

To: International Valuation Standards Committee

From: Don Anders, ASA
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USA
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Re: Comments to IVSC Discussion Paper- Determination of Fair Value of Intangible Asset for IFRS Reporting Purposes- July 2007

To The Committee;

I commend your efforts and admire the progress you have made to date to provide a common sense standardization of principles and to converge various countries accounting pronouncements in this subject matter.

I would encourage you to make a fresh start and not be influenced by legacy pronouncements and precedent that has evolved from a patchwork of pronouncements on the subject of fair value and intangible assets. You should not be obligated to reconcile past IFRS or FAS with this current one. I would encourage you to be swayed by valuation principles and not accounting principles or precedent.

My comments by your paragraph numbers are:

2.1.1 There is a great need for guidance with respect to valuation of intangible assets

2.1.2 The guidance you are proposing is at the right level of detail – except perhaps with too much information on relief from royalty benchmarking in 6.27-6.43.

2.1.3 When you complete your task, I think the document will be very valuable to the valuation industry.

2.1.4 I believe that a technical paper follow up can help to create a trail of updates and add clarity as the principles evolve and questions arise.

2.2 – 2.7 I applaud your wisdom in confronting the SFAS 157 and concur that it is of little use in the valuation guidance intangible assets or for that matter, fixed assets. Do not give credence or try to reconcile to the SFAS 157, except perhaps for monetary assets.

2.8.1 Not sure if you are referencing the current paragraphs. See my prior comments on your paragraphs 2.2 – 2.7.

2.8.2 TO FOLLOW- SECT IV

2.8.3 TO FOLLOW

2.8.4 TO FOLLOW

2.17 TO FOLLOW –SECT V

2.19 TO FOLLOW – SECT VI

2.21 TO FOLLOW – SECT VII

2.23 TO FOLLOW – SECT VIII

3.12 I do not concur with your statement that this discussion paper is for the determination of fair value less cost to sell since value in use is not a measure of fair value. I am not sure what your definition of "value in use" is. For an operating company, all of its values should be in continued use. In a personal example, the value of your house to you is the utility it provides. For you to live there it is worth what you paid. A reduction for a selling cost has as its premise that you are going to sell it, which if you are going to stay living there is the wrong premise of value. Perhaps your use of the term "value in use" is not clear to me

SECT IV

4.6 I would strongly encourage an alternative approach to SFAS 157

4.9 Fully concur with your assessment

4.11 A better phrase would be "This Discussion Paper defines characteristics as:"

4.11.3 Perhaps the term "unique" or "proprietary" are better than "different". The word "different" is not succinct and has derogatory connotations in the US. i.e. (meaning odd). You correctly use the term "unique" in 4.54

4.13 Fully concur with your assertion.

4.16 Your definition of inactive is poor. If a market does not satisfy the three precepts of an active market, it is by definition Inactive. Your paragraph 4.17 accomplishes this.

4.18 Are you talking about participants who market a certain intangible or participants who are likely buyers of the business enterprise? The term market participant is a slippery one. It needs to be made clear that the actual buyer of the subject business is a market participant by definition – in fact they are the best one because they researched and completed the transaction with their own resources. It may be true that we cannot directly observe what was paid for a specific intangible by the buyer of a business; this does not preclude them from being a market participant. Your definition uses the phrase "for an intangible asset". Transactions for "an" intangible asset are rare.

4.21.1 This introduces the concept of synergy "its actual and potential uses"

4.23 This is a good assertion, but you are seeking justification from prior guidance, rather than striking out on your own.

4.24 I will be curious as to how you differentiate between synergies and entity-specific factors. This is an area where detail and examples would help.

4.25-4.30 This again is clear as mud. Sellers are seeking the highest price and they are aware that there is a market participant who will pay the most. Even if the buyer is the owner of the synergies (i.e. a national distribution network, a complementary product feature, a lower cost of capital, and the ability to cut overhead), the seller will demand and get a piece of that synergy.

4.29.1 I concur if you are indicting that a stand alone intangible warrants a higher rate of return. But it should be made clear that some or all of the market participants might have a lower total cost of capital than the subject seller and might value a business higher because of it. Your Paper should tell us if we are to use the cost of capital of the subject and let any excess purchase price fall to goodwill (or day 1 impairment) or if we are to consider what the market participants are willing to pay and use their cost of capital.

4.31 This is an understatement if there ever was one, and it is the crux of the issues in an untold number of discussions and disagreements among valuers and auditors. Perhaps the comments you receive will help give better examples of excluded and included

factors. Some of my thoughts on this exclude include NOLS, exclude an uplift of the buyers sales due to elimination of a competitor or perhaps vertical integration is a synergy that should be excluded i.e. an oil wholesaler buys a retailer who is not already their customer.

4.42 You use the term characteristics which you previously attempt to define in 4.11. Perhaps here in this section you could use the term “qualities” as you do in paragraph 4.40 or “differentiating factors” as in paragraph 4.54 or even “metrics” might be a substitute for characteristics.

4.45 This is another slippery slope. Who will be the arbiter of whether it can or cannot be reliably measured? I would not provide for this easy way out. Your footnote 6 is correct.

