

IP Symposium

IP Valuation for IFRS reporting

Budapest 2008



*connectedthinking

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Part

Relevant standards

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Relevant standards

		US GAAP	IFRS
Acquisition accounting	Business combinations	SFAS 141 Business combinations	IFRS 3 Business combinations
	Goodwill	SFAS 142 Goodwill and other intangible assets	IAS 36 Impairment of assets
Post-acquisition accounting	Intangible assets	SFAS 142 Indefinite lives SFAS 144 Definite lives	IAS 38 Intangible assets IFRS 5 Assets held for sale IAS 36
	Tangible assets	SFAS 144 Impairment or disposal of long-lived assets	IAS 16 Property, plant & equipment IFRS 5 IAS 36
Fair value measurements		SFAS 157	Discussion Paper

Joint exposure draft issued by FASB and IASB



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Identification of intangible assets

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Asset definition

An ASSET is according to

US GAAP (SFAC 6.25)

“Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events [...]”.

Identical

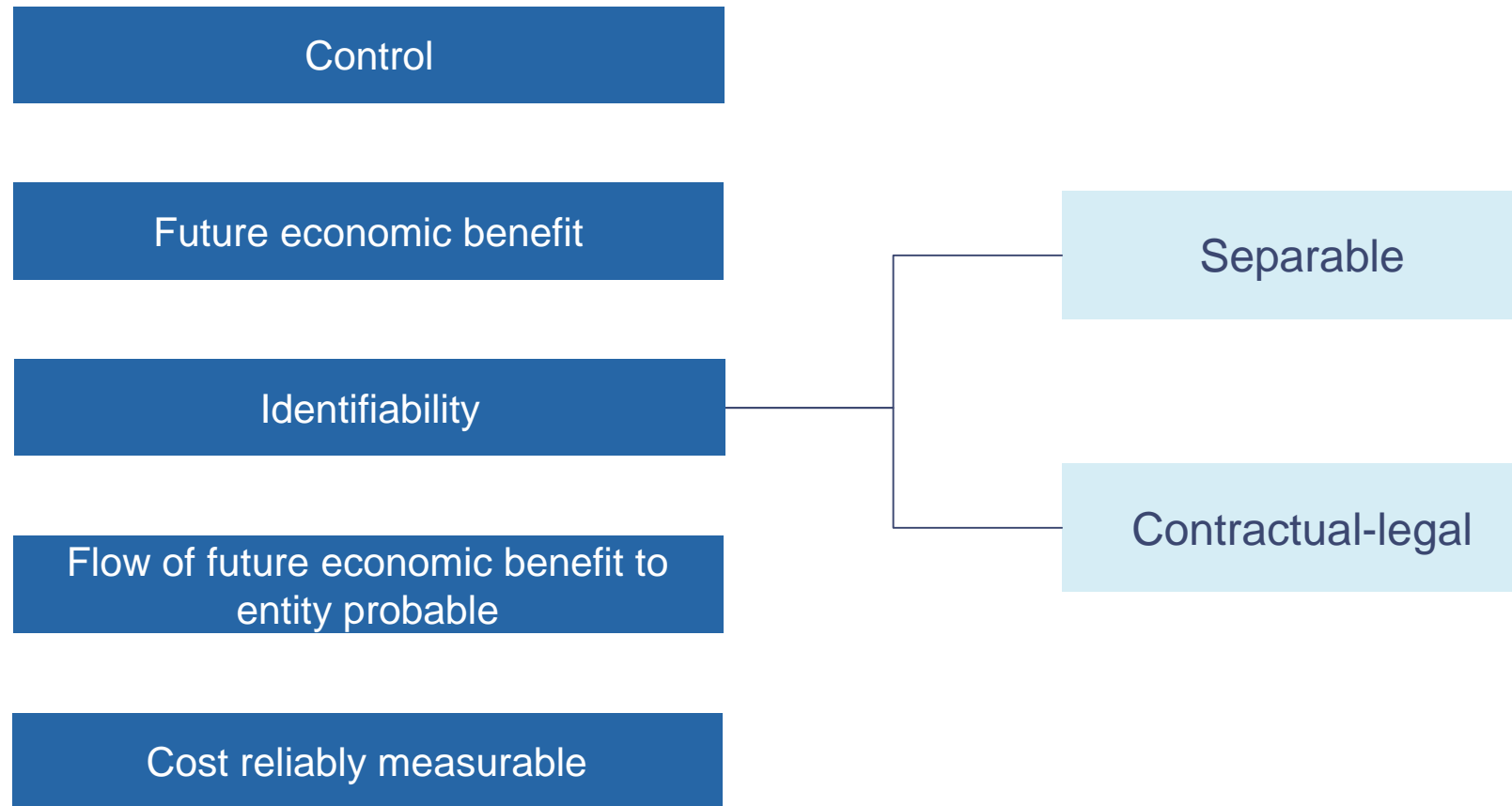
IFRS (Framework 49.a)

“An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow [...]”.

