Statement of Financial Accounting Standards No. 44

Note: This Statement has been completely superseded

FAS44 Status Page
FAS44 Summary

Accounting for Intangible Assets of Motor Carriers

an amendment of Chapter 5 of ARB No. 43 and
an interpretation of APB Opinions 17 and 30

December 1980

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 MERRITT 7, P.O. BOX 5116, NORWALK, CONNECTICUT 06856-5116

Statement of Financial Accounting Standards No. 44

Accounting for Intangible Assets of Motor Carriers

an amendment of Chapter 5 of ARB No. 43 and

an interpretation of APB Opinions 17 and 30

December 1980

CONTENTS

FAS 44: Accounting for Intangible Assets of Motor Carriers an amendment of Chapter 5 of ARB No. 43 and an interpretation of APB Opinions 17 and 30

FAS 44 Summary

Enactment of the Motor Carrier Act of 1980, deregulating motor carriers, raises questions regarding whether certain intangible assets of motor carriers should continue to be reported as assets or charged to income. This Statement requires the unamortized costs of motor carrier intangible assets representing interstate rights to transport goods with limited competition to be charged to income and, if material, reported as an extraordinary item. This Statement does not affect the accounting for other intangible assets of motor carriers, such as goodwill.

INTRODUCTION

1. The FASB has been asked to clarify the accounting for certain intangible assets of motor carriers because enactment of the Motor Carrier Act of 1980 [1] (Act) on July 1, 1980 raises questions regarding whether those intangibles should continue to be reported as assets or charged to income. Appendix A provides additional background information and Appendix B provides the basis for the Board's conclusions.

2. The Board has concluded that it can reach an informed decision on the basis of existing data without a public hearing and that the effective date and transition specified in paragraph 8 are advisable in the circumstances.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

3. When acquired, intangible assets of motor carriers may have included costs [2] related to expected benefits from established routes or customers, marketing or operating efficiencies, knowledge of the business, and other elements of goodwill as well as from specifically identifiable intangible assets, such as customer lists, favorable leases, or operating rights.[3] The costs of intangible assets acquired may have been identified previously as

operating rights or as goodwill. If not separately allocated in the past, the costs of intangible assets shall now be assigned to (a) interstate operating rights, (b) other identifiable intangible assets (including intrastate operating rights [4]), and (c) goodwill; the cost of identifiable intangible assets (including operating rights) shall not be included in goodwill.

4. For purposes of identifying and assigning costs to interstate operating rights, other identifiable intangible assets, and goodwill, a motor carrier shall apply the criteria in paragraph 88 of APB Opinion No. 16, *Business Combinations*, and paragraphs 24-26 of APB Opinion No. 17, *Intangible Assets*, based on the circumstances existing when the assets were acquired. Costs assigned to intangible assets shall not reflect costs of developing, maintaining, or restoring those intangibles after they were acquired. Costs assigned to identifiable intangibles, including operating rights, shall not be merged with or be replaced by amounts relating to other identifiable intangibles or goodwill. Paragraphs 8 and 10 of Chapter 5, "Intangible Assets," of ARB No. 43 are amended by this paragraph and paragraph 3 of this Statement with regard to the intangible assets addressed by this Statement.

5. If a motor carrier cannot separately identify its interstate operating rights, other identifiable intangible assets, and goodwill and cannot assign costs to them as specified by this Statement or finds that it is impracticable to do so, that motor carrier shall presume that all of those costs relate to interstate operating rights.

6. Unamortized costs of interstate operating rights subject to the provisions of the Act shall be charged to income and, if material, reported as an extraordinary item in accordance with paragraph 11 of APB Opinion No. 30, *Reporting the Results of Operations*. Subsequently, the cost of any other identifiable intangible asset or goodwill that is charged to income for reasons attributable to the Act shall not be reported as an extraordinary item. Tax benefits, if any, relating to the costs of interstate operating rights charged to income shall be reported in accordance with the provisions of APB Opinion No. 11, *Accounting for Income Taxes*, and paragraph 25 of Opinion 30.

7. Other identifiable intangible assets and goodwill relating to motor carrier operations shall be accounted for in accordance with Chapter 5 of ARB 43 or Opinion 17, as appropriate. However, the cost of intrastate operating rights shall be accounted for in accordance with the provisions of this Statement if a state deregulates motor carriers with effects similar to those of the Act.

