DUFF & PHELPS

Ms. Sue Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

August 23, 2013

Re: File Reference No. PCC-13-01A

Dear Ms. Sue Cosper,

Duff & Phelps appreciates the opportunity to provide comments on the Exposure Draft of the Proposed Accounting Standards Update – *Business Combination (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination* (a proposal of the Private Company Council).

Duff & Phelps is a global independent financial advisory and investment banking services firm. The comments herein reflect the experiences and insights gained in assisting our clients (both public and nonpublic business entities) with the purchase accounting for their business combinations under Topic 805 and subsequent impairment testing under Topic 350 and Section 360-10-35. We have thus focused our comments on highlighting some of the practical challenges of applying, as well as some unintended consequences of, the proposed accounting alternative.

We would be pleased to further discuss our comments below with the Board and staff. Please direct any questions to either of us via the contact information set forth below.

Sincerely,

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and Office of Professional Practice

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General Comments

The accounting alternative proposed in this Exposure Draft (ED) raises a fundamental question of whether the recognition and measurement of acquired identifiable intangible assets should be consistent with their underlying economics or be dependent upon the election of the business entity. Below are some important issues we believe the PCC and the Board needs to carefully consider in assessing the cost-benefits of the proposal.

- Identifiable intangible assets with the same (or similar) economic profile would be afforded disparate treatment between a nonpublic entity that elects to apply the accounting alternative and (i) the public and not-for-profit (NFP) entities that are precluded from applying the accounting alternative; (ii) the nonpublic entities that elect not to apply the accounting alternative; and (iii) the nonpublic entities that are precluded from applying the accounting alternative due to the absence of a business combination. We believe the current guidance that incorporates all market participant expectations consistent with the overall measurement principle of Subtopic 805-20-30 and Topic 820 provides the more decision useful information to users.
- The value of an identifiable intangible asset measured under the accounting alternative may be inconsistent with the rationale (economic, strategic, or otherwise) for the business combination and the business model of the acquired business entity.

  Most business combinations rely on the continuing ability of the acquired entity to generate revenue from its current customer base post-transaction, much of which is non-contractual and unlikely to meet the definition of having arisen from noncancelable contractual term as defined in the ED. The uncertainty (risk) of realizing those non-contractual cash flows is priced into the transaction's total consideration. The accounting alternative limits the measurement of the acquired identifiable intangible assets to their noncancelable contractual term, creating a disconnect between the economic considerations of the transaction and the financial reporting of that transaction.
- U.S. GAAP and IFRS are largely converged in the area of business combinations and fair value measurements, thanks to the joint efforts of both Boards and their Staff in recent years. The proposed accounting alternative would unwind those efforts and is inconsistent with the FASB's commitment to reach a unified set of high-quality global accounting standards. We should be reminded that financial statement users, regulators, and others have all urged standard setters to harmonize accounting principles in major capital markets around the world since the late 1950s (see International Convergence Of Accounting Standards—A Brief History on the FASB's Website).

Given the interdependency of the accounting for identifiable intangible assets in a business combination and the subsequent accounting for goodwill, we encourage the Board and Staff to concurrently consider our comment letters to this ED and FASB File Reference No. PCC 13-01B.

Response to Specific Questions

Question 1: Please describe the entity or individual responding to this request.

Duff & Phelps Response:
Duff & Phelps is a global independent financial advisory and investment banking services firm. As part of providing our services, we analyze financial statements and other financial information of our clients and their industry peers.

We have gained significant experience and insights in assisting both our public and nonpublic clients with the purchase accounting for their business combinations under Topic 805 and subsequent impairment testing under Topic 350 and Section 360-10-35. We have thus focused our comments on highlighting some of the practical challenges of applying, as well as some unintended consequences of, the proposed accounting alternative.

Question 3: Should the Board expand the scope of the accounting alternative to other entities, such as publicly traded companies or not-for-profit entities? If the scope is expanded to other entities, what changes, if any, should the Board consider for the recognition, measurement, and disclosure of identifiable intangible assets acquired in a business combination? If the scope is expanded to public companies or not-for-profit entities, should the accounting alternative continue to be elective?

Duff & Phelps Response:
In proposing the accounting alternative, the PCC considered management access an important attribute when evaluating the recognition criteria for identifiable intangible assets. The red-flag approach of asking follow-up questions that may be triggered by the qualitative disclosures is believed to be adequate for private companies. While this type of access to private companies should not be presumed in all cases, it is very unlikely that such approach would be effective for public companies, thereby limiting the effectiveness of the accounting alternative for public companies.

