International Valuation Standards Council

The Valuation of Intangible Assets

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The IVSC's roles:

A private sector organisation with two primary objectives:

- To develop and promulgate globally recognised valuation standards, acceptable to the world's capital markets, regulators and market participants.
- To protect the public interest by promoting strong ethical values, encouraging quality practice and supporting the development of all sectors of the valuation profession around the world.

June 2010

INTERNATIONAL VALUATION STANDARDS COUNCIL

EXPOSURE DRAFT
PROPOSED NEW INTERNATIONAL VALUATION STANDARDS

Comments to be received by 3 September 2010

IVS Improvements Project

Commenced in 2009

Exposure Draft June 2010

Redeliberation and Round Tables late 2010

Board Approved March 2011

Publication July 2011

- **Significant changes in style and format.**
- **Fundamental principles unchanged from previous editions.**

The Revised IVS

Objective of Standards:

To create greater confidence in the valuation process by those who rely on valuations for investment and other financial decisions.

Achieved by:

Promoting generally accepted concepts and principles to improve the understanding of users.

Requiring procedures that bring transparency to the valuation process.

The Revised IVS - overview

- **IVS Framework:**
  - Contains generally accepted concepts and principles.
- **General Standards:**
  - Scope of work
  - Implementation
  - Reporting

The Revised IVS - overview

- **Asset Standards:**
  - **Standard:** requirements additional to General Standards for specific asset types
  - **Commentary**: background including matters affecting value and identifying common methods
- **Valuation Applications:**
  - **Standard:** requirements additional to General Standards for the relevant purpose
  - **Guidance:** information on external requirements, eg IFRS, and valuation approaches to meet them

IVS Framework – identifies and discusses concepts

- **Valuation and Judgment**
- **Price, Cost and Value**
- **Valuation Bases**
- **Additional Assumptions and Special Assumptions**
- **Valuation Approaches:**
  - Market
  - Income
  - Cost

Valuation and Judgment

- **Applying the standards will require judgment**

- **Proper judgment is based on**
  - Independence
  - Objectivity
  - Competence

Price, Cost and Value

- **Price is the amount asked, offered or paid.**
- **Cost is the amount required to create or produce.**
- **Value is not a fact but an estimate of either:**
  - The most probable price to be paid in an exchange or
  - A measure of the economic benefit of ownership.

Valuation Basis

The valuation basis is:

"A statement of the fundamental measurement assumptions of a valuation." (IVS Framework)

IVS recognises that there are many different bases.

- Those assuming a market transaction
- Those reflecting value to a particular party or parties
- Those required by regulation or statute

The basis to use is determined by the purpose for which the valuation is required.

Valuation Bases

IVS defines a number of different bases:

- Market Value
- Special Value
- Synergistic Value
- Fair Value (equitable as opposed to usage of term in various accounting standards)

However, although there are IVS defined bases, IVS permits the use of other bases providing they are defined and referenced.

Market Value

The most common basis used is market value.

"The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion." (IVS Framework)

Supported by detail conceptual framework that explains each part of definition.

Is considered to be generally consistent with Fair Value as now defined by IASB and FASB

Market Value Components

Reflects highest and best use;

the buyer and seller are deemed to be acting knowledgeably and prudently. In an efficient market the price struck will be the best possible from the perspective of both buyer and seller.

Excludes "special value"

It reflects price that would be paid by market participants in general, not one that had a unique reason to pay more than the rest, eg because of synergies unique to that buyer.

This differs from many tax definitions of value that do not allow special value to be ignored if it existed.

Special Value and Synergistic Value

Special Value:

> *"An amount that reflects particular attributes of an asset that are only of value to a special purchaser."*

Synergistic Value:

> *"An additional element of value created by the combination of two or more assets or interests where the combined value is more than the sum of the separate values."*

Synergistic Value is the most common type of Special Value, but since in some circumstances it may also be available to multiple buyers it is not always Special Value

Other Assumptions

Basis defines fundamentals of hypothesis, ie is there a transaction, does it take place in the market and what are the motivations of the parties?

