

# Index

- Accounting Principles Board (APB),  
Opinions 16 and 17, 5
- Accounting Research Bulletin (ARB)  
43, 5
- Accounting Standards Codification  
(ASC)
- ASC 280, *Segment Reporting*, 194
  - ASC 323, *Investments—Equity  
Method and Joint Ventures*, 175
  - ASC 350, *Intangibles—Goodwill and  
Others*, 193, 195
  - ASC 360, *Property, Plant &  
Equipment*, 193, 198, 199, 203
  - ASC 718, *Stock Based  
Compensation*, 178
  - ASC 805, *Business Combinations*,  
168, 178, 183, 194, 197
  - ASC 820, *Fair Value Measurements*,  
6, 7, 13, 14, 21, 27
- Acquirer in business combinations  
determining, 174, 175  
success characteristics, 165, 166
- Activity-based costing (ABC), 58, 59
- Adjustments
- comparable transaction method  
(market approach), 74–76
  - control adjustments, DCF method,  
119, 120
  - equity risk premium, 107
  - to inputs, fair value hierarchy,  
74, 75
  - nonperformance risk, 150, 151
  - to quoted prices (blockage factors),  
26
  - Risk Rate Component Model  
(RRCM), 139
  - valuation multiples, 80
- AICPA. *See* American Institute of  
Certified Public Accountants  
(AICPA)
- Allen, Paul, 123
- Allocation
- of assets and liabilities to reporting  
units or cash-generating units,  
20, 198
  - fair value of real estate  
components, 86
  - purchase price. *See* Purchase price  
allocation (PPA)
- Alternatives, consideration of in  
determining fair value, 19
- Altman Z-score, 144–146
- American Institute of Certified Public  
Accountants (AICPA)
- corporate performance metrics,  
51, 52
  - Guide for Prospective Financial  
Statements*, 63, 64

- American Institute of Certified Public Accountants (AICPA) (*continued*)
- In-Process Research and Development (IPR&D) Practice Aid, 6
  - Statements on Auditing Standards. *See* Statements on Auditing Standards (SAS)
- Amortization
- entertainment assets, 96
  - intangible assets, 92, 93, 96, 97
  - leasehold improvements, 183
  - long-lived assets, 3
  - useful life determination, 92, 93, 96, 97
- Analyst reports, 41, 42
- Assembled workforce, 73, 101–103, 184, 185, 190
- Asset appraisers, 9
- Asset retirement obligations (AROs), 157, 158, 183
- Asset turnover ratio, 131
- Assets
- classification of, 72, 73
  - custom-built, replacement cost, 87
  - depletion, 92. *See also* Remaining useful life (RUL)
  - economic life, 92
  - entertainment assets, 96
  - financial. *See* Financial assets
  - group of assets, 19, 20, 22, 24, 25, 37, 196, 197, 199, 201
  - identifying in business
    - combinations, 180–184
  - intangible. *See* Intangible assets
  - liquidation value, 17, 18
  - location of, 23
  - mining rights, 184
  - noncore, 3, 171
  - property, plant & equipment. *See* Property, plant & equipment (PP&E)
  - revaluation under IFRS, 16, 17
  - transaction data, comparing, 73
  - unrecorded, 2, 5, 159, 171, 172, 203
- Assumptions
- benchmarking, 65, 66
  - financial projections, 54, 64–66
  - income statement analysis, 61
  - market participants, 6, 43–47, 53, 150–152, 208
  - reasonableness of, 64, 67, 208, 217
  - verifying, 215, 216
- Aswath Damodaran Online, 77
- Auction value, 17
- Audits of fair value
- assumptions, 208, 215–217
  - audit evidence, 210, 214–217
  - audit requirements, overview, 210, 211
  - challenges faced, 209, 210
  - communication with directors, 218
  - disclosures, 209, 218, 219
  - entity and its environment, understanding, 211, 212
  - experts, using the work of, 209, 217
  - financial instruments, 210, 212, 218
  - financial projections (Level 3 inputs), 216, 217
  - fraud, 219
  - going concern, 211, 219, 220
  - intangible assets, 210, 212
  - management representations, 217, 218
  - material misstatements, risks of, 210–218

