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DUFF & PHELPS

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International Valuation Standards Board  
12 Great George Street  
Parliament Square  
LONDON SW1P 3AD  
United Kingdom

**Re: Revised Guidance Note No. 4 - *Valuation of Intangible Assets* and  
Guidance Note No. 16 - *Valuation of Intangible Assets for IFRS Reporting  
Purposes***

Duff & Phelps appreciates the opportunity to provide comments on IVSC's two exposure drafts on the valuation of intangible assets: Revised Guidance Note no 4 *Valuation of Intangible Assets* (GN 4) and Guidance Note no. 16 *Valuation of Intangible Assets for IFRS Reporting Purposes* (GN 16). Our responses to the questions for comment and our additional observations are in the attached document.

We would be pleased to further discuss our comments with the International Valuation Standards Board and staff. Please direct any questions to Paul Barnes in our Philadelphia office at (215) 430-6025.

Sincerely,

/s/ Paul F. Barnes  
Managing Director  
Global Leader - Office of Professional Practice

## **GN 4: Valuation of Intangible Assets**

### **Questions for respondents:**

- 1. The existing GN4 in the International Valuation Standards (IVS) contains a lengthy list of definitions. During the review of this draft the Board formed a view that the majority of these definitions were unnecessary as they were of words or terms that were used in the text in accordance with their normal dictionary meaning or that were otherwise widely understood. It also has to be borne in mind that this GN is designed to be part of IVS, which already defines many valuation terms, such as different bases of value. This Exposure Draft only defines “Goodwill” and “Intangible Asset”.**

**Do respondents consider that further definitions are necessary to explain terms that are used in this draft?**

We appreciate the fact that many valuation terms are already defined in IVS. However, as the definition of the terms used in this GN may have subtle nuances that may be widely understood by valuation professionals, other intended users may not be as fluent in their meaning. Paragraph 1.1 states in part:

“A GN is also intended to provide information to those who commission or rely on valuations and their professional advisors on the generally recognised principles that a valuer should follow and of the principal techniques and methods that may be used.”

As it is clearly the intent of the Board to encourage widespread use of this GN, creating the need for users to pour through and reference other portions of IVS may be counterproductive. The GN would benefit from the inclusion of the definition of all terms used. We would suggest that such definitions be located in an appendix or glossary to the GN rather than in its main body. Alternatively, an Appendix to IVS can be created that consolidates all defined terms within IVS.

- 2. Section 3 is a discussion on the identification of different types of Intangible Asset. This uses the four category descriptions of “Marketing Related”, “Customer or Supplier Related”, “Artistic Related” and “Technology Related”, with a note that under each of these categories, assets may be either contractual or non-contractual. These categories are different from those in the existing GN4 but are similar to those used in the Illustrative Examples in previous versions of IFRS 3. Under IFRS 3 “Contract Based Intangible Assets” are identified as a separate Category. The Board is interested in the views of respondents on:**

- Whether the categorisation of Intangible Assets is important because it helps valuers identify assets that have similar characteristics and for which similar**

**valuation approaches may be adopted, or whether it is simply a convenient way of describing the different types of asset that exist?**

The categorization of Intangible Assets provides an excellent working framework for assessing the nature of a specified asset and the appropriate valuation approach. It is not simply a convenient way to describe the asset, but an integral aspect of the valuation thought process.

While it is true that the categorization of an Intangible Asset should not dictate a specific valuation approach, it does alert the valuer as to the more common approaches applied. For example, trade names, trademarks and brands (marketing-related intangibles) are often valued via the relief from royalty approach. Furthermore, a contractual-based Intangible Asset will draw one to focus on the terms of the contract and alert the valuer to the need to consider the potential renewals of the contract in assessing the remaining useful life and PFI.

- **If categorisation is important, is it important that the categories in GN 4 follow the illustrative examples in IFRS 3?**

We see no reason to deviate from those categories reflected in IFRS 3. Intangible Asset valuations have been and will continue to play a significant role in business combinations; therefore, aligning the GN with IFRS 3 is prudent. Creating a new set of categories would only add confusion to the valuation practice while the goal should be one of consistency rather than diversity.

- **If is considered important to follow the categorisation in IFRSs, should “Contract Related” assets be separately categorised from the other types?**

Yes, Contract Based Intangible Assets should be separately classified for consistency with the categories outlined in IFRS 3. Also see our earlier comments to question #2.

