

31 October 2007

Our ref: LAL/MP

Mrs M Tissier  
IVSC  
5 Kingsdale Road  
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Herts, HP4 3BS

Dear Marianne,

**Discussion Paper: Determination of Fair Value of Intangible Assets for OFRS Reporting Purposes**

The Royal Institution of Chartered Surveyors (RICS) has noted the publication of the Discussion Paper and welcomes the opportunity to comment.

We have a number of members who deal with the valuation of intangibles: some in association with real estate and other assets, and some as specialists in the field. Examples include trading properties (hotels, restaurants), milk quota, water rights fishing rights, and the goodwill elements of leasehold premiums. Our members get involved in corporate recovery valuations and value software, databases, patents, brands, internet domain names, libraries, and technical records. Specific examples include the ITV Digital customer database, and the brand value of Asprey and Garrards.

It is our opinion that when dealing with standards it is important to recognise that valuation is a single discipline which is applied across a number of asset types and standards should be drafted on that presumption. The division into various categories of valuer is inappropriate and can lead to a limitation of skills.

This means that one of our comments on the Discussion Paper is that it should not be limited to valuations for IFRS. Certainly we recognise that this may be the purpose for which many valuations may be required but the value of intangible assets may be required for other purposes. As we remarked in our response to the IVS review, the valuation standards should be written so that valuations are fully compliant with IFRS but not solely for that purpose.

We have made some detailed comments in response to your questions but there are two common themes which run through our responses:

- in our opinion that there should be a clear distinction between a standard, guidance on that standard, and discussion on valuation methodology; and
- the methodology should not be drafted in a form that structurally inflexible, as this will need to evolve as techniques and methods are invented and refined.

Our comments are attached.

If you would like to discuss any part of our response please contact the undersigned.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Luay Al-Khatib', with a large, sweeping flourish at the end.

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## Annexe

### RICS responses to the questions in the Discussion Paper

#### Section II: General approach of Discussion Paper

##### 2.1.1 Do you consider that there is a need for guidance in respect of the valuation of intangible assets for IFRS purposes?

We agree that there is a need for guidance on the valuation of intangible assets but such guidance should not be limited to IFRS purposes. The value of intangible assets is relevant in other circumstances, such as business sales, or takeovers/mergers for example and to limit the guidance to a specific topic is inappropriate. However, it is clear that the immediate demand for guidance is likely to be driven by the requirements of international accounting standards especially for business combinations. Therefore the guidance must be adequate to satisfy this need, as a minimum requirement.

##### 2.1.2 Do you consider that the guidance given in this Paper is at the right level of detail or should there be additional or less detail?

In our opinion there is a three-level hierarchy in providing standards, and guidance upon them. The first level is the standard itself – e.g. Market Value – which is a robust statement of valuation principles. The second level is what we in the RICS define as a Guidance Note. This is an explanation that can be understood by a non-specialist reader which outlines the approach that might be adopted in certain specific applications of a standard. It outlines the matters the valuer would be expected to investigate, and the information that will need to be applied, including the regulatory context. The third level is what we term an Information Paper. This generally is aimed at the technical reader and discusses valuation techniques in detail, including examples. Each level of the hierarchy is deliberately less prescriptive than the one above. The Standards are mandatory; the Guidance Notes are advisory but any deviation would prime facie require explanation; and the information Papers are informative only but are useful in promoting a common approach and best practice.

The Discussion Paper is a mixture of levels 2 and 3 in the hierarchy explained above. In our opinion, generally all the information is useful but there should be a clearer distinction between the two levels, to assist readers of different expertise and requirements. In effect, this would largely be achieved by separating Parts V and VI from the remainder. The present blurring of the distinction between these two levels means it is not clear as to whom the guidance is intended to be relevant. Is it intended to be aimed at the valuer or a much wider audience including the users of valuation reports?

##### 2.1.3 Do you consider that the Paper achieves the intentions set out in paragraph 1.4?

We think this question should relate to 1.3. Our response here is the same as for question 2.1.1.

