



## MINUTES OF THE MEETING OF THE INTERNATIONAL VALUATION STANDARDS BOARD

HELD IN MADRID

ON THURSDAY 5 NOVEMBER 2009

### PRESENT:

Chris Thorne            Chairman  
Frank Bollmann  
Tom Boyle  
Bob Connolly  
Jim Eales  
Jeffrey Harder  
Simon Landy  
Arvind Nandan  
Siu Yu Nova Chan

Ana Castañeda, member, IVSC Expert Group, Valuation of Financial Instruments attended for part of the meeting

### 1. CHAIRMAN'S INTRODUCTION

1.1 The chairman opened the meeting and welcomed members and observers to the meeting.

### 2. MINUTES OF PREVIOUS MEETING AND MATTERS ARISING

2.1 The minutes of the previous meeting were approved.

### 3. INTERNATIONAL VALUATION STANDARDS IMPROVEMENTS PROJECT

3.1 A report on progress was circulated with the agenda papers by the Chairman, who is leading the project with a Technical Writer. This report contained a number of questions for the Board. The Board's decisions are summarised below.

**1 Does the Board consider that the current stance of IVS that all classes of asset or liability should be referred to as "property" is correct or does it reinforce the real estate bias?**

Although the legal use of "property" to mean something that is owned is widely understood internationally, it was agreed that it is preferable to confine the use of the term in future IVSC to real estate, and to use the term asset or liability (or both as the context may determine) where a generic term for the subject of a valuation is required.

- 2 Does the Board consider that there is any need to retain an equivalent section to the current “Property Types” in the new standards giving an overview of different asset types, or is the discussion of what type of asset or liability is covered by a particular standard best dealt with in the standard specific to that asset or liability?**

The Board was keen to retain some aspects of the “Real Property” section in a new standard for real property, (see 3.5 below). Otherwise, it was agreed that this section is superfluous.

- 3 Does the Board agree that the word “item” should replace “property” in the market value definition?**

Although the meaning of “property” in a legal sense is understood (see 3.2 above) it was felt that the use of the word in this context does make it appear to be specific to real estate: it also would be difficult to apply to financial instruments. After discussion of a number of alternatives the Board agreed that the words “asset or liability” should replace “property” in future editions.

- 4 Does the Board agree with the proposal that a single Real Property standard be created to consolidate the material equivalent to that appearing in the Intangibles ED, which would replace the current GN1 and GN2?**

This was agreed by the Board.

- 4 In the experience of Board members, is the distinction currently made in IVS between real property and real estate one that is generally recognised?**

The Board agreed that this distinction was confusing and that the different types of property interest should be explicitly referred to in the new Standard on Real Property.

- 5 Does the Board agreed with the proposal that the Sales Comparison approach and the Market Comparison approach be simply described as the Comparison approach in the new core standards, with any additional illustration or explanation needed to clarify its use in different situations being made in the appropriate Standard?**

Most of the Board agreed that the term “Market Approach” had been misinterpreted, but there was no agreement on a simple alternative. It was felt that this will probably need to be a specific consultation point in the exposure draft of the revised standards. One compromise suggestion was “Direct Market Comparison” to emphasise that the income and cost approaches could also be used to arrive at a market value.

- 6 Does the Board agree with the proposal that a new standard be developed to identify the high level principles that should be considered to define a given valuation assignment with sufficient precision to provide a clear and unambiguous response when reporting?**

There was some debate as to whether this was needed as much of the necessary detail would be covered in the reporting disclosures. There was also concern that the standard could become too prescriptive and incapable of accommodating the huge range of valuation services and “products” required. After debate it was agreed that a draft standard should be produced for scrutiny by the Board.

- 3.2 The Annex to the Report set out initial proposals for each existing section of the IVS seventh Edition. These were largely agreed by the Board, with the following variations:

- (i) GN 6 – Business Valuation. Following a review by a sub group led by Jim Eales, it was felt that this needs updating although there are no major technical deficiencies. It was agreed that the Board would look at the results of the reformatting of the GN as part of the rewrite before deciding whether further improvements are required to the content and/or scope.
- (ii) GN 10 – Agricultural Property. To be reviewed in line with decisions taken following discussion on Forestry Valuation – see minute 7 below.
- (iii) IVA 1 – a sub group of the Chairman, Frank Bollmann and one member from the Financial Instruments Expert Group will review and update. Nova Chan will be providing technical input during the process.

#### **4. PROPOSED GUIDANCE NOTE: THE VALUATION OF INVESTMENT PROPERTY UNDER CONSTRUCTION**

- 4.1 Simon Landy led the discussion on the responses received to the Exposure Draft. Five questions had been asked of respondents:

##### **1 Scope of ED**

There was a suggestion by one respondent that the proposed GN be expanded to include owner occupied property under construction and one respondent suggested that the principles could be extended to any type of asset “under construction” including a patent under development. Others were happy with the scope proposed, and none argued that the GN should be confined solely to valuations under IAS 40, which had been the limit of the original Interim Position Statement issued by the Board.

