July 13, 2016

International Valuation Standards Council
1 King Street
LONDON EC2V 8AU, UK

**Reference:** ***Exposure Drafts on IVS 2017, Introduction & Framework; IVS 104, Bases of Value; IVS 105, Valuation Approaches & Methods; IVS 210, Intangible Assets***

Dear Technical Director:

Duff & Phelps is pleased to provide a response to the above-referenced Exposure Drafts comprising IVS 2017. Duff & Phelps is the premier global valuation and corporate finance advisor with expertise in complex valuation, dispute and legal management consulting, M&A, restructuring, and compliance and regulatory consulting. Our valuation advice is sought by hundreds of global clients annually as we work with them in developing pragmatic solutions for applying fair value techniques.

We support the idea of a set of harmonized global valuation standards and we appreciate the Board's effort in revising, improving and augmenting IVS.

## IVS 2017: Introduction & Framework Exposure Draft

a) **In IVS 2013, all substantive portions of the standards were labelled as "commentary" (except for scope and effective date). This label seems to have created some confusion amongst stakeholders as to whether the standards were mandatory. The Board's position is that all aspects of IVS 2017 should be mandatory and this exposure draft has removed the "commentary" label for clarity. Do you agree with the removal of the commentary label?**

   **Response**

   We agree with the removal of the commentary label.

b) **Do you agree with the Board's decision to remove the section on Bases of Value from the IVS Framework and produce a single chapter on Bases of Value in order to clarify the mandatory nature of this section and to avoid repeating certain guidance throughout the IVS? If not, why?**

   **Response**

   We agree with the development and inclusion of a separate standard on Bases of Value in IVS 2017. Please see our detailed comments on IVS 104.

**c) Do you agree with the Board's decision to remove the section on Valuation Approaches from the IVS Framework and produce a single chapter on valuation approaches and methodologies in order to clarify the mandatory nature of this section and to avoid repeating certain guidance throughout the IVS? If not, why?**

**Response**

We agree with the development and inclusion of a separate standard on Valuation Approaches in IVS 2017. Please see our detailed comments on IVS 105.

**d) Do you agree with the IVS definition of Exceptions and Departures? If not, why?**

**Response**

We agree with the definition of Exceptions and Departures. Here, as well as elsewhere, it would be helpful to include implementation guidance in an Appendix (similar to FASB and IASB practices) and illustrate a few sets of circumstances of Exceptions and Departures; to include an illustration of a situation when the statement of compliance with IVS cannot be made; and other examples. Alternatively, this can be addressed via FAQs (as in USPAP).

## Miscellaneous Comments by Line

**Lines 6 - 11:** Can the standards be applied/ are they intended to be applied to equity valuations as well? If so, the framework does not address how equity and business interests are considered.

**Lines 13 - 42:** The Board should consider if the IVSC's International Professional Standards (IPSs) should be mentioned here. The IPSs address the qualities of the valuer.

**Lines 30 - 31:** We think that the last sentence should be deleted; it is redundant with the rest of the paragraph.

## IVS 104: Bases of Value Exposure Draft

a) **Do you agree that valuers should be responsible for choosing the appropriate basis (or bases) of value according to the terms and purpose of the valuation assignment, and that the basis of value may not be one defined by the IVSC? If not, why?**

**Response**

While we agree that a valuer is often responsible for selecting the appropriate basis of value according to the purpose of the assignment, the standard should recognize that the client (party commissioning the valuation) may also choose to dictate the basis of value that the valuation should follow. Thus, while it is incumbent on the valuer to ensure the chosen basis of value is appropriate for the purpose and to consistently apply the requirements associated with the selected basis of value, the valuer does not have the *sole* responsibility to choose the relevant basis of value. We believe the language in IVS 104 should reflect this.

b) **Prior versions of international valuation standards included Special Value as a separate and distinct basis of value. The Board generally believes that valuers seldom perform valuations using Special Value as a distinct basis of value. Rather, valuations are typically performed using another basis of value predicated on certain hypothetical assumptions ("special assumptions") or a specific purchaser (resulting in synergistic value). Do you agree with the removal of Special Value as a separate and distinct basis of value? If not, please describe the circumstances in which you use Special Value as a distinct basis of value?**

**Response**

We agree with the removal of Special Value as a separate basis of value.  We think that the valuation needs underlying a Special Value basis could be met by choosing a different basis of value (included in IVS 104, or outside of IVS 104) that reflects the characteristics of an identified party (or parties). Any additional assumptions made in the valuation process could be clearly stated.

c) **The IVSC has retitled the previously defined Fair Value as Equitable Value in order to avoid confusion with other definitions of Fair Value. Do you agree with this change, if not why not?**

**Response**

We agree with the renaming of the former IVS Fair Value to Equitable Value. This helps avoid unnecessarily confusion with Fair Value in financial reporting and Fair Value for statutory purposes.

d) **Liquidation Value has been added as an additional basis of value. Do you agree with its inclusion within IVS 2017 and are you in accordance with the definition used? If not, why not?**

**Response**

We think that liquidation value is more descriptive of a premise of value rather than a basis of value in and of itself. For example, even under a liquidation premise, some assets could conceivably be valued at Market Value. In addition, a liquidation premise could reflect 1) orderly liquidation of individual assets; 2) forced liquidation of individual assets; 3) liquidation as an assemblage of assets, which reflects the value of the assets in place, but not currently income-producing, and not transacted as a going concern.

**e) Replacement Value has been added as an additional basis of value. Do you agree with its inclusion within IVS 2017 and are you in accordance with the definition used? If not, why not?**

**Response**

While we are aware of engagements in which the replacement cost of an item is sought[1], there could also conceivably be engagements in which reproduction cost is being sought, as one example.

Further, with respect to "replacement value", we think that the lines between price, cost and value are being blurred. Price is the amount paid for an asset. Cost is the amount required to acquire or create an asset. Price and cost are factual; while value is an opinion. Perhaps "value" is being used in this context to signify the potential existence of a valuation engagement to estimate replacement cost?

We do not know what criteria the Board uses to formally recognize a valuation basis in the text of IVS 104, and whether the fact that a valuation engagement could conceivably exist to estimate a certain amount under certain conditions is one such criterion.

**f) Are there other bases of value defined by other entities/organisations that should be mentioned in IVS 104? Which ones? Why?**

**Response**

We think that Intrinsic Value (Fundamental Value) could be included, more so for the purpose of acknowledging it and juxtaposing it against other IVS and non-IVS bases of value. Intrinsic value, or fundamental value, is a corporate finance term which relates to the innate value of the asset as supported by its fundamentals, and which may be different from the manner in which the market may perceive the asset.

Intrinsic (fundamental) value is part of the typical list of common bases of value in many valuation resources and publications.

[1] We also note that IVS 105 refers to a "reinstatement value" – solely mentioned in IVS 105.

## Key Observations

### Synergistic Value

We do not believe that Synergistic Value should be a separate basis of value. “Synergistic” describes an attribute of a basis of value rather than a standalone concept.

As the discussion in lines 202-210 acknowledges, Synergistic Value may be consistent with Market Value if the synergies are available to market participants; it is also possible for Synergistic value to be available only to a specific purchaser. These are practically two opposite ends of the spectrum. This also demonstrates that Synergistic Value does not describe a distinct basis of value.

