance sheets. Similarly, it is expected that the ability to amortize goodwill over time will reduce the likelihood of impairments, and private companies will need to perform a full goodwill impairment test less frequently.

Additionally, this potential change may have an impact on income tax accounting. If pre-tax goodwill amortization charges are recorded, a company will need to assess what tax benefit, if any, should be recorded. In addition, valuation allowance assessments may also need to be revisited. Under the new alternative, deferred tax liabilities related to goodwill may potentially be considered a source of future taxable income in valuation allowance assessments, given that it is likely that a company could determine the expected timing of the reversal of a temporary difference related to goodwill.

As discussed above, companies must consider these benefits in the context of their long term strategic objectives and the new definition of a public company per the FASB. A private company that elects the goodwill alternative may incur additional costs and complexity in later periods if it later meets the definition of a public company (e.g., files a Form S-1) and therefore must “unwind” the accounting under the alternative and perform an annual impairment analysis for such periods.

In addition, companies should ensure that key financial statement users, such as lenders, will accept the alternative, and should consider any economic consequences, such as the impact on debt covenant compliance, that will arise from increased amortization expense.

*The goodwill alternative will reduce costs of compliance and complexity for certain private companies. However, companies should consider key financial statement users, implications to existing agreements, and future strategic objectives prior to making the election.*

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