4.47-4.52 This is a faulty premise as I previously discussed. If the buyer is intending to continue to use the assets in an operating business the assets have the utility in the amount paid. Why introduce this very subjective requirement to estimate this cost to sell. It becomes perilously close to the “exit price” debacle portended in SFAS 157. If I buy a piece of artwork at an auction, is my exit price the amount to the next lowest bidder? What if there were not other bidders? Is the value zero? Again, sellers will sell to the highest price. And again, I paid that price because it has that utility to me. Why else did I pay so much? I am not intending to sell the asset, certainly not for less than I paid. It is worth my “all in” cost to acquire that asset. The concept of deducting a selling price has as it premises, an intention that does not exist.

If certain assets are being held for sale, they should be valued at an estimated net realizable value. You should outline whether that should include some holding costs such as interest expense and broker costs.

4.53 Absolutely I concur!!

4.57 Your use of the term “in use” and “value in use” is confusing to me. See also my comment 3.12.

SECT V

5.1.2 You use the term “income capitalization approach”. In the states we refer to this simply as the “income approach”. Income capitalization is a very specific method i.e. whereby you divide the income by the cost of capital divisor. To avoid confusion, can you drop the word “capitalization” from this approach definition?

5.10-5.11 You use the phrase “market transaction method” then in 5.17 you use “market comparables valuation method” Are they the same?

5.22 “Capitalization” should not be used

5.26 This is not a circular calculation and it can be determined with precision by a simple formula. Iteration is not needed. The formula to arrive at the TAB is: $(L/(L-P2*t))-1$ where L = tax life, P2 is present value of a \$1 annuity for L years at the cost of capital, and t = tax rate.- Remove paragraph 5.27.

5.44 I would recommend that you suggest that this method be used for the strategic asset that was acquired. i.e. either the customer relationships or the technology

5.5 On your example I would caution that the calculated CAC is applicable to both the existing and new customers in the year following the transaction. In certain occasions the

% utilization is also appropriate in the case of tangible assets. For example, a factory may only be utilized 50% by the current customers and projected future customers will utilize the remainder. So the existing customers would only get a portion of the CAC. I would also note that you use the phrase “after tax cash flow” This is not correct. It is the excess “earnings” that you are measuring. Depreciation from the tangible assets should stay in as a real expense (economic rent) for the subject intangible.

Finally, I know I have lost this battle, but “economic rent” is more appropriate above the tax line. You will get the same results if you use after tax or pre-tax rates of returns as appropriate, so it may be a moot point. When an entity (or an intangible for that matter) rents a building, the charge is pretax.

5.52 I would change the phrase “are not available” to be “are less reliable”

5.56.1 I fully concur

5.56.3 How do we do this? They paid what they paid because of some synergies.

5.56.7 “Cash Flow” should be “earnings”

5.57 You intermingle the terms entity-specific and synergies. I thought you were trying to differentiate these.

5.60 This comment is not necessarily true per the SEC which insists on using only the income approach on customer relationships.

5.67 You should include the cost of failures. In other words, it may take 10 calls to sign up one customer or it may take many prototypes to develop a final design. Those cost need to be included in the cost approach.

5.68 I concur

SECT VI

6.5-6.6 I would caution that the principles of CON 7 are not used. Just because you have 3 possible scenarios does not reduce the projection risk to zero. A risk free rate can never be used unless the income is guaranteed by the government. Stick with the traditional one projection approach.

6.15 I would not encourage the use of the IRR to justify the value. The IRR is a self fulfilling prophesy. The IRR will make the purchase price “fair” even if you use random or unrealistic projections. Why bother with a Prospective Financial Information (PFI) at all? Too often valuers will talk away wide gaps between IRR and WACC with nonsensical interpretations. We can get untrained personnel to do the allocations by rote if the IRR is an acceptable method to allocate the purchase price. If the purchase price cannot be justified from management’s projections, serious discussions are needed as to why that amount was paid.

A discussion and procedure needs to be included about the situation (hopefully rare) where the valuator cannot justify the purchase price with the projections and the cost of capital. Should there be an immediate impairment of goodwill or should the amount overpaid merely become goodwill and tested in the next cycle?

6.27-6.43 This seems like a disproportionate discussion of benchmarking better left for a technical paper.

6.54 CAC’s could be and perhaps should be calculated on a pre-tax basis, they are rent after all.

6.57 They need to consider the debt and equity mix that would likely used to invest in the various classes of assets. A banker's viewpoint would be informative. What percent might they invest against net working capital or fixed assets or intangible assets?

6.62 Again it is a multi-period earnings method not cash flow. Depreciation should not be added back.

6.63-6.67 Very good

6.68 Error in table Net Current Assets fair return should be 4.5% not 34.5%

6.69 Use of WACC is correct

6.71 Typo – same sentence is repeated

6.77.1 “Gearing” is an unusual term in the US – perhaps “Debt/Equity Mix” would be clearer.

SECT VII

7.2 I would concur and you should concede that we are operating in Level 3 for the most part.

7.28 Drop the word “capitalization” You should also indicate that the multi-period earnings method should be used on the more senior or more strategic asset that was the driver in the deal when there are no other more reliable method available for the several assets. Using the multi-period method on only one intangible will help avoid double counting or arbitrary splitting.

7.34 This is confusing -7.34.2 is approaches not methods. Suggest using the multi-period method for the strategic asset acquired.

Best Regards

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