However the response suggesting widening the scope to all assets brought forward questions from other Board members as to the definition of Investment property. The point was made that this could be interpreted as extending to an infrastructure asset such as a toll road, and that therefore there was a need to consider carefully the definition, especially as the scope was no longer specific to IAS 40. It was agreed that a definition of investment property would need to be included to clarify the scope of the standard. It was noted that the IAS 40 definition of an investment property is:

*“A property (land or building – or part of a building – or both) held by the owner (or lessee under a finance lease) to earn rentals or for capital appreciation or both rather than for: a) Use in the production of goods or services or for administrative purposes; or b) Sale in the ordinary course of business.”*

##### **2 Level of Detail on Valuation Approaches**

Most respondents felt that the degree of detail was about right, although one did argue that a list of acceptable methods be included. The Board decided that no changes were required.

##### **3 Current versus Prospective Values**

The responses indicated that both growth implicit and growth explicit models are used in different markets. The key issue is understanding the difference and making sure that assumptions are not mixed. It was agreed that the wording of the ED should be amended to emphasise this point.

##### **4 Finance Costs and Risk**

Some respondents proposed that the language of paras 3.5 and 3.7 be clarified as there was confusion between the cost of debt and developers risk. It was agreed to make some

appropriate revisions to the wording.

## **5 Valuation Reliability**

There was general agreement that IVS should not determine when a property might be reliably valued for the purposes of IAS 40. However some respondents wanted the valuer to indicate the degree of reliability in the report. It was agreed that express provisions to this effect in this GN were inappropriate as this was a general reporting and disclosure issue, covered in IVS 3 and in the proposed Position Paper on Valuation Certainty (see agenda item 7).

- 4.2 The Board approved publication of the GN subject to the changes agreed during the discussion.

## **5. VALUATION OF INTANGIBLE ASSETS**

- 5.1 Following the discussion of the responses to the Exposure Draft of a revised GN4 at the June Board meeting, a sub group of the Board had worked on a further draft. The following discussion points were highlighted by Frank Bollmann,

- 5.2 There are extensive references to and use of material from IFRS. The Chairman advised that when the ED was published, the IASB asked for a payment for consent to reproduce their material. As the references to IFRS were now more extensive, he would ask to the Trustees to take up the matter with IASCF Trustees. Clearly as IVSC is producing valuation standards that are in part designed to assist in applying IFRS consistently, it needs to be able to reference relevant parts of IFRS freely. To use alternative wording to avoid copyright fees would not be desirable.

- 5.3 The definition of goodwill used is the IASB's definition. There was a discussion as to whether it was correct to classify goodwill separately from other intangible assets as the Board is agreed that goodwill is an intangible. It was agreed that it should be separated, as it needs to be clearly defined as a residual value in a business after all tangibles and other identifiable intangibles have been taken into account. Reference was also made to a definition of goodwill in the ASA's standards, which some felt was better than IASB's. The sub group was asked to consider this. Although goodwill needs to be valued for purposes other than under IFRS 3, it may be better to avoid confusion by using the IASB definition unless this is clearly deficient.

- 5.4 Some Board members suggested various minor drafting changes to improve clarity. These are to be considered by a sub group consisting of Frank Bollmann, Jim Eales, Jeff Harder, Nova Chan and Bob Connolly. Specific points raised in discussion included:

- Removing 4.24 – the reference to GN 9 is inappropriate as this is real estate specific and is not being carried forward in future IVS.
- That the positioning of some of the text in section 5 (Valuation Inputs) is descriptive of the valuation approach itself and should be better placed in Section 4 (Valuation Approaches). It was agreed that the sub group would look carefully at this.

- 5.5 The document was approved subject to the minor alterations referred to above. It was agreed that the sub group would produce a final document for approval by the whole Board in early December, with publication in early January.

## 6. VALUATION CERTAINTY

- 6.1 The Chairman introduced Ana Castañeda, a member of the Financial Instruments Expert Group and who been a member of the small working group that developed the draft paper now submitted to the Board. The paper concluded that while it was important for valuation credibility that users understood the degree of confidence, or certainty that could be attached to a valuation it concluded that this was generally best served by appropriate qualitative disclosures in the valuation report. Quantitative statements of certainty were generally not favoured for most non financial assets as it was felt that these could be self defeating; a numerical probability “score” would tend to undermine the valuation.
- 6.2 The situation in the financial markets is different. Ana Castañeda reported that the volumes of instruments valued and the automated methods used for valuation, meant that there was greater reliance on statistical models for valuation and a greater requirement for quantitative rather than qualitative measures. It was agreed that the paper should limit its scope to non financial assets. The Financial Instruments Expert Group is considering certainty in its sector as a separate project.
- 6.3 The point was made that the paper did not discuss different types or causes of valuation uncertainty. Uncertainty that was inherent in a market should be distinguished from uncertainty caused by abnormal events or arising from the use of a particular valuation approach, e.g. one where there was abnormal sensitivity to different valuation inputs.
- 6.4 There was discussion as to what implications the paper would have on the International Valuation Standards. The Board was in general agreement that this topic could not be developed into a specific standard. IVS 3 *Valuation Reporting* states that valuation reports should disclose material assumptions, procedures adopted and reasoning, all of which help a user put the advice into context and assess the confidence that may be attached to the opinion provided. However, there is not currently an explicit requirement to address certainty. Including appropriate words to reinforce the objective of reporting disclosures could improve this standard.
- 6.5 The Board considered the status of the paper. While it was agreed that IVSC should have a position on the issue given the current political focus on valuation certainty, it was also agreed that, for non financial assets at least, the matter could be addressed through a minor change to the presentation of long established IVS principles. It was therefore debatable whether this was a project for the Standards Board to take forward and thus agreed that the paper should be passed to the Professional Board for review, with a recommendation that this be issued as an IVSC Position Statement.

