

Comments from Jerry Leech  
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## **Response to IVS Exposure Draft - Proposed New International Valuation Standards**

In response to the specific questions posed.

Some of the comments are detail that are relevant in that they fit the "reefs and wrecks" category in the Board Chairman's overview. This response is from a forestry, not general, perspective and so the comments have been hedged somewhat. They are provided for consideration. We will await IVS 306.01.

Q1 Yes

Q2 I would prefer more explanatory information as it leaves some things too wide open and, in my opinion, does not provide desirable guidance.

Q3 Download. If anyone wants a copy then it can always be printed.

Q4 Objective has been met.

Q5 Believe it is unambiguous.

Q6 The draft IVS includes basically three approaches, market, income and cost and suggests this is the hierarchy. In Australia there are few forestry transactions available for consideration and these are difficult to interpret as not all the information is made publicly available. So market transactions can only rarely be used. In para 4 the income approach is divided into two commonly used methods income capitalisation and discounted cash flow. Income capitalisation is difficult to assess if companies manage both forests and sawmills as the transfer prices between the two entities is generally unclear. Cost approaches have been used for fire insurance purposes but are flawed if used for forest valuation as cost does not equate to value. This leaves only the discounted cash flow methods. That said, we agree with the hierarchy.

In valuing forest plantations in Australia discounted cash flows are commonly used but there is a subset method which we denote as the "immediate liquidation method" which assumes that all the forest can be harvested at the time of valuation. The assumptions inherent in this are considered by some to be far easier to detail, document and discuss as reasonable market derived information is commonly available (eg log prices and falling and hauling costs) to enable this approach to be better audited.

It should be recognised that most forest valuations are not for sale but are made so that the annual change in valuation of the biological asset component of the forest estate can be included in the Profit and Loss Statement. It is generally impossible to tell from any annual report that details the annual change in value exactly what assumptions were made in deriving that value. The rhetorical question is - should they be stated?

Q7 I believe that a hierarchy is needed, it is not just "helpful". The hierarchy should ideally be conformed with the IASB hierarchy (eg as in IAS41) and if this cannot be achieved then the hierarchy should ideally spell out where there is a difference and why. In much forestry valuation the higher levels in the hierarchy need to be discussed and written off as inappropriate simply because there is no quoted price, no market and because cost does not equate to value. We are not arguing with the hierarchy at all but want to be able to prepare a relatively simple paragraph for a valuation report that discusses the higher (or other) levels in the hierarchy concluding why a particular method has been used. It is just more complicated if one has to refer to two different hierarchies, IVSC and IASB.

Q8 No comment.

Q9 No comment.

Q10 No real comment, we would tend to support the change.

Q11 No real comment, we would tend to agree with retaining the term.

Q12 The approach to H&BU used in the IVS seems to assume that the asset is a single asset. Refer p12-15 and 23-29 of the draft. There are a number of points that perhaps need to be considered.

The H&BU of a large forest estate and the H&BU of component stands of that forest estate can be different. This does not seem to be covered in the draft IVS. For example the H&BU of individual plantation forest stands may well be conversion to (say) dairying, but it may not be possible for all stands to be converted. The forest owner generally has long term wood supply contracts that have to be met. So there may be an alternative H&BU that can be achieved for some part of the forest without dramatically impacting the contracts, but it could not be applied to the whole forest. There may be a spatial consideration here too and what applies to one part of the asset may not apply to the whole asset. How should this be handled when determining the value of the whole asset? Also under IASB standards as well. This constraint on sale does not seem to be covered by page 23 para 10. It is not quite covered by page 25 para 21 - 23 special value and synergistic value.

What about the synergies that may result from buying an asset that would increase a buyers holding? For example a company owning forest may desire to acquire more forest so they have a large enough holding to attract a larger willing buyer of timber. How should this be built into the valuation? It is certainly built into the price tendered for a block of forest. Another example is that a company that has entered contracts that have over committed its resource, and this can be quite common, may find it difficult to bring growth and allowable cut back into balance but may be prepared to buy forest, and pay far more than one might expect to be the general market rate, simply because this is one way of getting their total forest estate into balance again. P12-15 para 15, 17 and 18(b) sort of covers this but not completely. See also the answer to Q19.

It can become quite complicated when carbon credits have been sold which in essence mean that either the forest must remain forest for a number of rotations depending on the nature of the Emission Trading Scheme, or that carbon credits may need to be bought back, presumably at a higher price than they were sold for. Certainly there are

ways of mitigating this effect but it should be considered in any forest valuation. It certainly can affect consideration of the possible H&BU options.

Q13 I understand the change and consider this is a natural evolution. However, that said, the differences mean that it is confusing and that is not ideal.

Q14 Agree with the inclusion. It is a minimum and not an ideal.

Q15 I, and my ACFA colleagues, would prefer that the IVS be more prescriptive rather than less, but recognize that the Critical Review Group may well reflect the contrary general approach of the IVSB. Adherence to any standard should facilitate better valuations that are more precise. Simple adherence to principles cannot and will not achieve this.

Q16 It is the **interpretation** of the fundamental principles of valuation that is important. That is why the preference is for more prescriptive standards in order to achieve better and more precise valuations. We strongly believe the IVS should contain application standards.

Q17 Forestry has had considerable difficulty interpreting the IAS standards and the IFRS. This is why the Association of Consulting Foresters of Australia developed "An Australian Standard for Valuing Commercial Forests". The Chair of the Australian Accounting Standard Board, Prof David Boymal considers it entirely appropriate for professional organisations to produce guidance for members and has commended ACFA for their efforts.

How does this approach sit with IVSC/IVSB? The current draft IVS is so general that IFA/ACFA could argue that the IVS is totally consistent with our standard. I would argue that without the prescriptive elements that are missing from the IVS that almost any forest valuation could claim to be appropriate under IVS. This can only lead to a wider range of forest valuations for a particular forest estate and that imprecision can only be to the detriment of the consideration of production forests as an asset class. It was just this lack of consistency that led ACFA to develop the forest valuation standard we have now developed. We strongly believe that it needs to be tightened, not generalised more.

View (a) seems to be a head in the sand approach, view (b) will hopefully lead to conforming IASB and IVSB standards.

Q18 No, we believe that they are necessary. We await IVS301.

Re "personal property", no comment .

Q19 Is this where timber supply contracts (see Q12 above) should be considered? If so then I have difficulty understanding exactly how. A long term contract is desirable to provide some certainty for forest management while at the same time providing a constraint on some management activities.

The classic forestry and timber industry case is where a wood processor has a wood supply contract for a certain volume but wants to expand processing. If he has the extra wood available under contract then the banks will talk. If he doesn't then he is unlikely to be able to expand. Secure future supply has a competitive benefit that is often far in

excess of the price paid or the price deemed H&BU under normal circumstances. The advantages can significantly outweigh the constraints to forest management.

Q20 The general feeling of IFA is that forestry should ideally be treated as a separate asset type to agriculture and not included under the catch all "biological assets". This is because although the principles are the same the treatment is quite different. IAS41 clearly does not address the forestry issues and neither does GN10. All members of the IFA were provided with the opportunity to comment on this issue (The Forester 52(2) June 2010, p13) and the view I expressed therein was ratified by the IFA Board in May 2010.

We strongly believe that there needs to be a much clearer recognition of the fundamental differences between various biological asset classes.

### **Specific comments**

P5 - 5. Does this mean IASB standards as well? Or is this restricted to the IVSB standards that follow? Could be simply clarified.

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