

SFAS 141: The First 5 Years

The S&P 100's Reporting of Acquired Intangible Assets 2002 - 2007

World's Biggest Countries, by GDP

Rank	Country	US\$ billion
13	South Korea	888
14	Mexico	839
15	Australia	768
16	Netherlands	658
17	US Goodwill*	490
18	Turkey	403
19	Belgium	392
20	Sweden	385

* If goodwill attributed by the 100 biggest US companies on corporate acquisitions over the past 5 years was a country's annual GDP.



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SFAS 141: The First 5 Years. The S&P 100's Reporting of Acquired Intangible Assets 2001 - 2007

1. Introduction

SFAS 141, Business Combinations, was introduced in the US in 2001 to standardize the accounting for assets acquired during a business combination. SFAS 141 has now been implemented for five years and this report is the first time that analysis of its application over five years has taken place.

This report analyzes five years of the application of SFAS 141 by the 100 largest US corporations to acquired intangible assets.

With a trend towards convergence of accounting standards, this report also compares the findings to the equivalent standard in the UK, IFRS 3, and the conclusions drawn from Intangible Business' 2006 report, 'IFRS 3: The First Year'.

**"...212 acquisitions
worth over \$1trillion."**



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2. Methodology

This study is based on the annual reports and 10-K filings of the largest US corporations comprising the current Standard & Poor's 100 index ("S&P100"). US corporations have been required to apply SFAS 141 to all business combinations from July 1st 2001 and we captured data for each S&P100 corporation from their first full year of reporting under SFAS 141. In most cases this was the year ended 31 December 2002. For most corporations, we therefore had access to five sets of reports.

With the exception of Google Inc, all the current members of the S&P100 have been quoted companies throughout the period. All the members of the S&P100 report in US Dollars under USGAAP.

Intangible Business is a leading international independent intangible asset valuation consultancy. Valuing intangible assets has been the focus of our activities for the past five years, during which time we have valued some of the world's biggest intangible assets for management, financial and legal purposes. Using this experience and skill, we have reviewed this analysis at an overall level, and at the level of individual transactions.

"...five years of acquisitions by the 100 biggest listed companies in the US."

In this report we have used the following terms:

- Purchase Price Allocation ("PPA") – the allocation of the cost of an acquisition to the fair values of the underlying assets and liabilities both tangible and intangible.
- Identifiable Intangible Assets – non financial assets without physical substance, not including goodwill.
- Goodwill – the difference between the acquisition cost and the total of the individual fair values of the related assets and liabilities.



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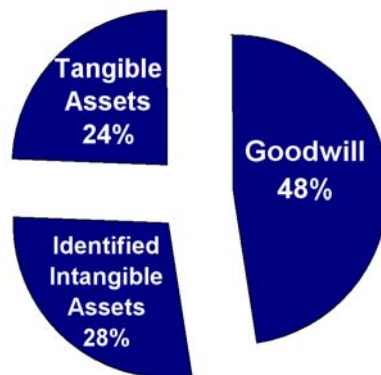
3. Summary

1. A trillion dollars invested

In five years the 100 largest US corporations reported 212 major acquisitions valued at \$1,033 billion in total. Net tangible assets were reported at \$253 billion and total intangible assets at \$780 billion. Of these, \$290 billion were identified and almost two thirds, \$490 billion, remained as goodwill.

“...cost of compliance is estimated at \$1bn.”

S&P 100 2002 – 2006 Purchase Price Allocation



“...nearly half the value of all acquisitions is hidden in goodwill.”

2. The half trillion dollar ‘black hole’

We have assumed that tangible assets have been given fair values on acquisition on a reasonable basis. Our focus is on the identification and valuation of intangible assets and the balancing figure, the ‘black hole’ of goodwill – a ‘black hole’ because no description or analysis is given of what this value includes.

In the last five years, the S&P100 corporations in the USA have invested \$490 billion in goodwill. SFAS 141 (unlike IFRS 3) does not require any explanation of goodwill and investors consequently have little opportunity to gauge whether this is money well spent.

Much of this goodwill does represent valuable assets such as synergies and a skilled workforce, and these can be valued. However, we believe it is a serious shortcoming of the current standard that acquiring corporations are not required to explain and quantify the major elements of goodwill.

Goodwill is capable of meaningful analysis, and this is all the more important when it is significant. In our view this should not be avoided.

This ought to require acquirers, their advisors and auditors to look more closely at the values attributable to the component parts of goodwill and reduce the risks of overpayment for acquisition targets being over looked.



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3. Identified intangible assets

We believe that an instructive measure of the adequacy of reporting of intangible assets is the proportion of identifiable intangible assets as a percentage of total intangible assets. Although just one measure, it is a good overall indicator of what has been reported. To avoid skewing our results with data from a small number of very large deals, we have calculated the percentage of identifiable intangibles for each transaction and have summed these percentages.

Over the last five years the average percentage of identified intangible assets from total intangible assets has ended up at 36% in 2006. This is very similar to our findings for the FTSE 100 companies in the UK, reporting under IFRS, with 36% identifiable intangible assets.

However this simple arithmetic mean figure hides a very broad range and the most frequently reported percentages are in the 20% - 35% range. There also significant acquisitions with either 100% identified intangibles or 100% goodwill.

4. Too much goodwill?

We believe that US corporations are overstating the value of goodwill. This is likely to be a combination of failure to identify and value some intangible assets and undervaluation of some that are identified.

In addition some corporations will have overpaid for acquisitions and that overpayment is reflected in the goodwill figure. An overpayment for an acquisition often takes years to come to light.

