

ACCOUNTING & VALUATION GUIDE

# Assets Acquired to Be Used in Research and Development Activities



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- Options-based methods
- Manufacturing cost savings
- Incremental revenue or profit (for example, price premium)
- "With and without" analysis
- Greenfield method

**1.18** The stream of cash flows from each of these methods is discounted to present value, including, as appropriate, any tax benefits derived from amortizing the intangible asset for tax purposes,<sup>6</sup> to estimate the fair value of the intangible asset.

**1.19** The valuation specialist should apply income-based method(s) or technique(s) that most accurately captures the benefit of owning the IPR&D asset, given the nature of the asset and availability of required inputs.

**1.20** *Multiperiod excess earnings method.* In cases when there is an identifiable stream of prospective cash flows for a collection of assets, a multiperiod excess earnings method may provide a reasonable indication of the value of a specific asset. Specifically, under the multiperiod excess earnings method, the estimate of an intangible asset's fair value starts with the PFI associated with a collection of assets, rather than a single asset. *Contributory asset charges*, also referred to as *economic rents*, are then commonly deducted from the net (or after-tax) cash flows for the collection of the associated assets to isolate remaining or "excess earnings" attributable solely to the intangible asset being valued. The contributory asset charge is a deduction for the contribution of supporting assets (for example, net working capital, fixed assets, customer relationships,<sup>7</sup> trade names, and so on) to the generation of the prospective cash flows. Contributory asset charges should be applied for all assets, including other intangible assets, which would be required by market participants to generate the overall cash flows of the collection of assets. The excess earnings, net of the charges for contributory assets, are ascribed to the asset being valued and discounted to present value. The multiperiod excess earnings method is discussed in detail in chapter 6, "Valuation of In-Process Research and Development Assets."

**1.21** *Relief from royalty.* The premise of the relief from royalty method is that ownership of the subject asset *relieves* the owner of the need to license the asset from a third party. Thus, by owning the intangible asset, the owner avoids the royalty payments required to license the asset. The relief from royalty is cash flow savings that are discounted to present value. The present value of the prospective after-tax royalty payments are commonly used to approximate the fair value to the investor of owning the intangible asset. When selecting a royalty rate, one needs to consider whether it is licensor or licensee that is responsible for costs associated with various functions. For instance, when valuing IPR&D assets using the relief from royalty method, it may be appropriate to consider costs to complete, probability of completion, postcompletion

<sup>6</sup> The need to include the benefits of tax amortization will depend on which tax jurisdiction the intangible asset is located, or would be located, from a market participant perspective. Also, as further discussed in paragraph 6.123, the task force believes that tax amortization benefit should be included regardless of whether the actual transaction is a taxable transaction in which the buyer will receive a step-up in basis for tax purposes.

<sup>7</sup> The inclusion of customer relationships in the contributory asset charge indicates that a different methodology would need to be used to value customer relationships in order to avoid cross charges. For further discussion regarding cross-charges, see paragraphs 3.5.04–.07 in the Appraisal Foundation document setting forth best practices for *The Identification of Contributory Assets and the Calculation of Economic Rents* (the Appraisal Foundation document).