HDH ADVISORS LLC

August 23, 2013

Via email to director@fasb.org

Ms. Susan Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. PCC-13-01A; Private Company Council's Proposed Accounting Standards Update – Accounting for Identifiable Intangible Assets in a Business Combination

Dear Ms. Cosper:

We appreciate the opportunity to provide our comments regarding the Private Company Council's ("PCC") exposure draft regarding the proposed changes to accounting for identifiable intangible assets in a business combination. HDH Advisors LLC is a financial advisory firm that specializes in providing business valuation services for a variety of purposes including, but not limited to, financial reporting, tax compliance and reporting, employee benefit plans, and litigation support. Our clients include private and public operating companies, asset holding companies, and high-net worth families. At present, our firm consists of 20 professionals with offices in Atlanta, Georgia and Des Moines, Iowa.

General Comments to Exposure Draft

While we understand the intent of the PCC in simplifying the accounting standards for private companies in general, it is our opinion that the approach proposed with regards to the accounting of intangible assets acquired in a business combination lacks needed substance, transparency, and convergence with other standards. We believe that the proposed standards are inconsistent with the Financial Accounting Standard Board's *Conceptual Framework for Financial Reporting* (the "Conceptual Framework") with regards to understandability and verifiability.[1] In particular, we believe that the guidance is inconsistent with certain of The Objectives of General Purpose Financial Reporting and certain of the Qualitative Characteristics ("QC") of Useful Financial Information set forth in the *Conceptual Framework*.

We believe the guidance pertaining to the treatment of goodwill and intangible assets is inconsistent with the framework covering understandability, such as QC31, which states:

> "Some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from financial reports might make the information in those financial reports easier to understand. However, those reports would be incomplete and therefore potentially misleading."

[1] Financial Accounting Standards Board *Statement of Financial Accounting Concepts No. 8*. September 2010.

Further, the verifiability of the financial statements would be compromised, as it is our opinion that such disclosures would not be consistent with QC26, which states:

> "Verifiability helps assure users that information faithfully represents the economic phenomena it purports to represent."

We noted that the Private Company Decision-Making Framework was intended to "augment" the Conceptual Framework. Augment, by definition, means to 'make greater by adding to it'. In our opinion, the recent proposals appear to be stripping away certain standards and criteria from the Conceptual Framework, rather than augmenting them. It is our view that the understandability and verifiability of a private company's financials would be diminished upon an affirmative election of the guidance proposed in the exposure draft, and we have attempted to address these issues in the body of our responses to certain of the questions issued by the PCC.

Specific Responses

Question 4: *Would the proposed amendments reduce overall costs and complexity compared with existing guidance? If not, please explain why.*

We believe that the proposed amendments may slightly reduce the overall costs of accounting for business combinations, but the practical application of the proposed amendments would do little to reduce the overall complexity.

The proposed amendments appear to be primarily aimed at eliminating the recognition of customer-related intangible assets, since it is relatively infrequent that a company has a customer relationship with a third party under a noncancelable contract. In our experience, customer relationships are often a primary motive for business combinations, and customer-related intangible assets are frequently the dominant intangible assets. As such, it is often valued using a multi-period excess earnings method ("MPEEM"), which does take considerable time to properly perform and to develop supportable assumptions.

It is, however, important to remember that all of the various components in a PPA analysis are inherently interconnected. One of the most important aspects of a PPA analysis is to reconcile the weighted average return on assets ("WARA") to the weighted average cost of the capital. In performing a WARA reconciliation, it is generally expected for goodwill to have the highest required rate of return as it is considered to be the riskiest asset. The identifiable intangible assets, by comparison, typically have required rates of return less than that of goodwill, but greater than that of the acquired tangible assets. If the customer-related intangible asset gets subsumed into goodwill, it may become very challenging to determine the discount rates applicable to the identifiable intangible assets. It may still be necessary in certain cases to value the customer relationships solely to ensure that the selected discount rates on the identifiable intangible assets are reasonable within the context of a WARA reconciliation analysis.

It is also our opinion that the proposed guidance could complicate any appraisals performed using a MPEEM, as all intangible assets (whether or not meeting the legal criterion) must be fair valued as part of such analysis in order to calculate contributory asset charges.