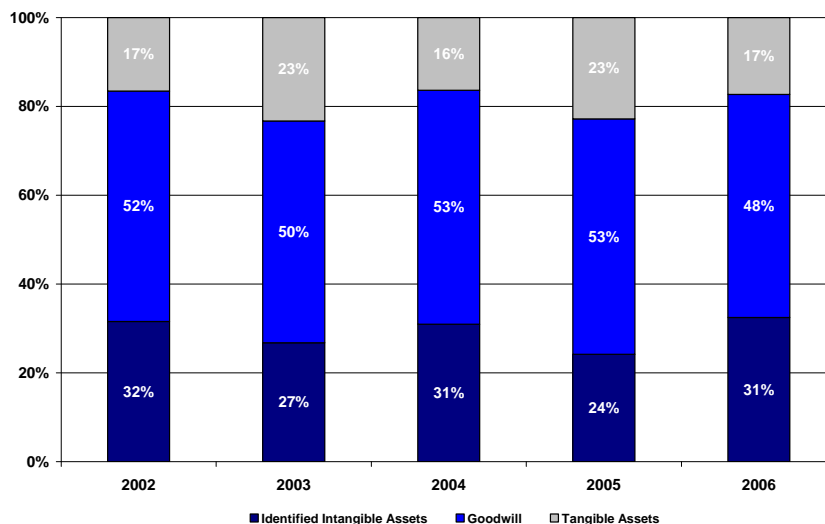
5. No change

We note that there has been no discernible improvement in the quality of reporting of acquired intangible assets over the five years since SFAS141 was introduced. The percentage of identifiable intangible assets has varied between 18% (in 2004) and 54% (in 2003). These conclusions are very similar to those in respect of reporting by FTSE 100 companies under IFRS 3.

“...no description of goodwill is required under SFAS 141.”

“...no improvement in reporting intangibles.”

S&P 100 2002 – 2006 Purchase Price Allocation





SFAS 141: The First 5 Years. The S&P 100's Reporting of Acquired Intangible Assets 2001 - 2007

4. Key Findings

1. Reported values

The totals reported by asset category by year, together with the percentage split between identified intangible assets and goodwill, are summarized in the table below:

	2002	2003	2004	2005	2006	5 year total	FTSE 100 IFRS
No. of acquisitions	29	36	47	48	52	212	87
Reported Values (US\$bn)							
Identified Intangible Assets	54.4	45.2	26.0	54.1	110.7	290.4	21.7
Goodwill	74.3	38.8	119.5	87.6	169.6	489.7	38.0
Tangible Assets	26.5	0.4	72.2	54.2	99.4	252.6	12.0
Total acquisition cost	155.1	84.4	217.6	195.8	379.6	1,032.6	71.7
Allocations based on percentages for each acquisition							
Identified Intangible Assets	37%	37%	37%	31%	36%	35%	37%
Goodwill	63%	63%	63%	69%	64%	65%	63%
Total Intangible Assets	100%	100%	100%	100%	100%	100%	100%

2. Goodwill is too high

As goodwill is that part of the purchase price that is left after all the tangible and identified intangible assets have been fair valued, a high proportion of goodwill left means there is a risk that there has been either a failure to identify and fully value intangible assets.

An alternative possibility is, of course, that the price paid was too high in which case the overpayment is allocated to goodwill. It can take several years to identify overpayments and management is usually reluctant to acknowledge that mistakes have been made. History is littered with examples of poor acquisitions such as that of AOL by Time-Warner and, in Europe, Mannesmann by Vodafone.

One significant difference between the disclosure requirements of the two standards is that SFAS 141 does not require any description of the factors which justify the amount paid for goodwill. We believe strongly that it is in the interests of shareholders that this information should be provided and that SFAS 141 should be better drafted in this respect.

Of course, as we pointed out in our original report, 'IFRS 3: The First Year', it is lamentable that this key disclosure requirement was disregarded or inadequately complied with in so many cases by FTSE 100 companies.

"...goodwill accounts for 48% of all acquisitions - \$490bn."



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3. Large deal distortion

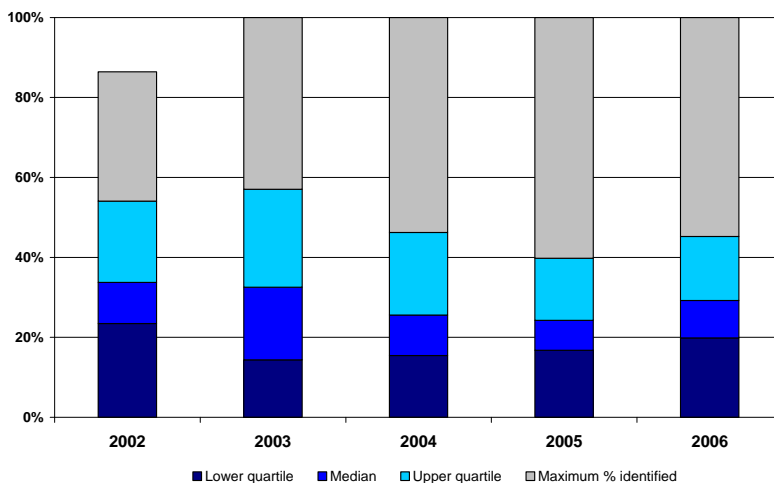
Acquisitions, individually in excess of \$10 billion, account for between 46% and 70% of total acquisition value in each year. The acquisition of Pharmacia by Pfizer in 2003, accounted for 82% of all the reported intangible asset value in that year.

We have eliminated any distortion caused by these large deals by aggregating the percentages by reported acquisition for each asset category, such that each reported acquisition has equal weighting.

On this basis, the percentage of identifiable intangibles averages 35% over the five years. The annual mean percentage of identifiable intangibles has been in the range 31% to 37% in the five years since SFAS was introduced. However, this does not tell the whole story as the range of reported percentages for individual acquisitions extends all the way from 0% to 100%. To get an idea of the range of percentages, we plotted a graph showing the median value, together with the lower and upper quartile values, shown below.

“...the percentage of identifiable intangibles over the five years is 35%.”