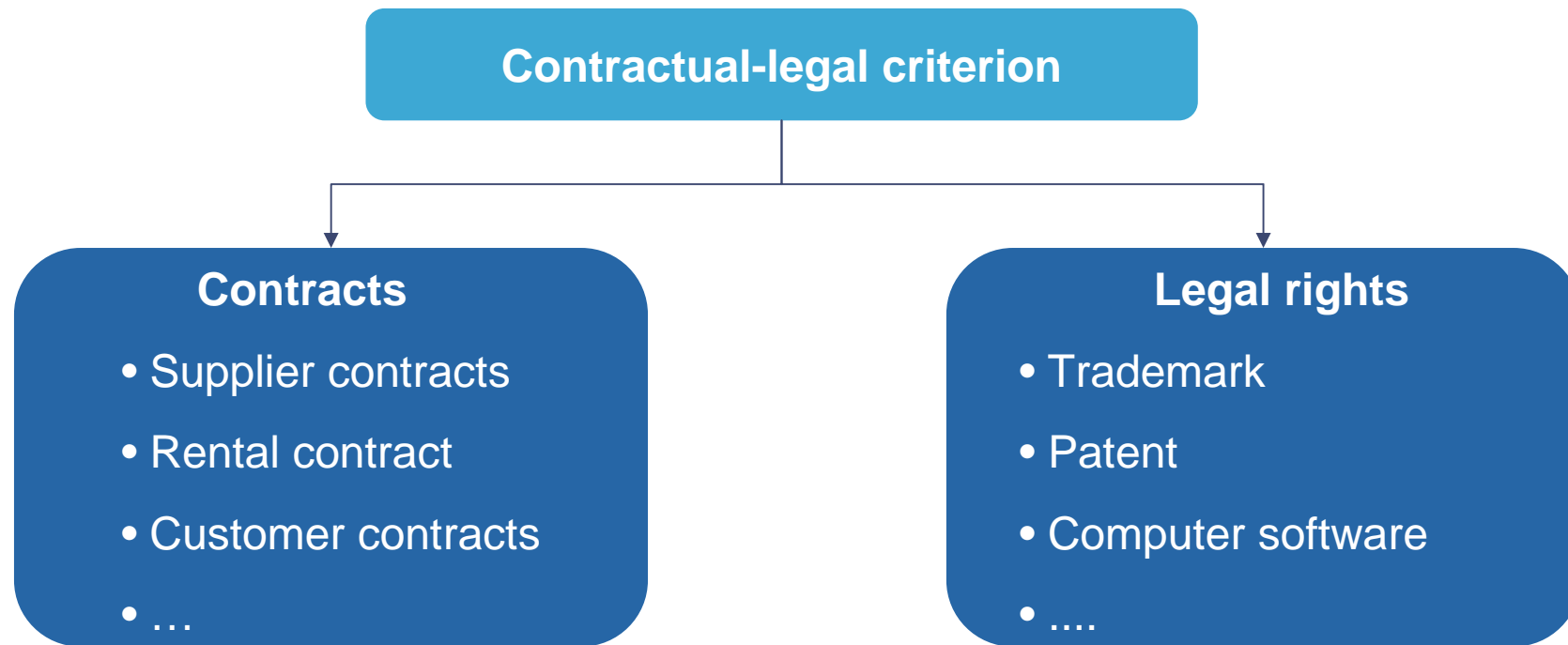
Intangible assets are assets, other than financial instruments, that **lack physical substance** (SFAS 141. B147; similar IAS 38.8)

Identification of intangible assets is difficult

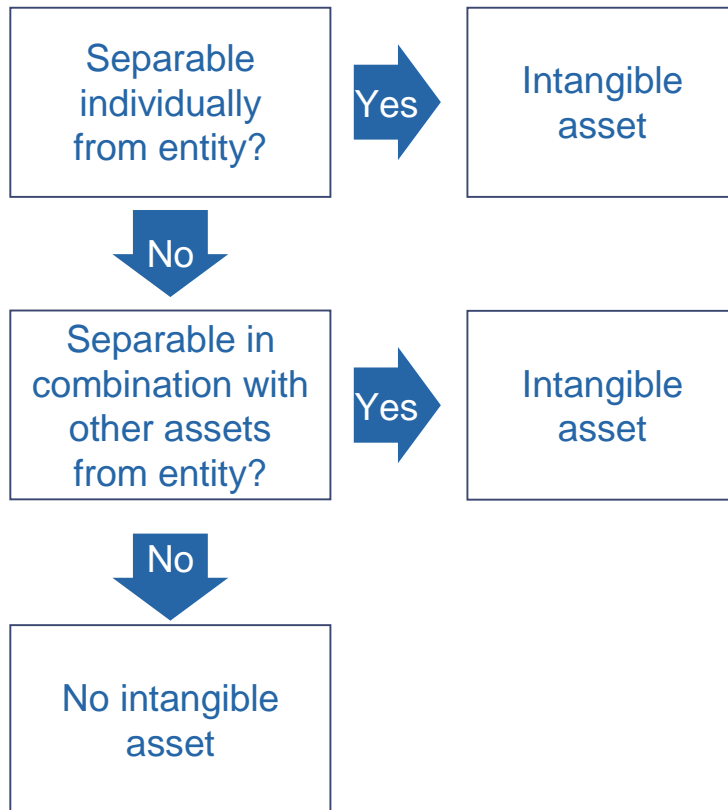
Recognition criteria of intangible assets in a business combination



Contractual-legal criterion



Separability criterion



An intangible asset is separable, if:

- capable of being separated or divided from the acquired entity and
- capable of being sold, transferred, licensed, rented, or exchanged
- even if those exchange transactions are infrequent and regardless of whether the acquiring entity intends to sell, lease or otherwise exchange that asset

Separability criterion

Examples

Process know-how

Customer lists

Unpatented technology

Databases, e.g. title plants

...

Intangible assets satisfying the criteria for recognition separately from goodwill

Marketing-related intangible assets

- Trademarks, trade names
- Service marks, collective marks, certification marks
- Trade dress (colour, design)
- Newspaper mastheads
- Internet domain names
- Non-competition agreements
- ...

Non-exhaustive list!

Customer-related intangible assets

- Customer lists
- Order or production backlog
- Customer contracts related customer relationships
- Non-contractual customer relationships
- Sales dealer network
- ...

Artistic-related intangible assets

- Plays, operas, ballets
- Books, magazines, newspapers
- Musical works such as compositions, song lyric advertising jingles
- Pictures, photographs
- Video and audiovisual material
- ...

Technology-based intangible assets

- Patented technology
- Unpatented technology
- Computer software and mask works
- Databases
- Trade secrets
- ...

Contract-based intangible assets

- Licensing, royalty, standstill agreements
- Advertising or supply contracts
- Lease & Franchise agreements
- Construction permits
- Broadcast rights
- Use rights
- ...

Source: SFAS 141 Appendix A A14, IFRS 3, Illustrative Examples

Assets not to be recognised apart from goodwill

Assets left in goodwill



- Assembled workforce
- Customer service capability
- Presence in geographic markets or locations
- Non-union status or strong labour relations
- Ongoing training or recruiting programs
- Outstanding credit ratings
- Access to capital markets
- Favourable government relations
- ...



