

# BDO Tech

THE NEWSLETTER OF THE BDO SEIDMAN TECHNOLOGY PRACTICE

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## The Big Picture

### VALUING INTELLECTUAL PROPERTY

By Jay Howell of BDO Seidman, LLP and  
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**Intellectual property (IP) often represents the single most valuable asset for companies in the technology sector. However, there is currently little public information reported to investors about the valuation, composition and fair value of companies' IP.**

If useful measurement information about IP assets can be developed and communicated to investors in a meaningful way by applying fair value accounting, it is likely that this additional information and transparency could significantly enhance and improve investors' perceptions of company value. Moreover, if a company can identify IP and assign fair value to it, the company can manage IP, helping the company realize its optimum value.

#### Valuing IP

Intellectual property has historically been viewed as a single composite asset subject to identification and valuation. However, to obtain a truer value, an intellectual asset should be viewed as a portfolio of three commingled assets, each with ascertainable value: a legal entitlement asset, a legacy asset and an exploitation asset.

- The legal entitlement asset held by the owner captures a fair return for the exclusive legal right of control, which may or may not become invoked in whole or in part at any given time. The value of legal entitlement reflects the enablement of competition and its defense.

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- The legacy asset held by an owner, licensor, and/or licensee, captures a fair return for the existing IP equity in place in the holder's field of use and/or geography. Legacy asset value reflects the current stock or inventory of IP equity. Its value is intrinsically tied to its remaining useful life, which is represented by the time in the future when the IP would be substantially depreciated to "salvage value."
- The exploitation asset held by an owner, licensor and/or licensee, captures a fair return for future incremental IP value exploited by the holder under defined terms, conditions, circumstances and limitations. Exploitation value reflects the future opportunity for IP extension and incremental equity and its value is tied to the creation of IP where legacy value does not exist, or incremental IP value where legacy value does exist.

This trifurcation framework is a proven example of a conceptual rubric designed to capture IP benefits across product and technology bundles. The benefits to trifurcating intellectual assets into three component assets include:

- A better understanding as to the drivers of IP value.
- The establishment of a successful and clarified licensing campaign with better appropriated value between licensor and licensee.
- An improved alignment of internal IP management across associated business lines.
- Maximization of IP portfolio value through further diversification.
- IP expense is strategically allocated between U.S. technology companies and their controlled foreign affiliates.

### Fair Value and Internally-Developed vs. Acquired IP

The Financial Accounting Standards Board (FASB) Statement no. 157 defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

Currently, financial assets and liabilities are reported using fair value and non financial assets and liabilities are reported using historical costs. For IP that is developed internally, the costs of research and development are generally expensed as incurred, so no value is typically recorded as an asset. Purchased IP is generally recorded at fair value when it is acquired (unless it is still under development), which can result in a lack of comparability.

The recent trend in accounting and financial reporting standards is to increasingly allow or require the use of fair value information to measure assets and liabilities reported in companies' financial statements, in lieu of applying historical cost. This trend is being driven at the request of investors and other users of accounting information to receive more relevant performance information.

Heretofore, companies have estimated the value of IP assets in other circumstances such as when assessing how much to charge when selling or licensing IP, and in certain litigation matters where the value of IP is consequential in determining poten-

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tial damages to an allegedly harmed plaintiff asserting unauthorized third party use.

### Future Considerations

In the third quarter of 2008, the U.S. Securities and Exchange Commission (SEC) announced a timetable for the U.S. to discard its own accounting standards (U.S. Generally Accepted Accounting Principles) in order to embrace the International Financial Reporting Standards (IFRS) already adopted by many countries. The move to international accounting standards will result in important changes in how companies account for IP.

Beginning in 2009, both U.S. companies and companies reporting under IFRS will be required to recognize the fair value of acquired, in-process research and development (IPR&D) as an asset. Historically, the fair value of IPR&D was required to be expensed at the time of acquisition. The values of these IPR&D assets will then need to be monitored and evaluated by companies for potential impairment.