- procedures, 214, 215
  - subsequent events, effect of, 216
  - valuation methods, 213
  - valuation report, 208, 209
- Balance sheet
- fair value of assets, 17
  - intangible assets, 2
  - realized versus unrealized income, 67
  - tangible assets, 180
- Bankruptcy, 17, 31
- Bargain purchase, 176, 198
- Bazerman, Max, 138
- Beane, Billy, 138
- Benchmarks/benchmarking
- assumptions, 65, 66
  - corporate performance, 51, 52
- Benefit stream, 65, 66, 117
- Beta, 107, 108
- Bias, 137, 138
- BigCharts, 77
- Black-Scholes option pricing model (BSM), 154–156
- Blockage factors, 26
- BNET, 78
- Board of directors, communication with, 218
- Bonds
- comparable transactions method, 74
  - Kondratiev cycle, 110
  - risk-free rate of return, 107, 139.  
*See also* Risk-free rate of return
- Bottom up revenue projection
- method, 60
- Brand, 186
- Broker markets, 30
- Brooks, Mel, 125
- Brown, Bruce, 126, 127
- Bubbles, 70, 71
- Budget
- described, 42
  - flexible, 50
  - and future performance, 41
  - and planning capabilities, 50
- Buildup method, 107, 108, 112, 115, 116, 135, 170
- Business combinations
- acquirer, determining, 174, 175
  - bargain purchase, 176, 198
  - conglomerate discount, 170, 171
  - consideration, fair value of, 176–178
  - control, 174, 175
  - cost savings, 162, 163
  - extra expenses, 168
  - failures, 162, 166
  - financial statement analysis, 178–180
  - intrinsic value, 167–169
  - investment value, 167–169
  - merger waves, 161
  - noncore activities, 170
  - purchase price allocation. *See* Purchase price allocation (PPA)
  - reasons for, 163–166
  - replacement awards, 177, 178
  - revenue growth, 162, 163
  - successful acquirers, characteristics of, 165, 166
  - synergies, 66, 162–172, 180, 198. *See also* Synergies target, research on, 178
  - valuation, need for, 2, 3
  - valuators, role of, 4
  - voting rights, 175

- Business enterprise value (BEV), 79–81, 107
- Business facets
- emerging activities, 42, 43, 56, 121, 122, 168, 169
  - existing operations, 42, 43, 56, 57, 117, 121, 122, 168, 169
  - future opportunities, 42, 43, 56, 73, 121, 122, 167–169
- Business plans, 42, 43
- Business risk, 117
- Business systems, 125
- Business.com, 77
- Byrnes, Jonathan, 132, 133
- Calculation of fair value
- fair value conclusions (stage 6), 37–39
  - most advantageous market, establishing (stage 4), 30–33
  - premise of value, evaluating (stage 2), 24–29
  - principal market assessment (stage 3), 29, 30
  - stages of, overview, 21
  - unit of account, determining (stage 1), 22–24
  - valuation methods, selection of (stage 5), 33–37
- Capital asset pricing model (CAPM), 107
- Capital leases, 72
- Capital structure, 111–114, 120
- Capitalization methods (income approach)
- buildup method, 107, 108
  - capitalization rate, 11, 106–109, 112, 115, 117, 121, 135
  - described, 105, 106
  - discount rate, selection of, 107
  - international equity risk premiums, 109, 110
- Capitalization rate, 11, 106–109, 112, 115, 117, 121, 135
- Carrying amounts, 4, 199–206, 218
- Cash flow projections, 68, 110, 111, 120, 169, 211, 213. *See also* Discounted cash flow (DCF) method
- Cash-generating units (CGUs). *See also* Reporting units
- allocation of assets and liabilities to, 20, 198
  - described, 20
  - emerging activities and future opportunities, 122
  - impairment testing, 113, 194, 196, 197, 200–202
  - market participants, 16
  - and market selection, 32, 33
  - weighted average cost of capital (WACC), 113, 114
- Certification marks, 186
- Change
- and innovation, 124–126
  - S-curves, 55, 56
  - speed of, 126
- Claywell, J. Richard, 139
- Coase, Ronald, 126
- Collective marks, 186
- Communication with directors, 218
- Comparable transactions method (market approach), 73–76
- Comparisons of Technology Substitutions in Telecommunications and Other Industries* (Lenz and Vanston), 89

- Competition, assessing, 140–142  
 Concepts Statement (CON) 7,  
     *Using Cash Flow Information  
     and Present Value Accounting  
     Measurements*, 6, 111  
 Condition of assets, 23  
 Conglomerate discount, 170, 171  
 Contingent liabilities, 158, 159  
 Control, determination of in business  
     combinations, 174, 175  
 Control premium, 79, 80, 119, 120,  
     206  
 Controlling interests, 119, 120  
 Conversion rights, 154–156  
 Copyright Extension Act, 186, 187  
 Copyrights, 72, 94, 97–99, 186,  
     187  
 Corporate performance  
     growth, measures of, 42  
     key performance indicators (KPIs),  
         51, 52  
 CorporateInformation.com, 77, 78  
 Cost accounting, 58  
 Cost (asset-based) approach  
     asset retirement obligations, 158  
     current replacement cost, 85–87,  
         132  
     described, 35  
     duplication cost (reproduction  
         cost), 86  
     DuPont analysis, use of, 132. *See  
         also* DuPont analysis  
     economic deprivation, 86, 88,  
         90, 91  
     functional deterioration, 85–88,  
         90, 91  
     impact rates, 90–92  
     intangible assets, 97–103  
     physical decline, 86, 87, 90, 91  
     as reasonableness check of value,  
         85, 92, 103  
     residual value, 92  
     technological obsolescence,  
         86–91, 93  
     useful lives, 92–97  
 Cost of capital, 164, 168. *See also*  
     Weighted average cost of capital  
     (WACC)  
 Cost of debt, 111, 113, 164  
 Cost of equity, 111–113, 116, 139,  
     146, 202  
 Cost reductions, 66  
 Costs of sale, 18  
 Credit ratings, 112, 149, 151  
 Credit risk, 25–26, 150–152  
 Credit Suisse Global Investor Return  
     Yearbook 2011, 109  
 Current replacement cost, 85–87,  
     132  
 Customer needs, 125  
 Customer relationships, 23, 24, 118,  
     119, 168, 188–189  
  