Effective Date and Transition

8. The provisions of this Statement shall be effective on December 19, 1980 for financial statement for fiscal periods ending after December 15, 1980. Earlier application is encouraged for financial statements for fiscal periods ending before the effective date of this Statement that have not been issued before December 19, 1980. This Statement shall not be applied retroactively to previously issued financial statements.

The provisions of this Statement need
not be applied to immaterial items.

This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. March and Walters dissented.

Messrs. March and Walters dissent because they believe that the attempt in this Statement to differentiate between operating rights and other intangible assets is misplaced emphasis on form at the expense of substance. Operating rights represent a franchise to conduct business over a route with the objective of making a profit.

Because of the limited or exclusive nature of those rights in the past, their value often could be supported by reference to a resale market. The Act effectively eliminates this market. The fact that the rights have lost the value that attaches to exchangeability creates a presumption that their value has diminished. However, in the FASB Exposure Draft, Elements of Financial Statements of Business Enterprises, the Board said that exchangeability is not a necessary characteristic of an asset. A required characteristic of an asset is the capacity, either singly or in combination with other assets, to contribute to future net cash inflows. In some cases, there may be persuasive evidence that the real asset, the purchased opportunity to conduct business over a specific route with the objective of making a profit, is in fact generating, and is expected to continue to generate, profits. In those cases, an immediate charge to income of the cost of operating rights is not consistent with the economic facts and does not measure properly either the operating resources or the return on investment of the enterprise.

Messrs. March and Walters further believe that the conclusion by the Board that all interstate operating rights have lost their value is a finding that substitutes the Board's judgment for the individual evaluations that should be made by the motor carriers and reviewed by their auditors. They believe that the Board should concern itself with setting standards. Application of standards to specific fact situations is a primary function of management. Existing accounting pronouncements are relatively clear in the requirements to charge to income the cost of intangible assets that no longer have value and to revise the periods of amortization when warranted by changed circumstances. At the very most, all that is needed is an interpretation of those pronouncements to demonstrate how they should apply to motor carriers.

Members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters

Appendix A: BACKGROUND INFORMATION

9. The Board understands that the Motor Carrier Act of 1980 provides for:

a. Easier entry into the motor carrier industry by new carriers and easier route expansion for existing carriers.
b. Removal of most route restrictions and a broadening of the classification of commodities that carriers are permitted to haul
c. Eventual freedom for motor carriers to change freight rates without the ICC's permission
d. Limitations on the scope of collective rate making exempt from antitrust considerations.

10. The Accounting Standards Division of the AICPA prepared an Issues Paper, Accounting for Intangibles in the Motor Carrier Industry, and asked the Board to consider the impact of the Act on accounting for intangible assets of motor carriers. The Board has considered the accounting issues relating to the impact of the Act on intangible assets and reached the conclusions presented in this Statement.

11. The Board understands that intangible assets of motor carriers consist principally of operating rights and goodwill. Most motor carriers have not distinguished among operating rights acquired (a) from the ICC or other licensing agency, (b) from other motor carriers, or (c) through business combinations, nor have they distinguished operating rights from other purchased intangibles, such as goodwill, in their financial statements. Intangible assets of motor carriers generally have been reported in general purpose financial statements at original cost, as permitted by Chapter 5 of ARB 43, or amortized over 40 years, the maximum life permitted by Opinion 17, depending on the date of acquisition of those assets.

12. An Exposure Draft of a proposed Statement, Accounting for Intangible Assets of Motor Carriers, was issued on October 24, 1980. The Board received 41 comment letters in response to the Exposure Draft. Certain of the comments received and the Board's consideration of them are discussed in Appendix B, "Basis for Conclusions."

Appendix B: BASIS FOR CONCLUSIONS

13. This appendix discusses the factors that the Board considered significant in reaching the conclusions in this Statement, including various alternatives considered and reasons for accepting some and rejecting others. Individual Board members gave greater weight to some factors than to others.

