



INTERNATIONAL VALUATION STANDARDS COUNCIL

IVS 210: INTANGIBLE ASSETS

EXPOSURE DRAFT

Publication date: 7 April 2016

Comments on this Exposure Draft are invited before 7 July 2016. All replies may be put on public record unless confidentiality is requested by the respondent. Comments may be sent as email attachments to:

commentletters@ivsc.org

Or by post to IVSC, 1 King Street, LONDON EC2V 8AU, UK

Copyright © 2016 International Valuation Standards Council. All rights reserved. Copies of this Exposure Draft may be made for the purpose of preparing comments to be submitted to the IVSC provided such copies are for personal or intra-organisational use only and are not sold or disseminated and provided each copy acknowledges IVSC's copyright and sets out the IVSC's address in full. Otherwise, no part of this Exposure Draft may be translated, reprinted or reproduced or utilised in any form either in whole or in part or by any electronic, mechanical or other means, now known or hereafter invented, including photocopying and recording, or in any information storage and retrieval system, without permission in writing from the International Valuation Standards Council.

Please address publication and copyright matters to:

International Valuation Standards Council
1 King Street
LONDON EC2V 8AU
United Kingdom
Email: ivsc@ivsc.org
www.ivsc.org

The International Valuation Standards Council, the authors and the publishers do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

Introduction to Exposure Draft

Why is the International Valuation Standards Board (IVSB) issuing IVS 210 Intangible Assets?

In October 2015 the IVSC published its *Purpose and Strategy Document* which stated that the priority of the IVSC is to expand the quality and depth of International Valuations Standards (IVS) and ensure they are fit for purpose and provide much needed clarity and market efficiency. Further to discussions with the Standards Board and other stakeholders, IVS 210 *Intangible Assets* was identified as a priority chapter within IVS 2017.

IVS 2013 included information on intangible assets in two places: IVS 210 *Intangible Assets* and Technical Information Paper (TIP) 3 *The Valuation of Intangible Assets*. Feedback from stakeholders was that this requirement in IVS 2013 was too high level and did not meet the needs of the market and stakeholders. As such, this Exposure Draft incorporates elements of those chapters as well as new elements developed by the Standards Board (the “Board”) based on that feedback from stakeholders.

What are the Main Provisions?

The main provisions of this chapter are:

- (a) an overview of intangible assets and the circumstances in which they are valued,
- (b) a framework for the selection and application of approaches and methodologies for the valuation of intangible assets, and
- (c) a discussion of special topics related to the valuation of intangible assets including discount rate selection, economic life considerations and tax amortisation benefits.

How do the Proposed Provisions Compare with IVS 2013?

This chapter includes elements from IVS 2013 that were included in IVS 210 *Intangible Assets* and TIP 3 *The Valuation of Intangible Assets*. Many of the concepts from IVS 2013 have been expanded upon in this Exposure Draft. In addition new sections have been added related to selection of approaches and methodologies, and the inclusion of additional methods not mentioned in IVS 210.

Some aspects of TIP 3 were deemed to be unsuitable for inclusion in IVS 210 as those sections represented guidance applicable in certain circumstances rather than standards that could be followed by all valuers.

Questions for Respondents

The Board invites individuals and organisations to comment on all matters in this proposed update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

- (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?
- (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?
- (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?
- (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?

IVS 210 Intangible Assets

10. Requirements

- 10.1 The principles contained in the General Standards apply to valuations of intangible assets and valuations with an intangible assets component.

20. Overview

- 20.1. An intangible asset is a non-monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and economic benefits to its owner.
- 20.2. Specific intangible assets are defined and described by characteristics such as their ownership, function, market position and image. These characteristics differentiate intangible assets from one another.
- 20.3. There are many intangible assets, but they are often considered to fall into one of the following five categories (or goodwill):
- (a) marketing-related: marketing related intangible assets are used primarily in the marketing or promotion of products or services. Examples include trademarks, trade names, unique trade design and internet domain names,
 - (b) customer-related: customer-related intangible assets include customer lists, backlog, customer contracts, and contractual and non-contractual customer relationships,
 - (c) artistic-related: artistic-related intangible assets arise from the right to benefits such as royalties from artistic works such as plays, books, films and music, and from non-contractual copyright protection,
 - (d) contract-related: contract-related intangible assets represent the value of rights that arise from contractual agreements. Examples include licensing and royalty agreements, service or supply contracts, lease agreements, permits, broadcast rights, servicing contracts, non-competition agreements and natural resource rights, and
 - (e) technology-based: technology related intangible assets arise from contractual or non-contractual rights to use patented technology, unpatented technology, databases, formulae, designs, software, processes or recipes.
- 20.4. Although similar intangible assets within the same class will share some characteristics with one another, they will also have differentiating characteristics that will vary according to the type of intangible asset.
- 20.5. In valuing an intangible asset, it is critical to thoroughly understand specifically what needs to be valued. For example, customer data (names, addresses etc.) typically has a very different value from customer contracts (those contracts in place on the

valuation date), and customer relationships (the value of the ongoing customer relationship including existing and future contracts). What intangible assets need to be valued and how those intangible assets are defined may differ depending on the purpose of the valuation.

