

# Standardising IP valuations: whether, what and how

Valuing IP is complex, with more than 50 different methods currently in use. Given the growing importance of IP to so many organisations, perhaps now is the time to re-think whether global valuation standards make sense

By Dr Patrick H Sullivan

There is an increasing recognition that ideas, knowledge, know-how, innovations and other intangibles are fundamental sources of value in business. But identifying and measuring that value is complicated, with more than 50 methods currently available to do so. In the case of intellectual property, a valuable form of intangible to the business and financial communities, there is a particular interest in improving the consistency, quality and usefulness of valuations.

The valuation of IP matters to a large number of professional groups. They include businesspeople, valuation professionals, accountants, academics, consultants, regulators, tax authorities and valuation thought-leaders. But there is no general agreement among them on how the valuation of intangibles should be conducted.

Several attempts have been made over the past decade to develop standards for valuing intangibles (see Box B for some examples), but none has had a visible impact on IP valuations or significantly improved the quality and consistency of IP valuation reports. Why not? What are the major issues that have prevented the development of IP valuation standards?

Although none of the previous attempts to standardise IP valuations has succeeded, each one furthered our understanding of

intangibles and the characteristics that affect their value. With that greater understanding in hand, and given the importance of IP to an increasing number of businesses, it seems time to investigate three fundamental questions related to standardising IP valuations:

- Does it make sense to standardise IP valuations?
- If so, what should be standardised?
- How could valuation standards be created and implemented successfully?

The answers to these questions depend on the perspective of the person asked and the professional communities within which they operate. The different, and sometimes narrow, interests and focus of each community have made it impossible for them to agree on any one standard for IP valuation. Further, the tendency of businesses to consider IP valuation mainly within the context of the financial accounting paradigm has been a major impediment to the development of credible and useful valuation standards.

Although standardisation affects diverse communities, the one most directly affected is the IP valuation community itself. For this reason it seems reasonable to begin an exploration of standardisation through the eyes of this community.

For credible views on the three fundamental questions above, I sought the opinions of respected academics and practitioners who have made significant intellectual contributions to the field of intellectual property valuation, both in theory and in practice. Six such people agreed to be interviewed (see Box A). This article presents the views of these experts (referred to here as the panel). My interviews with them were conducted serially with each independent from the



others. No one thought leader expressed all of the ideas presented here, although there was remarkably little disagreement on the basics. The collective perspective that emerges from their views may establish a context and criteria for future attempts to standardise IP valuations.

**Standards and standardisation**

There are two broad types of standards: rule-based standards and principle-based standards (I use standards in this context to mean guidelines and definitions, such as ISO 9000 for quality systems and ISO 400 for film speed). Rule-based standards are often found in environments where there is both a need and a capability to enforce the standard. Principle-based standards are often used in professional environments where definition and understanding of accepted professional behaviour (more than enforcement) is often the main issue.

Traditionally, there has been a boundary between technical standards organisations and professional standards organisations, although the lines between them are beginning to blur. On the technical side, perhaps the premier organisation is the International Organisation for Standardisation (ISO), formed to: “Facilitate the international coordination and unification of industrial standards.” ISO is made up of member bodies that are “most representative of standardisation” in their countries. Only one organisation from each country is accepted for membership in the ISO. So, for example, in the United States the member body is the American National Standards Institute (ANSI); in Canada it is the Canadian Standards Council; and in Japan it is the Japanese Standards Association.

The need for an ISO standard is usually expressed by an industry sector, which communicates this need to an ISO national member body. The latter proposes the new standard to the ISO as a whole. Once the need for an international standard has been recognised and formally agreed, the first phase involves defining the technical scope of the future standard. This phase is usually carried out in working groups of technical experts from countries interested in the subject matter. Although the ISO and its member bodies have typically focused on technical and industrial standards, they have more recently become involved with management systems standards.

In contrast to technical standards organisations, professional standards organisations focus on the ethics, methods and practices in specific professions. Examples include the accounting profession

(in North America they are the US Financial Accounting Standards Board (FASB), the Canadian Institute for Chartered Accountants (CICA) and Mexico’s *Instituto de Contadores Publicos*); the legal profession – the professional standards committees of the national bar associations; and the medical profession – the professional standards committees of the national medical associations; to name but a few. Each profession establishes its own standards, some relating to ethics, others to methods of operation and still others to specific practices.

