IVSC Standards Board
1 King Street
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By email to: commentletters@ivsc.org

2 June 2016

Dear Sirs

Response to Exposure Draft

IVS 2017: IVS 104 Bases of Value

Please find attached our comments on the above exposure draft.

The directors of Valuology have considerable experience of valuation standard setting generally and knowledge of the existing IVSs and their evolution.

If you would like any additional information in relation to our responses or comments, please do not hesitate to contact us

Yours faithfully,

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Comments on Exposure Draft of IVS 2017

IVS 104 Bases of Value

Answers to Questions in ED

(a) Do you agree that valuers should be responsible for choosing the appropriate basis (or bases) of value according to the terms and purpose of the valuation assignment, and that the basis of value may not be one defined by the IVSC? If not, why?

Yes. This is a requirement of the existing standards, IVS 101 2(e), IVS 102 6 -8 and IVS 103 5(e).

(b) Prior versions of international valuation standards included Special Value as a separate and distinct basis of value. The Board generally believes that valuers seldom perform valuations using Special Value as a distinct basis of value. Rather, valuations are typically performed using another basis of value predicated on certain hypothetical assumptions ("special assumptions") or a specific purchaser (resulting in synergistic value). Do you agree with the removal of *Special Value* as a separate and distinct basis of value? If not, please describe the circumstances in which you use Special Value as a distinct basis of value?

The question is incorrect when it posits that prior versions of the IVSs included special value and synergistic value as distinct bases of value. Nowhere in IVS 2011 or 2013 are they described as such. They are both elements of value that may arise in different bases. For example, synergistic value can arise in market value if the synergies are realisable by multiple market participants, in equitable value where the synergies are shared between two parties or in investment value when the synergies are only available to the current owner. Although some constituents have always made a distinction between special value and synergistic value, this is not shared or understood by all. However, special value is specifically excluded from market value, see 30(a) of current IVS Framework. If it is no longer identified and defined in the IVSs, this will need attention.

(c) The IVSC has retitled the previously defined Fair Value as Equitable Value in order to avoid confusion with other definitions of Fair Value. Do you agree with this change, if not why not?

Yes. This was also proposed in the 2015 ED

(d) Liquidation Value has been added as an additional basis of value. Do you agree with its inclusion within IVS 2017 and are you in accordance with the definition used? If not, why not?

No. It is not a description of a type of value but of a disposal scenario. See the General Comments on this draft below, lines 42 -51.

(e) Replacement Value has been added as an additional basis of value. Do you agree with its inclusion within IVS 2017 and are you in accordance with the definition used? If not, why not?

No. As defined in the draft it is not a value but a cost. There are other problems with this definition which are explained in the General Comments on this draft, lines 52 -72.

(f) Are there other bases of value defined by other entities/organisations that should be mentioned in IVS 104? Which ones? Why?

No. See General Comments on this draft below, lines 74-95.

General Comments

This draft Standard starts with a highlighted statement that "*Compliance with this mandatory standard requires a valuer to select the appropriate basis (or bases) of value and follow all applicable requirements associated with that basis of value whether those requirements are included as part of this chapter (for IVS-defined bases of value) or not (for non IVS-defined bases of value)*."

This is effectively a replication of the current Requirements in IVS 101 2(e), IVS 102 6-8 and IVS 103 5(e) and is therefore redundant. The rest of this standard includes nothing which can be made mandatory as while definitions are provided, there is not requirement to use the defined bases in any given situation and it is acknowledged that many other bases exist beyond those identified which may be the appropriate in order to comply with this requirement. An unlimited list of options cannot be mandatory. This was the very reason why the Board responded to the comments received during the 2010 consultation by removing the proposed standard on bases of value to the newly created the Framework.

The current IVS Framework identifies three types of bases – exchange between two unconnected parties in the market, exchange between two specific parties in private transaction and value to a specific entity. The proposed Introduction (10.4) assumes all bases reflect a transaction, in spite of the fact that non-transactional bases are included in this standard. As it is, the examples in 10.4 make no sense, for example, how can an assumed transaction also be an actual transaction? Further, it purports that a purchase transaction can be distinguished from a sale transaction in valuation terms, disregarding the fact that any transaction involves both a buyer and a seller and it is the interaction of the two that determines the price, and therefore any valuation based on a premise of a transaction. Egregious statements such as this may encourage diverse interpretations or manipulation of values, and cause confusion to those who provide or rely on valuations.

The draft does include the proposal made in the 2015 exposure draft of renaming "fair value" for purposes outside of financial reporting as "equitable value" to avoid the inevitable confusion with the IFRS definition, which is to be welcomed.