- 20.6. Goodwill is any future economic benefit arising from a business, an interest in a business or from the use of a group of assets which has not been separately recognised in another asset. In general terms, the value of *goodwill* is the residual amount remaining after the values of all identifiable tangible, intangible and monetary assets, adjusted for actual or potential liabilities, have been deducted from the value of a business. It is typically represented as the excess of the price paid in a real or hypothetical acquisition of a company over the value of the company's other identified assets and liabilities.
- 20.7. As the amount of goodwill is dependent on which other tangible and intangible assets are recognised, its value can be different when calculated for different purposes. For example, in a business combination accounted for under IFRS or US GAAP an intangible asset is only recognised to the extent it:
- (a) is separable, ie, capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so, or
 - (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
- 20.8. While the aspects of goodwill can vary depending on the purpose of the valuation, goodwill frequently includes elements such as:
- (a) company-specific synergies arising from a combination of two or more businesses (eg reductions in operating costs, economies of scale or product mix dynamics),
 - (b) opportunities to expand the business into new and different markets,
 - (c) the benefit of an assembled workforce (but generally not any intellectual property developed by members of that workforce),
 - (d) the benefit to be derived from future assets, such as new customers and future technologies, and
 - (e) assemblage and going concern value.
- 20.9. Valuers may perform direct valuations of intangible assets where the value of the intangible assets is the purpose of the analysis or one part of the analysis. However, when valuing businesses, business interests, real property, and machinery and equipment, valuers should consider whether there are intangible assets associated with those assets and whether those directly or indirectly impact the asset being valued. For

example, when valuing a hotel based on an income approach the contribution to value of the hotel's brand may already be reflected in the profit generated by the hotel.

- 20.10. Intangible asset valuations are performed for a variety of purposes. It is the valuer's sole responsibility to understand the purpose of a valuation and whether intangible assets should be valued, whether separately or grouped with other assets. A non-exhaustive list of examples of circumstances that commonly include an intangible asset valuation component is provided below.
- (a) For financial reporting purposes, valuation of intangible assets are often required in connection with accounting for business combinations, asset acquisitions and sales, and impairment analysis.
 - (b) For tax reporting purposes, intangible asset valuations are frequently needed for transfer pricing analyses, estate and gift tax planning and reporting, and ad valorem taxation analyses.
 - (c) Intangible assets may be the subject of litigation, requiring valuation analysis in circumstances such as shareholder disputes, damage calculations and marital dissolutions (divorce).
 - (d) Other statutory or legal events may require the valuation of intangible assets such as compulsory purchases/eminent domain proceedings.
 - (e) Valuers are often asked to value intangible assets as part of general consulting and transactional support engagements.

30. Valuation Approaches and Methods

- 30.1. The three principal valuation approaches described in IVS 105 *Valuation Approaches* can all be applied to the valuation of intangible assets.
- 30.2. When selecting an approach and method, in addition to the requirements of this chapter, a valuer must follow the requirements of IVS 105 *Valuation Approaches*, including para 10.3.

40. Income Approach

- 40.1. Under the income approach, the value of an intangible asset is determined by reference to the present value of income, cash flows or cost savings attributable to the intangible asset over its economic life.
- 40.2. Generally, the income approach should be used as the primary basis of value for intangible assets only if the following criteria are met:
- (a) the primary economic benefit associated with ownership of the subject intangible asset is the ability to generate income, additional income, or reduced costs, and
 - (b) those future economic benefits can be reasonably forecast.
- 40.3. Income related to intangible assets is frequently included in the price paid for a good or service. It may be challenging to separate the income related to the intangible asset from income related to other tangible and intangible assets. Many of the income approach methods are designed to separate the economic benefits associated with a subject intangible asset.
- 40.4. The income approach is the most common method applied to the valuation of intangible assets and is frequently used to value intangible assets including the following:
- (a) technology
 - (b) customer-related intangibles (eg backlog, contracts, relationships)
 - (c) tradenames/trademarks/brands
 - (d) operating licenses (eg franchise agreements, gaming licenses, broadcast spectrum)
 - (e) non-competition agreements.