Is the IP valuation community sufficiently organised and cohesive to warrant the establishment of either a rule-based or a principle-based set of standards such as those described above? The IP valuation community spans different disciplines, each with its own perspective. It is a fragmented community populated by people trained in accounting, economics and finance; IP valuation has not yet achieved the degree of cohesion necessary to call itself a profession. A standard for IP valuation developed around the context of any one of its constituents (accounting, economics or finance) could be entirely wrong for the others.

Standards are more easily implemented when they are reinforced. A good example of reinforcement is found in the Canadian accounting profession, which uses four main sets of standards:

- Financial reporting standards – standards for measurement and disclosure.
- Auditing standards – dealing with matters concerning the process of auditing.
- Ethical standards – a code of professional conduct for accountants.
- Certification standards – defining the body of knowledge and the competencies that accountants are expected to possess.

The first two sets of standards are the responsibility of an independent standard-setting organisation and the profession itself manages the latter two. The four different categories of standards are mutually reinforcing. The auditing standards reinforce the financial reporting standards; the ethical and certification standards ensure that accountants are qualified and motivated to live up to the financial and auditing standards, as a failure to maintain one’s knowledge or to act ethically can cut a career short.

In short, standards of practice or

**Box A: The panellists**

Six thought leaders in the field of intangibles valuation whose views on IP valuation issues are discussed here:

- Dr Daan Andriessen: Professor of Intellectual Capital at InHolland University and author of *Weightless Wealth*
- Dr Baruch Lev: Professor of Accounting and Finance at New York University; author of two books and many articles on intangibles and their value
- Rob McLean: President of MatrixLinks, author of *Re-Discovering Measurement*, and adviser to the Canadian accounting profession on intellectual capital and value measurement
- Russell Parr: President of Intellectual Property Research Associates Inc (IPRA); author and co-author of 10 books on intangibles and valuation
- Gordon Smith: Chairman AUS, Inc., author and co-author of several books on IP valuation; Adjunct Professor and director of IP Institute at Pierce Law.
- Dr Alexander Wurzer: Managing Director of PATEV; Director of the Institute for Intellectual Property Management at Steinbeis University, and author of several books and articles on IP valuation.



**Dr Daan Andriessen**  
Professor of Intellectual Capital at InHolland University

## Box B: Standardisation attempts

Selected list of organisations and activities that have attempted to develop IP valuation standards:

- Brookings Institution Project on Licensing Executives Society (LES) “Gold Standard” Project
- US Financial Accounting Standards Board (FASB) Statements 141 and 142.
- Value Measurement and Reporting Collaborative (VMRC)
- International Valuation Standards Committee
- German Institute for Standardization, General Principles of Proper Patent Valuation
- International Organizations for Standards
- International Financial Accounting Standards Board (IFASB)

performance may work best when they can be developed in concert with other standards that reinforce the desired conduct.

### What is the generic process for valuing intangibles?

Whether estimating price or worth, professionals who seek to value IP follow a generic process. Before doing any calculations they identify the factors that define the context of the valuation at issue (see Box C). They identify the method that will be used, the parameters involved, the data required for the calculation and information about the markets, as well as any external factors deemed to be pertinent.

Professional valuers recognise that valuation is as much an art as a science, meaning that while there are protocols and accepted procedures (the science), the decisions that precede calculation are perhaps more crucial to a successful IP valuation activity than the calculations themselves. Making those judgements (the art) is inherent in the process and must be considered in any standardisation procedure.

### Why should IP valuations be standardised?

The reasons for standardising IP valuations depend largely on the perspective of the person asked. People outside the IP valuation community – for example, regulators, tax authorities and accounting standards setters – answer differently from those inside it. Regulators are interested in levelling the playing field, ensuring that IP valuation information is understandable and available to all interested parties. Tax authorities want IP valuations to be consistent, credible and conducted in accord with their own standards; financial accountants need valuations to comply with Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS). But professional IP valuers, people inside the IP valuation community, have different concerns. The focus of IP valuation professionals is on improving the quality and consistency of IP valuations, whereas the focus of those outside the community is on ensuring that IP valuations be conducted within unique frameworks associated with their different perspectives and IP contexts.