We think that if one were commissioned to perform a valuation to arrive at Synergistic Value, this sole instruction would be greatly insufficient – one would need to have more information about the hypothetical circumstances underpinning this value and the purpose of the valuation. This, too, demonstrates that Synergistic Value is not a distinct basis of value.

Therefore, we recommend discussing the synergistic nature of other IVS basis of value - where appropriate - and eliminating Synergistic Value as a standalone basis.

### Assessment of Market Participant Synergies

We have some concerns about the discussion of quantification of market participant synergies (lines 390 - 395). See excerpt from IVS 104 below:

> “200.5 Generally an assessment of whether synergies are available to other market participants is based on the amount of the synergies rather than a specific way to achieve that synergy. For example, if multiple market participants could improve cash flow from a subject asset by 10%, that increase in cash flows would typically be considered a market participant synergy even if the various market participants would achieve that 10% increase in cash flows in different ways (ie, increasing revenue vs lowering expenses).”

While the above approach to quantifying synergies in the aggregate *appears practical*, it is overly simplified and can obscure the process of thinking through market participant synergies. This could result in an inappropriate outcome.

For example, if a buyer’s synergy arises from plans to shut down a factory that market participants would continue, while other buyers would expect to realize either G&A savings or incremental revenues of approximately the same currency amount, then taking the buyer’s perspective in valuing the factory operations may result in the non-recognition (or mis-valuation) of the factory assets even if market participants would ascribe value to it. Thus, while market participants may achieve various synergies in different ways, considering them in the aggregate by default, without any additional consideration of the facts and circumstances, could lead to an incorrect outcome.

Further, the current discussion of synergies could also lead some users of IVS to incorrectly presume that all forms of synergies are market participant in nature, i.e., that buyer-specific synergies do not end up in the purchase price. While from a rational economic standpoint, one would like to believe that buyers will never give away the value of their own buyer-specific synergies to the seller, companies often increase the purchase price over and above what other market participants would pay "just to get the deal done". Therefore, the guidance should contemplate setting up a more robust framework for the identification of both market-participant and buyer-specific synergies.

If the IVSC would like to provide a practical approach to thinking through market participant synergies, we suggest incorporating a discussion along the lines of the one in *ASC 820, Fair Value Measurement* ("ASC 820"), shown below:

> **FASB ASC 820 Fair Value Measurement - 10 Overall - 35 Subsequent Measurement**
>
> **35-54A** A reporting entity shall develop unobservable inputs using the best information available in the circumstances, which might include the reporting entity's own data. In developing unobservable inputs, a reporting entity may begin with its own data, but it shall adjust those data if reasonably available information indicates that other market participants would use different data or there is something particular to the reporting entity that is not available to other market participants (for example, an entity-specific synergy). A reporting entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, a reporting entity shall take into account all information about market participant assumptions that is reasonably available. Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement.

We would like to point out that ASC 820 also illustrates that market participant synergies can vary between strategic buyers and financial buyers. This can lead to different sets of assumptions underlying the valuation of the assets and can produce vastly different results, as shown in *Case A: Asset Group*, in ASC paragraphs 820-10-55-26 through 820-10-55-29.

Even though this guidance was written for financial reporting purposes, its applicability is much broader, similar to the concept of highest and best use, widely used in valuation. This guidance is simply a reflection of the premise that market participants act in a value-maximizing, rational manner, and use assumptions that are internally consistent - which is a premise with a universal application.

The identification, analysis and interpretation of synergies may at times involve significant judgment, but this step is an integral part of a well-executed valuation analysis. Therefore, we think that the Board needs to revise the discussion on market participant synergies in IVS 104 accordingly.

## Most Probable Price

To provide necessary context, we understand that the IVS are intended to be global standards with applicability across asset classes. This is our starting point for evaluating the content and guidance in IVS, and for our observation below.

Market Value is described in IVS 104 as the "most probable price" reasonably obtainable in the market at the valuation date (lines 81-82). "Most probable" has a specific statistical connotation which differs from "expected price". In the absence of observed prices, when a value is computed based on an income approach, it is not uncommon to work with a set of scenarios to arrive at an expected value as a proxy for an actual price at which market participants would transact. This is based on corporate finance, whereby a valuation represents the expected value associated with a range of possible outcomes. The same holds true for a market price, which is the present value of the expected dividend stream and capital gains.

That said, we are aware of the differing definitions of Fair Market Value (ASA Business Valuation Standards)[2], and of Market Value (USPAP)[3], which are reproduced in the footnotes below. It is possible that certain definitions are better suited to certain asset classes, valuation purposes, and jurisdictions. But when a set of standards, such as the IVS, is attempting global acceptance and applicability, the detail and the meaning behind each term become very important. In short, the definition of IVS Market Value and its interpretation in IVS 104 seems to be a blend of both of the ASA and USPAP definitions, and it is not clear why – or what the consequences are for the valuation and its execution.

While it could be argued that the IVS definition of Market Value stands on its own, such variation only contributes to diversity and fragmentation in the valuation standards and definitions. We urge the Board to work towards convergence of definitions and terms, rather than divergence. If there is a reason for a divergence, it should be clearly explained, as well as the reasons for divergence and implications for the valuation process.

In the situation at hand, the practical question that seems to arise is whether one can even use an expected present value technique to estimate IVS Market Value, which is said to seek a most probable price?

## Market Rent Basis of Value

We think that the inclusion of Market Rent as an IVS basis of value is confusing. We view the derivation of Market Rent as that of any other market input.

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[2] ASA Business Valuation Standards: "**Fair Market Value.*** The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. (Note: In Canada, the term "price" should be replaced with the term "highest price")"

[3] UNIFORM STANDARDS OF PROFESSIONAL APPRAISAL PRACTICE **2014-2015 EDITION:** "*Market value* means the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus…"

IVS 104 states that “in some instances market rent can be seen as independent basis of value, whereas in other instances market rent is an intermediate step in determining value under other bases of value.”

We understand this to mean that in some circumstances, a valuation engagement may call for the determination of market rent. We still think this does not justify elevating market rent into its own basis of value; by the same token, valuation engagements, the purpose of which is to derive and provide specific valuation inputs to a client (e.g. a discount rate or a royalty rate), could also describe such inputs as a basis of value.

We are aware of USPAP recognizing a market rent engagement as an opinion of value.[4] However, this takes us to our earlier question – what are the Board’s criteria to formally recognize a valuation basis in the text of IVS 104? Does the fact that a valuation engagement could conceivably exist to estimate a certain amount under certain conditions is one such criterion?

### Assumptions and Special Assumptions

We understand there is a current desire and an ongoing effort to converge standards of member VPOs and IVS. We encourage the Board to reconsider the use of terminology with this convergence goal in mind. For example, IVS 104 uses the terms “assumptions” and “special assumptions”. The Appraisal Foundation’s proposed changes to USPAP 2018-19 refer to “general assumptions” and “specific assumptions”. It is not entirely clear if these terms describe the same sets of assumptions or not.

Given the desire to converge various valuation and VPO standards, we think the Board should use the opportunity provided by the current revisions of IVS to advance this goal.