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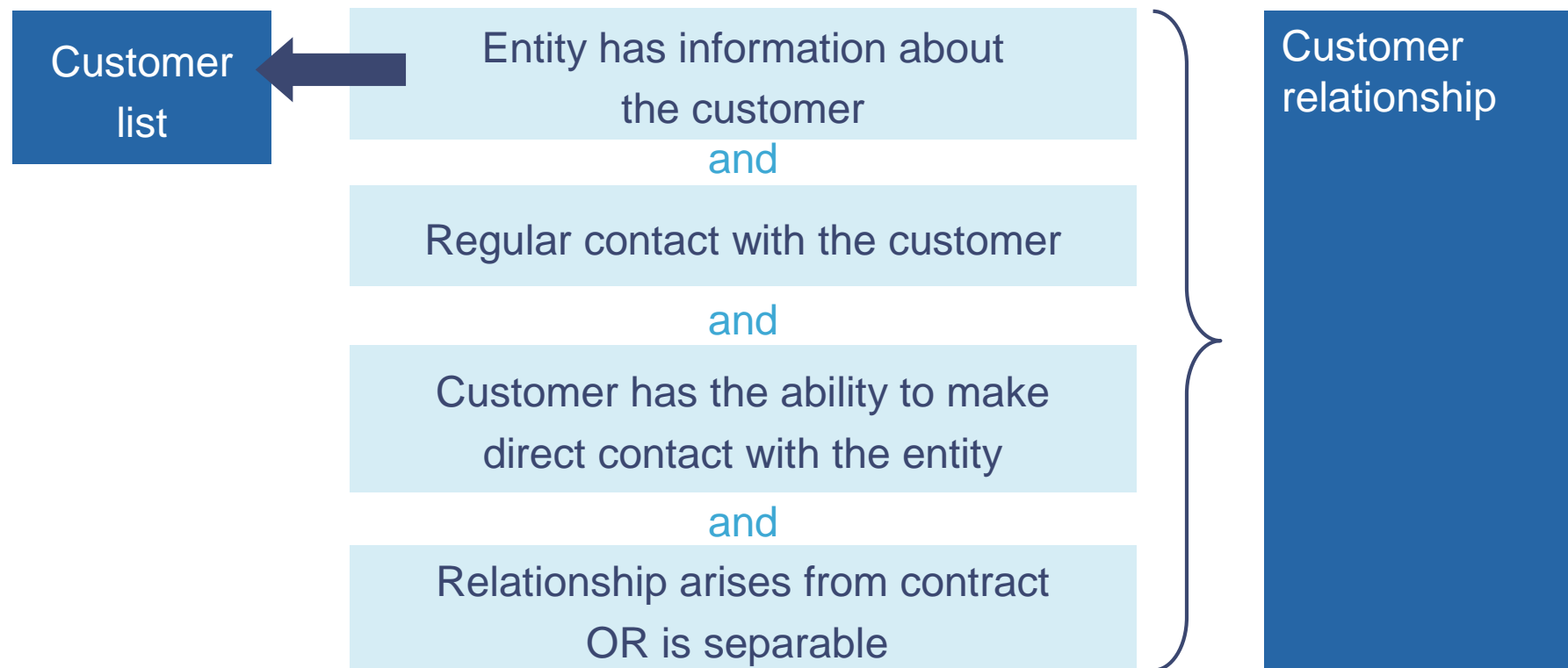
Focus: Customer-related
intangible assets

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Customer-related intangible assets

Criteria and types of customer relationships



Customer-related intangible assets

Example

A newsstand in a large city has a number of customers who habitually purchase a daily newspaper.

Is this a recognisable customer relationship?