 DailyStocks.com, 77  
 Dasgupta, Shamik, 126, 127  
 Databases  
     comparable transaction data, 75  
     financial ratios, 142  
     guideline transactions/entities  
         data, 76, 77  
     industry information, 78, 79  
 DCF. *See* Discounted cash flow (DCF)  
     method  
 Dealer markets, 30  
 Debenture values, 153–157  
 Decision making  
     biases, 137, 138  
     judgment framework, 137

- Defensive assets, 27
- Delivery channels, 72
- Depreciation, 22, 86, 90
- Development rights, 94
- Disclosures, 209, 218, 219
- Discontinued operations, 18
- Discount for lack of marketability (DLOM), 75, 80
- Discount rates
  - discounted cash flow (DCF)
    - method, 65, 110, 111, 114–117, 120
    - private market rates, 114, 115
    - risk-adjusted (RADR), 110
    - selecting, 107
    - value in use, 201, 202
    - venture capital equity returns, 114, 115
- Discounted cash flow (DCF) method
  - control adjustments, 119, 120
  - customer relationships, 188, 189
  - described, 106
  - discount rate, 65, 110, 111, 114–117, 120
  - historical performance, use of in determining projected cash flows, 68, 211
  - income approach, 105, 106
  - intangible assets, 116–119
  - internal consistency, 110
  - investment value determination, 169
  - limitations of, 62
  - projected cash flows, 110, 111, 120, 169, 213
  - terminal amount, 106, 115, 116
  - weighted average cost of capital (WACC), 111–114
    - weighted average return on assets (WARA), 117–119
- Distressed sales, 31, 32
- Drucker, Peter, 137
- Duff & Phelps, 11, 107, 109
- Duplication cost (reproduction cost), 86
- DuPont, 129, 170
- DuPont analysis, 129–132
- Early adopters, 123
- Earnings, quality of, 67, 68
- Earnings before interest after notional tax (EBIAT), 59
- Earnings before interest and taxes (EBIT), 188
- Earnings before interest, taxes, depreciation, and amortization (EBITDA), 65, 76, 79–82, 188
- Earnings per share (EPS), 106
- Earnouts, 176, 177
- Economic deprivation, 19, 86, 88, 90, 91
- Economic Value Added (EVA<sup>®</sup>), 59
- Economic value generated (EVG), 59
- Economies of scale, 162, 164, 165, 168, 172
- EDGAR, 77
- Emerging activities, 42, 43, 56, 121–122, 168, 169
- Employee IQ testing, 136
- Engineering designs and drawings, 5, 186
- Enhanced Business Reporting Consortium (EBRC), 51
- Enron Corporation, 67, 68
- Entertainment assets, 96
- Entity-specific risk, 108

- Environmental liabilities, 159
- Equity risk premium (ERP), 107, 109, 110
- Event-driven planning, 50
- Excel, 59–61
- Exchange markets, 30
- Existing operations, 42, 43, 56, 57, 117, 121, 122, 168, 169
- Exit price, 6, 14–16, 21
- Expected cash flow method, 65, 111
- Experts, using the work of, 209, 217
- External factors, consideration of in determining fair value, 19
- Facets of business
  - emerging activities, 42, 43, 56, 121, 122, 168, 169
  - existing operations, 42, 43, 56, 57, 117, 121, 122, 168, 169
  - future opportunities, 42, 43, 56, 73, 121, 122, 167–169
- Fair market value
  - defined, 14
  - fair value distinguished, 14
  - overview, 4–6
  - Revenue Ruling 54–60, 6
- Fair value
  - accounting, 7, 13, 14, 16
  - auditing. *See* Audits of fair value
  - calculation. *See* Calculation of fair value
  - changes in, 210
  - concept, 4, 13–20
  - definitions, 14, 15, 17
  - and financial reporting, 6
  - hierarchy. *See* Fair value hierarchy
  - legal, 17
  - litigation risk, 9, 10
  - range of fair values, 34, 37, 39
- Fair value hierarchy
  - adjustments to inputs, 74, 75
  - described, 35–37
  - judgment required, 9, 10
  - Level 1 inputs, 9, 26, 35, 37, 69, 70, 74, 181
  - Level 2 inputs, 10, 35, 37, 74, 181, 182
  - Level 3 inputs, 10, 35, 36, 70, 75, 216, 217
- Fair value less costs to sell (FVLCS), 183, 200–202
- Fama, Eugene, 111
- Financial Accounting Standards Board (FASB)
  - Accounting Standards Codification. *See* Accounting Standards Codification (ASC)
  - CON 7, *Using Cash Flow Information and Present Value Accounting Measurements*, 6, 111
  - statements issued during “Goldilocks” era, 6
  - Statements of Financial Accounting Standards. *See* Statements of Financial Accounting Standards (SFAS)
- Financial assets
  - classification of assets, 72
  - comparable transaction method, 73–76
  - credit risk, offsetting, 25, 26
  - fair value, 75
  - identifying in business
    - combinations, 180, 181
  - marketability, 75, 76
  - unit of account, 22
- Financial buyers, 3, 15, 66. *See also* Market participants