It also proposes to add two more basis of value, "Liquidation Value" and "Replacement Value". Neither of these represents a useful addition to the bases currently defined by the IVSC, as is explained below. Also, the proposed addition of "/Worth" to "Investment Value" is not only contrary to the outcome of the specific consultation carried out in 2010 as to the most appropriate term for an entity specific bases of value, but to research undertaken on behalf of the Board that revealed that in many languages other than English, "Value" and "Worth" translate as the same word, so the intended distinction would be confusing to many constituents.

However, "Discharge Value" which was proposed by the Board in the 2015 ED as an entity specific value applicable to liabilities has been omitted. This is in spite of the proposed definition having been developed in conjunction with the International Actuarial Association following broad support for the need for a basis to reflect the current cost to an entity of discharging a future liability in the responses to the 2013 Discussion Paper on Liabilities.

Synergistic Value

As indicated in the response to question b), this is not a basis of value but is the description of an element of value that can arise in in valuations undertaken on a number of different bases.

Liquidation Value

As defined in the draft, "Liquidation Value" is not a basis of value but a description of how the assets being valued are presented to the market, in other words a disposal strategy. In the current standards, the need to consider what is being valued and in particular how separable assets are aggregated for valuation purposes is part of the Framework. The introduction of Liquidation Value does not address this issue as comprehensively or with the same clarity. It also fails to recognise that in a liquidation situation, the previously defined bases, Market value, Equitable Value and Investment Value can all be applicable depending on the circumstances of the liquidation. While the Market Value of a business's assets assuming liquidation makes sense, the Market Value on the assumption of Liquidation Value does not.

Replacement Value

The proposed "Replacement Value" is both an oxymoron and contradictory.

It is an oxymoron as the definition in 90.1 indicates it is a cost. The difference between cost, price and value is something that does cause confusion, especially among valuation users, and is the reason why this is explained in the current Framework. This is an immediate example of how the proposed removal of concepts that underpin the IVSs would lead to a loss of clarity and lead to incorrect interpretations.

The rest of 90.1 appears to be based on a definition that might appear in a buildings' insurance policy. The Board has received a number of requests over the last 20 years to include "insurance values" in the IVSs. On each occasion it has concluded while a valuation may be required to estimate the required amount of insurance cover, the variation in the types of cover available for different types of asset (eg reinstatement, indemnity, first loss, etc) and the variations in the policy wording between different insurers would mean, at best, any IVSC definition would serve little purpose. At worst, an IVSC definition could cause difficulties if it was not consistent with the relevant policy, which would be the case in the majority of cases where its use may be contemplated.

It is contradictory because paragraph 90.1 states that it is the cost of replacing an asset in its current form, whereas 90.2 says that it can be the cost of a modern equivalent. In the current IVSs (TIP2) Replacement Cost is defined as "the current cost of a similar asset offering equivalent utility". Replication Cost is defined as "the current cost of recreating a replica of the asset." These are both alternative cost inputs that can used when applying the depreciated replacement cost approach, and are not valuation bases.

Other Bases

The draft includes a random list of other bases of value, primarily different definitions of "fair value" and "fair market value". While this list is stated in 20.1 to be "non-exhaustive" its limited scope is nevertheless unhelpful, not least because some actual definitions are provided. By including the definitions themselves it creates issues of copyright (it is noted that no copyrights or sources are acknowledged) and of maintaining consistency in the event of another organisation changing its material. Above all their inclusion in part of the standards declared to be mandatory will surely confuse users of the IVS as to which is the authoritative source.

The limited list is also hardly representative as it is dominated by North American examples. The reality is that the number of defined bases that may need to be used is vast. For example, in the field of financial reporting alone, while IFRS is used in 130 countries, in most cases that is only for publicly listed companies. There are many cases where national standards apply to non-listed or public sector entities, which if they require valuations, do not follow IFRS. Likewise, many valuations are required on the terms set out in private contracts ranging from business sale agreements through shareholder agreements to sale or purchase options, the majority of which will have provisions for price determination which differ significantly from the limited examples referenced here. The variations in tax definitions of value, even within a single country, can be significant. Overlaying this multitude of definitions are the interpretations made on those definitions by the courts in each jurisdiction. Paragraph 28 of the current IVS Framework deals with this issue succinctly and attempting to add a limited list of examples can only serve to limit comprehension of the principle that the IVS can be used with any basis providing it is appropriate for the intended purpose and that the source of its definition is cited.

