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# Defining Issues®

## FASB extends certain private company alternatives to not-for-profits

May 31, 2019

ASU 2019-06[1] changes the accounting for goodwill and certain intangible assets for not-for-profit entities.

### Applicability

All not-for-profit entities, including those that are conduit bond obligors.

### Key facts and impacts

The ASU extends the private company optional alternatives on goodwill[2] and certain intangible assets acquired in a business combination[3] to not-for-profits (NFPs). The FASB intends to reduce cost and complexity without significantly diminishing the usefulness of financial statement information. The alternatives are intended to:

— reduce the frequency of impairment tests;
— simplify the impairment test when it is required; and
— result in recognition of fewer intangible assets in future business combinations.

| Current US GAAP | Accounting alternative under ASU 2019-06 |
|---|---|
| Do not amortize goodwill. | Amortize goodwill (including equity method goodwill) on a straight-line basis over 10 years (or less, if more appropriate). |
| Test goodwill for impairment at least annually and more frequently if a triggering event occurs. | Test goodwill, excluding equity method goodwill, for impairment on a triggering event. |
| Test goodwill for impairment at the reporting unit level. | Test goodwill for impairment at the entity level, or continue to test at the reporting unit level. |
| Recognize all identifiable intangible assets acquired in a business combination separately from goodwill. | Include in goodwill certain identifiable intangible assets acquired in a business combination. |

1 ASU 2019-06, Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities, May 30, 2019

2 ASU 2014-02, Accounting for Goodwill

3 ASU 2014-18, Accounting for Identifiable Intangible Assets in a Business Combination

## Goodwill accounting alternative

### Amortization

An NFP electing this accounting alternative amortizes goodwill on a straight-line basis over 10 years, unless it demonstrates that a shorter useful life is more appropriate. Similar to depreciation of fixed assets and amortization of finite-lived intangible assets, goodwill amortization should be functionalized and included in the expense analysis in an NFP's financial statements.[4] The aggregate amount of goodwill, net of accumulated amortization and impairment, is presented as a separate line item on the balance sheet.

**KPMG observation**

An NFP is not required to justify a 10-year amortization period for goodwill, even in circumstances when the primary asset acquired in the transaction is expected to generate cash flows for less than 10 years. However, an NFP may elect to justify a shorter amortization period if it expects to benefit over a shorter period. For example, goodwill at an NFP applying the intangible asset alternative treatment (discussed below) may consist of significant customer-related intangibles or noncompete agreements that, if recognized separately, would have a useful life of less than 10 years.

### Impairment test

Under this election, an NFP is required to test goodwill for impairment only when a triggering event occurs that indicates that the fair value of the entity (or a reporting unit) may be below its carrying amount. An annual impairment test is not required.

An NFP applying the alternative is permitted to continue to test goodwill for impairment at the reporting unit level, or it may elect to test impairment prospectively at the entity level without demonstrating that this policy election is preferable.

When a triggering event is identified, an NFP has the option to first qualitatively assess whether it is more likely than not that goodwill is impaired. If it is not, no further testing is necessary. Otherwise, the NFP must perform a quantitative test that compares the entity's fair value with its carrying amount, including goodwill (or the fair value of the reporting unit with its carrying amount, including goodwill).

**KPMG observation**

The reporting unit level versus entity level alternative likely will not affect most NFPs because, if they have goodwill, they generally evaluate it for impairment at one aggregate reporting unit level under current US GAAP. However, certain large NFPs (e.g. large NFP business-oriented healthcare entities) may have multiple reporting units, and they may elect to test goodwill for impairment at the entity level, rather than the reporting unit level, because doing so is likely less costly and complex.

### Impairment loss

A goodwill impairment loss is measured as the amount by which the carrying amount of the entity (or reporting unit), including goodwill, exceeds its fair value. The goodwill impairment loss may not exceed the entity's (or reporting unit's) goodwill carrying amount. If the impairment relates to tax deductible goodwill (e.g. at a taxable subsidiary), simultaneous equations are used to calculate the impairment loss and related adjustment to deferred taxes.[5] Impairment of goodwill is presented in the statement of activities (or operations for an NFP business-oriented healthcare entity) within continuing operations (or similar caption) unless the impairment loss is associated with a discontinued operation.

