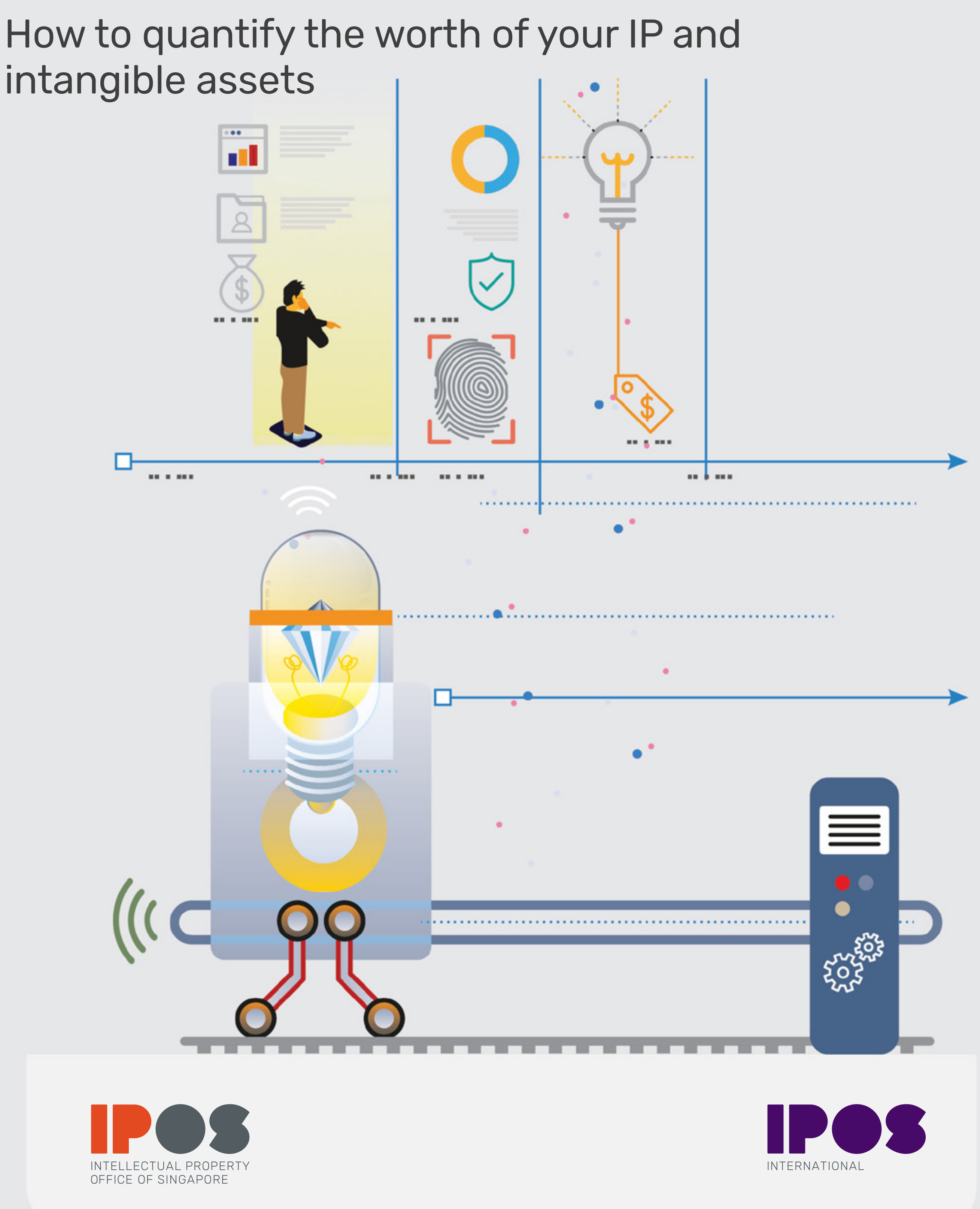
UNCOVERING YOUR HIDDEN VALUE

How to quantify the worth of your IP and intangible assets



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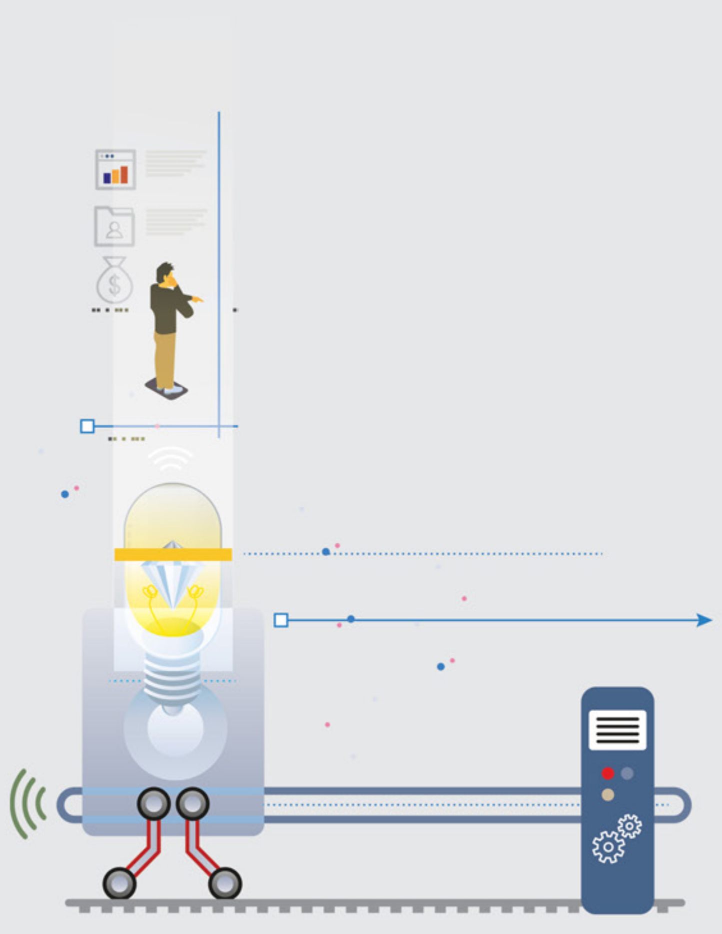

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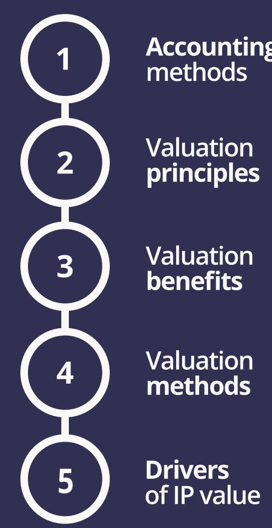
Introduction

Have you ever wondered what your intellectual property (IP) is worth? Or wished that you could express the value that is 'hidden away' in your intangible assets, which isn't reflected on your balance sheet but represents a vital investment for the future? If so, this guide is for you.

The main purpose of this guide is to help you determine whether, and when, conducting an IP valuation might be commercially beneficial for your business. It's divided into five main chapters (plus some worked examples and further references) that are intended to address the most important questions you may have about the process and the advantages. You don't need to be an accountant or lawyer to use it.

Chapter 1 addresses the question: if IP is so important, why isn't its value obvious from my company's accounts? The guide takes you through a few accounting basics to explain when IP and intangibles feature, and when they do not. It then explains why this position might be disadvantaging your business, and how an IP valuation report may help.



Chapter 2 introduces you to the main principles that guide the IP valuation process and provides an overview of the regulations and standards that govern it.

Chapter 3 then goes into more detail about the contexts in which having an IP valuation could be most useful. It starts by setting out cases where getting a valuation prepared is more or less mandatory and then moves onto several other business purposes that can be facilitated by a suitable report.

Chapter 4 then runs through each of the three main methods that are employed, summarising the advantages and disadvantages of each one, and how the appropriate method is selected.