- Financial instruments, 26, 37, 208, 210, 212, 218, 219
- Financial projections  
 assumptions, 54, 63–66  
 audits of fair value, 216, 217  
 cash flow. *See* Cash flow projections  
 context, 54–56  
 continuity, 55  
 described, 43  
 developing, 53, 54  
 as iterative process, 53  
 models, 54, 59–63  
 past as indicator of future, 54, 55  
 quality of earnings, 67, 68  
 results, 54, 66, 67  
 revenues, 60, 61, 65, 66  
 structure (parts of business versus whole), 54, 56–59
- Financial reporting  
 changes in, impact on valuation, 3–7  
 fair market value versus fair value, 4, 5  
 fair value accounting, 7
- Financial risk, 117
- Financial statements  
 analysis of, business combinations, 178–180  
 comparing, 55
- Financial strength, assessing, 142, 143
- First Chicago method, 169
- Fisher, J. C., 89
- Forecasts. *See also* Financial projections  
 described, 43  
 past as indicator of future, 54, 55  
 reasonably objective basis for, 64
- Foster, John M., 24
- Fraud risk, 219
- French, Kenneth, 111
- Fuld.com, 78
- Functional deterioration, 19, 85–88, 90, 91
- Future benefits, 19, 35, 72
- Future opportunities, 42, 43, 56, 73, 121, 122, 167–169
- GAAP. *See* Generally Accepted Accounting Principles (GAAP)
- Gartner Group Inc., 51
- Gates, Bill, 123
- General Electric (GE), 133
- Generally Accepted Accounting Principles (GAAP)  
 convergence with IFRS, 3  
 goodwill impairment testing, 3, 4, 66, 202–205  
 impairment testing, 193–196, 198–200, 202–206. *See also* Impairment testing  
 real estate, 86  
 rules-based accounting, 10  
 and unit of account  
 determination, 22
- Germany, Rhonda, 122
- Gibson, William, 56
- Going concern, 4, 17, 25, 164, 197, 211, 219–220
- Goodwill  
 assembled workforce, 73, 184, 185, 190  
 future opportunities, 73  
 impairment testing, 3, 4, 66, 202–205  
 purchase price allocation, 173  
 reporting units, 20
- Gordon, Myron J., 106



- Gordon growth model, 106, 116
- Governance, 137, 218
- Group of assets, 19, 20, 22, 24, 25, 37, 196, 197, 199, 201
- Growth rate, 66, 108
- Guide to Fair Value under IFRS* (Catty), 139
- Guideline entities method (market approach), 73, 76–82
- Hang, C. C., 126, 127
- Hanlin, William A., Jr., 139
- Henretta, Deb, 126, 127
- Hezlett, Sarah, 136
- Highest and best use, 22, 25, 27, 28, 30, 184
- Hoovers.com, 77, 78
- Horizontal mergers, 164
- Human capital, 73, 184, 185
- IAS. *See* International Accounting Standards (IAS)
- Ibbotson, 11, 109
- “IC Value Drivers Report,” 146
- IFRS. *See* International Financial Reporting Standards (IFRS)
- Impact rates, 90–92
- Impairment losses, 7, 96, 167, 199, 202–204, 206, 210
- Impairment testing
  - cash-generating units (CGUs), 113, 194, 196, 197, 200–202
  - and changes in WACC, 113
  - under GAAP, 193–196, 198–200, 202–206
  - goodwill, 193, 194, 196–198, 202–206
  - under IFRS, 193, 194, 196, 197, 200–202
  - impairment losses, 96, 199, 202–204, 206
  - intangible assets, 97, 193, 194, 197–200
  - long-lived assets, 198–200
  - and remaining useful life determination, 96
  - reporting units, 113, 193–196, 202–206
- In-process research and development (IPR&D), 122
- Inactive/illiquid markets, 208–213, 219
- Income approach
  - asset retirement obligations, 158
  - benefit stream assumptions, 65, 66
  - capitalization methods, 105–110
  - customer relationships, 188, 189
  - described, 35
  - discounted cash flow (DCF) method, 106, 110–120. *See also* Discounted cash flow (DCF) method
  - methods, overview, 105, 106
- Income statements
  - analysis of historical income statements, 61, 62
  - realized versus unrealized income, 67
- Incremental analysis (copyrights), 187
- Incremental profitability technique, 119
- Indefinite lives, 95, 96
- Industrial buyers, 15
- Industry factors, guideline transactions/entities, 78
- Industry research, 77, 78, 178