% identifiable intangible by year



This shows that only in 2002 and 2003, did a quarter of all reported acquisitions have identifiable intangibles of at least 50%. In 2005 three quarters of acquisitions reported less than 40% of intangibles as identifiable, while the median was only 24%.

This suggests that many acquisitions are reporting a lower percentage of identifiable intangibles than we would expect, and hence higher goodwill.

The percentage of identifiable intangible assets will, legitimately, vary significantly from one acquisition to another depending on the industry and the nature of the acquired entity. It is difficult to estimate an average proportion over a large group of acquisitions but SFAS 141 sets out many categories of intangible asset which must be identified separately and we believe that, on average, identified intangible assets should represent well over 50% of total intangibles.

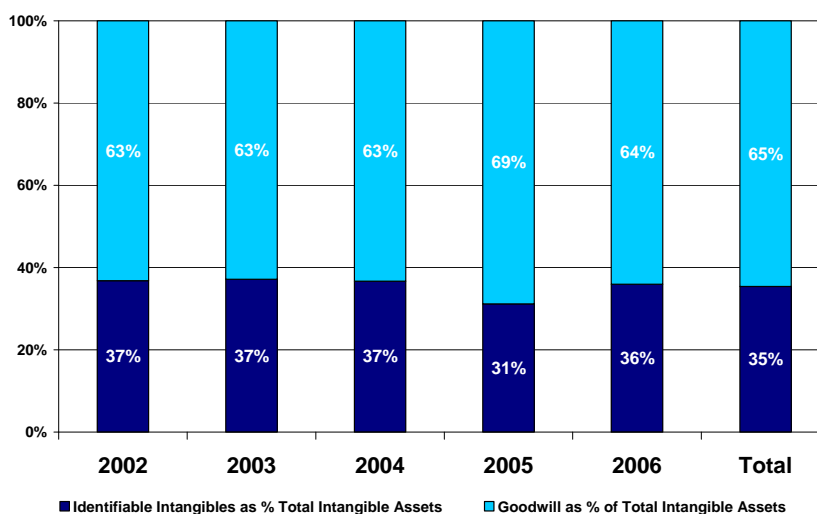


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4. The trend over time

There have been substantial variations year on year but there is no discernible trend either for the better (more intangibles and less goodwill) or worse. The proportion of identified intangible assets averages at 35% with goodwill at 65%.

S&P 100 2002 – 2006 Purchase Price Allocation



“...there is no discernible trend for the better.”



SFAS 141: The First 5 Years. The S&P 100's Reporting of Acquired Intangible Assets 2001 - 2007

5. Interpretation of materiality

The number of acquisitions for which a PPA was reported by the S&P100, including groups of smaller acquisitions reported in aggregate, averaged just over forty per year for the five years from 2002 to 2006. In the first year of IFRS 3, the FTSE100 companies reported 87 acquisitions.

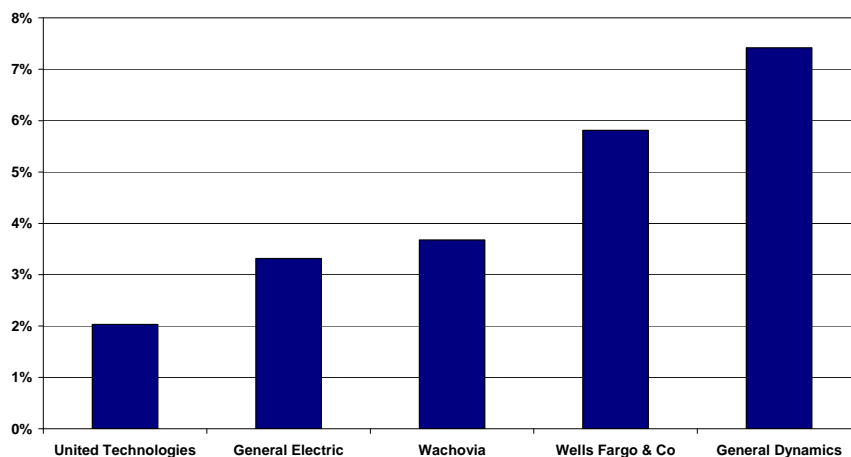
While there are a number of the largest US corporations which undertook little or no acquisition activity at all (seventeen), and some do report PPAs for relatively small acquisitions, the US companies do tend to avoid the requirements of PPAs through their interpretation of materiality. For instance, Wells Fargo, a financial services company with a market capitalization of \$117 billion, concluded that acquisitions priced at \$6.8 billion and \$ 4.1 billion in 2002 and 2003 respectively were immaterial and therefore did not require disclosure of the PPA.

General Electric (market cap. \$353 billion) deemed that two acquisitions each in excess of \$11 billion in 2005 and 2006 were immaterial and reported no PPAs.

In 2006 General Dynamics completed three acquisitions for a total consideration of \$2.3 billion. One of these, Anteon, cost \$2.1 billion but the 10-K for 2006 did not include a PPA for the acquisition. As General Dynamics' current market capitalization is approximately \$31 billion, making the total consideration over 7% of market capitalization.

“...there is no common standard on materiality.”

Acquisition cost without PPA as a percentage of market capitalization





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6. Type of intangible assets reported

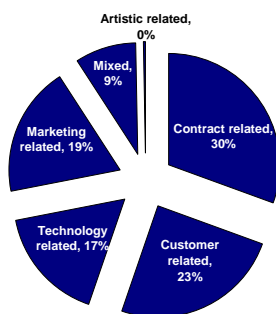
Under SFAS 141, intangible assets must be identified as belonging to one of six specific categories: contract, customer, marketing, technology, mixed and artistic related intangibles. US corporations have generally been better at reporting the descriptions of acquired intangible assets compared with the UK with only 9% of acquisition cost in the 'mixed' category compared with 13% for UK companies.