Finally, Chapter 5 discusses the factors that are most likely to influence an IP valuation calculation and tells you what you will need to provide to get a report produced.

Produced by **IPOS International**, these intellectual property management (IPM) business guides aim to deliver a suite of IP solutions for enterprises based on industry best practices. As the expertise and enterprise engagement arm of the Intellectual Property Office of Singapore (IPOS), IPOS International helps enterprises and industries use IP and intangible assets for business growth. Some of these engagements may be eligible for Enterprise Singapore (ESG) funding, such as the intangible asset audit and strategy development aligned with business goals. IPOS International's business portal ***www.iposinternational.com*** also contains case studies and videos of enterprises leveraging IP to gain a competitive edge in their innovations. Should you have questions on IPM matters or wish to speak with our Intellectual Property Strategists, do email us at **enquiry@iposinternational.com** or call **+65 63308660.**

Why can't I see the value of my IP in my company accounts?

01

1. Why can't I see the value of my IP in my company accounts?

How do general accounting principles treat IP?

The format of company accounts is governed by a series of national and international standards. These determine the accounting treatment a business is allowed to give to non-physical ('intangible') assets like intellectual property (IP). It is different from how purchases of physical ('tangible' things like property or equipment are generally shown.

Many types of **tangible** assets are regularly traded. Independent evidence is available to establish the price they might fetch if they had to be sold, making resale values predictable. This gives companies opportunities to strengthen their balance sheets by showing the likely market value of the assets they own. If the value changes, their accounts can be updated to reflect it.

Also, most of the tangible assets a company owns (like commercial property, plant and equipment and vehicle fleets) will have been bought from someone externally. There is a documented transaction, with an associated price, to provide a starting point to 'write down' or spread this cost of purchase over time. Accountants generally call this **amortisation** when it simply distributes the cost over several periods or **depreciation** where it reflects diminishing value (as an asset wears out or gets used up).

Intangibles like IP are different. They usually get bought and sold together with the businesses that create and own them, and it is only comparatively recently that they have started to be identified in their own right rather than bundled up as 'goodwill'. The problem with this phrase is that 'goodwill' does not reflect the presence of real assets, and is often viewed sceptically by important people (like financiers).

In cases where IP is traded separately, deals are often done by specialist brokers and agents. The data on the price paid is seldom made public, making it difficult to draw comparisons between the value of your IP and 'real deals' in the market.

Also, most intangibles aren't bought from third parties; instead, they are generated internally. As well as making assets like these harder to sell (because they are often very closely connected with a firm's business model), there is no independent transaction to confirm their value or price.

If Company A buys in a design from Company B, it has a clear record of its cost. If Company B creates the same design but decides to use this internally rather than sell it to Company A, it doesn't have a single figure it can use; it has to work out the cost from internal records.

The combination of a lack of transparent markets and IP's internally generated nature causes problems for accountants who are trying to recognise investments in IP. Valuation reports provide a helpful—and sometimes an essential—way of filling the information gap.

When can IP value be recognised in my accounts?

There are two main ways to show IP value in business accounts. If you buy IP—either on its own or as part of a company acquisition—you can spread the cost of any identifiable intangible assets over their useful life (which, in the case of brands, might be indefinite). Alternatively, you can spread the cost of some types of IP investment, provided this meets a set of tests.

A 'standalone' IP purchase can be treated similarly to other asset purchases. The price you have paid (perhaps for a family of patents or a set of creative works) can be shown as an intangible asset on your balance sheet. The transaction provides evidence of a cost and sets a value that can then be amortised or 'written down' over time.

This has the benefit that the cost of your purchase can be distributed over the asset's useful life (subject to the relevant rules), so it doesn't impact your profitability all at once. The 'flip' side, however, is that with very few exceptions, there is no accounting provision for revaluing the asset – so even if the creative works referred to above start selling like hot cakes, their balance sheet value always appears to be going down.