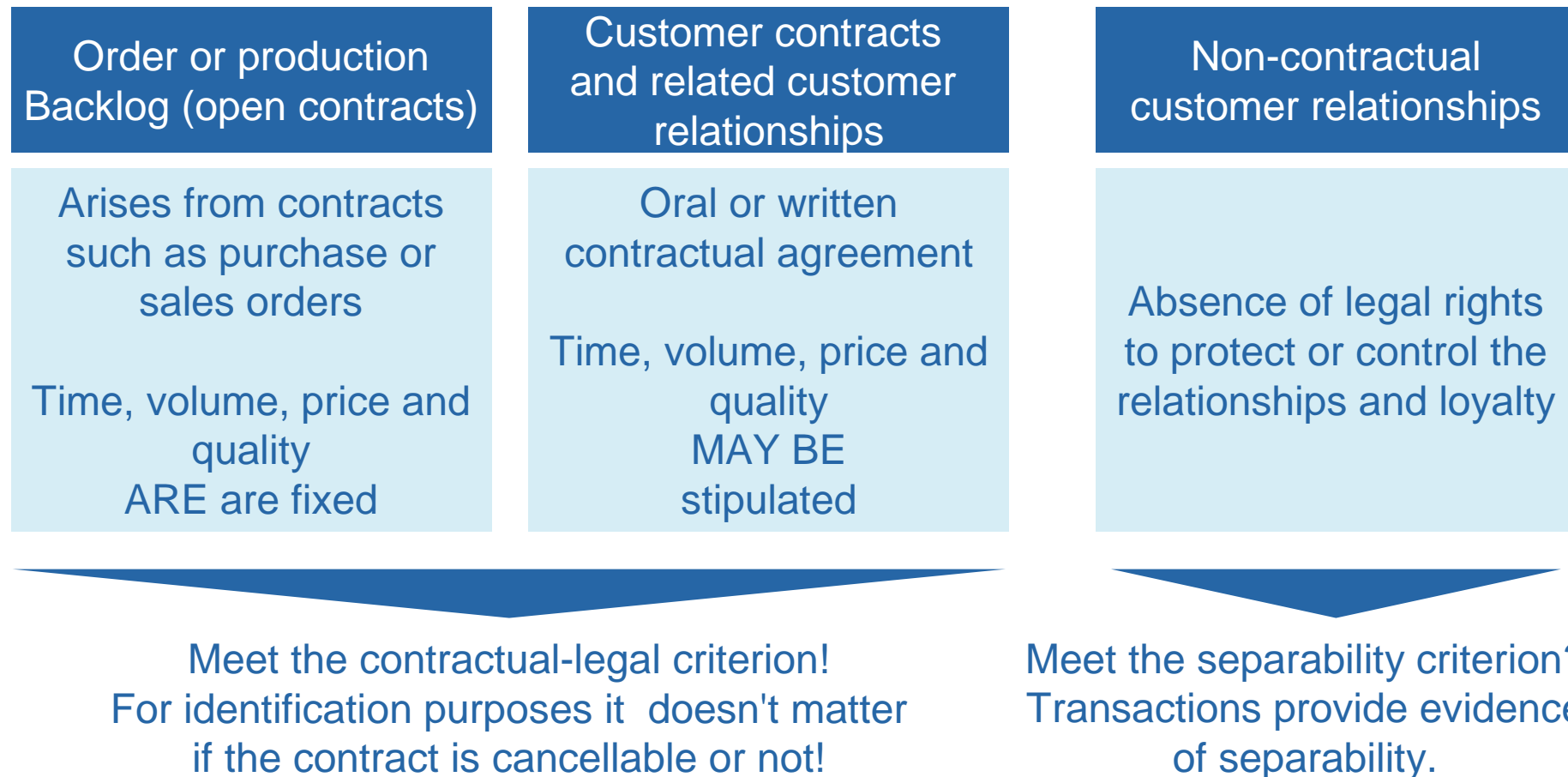
Customer base

Entity does not know individual customers
→ no communication possible

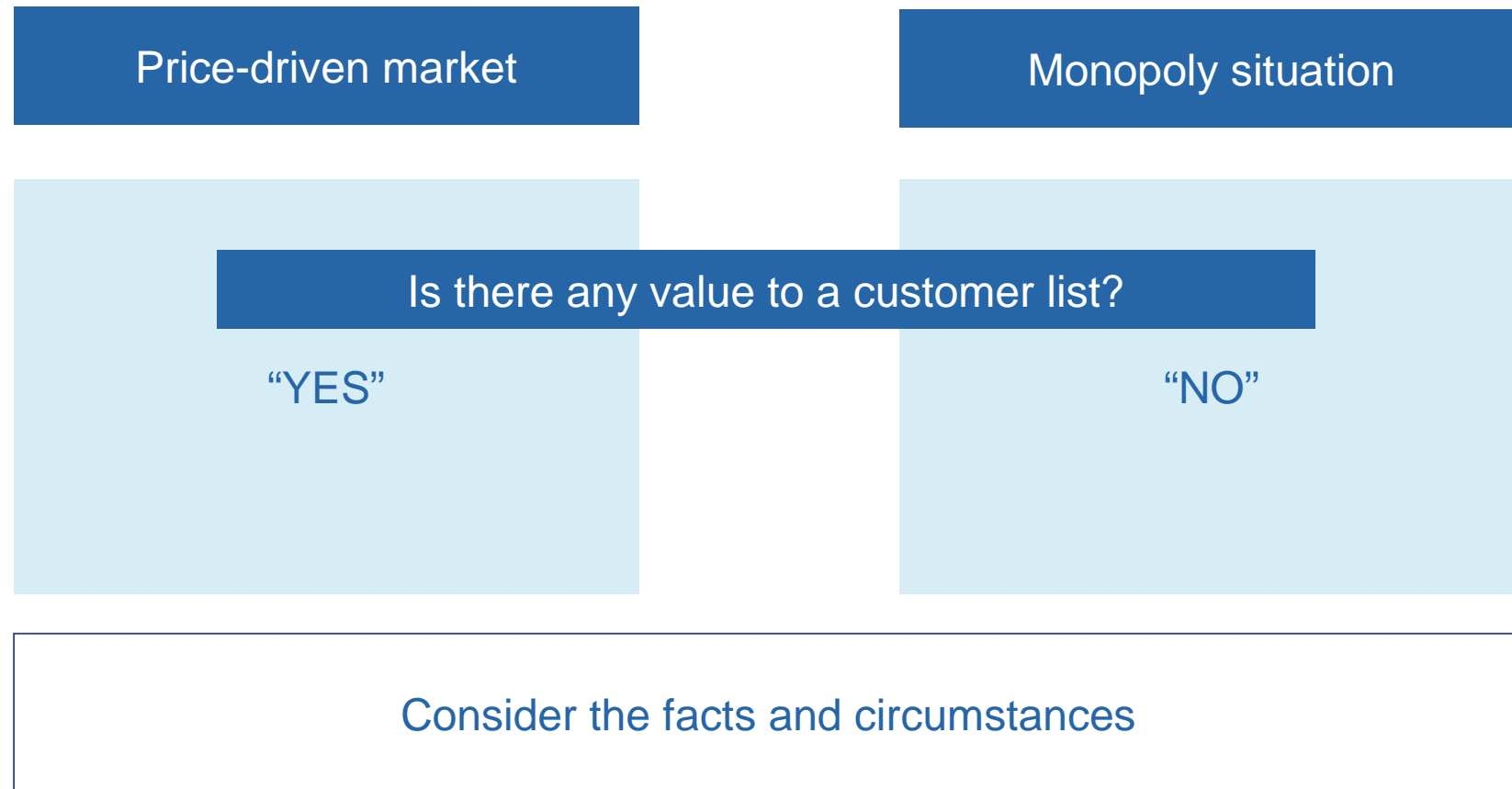
Not an identifiable intangible asset
according to SFAS 141 / IAS 38

Customer-related intangible assets

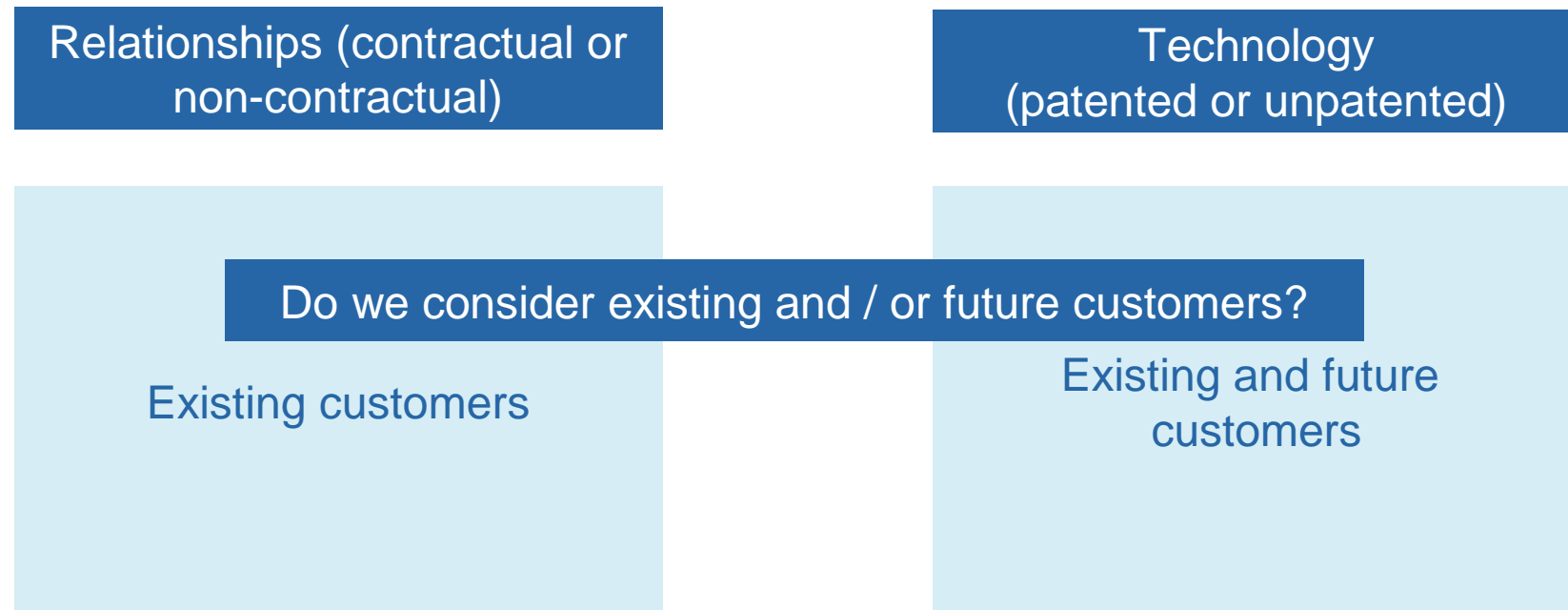
Types of customer-related intangible assets