## 7. FORESTRY VALUATION

- 7.1 Bob Connolly introduced the paper submitted by the Association of Consulting Foresters of Australia which outlined a number of suggested principles concerned with valuing commercial forestry. He proposed that the Board commenced a project on Forestry Valuation in order to examine the issues.
- 7.2 In discussion the Board heard anecdotal evidence of diversity in practice, especially in large timber producing countries such as Canada, China, Russia, and the USA.
- 7.3 The Board agreed that current GN 10 *The Valuation of Agricultural Properties* needed reviewing and updating, and that any specific concerns about forestry might best be dealt with in an amendment to that paper, as many of the principles of Forestry Valuation apply to

biological assets generally.

- 7.4 The Board noted that the Australian paper was not clear as to whether the principal issues identified were concerned with a lack of clarity as to the valuation objectives of the appropriate methods to be used.
- 7.5 The Board agreed that a call for applications be published for an Expert Group to review GN 10 generally, and that the group should include forestry experts as well as experts in other types of agricultural/biological asset. If this group identified the need for practice guidance, then this would need to be referred to the Professional Board.

## **8. REPORT FROM THE EXPERT GROUP ON THE VALUATION OF FINANCIAL INSTRUMENTS**

- 8.1 The Chairman confirmed that the Expert Group had been formed in June and has had two meetings so far. A report was included with the agenda for the meeting. Apart from the question of Valuation Certainty (See Agenda Item 7), other projects in hand include an overview of valuation methods used in the sector and a study on the identification and measurement of liquidity premiums. The Group has also contributed to the IVSC response to the IASB Fair Value Measurement Exposure Draft, and a representative had joined the Chairman and Frank Bollmann at a meeting in September with IASB staff to discuss the Exposure Draft.
- 8.2 It was clear that the output from the Group would provide inputs for the agendas for both the Standards Board and the Professional Board. The Chairman also felt that it was probably that the present Group would need to be changed. At the last meeting, the need to seek the involvement of one or more of the global investment banks was identified, together with a couple more global commercial banks to ensure geographic and sector coverage. Because of the scope and diversity of the financial markets the number involved suggest that there will be a need to form more than one group. The split could either be between a "Processes and Objectives" group supporting the Standards Board and a "Technical Practice" group supporting the Professional Board, or along sector or instrument type.
- 8.3 One point that was emerging was the need for transparency in the "control environment" where instruments are valued by banks internally for use in financial statements. Ana Castañeda confirmed that most large banks use self generated valuations in their statements, although smaller banks will tend to use external consultants. Many of the principles behind establishing and maintaining valuation objectivity are common to other asset classes and covered in existing IVS. Another project for the Group might be to consider the development of a standard on the application of some of the core IVS principles in the financial instruments market.

## **9. IVSC/IFAC MEMORANDUM OF UNDERSTANDING**

- 9.1 The Chairman advised the Board of the MoU and of a subsequent meeting he had had with the IFAC Executive Director for Professional Standards in New York. It had been agreed that a useful first project would be to form a joint working group to produce non-mandatory guidance for both auditors and valuers on their respective roles and what one can expect from the other. This project is to be taken forward by the Professional Board.
- 9.2 It was noted that Frank Bollmann has been appointed as representative of the IVSC on the IFAC Consultative Advisory Group of the International Auditing and Assurance Standards Board (IAASB). The opportunity to improve links between the valuation and audit profession was welcomed.

## **10. IASB FAIR VALUE MEASUREMENT EXPOSURE DRAFT**

10.1 The Board noted the response letter that had been sent by the Chairman of the Professional Board on behalf of the IVSC, and to which members of the Standards Board had contributed. The Executive Director, Chairman, Frank Bollmann and Tanguy Dehapiot (a member of the Financial Instruments Expert Group) had also met with IASB staff in September to discuss some of our concerns with the paper. The IVSC has asked it if can be included in the Round Table meeting that the IASB is scheduling for December in London. (post meeting note: invitation to meeting on 11 December received)

## **11. WORK PLAN**

11.1 The Board noted the draft work plan that was to be amended and updated to reflect decisions taken at this meeting.

## **12. DATE OF MEETINGS**

The proposed dates for the meetings of the Board during 2010 are:

- February 5/6 – London
- April 23/24 – London
- October 7/8 – Miami. These meetings will coincide with the 2010 IVSC AGM and take place immediately after the ASA/CICBV Business Valuation Conference.