



7 November 2007

International Valuation Standards Committee  
12 Great George Street  
Parliament Square  
London SW1P 3AD  
UNITED KINGDOM

Dear Committee Members,

**IVSC Discussion Paper - Determination of Fair Value of Intangible Assets for IFRS Reporting Purposes**

Thank you for the opportunity for the Institute of Chartered Accountants in Australia ("ICAA") to provide comments on the IVSC discussion paper – Determination of Fair Value of Intangible Assets for IFRS Reporting Purposes ("Paper"). These views are set out in the attached document and were prepared by the Institute's Business Valuation Special Interest Group ("BVSIG"), a special interest group whose members are most affected by the proposed Exposure Draft.

The Institute is Australia's premier accounting body, which represents over 45,000 members who are fully qualified Chartered Accountants working either in the accounting profession providing auditing, accountancy, taxation and business consultancy services or in diverse roles in business, commerce or government.

The Institute is a founding member of the international accounting coalition called the Global Accounting Alliance (GAA), which provides reciprocal arrangements with eight of the other leading accounting bodies in the world. The Institute is the only Australian accounting body within the alliance. The GAA represents more than 700,000 members world-wide and includes professional accounting organisations from America, Canada, Hong Kong, England/Wales, Ireland, Scotland, New Zealand and South Africa.

In July 2005 the Institute established the Business Valuation Special Interest Group (BVSIG) for the benefit of the Institute, members and stakeholders, including regulators and the community. The BVSIG currently has over 900 members working in the field of business valuation. The key aim of this group is to provide standards in the area of business valuations. The BVSIG is currently finalising a Statement of Business Valuation Standards through the Accounting Professional and Ethical Standards Board ("APESB"), Australia. The BVSIG is represented in most states and nationally.

Should you have any questions in relation to the matters discussed in the attached document, please contact John Gibson, Chair, BVSIG on +61 2 9248 4616.

Yours sincerely,

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## Preamble

We are supportive of the general approach relating to the content of Standards and guidance as compared to the concept of “Technical Papers”. In particular, we support standards and guidance being confined to high level principles. If it is felt that details of methodologies and worked examples are required then we consider this is best dealt with in textbooks or Technical Papers.

We note that the following documents in the International Valuation Standards (“IVS”) are also relevant to the matters covered in the Paper:

- IVS 3 Valuation Reporting
- IVA 1 Valuation for Financial Reporting
- GN 4 Valuation of Intangible Assets

Many of the issues raised in the Paper are specific to financial reporting generally, (e.g. reliability of Prospective Information) and 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 the material contained in this Paper should ultimately be incorporated within the relevant existing sections of the IVS and not incorporated as a separate stand-alone document.

It may be useful to provide an integrated worked example as a Technical Paper to highlight the interrelationships and interdependencies between various types of identifiable intangible assets. However in publishing any standards or guidance, there is a fine balance between being *descriptive* and not *prescriptive*. Such literature cannot encompass all possible circumstances and would not be exhaustive. Any worked examples should assist the valuer in exercising their judgement, but not constrain them by either setting limits on the minimum or maximum extent of their work. Our responses to each of the specific questions posed in the Paper are detailed below.

### **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?**

We believe that further guidance is required. To the extent that there are general matters specific to valuations for overall 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?**

Additional detail could be useful, however the issues noted above regarding being *descriptive* vs. *prescriptive* should be observed. An illustrative worked example (with a primary methodology, and secondary cross-checks) may be useful to demonstrate the intricacies involved in valuing multiple intangible assets owned by a business.

In relation to the guidance provided in the Paper, the majority of the material included in the Paper would be appropriate for guidance and the details would be dealt with more appropriately as a Technical Paper or papers.

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

Subject to the comments on paragraph 2.1.2 above, 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. It is important for any illustrative examples to provide the valuer with sufficient latitude to utilise their professional judgement in adopting a different approach, or applying a different methodology.

**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?**

The issues raised in paragraphs 4.56 to 4.59 of the Paper are often difficult to apply in practice. However IFRS requires that Fair Values be determined having regard to the highest and best use 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. These issues are more appropriately dealt with by submission by the ISV to the IASB, in respect of its Fair Value Measurement project.

**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'?**

As noted in the Paper, there are few intangible assets where an active market exists (e.g. taxi plates). Therefore in practice most intangibles would not exist in an active market.