## Miscellaneous Comments by Line

- **Lines 3 - 4:** We think that the IVS 104 definition of a basis of value is incomplete. The definition provided IVS 104 is as follows:

  > “Bases of value (sometimes called standards of value) are statements of the fundamental measurement assumptions of a valuation.” We think that the definition should be clear that reference is made to the subject of valuation in the aggregate.

  We suggest adding the following (or a similar) edit:

  > “Bases of value (sometimes called standards of value) are statements of the fundamental measurement assumptions of a valuation <u>applied to the asset, liability or business interest that is the subject of the valuation</u>.”

  This will make it clearer that individual inputs into a valuation analysis are not a “basis of value” themselves. (Also see our comments on the Market Rent basis of value.)

[4] UNIFORM STANDARDS OF PROFESSIONAL APPRAISAL PRACTICE **2014-2015 EDITION**, FAQ 162:” … USPAP defines an appraisal as an opinion of value, and market rent is an expression of value for the right to use a property. Therefore, to comply with USPAP in this assignment, an appraiser would have to follow STANDARD 1 to develop the opinion of the market rent, and STANDARD 2 to report the assignment results.”

- **Lines 5 - 7:** Suggest revising the parenthetical as follows: "(eg, the nature of the ~~hypothetical~~ assumed transaction, the relationship and motivation of the parties…" This would conform to the discussion in lines 18 - 24 which make it clear that the transaction does not have to be hypothetical, and refers to the transaction as an "assumed transaction".

- **Lines 26 - 28:** Suggest using the word "limit" rather than "prohibit". Also see following suggested edits: "Most bases of value ~~prohibit~~ limit the consideration of information or market sentiment to those that ~~would not be~~ are known or knowable on the measurement/valuation date by ~~typical~~ market participants."

- **Line 28:** Here (as well as elsewhere), reference is made to "typical participants". We believe the intent was to say "market participants". We think the IVS should be consistent in using such terms.

- **Lines 29 - 30:** Delete as it is redundant with line 21.

- **Line 47:** In this list, "Investment Value/Worth" appears in a different order compared to the order in which it is discussed subsequently (refer to line 190) of the document.

- **Lines 74-136:** While we recognize that the IVS definition of Market Value is similar, but not equivalent to the FMV definition under IRS Revenue Ruling 59-60, one question is whether the words "should exchange" vs. "would exchange" of any consequence. Perhaps this could be addressed in the detailed discussion of the definition in the paragraphs shown.

- **Lines 80 - 136:** We think that the discussion of the various components of the definition of Market Value is useful. We suggest that a similar approach be taken to the remaining bases of value addressed by IVS104.

- **Lines 137 - 147**: Perhaps this discussion should clarify that Market Value is not specifically identified either as an entry or an exit transaction, but merely presumes "an exchange".

- **Line 163:** The phrase "a valuation of market rent" does not read well

- **Line 196:** The Investment Value/Worth does not involve an exchange. We suggest the following edit: "does not ~~necessarily~~ involve a presumed exchange."

- **Line 202:** Reference here is made here to "interests" in addition to "assets". We think that the Board should consider where else within IVS the reference to "interests" should be made (in addition to assets).

- **Lines 212 - 213**: Suggest editing the writing further as the discussion implies that a single asset is sold piecemeal.

- **Lines 219 - 225:** We believe the discussion of Replacement Value would be much more informative and useful if it this basis of value was briefly contrasted with

Reproduction Value. (However, also see our comments on replacement cost in response to the specific questions asked about IVS 104.)

- **Line 221**: Consider replacing reference to “professional fees” with soft costs”
- **Lines 225 - 265:** The discussion should reference the fact that other (non-IVS) bases of value definitions may change and the valuer should ensure they are using the most current definition and related framework. This is not as much of a concern for the IVS bases of value as changes thereof would be subject to the biennial amendment cycle of IVS.
- **Line 227:** In addition to IFRS 13, include reference to ASC 820 here as well.
- **Lines 230 - 233:** We believe that the background discussion about IFRS use around the world is unnecessary.
- **Lines 238 - 240:** We believe that the background discussion about the OECD is unnecessary.
- **Line 276**: The value of a liability should not be maximized under a H&BU concept
- **Line 276 - 277**: It would be very helpful to more prominently emphasize the market participant perspective when discussing H&BU upfront
- **Lines 278 - 285:** In addition to explicit conversion costs, we believe that a H&BU determination should also consider incremental liabilities that would be incurred (for example, whether social liabilities would be incurred if an operation is shut down). We strongly recommend including this guidance.
- **Lines 288 - 289:** In addition to the example provided (“the highest and best use for assets employed in a loss-making business may be an orderly liquidation of the assets”), we believe this IVS should further clarify that if a liquidation (or a conversion to an alternative use) triggers a liability that would exceed the benefit of liquidation/conversion, H&BU may be the current use, even if the business is loss-making.
- **Line 301:** Consistent with our preceding comments, we think that it should be noted that market participants may accept a lower rate of return if the alternative use triggers a liability that exceeds the benefit of conversion.
- **Line 381:** Synergies can also arise from a reduction in risk – and not only due to a reduction in costs or increase in revenue.
- **Line 415:** The language in this sentence can be improved (“an assumption is made that assumes facts…”)
- **Basis for Conclusions**: A statement is made as follows:

  “…a valuation performed for financial reporting purposes under IFRS would not be performed in accordance with IVS if it utilised a basis of value other than Fair Value

> as defined by the IASB, regardless of whether the valuer was instructed to use a different basis of value."

However, we observe that there are other bases of value in IFRS which would call for a valuation analysis for financial reporting purposes – for example, value in use (VIU). If the Board plans to retain any of the discussion in the Basis for Conclusions in some form in the final standard, it may need to amend the above statement.

## Other General Comments

- We recommend that defined terms be presented in **bold** in the text of IVS.
- Consistency in the capitalization of terms (e.g. Market Value)
- Consistency in the reference to certain terms (e.g. reference is made to a "specific, identified party" in line 175-176 and a reference to a "particular owner" is made in line 191. Also, reference is made to a "specific buyer" in line 204 and to a "specific purchaser" in line 206). Market participants are also referred to as simply "participants", "*multiple* market participants", and "*typical* participants". They should consistently be referred to as "market participants" without additional descriptors.

  The use of different terms to describe the same thing raises a question as to whether there is in fact a substantive difference in the different nomenclature.

## IVS 105: Valuation Approaches & Methods Exposure Draft

1) **Do you agree that when selecting an appropriate valuation approaches and methods a valuer should consider the following?**

   **a)** the appropriate bases of value, determined by the terms and purpose of the valuation assignment,

   **b)** the respective strengths and weaknesses of the possible valuation approaches and methods,

   **c)** appropriateness of each method in view of the nature of the asset, and the approaches or methods used by participants in the relevant market,

   **d)** the availability of reliable information needed to apply the method(s), and

   **e)** if not, why? What considerations would you add to or remove from this list?

### Response

We think that considering the relevance and quality of available inputs which (d) is attempting to describe should come after (a), considering the appropriate bases of value. Further, (c), the appropriateness of each method given the nature of the asset, should come before (b), strengths/weaknesses of each method. (Thus, the reorder would be: (a), (d), (c), (b)). Ultimately, the strengths and weaknesses of each method may affect the final weighting placed on the method more so than the decision to use/not use the method at all. Practically all methods have shortcomings.