##### 2.1.4 Do you agree that any future guidance issued by IVSC on this topic should be principles based, with detailed discussion of different methods and illustrative examples clearly distinguished in a Technical Paper?

Broadly, 'yes'. As we have indicated above the future material should be a combination of a revision of the existing paper as a Guidance Note coupled with technical guidance in a distinct format; either a separate publication or at least a separate and differentiated section of the final publication. This will be dependent to some extent on the future direction of the IVSC Standards.

#### 2.8 Questions regarding technical valuation issues

##### 2.8.1 Do you agree with the approach taken as regards each of the issues set out in paragraphs 2.6–2.8 above?

We find the parameters in SFAS 157 confusing in the context of intangible assets. It appears to us that SFAS 157 is intended to mainly to deal with financial instruments and it has little relevance to the valuation of intangible assets.

In our opinion the distinction made in the Discussion Paper between 'active' and 'inactive' markets (paragraphs 4.12 to 4.17) is not a useful valuation distinction. SFAS 157 defines markets by their transaction structure (paragraph 11 on page 4 of the IASB exposure draft), which is an alternative approach. A market is a meeting point of potential buyers and sellers for an asset class or commodity. The frequency of transactions and similarity in the assets traded both contribute towards the usefulness of information for valuers, but to attempt to define 'active' and 'inactive' will be subjective and virtually meaningless across asset categories. If end users want to know the reliability of a valuation, this will need a more graduated approach, but it must be recognised that reliability (by which some commentators seem to mean 'provability') does not directly translate into usefulness (or lack of it).

For instance, it is very unlikely that an intangible asset will ever have an active market, as defined, but there may be a market from time to time and the use of the two terms means that in almost all cases an intangible asset will be classified as Level 3 in SFAS 157 terms. In our opinion this will tend to give the impression that such a valuation has little validity.

We suggest that the division of intangible assets into various types is also inappropriate as is the attempt to identify different markets. This question links with the comments in paragraphs 4.55-58 and we would make some comments on the issues.

4.55.1. Where an intangible asset is identified it may have a market and the valuer will need to identify that and adopt the most likely best market that is available at the date of valuation. If the circumstances are such that the market is very limited then this should be dealt with in the explanation of how the valuation has been derived and not by categorising it as either 'principal' or 'most advantageous'. We therefore support the attitude in the Discussion Paper that this distinction in SFAS 157 is not helpful.

4.55.2. and 4.57 There is a confusion regarding the terms 'in use' and 'in exchange' and 'value in use' generally amongst both valuers and accountants. This paper illustrates the difficulty. For most intangibles, to be valued at the highest and best use also means valuing under the 'in use' premise as indicated in SFAS 157. This might not be true for other assets, which can introduce an element of inconsistency in the assumptions underlying valuations, especially in financial statements. What the valuer needs direction upon are the assumptions as to the degree of aggregation of the asset with other assets for the purposes of valuation for the purposes of the valuation. The valuation should depend upon the assumptions, rather than the assumptions be changed to whatever would show the 'highest and best use' for any particular asset.

4.55.3 and 4.58. We think there is a false distinction here, possible due to the framework of SFAS 157. If some information is available then its relevance has to be assessed by the valuer. The distinction promoted by the IASB seems to relate to 'objective' and 'entity specific' inputs, where the latter are not viewed favourably. We consider this distinction is not crucial, as entity specific information may be the only and most relevant and useful available to the valuer, especially in the field of intangibles.

4.55.4. We have dealt with this point previously. It would appear that intangible assets will usually be level 3 but we agree that repetitively stating this does not provide useful information for the users of valuations.

We suggest that for intangible assets a separate system of reliability be established but we are not in favour of the suggested benchmarking scheme in Section VI because that suggests a degree of precision that is not actually achievable in practice.

2.8.2 In particular, do you consider that 'inactive market' is a suitable term? If not, which other term would you use for an 'inactive market'?