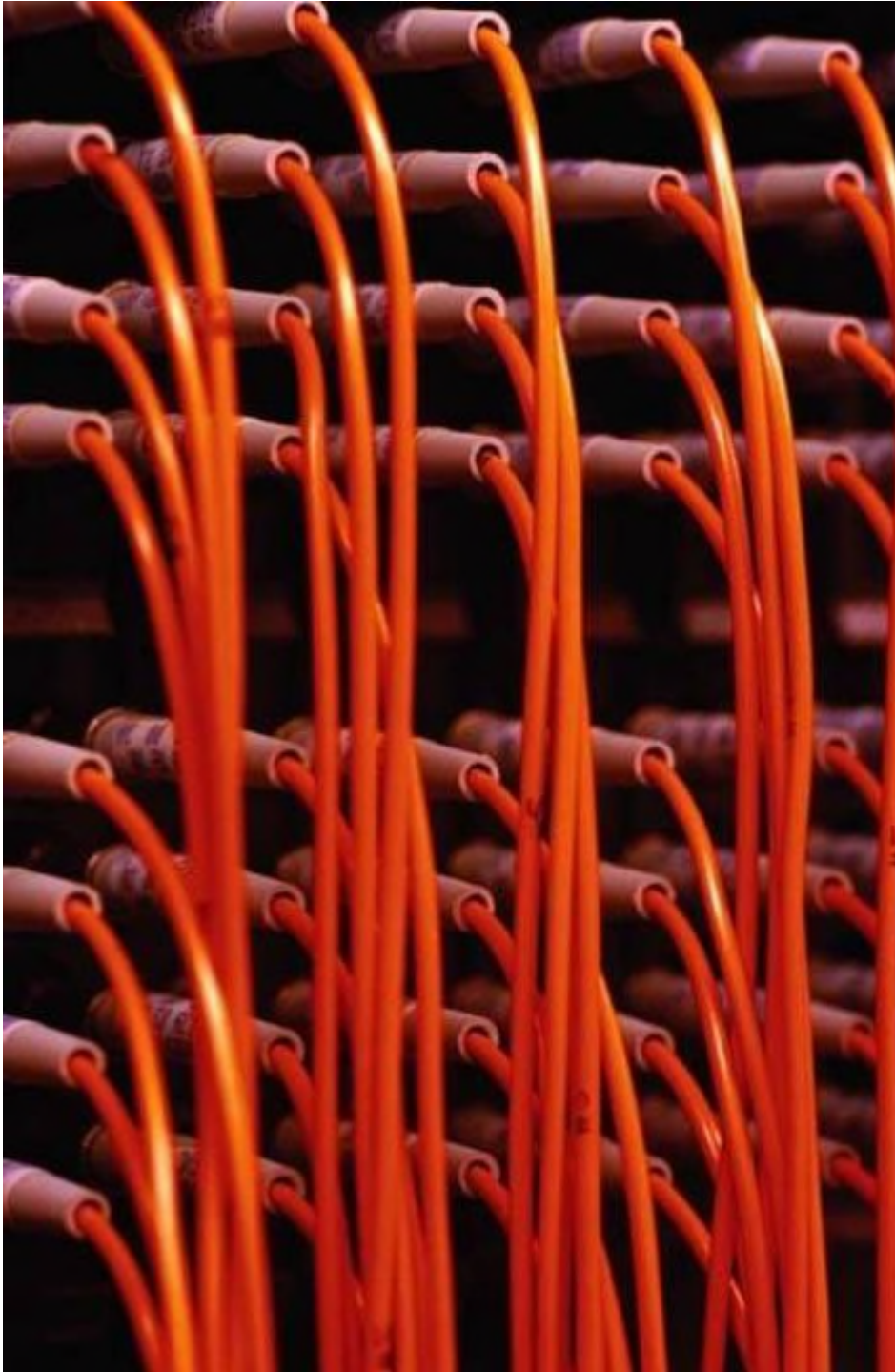


Issue: When is there value to a customer list?



Issue: Technology vs. customer-related intangible assets





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Useful life

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Useful life Determination

“...the useful life of an intangible asset is related to the expected cash inflows that are associated with that asset.” (IAS 38.BC61)

