



27 April 2009

Working Group 1 - CACs
c/o Paula Douglas Seidel
The Appraisal Foundation
1155, 15th Street NW, Suite 1111
Washington DC, 20005

By email: commentsCACs@appraisalfoundation.org

Dear Sir/Madam,

Comments on The Appraisal Foundation Best Practices for Valuation in Financial Reporting: Intangible Asset Working Group Exposure Draft entitled "The Identification of Contributory Assets and the Calculation of Economic Rents" dated 25 February 2009.

Thank you for the opportunity for The Institute of Chartered Accountants in Australia ("The Institute") to provide comments on The Appraisal Foundation Best Practices for Valuation in Financial Reporting: Intangible Asset Working Group Exposure Draft "The Identification of Contributory Assets and the Calculation of Economic Rents". These views are set out in the appendix and were prepared by the Institute's Business Valuation Special Interest Group ("BVSIG"), a special interest group whose members are most affected by the proposed Exposure Draft.

The Institute is Australia's premier accounting body, which represents over 45,000 members who are fully qualified Chartered Accountants working either in the accounting profession providing auditing, accountancy, taxation and business consultancy services or in diverse roles in business, commerce or government.

The Institute is a founding member of the international accounting coalition called the Global Accounting Alliance (GAA), which provides reciprocal arrangements with eight of the other leading accounting bodies in the world. The Institute is the only Australian accounting body within the alliance. The GAA represents more than 700,000 members world-wide and includes professional accounting organisations from America, Canada, Hong Kong, England/Wales, Ireland, Scotland, New Zealand and South Africa.

In July 2005 the Institute established the Business Valuation Special Interest Group (BVSIG) for the benefit of the Institute, members and stakeholders, including regulators and the community. The BVSIG currently has over 900 members working in the field of business valuation. The key aim of this group is to provide standards in the area of business valuations. The BVSIG is represented in most states and nationally.

Should you have any questions in relation to the matters discussed in the attached document, please contact John Gibson, Chair, BVSIG on +61 2 9248 4616.

Yours sincerely,

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Comments on The Appraisal Foundation Best Practices for Valuation in Financial Reporting: Intangible Asset Working Group Exposure Draft entitled “The Identification of Contributory Assets and the Calculation of Economic Rents” dated 25 February 2009.

We have identified certain issues relating to contributory asset charges (CAC) that have not been adequately addressed by the Exposure Draft:

- ▶ Assets that are not identifiable, such as monopoly profits, have not been adequately addressed and the Exposure Draft does not suggest any methodology to value these assets. In addition, certain specific contributory assets were not mentioned in the Exposure Draft (e.g. capital reserves required in insurance companies)
- ▶ Misapplication of the level rent method for calculating return on and of an asset.
- ▶ Unusual high or low balances as at the valuation date (e.g. working capital) are an issue in calculating CAC that have not been adequately addressed.

These issues are discussed further below, with reference to the Exposure Draft, where applicable.

Intangible assets that are components of goodwill

Refer: Page 9, table and footnote 4; page 11, line 131

The Exposure Draft specifically refers to assets that are not identifiable intangible asset but that may be included as contributory assets. The Exposure Draft refers specifically to components of goodwill such as assembled workforce, proprietary know-how, monopoly or oligopoly positions, infrastructure, attractive site location and going concern. The Exposure Draft does not, however, recommend valuation methodologies for these assets, and actually refers to the SEC Staff Announcement Topic D-108 *Use of the Residual Method to Value Acquired Assets Other Than Goodwill*, which effectively states that assets must be valued directly (i.e. not using the residual method) in order to be included as contributory assets.

Comment

There does not appear to be sufficient explanation regarding suggested valuation methodologies, nor does there appear to be sufficient explanation of why “infrastructure” should be included as a non-recognisable intangible asset. There is also no consideration of other specific contributory assets, such as minimum required capital for insurance companies.

Level rent method to calculate CAC for fixed assets

Refer: Page 17, line 351; page 43

The Exposure Draft recommends the level rent method for calculating the return on and of fixed assets.

Comment

The key drawback of the level rent method is that it causes a mismatch between the implicit return of and the deterioration of (i.e. economic depreciation). The lease formula (i.e. the

“PMT” function in Excel) estimates a level payment. This level payment ends up pushing “principal payments” or *return of* to the end of the asset’s economic life rather than when the asset is actually being utilised.

We agree that the level rent method may be used to calculate return on and of an asset, however we note that it is very difficult to correctly apply this methodology.

Unusual balances at the valuation date

Refer: Page 15, lines 242 – 249

The Exposure Draft refers to the issue regarding one-time adjustments to working capital, however does not adequately deal with adjustments that should be made to “normalise” unusually high or low balances at the valuation date.

Comment

There should be more discussion / guidance given regarding how to normalise asset balances at the valuation date.

Typographical error

Refer: Page 14, line 209

There is an “l” in this line that should not be there: the line currently reads: “assets generally is based on the l relative revenue ...” We believe this should be: “assets generally is based on the relative revenue ...”