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Mr Chris Thorne
Chairman
International Valuation Standards Board
12 Great George Street
London SW1P 3AD

Our ref ED GN4, 16
Contact MT/288

28 May 2009

Dear Mr Thorne

Exposure Drafts:
Revised International Valuation Guidance Note No. 4 *Valuation of Intangible Assets*
Proposed new International Valuation Guidance Note No. 16 *Valuation of Intangible Assets for IFRS Reporting Purposes*

We appreciate the opportunity to comment on the Exposure Drafts *Revised International Valuation Guidance Note No. 4 Valuation of Intangible Assets* (GN 4) and *Proposed new International Valuation Guidance Note No. 16 Valuation of Intangible Assets for IFRS Reporting Purposes* (GN 16) (the EDs). This letter expresses the views of KPMG IFRG Limited, which are not necessarily those of the international network of KPMG member firms.

We support the International Valuation Standards Board's (IVSB's) efforts to provide additional guidance on the valuation of intangible assets. We set out specific responses to the questions raised in the EDs in Appendix 1 and Appendix 2 as well as limited other comments. We offer some general comments on the EDs below.

GN 4 states that the purpose of the ED is to provide guidance to experienced valuers and to inform those who retain valuers and rely on valuation reports. These are different audiences with different knowledge and requirements. We believe that the note contains a useful high-level overview of the valuation of intangible assets for non-valuers. However, we believe that additional deliberation and detail is required to provide more useful application guidance for valuers. For example, some of the descriptions in the note of individual valuation techniques are inconsistent with our experience of the application of these techniques by some valuers in practice. We believe that such issues should be the subject of greater deliberation before the release of formal guidance for valuers. We understand that the IVSB is planning to establish working groups to address specific valuation techniques and issues. Therefore, the Board should consider limiting the guidance in GN 4 to higher level information for non-valuers, pending the deliberation of more definitive guidance on individual valuation techniques for valuers.



GN 16 provides an overview of valuation-related points from various IFRSs. We welcome the note as a way to increase the familiarity of valuers with accounting guidance that applies when performing valuations for financial reporting purposes. We believe that it is important that valuers who perform valuations for financial reporting purposes be aware of the underlying accounting requirements and guidance. We note that the International Accounting Standards Board (IASB) has a project to provide additional guidance on fair value measurements, and an exposure draft has just been published for comment. We believe that the IVSC should consider this additional guidance in formulating a final guidance note. More generally, the IVSC should clarify that an IVSB guidance note that summarises extracts of underlying IASB material is not a substitute for valuers being familiar with the underlying accounting requirements that should be considered in valuations for financial reporting purposes.

If you have any questions about our comments or wish to discuss any of these matters further, please contact Jim Calvert at +353 1 410 1001, or Mary Tokar or Julie Santoro at +44 (0)20 7694 8871.

Yours sincerely

KPMG IFRG Limited

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cc: Sir David Tweedie, IASB

Appendix 1

Revised International Valuation Guidance Note No. 4 – Valuation of Intangible Assets

Question 1

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

We believe that further definitions are not required. As a general principle, we believe that care should be taken to ensure that no conflicts exist or develop between IVSB definitions and those that exist in International Financial Reporting Standards (IFRSs) or that an explanation is given of the basis of any such differences. The IVSB should clarify that in valuations performed for financial reporting purposes, when differences between IVSB and IASB definitions exist, the IASB definitions should be followed.

Question 2

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? If categorisation is important, is it important that the categories in GN 4 follow the illustrative examples in IFRS 3? If is considered important to follow the categorisation in IFRSs, should “Contract Related” assets be separately categorised from the other types?

We believe that categorisation of intangible assets is a very useful way to assist companies and valuers to consider the possible existence of a wide range of intangible assets.

We believe that many valuers, companies and auditors are familiar with the illustrative examples in IFRS 3 and that it is preferable to use these categories in GN 4.

As stated previously, we believe that using the same categories of intangible assets as the IASB is useful. However, we note that in March 2009 the International Financial Reporting Interpretations Committee recommended that the IASB, together with the U.S. Financial Accounting Standards Board, remove the distinction between “contractual” and “non-contractual” customer-related intangible assets recognised in a business combination; the IVSC should monitor the progression of this issue.

Question 3

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?

We believe that most major methods have been considered. However, the Greenfield approach has not been discussed.

Question 4

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.