Additional assumptions are often required concerning the status or circumstances of the asset or assets, eg:

- How are the assets grouped (“unit of account”)?
- Are the assets part of a going concern or sold separately from the business?

IVS identifies common assumptions for different situations. Standards require all assumptions to be clearly stated.

Intangible Assets

Between 2007 and 2010 IVSC undertook a major project to review and update old standard GN4.

This reflected concerns about diversity in practice from implementing valuation requirements under IFRS 3, and similar provisions in US GAAP.

Revised GN4 published in February 2010

- Identifies different types of intangible asset,
- Provides guidance on the most commonly recognized valuation methods for intangibles,
- Discusses issues that should be addressed when valuing intangibles.

Intangible Assets – IVS pronouncements

The new IVS standards are principles based and do not include detailed guidance.

In revised standards the main principles from GN4 are carried forward into IVS 210.

The more detailed discussions on different methods are to be reformatted and republished as a "Technical Information Paper".

Unlike GN4, the new TIP will include some examples.

Intangible Assets – IVS pronouncements

IVSC also has agreement with the Appraisal Foundation in the USA to jointly develop detailed guidance on:

- Contributory Asset Charges
- Customer Relationships

Exposure drafts on both of these anticipated by Q3 2011.

Intangible Assets – some basics

Intangible assets can be identifiable or unidentifiable.

An identifiable asset is so because it can either:

- Be separated from the entity and is capable of being sold, leased or licensed to another party, or
- It arises from a contractual or other legal right.

An unidentifiable asset is generally known as goodwill

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Intangible Assets – Goodwill

"Any future economic benefit arising from a business, an interest in a business or from the use of a group of assets which is not separable." (IVS 210)

In valuation terms it is any additional value over and above the sum of the value of:

- tangible assets + identifiable intangible assets,
- Cash and cash instruments,

Different definitions of goodwill appear in accounting standards and various tax legislation.

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Identifiable Intangible Assets

Four main classes identified:

- marketing related,
- customer or supplier related,
- technology related,
- artistic related.

This is similar to categories identified in IAS 38, but IVS recognises them as being relevant to valuations for other purposes.

May be contractual or non contractual.

Intangible Assets – Valuation Approaches

All three main valuation approaches identified in IVS can be applied to intangibles:

- Market Approach
- Income Approach
- Cost Approach

Within each approach there are numerous methods.

Most methods used for valuing intangible assets fall within income approach.

Intangible Assets – Valuation Approaches

Market Approach infrequently applied due to:

- Lack of homogeneity,
- Lack of active markets.

Cost Approach mainly restricted to self developed assets, eg:

- Software and web sites,
- An assembled workforce.

Intangible Assets – Valuation Approaches

Methods used under Income Approach:

Relief from Royalty:

Value of asset reflects saving to owner of not having to pay a royalty (license fee) to another party for its use.

Premium Profits:

Value of asset reflects difference in profits that would be earned with or without the asset.

Intangible Assets – Valuation Approaches

Methods used under Income Approach (cont):

Excess Earnings:

Value of asset reflects cash flows it generates less any amounts contributed by other assets.

Because analysis of cash flows is often over a number of periods it is also known as the multi period excess earnings method (MPEEM).

“Greenfield” method is a variation on the concept that removes the cash flows contributed by other assets by calculating the cost of creating those assets.

Intangible Assets and IVS

What can IVS do for OECD?

IVS identifies types of intangible assets and recognised methods for valuing them;

IVS provides a framework to produce consistency of application;

IVS requires procedures to promote transparency, relevance and confidence.

However, IVS determines the approach – it is for tax authorities to define the measurement basis for taxation.

Thank you for your attention!

In case of questions, please don't hesitate to ask them now or contact:

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