US companies also have to report separately the value of acquired intangibles in process research and development and distinguish between indefinite lived intangibles and those with definite lives (which are therefore subject to amortization). Again, these disclosure requirements are generally adhered to.

In the years 2002 to 2006, contract related intangibles was the largest category, comprising of \$89bn. \$72bn was allocated to customer related intangibles, and to marketing intangibles – which include brand names – just \$55bn, or 5% of the total spent on acquisitions during the period. Technology related intangibles had \$48bn allocated, mixed \$27bn and artistic only \$435m from just one year, 2003.

The following chart illustrates the proportion of intangible assets which were assigned to the different categories:

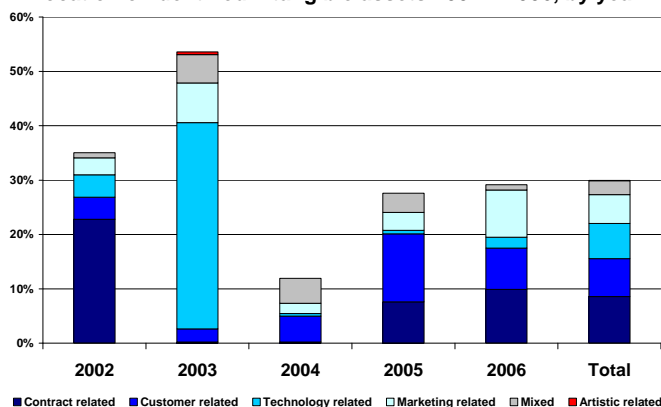
Allocation of identified intangible assets 2002 – 2006



“...only 5% of total spent on acquisitions was allocated to marketing related intangibles such as brands.”

This chart shows the proportion of intangible assets allocated to the different categories over the full during of the application of SFAS 141:

Allocation of identified intangible assets 2002 – 2006, by year



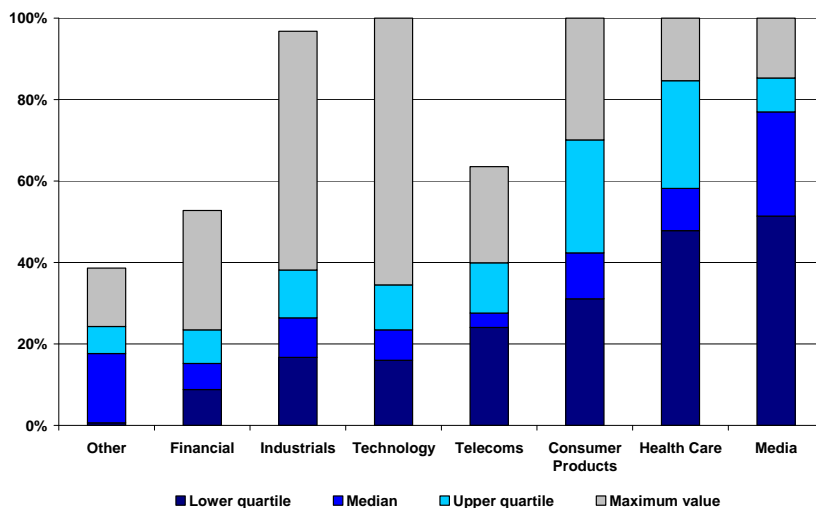


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5. Reporting by Sector

As can be seen from the chart below, the Telecoms, Technology, Industrials, Financial and Other sectors each have a median number of acquisitions with no more than 30% of identifiable intangibles, and as low as 15% in the case of the Financial sector. The inter-quartile ranges for Consumer Products (31% - 70%), Health Care (48% - 85%) and Media (51% - 85%) look much more as we would expect.

% Identifiable Intangibles by Sector



“...the media sector has the highest proportion of identified intangible assets.”

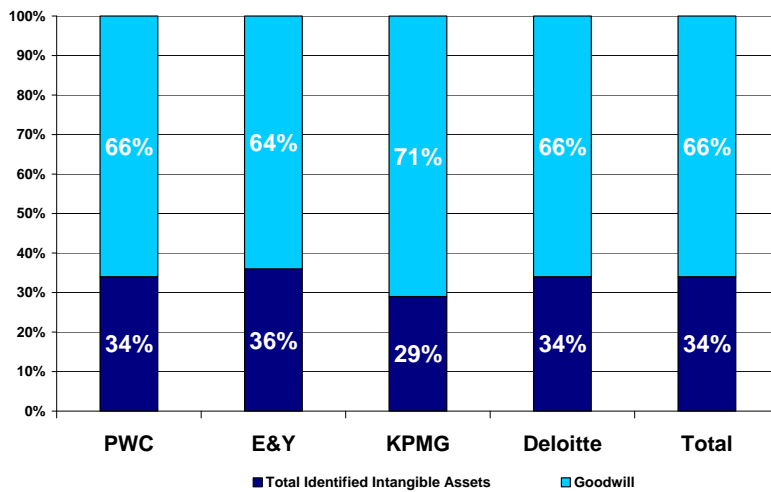


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6. Auditor Analysis

We also looked at the percentage of identifiable intangibles analyzed by the big four audit firms, Deloitte & Touche, Ernst & Young, KPMG and PWC, and found little variation between them. The acquisitions of all four had identifiable intangibles in the range 29% - 36% of total intangibles on a sum of percentages basis.

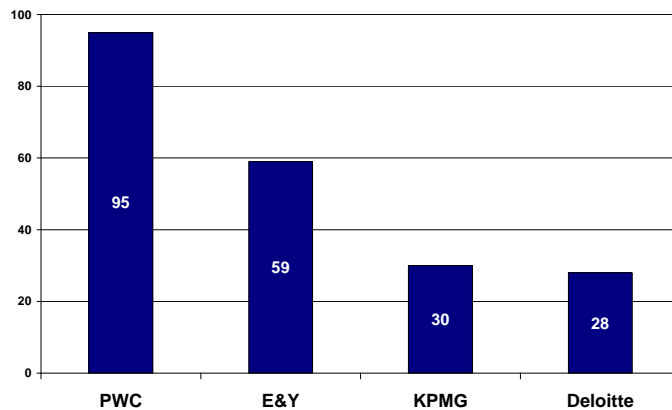
Allocation of intangible assets and goodwill by auditor



“...there is little difference between the PPAs done by auditors .”