50. Income Approach Methods

- 50.1 There are many income approach methods. The following methods are discussed in this chapter in more detail:
- a) excess earnings method,
 - b) relief-from-royalty method,
 - c) premium profit method or with-and-without method,
 - d) greenfield method, and
 - e) distributor method

60. Excess Earnings Method

- 60.1. The excess earnings method determines the value of an intangible asset as the present value of the cash flows attributable to the subject intangible asset after excluding the proportion of the cash flows that are attributable to other assets. It is often used for valuations where there is a requirement for the acquirer to allocate the overall price paid for a business between tangible assets, identifiable intangible assets and goodwill.
- 60.2. The concepts behind the excess earnings method were first described in 1920 in the United States Internal Revenue Services' Appeals and Revenue Memorandum (ARM) 34. The method was developed to provide a way to calculate the intangible and goodwill value lost by business owners as a result of the prohibition of alcohol.
- 60.3. The excess earnings method can be applied using several periods of forecasted cash flows ("multi-period excess earnings method" or "MPEEM"), a single period of forecasted cash flows ("single-period excess earnings method"), or by capitalising a single period of forecasted cash flows ("capitalised excess earnings method" or the "formula method").
- 60.4. The capitalised excess earnings method or formula method is generally only appropriate if the intangible asset is operating in a steady state with stable growth/decay rates, constant profit margins and consistent contributory asset levels/charges.
- 60.5. The single-period excess earnings method is only appropriate for intangibles that will be used/consumed in a single period.
- 60.6. As most intangible assets have economic lives exceeding one period, frequently follow non-linear growth/decay patterns, and may require different levels of contributory assets over time, the MPEEM is the most commonly used excess earnings method as it offers the most flexibility and allows valuers to explicitly forecast changes in such inputs.
- 60.7. Whether applied in a single-period, multi-period, or capitalised manner, the key steps in an excess earnings method are:
 - (a) forecast the amount and timing of future revenues driven by the subject intangible asset and other supporting (ie contributory assets).
 - (b) forecast the amount and timing of expenses that are required to generate the revenue from the subject intangible asset and related contributory asset.
 - (c) adjust the expenses to exclude those related to creation of new intangible assets. Profit margins in the excess earnings method may be higher than profit margins for the overall business because the excess earnings method excludes investment in new intangible assets. For example:

1. research and development expenditures related to development of new technology would not be required when valuing existing technology, and
 2. marketing expenses related to obtaining new customers would not be required when valuing existing customer-related intangible assets.
- (d) identify the contributory assets that are needed to achieve the forecast revenue and expenses. Contributory assets often include working capital, fixed assets, assembled workforce and identified intangible assets other than the subject intangible asset,
- (e) determine the appropriate rate of return on each contributory asset based on an assessment of the risk associated with that asset. For example, low-risk assets like working capital will typically have a low required return. Contributory intangible assets and highly specialised machinery and equipment often require high rates of return,
- (f) in each forecast period, deduct the required returns on contributory assets from the forecast profit to arrive at the excess earnings attributable to only the subject intangible asset,
- (g) determine the appropriate rate of return for the subject intangible asset and present value or capitalise the excess earnings, and
- (h) if appropriate for the purpose of the valuation (see paras 180.1 to 180.4), calculate and add the tax amortisation benefit (TAB) for the subject intangible asset.
- 60.8. Contributory asset charges (CACs) should be made for all the current and future tangible, intangible and financial assets that contribute to the generation of the cash flow, and if an asset for which a CAC is required is involved in more than one line of business, its CAC should be allocated to the different lines of business involved. While a CAC may be taken for an identifiable component of goodwill such as assembled workforce, it is not appropriate to take a CAC on goodwill as a whole, assemblage value or going-concern value.
- 60.9. CACs are generally computed on an after-tax basis as a fair return on and of the value of the contributory asset. The appropriate return on a contributory asset is the investment return a typical market participant would require on the asset. The return of a contributory asset is a recovery of the initial investment in the asset. Although rare, CACs may be computed on a pre-tax basis. However, if done correctly, there should be no difference in value regardless of whether CACs are computed on a pre-tax or after-tax basis.
- 60.10. If the contributory asset is not wasting in nature, like working capital, only a fair return on the asset is required.

- 60.11. For contributory intangible assets that were valued under a relief-from-royalty method, the CAC should be equal to the royalty (generally adjusted to an after-tax royalty rate).
- 60.12. The excess-earnings method should generally be applied only to a single intangible asset for any given stream of revenue and income (generally the primary or most important intangible asset). For example, in valuing the intangible assets of a company utilising both technology and a tradename in delivering a product or service (ie the revenue associated with the technology and the tradename is the same) the excess earnings method should only be used to value one of the intangible assets and an alternative method should be used for the other asset. However, if the company had multiple product lines each using a different technology and each generating distinct revenue and profit, the excess earnings method could be applied in the valuation of the multiple different technologies.