There is one set of circumstances when the 'full' value of your intangible assets like IP will be recognised. If you are acquired by a big company, they will have to determine how much they have paid for any of your intangibles (which by definition includes any IP rights). Things you were never able to show on your balance sheet will now appear on theirs because by buying them, these assets are confirmed to have value. So, if you are contemplating selling your business, finding out what that 'hidden' intangible value might be may assist your negotiations.

Many countries, including Singapore, also allow you to spread the cost of expenditure that can be classed as development. If for example you have invested considerable staff time and effort in developing new software to run your business, or prototyping a finished product, you can capitalise these costs. Only certain assets may qualify, and the process has the same advantages and disadvantages as those explained above.

1. Why can't I see the value of my IP in my company accounts?

What IP can't be recognised in my accounts?

Any IP that has been created internally within a business can only be put on your balance sheet at the amount it cost. Also, unless your asset creation activity is directly associated with a current income stream, or underpins future revenues that your business can forecast with confidence, it normally has to be expensed as and when costs are incurred.

The chief difficulty this raises relates to research activity. Where risk and uncertainty are involved, expenditure cannot be capitalised (meaning you cannot put it on your balance shee—either at cost or on any other basis). To recognise this cost as an asset, you need to demonstrate you can measure it reliably, and more importantly, show it is probable that the expected future benefits attributable to the asset will flow to your company.

Arguably, this position is quite reasonable, because it will often be unclear at such an early stage whether any assets of value have actually been created from pure research. However, it does mean that the more research a company does, the less profitable it will appear to be because all such expenses have to be put through the profit and loss account in the period in which they are incurred.

Even where write-down of cost is possible, it is important to note that the value of the assets themselves is not in fact what is being recognised. If you patent an invention, which may involve significant expense, you may be able to distribute your filing costs over time and not bear the full expense at the point it is incurred, but this does not reflect the value of the IP rights protection you have created.

In Singapore, the key provisions concerning permissible accounting treatments are contained within Statutory Board Financial Reporting Standard 38. It is important to take independent professional advice if you are considering trying to reflect IP value in your accounts in any way.

Recognition of intangible assets on the balance sheet

Can be featured under accounting standards		Cannot be featured under accounting standards	
	Identifiable intangible assets that have been acquired in the course of a 'business combination' (a merger or acquisition)		Research-related expenditure

Can be featured under accounting standards	Cannot be featured under accounting standards
✓ Goodwill associated with a 'business combination' (which is a figure allocated to unidentifiable assets: essentially, the price premium paid to buy the company over and above value that can be justified based on assessment of its identifiable assets)	✗ Estimated contribution of the intangible assets to overall business value (however derived)
✓ Costs associated with developing intangible assets of definite commercial feasibility and use	✗ Estimated resale value (with a very small number of specific exceptions, where intangible assets are routinely traded)
✓ Price actually paid for an asset the business has bought at arm's length	

What problems does this lack of recognition cause?

Most businesses that innovate are disadvantaged by the difficulties that are inherent in recognising the investment they make in IP and other intangibles. Their profitability appears lower, and because they are not spending as much on tangible assets, they have less traditional collateral to offer as security for finance.

If you do capitalise permissible investment in IP, you are likely to end up with a figure on your balance sheet that can only go downwards, even if your IP rights are making a business contribution that is clearly increasing in value. With a couple of minor exceptions (for highly specialist intangibles like mining rights or aircraft landing slots, for which the market is more open), there is no mechanism to enable you to change this position, other than to test any goodwill figure for impairment (and goodwill only applies if you have bought another business).

For this reason, some companies prefer to 'take the hit' to their expenditure line as they incur the costs of innovating because the profit in future years is not impacted. If you are thinking of selling your business and you expect the price to be determined by earnings multiples, this may be a consideration. However, in the short term, reducing your profits by expensing everything you can may impact your perceived ability to service debt.

The advantage of capitalisation is that you can align the cost of your innovative activity with a period that more closely reflects the expected benefits. The downside is that your balance sheet will show an unrepresentative value which will impact future profitability (because it then keeps appearing as an expense line on the profit and loss account each year).