PWC dominates the audit market in the S&P 100 with a 45% share of the number of audits carried out. Ernst & Young follows with 28%, followed by KPMG and Deloitte with 14% and 13% respectively.

Number of audits of the S&P 100 carried out between 2002 – 2006 by auditor



“...PWC has a 45% share of the number of audits carried out.”



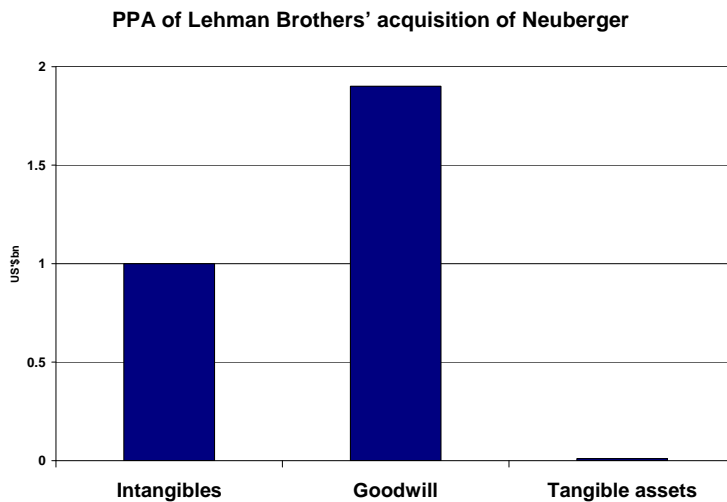
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7. Examples of Better Reporting

1. Lehman Brothers' acquisition of Neuberger Berman (\$2.9bn)

In 2003 Lehman Brothers acquired Neuberger Berman, a private wealth and asset management group for \$2.9 billion. Customer relationships were valued at \$0.8 billion and other intangibles at a further \$0.2 billion, with goodwill of \$1.9 billion. Goodwill still looks high at 66% of total intangibles but at least customer relationships are recognized as a substantial asset.



“...customer relationships were given rare value, accounting for 27% of the deal value.”



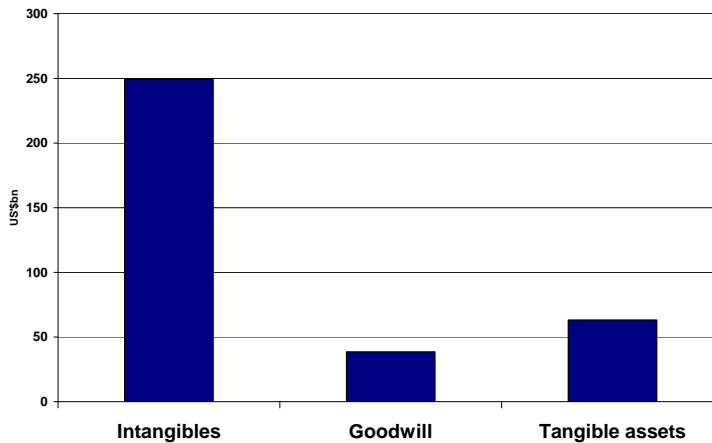
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2. PepsiCo's acquisition of Wotsits (\$351m)

Pepsi Cola acquired the UK snack brand, Wotsits and other smaller brands, in 2002 for \$0.4 billion, of which \$0.2 billion was allocated to the brand and less than \$0.1 billion to goodwill. Identified intangibles were 86% of total intangibles. The brand accounting for half the acquisition price seems a reasonable position and is significantly greater than the average of 28%.

PPA on PepsiCo's acquisition of Wotsits



“...71% of the acquisition value was attributed to identified intangible assets and only 11% to goodwill



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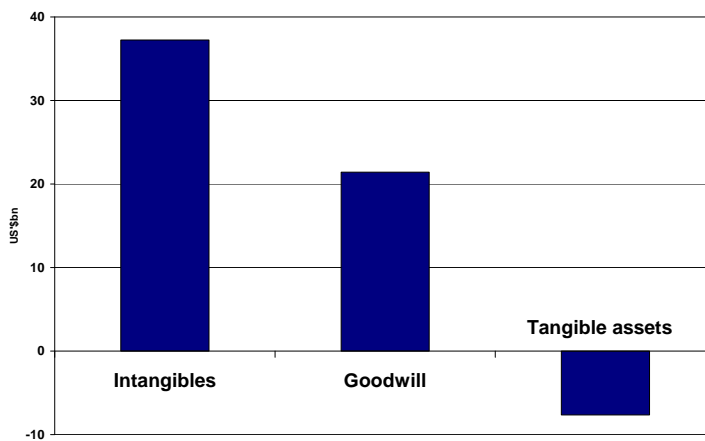
3. Pfizer's acquisition of Pharmacia (\$56bn)

Pfizer's acquisition of Pharmacia, at a cost of \$56 billion, dominated the M&A market in 2003. With marketing related intangibles valued at \$5 billion, technology related intangibles at \$31 billion and goodwill of \$21 billion, identified intangibles represented 63% of all intangibles – considerably over the average across all sectors.

Other smaller acquisitions by Pfizer in 2004 (100%), 2005 (100%) and 2006 (86% and 100%) also recognize significant, and in many cases, all the intangible assets. It is worth noting that Pfizer also made further acquisitions in both 2004 and 2005 with no identified intangible assets at all.

“... this acquisition accounted for 82% of all the reported intangible asset values in 2003.”