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

Duff & Phelps Response:
Existing perceptions of undue cost and complexity in the valuation of certain identifiable intangible assets were cited as one of the primary reasons for considering this proposed accounting alternative. Broadly speaking, tightening the recognition criteria and reducing the number of intangibles on its face would seem to have the impact of reducing the overall cost and complexity of applying the acquisition method for business combinations. However, the nature of valuation and in particular the highest and best use criteria inherent in fair value

measurements (see Example 1 of Topic 820 and the measurement of the fair value of an asset within the group of assets) may lead to some unintended consequences. The following are some examples of what might be encountered in practice with the adoption of the proposed accounting alternative.

- The Multi-Period Excess Earnings Method ("MPEEM") is a commonly utilized methodology in the valuation of a variety of identifiable intangible assets (such as customer-related and technology-based intangible assets).[1] Fundamental to the method is the application of contributory asset charges to estimate the excess earnings attributable to the subject asset. The accounting alternative presents the challenge of whether contributory asset charges should be applied for contributory assets recognized consistent with the accounting alternative or consistent with the recognition principles and measurement guidance of Topics 805 and 820, respectively. This issue currently presents itself with a contributory asset charge based on a fair value estimate of an assembled workforce, an asset not permitted to be recognized separate from goodwill.

  A number of similar situations will likely present themselves where assets that are no longer required to be recognized are also considered contributory assets. That is, similar to assembled workforce, the unrecognized asset may still require a valuation estimate arrived in conformity with Topics 805 and 820 in order to properly measure the fair value of the subject intangible asset. A specific example of this would be where the subject intangible asset is a brand measured with a MPEEM and one of the contributory asset being customer-related assets measured with a distributor or disaggregated method.

  As a result, broadly applying the accounting alternative may overvalue intangible assets measured via the application of the MPEEM. If the Board's intent is to remain consistent with Topic 820 and the perspective of market participants, preparers and users would need to be mindful of the different valuation results when measuring identifiable intangible assets under the accounting alternative.

- Similar-lived assets are typically valued in aggregate. Not recognizing one of the assets in the asset group under the accounting alternative would lead to the need to extract it from the group value. This could be accomplished via a contributory asset charge discussed in the prior example or via the more challenging process of developing projections that exclude the economic benefit of the unrecognized asset. For example, the fair value of a pharmaceutical product line is an assemblage of assets that includes patent(s), brand name, patient-related intangibles, and others. The accounting

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[1] See Appraisal Foundation, Identification of Contributory Assets and Calculation of Economic Rents, available at www.appraisalfoundation.org.

alternative may necessitate the unbundling of the patient-relationships from the product line fair value, greatly increasing the complexity of this analysis.

- There may be significant difficulty in exercising judgment when bifurcating an arrangement between its cancelable and noncancelable terms. In the automotive industry, for example, short term purchase orders are preferred over long-term contracts. However, an automaker is often unable to replace the incumbent supplier due to the significant lead time necessary for the new supplier to produce a suitable alternative. As a result, the incumbent is generally assured continuing business for the duration of the vehicle program that typically lasts 5 to 7 years.

  Paragraph 805-20-25-31 defines what constitutes a noncancelable contractual term. Whether the preceding example (and other similar situations) would meet the criterion of paragraph 805-20-25-31(c), which defines it as the portion of a contract that is cancelable only upon the occurrence of some remote contingency, will require exercise of significant judgment.

- The PCC might also consider that the root cause of certain elements of complexity may not lie in the recognition criteria but perhaps in what has evolved to be the pervasive practice of valuing many customer-related assets by the MPEEM. One perspective is that applying a MPEEM to customer-related assets may infer that the customer is in essence paying the company for a relationship with itself (the customer). If alternative measures of fair value such as cost savings or a reduction in the risk of the expected cash flows were more commonly applied then the level of complexity would be reduced. Limiting the application of the MPEEM to the non-contractual customer intangibles would reduce costs and complexity while still maintaining the same fundamental principles that currently exist. The Appraisal Foundation is addressing the valuation of Customer Relationship intangibles via one of its working groups in the area of financial reporting and the PCC/FASB Staff may want to reach out on this particular issue.

The accounting alternative is unlikely to achieve significant cost reductions for nonpublic entities and may instead increase overall costs to the financial reporting system and the capital markets as a result of the different bases of accounting.

