Mr. Bruce Bingham
International Valuation Standards Committee

Re: Discussion Paper "Determination of Fair Value of Intangible Assets for IFRS Reporting Purposes"

Dear Bruce:

Let me first express my appreciation to the IVSC for taking on this challenging assignment. While there is a large body of tax case law and tax literature relating to the valuation of intangible assets, the accounting literature is very thin in this area. And since the FASB and IASB have turned toward principles-based statements, and away from rules-based statements, guidance such as this discussion paper will be very beneficial to the advisor and preparer community.

I was also happy to see that the discussion paper begins with a thorough discussion of the International Financial Reporting Standards which address the initial recognition of intangible assets arising from a business combination, and their subsequent measurement for impairment testing purposes. This serves to orient the reader to the principles established by the accounting standard setters for the measurement of the fair value of the assets.

There are aspects of the discussion paper, however, which my collegues at American Appraisal Associates and I feel require further thought and clarification. I will try to address them in the same order in which they appear in the paper.

Paragraph 2.2 We agree that there are elements of SFAS 157, such as the discussion of the Principal (or Most Advantageous) Market, or blockage, that are relevant to financial assets and not intangible assets. However, it is clear that the FASB intended SFAS 157 to provide increased consistency and comparability in fair value measurement across a wide range of financial and nonfinancial assets and liabilities, including intangible assets. I do not believe that highlighting the fact that the approach of the expert group is not fully consistent with SFAS 157 serves any useful purpose.

Paragraphs 3.10, 3.11, 3.12, and 4.57 We understand that, to the real property appraisal community, the term "value in use" represents the value a specific property has to a specific person or specific firm as opposed to the value to persons or the market in general. Under that definition, "value in use" does not represent fair value, as fair value results from employing market participant assumptions regarding the asset. But fair value should reflect the highest and best use of the asset, either value "in exchange" or value "in use." Paragraph 4.57 attempts to clarify the potential confusion between an "in use" approach to valuation, which is permissible so long as market participant assumptions are employed, and a "value in use," which presumably uses entity specific assumptions and does not represent fair value. Statements such as "value in use is not a measure of fair value" (4.57) would be either misleading or confusing to valuers of

intangible assets. “Value in use” – is a defined term in the real estate valuation community, but not in the intangible asset valuation community. But the “in use” approach **is** a measure of fair value.

Paragraphs 4.18 through 4.24 There is some discussion at the FASB as to whether the entity measuring the fair value of an asset is considered to be a market participant. Paragraph 4.22.1 states that the present property owner in included among those who constitute the market. Paragraph 4.22.2 states that the factual circumstances of the actual property owner are not part of this consideration because the “willing seller” is a hypothetical owner. Would the expert group be comfortable taking the position that the actual property owner is a market participant, but the measurement of fair value must exclude any assumptions of entity specific synergies, or synergies not available to market participant in general?

Paragraph 4.55.2 states that the highest and best use of an asset and whether this is “in use” or “in exchange” is not considered in detail in this Paper. Yet most of the approaches discussed in the paper for valuing intangible asset are income-based approaches, implying that the highest and best use is “in use.” It is our experience that, in practice, the highest and best use of an intangible asset is typically “in use” in concert with the other assets of a going concern, and not “in exchange” on a stand-alone basis.

Paragraph 5.1 states that the three fundamental approaches identified in current IVS are:

5.1.1 the sales comparison approach
5.1.2 the income capitalization method; and
5.1.3 the cost approach

From our experience, these are terms that are typically used in the real property appraisal community, but not in the financial valuation community. We suggest that the comparable terms which would be more recognizable to persons valuing intangible assets would be:

5.1.1 the Market approach
5.1.2 the Income approach, and
5.1.3 the Cost approach

Paragraph 5.8 We maintain that the overall reliability of an intangible asset valuation exercise depends upon both:

5.8.1 the relevance (not reliability) of the underlying method, and
5.8.2 the reliability of the valuation inputs.

Paragraphs 5.9 through 5.21 In our experience, as stated in paragraph 5.19, very few intangible assets are exchanged outside of a business combination. And the intangible assets that are exchanged have such unique characteristics that a Market approach is rarely employed. We suggest that this point be made at the outset of this section, and then provide some specific exceptions to this general premise to reinforce the limited applicability of the approach. Such exceptions could be taxi medallions, stock exchange seats, or landing slots at airports. The discussion of relating the transaction price of an

intangible asset to a financial parameter such as turnover or profit is misleading and should be eliminated, as such information is rarely available.

Paragraph 5.22 et seq. We requested above that the term "income capitalization approach" be replaced by the term "Income Approach." Our reason for this request is demonstrated by the examples given in paragraphs 5.22 through 5.43. It is a vast oversimplification to suggest that an intangible can be reliably valued through the capitalization of a financial parameter. (To make sure we're using terms consistently, among valuers of intangible assets, "capitalization" means dividing a single period income flow by a percentage generally representing the discount rate minus an assumed growth rate – referenced as a "factor" below.) Most intangible assets have limited useful lives, unlike real estate. The annual benefits to be enjoyed through ownership of an intangible asset typically grow through the early years of its use, and decline in the later years. These two elements alone cannot be accurately captured through the application of a capitalization factor or valuation multiple. Frequently, the fair value can only be measured by modeling the benefits on a periodic basis over the entire remaining useful life of the subject asset.

Paragraph 5.27 demonstrates an iterative method for determining the value of the TAB. We submit that the TAB can be calculated more directly through a model that converts the pre-TAB value to an after-TAB value directly. We can provide such a model at your request.

Paragraph 5.29 uses the term "market value" when the basis of value for financial reporting purpose is fair value. Please note and revise.

Paragraph 5.30 and other paragraphs in Section V. Terms such as "capitalized value" and "capitalization multiple" are used. Again, for intangible assets, "capitalized value" would only be appropriately used when discussing single-period capitalization models (not multi-period discounted cash flow). And the meaning of the term "capitalization multiple" is unclear. We would tend to use either "capitalization rate" or "capitalization factor" (and this number is a percentage divisor) – or we would use the term "multiple" to mean a multiplier.

Paragraph 5.43 Please revise this model. It appears that the premium profit resulting from use of the brand is $2000. The business is valued at 12x profit after tax. The value of the brand pre-TAB should be $24,000. There seems to be no rationale for raising the multiple from 12x to 15x.

There are two examples of Benchmarking analyses on pages 40 for Brands and on 42 for technology. In both cases, through the discussion of how each transaction compares to the subject asset, there is a presumption of a level of transparency into comparable transactions involving intangibles that is rarely if ever seen in practice. While differentiating between transactions is a necessary exercise in the valuation of real estate, insight into such differences between intangibles cannot be derived from most publicly

available sources of data. It does not seem to serve a purpose to describe a method that is so difficult, if not impossible, to perform.

Chart 6.42 and paragraph 6.43 There is a body of study into profit splits between licensor and licensee that would indicate that the licensee would pay no more than 25% to 33% of pre-tax profits attributable to an intangible asset to the licensor. These studies should be referenced, in addition to the general advice to check industry surveys of profit splits. Also, the example provided does not seem to reflect typical practice in the application of this form of analysis.

Please accept these comments as our attempt to improve the overall usefulness of this important document. And, as these comments alter many of the positions taken in the July draft of the discussion paper, we would appreciate you considering a re-issue of the paper for further review and comments.

Respectfully submitted,

Gerald Mehm
Carla Glass