We do not consider "inactive market" as a suitable term, as this term is just a negative definition of "active market". As "active market" is clearly defined in existing accounting standards, any additional definition is likely to cause confusion.

**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?**

The guidance provided by 4.25 et al summarises to a large extent existing guidance about entity-specific factors in different IFRS pronouncements. The guidance in IVS 1 provides no new insights compared to existing pronouncements.

In an acquisition, the price paid is usually that of the highest bidder. This forms the basis of fair market value, even though the value to the purchaser may be higher than this (e.g. due to additional synergies available to the bidder, ability to leverage additional markets). In valuing intangible assets, additional guidance would be helpful, e.g. providing a definition of market-participant synergies vs. entity-specific synergies, role of buyer intent (e.g. to discard acquired brand and replace with bidder's brand).

**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?**

We agree that it may only be possible to consider the value of some intangible assets in aggregate. Where measures impacting projected cash flows (e.g. customer churn or attrition rates applied in valuing customers related intangibles) are based on historical averages, it would be difficult to consider the value of each customer relationship in isolation.

In addition, the value of intangible assets may need to be allocated to individual cash generating units, which presupposes an ability to dissect a portfolio of assets into some level of detail.

We note that the majority of the discussion relates to valuations for financial reporting purposes and deals with both tangible and intangible assets. Sub Sections 4.40 to 4.42 which deal with intangible assets would be applicable for intangible valuations prepared for other purposes as well.

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

We do not agree that the three methods (five sub-methods) named are the most regularly used methods for determining the value of intangible assets. In the vast majority of cases, intangible assets are valued using the income approach which comprises of the relief-from-royalty-method, the incremental cash-flow method and the multi-period excess earnings method. In very limited cases we see the application of the cost approach (e.g. software) and the market approach (e.g. taxi licenses).

We agree to the structure of valuation approaches as provided by SFAS 157. i.e. market approach, income approach and cost approach. Additionally we do not see a need to change the wording of the generally accepted terms.

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

No. We are comfortable that the valuation methods identified fall within one of the three broad approaches listed, however we note 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?**

Please refer to our comments on questions 2.1.2 and 2.1.4 above. In the context of a GN, there is probably too much description. Much of the detail within the Paper better fits within a Technical Paper and does not correspond to the relevance of the methods in practice.

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 commonly used in Australia. Generally, valuers refer to the market comparison approach or in the case of the method described in the Paper 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 software<sup>1</sup>. 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?**

Please refer to our comments above regarding the benefits and pitfalls of illustrative worked examples. Examples are often helpful to illustrate the intention as provided with a guidance note. However, the examples provided in the Paper tend to largely oversimplify the complexity of the underlying valuation procedures. 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. In particular an integrated worked example which involves a number of methodologies used (e.g. showing the link between a cost based

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<sup>1</sup> 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.

methodology and the multi-period excess earnings methodology via a contributory asset charge) could be useful.

**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?**

Our understanding is that the TAB only applies to assets for which a tax deduction can be obtained. This usually requires the provision of separate taxation advice, which may be outside the valuer's expertise.

We agree that the description of the tax amortisation benefit is helpful to understand its nature. However, we believe that for non-advanced readers, the structuring of the numeric example would be rather confusing and does not reflect the procedure as performed in current valuation practice.

Guidance on the tax amortisation benefit would be better understood if it was dealt with in the context of additional guidance on the treatment of income taxes when using the income capitalisation approach. This is particularly important in the context of the valuation of assets (both intangible and tangible) under IAS 36. The discussion at BCZ81 to BCZ89 to IAS 36 could be expanded and published as guidance.

Further discussion of the reasons for including or omitting a TAB using the cost approach (as noted in paragraph 5.68 of the Paper) would also be helpful.

**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?**

We agree to the statement that each valuation method selected must be based on reliable and reasonable assumptions. We agree on the assessment regarding each approach as mentioned in paragraphs 5.21, 5.54 and 5.65. However the assessment should include other factors, which are not to be found in the Paper (e.g. economic useful life).

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

Yes, we agree that each of the eight key assumptions set out in paragraph 6.1.1 – 6.1.8 should be considered in undertaking a valuation of identifiable intangible assets. However, we consider that discussion of these inputs would be better incorporated within the discussion of each relevant valuation method and not addressed as a separate section. The selection of a particular valuation methodology as a primary valuation methodology often depends on a number of factors, including the availability of information. Hence there is an element of circularity involved in assessing valuation inputs and selecting and applying valuation methodologies.