1. Why can't I see the value of my IP in my company accounts?

This might be characterised as a 'Catch 22' situation. Fail to invest in IP and intangibles, and your business value will diminish. Spend money on them, and your profit goes down, which affects your ability to borrow and sell. Decide to invest instead on tangibles like commercial property, and your bank will think you can offer great security, but it will do nothing for your future competitiveness!

Even if you do find a satisfactory way to place a value for your intangibles on your balance sheet, and it works for your business, do not be surprised if lenders discount it when assessing your creditworthiness.

This is because unlike entries for tangible assets, which nearly always reflect your ownership of property that a bank can see, touch and (if necessary) sell, intangible entries do not necessarily indicate the presence of assets from which value can be realised. Due to this uncertainty and its associated risks, lenders often discount the value of these intangible assets.

*An accompanying guide in this series—**Unlocking IP's Financing Potential**, sets out in more detail how lenders view IP assets, and what steps can be taken to harness their value in a variety of different funding mechanisms.*

How far can an IP valuation report solve these problems?

Most IP valuation reports are not designed to provide you with a value you can add to your balance sheet. Instead, an IP valuation can help you to establish and demonstrate the value that is not shown in your accounts. It can be used to complete a range of different types of transactions, and provide you with important insights into your 'hidden value'.

For the reasons set out in this chapter, whatever type of IP valuation report you produce, it will not normally provide a figure you can expect your accountant to recognise in your formal company accounts (because it represents a professional opinion, rather than a transaction that has happened and that could be replicated on an open market).

The exception relates to Purchase Price Allocation reports, which happen after a business acquisition. These are specifically designed to tell you how much of the price you have paid is attributable to identifiable intangibles and should be shown in your accounts (usually on an amortising basis). They also set out separately how much of a price paid for a business is 'goodwill' (a premium that cannot be associated with assets that are identifiable and separable).

Without proper explanation in accompanying notes, allocating a large balance sheet figure to intangible assets may be interpreted by lenders and investors as showing that you are trying too hard to shore up your balance sheet with assets of uncertain identity and value. They may conclude that you are just very good at spending money! Anything shown as 'goodwill' is especially vulnerable in this regard. This is where an IP valuation report can help because it demonstrates and explains the value that your accounts leave out.

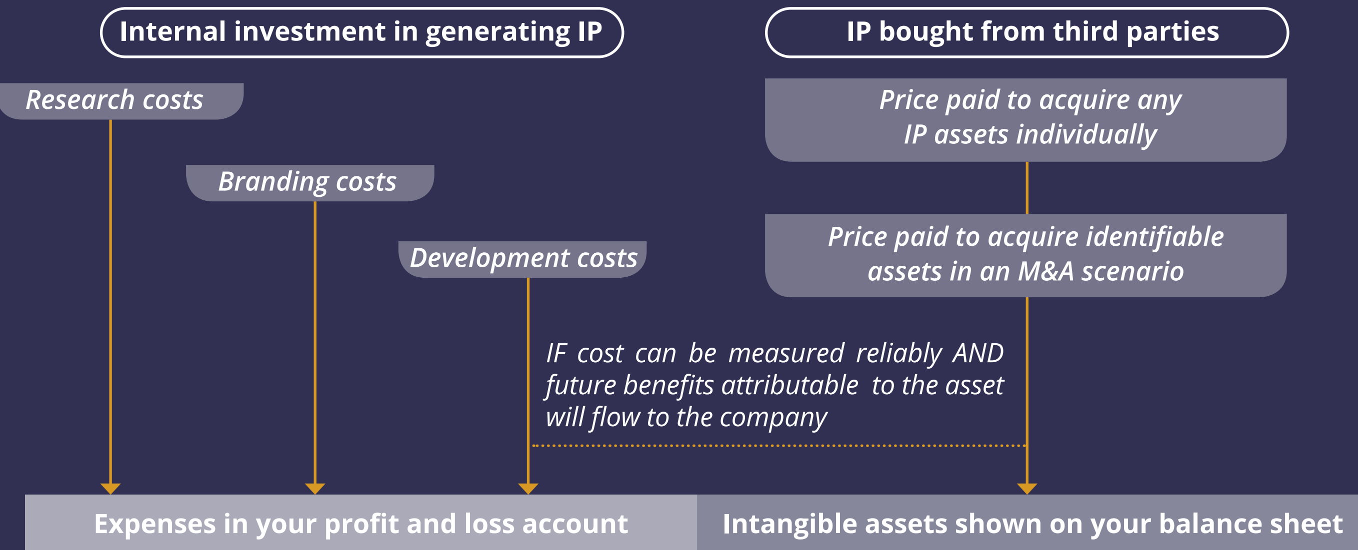
IP valuation reports come in a variety of shapes and sizes. The following sections explain the different ways of calculating value, which depend on context or purpose, and the amount of internal and external information available.