Highest and Best Use

Paragraph 150 contains an embellished version of the text in the current IVS Framework paras 32-34. The principal addition is in paragraph 150.2, where the second sentence suggests that if different from the current use, the costs to convert an asset to its highest and best use would impact the value. An example is then given. Particularly when considered with the example, this makes no sense as it muddles cause and effect. The value for an alternative use must take into account the costs of converting to that use. Therefore, in the example given, if the current value for the alternative use of the land is CU 120m this value must reflect the all costs of redevelopment. Setting aside the unlikely scenario of redevelopment costs of only CU 20m being incurred on site worth CU 120m, the statement that the HABU would be the value for the existing use if the redevelopment costs were less than CU 20m is mathematically and conceptually wrong. If an example is needed, notwithstanding that previously the Board has been sympathetic to those respondents who oppose the inclusion of examples in the standards, a more coherent one is provided as Example 2 in the Illustrative Examples that accompany IFRS13.

The other alteration in the proposed 150.3 is also unhelpful as well as being unnecessary. The more straightforward wording that appears in the final two sentences of the Framework paragraph 32 in the current standards say all that is needed. The proposed wording obfuscates the concept expressed in the current standards by introducing the criterion that an asset must be being used “optimally” in order to for that use to be the HABU. This is untrue, as an asset may be used sub optimally but still be more valuable in that use than any other. Also, the suggestion that “orderly liquidation” might represent the HABU is misleading. Liquidation in any form is not a use, it is a disposal strategy.

A major omission from this section is the paragraph that was proposed in the 2015 ED that explained the application of the HABU principle to assets with no identifiable alternative uses and to liabilities. The Board agreed to include this in after receiving questions about how HABU related to a machine with only one possible use, and discussions with the International Actuarial Association on the application of the concept to liabilities.

Existing / Current Use

The proposed paragraph 160 is a statement of the obvious and is unnecessary.

Orderly Liquidation

Again paragraph 170 incorrectly describes “orderly liquidation” as a type of value when it is an example of a disposal strategy, alongside going concern, or presumably “disorderly liquidation”. If the discussion in the standards extends to include disposal strategies then logically it should also discuss methods of disposal, eg private treaty, auction, private tender, public tender etc. It would appear odd to extend the scope of guidance into such matters when discussion of key valuation concepts that apply regardless of the disposal strategy or method are being removed from the standards.

Forced Sales

It is noted that the current guidance in paragraphs 53-54 of the Framework has been retained but a further paragraph 180.3 has been added which purports to list no fewer than nine conditions that would normally indicate a forced sale. By their very nature the circumstances that lead to a sale being forced will be infinitely variable and therefore unpredictable and it is extremely misleading to attempt to catalogue the conditions that will be found in a forced sale beyond what is already said in paragraph 180.1. Notwithstanding this fundamental problem with the whole paragraph, the list itself is problematic, for example (g) is a repeat of (a) and the final condition that states that the price will reflect the "normal consideration for the property sold" contradicts everything that precedes it explaining why the consideration in a forced sale will be lower than normal.

Entity Specific Factors

It is noted that section 190 is the same as paragraphs 20-22 in the current Framework, with the only change being the proposed unhelpful and unnecessary addition of /Worth.

Synergies

In Section 200 the draft expands the discussion on Synergies compared with the current IVS Framework, and generally this is a helpful and welcome addition, albeit misplaced in a mandatory section of the standards. It also illustrates that "Synergistic Value" is not a basis, see response to Question b). However, the wording of the opening sentence of 200.01 is misleading as it implies synergies only arise through the combination of assets with liabilities. We believe that it is intended to say that synergies can arise from the combination of different assets or different liabilities, or from combining both assets and liabilities.

It is again unfortunate that an additional paragraph agreed with the International Actuarial Association explaining how synergies can affect the value of liabilities which was included in the 2015 ED has been omitted.

Assumptions and Special Assumptions

Section 210 expands the guidance in the existing Framework, principally by including examples of special assumptions. Subject to the overriding point that none of this can be or should be mandatory, the additional material is helpful. It also reinforces the inappropriate categorisation of liquidation as a type of value, as the examples of assumptions in 210.3 all describe the disposal scenario assumed, one of which is analogous to a liquidation scenario.

Transaction Costs.

The examples in 220.2 are flawed. Many readers would struggle to understand how transaction costs are relevant to HABU and not Market Value, when the former is inherent in the latter. Also, the reference to "a valuer" doing something has been avoided in the IVSs as explained in our comments on the Introduction and Framework. Paragraph 220 could be improved as follows:

> *Most bases of value represent the estimated exchange price of an asset without regard to transaction costs. Consequently, the reported value is not generally adjusted to reflect the*

seller's costs of sale, the buyer's costs of purchase, or any taxes payable by either party as a direct result of the hypothetical transaction.

However, transaction costs and taxes may need to be considered as part of the valuation process, for example when analysing relevant sales data or when preparing cash flow forecasts. Transaction costs may also be relevant when determining the market in which an asset will normally exchange and identifying likely market participants