- Industry Research Desk, 78
- Industry risk, 107, 108
- IndustryWatch.com, 77
- Innovation
  - defining the business (phase 2), 123–125
  - DuPont analysis, 129–132
  - feasibility (phase 1), 122
  - process, overview, 122
  - Procter & Gamble (P&G), 126, 127
  - returns, maximizing (phase 3), 125
  - 3M Company, 128, 129
  - value constellations, 125, 126
  - value maps, 127–129
- Inputs. *See also* Fair value hierarchy and marketability, 75
  - Monte Carlo simulation, 62, 63
  - observable, 29, 30, 35–37, 74
  - unobservable, 35, 74, 75, 213
- Intangible assets
  - adjusted equity rate, 113
  - amortization, 92, 93, 96, 97
  - artistic related, 184
  - audits, 210, 212
  - cash flows from, 116
  - classification as, 72, 73
  - contract based, 184
  - contractual/legal, 184
  - cost approach method, examples of, 97–103
  - customer relationships, 23, 24, 184
  - fair value of, business combinations, 173, 180, 181, 184–190
  - government granted, 184
  - identifying and recording in business combinations, 184–188
  - impairment testing, 97, 198–200
  - incremental profitability technique, 119
  - indefinite lives, 95–97
  - intellectual property. *See* Intellectual property
  - internally created, 23, 24
  - marketing related, 184
  - physical items, linked to, 94
  - recognition, 4
  - relief-from-royalty method, 34, 73, 82–84
  - remaining useful life determination, 92–94
  - risks, 117
  - separable, 184
  - technology based, 184
  - weighted average cost of capital (WACC), 113
  - weighted average return on assets (WARA), 117–119
- Integra Benchmarking Data, 142
- Intellectual capital (IC), 146, 147
- Intellectual property
  - and business combinations, 5
  - copyrights, 5, 72, 94, 97–99, 186, 187
  - engineering designs and drawings, 186
  - licensing, databases on, 34
  - patents, 5, 73, 116, 117, 123, 186, 199, 200
  - protection of, 123, 124, 185
  - trade secrets, 5, 72, 83, 185, 187–189
  - trademarks, 5, 73–76, 94, 184–186
- Intelligence quotient (IQ) tests, 136
- Interest rate risk, 25, 26

- Internal controls, 37, 137, 211, 212, 214, 218, 219
- Internal Revenue Service (IRS), Revenue Ruling 54-60 (fair market value), 6
- International Accounting Standards (IAS)
- IAS 16, *Property, Plant & Equipment*, 16
  - IAS 36, *Impairment of Assets*, 193, 194, 200
  - IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, 150, 158
  - IAS 38, *Intangible Assets*, 197
  - IAS 40, *Investment Properties*, 16, 17
- International Association of Consultants, Valuators, and Analysts (IACVA), 139
- International equity risk premiums, 109
- International Federation of Accountants, 207
- International Financial Reporting Standards (IFRS)
- convergence with U.S. GAAP, 3
  - IFRS 2, *Share-Based Payment*, 178
  - IFRS 3, *Business Combinations*, 168
  - IFRS 11, *Joint Arrangements*, 175
  - IFRS 13, *Fair Value Measurement*, 13, 21
  - impairment testing, 3, 193, 194. *See also* Impairment testing principles-based accounting, 10
  - real estate components, 86
  - and unit of account determination, 22
- International Standards on Auditing (ISA)
- audit standards, 207
  - ISA 240, *The Auditor's Responsibilities Relating to Fraud*, 219
  - ISA 260, *Communication with Those Charged with Governance*, 218
  - ISA 500, *Audit Evidence*, 214
  - ISA 545, *Auditing Fair Value Measurements and Disclosures*, 210, 211, 213, 217
  - ISA 570, *Going Concern*, 220
  - ISA 620, *Using the Work of an Expert*, 217
- Intrinsic value, 18, 167–169
- Inventory
- asset classification, 72
  - finished goods, 182, 183
  - materials and supplies, 181
  - replacement cost, 87
  - work in process, 181, 182
- Invested capital, 9
- Investment bankers, role of, 8
- Investment value, 18, 19, 45, 167–169
- ISA. *See* International Standards on Auditing (ISA)
- Islands of Profit in a Sea of Red Ink* (Byrnes), 132
- Joint ventures, 175
- Judgment
- assumptions, 64, 67
  - comparable transactions/entities, identifying, 76
  - decision making, 137, 138
  - financial instruments, valuing, 208
  - valuation, 9, 10