In addition, we believe that a general principle should be laid out along the following lines: one should use valuation approaches, methods and techniques that are appropriate in the circumstances, given the characteristics of the valuation subject and the purpose of the valuation, and for which sufficient relevant data is available. Currently, no such overarching principle has been included in IVS 105.

We also believe that the standard should contain guidance on the (qualitative) weighting of the indications of various valuation approaches and the considerations taken into account in arriving at a valuation conclusion when using more than one valuation approach.

We think the standard should describe the meaning of “reliable” information, data, etc. - a term that was used multiple times. What makes data reliable? Is it observability? (The standard needs to have a fuller discussion on what comprises observability). And when data is not observable, what criteria does it have to meet to be “reliable”? We think that guidance on all of the above would be very beneficial.

2) **Under each valuation approach, this exposure draft includes criteria for when the approach should be used. Do you agree with the criteria presented under each approach? If no, what changes would you make? Why?**

**Response**

We have provided detailed suggestions in our comment letter. As a general comment, we did not see a discussion of strengths and weaknesses of approaches consistently addressed.

3) **Are there areas of this chapter that you feel should be expanded upon in future board projects (eg, discount rates, discounts/premiums, etc)?**

**Response:**

This could be helpful, however, the Board needs to follow a rigorous process in developing these and emphasize robustness over other considerations. We recommend that the Board also debate and include relevant authoritative literature and non-authoritative guidance that is in place and is being used by the valuation community. It also needs to strike a balance between prescribing and setting principles, and needs to consider the inclusion of implementation guidance where appropriate.

## Key Observations

### DLOM

There is no discussion of whether the restrictions are an attribute of the asset or the holder. This is an important distinction that should be addressed in IVS 105.

### DLOC

We think that the discussion does not capture the conceptual underpinnings and meaning of control. Furthermore, it does not discuss the MPAP perspective laid out in TAF's exposure draft[5] as at least one possible viable alternative in determining premiums/discounts. At the same time, IVS 105 does mention the term "MPAP", which is misleading, as the essence of MPAP is not actually discussed.

### Summation Method

The Summation Method (lines 562-563) is not a separate Cost Approach method and should be removed. In valuing tangible assets for "summation", one typically uses a replacement or reproduction cost method. In this context, the "summation" can be better described as a process.

We are aware that the Summation Method has been previously defined by the IVSC in the context of tangible assets as follows:

> "A valuation method that provides an indication of the value of an *entire asset* by the addition of the separate values of its component parts."[6] *[emphasis added]*

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[5] TAF Valuation Advisory, Best Practices for Valuations in Financial Reporting: *Intangible Assets Working Group – Contributory Assets,* May 31, 2010

[6] IVSC Technical Information Paper (TIP) 2, *The Cost Approach for Tangible Assets*

The same source also states:

> "The cost approach is also frequently used with or without other approaches when using the summation method."

Given the above, the current discussion of the Summation Method in IVS 105 is misleading for at least the following reasons:

- The discussion is placed in the Cost Approach section of the standard, thus implying that the summation only comprises application of the Cost Approach, and no other approaches and methods are applied in this process.
- No distinction is currently being made between the application of this *process* to (tangible) assets and an entire business - we note that the current discussion also references investment companies (line 562).

  Although similar in nature, IVS 105 should not confuse the summation process for tangible assets with what is known as the Net Asset Approach applied to an entire company (or an entire company balance sheet).

  In the context of business valuation, the Net Asset Approach is also known as the Asset-based Method; or the Net Asset-based Method; or the Asset Accumulation Method.

  To the extent the Board would like to address a Net Asset Approach in the context of an entire company, it should be placed elsewhere in the standard (in a separate section, and not within the Cost Approach section). And then, IVS 105 should also discuss the consideration of any additional adjustments, such as a DLOM. (Note that in this regard, also in the context of investment companies, some trade at a discount to NAV.)

## Economic Obsolescence

We recommend that the Board revisit the discussion of economic obsolescence (lines 644-656), and discuss and explain how it reconciles with the concept of H&BU. It appears that the guidance provided in lines 654-656 of IVS 105 can be at odds with the concept of H&BU. There currently is diversity in practice in addressing this issue.

IVS 105 (lines 654-656) states the following:

> "…Marketable assets are not adjusted below their market value determined using the market approach."

This appears to be at odds with the concept of H&BU, discussed in IVS 104 as follows:

> "150.1 Highest and best use is the use that would produce the highest value for an asset, liability or *a group of assets and/or liabilities*, regardless of the actual current use." [emphasis added]

It seems that the obsolescence adjustment discussion in IVS 105 above tends to view assets on a standalone basis; meanwhile the H&BU of an asset may be as part of a group, such that the use of the asset within the group (and other assumptions) may be different from its standalone use[7]. Further, there should be consistency in the concluded valuation premise for the individual assets within the group when it is concluded that the H&BU of the assets is for them to be used in that group.

A common occurrence in some jurisdictions is to have a business generating minimal return, or operating at a loss, but unable to liquidate its operations because of significant social liabilities that would be triggered by a liquidation. In this case, market participants choose to continue the operation, since pursuing a liquidation path would result in an even greater loss of value. Therefore, the conclusion would be that the H&BU of the business/assets is the current use, with the assets operated together as a group.

Thus, even though market value indications may be available for certain assets, the reality is that this value can never be realized, as the business cannot in fact be liquidated. It could be argued that the economic obsolescence present in this scenario encumbers all assets but the cash and equivalents.

We urge the Board to debate this situation in providing guidance on the application of economic obsolescence, which should be consistent with the concluded H&BU by market participants[8]. We believe that the current guidance in lines 644-656 (and especially 654-656) is insufficient and can lead to outcomes that are inconsistent with a market participant perspective.

Additionally, on the topic of obsolescence, IVSC TIP 2, *The Cost Approach for Tangible Assets,* included a useful example that we think should be retained. The example (IE3 in the above-mentioned document) illustrates how economic obsolescence for an asset valued using the cost approach can be measured by reference to the value of the whole business/business unit that the asset is part of. In other words, the economic obsolescence is measured as the difference between the enterprise value and the sum of the identifiable net assets of the business, and this deficit (economic obsolescence) is then applied to the subject asset (i.e., to the tangible asset(s) valued by the cost approach). We think that the notion of measuring economic obsolescence by reference to cash flows should be retained in IVS 2017.

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[7] To this point, note that the IVS 104 Exposure Draft also states that "…the highest and best use of an asset valued on a standalone basis may be different from its highest and best use as part of a group, when its contribution to the overall value of the group must be considered."

[8] In this regard, the IVS 104 Exposure Draft states that "…the determination of the highest and best use involves consideration of the following: (a) to establish whether a use is possible, regard will be had to what would be considered reasonable by market participants…"

### Guideline Company Method and Transaction Method

Much of the discussion in IVS 105 under “guideline publicly traded comparable method” references assets when it in fact refers to companies/equities. The reference to *assets* in this discussion is misleading because most assets are not necessarily traded in active markets, which is typically the context of the guideline company method.