- 3. Various common valuation methods are described in this draft. These are based on those in the discussion paper and the responses received. The Board would be interested to learn if respondents consider that the major valuation methods in use for the valuation of intangibles assets are all included? Conversely, are methods included that are seldom used in practice?**

The valuation methods described in the GN are generally inclusive of those applied in practice. We also believe that the level of discussion afforded each of the methods is appropriate given their level of use. One method that is occasionally applied to franchises in certain industries (e.g. cable television), the Greenfield Method, is not mentioned. While its use is not widespread, a brief discussion would serve to recognize its use and make for a more comprehensive summary of valuation methods.

- 4. The aim of the Guidance Note is to identify the principal approaches and methods used in intangible asset valuation and define them, with the objective of reducing the diversity of terminology and making valuation reports more comprehensible to users. It is not to provide a comprehensive discussion of all the nuances of different valuation techniques nor instructions on how to value.**

Some members of the expert group involved in the preparation of the Exposure Draft considered that the Guidance Note provides too much detail, especially in relation to the discussion on Valuation Inputs. They believe that this material risks being interpreted as either constraining a valuer's discretionary judgement or giving limited, and therefore potentially misleading, instruction. The Board would be interested in the views of respondents on the degree of detail in the Guidance Note, and particularly if this goes beyond that which is necessary for a professional user of an intangible asset valuation to understand the basic techniques and principles that an expert valuer should normally adopt.

We believe that the level of detail is appropriate for the purpose of the GN as its intent is to improve the consistency and transparency of the valuation process. Certain elements of valuation are quite complex and erring on the side of less information and guidance would infer that it is a straight-forward process.

While the valuation methods themselves are important, the inputs are critical to the proper application of a specific method. Valuers are being increasingly called upon to support the inputs into their analysis so the discussion on Valuation Inputs is timely and appropriate. The old adage of "garbage in - garbage out" rings clear in this context.

- 5. Section 6, *Selection of Valuation Methods* advocates the use of multiple valuation methods when the necessary data is available without undue difficulty or cost, and gives guidance on how these methods may be ranked in different situations. Do respondents agree that it is preferable to use multiple methods, and if so, do they consider that the guidance provided is sufficiently comprehensive to prevent unnecessary cost and confusion being incurred in undertaking valuations of intangible assets?**

We agree that, in general, the use of multiple valuation methods is preferable where possible without undue difficulty or cost. However, in many circumstances the appropriate valuation method is clearly identifiable and should be applied accordingly. In these circumstances, the use of alternative methods should not be relied upon as an indicator of value but rather as a cross-check to the method applied. Judgment will be required as to when this may be the case but the GN should not create the perception that just because other methods are available without undue difficulty or cost that their outcome must be explicitly considered in arriving at a conclusion of value through a weighting of the outcomes or otherwise.

## GN 16: Valuation of Intangible Assets for IFRS Reporting Purposes

### Questions for respondents:

1. Some respondents to the discussion paper consider that because IAS 38 only permits intangible assets for which there is an active market to be carried at their revalued amount, and that the definition in IAS 38 of an active market includes a requirement that the assets traded are homogenous, or identical, it is necessary to further define the characteristics of assets that are “identical, similar and different”. They argue that because IAS 38 effectively directs that the fair value of qualifying identical assets is based on prices that are available to the public, valuers need guidance for which assets a valuation technique other than a straight forward price x quantity calculation may be used when valuing intangible assets under other IFRSs. The Board’s view is that there is little scope for confusion as the adjectives in question are used in IAS 38 with their normally understood meaning, and any attempt to draw clear lines between classes of intangible assets based on prescriptive definitions is not only unnecessary but also a source of potential anomalies.

Do respondents consider that further explanation of the characteristics of identical, similar and different intangible assets is required?

We agree with the Board’s view that further explanation of the above is not required.

2. IAS 38 contains a precise definition of an “active market”, which describes not only the characteristics of the market but also the nature of the assets traded, i.e. they must be homogenous. This has led some commentators to the view that markets that either do not meet the criteria in IAS 38 or involve heterogeneous assets should logically be termed “inactive markets”. Others consider that this is misleading, as activity in markets is not dependant upon whether the goods being traded are similar, but upon supply and demand and the extent to which either is elastic. They point to the fact that there are many active markets involving assets that are not homogeneous.