The panel, largely (but not unanimously) agreed that an IP valuation standardisation process should be led by the IP valuation community. The arguments for standardisation were identified as follows:

- The need to create a common language:

The terms often used in the valuation of intangibles are not used uniformly. The word value itself is used to mean several different things. A standard should define the relevant terminology in order to provide clarity in communications and minimise the chances of misunderstanding.

- The need to improve the consistency of valuations and valuation reports: Because there are so many methods and so many IP valuers, with different professional training and levels of understanding, there is little consistency in how valuations are conducted and what IP valuation reports contain. Some include background information, the sources of data used and the details of business judgements. Others provide little more than the type of IP being valued and a value estimate. IP valuation standards could improve consistency by defining what a standard IP valuation report should contain.
- The need to minimise unethical and incompetent valuations: Professional valuers are implicitly entrusted to use their professional knowledge and skill to provide the best valuation estimate possible. But some intentionally abuse that trust; while others may be well-intentioned but lack knowledge and experience. Standards would help to minimise unethical and incompetent valuations by defining a set of ethical principles and behaviours to which IP valuers are expected to adhere.
- The need to define required valuator knowledge: People who are new to the field of IP valuation may lack an adequate understanding of the nature of IP – the special considerations related to valuing IP, how IP is used in business and the different kinds of value it can provide. In the absence of standards defining the level of knowledge and know-how necessary for valuing IP, such people blithely enter where others fear to tread. A standard could require or recommend a particular level of knowledge and understanding on the part of the valuator.
- The need to let clients and users of a valuation know what to expect: Clients and users of valuation results should know something about IP value and valuation, as well as what to expect from the person conducting the valuation. This might include educational information about the value and valuation of intangibles, examples of what a valuation report is expected to



**Rob McLean**  
President of MatrixLinks

contain, information about the level of knowledge required of IP valuers and information about what the profession has codified as its code of ethics.

The panel identified three major arguments against standardisation:

- The number of factors that are specific to each intangible makes standardising their valuations impossible.
- Standardisation could oversimplify what is inherently a complex process.
- We should avoid arriving at only one view of valuation – one that is North American or European centric, for example. Such a singular view of IP valuation could cause people to make assumptions about the value of IP that are not necessarily valid in all corners of the world.

#### What can be standardised?

The panel agreed that potential standards should provide the highest level of guidance and direction while avoiding detailed control. Standards at the micro-level, or valuation by rote, would recognise neither the many possible contexts for a valuation nor the need for judgement in the valuation process. Such a standardised approach would have little credibility and probably few advocates.

The panel recognised a need for flexibility in what is to be valued. Panel members pointed out that new forms of intangible enter our world every day. Only a few years ago, for example, websites and domain names were unknown, yet today they are common items for valuation. Because the items to be valued are changing constantly, any standards developed should focus on principles that can be adapted to new needs and situations. Excessively detailed, low-level or rule-based standards would stand in the way of that.

Nevertheless, the panel thought it could be possible and desirable to standardise the following:

- Ethical guidelines for valuers: There are currently no generally agreed ethical standards to which valuers in the IP valuation community must adhere. There are individual professional groups within the IP community that have developed standards of behaviour for their members, but these are neither accepted nor necessarily practised beyond the borders of the groups' membership lists.
- Terminology: Too frequently, valuation reports contain terms and phrases that are undefined, ambiguous or unique to an industry or area of business. A glossary or dictionary of commonly

used terms would minimise misunderstandings.

- The identification of elements that constitute the context of the valuation: It is now common wisdom in the IP management community that IP (and other intangibles) are operationally passive, having no value by themselves. It is only when these intangible assets are teamed with other (often tangible) assets, operational capabilities or uses that their value can be released. The context within which an IP asset is used defines the nature and amount of value it can provide to a specific owner or user. Although our understanding of context is still evolving, the panel provided an understanding of the elements that currently appear to define it (see Box C). Standards could require that the context of an IP valuation be included in any valuation report.
- The content of a valuation report: Clients often complain that IP valuations are inconsistent. In part, this is true because there is no broad agreement on the appropriate or necessary content. An IP valuation standard could list appropriate and desirable content categories, with examples.