70. Relief-from-Royalty Method

- 70.1. Under the relief-from-royalty method, the value of an intangible asset is determined by reference to the value of the hypothetical royalty payments that would be saved through owning the asset, as compared with licensing the intangible asset from a third party. The hypothetical royalty payments over the life of the intangible asset are adjusted for tax and discounted to present value at the *valuation date*. In some cases, royalty payments may include an initial payment in addition to periodic amounts based on a percentage of the revenues or some other financial parameter. Conceptually, the method may also be viewed as a discounted cash flow method applied the cash flow that the owner of the intangible asset could receive through licensing the intangible asset to third parties.
- 70.2. The key steps to a relief-from-royalty method are:
- (a) develop projections associated with the intangible asset being valued for the life of the subject intangible asset. The most common metric projected is revenue, as most royalties are paid as a percentage of revenue. However, other metrics such as a per-unit royalty may be appropriate in certain valuations,
 - (b) develop a royalty rate for the subject intangible asset. Two methods can be used to derive a hypothetical royalty rate. The first is based on market royalty rates for comparable or similar transactions. A prerequisite for this method is the existence of comparable intangible assets that are licensed at arm's length on a regular basis. The second method is based on a split of profits that would hypothetically be paid in an arm's length transaction by a willing licensee to a willing licensor for the rights to use the subject intangible asset,
 - (c) apply the selected royalty rate to the projections to calculate the royalty payments avoided by owning the intangible asset,
 - (d) estimate any additional expenses for which a licensee of the subject asset would be responsible. This can include upfront payments required by some licensors.

Some licensing arrangements may require licensees to pay for certain expenses associated with the licensed property, however, frequently there are no additional expenses falling under this category, as often a licensee's sole responsibility is payment of the royalty and most or all expenses associated with the intangible asset are paid by the licensor,

- (e) add the avoided additional expenses to the avoided royalty payments to calculate the total costs associated with licensing the subject intangible asset. This is the total amount avoided through ownership of the intangible asset,
- (f) if the hypothetical costs and royalty payments would be tax deductible, apply the appropriate tax rate to determine the after-tax savings associated with ownership of the intangible asset,
- (g) determine the appropriate rate of return for the subject intangible asset and present value or capitalise the savings associated with ownership of the intangible asset, and
- (h) if appropriate for the purpose of the valuation (see paras 180.1 to 180.3), calculate and add the TAB for the subject intangible asset.

70.3. Whether a royalty rate is based on market transactions or a profit split method (or both), its selection should consider the characteristics of the subject intangible asset and the environment in which it is utilised. The consideration of those characteristics form the basis for selection of a royalty rate within a range of observed transactions and/or the range of profit available to the subject intangible asset in a profit split. Factors that should be considered include:

- a) competitive environment: the size of the market for the intangible asset, the availability of realistic alternatives, the number of competitors, barriers to entry and presence (or absence) of switching costs,
- b) importance of the subject intangible to the owner: whether the subject asset is a key factor of differentiation from competitors, the importance it plays in the owner's marketing strategy, its relative importance compared to other tangible and intangible assets, and the amount the owner spends on creation, upkeep and improvement of the subject asset, and
- c) life cycle of the subject intangible: the expected economic life of the subject asset and any risks of the subject intangible becoming obsolete

70.4. When selecting a royalty rate, an appraiser should also consider the following:

- a) When entering a license arrangement, the royalty rate market participants would be willing to pay depends on their profit levels and the relative contribution of the licensed intangible asset to that profit. For example, a manufacturer of consumer products would not license a tradename at a royalty rate that leads to the

manufacturer realising a lower profit selling branded products compared to selling generic products.

- b) When considering observed royalty transactions, an appraiser should understand the specific rights transferred to the licensee and any limitations. For example, royalty agreements may include significant restrictions on the use of a licensed intangible asset such as a restriction to a particular geographic area or for a particular type of product. In addition, the valuer should understand how the payments under the licensing agreement are structured, including whether there are upfront payments, milestone payments, puts/calls to acquire the licensed property outright, etc.

80. Premium Profit Method or With-and-Without Method

- 80.1 The premium profit method, sometimes referred to as the with-and-without method, indicates the value of an intangible asset by comparing two scenarios: one in which the business uses the subject intangible asset and one in which the business does not use the subject intangible asset (but all other factors are kept constant). The relief-from-royalty method is sometimes viewed as a subset of the premium profit method, as the royalty payments represent the payments that would have to be made by a business that did not own the subject intangible asset.
- 80.2 The comparison of the two scenarios can be done in two ways:
 - a) calculating the value of the business under each scenario with the difference in the business values being the value of the subject intangible asset, and
 - b) calculating for each future period the difference between the profits in the two scenarios. The present value of those amounts is then used to reach the value of the subject intangible asset.
- 80.3 In theory, either method should reach a similar value for the intangible asset provided the valuer considers not only the impact on the entity's profit, but additional factors such as differences between the two scenarios in working capital needs and capital expenditures.
- 80.4 The premium profit method is frequently used in the valuation of non-competition agreements but may be appropriate in the valuation of other intangible assets in certain circumstances.
- 80.5 The key steps to the premium profit method are:
 - a) prepare projections of revenue, expenses, capital expenditures and working capital needs for the business assuming the use of all of the assets of the business including the subject intangible asset. These are the cash flows in the "with" scenario and will typically be the same projections used in the internal rate or return (IRR) calculation if the analysis is being performed as part of a business combination,