Valuation reports can be produced in-house, but are normally more highly regarded when produced by an independent IP valuation specialist or an accounting firm using a recognised approach or methodology. Importantly, any valuation report should make the basis for calculation clear, so that it can be followed by someone who is not an expert in accounting.

While a third party will seldom be able to rely on a valuation's findings, for contractual reasons (reports are written for the benefit of the company that commissions them, who may regard the detailed content as confidential), it will help you explain how your investment in IP translates into short and long-term business benefits.

Where is the value of my IP hiding?

This diagram shows how common forms of investment in intangible assets generally end up being represented in your accounts.



What rules apply to IP valuation?

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What are the main principles used in IP valuation?

The methods used to value IP have elements in common with business valuation. However, while a business valuation seeks to take all a company's assets into account, an IP valuation is only concerned with identifying, isolating and representing the value in its intangibles.

When valuing a business, such as for investment or acquisition purposes, the focus will usually be on the revenues and profits that it generates, and how these are expected to develop into the future. Often, multiples of profit (and sometimes of turnover/sales) will be used, based on research into financial markets. If a company is yet to generate any profits or is pre-trading, there may be a greater emphasis on investment received and made, and on comparisons with other businesses that have reached a similar stage of development.

Most tangible assets (such as domestic and commercial property, vehicles, plant and equipment) are valued using price comparisons based on market data. Since these are not readily available for intangible assets, there is usually a greater emphasis on quantifying the contribution that an identified set of assets is making to a business's performance. As with business valuation, the earlier stage a company is at, the greater the reliance on historical investment and market comparators is likely to be.

The main challenge with IP valuation is to isolate intangibles and their contribution (or cost) from the other things that a business uses. To do this, it also needs to consider what a company actually owns. An important example is its 'human capital'. There is a distinction between a workforce and their skills, which a company does not own (rather, it can influence and control), and the know-how embedded in processes that the workforce follows and innovations they use every day. The latter are assets a company is capable of owning and transferring.

Occasionally, there is a need to isolate value in one particular IP right, or group of rights. However, intangibles like IP almost invariably add value to each other in combination, and their relative contributions can be hard to separate. For this reason, they are usually examined on a whole business level, or grouped into 'baskets' of related assets and assessed together.

Most IP valuation reports are prepared using one or more of three methods: i) the amount it would cost to reproduce or replace the IP; ii) the amount paid for similar IP under similar circumstances; and iii) the contribution the IP makes to company turnover, cash flows and/or profits.

As discussed in the following chapter, some methods are best suited to particular contexts. Chapter 5 goes into detail regarding how each of these methods works.

2. What rules apply to IP valuation?

The three most common methods of IP valuation

	Cost	How much would it cost to re-create all the IP from scratch (called the reproduction cost method) or replace it with something of equal utility (called the replacement cost method)?
	Market	Have IP-related transactions taken place in similar sectors, with enough features in common to make a comparison relevant, subject to appropriate adjustments? Or is there enough IP detail in broader commercial deals to extract a point of reference?
	Income	What contribution do these assets make to past, present or future sales and/or profits?