#### How should valuation standards be created and implemented successfully?

The panel deemed several items to be particularly important in developing IP valuation standards that are viewed as credible by professionals within and outside the IP field. These were: oversight of the standards development process; broad-based professional participation; and an understanding of the steps to be followed during the standards development process.

#### Oversight of the process

The credibility of standards would be enhanced if they were developed under the auspices of a body, enterprise or activity held in high regard by those who conduct IP valuations. Several such bodies exist, each offering advantages and disadvantages. But in the view of the panel, there is no one body with sufficient focus, credibility and reach to sponsor an IP valuation standardisation effort. The panel concluded that a consortium of organisations might appropriately sponsor the development of IP valuation standards.

#### Professional participation in the standard-setting process

There was agreement that even if IP practitioners were to lead the effort, they



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Chairman AUS, Inc

### Box C: Potential valuation contexts

The context of an IP valuation may include a number of factors, among them:

- The purpose of the valuation estimate (eg, tax, external performance reporting, sale, licensing or litigation), as well as any purposes for which the valuation specifically may not be used.
- Identification of the beholder, the person from whose perspective the valuation estimate is viewed (eg, external beholders, such as potential investors, shareholders, prospective purchasers; or internal beholders, such as the CEO, the CFO, chief legal officer, licensing officer, chief R&D officer).
- The definition of value used; for example, worth – value in use to a specific beholder; or price – a historical or future estimated selling price.
- Any premises that should be understood to affect value (eg, whether the business is a going concern, has filed for bankruptcy and so on).
- Timeframe of the value estimate (past, current or future).
- The standard of measurement (market capitalisation, value in exchange, value in an accounting framework).
- The unit of measurement (eg, currency, indices, ratios, vectors).

must invite the other stakeholding individuals, societies and enterprises to the table. The list of interested stakeholders includes, but is not limited to:

- Regulators (eg, the US Securities and Exchange Commission).
- Taxation officials (national, federal, state, provincial).
- Standard setters (accounting standards boards; eg, FASB, CACSB, IASB).
- Professional organisations, such as the American Institute of Certified Public Accountants (AICPA); the Canadian Institute for Chartered Accountants (CICA); the Licensing Executives Society (LES); ASAM; CFAI; the existing business valuation communities, such as AICPA's Business Valuers (ABV), Canada's CSV's (Chartered Business Valuator), the (American) and the (International) Society of Appraisers, *et al.*
- Representatives from the capital markets.

The panel largely agreed, however, that the effort should be primarily intended for (and led by) IP professional valuers. Their reasoning is that if practitioners do not develop standards for their own profession, someone else will do so. Standards developed by other professions could very well be incomplete, inadequate or skewed; and IP valuers might be less inclined to adhere to standards developed by others, regardless of their adequacy.

#### Steps in the process

The standardisation effort might be divided into parts, with the IP valuation community focusing its efforts on improving the quality and consistency of IP valuations and valuation reports. Other concerned groups, such as the business community, the legal community, the regulatory interests and the capital markets, could develop and codify their own IP valuation standardisation needs. The IP valuation community could then integrate their efforts with the interests and needs of these customers of IP valuations.

#### Ensuring compliance

There is a spectrum of possible approaches to compliance. At one end of the spectrum compliance is voluntary; at the other end compliance is required and policed.

At the voluntary end of the spectrum, there is no reasonable way to ensure absolute compliance with any standard of practice; whereas at the enforcement end of the spectrum, policing is required. Valuation standards must be reasonable enough that a professional valuator would see them as advantageous and would

willingly adhere to them. Standards that are inappropriate, onerous or simply not credible would soon be abandoned by all.

Those who favour a stricter approach take the view that because there will always be people who flout standards, there should be some sort of an oversight group or committee to which ill-informed or unscrupulous actors may be brought for review and education, or even possible censure. Lacking such oversight of professional conduct, these people argue, it is difficult to see how compliance could be achieved.

The panel took no view on the question of compliance, except to express a hope that any standards would be so well conceived as to be accepted by all as worthwhile and good business practice.

