

## COMMENT LETTER 7 RECEIVED FROM PROPERTY INSTITUTE OF NEW ZEALAND

### EXPOSURE DRAFT

### PROPOSED NEW INTERNATIONAL VALUATION STANDARDS

#### QUESTIONS FOR RESPONDENTS

The International Valuation Standards Board invites responses to the following questions. Not all questions need to be answered but to assist analysis of responses received please use the question numbers in this paper to indicate to which question your comments relate.

Additional comments are also welcome. Please clearly identify the IVS number, title and relevant paragraph number to which your comment relates.

#### FOREWORD FROM NEW ZEALAND

**In preparing our comments, we have had available to us the draft response from API, however, the views included in our response are the views of the New Zealand Valuation Standards Board.**

**We have attempted not to duplicate responses where these exist, but this may occur to some extent.**

**Toward the rear of our response is a separate response on specific wording within the draft itself.**

#### GENERAL QUESTIONS

1. The proposed new edition of IVS follows the recommendations of the Critical Review that was commissioned by the old IVSC in 2007. Among the key recommendations of this review was that in future editions of the standards the term “International Valuation Standards” should apply to all pronouncements, not just to a limited number, and that all pronouncements should carry equal weight. In this draft the previous distinction between “standards”, “applications” and “guidance” in the titles of various documents has been removed. However, the Board recognises that standards still fall into different categories and has identified these as General Standards, Application Standards and Asset Standards, and grouped these together.

**Do you find the new structure of the Standards to be logical and easy to follow? If not, what alternative would you propose?**

**Yes, subject to the technical information / guidance papers being practical, user**

friendly, papers designed to assist valuers in their “everyday” tasks.

**We think that it would be useful to retain a category of documents that provide “guidance”. Such documents would deal with issues for which there are no settled views, such as often occurs with new issues. Rather there may be a number of views and the guidance document may serve the purpose of narrowing the range of acceptable approaches and for each of those approaches indicate the pros and cons. Then, as practice matures, the acceptable range will narrow (probably to a single acceptable approach) and the issue can then be dealt with in a standard. This approach was occasionally followed in standard setting for financial reporting in New Zealand prior to the adoption of IFRS**

2. The Application Standards contain some information on the background to the valuation requirement and the Asset Standards information on the asset type in question and the characteristics affecting value. They also identify particular actions that should be taken in order to apply the principles in the General standards to the particular valuation purpose or when valuing the particular type of asset.

**Do you consider that the combination of background information and specific directions to be helpful? Would you prefer all background information and explanatory information on asset classes to be removed from the standards so that only the specific directions applicable to each application or asset type remained?**

**Yes. However, there are limits or a balance to be achieved, and clearly there should not be excessive duplication.**

3. It is currently proposed that the final version of the Standards will be published both in hard copy and be available for downloading from the IVSC website.

**Which delivery method for the new edition of the standards are you or your organisation likely to use?**

**We expect that our membership (New Zealand) will prefer to have access to both a hard copy and be able to download a version from the IVSC website. Ideally, the download option should cover an option to download the total document, as well as reference individual standards / technical papers.**

## **IVS 101- GENERAL CONCEPTS AND PRINCIPLES**

4. This Standard is intended to explain fundamental concepts and principles that are referred to throughout the remainder of the standards to assist in their application. Some of the material has been carried forward from previous editions of IVS and some new concepts have been introduced, for example the discussions on market activity and market participants.

**Do you consider that this objective has been met? Do you consider that there are any**

**additional valuation concepts and principles that should be considered and discussed in this standard?**

**Yes.**

5. As indicated in paragraph 4, the word *valuation* can be used with two distinct meanings. Where the word is used in the Exposure Draft the Board believes that it is generally clear from the context which sense is intended and has only added words to emphasise whether the reference is to the process of estimating value or to the valuation result itself where there is scope for ambiguity.