As stated in our covering letter, we believe that the guidance note essentially targets two different audiences who have different requirements. We believe that non-valuers do not need detailed guidance to better understand at a high level the reports produced by valuers.

However, high level guidance that is suitable for non-valuers is less useful for valuers and would not serve the objective of increasing consistency across valuers. As stated in our cover letter, more detailed guidance would require greater discussion of individual valuation techniques and issues. We recommend that separate documents be issued for valuers and non-valuers.

Question 5

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?

Guidance that multiple methods be considered applies to valuations across all assets, not just intangibles. Selection of valuation method(s) should be based not only on whether information is available without undue difficulty or cost but also on professional valuer judgment on whether use of an additional method would be likely to provide additional relevant information to influence and support the valuer's opinion of value. FASB Statement 157 *Fair Value Measurements* refers to the use of methods that are appropriate and for which sufficient data is available, which appears reasonable to us.

Additional comments

We set out below some additional comments on other matters noted in GN 4:

3.5 We note that useful accounting guidance exists on recognising customer relationships, e.g., paragraphs IE23 to IE31 of IFRS 3 *Business Combinations*. It may be useful to include such concepts in a more detailed IVSB intangible asset valuation note.

4.27 In our view, marketing or other costs borne by a licensee should not be considered when valuing an asset using the relief-from-royalty approach unless the comparable royalty transactions did not require expenditure by the licensee. The relief-from-royalty method is based on the costs avoided by owning rather than licensing the asset being valued, such as a patent or brand. Typically, whether a party owns or licenses a technology, they incur marketing related costs to promote and market their products. Therefore such marketing expenditures are not an avoided cost and are excluded from a valuation using a cost approach.

We believe that market practice is to include a tax amortisation benefit (TAB) in the valuation of an asset using the relief-from-royalty approach when a TAB would be available in the relevant tax jurisdiction.

Inclusion of a TAB in the relief-from royalty approach may be an area in which diversity exists in practice for which more detailed guidance would increase consistency in valuations.

4.37 We would be concerned about allowing deductions for components of goodwill other than workforce without more detailed deliberation. There is diversity in practice on whether and in what circumstances it is appropriate to apply contributory asset charges for elements of goodwill other than workforce. The application of contributory asset charges should be deliberated carefully and subsequent detailed guidance would be useful to increase consistency between valuations.

4.45 The statement that a cost approach is the highest value may not always be true in light of the way that the cost approach commonly is implemented, e.g., some valuers exclude while other valuers include time to market issues and the opportunity cost of lost sales.

The application of the cost approach should be deliberated carefully and subsequent detailed guidance would be useful to increase consistency between valuations.

- 4.49 We question the statement that *[t]he 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*. The cost approach is important to a market participant as reflecting the first element of any “make versus buy” decision. As this will influence and determine the price of an intangible asset, we believe its use should not be restricted as outlined above.
- 4.50 The guidance in this paragraph does not clarify the general practice that cash flows used to apply a cost approach should be after tax and that a TAB may apply.
- There is diversity in practice on the inclusion of a tax charge and a TAB when valuing intangible assets using a cost approach. The issuance of more detailed guidance following further discussions would increase consistency in valuations.
- 5.29-5.39 The discussion on contributory asset charges (“CACs”) seems overly simplified. For example, paragraph 5.33 refers to CACs being calculated as a return “on” and “of”. A return “of” may not be required if the cost to maintain the value of the asset is included in the cost structure. We understand that the IVSC may establish a working group to develop guidance in this area, which we believe would be useful.
- 5.29 Intangible assets generally are valued on a post-tax rather than on a pre-tax basis.
- 5.36 This states the return on working capital would be based on the interest rate on bank lending. This would assume working capital could be financed fully by debt, which generally would not be possible.
- 5.46 This appears to suggest that there would be no adjustment for systematic risk in a discount rate applied to expected cash flows. This is not consistent with general valuation practice and, for example, FASB Statement 157.

Appendix 2

Proposed new International Valuation Guidance Note No. 16 – Valuation of Intangible Assets for IFRS Reporting Purposes

Question 1

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

We agree with the IVSB that further clarification is not required on the terms *identical*, *similar* and *different*. In particular, in the context of intangible assets, an active market would be unlikely except for the examples given in IFRSs such as taxi licenses, fishing licences and production quotas, as well as emission allowances. In general, the IVSC should be careful about defining or refining terms that already have been defined under IFRSs.

Question 2

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?