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

Yes – in relation to valuing customer intangibles and using the DRC / DORC methodologies.

In relation to valuing customer related assets, the measurements of customer attrition / churn is often required, as is the number of periods the multi-period excess earnings projections should include.

The following key valuation inputs are required as part of the DRC method and hence should also be included:

- replacement Vs reproduction cost (optimisation);
- total and remaining economic life;
- depreciation method (e.g. straight line vs. units of production);
- obsolescence (e.g. technical, market); 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?**

The discussion presented highlights some key issues to be considered during the valuation procedure. It is important to understand that the catalogue of valuation inputs to be considered is dependant on the valuation method selected (and as noted above, the methodology selected is sometimes a function of information used to determine these inputs). Further it should be noted that the discussion as presented could easily be misinterpreted as being exhaustive. This results from discussing the valuation inputs detached from the description of the valuation methods. The guidance might be misunderstood as a kind of check list to be worked through in every valuation. We recommend to that any discussion of valuation inputs be linked with the respective valuation approach.

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

In respect of benchmarking, we consider that valuers exercise judgement regarding the quality and reliability of information as a matter of course and so perhaps the guidance is somewhat superfluous. We also note that these are not matters specific to the valuation of intangible assets.

**Q 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?**

We agree 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.

The availability of data relates to both the subject intangible asset being valued, and market data.

**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?**

This approach is not better suited to the valuation of intangible assets than the three level input hierarchy as set out in SFAS 157. The hierarchy set out in SFAS 157 is reasonably well understood and used in practice. As noted above the ultimate selection of a primary and secondary valuation methodology requires both consideration of the preferred intangible assets valuation methods and the availability / reliability of information.

**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?**

If a secondary method is reliable, we believe that it should be considered as a cross check. However, a reliable secondary method will not always be available (see comments on question 2.21.1 above).

**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 prescriptive 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. We consider 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.

## Other comments

We make the following additional general comments, which did not fit under the above headings:

- it may be helpful to further define the nature of customers relation intangible assets (as mentioned in paragraph 3.6.2) as different meanings for each of these definitions are used in practice
- the use of a “hierarchy” to specify the preferred order in which valuation methodologies should be selected could be more clearly articulated
- many transactions involve an element of special value. The treatment of special value (e.g. allocated to corporate goodwill) could be further discussed (e.g. as discussed in paragraph 4.24)
- it would be helpful to clarify the meaning of “reliable measurement” (e.g. footnote to paragraph 4.45)
- the TAB can be calculated using an iterative formula (paragraph 5.27)
- it may be helpful to provide guidance around the calculation of a work force in place (WFIP) (paragraph 5.46)
- there are a number of ways of calculating contributory asset charges e.g. as a percentage of sales vs. discrete calculation. The advantages and disadvantages of various methods could be discussed in a technical guide
- in applying the multi-period excess earnings methodology (paragraph 5.50), the choice of EBITDA vs. EBIT as a starting point could be discussed in light of the comments at paragraph 6.59
- there is no commentary on how the capitalisation multiple of 6.0 times is arrived at in the example in paragraph 5.51. The multi-period excess earnings methodology is often applied using a 10 or 20 year DCF approach, together with a customer churn / attrition analysis. There does not appear to be any discussion around customer churn / attrition in the Paper
- the source of premium profits (paragraph 6.44) could result from being able to charge higher prices, reduce costs, or simply from higher volumes resulting in scale benefits
- the value of a non-compete agreement (paragraph 6.50) might need to be considered in light of the probability of the exiting vendors using the proceeds from the sale of their business to start a new competing business
- in paragraph 6.69, in conducting a WARA, the return on goodwill should be the highest of all
- the application of the replacement cost approach (paragraph 6.90) should include an allowance for design and scoping the asset. The treatment of efficiency gains through improvements in technology, and advancements in general knowledge should also be considered

## Conclusion

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

We consider 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.

We agree that Valuation Standards and Guidance should be principles based and endorse the approach described at 2.1 of the Paper. We consider 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).

As previously stated, we would be pleased to discuss any of our responses in more detail.