Which regulations are most relevant for IP valuation?

Several sets of regulations may be applicable to the value a company can place on its IP under different circumstances. They come from three main sources: international rules, accounting regulations and quality standards. Each of these is briefly summarised below.

The rules governing the prices at which assets can be transferred between different parts of the same corporate entities have been strengthened in recent years. This is to address the practices by some large multinationals which were held by governments to verge on tax avoidance. OECD has published an Action Plan on Base Erosion and Profit Shifting (commonly known as 'BEPS').

The two key sets of international accounting rules, with which national accounting regulations such as Singapore's are broadly aligned, are IAS 38 and IFRS 3. These both establish the principle that an asset has to be separable and identifiable in order to be recognised by a business.

The only formally registered international valuation standard is ISO 10668, first introduced in 2010, which concerns requirements for monetary brand valuation. Like International Valuation Standards Council's (IVSC) guidance (see below), it specifies that the income, market or cost approach should be used, either individually or in combination with each other, with the choice dependent on purpose, value concept and brand characteristics.

Otherwise, standards have mainly been derived nationally. MyIPO in Malaysia has published an approved IP valuation model when it introduced its IP financing scheme, while in Europe, there is a Monetary Patent Valuation Standard in Germany (DIN77100), and two standards set by the Austrian Standards Institute, ONORM A6800 & A6801.

Key international regulations and their scope

International regulation or standard	What it covers
IAS 38	Sets out approved accounting treatments for intangible assets
IFRS 3	Sets out how 'business combinations', otherwise called mergers and acquisitions, should be accounted for, including guidance and examples illustrating how intangible assets may be identified
Base Erosion & Profit Shifting (OECD)	Recommends 15 actions to ensure that tax is paid in the jurisdiction where economic activity occurs. Action 8 is the key point of reference for valuation purposes

What industry and informal standards exist?

Industry norms and valuation guidance come in several forms. Some provide ways of addressing the deficiencies of standard financial reporting, while others relate to the actual practice of IP valuation.

The two best-known routes used by companies wishing to explain their intangible asset investments to markets and stakeholders are to make use of Intellectual Capital Statements or to adopt Integrated Reporting. Each of these provides a structure for additional reporting that may help companies articulate (among other things) what intangible resources have been created and how these add value to their business. Both frameworks are flexible; neither sets out whether any firm financial value should be attributed to intangible assets, or specifies how it should be done.

The most important international source of guidance for the valuation industry as a whole is the International Valuation Standards Council (IVSC), which is primarily concerned with best practice. IVSC publishes a Framework and Requirements document, covering generally accepted valuation concepts, principles and definitions, and separately offers supporting guidance in a series of Standards covering applications and technical information to cover most forms of valuation in business.

2. What rules apply to IP valuation?

This covers all business assets but does specifically include intangible assets (which are covered by a specific guide, IVS 210). Cost, market and income are the three main methods described in this guide, with commentary on specific variants that may be deployed.

While the IP valuation industry is not regulated, the growing contribution intangibles make to business value has led to an increasing number of government agencies to require practitioners to do more to raise standards. As one example, three organisations (ASA, AICPA and RICS) have responded to concerns from the US Securities and Exchange Commission (SEC) and introduced a new credential, known as Certified in Entity and Intangible Valuation (CEIV). In Singapore, there is now a Certified Valuer and Appraiser (CVA) qualification: this is applicable to many of those practising IP valuation, though it is not mandatory.

Separately, the litigation industry places some reliance on a series of factors (15 in total) to consider when valuing IP for damages, which are known as Georgia Pacific Factors . There is also a range of circumstances under which some consideration of IP value may be relevant in insolvency proceedings; however, reliable data to support the usual cost and income valuation process is not usually available, so market methods are more relevant (the primary consideration is to identify possible buyers and negotiate from there).

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