We believe that the IASB rather than the IVSC should provide guidance on what constitutes an active market for financial reporting purposes given the effect such a classification has on the subsequent accounting for the asset involved. Therefore the IVSC should not provide additional guidance in this area.

We also believe that the issues raised in the background to the question may misapply or misinterpret the IASB position.

The IASB definition does not imply that a market for heterogeneous assets is inactive. Clearly, as one expands the assets that are considered in assessing whether a market is active, the increased aggregated volumes reflect more activity so one would expect heterogeneous markets to be more active than homogenous markets. However, the basis for the IASB’s definition is that pricing for other assets may not provide reliable information for the pricing of a specific intangible asset, i.e., defining a market too broadly may not provide reliable pricing information for pricing a specific asset.

For example, the market for a specific car may not be active but the market for cars in general usually is active. Because of the similarity between cars and the fact that buyers regard them as substitutes for each other, active heterogeneous markets provide useful information to price individual cars. However, because intangible assets are highly specific, one often cannot infer reliable values for one intangible from the price of a different intangible asset.

Question 3

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?

We believe that the guidance note provides a useful introduction for valuers to IFRSs. It is important that valuers who work on financial reporting related valuations familiarise themselves with the underlying accounting standards, i.e., the guidance note cannot provide comprehensive up-to-date detailed guidance on all financial reporting requirements. For example, changes to accounting requirements may occur that might not be reflected in the guidance note. Valuers should be reminded of the importance of familiarity with the currently effective version of the underlying accounting guidance.

Additional comments

We set out below some additional comments on other matters noted in GN 16:

- 1.4 The reference to IAS 36 *Impairment of Assets* refers only to fair value less costs to sell. IAS 36 also includes value in use as a basis for estimating the recoverable amount. Is the exclusion of value in use here deliberate, given the discussion of value in use in paragraphs 5.11 to 5.13?
- 2.5 This paragraph mentions that an intangible asset is identifiable if it is separable or if it arises from contractual or other legal rights. It is important that valuers are aware of guidance in IFRSs on what constitutes a contract. For example, a contract-based customer relationship may exist for financial reporting purposes even if there is no contract in place on the acquisition date.
- 4.2 In general, whether an asset is insignificant depends in part on the materiality of the item to the financial statements as a whole. This assessment is made by the company and the valuer is generally not part of this assessment. Accordingly, valuers should discuss these issues carefully with a client before concluding an asset is insignificant.
- 4.6 The first bullet in A should refer just to “consideration transferred”, which is described in IFRS 3 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.”

Bullet B should refer to the “net sum of the acquisition-date fair amounts of the identifiable assets acquired and liabilities assumed measured in accordance with

IFRS 3.” This is because IFRS 3 includes certain exceptions from a fair value measurement.

- 4.7 This paragraph should clarify that when non-controlling interests are valued on the basis of their proportionate interest in the acquiree’s net assets, this is based on the values determined in accordance with IFRS 3, i.e., not the values in the acquiree’s own financial statements.
- 4.8 The first bullet should be characterised as resulting in goodwill attributable to both the controlling and non-controlling interests being recognised. When non-controlling interests are measured at fair value, it does not follow that the “full amount” of goodwill is included in the statement of financial position. This would require the acquiree to be measured at fair value in its entirety, with an amount being allocated to non-controlling interests.
- 4.10 In April 2009 the IASB amended paragraph 36 of IAS 38 *Intangible Assets* to refer to recognising and intangible asset with a “related contract, identifiable asset or liability”, which is broader than the ED. We recommend that this paragraph in GN 16 be updated accordingly.
- 4.17 Clarify the last sentence that if cash flows *exclude cash flows to providers of finance* and are discounted at the weighted average cost of capital, then the resulting value represents the enterprise value of the business.
- 5.2 In accordance with IAS 36 (paragraph 10), an intangible asset not yet available for use also is tested for impairment annually regardless of the existence of indicators of impairment.
- 5.10 This paragraph mentions the possible allocation of debt to cash-generating units (CGUs). In general, one would not expect many liabilities to be allocated to the CGU, consistent with paragraph 76(b) of IAS 36, unless the recoverable amount of the CGU cannot be determined without consideration of the liability.
- 5.12 The restriction of growth rates to industry growth rates applies in the terminal value rather than for intervening explicit cash flow period.

The treatment of tax in value in use calculations is relatively complex and should be considered in more detail.