- b) if comparing the value of the business with and without the asset rather than directly comparing profit, use an appropriate discount rate for the business to present value the future cash flows to determine the value of the subject business with all assets in place. This is the value of the business in the “with” scenario,
- c) prepare projections of revenue, expenses, capital expenditures and working capital needs for the business assuming the use of all of the assets of the business except the subject intangible asset. These are the cash flows in the “without” scenario,
- d) if comparing the value of the business with and without the asset rather than directly comparing profit, use an appropriate discount rate for the business to present value the future cash flows to determine the value of the subject business with all assets in place except the subject intangible. This is the value of the business in the “without” scenario,
- e) deduct the cash flows or value of the business in the “without” scenario from the cash flows or value of the business in the “with” scenario, and
- f) if appropriate for the purpose of the valuation (see paras 180.1 to 180.3), calculate and add the TAB for the subject intangible asset.

80.6 As an additional step, the difference between the two scenarios may need to be probability-weighted. For example, when valuing a non-competition agreement, the individual or business subject to the agreement may choose not to compete even if the agreement were not in place.

80.7 The differences in value between the two scenarios should be reflected solely in the cash flow projections rather than by using different discount rates in the two scenarios.

90. Greenfield Method

90.1 Under the greenfield method, the value of the subject intangible is determined using cash flow projections that assume the only asset of the business at the valuation date is the subject intangible. All other tangible and intangible assets must be bought, built or rented.

90.2 The greenfield method is conceptually similar to the excess earnings method in that it identifies the incremental or “excess” cash flow associated with the subject asset. However, instead of subtracting contributory asset charges from the cash flow to reflect the contribution of contributory assets, the greenfield method assumes that the owner of the subject asset would have to build, buy or rent the contributory assets.

90.3 The greenfield method is often used to estimate the value of franchise-based intangible assets and broadcast spectrum.

- 90.4 The key steps to the greenfield method are:
- a) prepare projections of revenue, expenses, capital expenditures and working capital needs for the business assuming the subject intangible asset is the only asset owned by the subject business at the valuation date, including the time period needed to “ramp up” to stabilised levels,
 - b) estimate the timing and amount of expenditures related to the acquisition, creation or rental of all other assets needed to operate the subject business,
 - c) using an appropriate discount rate for the business, present value the future cash flows to determine the value of the subject business with only the subject intangible in place, and
 - d) if appropriate for the purpose of the valuation (see paras 180.1 to 180.3), calculate and add the TAB for the subject intangible asset.

100. Distributor Method

- 100.1 The distributor method is a variation of the multi-period excess earnings method sometimes used to value customer-related intangible assets. The underlying theory of the distributor method is that businesses that are comprised of various functions are expected to generate profits associated with each function. As distributors generally only perform functions related to distribution of products to customers rather than development of intellectual property or manufacturing, information on profit margins earned by distributors is used to estimate the excess earnings attributable to customer related intangible assets.
- 100.2 The distributor method is also similar to the relief-from-royalty method when a profit-split is used to estimate an appropriate royalty rate.
- 100.3 The distributor method is appropriate to value customer-related intangible assets when another intangible asset (for example, technology or a brand) is deemed to be the primary or most significant intangible asset and is valued under a multi-period excess earnings method.
- 100.4 The key steps to the distributor method are:
- (a) prepare projections of revenue associated with existing customer relationships. This should reflect expected growth in revenue from existing customers as well as the effects of customer attrition,
 - (b) identify comparable distributors that have customer relationships similar to the subject business and calculate the profit margins achieved by those distributors,
 - (c) apply the distributor profit margin to the projected revenue,
 - (d) identify the contributory assets related to performing a distribution function that are needed to achieve the forecast revenue and expenses. Generally distributor

contributory assets include working capital, fixed assets and workforce. However, distributors seldom require other assets such as trademarks or technology. The level of required contributory assets should also be consistent with market participants performing only a distribution function,

- (e) determine the appropriate rate of return on each contributory asset based on an assessment of the risk associated with that asset,
- (f) in each forecast period, deduct the required returns on contributory assets from the forecast distributor profit to arrive at the excess earnings attributable to only the subject intangible asset,
- (g) determine the appropriate rate of return for the subject intangible asset and present value the excess earnings, and
- (h) if appropriate for the purpose of the valuation (see paras 180.1 to 180.3), calculate and add the TAB for the subject intangible asset.