IVS does not have a single definition of a market, although in discussion under “Concepts Fundamental to Generally Accepted Valuation Principles” (p21 IVS 2007) it is described simply as an environment in which goods and services are exchanged through a price mechanism. Although market concepts are discussed throughout IVS, no need has previously been identified to categorise and define different types of market.

Do respondents consider that in order to improve consistency of intangible asset valuations prepared for use under IFRSs it is necessary for IVS to explore and define what is meant by a “market” and by sub descriptions such as “active”, “inactive”, “accessible”, etc?

A certain amount of confusion regarding the interpretation of active and inactive markets in the context of Intangible Asset valuations lies in the perception as to appropriate level at which the asset should be viewed. Intangible Assets by their nature are present and operate in conjunction with other assets. As such it is important to define the appropriate group of assets or “unit of valuation” prior to evaluating the markets in which they trade. It is quite common to define the unit of valuation wherein the Intangible Asset resides as being contained within the subject business as a whole. In this context, the Intangible Asset is utilized along with the working capital and fixed assets of the business, or with other intangibles. If viewed from this perspective, the market is defined as the M&A market rather than a market for a specific intangible, which is rarely present.

As to the meaning of an active and an inactive market, developing such guidelines may be difficult. As stated in GN 4, the availability of comparable transaction prices will be rare; therefore it seems inappropriate to overemphasize this issue.

Finally, further guidance on the characteristics of markets that are active or not active will likely be provided as part of IASB’s Fair Value Measurements project and related IASB/FASB initiatives.

- 3. This draft is intended to provide valuers with a briefing of the valuation objectives under various IFRSs. It is not intended to be a guide to the accounting requirements. Consequently, only selected extracts from relevant IFRSs documents have been referred to, and elsewhere the IFRSs requirements have been paraphrased or précised.**

**Do respondents consider that this guidance contains sufficient references to IFRSs to enable a valuer to understand the valuation objectives and criteria necessary to produce valuations that are suitable for use by a reporting entity in preparing its financial statements, or is more background material on IFRSs required?**

The Board should not attempt to provide a comprehensive discussion and references to all IFRSs. It is incumbent upon the valuer to have a working knowledge and understanding of the accounting standards for which the valuation is being prepared.

We would suggest that the GN address the impending issuance of IASB’s Fair Value Measurements standard, and be thoroughly updated for consistency with this standard after its issuance. This standard will become a critical consideration for all valuations prepared under IFRS and should be discussed in this document.

**In addition to our responses to the specific questions posed we have the following observations on the indicated paragraphs (repeated for reference) in the exposure drafts:**

**GN 4: *Valuation of Intangible Assets***

**2.1 Goodwill: Any economic benefit arising from an asset or assets that is not capable of being individually identified and separately recognised.**

In order to avoid confusion by creating new terms or new definitions in IVS when such exist in IFRS, it might be helpful for this definition to be consistent with that found in IFRS 3 (which defines goodwill in the context of a business combination).

Further, the GN can be supplemented by the more expanded discussion of goodwill in IFRS 3:

“[Goodwill] Component 3— The fair value of the *going concern* element of the acquiree’s existing business. The going concern element represents the ability of the established business to earn a higher rate of return on an assembled collection of net assets than would be expected if those net assets had to be acquired separately. That value stems from the synergies of the net assets of the business, as well as from other benefits (such as factors related to market imperfections, including the ability to earn monopoly profits and barriers to market entry—either legal or because of transaction costs—by potential competitors)...

Component 4—The fair value of the expected synergies and other benefits from combining the acquirer’s and acquiree’s net assets and businesses. Those synergies and other benefits are unique to each combination, and different combinations would produce different synergies and, hence, different values...

The boards also observed that the third and fourth components are part of goodwill. The third component relates to the acquiree and reflects the excess assembled value of the acquiree’s net assets. It represents the pre-existing goodwill that was either internally generated by the acquiree or acquired by it in prior business combinations. The fourth component relates to the acquiree and the acquirer jointly and reflects the excess assembled value that is created by the combination—the synergies that are expected from combining those businesses. The boards described the third and fourth components collectively as ‘core goodwill’.”

To the extent there may be any differences relative to an alternative definition that the Board would like to use, an explanation of such differences should be discussed. See also our comments provided for the corresponding section of GN 16.

**2.2 Intangible Asset: A non monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and privileges to its owner that usually generate income.**

As there is an alternative definition provided in GN 16 (based on IAS 38) it might be beneficial to provide a footnote referencing the definition in GN 16 and IAS 38 and discuss the perceived differences, if any, that the Board believes to be present.