Many factors are considered in determining the useful life



Expected use by the company



Typical product life cycles for the asset



Technical, technological, commercial or other types of obsolescence

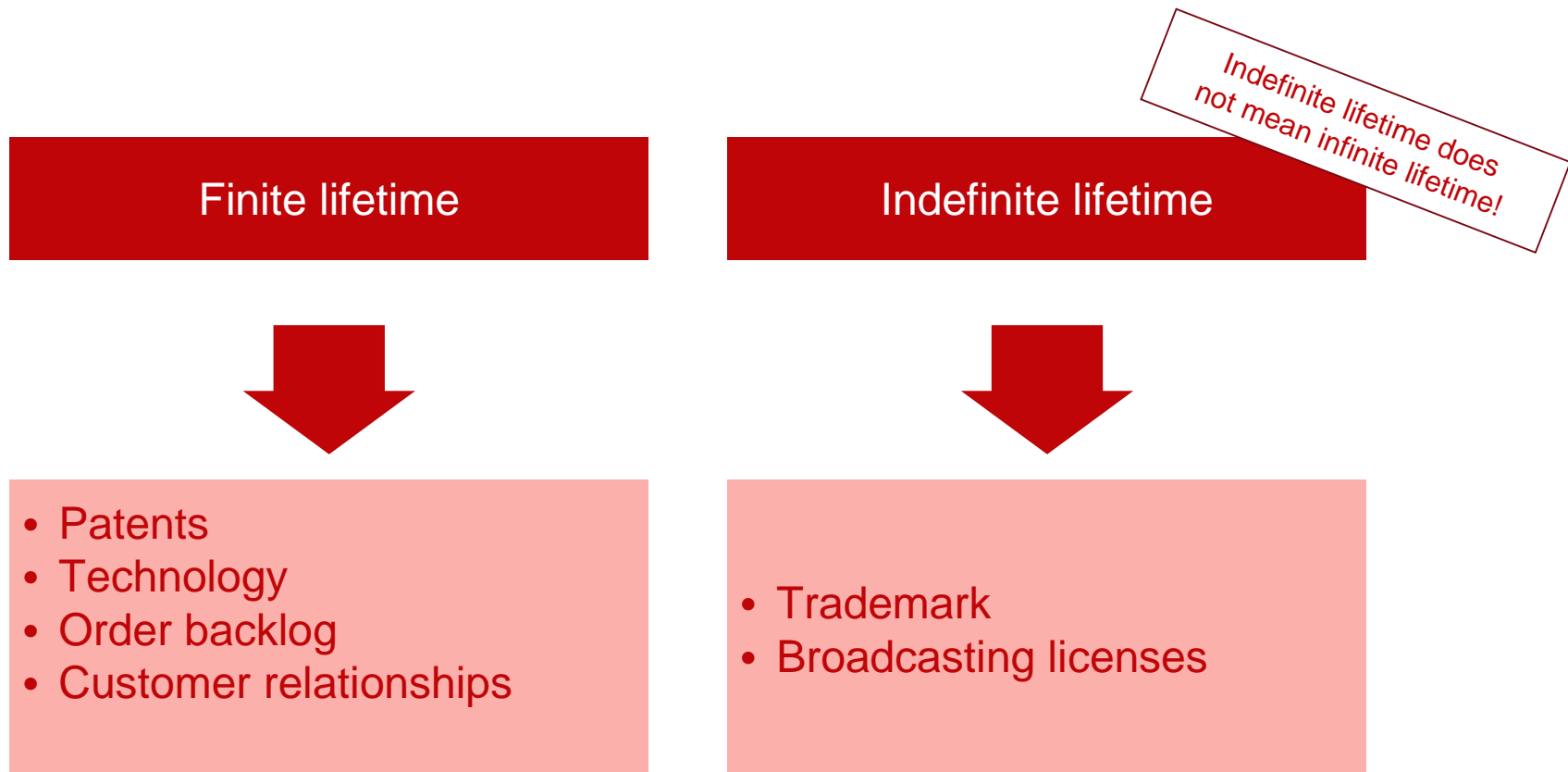


Industry, demand, competitors



Period of control over the asset ...

Useful life



Lifetime Customer-related intangibles

The useful life of an intangible asset that arises from contractual rights shall not exceed the period of the right.

Useful life shall include the renewal period only if



Evidence (past experience) exists that contracts will be renewed



Contract renewal/extension come without substantial cost



Contract renewal/extension accomplished without material modification

Source: SFAS 142.11, EITF 03-09

Lifetime Customer-related intangibles

Expected useful lifetime of a customer-related intangible asset should be based on the actuarial-based retirement-rate method

Develop a stub survivor curve with historical data

Statistical curve fitting process

Estimation of remaining useful life and calculation of living curve

It is not sufficient to apply a churn rate!