PPA on Pfizer's acquisition of Pharmacia





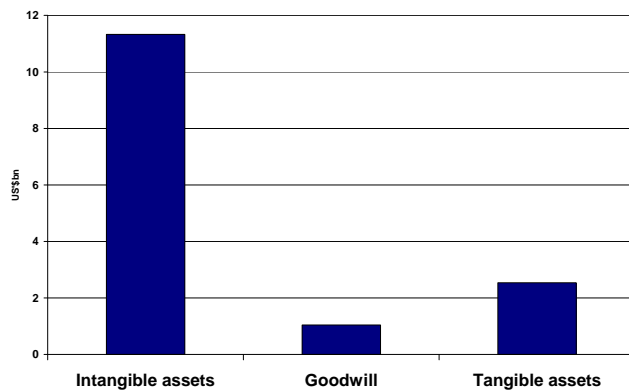
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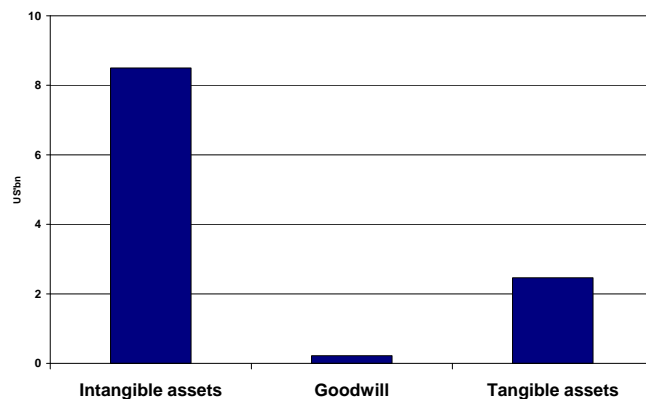
4. Time Warner and Comcast's acquisition of Adelphia (\$26bn)

In 2006, the assets of Adelphia Communications Corporation, a cable systems group, were acquired by Time Warner and Comcast, with respective acquisition costs of \$11 billion and \$15 billion respectively. Total intangible assets acquired were \$9 billion and \$12 billion and the acquirers were able to identify 97% and 92% respectively of the intangibles, split between contract and customer related intangibles. This is one of the best examples of fair reporting of intangible assets seen over the five years.

PPA on Time Warner's acquisition of Adelphia



PPA on Comcast's acquisition of Adelphia



“... 97% and 92% of the Adelphia's value was attributed to intangible assets by Time Warner and Comcast respectively”



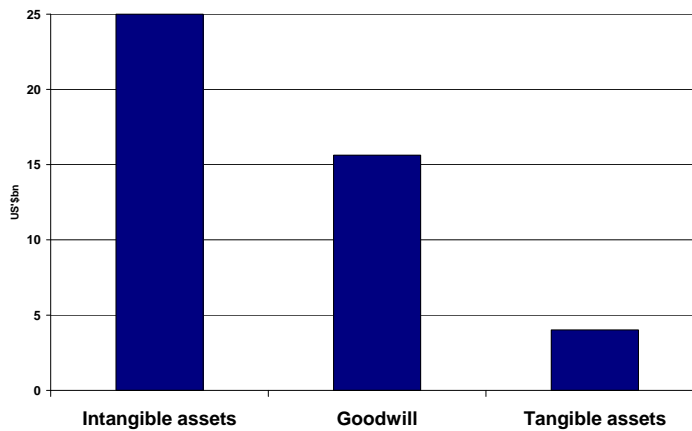
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5. Sprint's acquisition of Nextel (\$45bn)

Mobile phone operators Sprint and Nextel merged in 2005 to create Sprint Nextel. Under SFAS 141 rules, Sprint was deemed to be the acquirer and the purchase price for Nextel was \$45 billion, of which \$41 billion represented intangible assets. Of the \$41 billion, 62% was identifiable mainly as contract and customer related.

PPA on Sprint's acquisition of Nextel



“... intangible assets accounted for over half the acquisition value, 56%”



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8. Examples of Inadequate Reporting

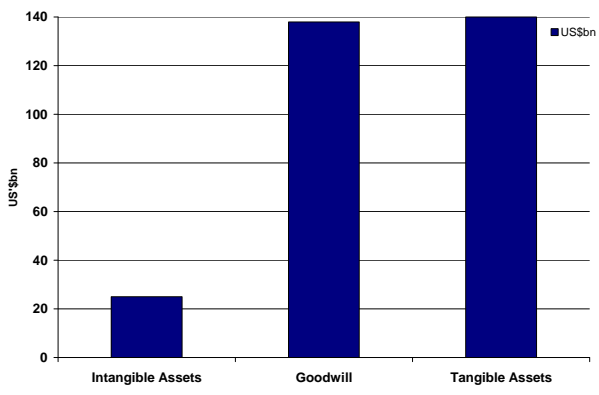
1. Banks and financial institutions

It is generally the case that acquisitions by banks and financial institutions are characterized by very low valuations of intangible assets and large proportions of goodwill. For the twenty acquisitions reported by banks and financial institutions within the S&P100 between 2002 and 2006, intangible assets represented only \$25 billion (8%) of the total purchase price of \$303 billion, while goodwill was \$138 billion (46%). Given that most of these acquisitions were of regional banks or specialist financial institutions such as the credit card issuer MBNA or Goldfish, we would expect a substantial proportion of the value of these acquired companies to be related to their customer base and brands.

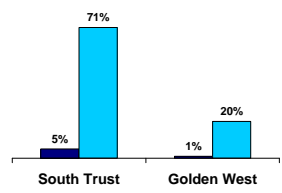
“...intangible assets only account for 8% of all acquisition value in the banking and financial sector...”

“...goodwill accounts for 46%.”