Further, as stated earlier, existing IFRS definitions and categorizations should be leveraged as much as possible in order to avoid confusion by creating new terms or new definitions in IVS.

**3 Types of Intangible Assets**

The order and location of certain paragraphs may improve the flow in this section. Some suggested restructuring of the section include:

- Relocate paragraphs 3.3 through 3.10 to follow 3.1;
- The discussion of goodwill in paragraph 3.2 may be better suited at the end of the section following 3.10 and
- Paragraphs 3.11 through 3.12 could be relocated into section 4.

**3.1 An intangible asset can be either identifiable or unidentifiable. An asset is identifiable if it either...**

As this is the definition from IAS 38 it should be footnoted as such.

**3.2 Goodwill is a future economic benefit attaching to a business. Goodwill cannot be secured legally by a business and is not separable from a business. Examples of goodwill include:**

- the tendency for customers to return to a place of business;
- the extra income generated by a business over and above a fair return from the identifiable tangible, intangible or monetary assets; or
- the extra value of the entity as a whole over and above the aggregate value of its identifiable tangible, intangible or monetary assets.

**In general terms, the value of goodwill is the residual amount remaining after the value of all identifiable tangible, intangible and monetary assets less liabilities and potential liabilities have been deducted from the total value of a business.**

The examples are more properly stated as “Examples of certain elements of goodwill” rather than “Examples of goodwill”.

It may be misleading to provide the example of customers returning to a place of business as an example of (an element of) goodwill. Such a tendency may often be included in the value of customer relationships, to the extent that such (existing) customers can be identified at the valuation date. This example would benefit from further discussion as to the type of customer relationships that should be absorbed in goodwill.

An additional example of (an element of) goodwill that might be considered is that it also includes future assets that have yet to be created such as customer relationships, intellectual property, brands and other assets.

In addition, the use of the term “total value of a business” is not clear as to whether it is an enterprise or equity value. In that the description states that liabilities and potential liabilities are deducted from the asset it is indicative of the equity value of a business. For avoidance of doubt the total value of a business should be defined either in the body of the narrative or in a footnote.

In general we have found that there is not a complete understanding in practice of the specific attributes of goodwill. This lack of understanding lies in the additional accounting adjustments to goodwill that are made in the context of a business combination. One example of this is the calculation of a deferred tax liability and the related debit to goodwill. This adjustment increases the recorded amount of goodwill beyond that derived from the residual calculation discussed. Readers might benefit from a short discussion of certain adjustments to the residual value to clarify that the ultimate amount of goodwill recorded is also inclusive of certain accounting adjustments. Such a discussion may be more appropriately included in GN 16 within the Measurement of Goodwill section thereof, and could incorporate the broader discussion of goodwill as suggested in our comments in 2.1 above.

**3.9 The characteristics of an intangible asset include the ownership rights, privileges and conditions attributable to the subject asset. Ownership rights are generally set out in legal documents and include, according to the jurisdiction involved, patents, trademarks, and copyrights. Ownership rights and conditions may be set out in an agreement or exchange of correspondence and may or may not be transferable to a new owner.**

This paragraph would benefit from a brief discussion of the characteristics of customer relationships that may not be reflected in any specific ownership rights.

**3.12 Another important factor is to determine the life of an intangible asset. This may be a finite period limited by either contract or typical life cycles in the sector; other assets may effectively have an infinite life. Determining the life will include consideration of legal, technological or functional and economic factors. For instance, an asset comprising a drug patent may have a remaining legal life of five years before expiry of the patent, but a competitor drug with expected improved efficacy may be expected to reach the market in three years. This might cause the remaining life of the first to be assessed as only three years, being the lower of the remaining legal and economic lives.**

The term “indefinite” life in the context of intangible assets does not mean “infinite” (see par. 91 of IAS 38). The discussion of intangible asset lives above should be adjusted accordingly.

Further, we observe that the use of the term “Remaining Useful Life” or RUL is more common in practice and should be considered. In addition, RULs are generally “estimated” rather than “determined” as there is a reasonable amount of subjectivity in the analysis.