*Judgment in Managerial Decision**Making* (Bazerman), 138

Key performance indicators (KPIs), 51, 52

Know-how, 72, 189. *See also* Trade secrets

Kondratiev cycle (bond yields), 110

Kuncel, Nathan, 136

Kundera, Milan, 110

Leasehold improvements, 183, 184

Leases, 183, 184

Least squares fit, 61

Lenz, R. C., 89

Level 1 inputs, 9, 26, 35, 37, 69, 70, 74, 181

Level 2 inputs, 10, 35, 37, 74, 181, 182

Level 3 inputs, 10, 35, 36, 70, 75, 216, 217

Liabilities, valuing

asset retirement obligations (AROs), 157, 158

contingent liabilities, 158, 159

credit changes, 153  
and credit ratings, 149

credit risk, 150–152

debenture values, 153–157

fair value, 150, 152

market participant assumptions, 150–152

in purchase price allocation (PPA), 149. *See also* Purchase price allocation (PPA)

settlement amount, 150, 152

transfers of liabilities, 150

Licenses and permits, 72, 95, 96, 184

Linear thinking, 56

Liquidation value, 17, 18

Litman, Joel, 171

Location of assets, 23

Long-lived assets, 3, 4, 198–200

Low Teck, Seng, 126, 127

Machinery and equipment,

comparable transaction method, 73–76. *See also* Property, plant & equipment (PP&E)

MagPortal.com, 78

Management

assessing, 143, 144

assumptions of versus market participants' assumptions, 43–47

representations, 217, 218

responsibilities of, 211

Marchesini, Maurizio, 126, 127

Mark-to-market, 75

Mark-to-model, 75

Market approach

asset retirement obligations, 158

assets, classification of, 72, 73

comparable transactions method, 73–76

described, 34

guideline entities method, 73, 76–82

marketability, 75

markets, nature of, 70–72

methods, overview, 73, 74

overview, 69, 84

relief-from-royalty method, 34, 73, 82–84

Market participants

assumptions, 6, 43–47, 53, 150–152, 208

described, 15, 16

synergies, 66

- Market selection, 32, 33
- Market value, 6, 14, 15
- Marketability, 75
- Markets, nature of, 70–72
- Material misstatements, risks of, 210–218
- Materials and supplies, 181
- McLuhan, Marshall, 54
- Merger waves, 161
- Mergers and acquisitions. *See* Business combinations
- Mergerstat, 79
- MicroBit Corporation, 142
- Miller Analogies Test (MAT), 136
- Mineral rights, 184
- Mining assets, 184
- Monte Carlo simulation, 62, 63
- Moore's law, 55
- Morningstar.com, 79
- Most advantageous market, 30–33, 158
- Mualidharan, Raman, 122
  
- “The Nature of the Firm,” 126
- Net salvage value (NSV), 92, 96
- Net selling price, 200
- Noncontrolling interests, 119, 120
- Noncore activities and assets, 3, 170, 171
- Nonperformance risk, 151
- North American Industry Classification System (NAICS), 77
  
- Obsolescence, technological, 19, 86–91, 93
- Offsetting positions, 26
- Ones, Deniz, 136
- OneSource.com, 77
  
- Operating cash flow, 111–114, 115
- Operating earnings before interest, taxes, depreciation, and amortization (OPEBITDA), 79, 81
- Operating earnings before interest, taxes, R&D, amortization, and depreciation (OPEBITRAD), 80, 81
- Operating leases, 72
- Orderly transactions, 31, 32
- Other comprehensive income (OCI), 149
  
- Paglia, John, 114
- Patents, 5, 73, 116, 117, 123, 186, 193, 200
- Physical assets, 72, 181–184
- Physical decline, 19, 86, 87, 90, 91
- Pooling of interests, 5
- Porter, Michael, 162
- Prahalad, C. K., 125
- Premise of value
  - blockage factors, 26
  - credit risk, offsetting, 25, 26
  - defensive assets, 27
  - highest and best use, 22, 25, 27, 28, 30, 184
  - liabilities, 157
  - restricted assets, 27
  - shareholders' equity, 26
  - stand-alone value, 24, 25
  - and unit of account, 27–29
  - value in combination with other assets, 24, 37
- Premiums
  - control premium, 79, 80, 119, 120, 206
  - international equity risk, 109

Premiums (*continued*)