**Are you in agreement with this approach or would you prefer the word “valuation” either not to be used at all or always used with qualifying words to indicate the intended meaning, for example “valuation process” or “valuation result”?**

**We agree that the intended meaning is typically obvious from the context and that introduction of the qualifiers on the term “valuation” in all circumstances is not necessary.**

## **IVS 102- VALUATION APPROACHES**

6. Previous editions of IVS have identified the principal valuation approaches listed in this proposed standard.

**Do you agree that these three approaches encompass all methods used in the assets or liabilities that you value? If not, please describe what approaches you feel have been omitted.**

**Yes.**

**We consider that the discussion should make specific reference to valuation methods such as price earnings multiples and option pricing models. This is particularly relevant to financial or business valuations**

7. Paragraph 6 of the draft sets out a proposed hierarchy of approaches which indicates that the direct market comparison approach is generally to be preferred where there are observable prices for similar assets available at the valuation date.

**Do you agree with this hierarchy and do you consider it helpful? If not explain if you would prefer to see no reference to a hierarchy or would prefer an alternative hierarchy.**

**We agree that the hierarchy is useful but (i) there should be additional discussion on the emphasis to be placed on firm specific information on valuation inputs versus market based information, and (ii) there should be close correlation with the work of the IASB**

**and FASB on fair value.**

**We would prefer the description of the hierarchy of approaches to be more definitive to the extent that the direct market comparison approach is preferred, followed by the income approach and, then, the cost approach. Currently the wording implies that the income and cost approaches have equal weight where there are no directly observable prices for identical or similar assets.**

8. In the current edition of IVS, the term “Sales Comparison Approach” is used to describe the process of estimating value by comparison with the prices of identical or similar assets in the market. The Board received representations that this term was too restrictive as it seemed to preclude market evidence that was not related to an actual sale. Some advocate the use of the term “Market Approach”; however, others find this confusing as both the income and cost approaches can use market based inputs. The Board also received evidence that some believed that only a “market approach” could be validly used to determine market value. After deliberation the Board has proposed the term “Direct Market Comparison Approach” in this edition of the standards.

**Do you find this change of terminology to be helpful? If not please explain what alternative you would prefer and why.**

**Yes, because the “market approach” can commonly include reference to an income approach whereas the word “direct” makes it clear that you are referencing a comparative approach.**

## **IVS103 - BASES OF VALUE**

9. Basis of value is defined in the draft as a statement of the “fundamental measurement assumptions of a valuation”. In the current edition of IVS it defined as a statement of the “fundamental measurement principles of a valuation”. Supporters of the proposed change believe that the word “assumptions” is more precise. It is self evident that a basis of value is a principle but IVS needs to explain the nature of that principle. The bases of value defined in IVS all consist of a set of assumptions that define the underlying hypotheses on which the value is based. The fundamental assumptions within a defined basis can then be used in conjunction with additional assumptions or special assumptions as explained in IVS 103 and 104. . Others prefer to retain the use of the word “principles”, while some consider that a basis of value is more precisely described as a statement of the measurement objectives of a valuation.

**Do you agree with the proposed change to the definition? If not indicate what alternative you prefer and why.**

**We had differing responses on this issue. However, on balance, we disagree with the proposed change. We consider the word “principles” to be more appropriate. It has a wider context covering both the approach / methodology used and the “assumptions” upon which the valuation is based, both of which can be a subset of the overall**

**“principles”. The distinction between “assumptions” and “principles” is important.**

10. A change is proposed to the definition of Investment Value. The Board had received representations that some are confused by the distinction between Investment Value and Special Value in the current edition of IVS. The Board has proposed to amend the definition so that it only reflects the value to the owner, not the value to prospective purchasers. The rationale is that a prospective purchaser for whom an asset had value in excess of that to market participants generally could also be described as a special purchaser, which is separately defined. A reciprocal change is proposed to the definition of “special purchaser” to make it clear that it can include a single buyer with a special interest or a restricted class of buyers that can realise additional value not available to the market participants at large.