- As discussed in the FASB Staff paper on PCC Issue No. 1–*Accounting for Identifiable Intangible Assets in a Business Combination and Subsequent Goodwill* for the May 7, 2013 meeting of the Private Company Council, opponents believe that View A (which is consistent with the proposed accounting alternative) "does not result in enough cost relief for private companies because most intangible assets are already considered contractual-legal, and few are considered only separable, under current guidance. In addition, many contractual-legal intangibles are considered to be harder to value than intangibles that are only separable because, by definition, separable intangibles are more likely to have observable transactions from

which fair value can be derived. Therefore, opponents argue that little would change in the level of cost incurred by a private company under View A compared to current U.S. GAAP, because they believe that View A would continue to require extensive involvement by external valuation professionals and auditors."

- Before making investment or capital allocation decisions, investors and lenders would need to account for differences caused by the accounting alternative between entities and any internal differences as existing identifiable intangible assets would continue to be recognized on the financial statements in conformity with Topics 805 and 820.

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 contractual term? 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?

Duff & Phelps Response:
The PCC points to reducing subjectivity as the rationale for limiting the measurement of contractual assets to the term of the contract. However, some degree of subjectivity is also present in many other aspects of valuation. For example, developing scenarios for the valuation of an asset (e.g. probability of success for IPR&D) will continue to be present for many assets arising from legal rights. Similarly, some degree of subjectivity is inherent in many business decisions made by market participants faced by uncertainty; this, in itself, does not invalidate such decisions, or make them bad decisions. Using subjectivity as a reason for non-recognition of an asset strikes at a core attribute of many fair value measurements; where should the line be drawn between acceptable and non-acceptable subjectivity?

In addition to other unintended consequences highlighted in our response to Question 4 above, the isolation of the contractual terms of the customers may trigger the need to value individual customer contracts. Whereas including contractual renewals allowed for grouping them together in a customer-related asset and applying an attrition analysis, a limitation of value over a specific contract life may require a more discrete asset identification.

Lastly, the proposed accounting alternative would result in identifiable intangible assets being subsumed in goodwill, which would be inconsistent with the existing

notion of goodwill. In the Basis for Conclusion for FAS 141(R),[2] paragraph B313 through B317, the Board explained its views on the attributes of goodwill. Specifically, paragraph B314 states that, "[t]he second component[3] also is not part of goodwill conceptually; it primarily reflects intangible assets that might be recognized as individual assets."

Question 15: The scope of this proposed Update uses the term publicly traded company from an existing definition in the Master Glossary. In a separate project about the definition of a nonpublic entity, the Board is deliberating which types of business entities would be considered public and would not be included within the scope of the Private Company Decision-Making Framework. The Board and PCC expect that the final definition of a public business entity resulting from that project would be added to the Master Glossary and would amend the scope of this proposed Update. The Board has tentatively decided that a public business entity would be defined as a business entity meeting any one of the following criteria:

a. It is required to file or furnish financial statements with the Securities and Exchange Commission.

b. It is required to file or furnish financial statements with a regulatory agency in preparation for the sale of securities or for purposes of issuing securities.

c. It has issued (or is a conduit bond obligor) for unrestricted securities that can be traded on an exchange or an over-the-counter market.

d. Its securities are unrestricted, and it is required to provide U.S. GAAP financial statements to be made publicly available on a periodic basis pursuant to a legal or regulatory requirement.

Do you agree with the Board's tentative decisions reached about the definition of a public business entity? If not, please explain why.

Duff & Phelps Response:
Additional clarification may be necessary regarding criteria [a] above (defining a public business entity as a business entity is required to file or furnish financial statements with the Securities and Exchange Commission). For example, does the requirement of registered investment advisers (including advisers to hedge funds) to file financial information under Form PF constitute a provision of financial

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[2] FAS 141(R) has been codified as Topic 805 in the Accounting Standards Codification. However, the basis for conclusion was not included in the Codification.

[3] Component 2 is described in paragraph B313 as "the fair values of other net assets that the acquiree had not previously recognized. They may not have been recognized because they failed to meet the recognition criteria (perhaps because of measurement difficulties), because of a requirement that prohibited their recognition, or because the acquiree concluded that the costs of recognizing them separately were not justified by the benefits."

statements to the Commission? Similarly, would Proposed Rule 17Ad-22(c)(2) that requires a clearing agency to post on its Web site an annual audited financial report also be construed as having filed or furnished financial statements with the Commission?