INTERNATIONAL VALUATION STANDARDS COMMITTEE
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Ms Annette Kimble
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

4 April 2003

Dear Ms Kimble

Re. Exposure Draft of Proposed Amendments to IAS 36, Impairment of Assets, and IAS 38, Intangible Assets

The International Valuation Standards Committee is pleased to comment on the above Exposure Draft. We are aware that the amendments are consequential to ED 3 Business Combinations. However, the IVSC is not commenting on that draft and we confine our detailed comments in this letter to the valuation considerations in making allocations between the identifiable assets, goodwill and intangible assets where cash-generating units have become impaired.

General Comments

The IVSC supports with the proposed amendments to IAS 36 and IAS 38.

Valuers operating under the provisions of the International Valuation Standards have the capability to arrive at consistent and reliable figures for the reporting of both tangible and intangible assets and thus meet the requirements of the current International Accounting Standards and proposed amendments to IAS 36 and 38.

The 6th edition of the International Valuation Standards (available from beginning May 2003) includes instruction on the valuation of all types of asset classes and includes (inter alia):

International Valuation Application 1 – Valuation for Financial Reporting

Guidance Note	1	Valuation of Real Property
	3	Valuation of Plant and Equipment
	4	Valuation of Intangible Assets
	6	Business Valuation
	8	Depreciated Replacement Cost (DRC)
	9	Discounted Cash Flow (DCF) Analysis for Market and Non-Market Based Valuations

These Valuation Applications and Guidance Notes support the primary International Valuation Standards of:

International Valuation Standard 1	Market Value Basis of Valuation
International Valuation Standard 2	Valuation Bases other than Market Value

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The principles of valuation are well stated under these pronouncements and it is incumbent upon practitioners specialising in these particular fields to apply the stated principles having regard to their analytical and technical processes. Such valuation specialists are bound by the IVSC Code of Conduct regarding Ethics (section 4) and Competence (section 5).

In the practical application of valuations for financial reporting purposes, Valuers must have regard to the potential profitability of asset classes in making valuations under the principal valuation methodologies of income stream capitalisation, discounted cash flow and deprecated replacement cost.

In undertaking the above valuation methodologies, Valuers are constantly aware that figures provided to Directors for financial reporting purposes will be subject to the Directors' *Recoverable Amount Test* (higher of *Net Fair Value* and *Value in Use*).

Detailed Comments

The detailed comments of the IVSC are in response to Questions 1 and 3 from the ED of proposed amendments to IAS 36.

Question 1 Frequency of Impairment Testing

This process will place additional responsibilities on Directors to arrive at the *Recoverable Amount* of the cash generating units. Where impairment is indicated (alerted to by a reduction in the associated cash flows), there will now be a requirement for Directors to consider both *Net Fair Values* and *Value in Use* for the identifiable assets of the enterprise, as well as the additional value of any associated purchased goodwill or other intangible assets.

Directors or Financial Managers should take expert comment from real estate valuers as issues are involved that are normally the prerogative of real estate valuers in determining the market value of the identifiable assets and their associated level of return as a component of the overall cash flows. Any additional cash flows attributed to intangible assets should then be capitalised to arrive at the value of the goodwill or intangible asset component.

Question 3 Measuring Value in Use

- IVSC considers that the additional guidance for measuring *Value in Use* in proposed paragraph 25A is entirely consistent with its own recommended methodology for the determination of Business Valuations and Intangible Assets under the International Valuation Standards, excepting that *Value in Use*, as defined under IAS 36 excludes internally generated goodwill, taxation and finance issues which the valuer would take into account in undertaking a business valuation.

- The revised provisions of IAS 36 and IAS 38 require that purchased goodwill must be tested for impairment at the end of each reporting period. The

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impairment test must be conducted in conjunction with an associated impairment test of the carrying amounts shown for property, plant and equipment. It is not clear to IVSC that in circumstances where there is a drastic reduction in the total carrying amounts of purchased goodwill and property plant and equipment, how the amended figures for these assets are arrived at, bearing in mind that the Net Selling Price of property, plant and equipment must be arrived at under Net Fair Value principles.

In the calculations shown under Example 2 of the Exposure Draft the following figures have been determined:

	Allocation of Purchase Price	Fair Value of Identifiable Assets	Purchased Goodwill
Before Impairment	3000	2000	1000
After Impairment	1360	1000	360

The Net Fair Value of the Identifiable Assets is identified in the example as being the amount that the reporting entity would recognise if it acquired the cash-generating unit being 1000. The total value of 1360 has been arrived at by discounted cash flow, and is considerably lower than the Fair Value of Identifiable Assets shown as the carrying amount.

Valuers may well be asked to determine the Net Selling Price (now Net Fair Value) of the Identifiable Assets as the figure is obviously market related. How was the value reduced allocation of the Identifiable Assets determined in this example? There may well be a case that the purchased goodwill has been entirely eliminated and the Fair Value of the Identifiable Assets shown as 1360, still well below the previous carrying amount.

Example 2 raises new questions as to the valuer's role. In this example, the carrying amount of the acquired asset has been reduced very substantially because of the decision of a new government to restrict exports. The value of the acquired entity has been reduced by impairment from $3000 to $1360 and the fair value of the specialised identifiable assets from $2000 to $1000. The example explains that " T determines that the net fair value of the identifiable assets it would recognise if it acquired Country A cash generating unit at the date of this impairment test is $1000" etc.. How is this Net Fair Value to be determined? By definition, it is a market value approach. The sum total of purchased goodwill and identifiable assets is obviously calculated by the Directors by DCF but how under the new provisions of IAS 36 do they determine the split-up between the identifiable assets and purchased goodwill? The Exposure Draft is silent on this issue.

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We thank you for the opportunity to provide our comments. The IVSC would be very happy to meet with should you wish to discuss any aspects of our response in greater detail.

Yours sincerely,

John Edge
Chairman, International Valuation Standards Committee