

February 28, 2014

Working Group 2 – Customer Related Assets
c/o Paula Douglas Seidel
The Appraisal Foundation
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Dear Group Members:

This letter is in response to the exposure draft of *The Valuation of Customer Related Assets*.

The American Institute of Certified Public Accountants (“AICPA”) is a professional organization of approximately 395,000 certified public accountant (“CPA”) members. Our constituency actually exceeds that number. That is because, under various state accountancy laws, AICPA professional standards also encompass practicing CPAs who are not AICPA members.

The Forensic and Valuation Services Executive Committee (“FVSEC”) is a senior technical committee of the AICPA. The FVSEC is empowered to issue valuation standards for our members and to comment on valuation-related topics on behalf of the AICPA. In 2007, the AICPA issued valuation standards, Statement on Standards for Valuation Services No. 1.

This letter presents our comments with regard to the December 5, 2013, second exposure draft of *The Valuation of Customer-Related Assets (“VCRA”)*.

Paragraph 3.2.10 Customer Contracts and related Customer Relationships

The FVSEC recommends that the term “customer contracts and related customer relationships” be termed “Customer Contracts and Expected Contract Renewals.” The distinction is important because the values are different. For the customer contracts, there is less risk to the income amount and the income term, so a lower discount rate could be appropriate; whereas, the expected contract renewals are more risky because both the income term and the income amount are unknown. Lives on these are also different as the life of the contract is over when the contract term ends, resulting in a shorter amortization term. The life on the contract renewals is unknown and must be determined through estimation and analysis of historical renewals. The amortization term would inherently be much longer on the contract renewal asset.

The FVSEC recommends that all of these factors should be mentioned in *The Valuation of Customer-Related Assets*.

Paragraph 5.2.8 – Economic Life

The FVSEC believes that specific examples of market participant assumptions should be explained in the exposure draft. For example, if a market participant plans to increase prices on day two for specific products and that market participant believes that some attrition would occur as a result, this expectation should be taken into account in the income forecast (volume/price changes) as long as other market participants would do the same. Historical attrition reflects historical data that is known and can be quantified. Market participants often rely on (somewhat analogous to usage of historical volatility as a proxy for measurement date volatility in an options valuation) historical attrition statistics to form expectations about future attrition at the measurement date. The FVSEC believes that it would be inappropriate to subjectively change the attrition rate for upcoming events that are not known or knowable. The FVSEC believes that when attrition attributes are used that are contrary to historical attrition studies, the analysis will receive a higher degree of scrutiny when the analysis is subject to peer review, audit, or regulatory examination. The deal income forecast would need to consider such items and considerations from a market participant standpoint.

The FVSEC believes that these comments and thoughts should be addressed in the VCRA in order to make it clear as to what factors should (and should not) be considered in the attrition rate and the remaining useful life calculations.

Paragraph 5.2.22 – The FVSEC believes that the following factors should be considered in addition to those included in the exposure draft:

d. Market participant considerations

The FVSEC believes that all factors pertinent to a market participant should be factored into the valuation of a customer-related intangible asset.

The FVSEC believes this factor warrants consideration and discussion in *The Valuation of Customer-Related Assets*.

Paragraph 8.1.8 – The Cost Approach

The FVSEC recommends that the following considerations be included in the determination of when the cost approach is appropriate:

- 1.) The analyst does not have sufficient data to perform the market approach.
- 2.) The analyst does not have sufficient data to perform the income approach.
- 3.) The analyst has reliable replacement cost new data.
- 4.) The analyst has reliable obsolescence data.
- 5.) The analyst has remaining useful life data.

The FVSEC recommends that these factors are imperative to have in order to effectively apply the cost approach, and the VCRA should state so accordingly.

Paragraph 9.3 Deferred Revenue

The FVSEC believes the deferred revenue section should be expanded. The original view set forth that matches amortization with the post acquisition profit was as follows:

1. The deferred revenue liability (equal to fulfillment cost + normal profit margin) will be recognized as revenue and the fulfillment costs will be deducted in the period in which the obligation is fulfilled. Therefore, the acquirer will recognize post-acquisition profit associated with the deferred revenue equal to the normal profit margin on fulfillment.
2. If deferred revenue is excluded entirely from the customer valuation, then there will be no corresponding intangible asset related to the deferred revenue that will be amortized against the post-acquisition profit on deferred revenue, which is inconsistent with the treatment of other contract-based intangible assets. In addition, while there is no “cash in-flow” related to the acquired deferred revenue, the acquirer’s satisfaction of the performance obligation satisfies a liability and prevents a cash out-flow back to the customer for non-performance. Thus, consistent with revenue recognition for the acquired deferred revenue, the revenue is actually “earned” as the performance obligation is fulfilled by the acquirer.
3. Therefore, acquired deferred revenue should be included in the customer revenue forecast as it is expected to be earned (at fair value). Fulfillment costs should also be included. As a result, the post-acquisition profit will be included in the relationship valuation and will be amortized against the post-acquisition profit on deferred revenue. As a result, there is no double-counting or netting on the balance sheet and the amortization is correctly matched to the profit, consistent with other contract-based intangibles. Revenue in the prospective financial information (“PFI”) should be on an accrual basis, including future deferred revenue.
4. Consistent with A/R, inventory, A/P and accruals, since deferred revenue is recognized on an accrual basis in the PFI, it should also be included in working capital for purposes of calculating the contributory asset charges. The effect of including deferred revenue is to reduce the overall charge for net working capital, which accounts for the timing of the deferred revenue cash flow (i.e. it is paid in advance).

The FVSEC believes this is a significant issue to discuss in the VCRA given there is a wide diversity of practice regarding the deferred revenue liability. Can the VCRA expand and show an example?

General Comments:

The FVSEC believes the exposure draft is very well written. We commend the Group on issuing it for comments. Some general comments are as follows:

1. We recommend excluding paragraphs 5.2.37 and 5.2.38. These seem to be more of an overall reconciliation in accordance with FASB ASC 805: *Business Combinations* as opposed to dealing directly with the valuation of customer related assets;
2. There needs to be a reconciliation and clarification between the white paper and the previously issued white paper on contributory asset charges where there is overlap and ambiguity. Has a cross reference been done between this and the contributory charge work that has been done and issued?
3. The FVSEC recommends changing the term “customer contracts and related customer relationships” to “customer contracts and expected contract renewals.”
4. The FVSEC recommends a literature citation for the name “Distributor Method.” The FVSEC does not think the name is commonly used in valuation or accounting literature. The

FVSEC believes it is more commonly called the profit split method or the comparable profit method.

- 5. The FVSEC recommends guidance be given in the VCRA on the timeframe in which projected income for customer-related assets is done. For instance, do you project the income over the average remaining life or the customer total life? The results of these could be materially different. As a quick example, what if the average remaining life per the retirement method is 10 years and the total life is 20 years. What do you consider and use?**
- 6. On page 27, the distributor method is a “subset” of the profit split method or the comparable profit method, not the MPEEM. Typically there is no ROI procedure in the distributor method.**

Finally, we thank the Group for its consideration of our comments, and for its continued service to the valuation profession.

Very truly yours,

A handwritten signature in cursive script that reads "Carol Carden".

Carol Carden, CPA/ABV, ASA, CFE
Chair, AICPA Forensic and Valuation Services Executive Committee