14. Some respondents questioned the need for a project on accounting for motor carrier intangible assets. They indicated that current accounting pronouncements (Chapter 5 of ARB 43, Opinions 11, 17, and 30, and FASB Statement No. 5, Accounting for Contingencies) provide adequate guidance for evaluating those intangibles. They also said that those evaluations should be made on a case-by-case basis and that any uniform standard would fail to reflect the circumstances of individual motor carriers. The Board concluded that, although those existing pronouncements do provide some guidance with respect to the effect of passage of the Act on the costs of intangible assets of motor carriers, the provisions of paragraph 8 of Chapter 5 of ARB 43, which permits substitution or merging of intangible assets, should be modified and the other pronouncements should be clarified as discussed in paragraphs 15, 18, 19, and 21 of this Statement to ensure comparability in accounting for the impact of the Act. In addition, the Board concluded that motor carriers should allocate the

costs of their intangible assets to identifiable intangible assets and goodwill. That allocation may not have been made in the past because paragraph 10 of Chapter 5 of ARB 43 does not require specific identification of intangible assets with no limited term of existence.

15. Operating rights generally have represented the right to haul specified commodities between two points with limited competition; that is, the rights included oligopolistic or monopolistic benefits. The past resale and collateral values of the rights support that view. Comments received from the motor carrier industry and other sources have convinced the Board that interstate operating rights have been substantially and permanently impaired as a result of the passage of the Act. The Board believes that this economic loss is evidenced further by the significant loss in resale and collateral values and the current nominal replacement cost of operating rights and that this loss should be reflected in the financial statements of motor carriers. Therefore, the Board has concluded that the unamortized costs of those operating rights should be charged to income immediately.

16. Some respondents stated that operating rights may continue to have value irrespective of the provisions of the Act and, in those cases, should not be charged to income. They indicated that operating rights are still required for motor carrier operations and that those rights principally represent a franchise to conduct business over a route with the objective of making a profit. They acknowledge that the value of operating rights often could be supported by reference to a resale market in the past, but they believe that the loss of exchangeability does not necessarily diminish the value of the asset. They believe that operating rights continue to qualify as assets as long as the rights, either singly or in combination with other assets, contribute to future net cash inflows. They believe that in those cases an immediate charge to income of the cost of operating rights is not consistent with economic facts and does not properly portray either the operating resources or the operating performance of the motor carrier. The Board concluded, however, that operating rights no longer qualify as an asset because those rights no longer provide motor carriers with the benefit of protection from unlimited competition. Loss of exchange value is a consequence of the loss of that benefit.

17. Some respondents indicated that (a) time will be required to evaluate the impact of the Act on ICC actions and (b) the economic impact of increased competition resulting from the Act will take several years. They said that to date the ICC has not responded clearly to the provisions of the Act. They suggested that the uncertainty in the timing and amount of impairment of operating rights could be reflected best by amortizing the cost of the rights over an arbitrary short period, such as three years. They believe that amortization over a short period is consistent with the development of additional competition expected to result from the Act and with the transition provisions of the Act under which certain changes will be phased in over the next few years. The Board concluded that, in accordance with the provisions of Statement 5, a loss is both probable and reasonably estimable and that an arbitrarily short amortization period would defer recognition of the loss resulting from passage of the Act. Also, the Board believes that any arbitrary amortization period selected would not reflect either the general or specific impact of the Act.

18. Some respondents indicated that operating rights may include valuable benefits in addition to the right to provide transportation services with limited competition, such as the potential to increase a motor carrier's marketing or operating efficiency. They indicated that their purchases of operating rights were in combination with other benefits, such as a customer base, favorable leases on established freight terminals and equipment, and qualified and experienced personnel. The Board agrees that intangible assets acquired by motor carriers

may have included benefits in addition to being able to operate with limited competition, for example, the potential to increase a motor carrier's operating efficiency. The Board concluded that an enterprise that has not done so should now assign costs to its identifiable intangible motor carrier assets whether the assets were acquired before or after October 31, 1970, from the ICC, from other motor carriers, or through business combinations. The Board concluded that the cost assignment should be based on the circumstances existing when the assets were acquired. Some respondents indicated that the majority of motor carrier intangibles relate to operating rights. If identification and assignment cannot be made or if it is impracticable to do, the Board concluded that all unidentifiable intangible assets should be presumed to be interstate operating rights.