110. Market Approach

- 110.1 Under the market approach, the value of an intangible asset is determined by reference to market activity (for example, transactions involving identical or similar assets).
- 110.2 Transactions involving intangible assets frequently also include other assets, such as a business combination that includes intangible assets.
- 110.3 Generally, the market approach should be used as the primary basis for value of intangible assets only if the following criteria are met:
 - (a) information is available on arm's length transactions involving identical or similar intangible assets on or near the valuation date, and
 - (b) sufficient information is available to allow the valuer to adjust for all significant differences between the subject intangible asset and those involved in the transactions.
- 110.4 The heterogeneous nature of intangible assets means that it is rarely possible to find market evidence of transactions involving identical assets. If there is market evidence at all it is usually in respect of assets that are similar, but not identical.
- 110.5 Where evidence of either prices or valuation multiples is available, it will often be necessary to make adjustments to these to reflect differences between the subject asset and those involved in the transactions. These adjustments are necessary to reflect the differentiating characteristics of the subject intangible asset and the assets involved in the transactions. Such adjustments may only be determinable at a qualitative, rather than quantitative, level. However, the need for significant qualitative adjustments may indicate that another approach would be appropriate for the valuation.

110.6 Consistent with the above, examples of intangible assets for which the *market approach* is sometimes used include:

- (a) broadcast spectrum,
- (b) technology/patents,
- (c) internet domain names, and
- (d) taxi medallions.

120. Market Approach Methods

120.1 The guideline transactions method is generally the only market approach method that can be applied to intangible assets.

120.2 In rare circumstances, a security sufficiently similar to a subject intangible asset may be publicly traded, allowing the use of the guideline public company method. One example of such securities is contingent value rights (CVRs) that are tied to the performance of a particular product or technology.

130. Cost Approach

130.1 Under the cost approach, the value of an intangible asset is determined based on the replacement cost of a similar asset or an asset providing similar service potential or utility.

130.2 Generally, the cost approach should be used as the primary basis for the valuation of intangible assets only if the following criteria are met:

- (a) it would be possible for market participants to recreate an intangible asset of similar utility to the subject asset,
- (b) there are no legal protections (eg, patents, trademarks) or other barriers to entry (eg trade secrets) preventing market participants from recreating an asset of similar utility or profiting from such a recreated asset, and
- (c) the intangible 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.

130.3 Consistent with these criteria, the cost approach is commonly used for intangible assets such as the following:

- (a) acquired third-party software,
- (b) internally-developed and internally-used software, or
- (c) assembled workforce.

130.4 The cost approach may also be used when no other approach is able to be applied, however, a valuer should make every effort to identify an alternative method before applying the cost approach in situations where the subject asset does not meet the criteria in para 130.2. It is occasionally also used as a supporting or corroborative indication of value when another approach is used as the primary basis for value.

140. Cost Approach Methods

140.1 There are broadly two main methods that fall under the cost approach: replacement cost and reproduction cost. However, many intangible assets do not have physical form that can be reproduced and assets such as software which can be reproduced generally derive value from their function/utility rather than their exact lines of code. As such, the replacement cost is most commonly applied to the valuation of intangible assets.

140.2 The replacement cost method assumes that a market participant would pay no more for the asset than the cost that would be incurred to replace the asset with a substitute of comparable utility or functionality.

140.3 Valuers should consider the following when applying the replacement cost method:

- (a) the direct costs of replacing the utility of the asset, including labour, materials and overhead,
- (b) whether the subject intangible asset is subject to obsolescence. While intangible assets do not become functionally or physically obsolete, they can be subject to economic obsolescence,
- (c) whether it is appropriate to include a profit margin on the included costs. An asset acquired from a third party would presumably reflect their costs associated with creating the asset as well as some form of profit margin to provide a return on investment. As such, under bases of value (see IVS 104 *Bases of Value*) that assume a hypothetical transaction, it may be appropriate to include an assumed profit margin on costs, and
- (d) opportunity costs may also be included, which recognise that deploying assets in the recreation of the subject intangible asset may have certain associated costs.

150. Special Considerations for Intangible Assets

150.1 The following sections address a non-exhaustive list of topics relevant to the valuation of intangible assets.

160. Discount Rates/Rates of Return for Intangible Assets

160.1 Selecting discount rates for intangible assets can be challenging as observable market evidence of discount rates for intangible assets is rare. The selection of a discount rate for an intangible asset generally requires significant professional judgment.