Additionally, the International Accounting Standards Board (IASB), a London-based body that sets the international standards, is considering ways to reduce or eliminate inconsistencies in accounting treatment between acquired intangible assets accounted for at fair value and internally developed intangible assets which are recorded at cost. This could potentially result in significant changes in accounting and disclosure requirements related to IP

assets, including potentially requiring greater use of fair value to measure and record IP assets.

### Conclusion

For technology-based companies where IP assets play a large role in performance, thorough and reliable valuation for IP assets is useful for assessing performance. Companies should recognize the benefits of measuring and monitoring the fair value of IP both for internal use, when planning and executing strategic and operational initiatives, and for external communications with company stakeholders.

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## Did You Know...

Thirteen percent of large businesses have detected information security intruders, a tenfold increase in intruder attacks over the last two years, according to **ITAudit**...

In the second quarter of 2008 there wasn't a single IPO of a VC-backed technology company; according to **Fortune** magazine this is indicative of a dry spell that the industry has not seen the likes of in 30 years...

Regulatory compliance is the business issue that will most affect IT managers, executives and their enterprises during the next 12 to 18 months, according to a survey by the **Information Systems Audit and Control Association**...

Financial services firms account for 18 percent of overall IT spending, and IT spending will grow 6.1 percent in 2009, down from a previous forecast of 9.4 percent, according to **Forrester Research**...

Despite a total absence of IPO activity, **Rutberg & Co.** reported \$313.2 million in wireless investments in August versus \$233.9 million a year ago...

The European venture capital industry continues to flounder as deal volume hit a new low and investment dropped 35% to €858 million in the second quarter, according to **Dow Jones Venture Source**....

## Mark Your Calendars...

The following is a list of upcoming conferences and seminars from the leading technology associations and business bureaus:

### OCTOBER 2008

- Oct. 27-28**      **IT Audit Management Forum**  
Camelback Inn, a JW Marriott Resort & Spa – Scottsdale, AZ
- Oct. 28-29**      **Infosecurity New York**  
Jacob K. Javits Convention Center – New York, NY
- Oct. 30-31**      **Software Business 2008 Conference**  
San Francisco Marriott – San Francisco, CA

### NOVEMBER 2008

- Nov. 5-6**      **Information Security Decisions 2008**  
Hyatt Regency at McCormick Place– Chicago, IL
- Nov. 6**      **Ac'sense 2008 Business Combinations – Applying the New Standards**  
Webinar – <http://www.bdo.com/acsense/>  
BDO Online CPE Network
- Nov. 9-11**      **CIO | 09 The Year Ahead**  
Loews Coronado Bay – Coronado, CA
- Nov. 10-12**      **Information Security Management Conference – Europe**  
Golden Tulip Grand Hotel – Amsterdam, The Netherlands
- Nov. 12**      **The IT Summit**  
Los Angeles Convention Center – Los Angeles, CA
- Nov. 15-21**      **Computer Security Institute 32nd Annual Computer Security Conference and Exhibition**  
Hyatt Regency Crystal City – Arlington, VA
- Nov. 19-20**      **Security 2008 – The 9th Annual Security Conference & Exhibition**  
Ronald Reagan Building & International Trade Center – Washington, DC

### DECEMBER 2008

- Dec. 4-5**      **IT Controls for Sarbanes-Oxley: The Symposium**  
Hyatt Regency DFW Dallas Fort Worth Airport – Dallas, TX
- Dec. 7-10**      **Global Sourcing 2008**  
Marriott Marco Island Resort – Marco Island, FL
- Dec. 16**      **IT Roadmap**  
Washington Convention Center – Washington, DC

## BDO SEIDMAN TECHNOLOGY PRACTICE

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BDO Seidman, LLP works with a wide variety of technology clients, ranging from multinational Fortune 500 corporations to more entrepreneurial businesses, on myriad accounting, tax and other financial issues.

For more information on BDO Seidman's service offerings to the technology industry vertical, please contact one of our practice leaders:

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