“Assets” that are not actively traded are better suited for evaluation under the comparable Transaction Method. This is an important distinction and simply substituting one word for another (assets vs. securities) does not make the discussion applicable to assets generally – instead, it blurs some key underlying issues in the application of the Market Approach.

The text in lines 197-198 and the references to discounts in lines 227-262 also indicate that the discussion (under the Comparable Company Method) is in fact about securities rather than “assets” - but this may not be clear throughout.

We do agree with the reference to securities in the discussion of matrix pricing under the Transaction Method.

In summary, the Board needs to carefully consider the placement of words such as “asset” and “security” (as well as liability, equity/business interests) throughout IVS 2017, and especially in those standards with broader applicability, such as IVS 105.

## Miscellaneous Comments by Line

- **Line 22:** Here (as well as elsewhere), recommend using “market participants” throughout, for consistency. No other qualifiers are needed, and no shorthand should be used.

- **Lines 25 - 26:** Add the following edit “when the valuer has a high degree of confidence in the accuracy and reliability of a single method <u>given the facts and circumstances</u>”. Methods are not reliable in and of themselves.

- **Lines 38 - 43:** Even when the use of more than one approach does not produce “widely divergent” indications of value, the valuer still needs to interpret and qualitatively weight the various indications in order to arrive at a conclusion. The Board should address this process, rather than focus on the reconciliation only by exception.

- **Lines 48 - 53:** The discussion is misleading for two reasons: 1) it appears to give priority to the market approach over other valuation approaches; and, 2) it fails to mention that the information from an active market is *the strongest* evidence of value – *when, and only when* – the subject asset /liability being valued is identical to the asset/liability trading in the active market. If not, the adjustments needed to compensate for comparability and other characteristics of the subject asset may be quite subjective.

- **Lines 120 - 121:** Reference is made to Price/EBITDA, Price/Earnings and Price/Revenue multiples. Using "price" for each of the three multiples infers they are the same. It should be made clear that the EBITDA and Revenue multiples are enterprise value-based while the Price/Earnings is equity-based.

- **Lines 119 - 123:** The discussion does not address if the valuation metrics are historical or forecast (forward looking) and the considerations in evaluating either.

- **Lines 128 - 152:** The process outlined for the application of the comparable transaction method should include an explicit step in which one evaluates if the transactions are orderly or if they have occurred under duress (arm's-length does not fully capture this element). To this point, consider some of the guidance in ASC 820.

- **Lines 138 - 152:** The analysis should also address changes (specifically decreases) in the volume and level of activity in the market for the asset or liability. Consider some of the guidance in ASC 820.[9] Also consider the interaction of "orderly" with the assessment of the level of activity in the market – refer to ASC 820.[10] Given that the Board would like IVS to include a standard on financial instruments, these are very important concepts to capture and convey.

- **Lines 142 - 143:** In addition to considering the timing of comparable transactions relative to the valuation date, any difference in market conditions also needs to be considered

- **Lines 147 - 148:** The reference to full understanding and verification of the metrics and the evidence may infer the performance of audit procedures on the comparable companies. In practice, this is not possible to do. Recommend editing the language used.

- **Line 161:** Clarify what the growth pertains to.

- **Line 166:** The reference to "publicly-traded" in "guideline publicly traded comparable method" is a bit redundant. Perhaps it should be explained upfront what the method entails and there would be no need to repeat "publicly traded", but just refer to guideline companies/ guideline companies method.

- **Line 168:** Reference is made to *traded assets* when the method being discussed relates to publicly traded companies/ equities. The two are not quite the same.

- **Lines 178 - 188:** The discussion in these lines pertains to publicly traded companies/equities rather than assets. Also see prior comment.

[9] For example, ASC 820-10-35- 35-54D states: "If a reporting entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed. A decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly. However, if a reporting entity determines that a transaction or quoted price does not represent fair value (for example, there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary if the reporting entity uses those prices as a basis for measuring fair value and that adjustment may be significant to the fair value measurement in its entirety. Adjustments also may be necessary in other circumstances (for example, when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured or when the price is stale).

[10] For example, ASC 820-10-35-54I states: "The determination of whether a transaction is orderly (or is not orderly) is more difficult if there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). In such circumstances, it is not appropriate to conclude that all transactions in that market are not orderly (that is, forced liquidations or distress sales."

- **Lines 199 - 210:** See prior comments

- **Lines 227 - 252:** It should be made clear that the current discussion of DLOM and DLOC herein are more suited to companies and securities rather than "assets" generally.

- **Lines 260 - 262:** In financial reporting (per ASC 820) blockage discounts are prohibited throughout all levels of the fair value hierarchy, and not just when a subject security is publicly traded in an active market.

- **Line 272:** "Reliable projections" is perhaps not the best descriptor of the projections as typically projections embody various degrees of uncertainty

- **Lines 292 - 295:** We think that the second sentence should be removed – it is not needed to make the point, and it contains certain inaccuracies as the statement appears to have been taken out of context and modified.

  It is not necessarily more risky to invest in a single asset class when that asset class is, for example, U.S. Treasuries or another type of safe government securities. Also, the expected return on a single asset may in fact exceed that of a diversified portfolio, but exhibit a higher expected risk; in that case, this diversified portfolio would provide a greater return *per unit of risk*. In other words, the single asset with the higher return may not lie on the efficient frontier. The efficient frontier maximizes return for each level of risk. Thus the second part of the statement is only true if addresses the expected return per unit of risk.

- **Lines 301 - 302:** Consider removing this (last) sentence. The guidance related to explicit forecast periods (in lines 364 - 389), should not be ignored as it sets forth procedures to assess the relevance of an income capitalization method in the specific circumstances. Further, lines 381 – 384 recognize the possibility of utilizing an income capitalization method, when appropriate, once said procedures are completed.

- **Line 307** and **line 441:** note references to "perpetual-lived" and "indefinite-lived" assets. The terminology should be consistent

- **Line 367 - 369:** We find the reference to market participants having a "norm" with respect to the projection period for certain assets to be both prescriptive and peculiar.

- **Lines 407 - 410:** Contractual or promised cash flows should also be included in this list.

- **Lines 409 - 410:** This should be clarified as expected cash flows. We suggest that the Board leverage some language from ASC 820. See excerpt below:

  > 55-13: "The expected present value technique uses as a starting point a set of cash flows that represents the probability-weighted average of all possible future cash flows (that is, the expected cash flows). The resulting estimate is identical to expected value, which, in statistical terms, is the weighted average of a discrete random variable's possible values with the respective probabilities as the weights. Because all possible cash flows are probability-weighted, the resulting expected cash flow is not conditional upon the occurrence of any specified event (unlike the cash flows used in the discount rate adjustment technique)."

- **Lines 412 - 416:** The description of probability-adjusted cash flows - as incorporating expectations regarding *all* possible outcomes – *without* a discussion as to practicability and implementation, is likely to discourage wide application due to perceived complexity. We suggest that the Board leverage some language from ASC 820. See excerpt below:

  > 55-18: "to apply the expected present value technique, it is not always necessary to take into account distributions of all possible cash flows using complex models and techniques. Rather, it might be possible to develop a limited number of discrete scenarios and probabilities that capture the array of possible cash flows. For example, a reporting entity might use realized cash flows for some relevant past period, adjusted for changes in circumstances occurring subsequently (for example, changes in external factors, including economic or market conditions, industry trends, and competition as well as changes in internal factors affecting the reporting entity more specifically), taking into account the assumptions of market participants."