**4.3 It may be appropriate to consider more than one approach and within each approach there may be different methods available. When undertaking any valuation where the objective is to estimate a market price, the role of the valuer is to adopt the approach(es) and method(s) that most closely match those that would be used by the parties to the hypothetical transaction. Understanding the nature of the market for the subject intangible asset is generally critical to determining the most appropriate valuation approach.**

We would suggest that in addition to the nature of the market for the subject intangible asset, the attributes of the asset itself and the group of assets as part of which it would likely be transacted should also be considered in determining the appropriate valuation approach and method.

**4.6 Examples of entity-specific factors that may not be available to the generality of market participants include:**

- **additional value derived from the existence or creation of a portfolio of similar intangible assets ;**
- **synergies between the intangible asset and other assets owned by the entity;**

This discussion, and particularly the factors quoted above, may ignore situations in which a transaction between market participants would actually include the entire portfolio of intangible assets, or situations in which the subject intangible asset would be transacted together with other assets owned by the entity, consistent with the value-maximizing behavior of both parties. This gets to the level of the hypothetical

transaction in which the subject intangible would be bought or sold. An intangible asset often may not be transacted standalone, and any synergies inherent in its related group of assets would transfer to market participants along with the transfer of the entire group. Therefore, the above examples are not necessarily illustrative of entity-specific factors.

## Aggregation

**4.8 Although it may sometimes be appropriate and possible to value an intangible asset on a stand-alone basis, in other cases it may be either impossible or impractical to value an intangible asset other than in conjunction with other tangible or intangible assets. The valuer should document clearly in the valuation report whether an intangible asset has been valued on a stand-alone basis or in conjunction with other assets. If the latter is the case, the valuer should explain why it was necessary to aggregate the subject intangible asset with other asset(s) for valuation purposes and describe clearly the asset(s) with which the subject intangible asset has been aggregated.**

This discussion limits the circumstances under which intangible assets may be aggregated to situations where it is “impossible or impractical” to do so. There are situations where it would be appropriate to aggregate certain intangible assets because of the nature of the component assets as well as how they would generally be transacted in the market. For example, a brand consists of a group of complementary assets (see GN 16, paragraph 4.11) which would be transacted in aggregate rather than on a piecemeal basis. In these circumstances, it may be possible or practical to estimate the value of the intangible assets on a stand-alone basis, however an acquirer is permitted to recognize them as a single asset provided the individual assets have similar useful lives.

**4.11 A valuation multiple is a multiple determined by dividing the transaction price of an asset by a financial parameter, such as historical or prospective turnover or profit at a given level. Some of the valuation multiples that are used in practice in the valuation of intangible assets are calculated as transaction price divided by...**

Valuation multiples are not strictly limited to financial parameters. While they may more applicable for a business as a whole there are common operational parameters that are also used in practice such as price per: Bed (hospitals); Average Daily Rate (hotels); Subscribers (newspapers); or POP (cellular networks). This comment would also apply to paragraph 4.12.

**4.21 For further guidance on the application of the discounted cash flow method see IVS GN9 Discounted Cash Flow Analysis for Market Valuations and Investment Analysis. As an alternative to using discounted cash flow techniques, cash flows and income can be capitalised using multiples, particularly in simplified examples.**

Attrition of future cash flows is a common attribute of intangible assets. In such cases where income is capitalized the growth rate should be negative. While this issue may be addressed in other GNs, it would be beneficial if this document includes a discussion or example of this issue. Reference to paragraph 5.48 would also clarify this point.

**4.23 If estimating the Market Value an adjustment to the cash flows for tax amortization should be made only if this benefit would be available to market participants generally.**

No mention is made in the above about the tax jurisdiction in which the asset resides, which is the most important (and asset-specific) consideration in determining the TAB.

**4.24 When performing a valuation under a basis other than market value, a TAB adjustment should be made if availability of amortisation would be consistent with the basis of valuation. Thus, if an entity-specific valuation is being performed, a TAB adjustment should be included only if tax amortisation would be available to the specific entity concerned.**

Same comment as above.

**4.25 The relief-from-royalty method determines the value of an intangible asset by reference to the capitalised value of the hypothetical royalty payments that would be saved through owning the asset, as compared with licensing the asset from a third party. It involves estimating the total royalty payments that would need to be made over the asset's life, by a hypothetical licensee to a hypothetical licensor. The hypothetical royalty payments over the life of the asset are adjusted for tax and discounted to present value and then are capitalised.**

The use of the term “capitalised” in the GN is not always clear and may lead to misinterpretation of the GN. In the paragraph above, the use of the term in conjunction with a discounting to present value implies that the royalty payments are in some way discounted twice. The GN would benefit from a clear definition and example of how income or cash flow is capitalised verses the application of the discounted cash flow technique. The difference between these techniques is

important in the context of intangible assets in that they typically have a specified remaining useful life and expected cash flows with attrition that render the capitalisation technique inappropriate. Relocating paragraphs 5.40 and 5.41 to follow 4.20 would clarify this issue.