- Risk Rate Component Model (RRCM), 139
- size, 107
- Present value, discounted cash flow (DCF) method. *See* Discounted cash flow (DCF) method
- Price/earnings to growth (PEG) ratio, 42
- Price-to-book ratio, 5
- Price to earnings ratio (PER), 42, 44, 74, 105, 106, 165, 170
- Principal market, 29, 30, 158
- Procter & Gamble (P&G), 126, 127
- Product life cycle, 60
- Profit map, 133
- Profit margin drivers, 130
- Profit split analysis (copyrights), 187
- Profit strategies, 124, 125
- Profitability assessment, 144–146
- Profits, improving
  - DuPont analysis, 129–132
  - emerging activities, 121, 122
  - innovation, 122–129
  - profit map, 133
  - unprofitable business, pruning, 133
- Profits, sources of, 58, 59
- Projections, financial. *See* Cash flow projections; Financial projections
- Property, plant & equipment (PP&E)
  - acquired in business combination, 183, 184, 189, 190
  - asset classification, 72
  - cost approach, 189
  - depreciation, 22
  - functional deterioration, 88. *See also* Functional deterioration
    - machinery and equipment, comparable transaction method (market approach), 73–76
    - replacement cost, 87, 189
- Prospective financial information
  - management's versus market participants' assumptions, 43–47
  - scenario analysis, 45, 47–49
  - scenario implications, 49–52
  - sources of, 41–43
- Pry, R. H., 89
- Purchase price allocation (PPA)
  - acquirer, determining (stage 1), 173–175
  - audit requirements, 211
  - cash flow forecasts, 66
  - complexity of, 173, 192
  - consideration, fair value determination (stage 2), 176–178
  - fair value estimates, 190, 191
  - goodwill, 173
  - identification of all items acquired, 180–188
  - industry research, 178
  - intangible assets, 173, 180, 181, 184–190
  - overview, 3, 4, 192
  - reconciliation, 39, 190, 191
  - responsibility for, 173, 174
  - stages of, overview, 174
  - target research, 178–180
  - valuation methods, selection of, 188–190
- Quality of earnings, 67, 68
- Ramaswamy, Venkatram, 125

- Ranges
  - assumptions, 64
  - of fair value, 34, 37, 39
- Rate of return, 107, 115
- Real estate
  - comparable transaction method (market approach), 73–76
  - fair value allocation under GAAP and IFRS, 86
  - replacement cost, 86
  - unit of account, 22
- Real options, 122, 123, 169
- Reasonableness check of value, cost approach as, 85, 92, 103
- Recoverable amount, 200
- Relief-from-royalty method (market approach), 34, 73, 82–84, 189
- Remaining useful life (RUL)
  - cost approach, 86, 92–97
  - in DCF terminal amount, 106, 115, 116
  - intangible assets, 185
  - property acquired in business combination, 183
- Replacement awards, 177–178
- Replacement cost, 85–87, 132
- Reporting units. *See also* Cash-generating units (CGUs)
  - allocation of assets and liabilities to, 20, 198
  - described, 20
  - emerging activities and future opportunities, 122
  - goodwill, 20
  - impairment testing, 113, 193–196, 202–206
  - market participants, 16
  - and market selection, 32, 33
  - weighted average cost of capital (WACC), 113, 114
- Research and development (R&D), 72
- Residual value, 92
- Restrictions on sale or use, 23, 27
- Return on capital, 132
- Reuters.com, 77
- Revaluation, 16, 17
- Revenue enhancements, 66
- Revenue growth, in business combinations, 162, 163
- Revenue Ruling 54-60 (fair market value), 6
- Revenues, projecting, 60, 61, 65, 66. *See also* financial projections
- Risk
  - assessment, 139–146
  - business risk, 117
  - contingent liabilities, 158
  - credit risk, 25–26, 150–152
  - entity-specific, 108
  - financial risk, 117
  - fraud risk, 219
  - industry risk, 107, 108
  - inherent, 60
  - intangible assets, 117
  - interest rate risk, 25, 26
  - liabilities. *See* Liabilities, valuing
  - litigation risk, 9, 10
  - material misstatements, risks of, 210–218
  - nonperformance, 151
  - reduction. *See* Risk reduction
  - spreadsheets, use of, 59, 60
- Risk-adjusted discount rate (RADR), 110
- Risk-free rate of return, 107, 110, 139

- Risk Management Associates (RMA), 142
- Risk Rate Component Model (RRCM), 139–146
- Risk reduction
  - continuous monitoring and testing, 136–138
  - decision making, 137, 138
  - defined, 1335
  - employee IQ testing, 136
  - intellectual capital value drivers, 146, 147
  - Risk Rate Component Model (RRCM), 139–146
  - strategic advantages, 170
- Rolling forecasts, 50
- Royalty income analysis (copyrights), 187
- S-curves, 55, 56, 89
- Sales comparison method, 65
- Sales trends, 60, 61
- Sarbanes-Oxley Act, 180
- SAS. *See* Statements on Auditing Standards (SAS)
- Scenario analysis, 45, 47–50
- Seagram, 170
- Securities and Exchange Commission (SEC), EDGAR database, 77
- Sensitivity analysis, 49, 215
- Service marks, 186
- SEAS. *See* Statements of Financial Accounting Standards (SEAS)
- Shareholder litigation, 9, 10
- A Simple Substitution Model of Technological Change, Technological Forecasting and Social Change* (Fisher and Pry), 89
- Six Sigma, 51
- Size premium, 107
- Sloan, Alfred Pritchard, 56
- Software
  - asset classification, 72, 73
  - comparable transaction method (market approach), 73–76
  - copyrights, 72, 186, 188
  - cost approach, 35, 100, 101
  - protection of, 188
  - spreadsheet management, 59, 60
- Spearman, Charles, 136
- Spreadsheets, 59, 60
- Statements of Financial Accounting Standards (SEAS)
  - SEAS 5, *Accounting for Contingencies*, 158
  - SEAS 33, *Financial Reporting and Changing Prices*, 13
  - SEAS 141, *Business Combinations*, 6
  - SEAS 142, *Goodwill and Other Intangible Assets*, 6
  - SEAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, 6
  - SEAS 157, *Fair Value Measurements*, 6, 13, 150
- Statements on Auditing Standards (SAS)
  - AICPA as source of, 207
  - SAS 101, *Auditing Fair Values*, 6, 214
- Stern Stewart & Company, 59
- Strategic buyers, 2, 3, 66
- Strengths, weaknesses, opportunities, and threats (SWOT) analysis, 47, 130