- **Lines 441 - 442:** The Gordon growth/constant growth model can incorporate negative growth and is thus not limited to use with indefinite-lived assets. With a negative growth rate, the asset eventually peters out – i.e., it has a finite life.

- **Lines 447 - 448:** Include a discussion of other means of terminal value calculation (e.g., key value driver formula), as well as the inputs that should be considered such as ROIC.

- **Lines 450 - 452:** Application of an exit multiple must be made with great care. Current multiples cannot be applied without adjustments that remove the inherent value being created during the projection horizon. The Board should discuss the challenges of applying this method otherwise it may be subject to misuse.

- **Lines 467 - 474:** This list mixes direct methods for the computations of a discount rate with tools used to determine the reasonableness of the discount rate and is thus not helpful.

- **Lines 501 - 503:** IVS 105 states the following:

  > "…market participants would be able to recreate an asset with substantially the same utility as the subject asset, *without regulatory or legal restrictions, and the asset could be recreated quickly enough that a market participant would not be willing to pay a significant premium for the ability to use the subject asset immediately"* [emphasis added]

  We are unsure of the relevance of the italicized portion. Any type of plant or manufacturing facility takes time to build. Interest is usually capitalized and included as part of the Replacement Cost New to reflect that fact. The premium that might be paid for the use of a plant immediately is an element of going concern value. That is separate and apart from the depreciated replacement cost new of a plant.

  Generally speaking, the Cost Approach is the primarily method to value such plants because one cannot assign an income stream directly to an asset component of a plant (e.g., a reactor), so the Income Approach can only be applied in aggregate to check for economic obsolescence. The Market Approach might be used for certain components of the plant, but by its very nature one cannot get market prices for installed assets. In aggregate, one might be able to apply a Market Approach based on the overall capacity/output/cash flow of the plant.

- **Lines 506 - 507:** It is not clear what "reinstatement value" relates to. Was this intended to be addressed in IVS 104?

- **Lines 513 - 515:** We are unsure of the relevance of this guidance. Instead of creating a plant, one would be buying a plant. Some value should go to going concern value, but one would still use the Cost Approach to value the underlying assets of the plant. Also see our comments to lines 501-503 above.

- **Lines 519 - 520:** In is not clear why a situation in which an asset was recently created is included in this list. The list was said to be focused on the need for additional corroboration of the indications of the cost approach.

- **Lines 523 - 525:** This section states, in part: "…the expectations of market participants of the value of the property when complete, but consider the costs and time required to complete the asset and appropriate adjustments for profit and risk". It is not entirely clear what is being conveyed. Is it suggesting that the value can be arrived at by starting with a completed asset and deducting completion costs and profit thereon? Please clarify.

- **Lines 526 - 531**: There are more expansive definitions of the Replacement Cost Method and the Reproduction Cost Method that we think should be used. We can provide them to the Board, if needed.

- **Lines 532 - 533:** See our earlier comments on the Summation Method.

- **Line 539:** Should the reference to Replacement Cost here be to Replacement Cost <u>New?</u>

- **Line 545:** Clarify here if external obsolescence is inclusive of economic obsolescence.

- **Lines 558 - 560:** No, this is not the only step. Once one arrives at reproduction cost new, then one must address discounts for all forms of depreciation and obsolescence.

- **Lines 570 - 571:** Here (and elsewhere), it is not necessary to use a modifier to describe the market participant; thus, we think the following edit should be made "~~typical~~ market participant<u>s</u>".

- **Lines 582:** The Board should clarify the context in which commissions are included

- **Line 584:** The Board should clarify what taxes are included – especially since the Cost Approach is widely viewed as being a pre-tax approach

- **Lines 586 - 587:** Please clarify in reference to the profit (e.g. return to investors) that it is included when appropriate. Also see our comments to lines 588 – 592 below.

- **Lines 588 - 592:** This discussion should be further clarified and enhanced. Usually, the profit is embedded in the cost of replacement of an asset. If one hires an engineering firm to construct a plant, their profit will be included in the cost to the commissioning party. The guidance on profit may be relevant if one constructs their own assets. Then a reasonable profit that any third party provider would include in their pricing should be added into the cost.

- **Lines 600 - 601:** We recommend that the Board address trial and error costs market participants would incur and pay for (in other words, costs are expected to be recovered via the price of the asset)

- **Line 612:** We think the reference to "normal" usage is unnecessary. The word "usage" should suffice, without reference to the intensity of usage, since the latter may vary.

- **Line 616**: Reference to "external or economic or external obsolescence" sounds redundant.

- **Lines 625 - 626:** We believe the following edit should be made: "It will be influenced by the degree of functional, technological or economic obsolescence to which the asset is exposed ~~subject~~"

## Other General Comments

- IVS 105 refers to a "professional" and a "valuer" interchangeably. We recommend consistency.
- The Board should consider whether any guidance from the IVSC TIPs should be retained in the form of implementation guidance or examples in an appendix to each standard.

## IVS 210: Intangible Assets Exposure Draft

a) **In IVS 2013, all substantive portions of IVS 210 Intangible Assets were labelled as “commentary” (except for scope and effective date). This label seems to have created some confusion amongst stakeholders as to whether the standard was mandatory. The Board’s position is that all aspects of IVS 2017 should be mandatory and this Exposure Draft has removed the “commentary” label for clarity. Do you agree with the removal of the commentary label?**

**Response**

We agree with the removal of the commentary label from IVS 210.

b) **Do you agree with the decision to incorporate relevant portions of TIP 3 into IVS 210 and to eliminate TIP 3 as a standalone document? Are there any other elements of TIP 3 that you believe should be incorporated into IVS 210?**

**Response**

We agree with the removal of TIP 3. However, here as well as elsewhere it would be helpful to include implementation guidance or examples as an appendix (similar to FASB and IASB practices) or FAQs (similar to USPAP). Also, the Board should consider an acceptable way of referring users directly to relevant valuation guidance by asset type and/or purpose that has been developed by others.

c) **In addition to the contents of IVS 105, this Exposure Draft includes criteria that should be used by an appraiser in selecting an appropriate valuation approach and method for the valuation of intangible assets. Do you agree with the criteria presented under each approach? If no, what changes would you make? Why?**

**Response**

We have provided detailed suggestions in our letter. As a general comment, we did not see a discussion of strengths and weaknesses of approaches consistently addressed.

d) **The Board believes that the standard presented in this Exposure Draft can be applied in the valuation of intangible assets regardless of the purpose of the valuation (financial reporting, tax, transactions, litigation, etc.). Do you agree? If not, for what purpose(s) do you not believe this standard can be applied? Why?**

### Response

We think the standard is sufficiently general. However, it should be acknowledged more clearly that assets may be defined differently for different purposes (even though they may bear the same name, e.g., technology), and that such differences can be material.