**Do you agree with this proposed change? If not, please explain why and what you believe the distinction is between investment value to a prospective purchaser and special value to a prospective buyer who can realise that special value to be?**

**In the context of the New Zealand market, the words “investment value” are commonly used in a context which is synonymous with “market value”. Therefore, the way in which the wording references investment value would, from our perspective, be better referenced as an entity specific value.**

11. The Board has considered alternative names to “Investment Value” for the basis of value that describes value to a particular entity. Alternatives suggested include “Entity Specific Value”, “Owner Value”, “Value to Owner”, or “Invested Value”. Critics of Investment Value consider that the term is insufficiently precise; although it is a measure of the value of the investment in an asset to a particular party, it can also be interpreted as being the sum required to buy an investment in the market. Others consider that the term is sufficiently broadly understood that any change would cause confusion.

**Do you support the continued use of the term “Investment Value” or would you prefer an alternative? If so, what would that alternative be?**

**No, reference answer 10 above.**

12. In IVS highest and best use (HABU) is treated as an inherent feature of market value. This follows the economic theory that the price of an asset which is fully exposed to all potential buyers will sell for a price reflecting the most efficient or productive use of that asset. Other literature that has been published recently presents highest and best use as a separate concept from the price that would be paid in a hypothetical exchange between market participants.

**Do you agree with the approach taken in IVS? If not, explain why not and give examples where you believe the highest and best use may be different from the market value.**

**Yes.**

13. In the existing IVS a clear distinction is made between fair value in general use and fair value as defined in IFRS. Some found this confusing since the definition of fair value in IVS was identical to that currently appearing in IAS16. Although the IASB is likely to change the definition of fair value in IFRS in its proposed new Fair Value Measurement Standard, in this draft the definition of fair value in general use has been changed to emphasise the distinction from the usage of the term in IFRS.

**Do you consider this proposed change in the definition to be helpful? If not, please indicate how you believe it could be improved.**

**We would prefer the term fair value to be used in the sense of market value and therefore, as in financial reporting, be devoid of any notion of fairness defined as equity (or representing the specific circumstances of one party). However, to the extent that this is not always the case, we concur with the proposed change in the definition.**

#### **IVS 104 - SCOPE OF WORK**

14. Previous editions of IVS did not have a standard relating to scope of work, although the need to record the valuation instruction in writing was included under the heading of "Code of Conduct". The Board considers that a more specific standard is required to detail the minimum acceptable scope of work. This reflects established best practice in many markets and provides the necessary foundation for the valuation process to begin.

**Do you:**

- a) **Agree with the inclusion of a standard for scope of work in IVS?**

**Yes**

- b) **That the minimum contents identified in the draft are proportionate and represent a realistic minimum standard?**

**While we consider the inclusion of a standard for scope of work has considerable merit, the way in which it is currently written is potentially overly prescriptive and may create some difficulties for valuers. It is common, almost more common than not, that some of the scoping items (such as extent of investigation, identification of other intended users, identification of the asset or liability to be valued, (in the case of plant and machinery), for example), will be unclear at the outset of an assignment. In practice, it is often not until after the inspection or investigation that these matters become apparent. As a result, the inclusion of the standard may result in a situation where valuers are commonly having to acknowledge departures from the IVS 104. This may be resolvable by replacing the word "minimum" requirements (and referencing the same in paragraph 2), with "recommended" requirements and including acknowledgement that the various scope items may not be able to be accurately defined at the commencement of a valuation engagement.**

## IVS 105- VALUATION REPORTING

15. This proposed standard is significantly less prescriptive than the equivalent standard IVS 3 in the current IVS. The proposed changes reflect the general recommendation of the Critical Review Group that the standards should contain less prescription and focus on principles. It also reflects the need to ensure that these standards can be applied to a wider sector of asset classes than previously.

