

AUSTRALIAN PROPERTY INSTITUTE INC.

IVSC DISCUSSION PAPER

**Determination of Fair Value of Intangible Assets
for
IFRS Reporting Purposes**

**SUBMISSION TO THE
INTERNATIONAL VALUATION STANDARDS COMMITTEE**

OCTOBER 2007

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BACKGROUND

This submission responds to the Discussion Paper released by the International Valuation Standards Committee titled *Determination of Fair Value of Intangible Assets for International Financial Reporting Purposes*.

This submission by the Australian Property Institute (API) is in response to an invitation contained within the report of the Team to seek views from interested parties, regarding standardisation of the approach to take in the determination of the fair value of intangible assets for the purpose of reporting under International Financial Reporting Standards, 'IFRS'.

Thank you for the opportunity for the Australian Property Institute ("API") to provide comments on this Discussion Paper ("DP"). Clearly a great deal of effort has been made to generate this DP and the Institute's comments are therefore intended constructively and with a view to capturing and building on the work done so far.

Preamble

The DP requests that respondents address a number of specific questions. The Institute notes however that it was difficult to provide definitive answers absent a better understanding of the key over-arching principles and objectives. The key issue the Institute identified, which has a significant impact on a number of our potential responses, was to better understand what the ultimate objective the IVSC has in mind. Is it the intention of the IVSC for instance to incorporate this material into one or more of the following?

- Valuation Standard
- Valuation Application
- Guidance Note
- Technical Paper

The structure and content of each of these is somewhat different and therefore our views would likely differ in each case.

The Institute also noted that, as a general principle, it would be preferable to cover any matters that were not specific to the valuation of intangible assets in other relevant parts of the IVS. The following existing documents are relevant to a number of the matters covered in the DP:

- IVS 3 Valuation Reporting
- IVA 1 Valuation for Financial Reporting
- GN 4 Valuation of Intangible Assets
- GN 8 The Cost Approach for Financial Reporting – (DRC)
- GN 12 Valuation of Trade Related Property

Many of the issues raised specific to financial reporting, are not limited to the valuation of intangible assets. They are relevant to the valuation of all asset classes. Likewise many (but not necessarily all) of the valuation methodology issues are relevant to more than just valuations for IFRS reporting or valuations of intangible assets.

Our comments therefore, reflect our overall view that, as a general principle, we believe it would be preferable, and indeed essential to maintaining the integrity of the existing IVS, to ensure that the material contained in this DP be incorporated within the relevant existing sections of the IVS and not incorporated as a stand-alone document.

We also noted that the DP is generally focussed on the types of intangible assets commonly valued by professionals with accounting or financial valuation skills. There are also other intangible assets commonly valued by API members such as:

- Easement rights

- Water rights
- Air rights
- Building naming rights
- Logging rights
- Software
- Operating manuals
- Lease interests
- Brand names associated with real property (e.g. hotel chains, amusement parks, etc)

It is not intended that this be an exhaustive list but merely to serve as an indication that there are some types of intangible assets perhaps not contemplated in the DP. Given that this is a response of the API, whose members are principally engaged in the valuation of property, plant & equipment, many of our responses reflect this focus.

The API is happy to discuss any of the matters raised in its submission or to provide any additional information required. Arrangements can be made by contacting Mr. Grant Warner, API National Director on gwarner@api.org.au.

COMMENTS AND FEEDBACK

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

Broadly yes, but qualified to the extent of our general comments above in terms of structure and placement in the existing IVS framework. To the extent that there are matters specific to valuations for financial reporting, they should be incorporated into IVA 1, and to the extent that there are matters specific to the valuation of intangible assets, they should be incorporated into GN 4.

Q 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?

The material in the DP is, in different parts, reflective of the level of detail required for inclusion as a Valuation Application, a Guidance Note and a Technical Paper and therefore absent a detailed understanding of the IVSC's objectives in respect of this document it is difficult for us to make a definitive response.

In terms of overall structure rather than content, please refer to our response to Q 2.1.1 above. However any material incorporated into these existing documents should be principles based rather than a detailed text-book guide.

If there is significant detailed material that cannot be incorporated into either of these two documents, and a need for such detail can be clearly demonstrated, then a Technical Paper might be an appropriate vehicle. In part, the guidance provided in the DP goes beyond the level of detail typically required in an IVA or a GN.

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

Broadly, yes.

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

Yes, but as discussed earlier, incorporated within the existing structure and framework of the IVS.

Q 2.8.1 Do you agree with the approach taken as regards each of the issues set out in paragraph 2.6-2.8 above?