- 160.2 In selecting a discount rate for an intangible asset, valuers should perform an assessment of the risks associated with the subject intangible asset and consider observable discount rate benchmarks.
- 160.3 When assessing the risks associated with an intangible asset, a valuer should consider factors including the following:
- (a) intangible assets often have higher risk than tangible assets,
 - (b) if an intangible asset is highly specialised to its current use it may have higher risk than assets with other potential uses,
 - (c) single intangible assets may have more risk than groups of assets (or businesses),
 - (d) intangible assets used in risky (sometimes referred to as non-routine) functions may have higher risk than intangible assets used in more low-risk or routine activities. For example, intangible assets used in research and development activities may be higher risk than those used in delivering existing products or services,
 - (e) the life of the asset. Similar to other investments, intangible assets with longer lives are often considered to have higher risk,
 - (f) intangible assets with more readily estimable cash flow streams, such as backlog, may have lower risk than similar intangible assets with less estimable cash flows such as customer relationships.
- 160.4 Discount rate benchmarks are rates that are observable based on market evidence or observed transactions. The following are some of the benchmark rates that a valuer should consider:
- (a) risk-free rates with similar maturities to the life of the subject intangible asset,
 - (b) cost of debt or borrowing rates with maturities similar to the life of the subject intangible asset,
 - (c) cost of equity or equity rates or return for market participants for the subject intangible asset,
 - (d) weighted-average cost of capital (WACC) of market participants for the subject intangible asset or of the company owning/using the subject intangible asset,
 - (e) in contexts involving a recent arms-length business acquisition including the subject intangible asset, the IRR for the transaction should be considered,
 - (f) in contexts involving a valuation of all assets of a business, the valuer should perform a weighted average return on assets (WARA) analysis to confirm reasonableness of selected discount rates.

170. Intangible Asset Economic Lives

- 170.1 An important consideration in the valuation of an intangible asset is the economic life of the asset. This may be a finite period limited by legal, technological, functional or economic factors; other assets may have an indefinite life. The economic life of an intangible asset is a different concept than the remaining useful life for accounting or tax purposes.
- 170.2 Legal, technological, functional and economic factors must be considered individually and together in making an assessment of the economic life. For example, a pharmaceutical technology protected by a patent may have a remaining legal life of five years before expiry of the patent, but a competitor drug with improved efficacy may be expected to reach the market in three years. This might cause the economic life of the patent to be assessed as only three years. In contrast, the expected economic life of the technology could extend beyond the life of the patent if the knowhow associated with the technology would have value in production of a generic drug beyond the expiration of the patent.
- 170.3 In estimating the economic life of an intangible asset, a valuer should also consider the pattern of use or replacement. Certain intangible assets may be abruptly replaced when a new, better or cheaper alternative becomes available while others may be replaced slowly over time, such as when a software developer releases a new version of software every year but only replaces a portion of the existing code with each new release.
- 170.4 For customer related intangibles, attrition is a key factor in estimating an economic life as well as the cash flows used to value the customer related intangibles. Attrition applied in the valuation of intangible assets is a quantification of expectations regarding future losses of customers. While it is a forward-looking estimate, attrition is often based on historical observations of attrition.
- 170.5 There are a number of ways to measure historical attrition:
- (a) a constant rate of loss (as a percentage of prior year balance) over the life of the customer relationships may be assumed if customer loss does not appear to be dependent on age of the customer relationship,
 - (b) a variable rate of loss may be used over the life of the customer relationships if customer loss is dependent on age of customers. In such circumstances, generally younger/new customers are lost at a higher rate than older more established customer relationships,
 - (c) attrition may be measured based on either revenue or number of customers/customer count,
 - (d) customers may need to be segregated into different groups. For example, a company that sells products to distributors and retailers may experience different attrition rates for each group. Customers may also be segregated based on other

factors such as geography, size of customer, and type of product or service purchased,

- (e) the period used to measure attrition may vary depending on circumstances. For example, for a business with monthly subscribers, one month without revenue from a particular customer would indicate a loss of that customer. In contrast, for larger industrial products, a customer might not be considered “lost” unless there has been no sales to that customer for a year or more.

170.6 The application of any attrition factor should be consistent with the way attrition was measured. Correct application of attrition factor in first projection year (and therefore all subsequent years) must be consistent with form of measurement.

- (a) If attrition is measured based on number of customers at the beginning versus end of period (typically a year), the attrition factor should be applied using a “mid-period” convention for the first projection year (as it is usually assumed that customers were lost throughout the year). For example, if attrition is measured by looking at the number of customers at the beginning of the year (100) versus the number remaining at the end of the year (90), on average the company had 95 customers during that year assuming they were lost evenly throughout the year. Although the attrition rate could be described as 10%, only half of that should be applied in the first year.
- (b) If attrition is measured by analysing year-over-year revenue or customer count the resulting attrition factor should generally be applied without a mid-period adjustment. For example, if attrition is measured by looking at the number of customers that generated revenue in Year 1 (100) versus the number of those same customers that had revenue in Year 2 (90), application would be different even though the attrition rate could again be described as 10%.