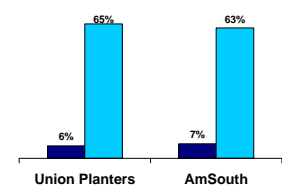
PPA on Banks and Financial Institution acquisitions 2002 - 2006



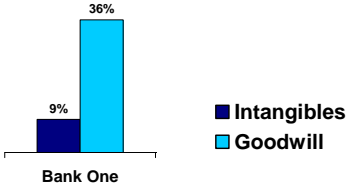
Two major acquisitions by Wachovia; that is South Trust acquired in 2004 for \$14 billion and Golden West in 2006 for \$75 billion, have only 5% and 1% respectively allocated to intangible assets while goodwill accounts for 71% and 20%.



Regions Financial has similarly low proportions of intangible assets for its acquisitions of Union Planters (6% of \$6 billion in 2004, goodwill of 65%) and AmSouth (7% of \$10 billion in 2006, goodwill of 63%).



JP Morgan Chase acquired Bank One in 2004 for \$95 billion, of which only 9% was allocated to intangible assets and 36% to goodwill.



“...hardly any value was attributed to these institutions’ customer relationships, contracts, employees, technology, intellectual property or brands”



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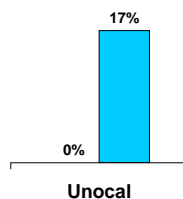


2. Oil Majors

Oil and gas exploration and productions companies are probably not highly dependent on intangible assets but it is difficult to believe that they have none at all.



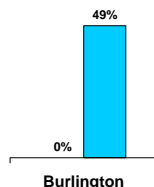
When Chevron acquired Unocal in 2005 for \$20billion, they determined that intangible assets had no value while goodwill of \$4.7 billion was recognized.



“...Unocal had no intangible assets at all.”



In 2006 Conoco Phillips acquired Burlington for \$35 billion, allocating just \$0.1 billion to intangible assets and \$17 billion to goodwill.



■ Intangibles
■ Goodwill



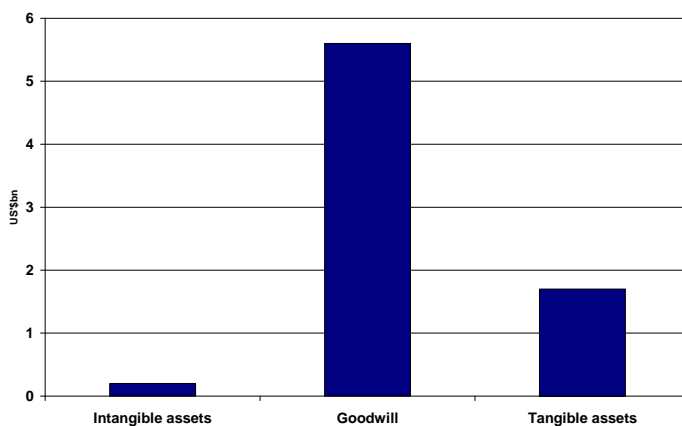
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WALT DISNEY P I X A R

3. Walt Disney acquisition of Pixar in 2006 (\$7.5bn)

Walt Disney paid \$7.5 billion for the digital animation studio, Pixar, which brought you Toy Story, Finding Nemo and other movie classics. The intangible assets, mainly trademarks and tradenames, were given a value of just \$0.2 billion while goodwill was \$5.6 billion. Of course, the skilled workforce of Pixar would be a key asset that Walt Disney wanted to acquire and both the US and IFRS standards on business combinations specifically exclude workforce from recognizable intangible assets. Nevertheless we do not believe that the value of other recognizable intangible assets is actually as low as that reported by Walt Disney.

PPA on Disney's acquisition of Pixar



“...only 3% of Pixar’s value was attributed to intangible assets...”

“...goodwill was given 75%.”



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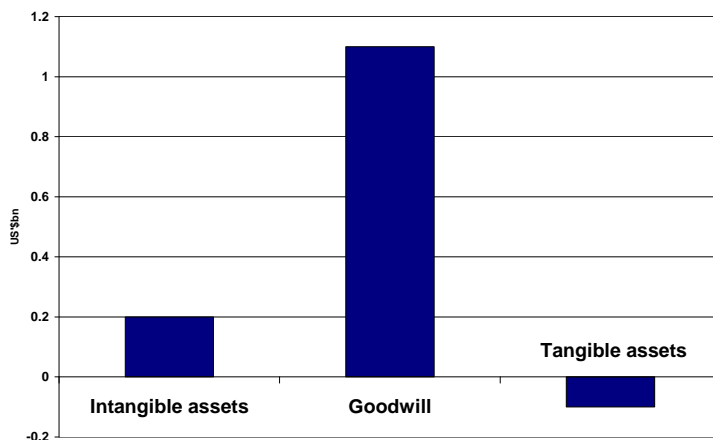


4. Google acquisition of YouTube (\$1.2bn)

Google acquired YouTube, the internet video sharing company, in 2006 for \$1.2 billion, of which \$0.2 billion was allocated to intangible assets and \$1.1 billion to goodwill (net tangible assets were negative). YouTube is the destination of choice for youngsters who want to share video content online. As such it depends largely on its brand name to attract subscribers. We are surprised that such a small proportion of the purchase price has been allocated to the brand.

A possible conclusion from this is that the value given to the intangibles is too low or too much was paid for YouTube.

PPA on Google's acquisition of YouTube



“...92% of what Google paid for YouTube is unaccounted for.”