Further, note that the discussion in 4.25 of GN 4 is affected by the IASB's Annual Improvements project to IFRSs (exposed in 2008, issued in April 2009), also consistent with our comments above. Excerpt from the IASB decisions: "Additionally, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraphs 40 and 41 of IAS 38 to clarify the description of valuation techniques commonly used to measure intangible assets at fair value when assets are not traded in an active market."

**3.27 • a discount rate to enable estimated periodic royalty payments to be brought to a single capital value; or**

The use of the term "single capital value" could be clarified and more directly stated by using the term "present value". This is consistent with the application of a discount rate and other references in the GN (e.g. paragraph 4.25).

**4.33 The following is a simple example of use of the premium profits method. Suppose a brand is being valued and the profit after tax in the most recent reporting period for the business using the brand was CU12,000. A comparable business is identified that does not use a brand and its profit after tax in the most recent reporting period was CU10,000. Thus, the incremental post-tax profit achieved through using the brand was CU2,000. This incremental profit could be capitalised using an appropriate multiple drawn from price earning ratios that are typical in the market for similar types of business.**

This example may reflect circumstances and information that is rarely, if ever, available. The assumption that a comparable business exists with sole difference being the brand is unrealistic. Numerous other variables are likely to exist such as differences in the number of products, geographic coverage, existence of other assets, etc. It would be beneficial to include a more common example such as premium pricing resulting from branded versus unbranded products.

**4.36 The method involves forecasting the cash flows expected to arise from the business or businesses that use the subject intangible asset. From this forecast of cash flows, a deduction is made in respect of the contribution to the cash flows that is made by assets, tangible, intangible and financial, other than the subject intangible asset.**

While it is important to assess the cash flows in the context of the business, the excess earnings method is generally applied at a level of cash flows below that of the business. Typically the lowest level of cash flows is identified for a group of assets all of which contribute to the cash flows of the group of assets (this is mentioned in paragraph 4.42 and perhaps can be combined with this paragraph). For example, a product line's expected cash flows can be estimated and a contributory asset charge deducted for the assets used in the manufacturing and marketing of the product. This comment also applies to paragraph 4.41.

### **Cost Approach**

The discussion should clarify that situations in which a "replacement cost" is obtained from the market, i.e., is based on a market price for an identical or similar asset, is actually an application of the market approach.

**4.45 The cost approach, often known as the depreciated replacement cost approach, determines the value of an intangible asset by calculating the cost of replacing it with an asset with similar or identical service capacity. This provides a ceiling or maximum for the value of certain intangible assets, as a rational purchaser would not pay more for an asset than he would need to pay to replace its service capacity. Adjustments, including that in respect of depreciation, may be required to reflect differences between the cost of replacing the asset with one with similar service capacity and replacing it with one with the depreciated service capacity of the subject asset.**

The statement that the cost approach provides a ceiling or maximum value for certain intangibles, while true, may lead to the perception that this is always the case. There are many instances where the cost approach results in a minimum value. For example, the discovery of a technology may come at a small cost relative to the future economic benefits of the technology. In this case the use of the cost approach would understate the value of the technology, and an income approach may be more appropriate. This also applies to paragraph 4.46. This point is addressed in paragraph 4.49, therefore making reference to 4.49 here to call attention to the exceptions may be beneficial.

**4.49 The cost approach is not suitable for valuing intangible assets for which there are no comparable assets with equivalent service potential for which a price can be obtained.**

See comment under "Cost Approach" above. The overemphasis on the availability of a price as an input tends to make this into a market, rather than a cost approach.

#### 4.50

- **the expected difference between the cost price of the replacement asset and the exchange price of the subject asset**

Reference to the term “cost price” seems inappropriate.

#### **5.5.2 Under the “expected” or “explicit” approach, express assumptions are built into the forecast cash flows to reflect the performance risk of the asset and therefore these are discounted at a rate that reflects the time value of money only.**

To the extent that the discount rate is based on the time value of money only (or risk-free rate), the expected cash flows must be adjusted downward using certainty equivalents to arrive at riskless cash flows. This also applies to paragraph 5.46.