IFRS requires that Fair Values be determined having regard to the highest and best of the asset and therefore by inference requiring an understanding of the difference between the 'principal' and 'most advantageous' market. Therefore it is not reasonable to ignore these questions. These issues are not unique to the valuation of intangible assets so any such discussion should be incorporated in the existing IVS framework such that it reflects this situation.

Q 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'?

The Institute considers that this concept is somewhat subjective and have some doubts regarding its inclusion. In any event this is not a matter specific to the Fair Value of intangible assets and therefore it is inappropriate to include such discussion in a document specific to the valuation of intangible assets.

Q 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?

This is not a matter specific to the Fair Value of intangible assets and therefore it is inappropriate to include such discussion in a document specific to the valuation of intangible assets.

Q 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. This appears to be a pragmatic and reasonable approach and consistent with that adopted by valuers of tangible assets.

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

In respect of the intangible assets typically valued by API members, the valuation methods most commonly applied fall within the three commonly recognised broad valuation approaches as follows:

- the market approach (e.g. easement and water rights);
- the income approach (e.g. logging rights); and
- the cost approach (e.g. software).

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

No. The Institute is comfortable that the valuation methods identified fall within one of the three broad approaches listed, however it is noted that it would be preferable to adopt the terminology used throughout the IVS viz: market approach, income approach and cost approach.

Q 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?

In the context of a GN, there is probably too much description. Much of the detail within the DP better fits within a Technical Paper.

The detailed discussion in respect of the market transactions method assumes that the only comparables required for the valuation of intangible assets are earnings multiples. There are other types of intangible assets where the unit of measure may be quite different (e.g. water rights measured in \$/ML).

The term ‘market transactions method’ is not one in common use in Australia. Generally, valuers refer to the market comparison approach or in the case of the method described in the DP the ‘earnings multiple method’.

In respect of the description of the cost approach, there is no consideration given to the Depreciated Replacement Cost (DRC) method. This method is typically used for certain types of software¹. Any discussion regarding the cost approach should be incorporated within the existing GN 8.

Q 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?

Assuming that a Technical Paper is one of the required outcomes then examples would typically fit within that level of document. Further examples would be appropriate in that context.

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

Generally in respect of the types of intangible assets valued by API members, the Institute does not consider that this approach is appropriate. Outside of that area, the Institute has no basis for comment.

Q 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 other factors should be included in this assessment?

The Institute agrees broadly with the correctness of the assessment as presented. However in the context of guidance for experienced valuers, the Institute feels that this is somewhat superfluous and certainly not a matter restricted either to valuations for financial reporting purposes or to the valuation of intangible assets.

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

Yes. However, the Institute considers that discussion of these inputs would be better incorporated within the discussion of each relevant valuation method and not addressed as a separate section.

¹ Software can be broadly separated into two types: i) software core to the generation of income by way of a license to third parties, and ii) software incidental to the generation of income (e.g. a financial system operated by a corporate). The former is typically valued using an income approach and the latter using a cost (DRC) approach.

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

Yes. The following key valuation inputs required as part of the DRC method should also be included:

- replacement Vs reproduction cost (optimisation);
- total and remaining economic life;
- depreciation method;
- obsolescence; and
- residual value.

However, these are matters already addressed in GN 8.

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

Yes. In the context of providing guidance to experienced practitioners, this is sufficient.

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

In respect of benchmarking, the Institute considers that valuers exercise judgement regarding the quality and reliability of information as a matter of course and so perhaps somewhat superfluous. It is also noted that these are not matters specific to the valuation of intangible assets.

Q2.21.1 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?

The Institute agrees in principal that a valuer must consider each of the three broad approaches to value and then apply one or more of those approaches having regard to the availability and reliability of information. Again this is not a matter specific to the valuation of intangible assets.

Q 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?

No basis for comment.

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

Generally, yes. It is conceivable that exceptions to this situation could exist so it would be better to be less proscriptive in this regard.

Q 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?

Generally, yes. It is conceivable that exceptions to this situation could exist so it would be better to be less proscriptive in this regard.

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

No. The Institute considers that this section is not required as the matters covered are captured within the existing IVS and are not matters specific to the valuation of intangible assets.

Conclusion

As noted above, the Institute believes a clearer articulation of the way in which the matters covered in the DP are intended to be incorporated into the existing IVS framework, will be extremely helpful in any future discussions.

The Institute considers that matters relating to the general debate around Fair Value reporting under IFRS are not matters appropriately captured in a paper limited to the valuation of intangible assets as they impact on the valuation of all assets, whether tangible or intangible.

The Institute agrees that Valuation Standards should be principles based and endorse the approach described at 2.1 of the DP. The Institute considers that the subject matter should be addressed within the existing IVS framework with careful consideration of what matters belong where (e.g. Valuation Application, Valuation Standard, Guidance Note or Technical Paper).