**Do you agree with the changes that have been made? If not, please explain what provisions of the current IVS3 you believe should be carried forward into the new standard.**

**Yes. The overriding objective should be that valuation reports contain sufficient information about the valuation to allow an informed reader to understand the valuation conclusion.**

## APPLICATION STANDARDS

16. The standards in the 200 series relate to valuations for specific purposes. They provide guidance on the background for the valuation requirement before setting out specific matters that should be reflected or considered when applying the principles in the General Standards. Some consider that the fundamental principles of valuation should remain unchanged regardless of the purpose for which it is being prepared and therefore these application standards are superfluous. Others consider that it is important that valuation standards highlight factors that could be relevant to determining the appropriate valuation hypothesis for different purposes, and to set down criteria to ensure that reports contain the appropriate information.

**Which view do you support? If you consider that future IVS should contain application standards, do you consider that the degree of detail of those in the draft is appropriate and help the better understanding of the valuation requirements?**

**We consider that IVS should contain application standards. We consider the degree of detail in the draft to be generally appropriate, although consider that some areas could be expanded on in future technical papers.**

**However, we do question the need for an application standard on depreciation. The valuations that may be undertaken for depreciation are standard and depreciation is simply an arithmetical allocation based on the valuation or cost amounts.**

17. The series 201.01 - 201.04 inclusive are all concerned with valuations under IFRS. With the exception of 201.01, which addresses the current IASB Fair Value project, the topics covered all appear in IVA 1 in the current edition of IVS, although in this draft the text has been updated and some additional detail included to address issues of particular relevance to the valuation task.

There are opposing views as to the extent and how IVS should address valuation issues under IFRS.

View (a) is that IVS should not refer to valuations under IFRS at all because the IASB is in the process of producing its own fair value standard that will clearly set out the valuation criteria for all valuation measurements required under IFRS and if parallel valuation standards are produced in IVS these will have no relevance. Supporters of this view also argue that limited references to the accounting requirements under IFRS can be misleading and lead to misinterpretation.

View (b) is that valuation measurements under IFRS are intended to reflect market reality and are not a special type of valuation reserved for financial statements. It is therefore important that the requirements under IFRS are properly related to wider valuation principles and practice through cross references in IVS. Supporters of this view also believe that limited references to IFRS are necessary to help those who are valuers rather than accounting experts understand the required criteria and assumptions so that appropriate valuations can be provided.

**Which of these views do you support?**

**We support view (b), subject to the IVS not replicating IASB referencing and rather referring back to these documents with discussion as appropriate in the context of IVS. This is especially so given the increasing use of fair value in financial reporting and therefore the increasing involvement of professional valuers.**

## **ASSET STANDARDS**

18. The proposed standards in the 300 series are all concerned with the application of the General Standards to specific asset types. Each standard contains some high level guidance as to the characteristics of each asset type that are relevant to value, a discussion on the principal valuation approaches and methods used and sets down specific matters that should be addressed in settling the scope of work or when reporting. Many of the asset classes included in this Exposure Draft are the subject of "Guidance Notes" in previous editions of IVS and much of the material has been drawn from these. Question 2 asked for your views on whether this combination of background information and specific directions was appropriate or whether you would prefer a clear separation.

**Do you have any other comments on the general structure of the Asset Standards**

**Only that further clarification on technical /guidance papers would assist with the general overview of the proposed standards. Without undermining the importance of the application and valuation standards, it is technical papers which will be relied upon significantly by valuers on a day-to-day basis.**

18. All the asset classes covered in Guidance Notes in the current edition of IVS are carried forward into this Exposure Draft. There are no equivalents for GN5 Personal Property, GN 10

Agricultural Property or GN14 Extractive Industries. Agricultural Property is to be included in the scope of a proposed new project on Biological Assets. A new project is also proposed on Extractive Industries. Personal Property has not been carried forward as the Board considered that the definition of what constitutes personal property in the current IVS is too widely drawn, with the result that much of the subject matter in the current GN5 is more specifically covered in other proposed standards.

**Do you consider that a class of “personal property” can be identified that is not already covered by the proposed new asset standards? If so, do you consider that it has distinct characteristics that need to be considered in valuations that would benefit from a new IVS asset standard being developed?**

**Yes. However, we do not consider that they have characteristics sufficiently distinct from other assets to require extra valuation guidance.**

19. The Board is proposing a project to produce a new standard on valuing non financial liabilities, i.e. liabilities that are not attached to a financial instrument.