SFAS 141: The First 5 Years. The S&P 100's Reporting of Acquired Intangible Assets 2001 - 2007

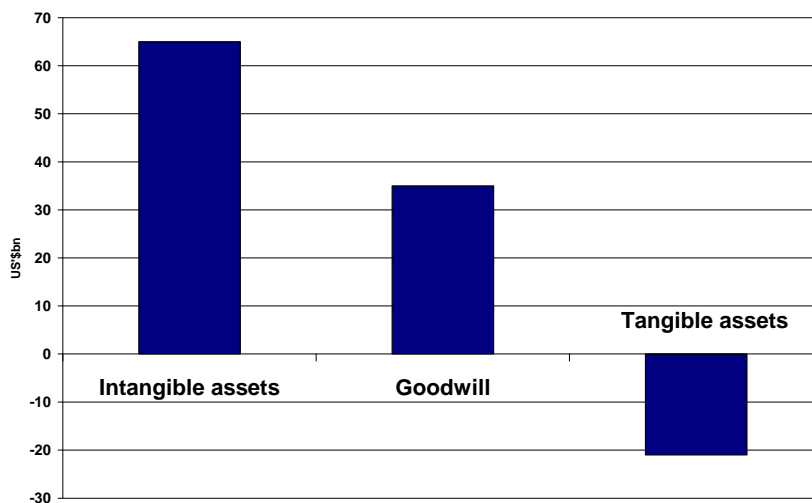


5. Proctor and Gamble acquisition of Gillette (\$53bn)

Gillette was acquired by Proctor and Gamble for \$53 billion, with total intangible assets of \$65 billion. While 46% of the intangibles were identifiable, mainly as marketing related (brands), this still left \$35 billion of goodwill.

It is not possible to say whether the purchase price allocation to identifiable intangibles is reasonable or not, but 46% appears low for the acquisition of such a strongly branded company as Gillette. The P&G annual report does refer to synergies in the areas of cost reduction and extended sales reach but these are not quantified. Under SFAS 141, P&G are under no obligation to analyze the components of goodwill, but such information would be very useful for investors.

PPA on Proctor and Gamble's acquisition of Gillette



“...\$35 billion has been left unidentified as goodwill.”



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9. Comparison with UK reporting under IFRS 3

We have only one year's data for the major UK companies reporting under IFRS, but the results, when compared with US reporting under SFAS 141 over five years, remarkably similar at around 38% of intangible assets reported as identifiable in both cases. One might be tempted to conclude that all is well and both standards are being applied correctly.

Our conclusion, however, is that UK companies have followed the US lead and have, generally, under-reported identifiable intangible asset value – or over paid for the acquisition. It is disappointing that barely one third of all intangibles are identified when both the US and IFRS standards on business combinations have been designed to encourage identification and disclosure.

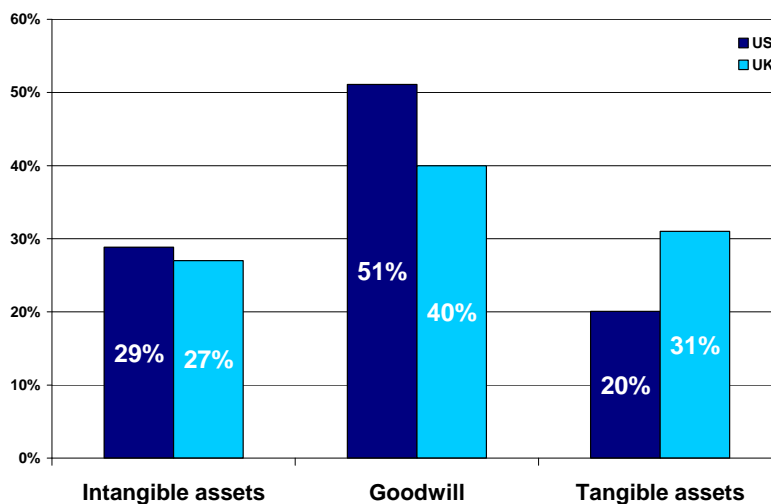
One of the substantive differences between the two standards lies in the requirement under IFRS 3 to disclose the nature of intangible assets included in goodwill and to explain why these assets cannot be separately identified and quantified. In practice, there is little difference in the level of information available to investors in the US and UK as UK companies, in their first year of reporting under IFRS 3 at least, have frequently ignored the standard's disclosure requirements on the nature of goodwill.

US corporations are better at disclosure of the nature of identifiable intangible assets under the categories of marketing, contract, customer related etc... The proportion of identifiable intangible assets which are not assigned to a category is only 9% compared to 13% for UK companies reporting under IFRS 3, on a sum of percentages basis.

“... there is little difference between the application of SFAS 141 and IFRS 3. “

SFAS 141 vs IFRS 3

PPA of acquisitions of S&P 100 under SFAS 141, 2002 – 2006 vs FTSE 100 under IFRS 3, 2006





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10. Conclusion

The values of identifiable intangibles appear to be lower than might be expected and, as a consequence, goodwill is higher. This may be because intangibles are not all being identified while some may be allocated low valuations. There is also likely to be an element of overpayment for acquisitions which has not been recognized or identified.

The lack of any requirement to disclose or quantify the constituent parts of goodwill is regrettable and should be addressed as part of the exercise of convergence with IFRS 3.

In other respects, the issues concerning quality of reporting by US corporations are very similar to those that we found for UK companies under IFRS 3.

The regulatory role of the Securities and Exchange Commission in the US appears to have had little impact on the quality of reporting of acquired intangible assets over the five years since the introduction of SFAS 141. In the UK, there is no comparable regulator and it is very unlikely that we will see any improvement from UK companies.

In summary, this research has highlighted a number of key issues which are reason for concern for corporate America.

1. \$1 trillion has been spent on acquisitions by the S&P 100 between 2002 - 2006
2. \$490bn has been unaccounted for in goodwill (48%)
3. \$290bn has been allocated to intangible assets (28%)
4. \$1bn is estimated to have been spent in compliance with SFAS 141
5. Benefits from implementation of SFAS 141 appear insignificant
6. There is little difference to the implementation of IFRS 3
7. There has been no improvement in quality of reporting over the five years

Intangible Business

Intangible Business is the world's largest independent brand valuation consultancy, specialising in valuing intangible assets, such as brands, for financial, management and litigation purposes.

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