Additionally, it will still be necessary to perform a business enterprise valuation ("BEV") analysis and related internal rate of return ("IRR") analysis using market participant assumptions and the consideration transferred. The BEV analysis is critical to performing a purchase price allocation properly, as it forms the economic basis and support for many of the valuation assumptions (e.g., discount rate, projected cash flows, synergies, etc.) used to determine the fair value of the identified assets and liabilities of the acquired entity. Moreover, the BEV analysis is a critical step in assessing whether or not a business combination should be considered a bargain purchase.

Question 5: *Do you agree that the accounting alternative for the recognition and measurement of intangible assets acquired in a business combination would provide relevant and decision-useful information to users of private company financial statements? If not, what accounting alternative, if any, would provide more relevant information to users?*

We believe that the exposure draft does not adequately address the recognition of certain intangible assets, specifically proprietary (unpatented) technology and software, unregistered trade secrets, and in-process research and development. Many companies are acquired that possess these types of intangible assets. Moreover, the acquirers, in many cases, view such intangibles as the primary motive for the transaction, implying that considerable value should be ascribed to such assets.

We recently performed a PPA analysis for a client that acquired a technology company that had spent several years developing a proprietary software product. The primary investment considerations of the acquirer were the proprietary software and the highly skilled assembled workforce. Had the proprietary software not been recognized separately from goodwill, it would not provide users of the acquirer's financial statements with an accurate representation of the true economics of the acquisition.

Question 6: *Do you agree that for contractual intangible assets, recognition and measurement should be limited to the noncancelable term of the contract? If so, do you agree with the proposed definition of a noncancelable term of the contract? Do you agree that market participant expectations about the potential renewal or cancellation of the contract should not be factored into the measurement? Do you foresee any increase in cost and complexity or other difficulties in applying this alternative recognition and measurement principle? If yes, would additional implementation guidance address those difficulties?*

In general, it would only be appropriate to assume the noncancelable term in a situation where a company had favorable/unfavorable contractual relationship. With that said, we believe that it would be more appropriate to remain consistent with existing accounting guidance; thereby, taking into consideration market participant expectations and the subject company's historical experience with renewals.

In our considerable experience, we do not believe the determination of the life of identified intangible assets to be a disproportionately time-consuming process. The determination of the appropriate recognition and measurement period is a byproduct of the analysis of the intangible assets and an understanding of regulatory, industry and company-specific conditions. With perhaps one exception in our experience, this process has never been problematic from the perspective of obtaining the required information, performing the calculations, and recommending a recognition and measurement period.

Limiting the recognition of intangibles to those that have noncancelable contractual terms or those arising from other legal rights oversimplifies the economic phenomena. From our experience, it has been observed that many customer contracts have cancellation provisions (without cause) exercisable by either party with terms ranging from 30 to 90 days. In such cases, a strict interpretation would establish lives of less than a quarter of a year. It is unclear from the guidance, but would this non-cancellable life establish the amortizable life for the intangible asset? If so, any acquisition occurring more than 90 days prior to the end of a fiscal year would ultimately result in fully expensing the of such assets within the same period, effectively expensing such portion of consideration.

The definition of "noncancelable" is adequately defined, but we believe the definition to be overly broad. Based on our interpretation of the guidance, it would include virtually all contracts with cancellation provisions, with no regard to historical cancellation experience or the true economic durations of the relationship outside of contract terms.

We believe that introduction of such standards would not achieve the intended results of decreasing cost and complexity of the PPA process. Further, it could complicate certain other analyses such as the appropriate recognition period for deferred revenues.

Question 7: *Do you agree that intangible assets arising from other legal rights should continue to be measured at fair value considering all market participant expectations, consistent with Topic 820? If not, what accounting alternative for measurement do you recommend?*

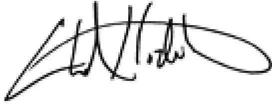
Yes, we agree that it is relevant to users of private company financial statements to continue recognizing intangible assets that meet the legal criterion.

Conclusion

Some of the changes proposed by the PCC, while noble and well-intentioned, attempt to oversimplify certain guidance at the cost of providing sufficient visibility to the economic phenomena occurring. The strict guidance as to the recognition of intangible assets would likely understate the value of recognized assets, and relegate the remainder to the footnotes, without providing adequate context to the users of the financials. We urge the Committee to consider the issues we have enumerated herein and the issues raised by the wider community.

Thank you for the opportunity to comment on this important proposal. If you would like to discuss any of the comments herein, please feel free to contact me at (770)790-5000.

Respectfully submitted,



Chad D. Hoekstra, CPA/ABV, ASA
Managing Director

Principal Drafters: Jonathan W. Whitehead
Chris Foster, ASA