Specifically, not only performance risk of the asset would have to be adjusted for, but also systematic, or market risk. We recommend that GN4 leverage the robust discussion of present value techniques and discount rates in Appendix B of SFAS No. 157, *Fair Value Measurements*.

#### **5.13 When using PFI to determine the value of an intangible asset, a sensitivity analysis of the resulting asset value should be performed to assess the impact of possible variations in the underlying assumptions.**

A sensitivity analysis should be promoted as a best practice in the application of all valuation approaches. This is an integral part of performing cross-checks or reasonableness checks.

#### **5.28 Account also needs to be taken of any differences in the level of investment that may exist between an apparently comparable brand and the subject. A branded product may produce higher gross profits than an unbranded product due to higher selling price. But sales of the branded product may require advertising and marketing expenses that the unbranded product does not. Similarly, a new manufacturing technology may reduce manufacturing costs, but require the purchase of additional machinery. The return on the additional machinery needs to be considered in the valuation of the technology.**

The return “of” the investment in additional machinery also needs to be considered in addition to the return “on”.

## **Contributory asset charges**

The discussion of contributory asset charges should reference the Best Practices document published by the Appraisal Foundation. To the extent that some discussion is desired in this document, it should extract from or be consistent with the “Best Practices”.

### **5.30 The determination of CACs generally comprises three steps:**

- **identification of the assets contributing to the cash flows;**
- **measurement of the fair values of such assets; and**
- **determination of an appropriate fair return on the capital value of such assets.**

The reference to “capital value” above is confusing and unnecessary. The context implies that the term “fair value” should be used instead. This comment (references to “capital” values or amounts) applies to other portions of the document as well.

### **5.38 A fair return on an intangible asset can be by reference to a hypothetical royalty rate that would be charged to lease the asset.**

A royalty rate that would be charged to lease the asset would be inclusive both of a return “on” and “of” the asset.

### **5.43 A discount rate under the traditional approach should reflect both the time value of money and the risks attaching to the single asset being valued. This is a different rate from that attaching to the business or businesses that use the asset. The following methods are available to determine this discount rate:**

An asset’s discount rate is not by definition always different than that of the business (WACC). There are many instances where the subject intangible asset is a significant asset and the WACC could be the appropriate discount rate to apply. Furthermore, there are instances where the WACC may also be appropriate for tangible assets (e.g. when they are the primary asset and there are few, if any, intangible assets in the business).

### **5.46 Under the expected value approach, the discount rate reflects only the time value of money as cash flow risks are explicitly reflected in the model. If all risks can be reflected in the model then it may be appropriate to use a risk-free discount rate, such as government bonds with maturity dates reflecting the life of the subject asset.**

The above discussion should be carefully revised as not all government bonds are risk-free. At this time, for example, U.S. Treasury securities are deemed (default) risk free because they pose neither uncertainty in timing nor risk of default to the holder.

**6.6 The following table shows a matrix of valuation methods that could be available for a brand:**

The matrix also includes inputs as well as valuation methods.

Some of the methods discussed in the matrix are not appropriate in the context of the illustration (a brand valuation). For example, using multiples (e.g., P/E) derived from “branded businesses” are almost never appropriate in the valuation of a brand; there are other assets resident in such businesses whose valuation is reflected in the overall multiple.

***GN 16: Valuation of Intangible Assets for IFRS Reporting Purposes***

**Measurement of Goodwill**

**4.5 Under IFRS 3, the initial measurement of the goodwill arising from a business combination is the difference between A and B as shown below.**

**4.6 “A” comprises:**

- **the consideration transferred, the fair value of any equity issued as consideration and any liabilities or obligations assumed...**

The first bullet of this paragraph misstates the measurement of goodwill. As written, it asserts that liabilities or obligations assumed should be included in A. This is essentially enterprise value. Paragraph 37 of IFRS 3 states: “The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the *liabilities incurred by the acquirer to former owners of the acquiree* and the equity interests issued by the acquirer.” {emphasis added}. Therefore, the consideration transferred is not inclusive of liabilities or obligations assumed.

For further reference, the computation of goodwill is described in par. 32 of IFRS 3. We recommend that such language be leveraged in the GN.