19. Other respondents indicated that their operating rights are as valuable today as they ever were because they have developed a customer base, favorable locations for operations, and qualified and experienced personnel. The Board recognizes that many enterprises build successful businesses and generate goodwill based on franchises such as operating rights; however, only purchased goodwill is capitalizable under present generally accepted accounting principles. The Board believes that costs assigned to intangible assets should not reflect costs of developing, maintaining, or restoring operating rights after they were acquired. The Board also believes that costs originally related to operating rights should not be merged with or be replaced by amounts relating to other identifiable intangibles or goodwill as would be permitted by paragraph 8 of Chapter 5 of ARB 43 for intangibles subject to the provisions of that Chapter. Opinions 16 and 17 do not permit such combining or merging and the Board believes that paragraph 8 of Chapter 5 of ARB 43 should be amended to make it consistent with those Opinions.

20. The Board believes that, as long as intangible assets other than operating rights provide a motor carrier with continuing benefits, costs relating to those assets should continue to be subject to existing accounting pronouncements rather than be addressed by this Statement. Although other intangible assets may be impaired as a result of the Act, the Board believes that existing accounting pronouncements (Chapter 5 of ARB 43, Opinions 11, 17, and 30, and Statement 5) provide adequate guidance for accounting for those intangible assets.

21. The Board believes that the loss of limited competition resulting from the Act is both unusual and infrequent and that charging the costs of operating rights to income as an extraordinary item is appropriate under Opinion 30. The loss of the benefits of limited competition is unusual because the Act significantly alters the regulatory and operating environment of motor carriers. Also, the loss resulting from the Act is infrequent because it can happen only once. Therefore, the Board concluded that the charge to income of the cost of operating rights, if material, should be reported as an extraordinary item in accordance with Opinion 30.

22. Some respondents said that a requirement to charge operating rights to income could create an undue burden for some motor carriers because such a requirement could needlessly force some motor carriers to violate debt covenants. Those respondents recommended a grace period for those motor carriers. The Board believes that the significant loss in value of operating rights is an economic fact that should not be masked by deferring recognition of the loss.

23. Some respondents expressed concern that the Act would have significant impact on intrastate operating rights and that in many cases the unamortized cost of those rights also should be charged to income. Their concern is based on increased competition from interstate carriers operating along intrastate routes. The Board

decided to address in this Statement only the direct effects of the Act, that is, the effect on interstate operating rights. Intrastate operating rights may or may not continue to provide motor carriers with benefits. The Board believes that existing accounting pronouncements (Chapter 5 of ARB 43, Opinions 11, 17, and 30, and Statement 5) provide adequate guidance for accounting for those rights. However, if a state deregulates motor carriers with effects similar to those of the Act, the Board concluded that the cost of intrastate operating rights should be accounted for in accordance with the provisions of this Statement.

24. Some respondents said that the guidance in the Exposure Draft regarding any income tax benefits relating to the charge to income of the unamortized cost of operating rights was inadequate. The Board concluded that existing accounting pronouncements (particularly Opinion 11 and paragraph 25 of Opinion 30) provide adequate guidance regardless of how the income tax issue ultimately is resolved. In most cases, those pronouncements would require tax benefits related to the charge to income of operating rights to be considered an adjustment of the extraordinary item. Therefore, the Board believes that in most cases any material recognized tax benefits should be included in motor carriers' financial statements as an extraordinary item whenever reported.

25. Some respondents indicated that the disclosure requirements in the Exposure Draft already exist in other accounting pronouncements. After considering those comments, the Board agreed and concluded that the disclosure requirements in the Exposure Draft were unnecessary.

Footnotes

FAS44, Footnote 1— Public Law 96-296, 96th Congress, July 1, 1980.

FAS44, Footnote 2— *Cost*, as used in this Statement, refers to the original cost or the unamortized cost of intangible assets as appropriate in the situation.

FAS44, Footnote 3— An *operating right* (also known as an *operating authority*), as used in this Statement, is a franchise or permit issued by the Interstate Commerce Commission (ICC) or a similar state agency to a motor carrier to transport specified commodities over specified routes with limited competition. Those rights were either granted directly by the ICC or state agency, purchased from other motor carriers, or acquired through business combinations.

FAS44, Footnote 4— See paragraph 7.