It should also be acknowledged that specific approaches or procedures may need to be applied for the valuation to be suitable for the intended purpose. For example, a valuation for litigation purposes in the U.S. may also need to consider relevant case law.

Also, the IVS 2017 Introduction & Framework acknowledge that Exceptions and Departures may occur in practice; perhaps this should also be picked up or referenced in IVS 210 which is attempting to cover many valuation purposes.

## Key Observations

### Cost Approach

We believe and strongly recommend that IVS 2017 take a position on the treatment of taxes in the Cost Approach. We believe that the Cost Approach should be applied on a pre-tax basis, consistent with the notion that it represents an investment in an asset, and not an operating cost expenditure.

We also recommend that the Board distinguish the Cost Approach from the Cost Savings method, which is an income approach. Thus, the Cost Savings method would consider taxes and a TAB, unlike the Cost Approach.

## Miscellaneous Comments by Line

**Lines 27 - 29:** Here, as well as elsewhere, reference should be made to the underlying asset as well as the rights to use the asset (e.g., the technology, and not just use rights).

**Line 38:** Suggest adding that differences in the way the assets are defined for various purposes *can be material*, *notwithstanding the use of the same term to describe the asset* (e.g., “technology”)

**Lines 42 - 47:** It is not clear what purpose the goodwill computation is for. For example, in financial reporting, a “potential” liability may not meet the definition of a liability (focus would be on present, not potential obligations, among other criteria) and thus would not be subtracted to arrive at residual goodwill.

Furthermore, we think that many valuers think of goodwill from an enterprise perspective (enterprise value less the value of working capital, fixed assets and identifiable intangibles) rather than from an equity perspective, as accountants do. We suggest that the standard also reflect this perspective.

We also think that there should be an explicit statement that the recognition and measurement of intangible assets will be influenced by the basis of value and applicable relevant literature (e.g., PCC alternative for intangibles)

**Lines 58 - 67:** The list in this section does not seem to differentiate between internally created goodwill and purchased or transaction-related goodwill. Goodwill can exist in the absence of a transaction, and we think that the discussion would be more useful if the various elements of goodwill were discussed under both of these scenarios.

Additionally, in the category of transaction-related goodwill, there could be overpayments that also get classified as goodwill for financial reporting purposes; this should be included as well.

**Lines 75 - 92:** Certain intangible assets may require valuations for collateral lending purposes.

**Line 76:** The reference to "sole responsibility" of the valuer should be removed. It implies that the commissioning party has no responsibility to understand their very own needs, which is untrue. We suggest simply stating that "the valuer should understand the purpose of the valuation, whether intangible assets should be valued, and whether they should be valued separately or with other assets…."

Furthermore, when it comes to issues relating to unit of account (which also has a lot to do with the grouping of assets), other expertise - such as accounting expertise in the case of financial reporting valuations - is also needed. The accountants would interpret the accounting requirements, and given this interpretation, the valuer should also have a responsibility to understand what the grouping of assets needs to be in order to meet the purpose of the valuation. Thus, the reference to "sole" responsibility is misleading.

**Lines 103 - 107:** We think that certain variations of the income approach (e.g. excess earnings) would be appropriate only when the subject intangible asset is a valuer driver, or a "pivotal" asset. We would also like to point out that the discussion here can apply not only to owned assets, but to licensed-in assets as well. In other words, the income approach can be applied to contractual assets (rights) bearing the characteristics described in this section.

**Line 126:** The Cost Savings method should also be mentioned.

**Line 128:** The distributor method should additionally be described as a subset of the "disaggregated method".

**Line 131:** Replace "determines" with "estimates".

**Lines 137 - 140**: The historical background discussion is unnecessary – not suited to be a part of a standard.

**Lines 157 - 186:** Profit splitting through the application of the relief-from-royalty method is a critical element of the MPEEM that should be identified as one of the early steps.

**Line 159 - 162:** Rather than switch between "supporting" and "related" contributory assets, suggest that contributory assets are defined once and are used thereafter without a modifier. *Contributory Assets* should be defined.

**Lines 163** and **Lines 167 - 168:** This reference - "adjust expenses to exclude those related to creation of new intangible assets", and the following discussion could be read as a general prohibition on the inclusion of R&D expense for new technology development when valuing intangibles. However, when valuing an intangible asset by the income approach that spans multiple generations of technology, certain R&D expenses should be considered. This should be made clear.

**Line 177 - 178:** Replace "low return" with "relatively lower" return, and "higher" with "relatively higher" rates of return.

**Lines 190 - 193:** The guidance provided here with respect to going concern is more restrictive that that in the TAF Valuation Advisory on Contributory Asset Charges[11]. See excerpt below:

> "2.2.15 The determination of whether a CAC for elements of goodwill is appropriate should be based on an assessment of the relevant facts and circumstances of the situation, and the valuation specialist should be cautioned to not mechanically apply CACs or alternative adjustments for elements of goodwill if the circumstances do not warrant such a charge. **The Working Group believes that assembled workforce is typically the only element of goodwill for which a CAC is taken. Accordingly, the burden of proof is higher to support taking CACs or making alternative adjustments for elements of goodwill other than assembled workforce** [emphasis added].
>
> 2.2.16 If other elements of goodwill are significant contributors to the stream of economic earnings associated with the subject intangible asset, the Working Group believes that the valuation specialist should a) seek to identify and estimate the fair value of those elements (when reliably measurable) for use in calculating CACs, b) make an alternative adjustment to the economic earnings stream in order to compensate for the contribution of the other element or elements of goodwill, or c) consider another method (e.g. the Greenfield method) that more accurately isolates the economic earnings stream attributable solely to the subject intangible asset."

We believe the strong language currently in IVS 210 should be relaxed.

**Line 194:** This should say "and in some cases a return of is also deducted" in place of the current reference to "of"

**Line 203 - 204:** There are other forms of profit splitting that may be captured in the MPEEM. For example, premium pricing or a contract with below-market terms have a defined stream of income. This income should be treated in a manner similar to the relief-from-royalty rather than estimating the fair value of the intangible asset and then in turn applying a return on and of the asset.

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[11] TAF Valuation Advisory, Best Practices for Valuations in Financial Reporting: *Intangible Assets Working Group – Contributory Assets,* May 31, 2010

**Line 205 - 214:** The discussion of MPEEM should also address its shortcomings (e.g., it captures going concern, assemblage value, etc.)

**Line 232 - 238:** Note that if others (licensees) are in fact paying the royalty, they are still expecting to commercialize the asset and earn an excess return. Therefore, market royalty rates only capture the underling IP and not the commercial rights. The nature of the asset and whether or not there is value related to the rights to commercialize the asset should be considered in the selection of the relief-from-royalty method.

**Lines 241 - 247:** We think that the discussion is not clear and potentially misleading. We recommend that the standard incorporate a discussion along the following lines:

> "A royalty rate should be analyzed to determine whether it compensates the licensor for all functions (ownership rights and responsibilities) associated with the asset. Such an analysis would include consideration of expenses recognized by the licensee versus expenses otherwise considered to be the responsibility of the licensor. A royalty rate that is "gross" would consider all functions associated with ownership of a licensed asset to reside with the licensor while a royalty that is "net" would consider some or all functions associated with the licensed asset to reside with the licensee."[12]

Further, depending on whether the royalty is "gross" or "net", per above, the PFI would exclude or include, respectively, a deduction for maintenance, marketing or advertising expenses related to the asset that is being (hypothetically) licensed in.