We do not agree with this distinction. The valuation must reflect the market at the date of valuation and to classify that as one of these categories is not relevant. In any event the definition of 'active' would appear to be derived from SFAS 157 and as that will apply only to Level 1 valuations it can never be applied to the valuation of an intangible asset (see question 2.8.1). Therefore what distinction is being made if (nearly) all intangibles are traded in 'inactive' markets? If there is no pertinent distinction, then there is no point in using the term.

In our opinion the word 'inactive' suggests something worse than the 'imperfect' markets that there are for many intangible and tangible assets. 'Inactive' markets as defined seems to mean 'any other market than financial instruments' or even 'any market for which, due to the lack of daily public price paid information, the services of a valuer might be required'. However the term is defined, any market that is not 'active' may be perceived as not existing.

2.8.3 Do you agree with the guidance in respect of entity-specific factors in paragraphs 4.25 et seq.? Do you consider that any additional guidance is required in respect of entity-specific factors?

We agree with the comments and in particular the comment in 4.31. The discussion here also has a link with the comments on 'in use' and 'in exchange'. The valuer will have to establish which is most appropriate in the context of the valuation.

We consider that additional guidance to the valuation community as a whole is required for all asset types regarding entity specific factors and the potential pitfalls and necessary disclosures in the use of such inputs.

2.8.4 Do you agree with the approach taken in this Paper, paragraph 4.32 with regard to the aggregation of identical and similar assets that form a portfolio?

Yes. Such aggregation is part of the normal consideration of the best value of any type of assets and not just intangibles. It is not useful to split down every intangible asset, just as it is unhelpful to break down a production line into its components. A company that only trades on the internet such as e-bay could not separate its brand value from the website value.

## **2.17 Questions regarding intangible asset valuation methods**

2.17.1 Do you agree that these are the five most regularly used methods for valuing intangible assets?

Yes. However there is no mention of 'cost' even though such an approach may be rare.

2.17.2 Do you think that there are any other valuation methods that should be covered?

It is not for IVSC to limit the range of valuation methods available. This list should be prefaced with a comment that it is indicative and may change over time. The cost approach might also need to be considered for intangible asset such as software systems produced in house and where the allocation of management time and development resources, or the direct relevance of the historic expenditure, might not be clear cut between different assets.

New methods will be developed over time and there should be no standards that limit methodology as in the rest of IVS

2.17.3 Do you think that the description of each method is sufficient or do you think that further details are required for any of the methods?

We refer to our response above – provided flexibility is built in to any guidance we would agree with the descriptions.

It is our view that the detailed advice on any valuation method should be the subject of a technical paper and not part of a 'Guidance Note'.

2.17.4 Some simple examples regarding the intangible asset valuation methods are included. Do you consider that these examples are sufficient or do you think that more detailed examples should be included?

Examples are always useful and provided they are in a distinct technical paper, should be developed to meet the needs of valuers as they arise. We have no comment on the detail of the examples.

2.17.5 Do you agree with the approach taken in this Paper with regard to the tax amortisation benefit, as set out in paragraphs 5.25-5.28?

To the extent that tax issues may affect the value of intangible assets, this needs to be drawn to the reader's attention as a relevant consideration in a 'Guidance Note' (using our term), and the detail of how such a calculation might be made might be included in an 'Information Paper'. However, tax implications usually would only be relevant when there is a recognisable class of potential purchasers who can all benefit from the tax treatment suggested. When competing in the market, the price paid would then reflect this tax situation.

When there is no reference market from which market values can be derived, and the valuer has to apply a derivation of the 'income' or 'cost' approach, then the valuer should have to justify using the tax amortisation benefit and identify the class of purchasers who could apply it.

In contrast, a tax advantage that relates solely to the circumstances of the asset owning entity should be distinguished and, *prime facie*, should not be included in a valuation.

2.17.6 Section V includes an assessment of the possible ways in which reliability might be restricted for each of the valuation methods. Do you agree with this assessment? Do you think that any other factors should be included in this assessment?