- Subsequent events, effect of on fair value, 216
- Substitution, 19, 88, 89
- Supply and demand, 19, 70
- Supply chains, 73, 123, 125–126
- Survivor curves, 95
- Synergies
  - business combinations, 66, 162–172, 180, 198
  - control premiums, 79, 120
  - cost reductions, 66, 167, 168
  - determining, 166, 167
  - effect of on value, 2, 3
  - extra expenses, 168
  - failure to achieve, 162, 166
  - fair value, 168, 169
  - goodwill impairment, 66
  - noncore activities, 170, 171
  - operating synergies, 164
  - overpaying for, 166
  - quantifying, 167–172
  - revenue growth, 66, 163, 167, 168
  - strategic advantages distinguished, 170
  - strategic buyers, 2, 3, 19
  - strategic objectives, 165
  - time required for realization of, 66, 170
- Systems, 73
- Technological obsolescence, 19, 86–91, 93
- Technology substitution, 88, 89
- Terminal amount, 115, 116
- 3M Company, 128, 129
- “The Three Phases of Value Capture,” 122
- Ticker symbols, 77
- Tobin’s Q ratio, 164
- Top down revenue projection method, 60, 61
- Total enterprise value (TEV), 9, 81, 164
- Total invested capital, 59
- Trade names, 94, 189, 190
- Trade secrets, 5, 72, 83, 185, 187–189
- Trademarks, 5, 73–76, 94, 184–186
- Transaction costs, 31, 33, 126
- Transfer price, 185
- Transportation costs, 33
- Trek Consulting Inc., 146, 147
- Trend line analysis, 60, 61
- Twain, Mark, 54
- Undervaluation, 164, 165
- Uniform Trade Secrets Act, 187
- Unit of account
  - asset retirement obligations, 157
  - characteristics of asset, 23
  - determining, 22, 24
  - examples of, 22, 23
  - and premise of value, 27–29
- United States v. Fourteen Packages of Pins*, 4
- Universal Studios, 170
- Upton, Wayne S., 24
- U.S. GAAP. *See* Generally Accepted Accounting Principles (GAAP)
- Useful lives, 92–97. *See also* Remaining useful life (RUL)
- Valuation
  - approaches, 8. *See also* Cost (asset-based) approach; Income approach; Market approach

Valuation (*continued*)

- assignment, 209
  - business inputs and outputs, 8
  - business uses, 2
  - copyrights, 187
  - fair market value versus fair value, 4, 5
  - and fair value hierarchy. *See* Fair value hierarchy
  - and financial reporting, 3–7
  - future versus past components of, 2
  - historical background, 1
  - improving value. *See* Profits, improving; Risk reduction
  - intangible assets, impact of, 2
  - investment bankers, 8
  - judgment required, 9, 10
  - mergers and acquisitions. *See* Business combinations
  - methods. *See* Valuation methods
  - principles, 19, 20
  - ten commandments of, 10, 11
  - valuators, 8, 9, 217
- Valuation methods
- choice of, 213
  - cost (asset-based) approach. *See* Cost (asset-based) approach
  - and fair value hierarchy. *See* Fair value hierarchy
  - income approach. *See* Income approach
  - market approach. *See* Market approach
  - overview, 33, 34
- Valuation multiples, 79–82
- Valuation report, 208–209
- ValuationResources.com, 79
- Valuators, 8, 9, 217
- Value constellations, 125, 126
- Value in use (VIU), 185, 200–202
- Value maps, 127–129
- ValueSource, 68
- Vanston, L. K., 89
- Venture capital firms, 16
- Vertical mergers, 164
- Vivendi, 170
- Volatility, 50, 155, 156
- Voting rights, 175
- Warranties, 159
- Weighted average cost of capital (WACC), 59, 107, 111–114, 202
- Weighted average return on assets (WARA), 117–119, 190
- Welch, Jack, 133
- Work in process, 181, 182
- World Intellectual Capital Initiative (WICI), 51
- XBRL International, 51
- Yahoo Finance, 77