

# Value Relevance of Acquired Intangible Assets

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# Accounting for Intangibles

- In 2001, FASB issued SFAS 141 and SFAS 142
- SFAS 141 requires most acquired intangibles be recognized as assets applying fair value measurement
- Intangibles can be acquired through business combinations or direct purchase
- Firms added billions of dollars of assets to balance sheets



# Accounting for acquired intangible assets – brief history

- Prior to 2002, firms could apply either the pooling of interest or the purchase method for business combinations. SFAS 141 eliminated the pooling of interest method.
- For intangibles, acquirers have to identify and estimate fair values of the target's assets.
- Intangible assets are identifiable when they are contractible or separable from the entity
- Practitioners and equity investors raised claims that the standard SFAS141 has been insufficient in valuing acquired intangible assets (Quick and Goldschmid, 2002; FASB, 2007; Andrews et al. 2009) □ revision of SFAS141 in 2008
- Revision of SFAS 141 mandated the capitalization of in-process R&D and increased disclosure requirements of acquired intangibles, particularly for indefinite intangibles.
- In 2014, FASB (No. 2014-18) eliminated the separate capitalization of non-contractual customer intangibles and non-compete agreements for private firms.
- On October 24, 2018, the Board added to its technical agenda a broad project to revisit the subsequent accounting for goodwill and the accounting for certain identifiable intangible assets.
- Subsequently, the Board hosted public roundtable meetings on November 15, 2019, to discuss the topics included in the ITC Invitation to Comment
- Final Project Update: On June 15, 2022, the Board discussed the future direction of the project and decided to deprioritize and remove the project from its technical agenda.



# Accounting for Intangibles

- An intangible asset is a non-physical asset that is expected to provide future economic benefits to the entity that owns or controls it.
- For recognition purposes, it must be identifiable and non-monetary.
- The standards distinguish between definite and indefinite intangible assets.



# Economic lifetime of Intangibles

- Definite
  - Assets have a finite lifespan
  - Include patents, computer software, licenses, franchises, and certain trademarks
- Indefinite
  - Assets have a infinite lifespan
  - Include in-process R&D, (FCC) licenses, and most trademarks



## Current FASB/IASB Proposals

- Concerns with intangibles' fair values being difficult to verify
- Has led to proposals to subsume certain individual intangible assets—e.g., customer related intangible assets and non-compete agreements—into goodwill
- FASB received numerous comment letters, reflecting what changes, if any, are necessary to improve intangible asset accounting
- IASB has launched a new project on the review for the “accounting for intangibles” in April 2024





# Current FASB/IASB Proposals

1st Approach: Private company alternative (i.e. subsuming non-contractual customer intangibles and non-competes into Goodwill)

[FASB: 1/3 in favor and 2/3 opposed]

2nd Approach: Principles-based criterion

[FASB: 1/2 in favor and 1/2 neutral or disagreed]

3rd Approach: Subsuming of all intangible assets into Goodwill

[FASB: majority opposed it, and a few supported it]

4th Approach: Do not change current guidance

[FASB: majority supported it, and a few opposed it]



# Examples from comment letters

Some examples:

- 1) “We encourage the Board to consider a model in which finite-lived intangible assets are subsumed in goodwill.” (T-Mobile, 2019)
- 2) “Other than NCAs, we note that the measurement of recognized intangible assets are generally reliable and auditable.” (Houlihan Lokey, 2019)
- 3) “Subsuming customer-related intangible assets into goodwill would certainly reduce costs for Medtronic, as customer-related intangibles are often the primary asset acquired in a business combination..., we do not support a proposal to subsume these assets into goodwill.” (Medtronic, 2019)
- 4) “Exelon would support the approach to extend the private company alternative to subsume certain non-contractual customer related intangibles (CRIs) and all non-compete agreements (NCAs) into goodwill. Separately presented CRIs and NCAs do not provide decision-useful information to investors since they are not typically sold separately.” (Exelon, 2019)





# Academic research is scarce

Comment letter from the Financial Reporting Policy Committee:

“Unfortunately, academic research in this area does not provide direct evidence concerning specific intangible assets, such as non-compete agreements and customer-related intangibles...However, there is indirect evidence, which we believe is worth bringing to the Board’s attention. That is, academic research tends to examine broad classes of intangibles that include different types of intangibles with similar properties, rather than examining individual types of intangible assets”

Please also see discussion of Clor-Proell et al. (2022) in *Accounting Horizons*

**LLS is the first study to provide direct evidence on several dimensions of the accounting for acquired intangible assets for different classes and economic lifetimes.**