**Do you agree that a standard on valuing non financial liabilities is required and what topics should it cover?**

**This might be better covered better by a technical guidance note and, in the context of a property lease for example, it could cover issues such as the probability of a right of renewal being exercised, make good commitments at the end of the lease term etc.**

20. The Board would welcome suggestions for additional asset (and liability) types that are not already the subject of a proposed new standard or project.

**Please identify any additional types of asset or liability that you believe should be considered for future inclusion in IVS, together with an indication of the benefits that you consider a new standard would bring.**

**We wonder whether it may be appropriate to cover the valuation of inventory (trading stock).**

**Furthermore, consideration should be given to standards (or guidance) on valuation of infrastructure assets (roads, harbours, airports) and aquaculture farms**

## RESPONSE TO ACTUAL WORDING IN THE DRAFT STANDARDS

The following is a commentary in relation to potential identified issues with the draft standards as proposed:

- ▶ **Valuation standard 101, paragraph 15** – another example of an entity specific factor that might be that a particular entity seeks to acquire an asset to maintain market dominance and exclude another market participant.
- ▶ **International standard 102, paragraph 8** – consider amending the words “in some cases it would be appropriate to use” to “it is common to use more than one approach ...”.
- ▶ **International standard 104** – consider adding reference to (1) a statement relating to independence and (2) a statement referencing that valuers are not aware of any conflict and that, should a conflict arise during the course of a valuation engagement, the valuer shall inform the client immediately and work with the client to resolve the situation.
- ▶ **International standard 202.01, paragraph 13** – it would be appropriate to explain that there is a material difference between the gross realisation (aggregate of the end value of the completed product) compared to value “as is”, prior to development, with the difference reflecting the costs of sale, holding costs, construction costs and adequate contingencies, risk and a profit element etc.
- ▶ **International standard 301.1, paragraph 24** – in New Zealand, it is seldom for property to be valued post tax whereas business assets are commonly valued post tax. Reference should be made to either pre or post tax with a comment that the discount rate or capitalisation rate needs to be consistent with the cashflow profile being valued.
- ▶ **International standard 302.01** – while we agree with the referencing of paragraph 12 generally, particularly bullet 1, in practice it may be very difficult for plant and machinery valuers to comment on bullet 2 (being the impact on the value of the plant and equipment assets attributable to the existence of any intangible assets). For example, if specialised dies / moulds are being valued and these items only have value because of the manufacturing rights associated with a certain product, the value difference may be quite binary (i.e. they could be worthless if the contract or rights did not exist). In practice, a plant and machinery valuer may or may not be aware of the contracts, have access to the contracts, and seldom be able to make comment as to the impact on value.
- ▶ **International standard 303.01,**
  - ▶ **paragraph 14** – the end of this paragraph states that “a unit of comparison is only useful when it is consistently selected and applied to the subject property and the comparable properties in each analysis *and is one used by participants in the relevant market*”. This could be amended to state that “...”... and it is helpful if it is one used by participants in the relevant market”. That is, just because participants in the market may not be using or considering a unit of comparison, it may still be

useful as a valuation comparison so long as the correlation between the unit rates and market prices is sufficiently strong.

- ▶ **Paragraph 16, line 5** – consider adding “(i.e. rent saved)” between the words “rent” and “based”.
  
- ▶ **Paragraph 17, line 4** – states that the all risks yield method “is quick and simple but cannot be reliably used where the income is expected to change in future periods ...” This, in our opinion, is not always the case. Where the expected change in the income in future periods is consistent with general expectations of systematic risk in the market, the all risks yield can still be a reliable method of assessing value. Perhaps the definition could be extended to say “where the income is expected to change in future periods *to an extent greater than that generally expected in the market ...*”, or some such similar wording.
  
- ▶ **International standard 303.03, paragraph 16, bullet 3** – consider adding “and the likely cost to complete”.