**4.10 IAS 38, paragraph 36, notes that it is appropriate to combine an intangible asset with another intangible asset or with a tangible asset, if the underlying intangible asset is not separable and its fair value is not reliably measurable...**

This paragraph is significantly affected by the IASB's Annual Improvements project to IFRSs (exposed in 2008, issued in April 2009). The discussion needs to be revised accordingly. Excerpt from the decisions: "When the Board developed IFRS 3 (as revised in 2008), it decided that if an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure the fair value of the asset reliably. The Board made related amendments to IAS 38 to reflect that decision. However, the Board identified additional amendments that were needed to reflect clearly its decisions on the accounting for intangible assets acquired in a business combination. Consequently, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraphs 36 and 37 of IAS 38 to clarify the Board's intentions."

**4.11 IAS 38, paragraph 37, considers the term 'brand'. It notes that this term is a general marketing term that is often used to refer to a group of complementary assets such as a trademark and its related trade name, formulas, recipes and technological expertise.**

Same comment as in 4.10.

**4.13 IAS 38 does not, specifically, address whether similar or identical intangible assets should be aggregated for the purpose of initial measurement. In practice, certain types of similar intangible assets that together form a portfolio of similar intangible assets are frequently aggregated for ease of valuation.**

The ease of valuation should not be stated as the determinant for aggregating assets. Rather, similar assets are treated as a portfolio of assets as the input assumptions are more robust and reliable (as discussed in paragraph 4.15). Further, the level of aggregation in the recognition of assets in financial reporting ("unit of account") may be explicitly dictated by the requirements of the respective IFRSs.

**Cross checking the valuation**

This section may be more appropriately included in GN 4.

**4.17 Prior to performing any valuation of the intangible assets in a business combination, it is common practice to value the whole of the acquired business. This will necessitate forecasting cash flows for the business and discounting them at a suitable cost of capital to reflect the risks specific to the acquired business. If the cash flows are discounted at the weighted average cost of capital**

**of the acquired business, the net present value arising from the DCF exercise represents the ‘enterprise value’ of the business.**

The nature of the cash flows should be identified (e.g. debt-free cash flows) as a factor to determine the appropriate discount rate. As written, the paragraph implies that the nature of the discount rate is what determines the outcome of the DCF exercise rather than the application of the appropriate discount rate to the specified type of projection.

**4.18 The value of the equity in the acquired business is determined by deducting the net debt from the enterprise value. This should be compared with the price paid for the equity purchased.**

The meaning of net debt should be defined. The lack of a definition may cause misinterpretation and diversity in practice.

**4.19 If the two figures are relatively close, the projections and the discount rate used in the valuation of the business are effectively supported by the price paid for the acquisition. In this case the projections and the discount rate can be used as starting points in the determination of the corresponding valuation inputs in the valuation methods applied to the intangible assets. In the case of the discount rate, adjustments will be required, to make the discount rate suitable for intangible assets rather than the business as a whole.**

The last sentence should be modified to state that adjustment *may* be required. In addition, discount rates for intangible assets may vary. The wording of the paragraph implies that all intangible assets would have the same discount rate. We suggest inserting “the respective” prior to intangible assets.

**4.20 If the DCF-derived value for equity and the price paid for the combination are not relatively close, this would suggest that one or more of the following has occurred:**

- **the projections used to value the business were not realistic;**

It would be more appropriate to consider whether or not the projections represented an optimistic scenario rather than expected cash flows as opposed to not being realistic.

- **the discount rate used to value the business was not realistic;**

Rather than referring to the discount rate as “not realistic” it might be better stated to say that the inputs and the calculation of the discount rate should be reassessed.

- **the price paid for the business was low and a bargain purchase has been achieved; or**
- **the price paid for the business was high and the purchase may have been made at an overpayment. Unless the price reflected synergies arising from the combination.**

Synergies in the above context should be clarified as entity-specific synergies. The inclusion of market participant synergies should not be a determinant in concluding that an overpayment was made.

**4.22 The internal rate of return implicit in the acquisition of the business or the weighted average return on assets could be also be used to provide support for both the projections and the discount rate used in the valuation.**

Reference should be made to the Appraisal Foundation Best Practices document on contributory asset charges for a discussion of the merits of the weighted average return on assets calculation, consistent with an earlier recommendation.

**5.2 IAS 36 requires:**

- **purchased goodwill to be tested for impairment annually; and**

IAS 36 does not refer to “purchased goodwill”. IN 5 states: “goodwill acquired in a business combination to be tested for impairment annually”. As this GN is specific to IFRS reporting purposes the use of the proper term is suggested.