170.7 Revenue-based attrition may include growth in revenue from existing customers unless adjustments are made. It is generally a best practice to make adjustments to separate growth and attrition in measurement and application.

170.8 It is a best practice for valuers to input historical revenue into the model being used and check how closely it predicts actual revenue from existing customers in subsequent years. If attrition has been measured and applied appropriately, the model should be reasonably accurate. For example, if estimates of future attrition were developed based on historical attrition observed from 20X0 through 20X5, a valuer should input the 20X0 customer revenue into the model and check whether it accurately predicts the revenue achieved from existing customers in 20X1, 20X2, etc.

180. Tax Amortisation Benefit (TAB)

180.1 In many tax jurisdictions, intangible assets can be amortised for tax purposes, reducing a taxpayer’s tax burden. Depending on the purpose of a valuation and the valuation method used, it may be appropriate to include the value of TAB in the value of the intangible.

- 180.2 If the market or cost approach is used to value an intangible asset, the price paid to create or purchase the asset would already reflect the ability to amortise the asset. However, in the income approach, a TAB needs to be explicitly calculated and included, if appropriate.
- 180.3 For some valuation purposes, such as financial reporting, the appropriate basis of value assumes a hypothetical sale of the subject intangible asset. Generally for those purposes a TAB should be included when the income approach is used because a typical market participant would be able to amortise an intangible asset acquired in such a hypothetical transaction. For other valuation purposes, the assumed transaction might be of a business or group of assets. For those bases of value, it may be appropriate to include a TAB only if the transaction would result in a step-up in basis for the intangible assets.
- 180.4 There is some diversity in practice related to the appropriate discount rate to be used in calculating a TAB. Generally, either of the following are acceptable:
- (a) a discount rate appropriate for a business utilising the subject asset, such as a weighted average cost of capital. Proponents of this view believe that since amortisation can be used to offset the taxes on any income produced by the business, a discount rate appropriate for the business as a whole should be used, or
 - (b) a discount rate appropriate for the subject asset (ie the one used in the valuation of the asset). Proponents of this view believe that the valuation should not assume the owner of the subject asset has operations and income separate from the subject asset and that the discount rate used in the TAB calculation should be the same as that used in the valuation of the subject asset.

IVS 210 Intangible Assets: Basis for Conclusions

The basis for conclusions do not form part of IVS 2017 and will not be included in the finalised document, but have been drafted to provide the reader with the rationale behind certain changes made within this Exposure Draft. The Board feels that the inclusion of this section is a necessary part of the consultative process and is in line with the recommendation contained within the IVS Purpose and Strategy Document requirement that “standards need sufficient consultation” and that the IVSC should be “operating in an open and transparent way”.

In October 2015 IVSC published their Purpose and Strategy Document which stated that the priority of the IVSC is to expand the quality and depth of IVS and ensure they are fit for purpose and provide much needed clarity and market efficiency. Further to discussions with the Standards Board and other stakeholders, IVS 210 Intangible Assets was identified as a priority chapter within IVS 2017.

Discussions with stakeholders indicated that there was a significant amount of confusion related to what content in IVS 210 represented mandatory standards versus what content represented non-mandatory commentary. The Board notes that in IVS 210 (like many other IVS 2013 standards), all substantive portions of the standard were labelled as “commentary” with the exception of the scope and effective date sections. This Exposure Draft has eliminated the “commentary” label to make it clear that the contents are mandatory for compliance with IVS.

The Board’s outreach also indicated that there was some confusion related to the publication of guidance related to the valuation of intangible assets in two documents: IVS 210 Intangible Assets and TIP 3 The Valuation of Intangible Assets. Based on that feedback, the Board has incorporated certain relevant parts of TIP 3 into this Exposure Draft. Upon finalisation of this proposed IVS 210, the Board would rescind TIP 3 as a standalone document.

Some stakeholders pointed out that in IVS 2013, the intangible assets standard was too high level and did not meet the needs of the market and stakeholders. In addition, some stakeholders felt IVS 210 was too focused on valuation of intangible assets for financial reporting purposes. For example, IVS 210 used the IFRS/US GAAP criteria to describe when an intangible asset is separable from the other assets of a business. The Board recognises that intangible assets may be valued for a variety of purposes and this Exposure Draft has been written in a way that the Board believes is more inclusive of the variety of purposes under which intangible assets may be valued.

The Board believes that one of the primary purposes of standards is to reduce diversity in practice. The IVSC performed outreach to stakeholders and identified several areas of diversity in practice related to the valuation of intangible assets. As a result of that outreach, this Exposure Draft includes new requirements related to:

- the selection of valuation approaches and methodologies,
- developing or selecting an appropriate discount rate, and
- determining the economic lives of intangible assets.