#### How to organise

Although the large number of concerned stakeholders in this effort creates the possibility for an unwieldy organisation, the panel did not provide specifics for how the effort might be organised. The panel agreed that a steering group should guide the process, though it did not agree on its make-up. One view was that the steering group should comprise only members of the IP valuation community, working closely with a more widely constituted working group made up of members of stakeholder organisations. The counterview was that the steering group should include both IP valuation community members and other stakeholder representatives.

#### Summing up

The valuation of intellectual property is more complex than valuation of real or tangible property. Numerous business, academic, regulatory, professional bodies and individuals have a stake in the valuation of IP. They view it through lenses that are polarised by the needs of their own community.

Developing any standard from the collective perspective of such a broad field of interested entities and individuals will be difficult. One practical alternative appears to be the potential development of IP valuation standards from the perspective of the IP valuation community, the group most directly concerned with the quality and consistency of valuation results. Other interested groups, individuals and organisations might adapt that standard to meet the needs of their own communities.

The thought-leaders interviewed for this article agreed that any attempt at standardisation must avoid oversimplifying the process, which requires a series of judgements on the part of the valuator.



**Dr Alexander Wurzer**  
Managing Director of PATEV

Individual panellists pointed out that there are several issues that standards could usefully define. First, a glossary of commonly used terms and phrases would minimise miscommunication. Second, the consistency of valuations and valuation reports could be improved by defining what kinds of information they should include. Third, valuation reports should identify and describe the context for the valuation. Fourth, a standard should include a code of ethical behaviour outlining acceptable business and valuation activities. Fifth, a standard should describe the minimum level of knowledge and know-how necessary for IP valuers to do their job. And, finally, because clients and users of valuation information should be made aware of what to expect from an IP valuator and an IP valuation report, a standard should include information such as this that could be provided to clients and users of IP valuation reports.

Most panellists posited that the chances for success in developing and implementing IP valuation standards would be enhanced if it were done under the auspices or sponsorship of a credible body or authority. But they reached no consensus on what group would be sufficiently authoritative to provide such credibility.

The two different kinds of standard-setting bodies, technical and professional, each deal with different kinds of standards, with different dimensions of standardisation and with different audiences. Technical standard-setting bodies, such as the ISO, have considerable experience developing rule-based technical standards for products, but they have little knowledge or experience with setting principles for a professional activity such as IP valuation. Using a professional standard-setting body is not an option in this case, however, because IP valuation is still in its infancy and lacks a professional oversight body.

In the final analysis, there are two conclusions one may draw about a sponsoring body: first, that it is desirable; and second, that no one existing body appears adequate for the task. A consortium of sponsoring bodies might therefore be needed to provide credibility to an IP valuation standard-setting activity.

Alternatively, any standardisation effort that is led by the IP valuation community must be populated with participants possessing sufficient knowledge and experience to be credible themselves.

If the focus of the IP community participants is to be on improving quality and consistency, then perhaps it makes sense to ask each of the several other

interested communities (eg, legal and capital markets) to define the contexts within which their community would like to have valuations conducted. Perhaps such a bifurcation would allow each community to focus on what it is able to influence, leaving the others to do the same.

#### Towards an IP profession

Although there are several conclusions one may draw from the preceding discussion, two are unequivocal:

- IP valuation standards would be useful, particularly if they were focused on principles rather than on detailed rules.
- At a minimum, such standards should focus on improving both the quality and the consistency of IP valuations and valuation reports.

On the question of how such standards might be developed and implemented, however, there is not yet a clear path. There is not yet an IP valuation profession, or even a common understanding of what or who constitutes the IP valuation community. Still, it appears that business and regulatory communities have a need and a desire for some sort of standard for valuation activity and performance. Perhaps it is time to discuss whether to formalise an IP community (as distinct from the broader valuation and assessment community) as a step towards the ultimate development of an IP valuation profession.

Because there is no single organisation capable of credibly and effectively sponsoring an IP valuation standardisation effort, a consortium of several potential sponsoring bodies could be created to provide the necessary oversight. Although today the IP valuation community is a community in name only, the importance of IP valuations and the concomitant desirability of an IP valuation profession mean that the development of an IP profession should be a topic for future discussion. **iam**

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The author gratefully acknowledges **Bill Swirsky, Sharon Oriel, and John Raley** for their constructive comments and suggestions

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