Part

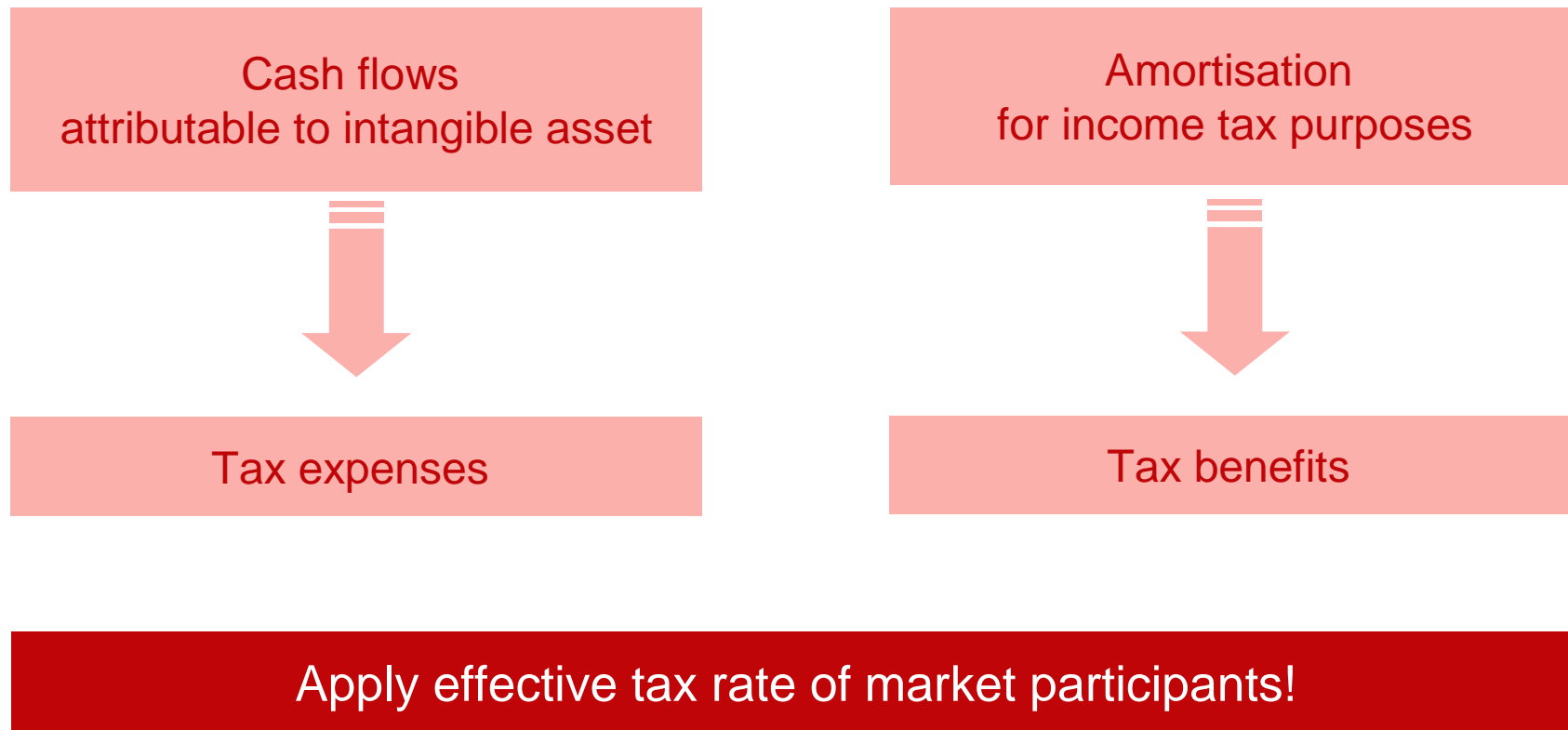
Tax issues

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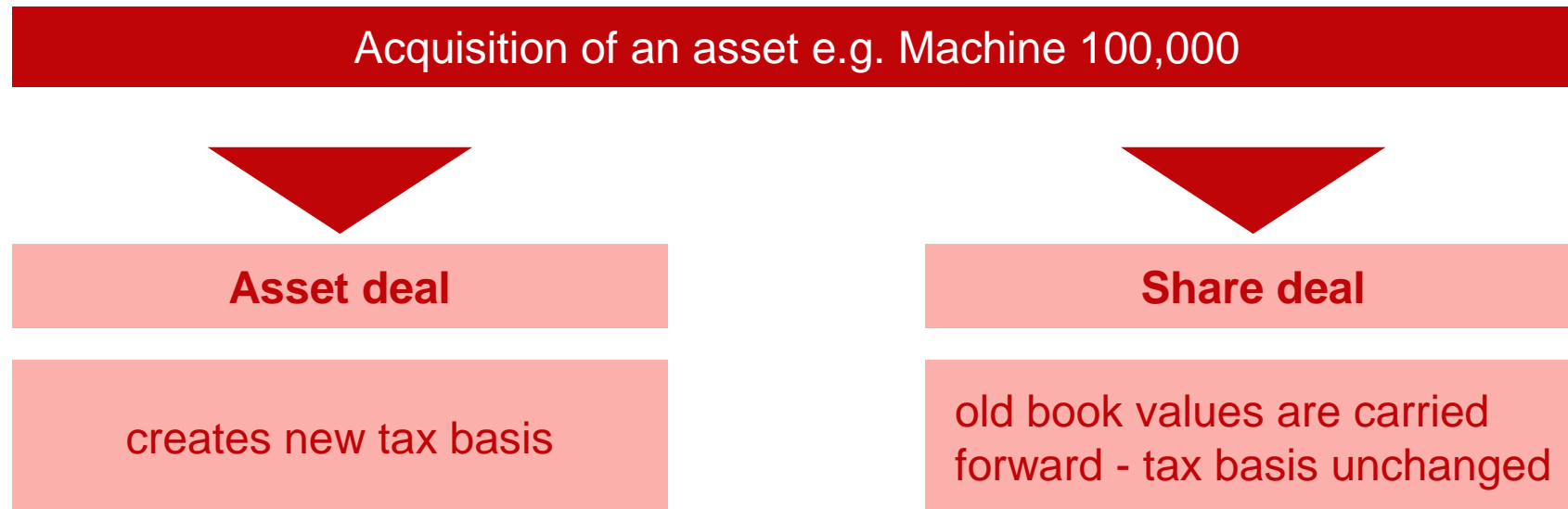
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Tax issues

Tax expenses and tax benefits



Concept of tax amortisation benefit

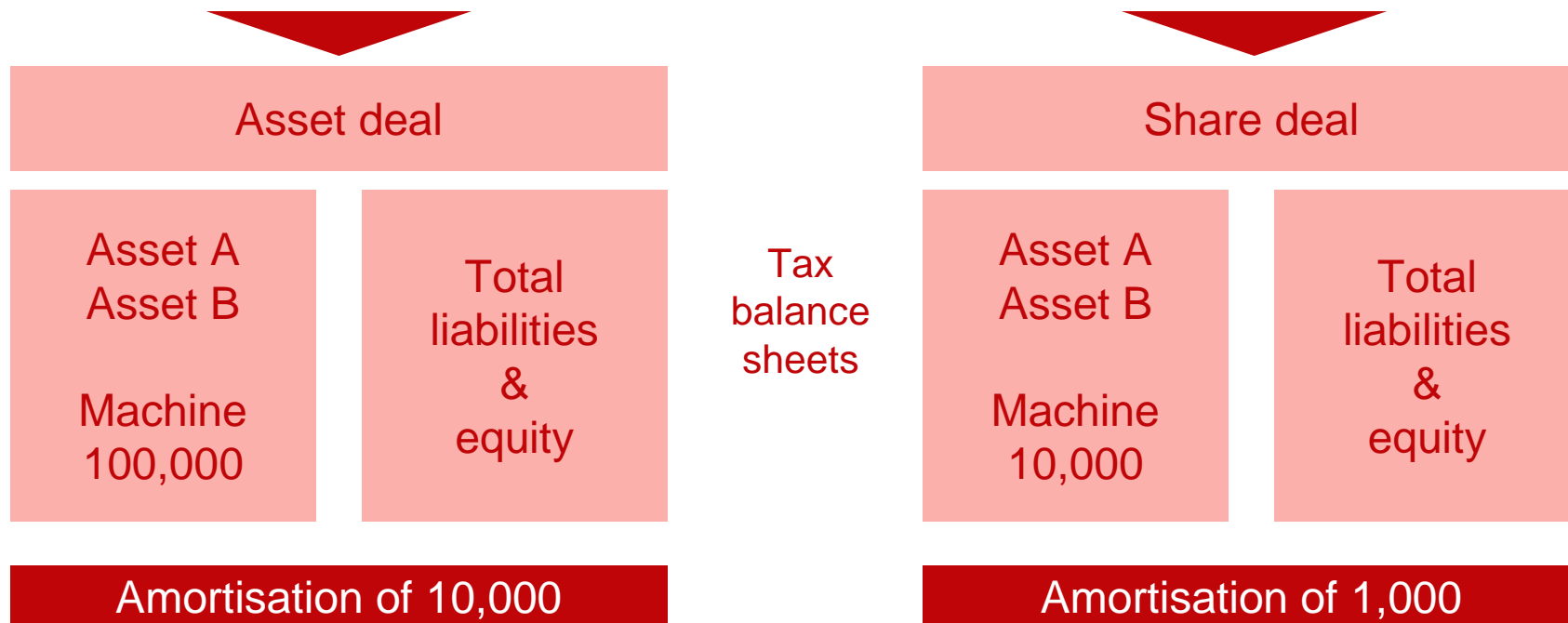


Deal structure and tax basis should not impact fair value

Difference in tax basis is reflected in computation of deferred taxes

Concept of tax amortisation benefit

Buyer Co. acquires Seller Co.
What is the effect on a machine worth 100,000
with an estimated economic lifetime of 10 years and a book value of 10,000?



Concept of tax amortisation benefit

By valuing the intangible asset not only the expected tax payments resulting from the cash flows attributable to the intangible asset have to be recognised

Also the tax benefits due to the tax amortisation of the intangible asset for income tax purposes have to be considered (SFAS 109.129)

Tax amortisation benefit has to be considered regardless of whether the acquisition of the asset results in a new tax basis!