**Lines 248 - 249:** We do not agree with this statement. See above comment and the related quote.

**Line 254:** Replace "rate of return" with "discount rate".

**Lines 289 - 295:** There is no discussion of the weaknesses of the with-and-without method (e.g., it could sweep in the value of other intangible assets).

**Lines 292 - 295:** The discussion here continues to overlook the fact that the royalty does not capture the commercial rights, just a payment for the IP. Also see our comment to lines 232 - 238.

**Line 314 - 315:** We disagree with the mention of the IRR here. The IRR would apply in specific circumstances, such as – the valuation is performed 1) on the level of the entire business, and 2) in the context of a purchase of such business (such that a price is already given in order to compute the IRR). We think the discussion here should not (need not) specify the IRR as the discount rate. Furthermore, the applicable projections may be at a level lower than the overall business.

**Line 328 - 329:** The cash flows under each scenario should be discounted first, and only then the difference between the two scenarios can be computed.

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[12] TAF Valuation Advisory, Best Practices for Valuations in Financial Reporting: *Intangible Assets Working Group – Contributory Assets,* May 31, 2010

**Lines 336 - 337:** Should clarify that this assumes that the impact of not having the asset in place is fully modeled into the cash flows.

**Line 339:** Replace “determined” with “estimated”.

**Line 348 - 349:** This discussion could use a broader description of the assets – i.e. “enterprise assets”.

**Lines 350 - 361:** The discussion does not address any of the weaknesses of the method.

**Lines 351 - 356:** A reference is made to incorporating a rental payment rather than incurring the expenditures to create the requisite assets. If the rental payment is intended to reflect a contributory asset charge in lieu of creating the asset, this may be conflating the MPEEM and the Greenfield method. This is not a flaw in the approach but rather one means of addressing a shortcoming of the Greenfield method. That shortcoming being that when the investment in supporting assets is limited to their respective costs, any excess returns resulting from the development of the assets is not considered. We suggest that this be discussed and clarified.

**Line 362 - 398:** We recommend that the Board more broadly discuss the *disaggregated method*, of which the *distributor method* is a subset (also see reference to only the distributor method in line 128). The *disaggregated method* is based on the theory that a business comprises a series of functional components (e.g., manufacturing; IP; distribution) and that market data can be used to isolate financial metrics related to these functional areas. Of these various functional areas, the distributor method only addresses the distribution function, and as such, the method can be used to value customer-related intangibles, when appropriate. But the disaggregated method more generally can be used to value other assets - such as IP or manufacturing knowhow - when applied to the other functions of the business (and when use of this method is otherwise appropriate). We therefore think that the Board should be more inclusive in its discussion of this method.

**Line 371 - 372:** We recommend removing this observation. This is a theoretical point; furthermore, all income approaches are similar. Saying this might lead some to believe the relief-from-royalty method is appropriate for customer-related assets.

**Lines 384 - 389:** It should be made clear that the level of working capital applied in the distributor method will be different than that of the entity in the aggregate. The distributor method essentially “splits” the balance sheet and income statement of the entity by function, thus reflecting hypothetical inter-divisional transactions. The working capital should therefore portray the transfer price between functional groups (e.g. the AP and inventory will be higher).

**Lines 442 - 444:** We think this statement is too strong. There may be intangibles that have legal protections (or present barriers to entry) where the application of the Cost Approach would be appropriate. This is another example of a situation in which the language used is too strong and too prescriptive.

**Lines 445 - 447:** The reference to “quickly enough” is both restrictive and vague. Opportunity costs are intended to adjust for the inability to utilize the asset during the period of creation. Perhaps the emphasis should be on “relatively readily replaceable”.

**Line 450:** The reference to acquired software suggests the market approach is being used, or perhaps a blend of the market and cost approaches.

**Lines 468 - 479:** Indirect costs should also be considered, as appropriate. In addition, trial and error costs that market participants would incur and pay for (in other words, costs are expected to be recovered via the price of the asset) should also be included.

**Lines 471 - 473**: We disagree with this statement. Intangible assets can become functionally obsolete.

**Lines 480 - 481:** We do not believe this is a proper definition/description of the concept of opportunity costs.

**Lines 485 - 506:** We think that the discussion of discount rates is too general and could be improved from a practical application standpoint.

**Lines 544 - 596:** We think that the attrition section was written on a much greater level of detail than other sections of this standard. We encourage the Board to maintain balance in addressing various topics. Specifically with respect to attrition, we suggest that the Board consults and harmonizes its guidance with the guidance on attrition in TAF's Valuation Advisory on customers[13], at the appropriate level of detail.

## Other General Comments

- In certain places, the guidance appears too prescriptive. For example, note the reference to "only if" in lines 103 - 107. We urge the Board to carefully consider its drafting language when revising IVS.
- The objective for the level of guidance and tone for the IVS has been set as follows:

  > "[t]he IVS consist of mandatory requirements that must be followed in order to state that a valuation was performed in compliance with the IVS. Certain aspects of the standards do not direct or mandate any particular course of action, but provide fundamental principles and concepts that must be considered in undertaking a valuation."[14]

  However, the IVS as currently written do not consistently seem to meet this objective. Guidance is at times limiting, or is stated in a tone that is too strong/ too absolute when judgment would be required. The language of a standard would require providing the suitable amount of detail when addressing a principle, and the appropriate balance between prescriptiveness and judgment, depending on the issues involved.

  In addition, we noted references to "best practices" (line 590) which sounds like application guidance rather than the principles typically contained in the body of a standard. Similarly, the reference to "diversity in practice" and the accompanying discussion (lines 614-615) is much more suited to application guidance rather than a mandatory principles-based standard. These are just a few examples.

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[13] APB VFR Valuation Advisory #2, *The Valuation of Customer-Related Assets,* June 15, 2016

[14] IVS 2017: Introduction & Framework, Exposure Draft.

One solution could be to include appendices to the IVS standards with relevant implementation guidance, which would allow the standards to focus on principles. This approach is also used by other standard setters (e.g., FASB, IASB).

Further, we think that some useful information may be lost by the elimination of the IVSC TIPs. Any relevant guidance that could be described as implementation guidance/examples that used to reside in the IVSC TIPs can be considered for inclusion in such appendices, or should be included in the standards if it rises to that level (e.g., cash flow-based measurement of economic obsolescence)

The guidance of a standard should also refrain from providing historical background or commentary on the evolution of certain methods, as this discussion is not suited to a standard, but rather could be included either in an Appendix or in the Basis for Conclusions.

Finally, another approach for consideration in IVS 2017 is a high level setting of principles with incorporation of other relevant guidance (issued by other bodies) by reference in an appropriate format (i.e., referenced in Appendices).

- We think that the Basis for Conclusions should be enhanced as a general matter going forward. The Basis for Conclusions should reflect the deliberations of the Board at the level at which this is addressed by other bodies, such as FASB and IASB.

***

We would be pleased to further discuss our comments with the IVSC staff. Please direct any questions to either of us via the contact information set forth below.

Sincerely,

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