In our opinion the reliability of a valuation depends on many factors, not least the expertise of the valuer, and to include a reliability factor can be misleading. For instance if a reliability is assessed as 50 in relation to 100 does this mean that the valuation is of little use? Certainly in the UK users of valuations have expressed the view that because they apply other risk techniques as part of the overall consideration of the purpose for which the valuation is required they do not need the valuer to comment on reliability as such. The reliability of a valuation should be judged from the amount of information given by the valuer in the report on the approach to the valuation and not an arbitrary 'mark'.

There is also the difficult question that, if any form of reliability mark is to be used, this needs to be comparable between asset classes in financial statements (for example) as a whole. Intangibles are likely always to have a 'low' reliability rating but that does not relate to the usefulness of the information to the end user. Therefore the RICS is not in favour of reliability ratings *per se*, but agree that some information as to the quality of the market evidence or other inputs to the valuation could provide useful information to the user of valuations, but only at a high level.

## **2.19 Questions regarding valuation inputs**

2.19.1 Do you agree that each of these eight key valuation inputs should be addressed?

Subject to our view that this amount of detail is methodology and should not be part of a 'Guidance Note' but contained within a technical 'Information Paper', we agree.

Consideration of contributory asset charges is only helpful if ALL asset classes have also been revalued.

Considering other valuation situations such as corporate recovery/insolvency, many of the inputs are unavailable or unusable in a particular situation, but valuers use those inputs that are available or comparable.

#### 2.19.2 Do you think that any additional valuation inputs should be addressed?

Subject to the previous comment, yes. The list of relevant inputs might change over time and technical innovation in valuations should not be prevented by a prescriptive approach to valuation inputs.

#### 2.19.3 Do you think that sufficient guidance is provided in respect of each of the eight valuation inputs?

Subject to the previous comment, yes. Guidance should, of course, be kept under review.

#### 2.19.4 Do you think that there are any additional benchmarking processes that should be included?

This section contains considerable detail on valuation methodology which should be part of an 'Information Paper'. The process identified is indicative of the way in which any valuation is prepared, that is weighing the asset against the known evidence. We would not identify this as 'benchmarking' but recognise the principles set out.

### 2.21 Questions regarding selection of valuation methods

#### 2.21.1 Do you agree with the approach regarding selection of appropriate methods that follows an assessment of the relative reliability of data available in respect of eight key valuation inputs, as set out in paragraph 7.34 of this Paper?

Provided it is recognised that the list is not prescriptive, we agree.

#### 2.21.2 Do you consider that this approach is more suitable to the valuation of intangible assets than that set out in SFAS 157 with regard to the level of reliability of valuation inputs used?

Yes.

#### 2.21.3 Do you agree that valuers should always seek to support the results from application of a primary valuation method with those obtainable from a secondary valuation method?

Clearly it is sensible that valuations are checked by comparison with secondary methods but we do not agree that the valuer 'should always' do this as in some cases there may not be an acceptable second method.

#### 2.21.4 Do you agree with the proposal in paragraph 7.35 that whenever a valuation method is available without undue cost and effort that such method should be applied as either a primary or supporting valuation method?

In our opinion this paragraph appears to indicate that where a valuation has to be prepared at a low cost then the amount of input required can be reduced. We fundamentally disagree with this premise.

A valuation that meets valuation standards must be carried out to comply with those standards and the element of cost and effort is determined by the amount of work required (and the precise terms of engagement) and to indicate otherwise could impact on the standing of the valuation profession.

## **2.23 Questions regarding valuation process**

2.23.1 In the light of guidance earlier in the Paper, do you think that additional guidance is required in Section VIII?

The guidance appears to be applicable to all asset classes and as it essentially appears in other sections of IVS it is not clear how it specifically varies in the valuation of intangible assets. As such this section might be brought forward in the Discussion Paper, to act as a structure for the matters discussed elsewhere.