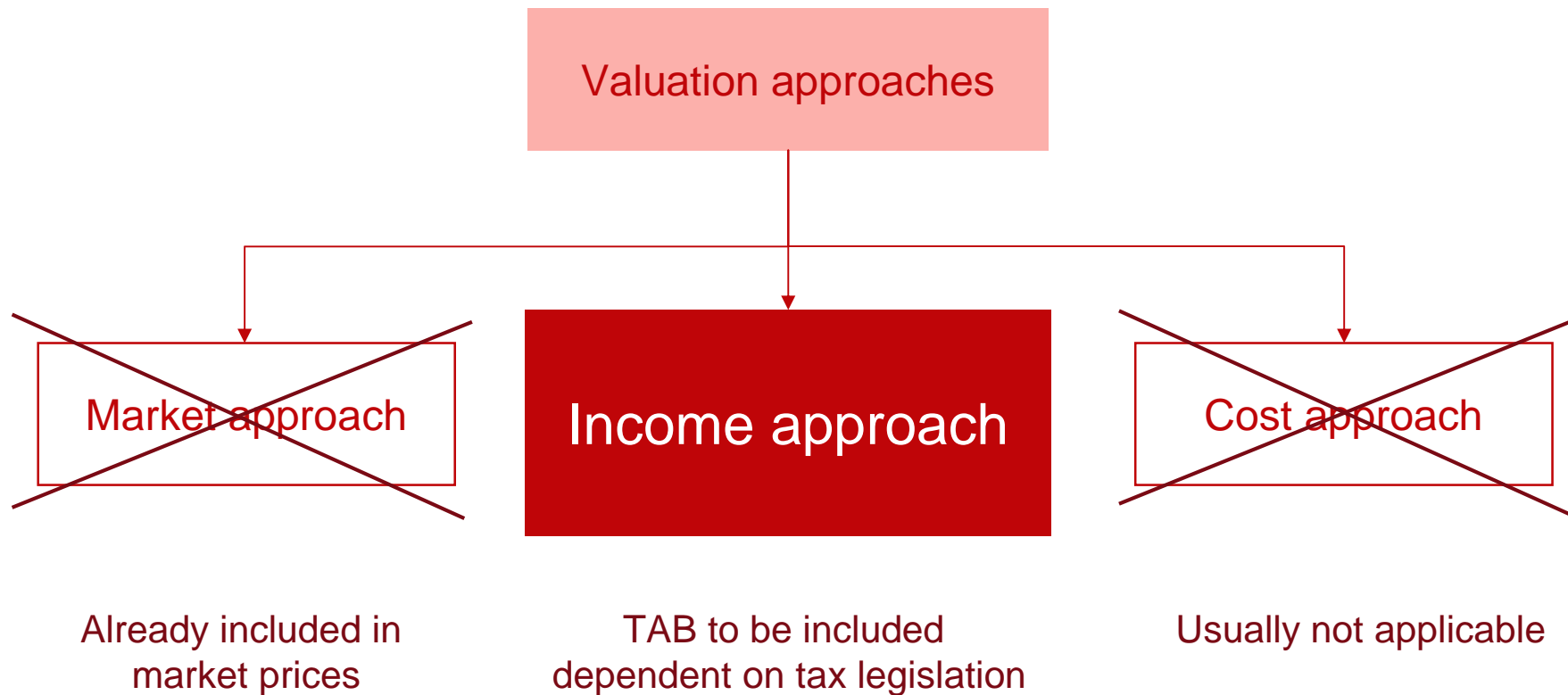
As the deal structure (e.g. share deal vs. asset deal) should not impact the fair value of the asset (SFAS 141.36), the appraiser should value the asset as if the asset was hypothetically acquired separate from all the other assets.

If for tax purposes the subject intangible asset is not recognised as tax asset, or the asset cannot be transferred in a way that could create a new tax basis in the asset, than it has to be considered whether the value is likely to be reflected in tax goodwill.

If this tax goodwill is amortisable, tax amortisation benefit should be considered.

The difference between tax base and accounting measurement will be reflected in the computation of deferred taxes.

Where to apply a tax amortisation benefit?



Concept of tax amortisation benefit

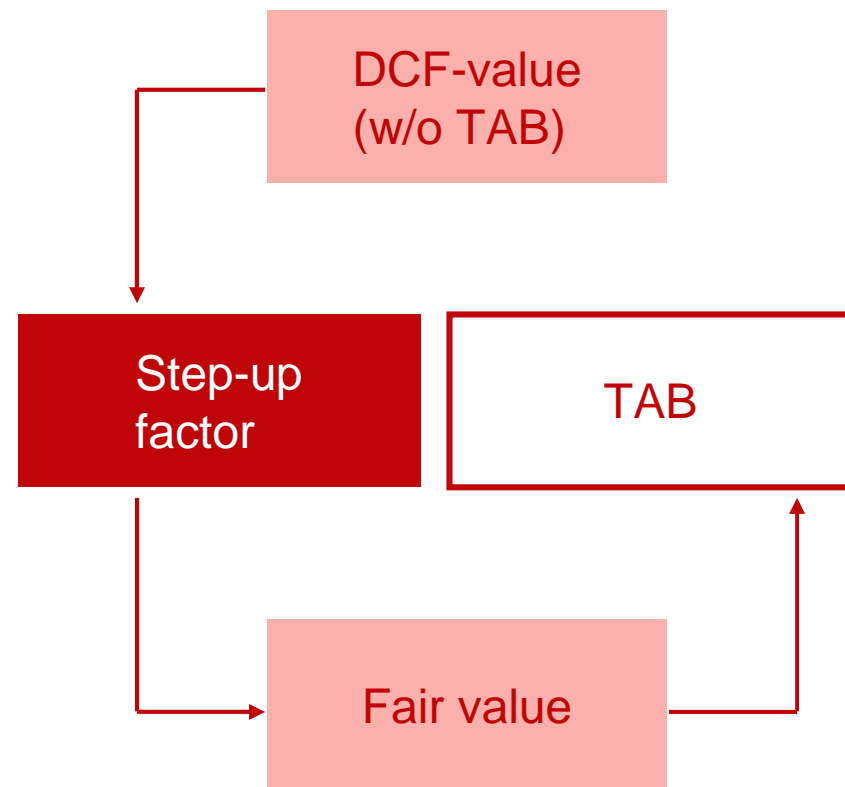
Calculation of present value of tax amortisation benefit (TAB)

Step 1

Value the asset in the absence of tax amortisation benefits

Step 2

Incorporate the present value of tax amortisation benefit by "grossing up" the value (from Step 1) by an appropriate step-up factor



Thank you



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