4 ASC 958, Not-for-Profit Entities

5 ASC 350-20-55-23A – 55-23D, Example 2A: Impairment Test When Goodwill Is Tax Deductible

### Equity method goodwill

An NFP that elects to amortize goodwill also must do the same for the goodwill implicit in its equity method investments (i.e. representing the difference between the cost of an investment and the amount of underlying equity in the net assets of an investee). However, equity method goodwill is not separately tested for impairment. Rather, the overall equity method investment is evaluated to determine whether an impairment is other than temporary.[6]

### Disclosure

An NFP that elects the goodwill alternative should disclose, if material:

- the fact that it has elected the alternative treatment;
- for additions to goodwill during the period:
  - the total amount added and the related weighted-average amortization period;
  - the individual amount added and the related amortization period by acquisition or reorganization event;
- gross carrying amounts of goodwill, accumulated amortization and accumulated impairment loss;
- aggregate amortization expense for the period;
- goodwill included in a disposal group classified as held for sale;
- goodwill derecognized during the period that was not previously reported in a disposal group classified as held for sale; and
- for each goodwill impairment loss:
  - a description of the facts and circumstances leading to the loss;
  - the amount of the loss and method of determining the fair value of the entity or the reporting unit;
  - the caption in the statement of activities/operations in which the loss is included; and
  - the method used to allocate the loss to individual amortizable units of goodwill.

The quantitative disclosures about significant unobservable inputs used in fair value measurements categorized within Level 3 of the fair value hierarchy are not required for fair value measurements related to goodwill after its initial recognition.

## Identifiable intangible assets accounting alternative

### Customer-related intangibles and noncompete agreements

An NFP electing the accounting alternative will apply it to all in-scope transactions entered into after the adoption date. An NFP may use the alternative when:

- applying the acquisition method for a business combination;[7]
- assessing the nature of the difference between the carrying amount of an investment and the amount of underlying equity in net assets of an equity method investee; and
- applying fresh-start reporting when emerging from a Chapter 11 reorganization action.[8]

By electing the alternative, an NFP will not recognize separately from goodwill the following intangible assets:

- customer-related intangible assets, unless they are capable of being sold or licensed independently from other assets of a business; and
- noncompete agreements.

6 ASC 323, Investments—Equity Method and Joint Ventures

7 ASC 805, Business Combinations, or Subtopic 958-805, Not-for-Profit Entities—Business Combinations

8 ASC 852, Reorganizations

The following are not considered customer-related intangible assets when applying the alternative and should be recognized separately from goodwill:

- contract assets recognized in revenue transactions with customers;[9] and
- leases, including favorable and unfavorable lease intangibles.

Customer-related intangibles and noncompete agreements recognized as of the adoption date should continue to be subsequently measured based on existing US GAAP (i.e. they should not be subsumed into goodwill on adoption).[10]

**KPMG observation**

**Customer-related intangible assets**

Although worded slightly differently, we believe a customer-related intangible asset that meets the separability criterion in the definition of an identifiable intangible asset is not eligible for the alternative accounting treatment. An intangible asset meets the separability criterion if it is capable of being sold or licensed independently, regardless of whether the NFP intends to sell it.

**Noncompete agreements**

A noncompete agreement places restrictions on an individual's or a business's ability to compete with another entity and therefore meets the contractual-legal criterion for recognition as an intangible asset. The restrictions generally relate to specified markets, products or activities for a specific time period. These agreements may be entered into on a stand-alone basis, or they may be embedded in another agreement, such as an acquisition agreement or an employment contract.

We understand that some entities consider noncompete agreements as part of the business combination and some do not because they regard these transactions as separate from the business combination. Noncompete agreements are not specifically addressed in the business combinations guidance. Noncompete agreements that are not included in an entity's acquisition accounting will not be affected by the entity's election to use the intangible asset alternative.

### Disclosure

NFPs electing this alternative should refer to the current disclosure requirements for intangible assets that do not require separate recognition in business combinations. These NFPs also should disclose the application of the alternative as an accounting policy election, if material.

## Effective dates and transition

The amendments are effective with the ASU's issuance. An NFP electing to adopt these alternatives may do so at any time without having to demonstrate preferability.

An NFP should apply the goodwill accounting alternative, if elected, prospectively for all existing or newly recognized goodwill. An NFP should apply the intangible assets accounting alternative, if elected, prospectively when the first transaction within the scope of the alternative occurs.

When an NFP elects the intangible assets alternative, it must also elect the goodwill alternative. However, if an NFP elects the goodwill alternative, it is not required to elect the intangible assets alternative.

## Related project

The FASB has a project on its technical agenda to broadly reconsider the accounting for goodwill and identifiable intangible assets. It is expected to issue an Invitation to Comment in the near future.

9 ASC 606, Revenue from Contracts with Customers

10 ASC 350, Intangibles—Goodwill and Other

We expect the FASB to ask about:

- returning to an amortization approach to accounting for goodwill; and
- subsuming intangible assets into goodwill, and if so, which ones.

The Invitation to Comment will not include any Board decisions. Instead, it will ask whether the Board should move forward with the project.

If the Board ultimately elects to change the model for accounting for goodwill and intangible assets for all entities, an NFP electing the current accounting alternatives may need to again change its accounting policies. The FASB decided that it is preferable to permit NFPs to adopt the alternatives now rather than delay this relief while it works on the broader project.

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