

**Comment Letter 16 from the National Association of Romanian Valuers, ANEVAR**

**Comments on the Exposure Draft – Proposed New International Valuation Standards, published June 2010**

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After the review of the draft IVS 2010, ANEVAR made the following improvement proposals, grouped in two parts:

- the first part contains 5 proposals of substance modifications which, if not addressed, would result into several ambiguities and, implicitly major errors in determination of the final value; and
- the second part, which contains specific modifications.

**First part – The 5 proposal of substance modifications regard the following:**

1. In IVS 102 – *Valuation Approaches*, section “Use of Multiple Approaches and Methods”, paragraph 8, the use of the wording “...*these should be weighted*...” is mistaken, causing not only ambiguity, but leading also to miscalculation of the final individual value.

The term “*weighted*” must be replaced as its usual meaning is “ponderation”, usually by attaching subjective percentages to the different values obtained by applying various valuation methods (*see* meaning and formula of weighted average cost of capital – WACC).

But this weighting violates one of the fundamentals of valuation: in perfect conditions, if all the valuation methods are used correctly and rely on sufficient, verified and reliable market information, the resulting market values have to be similar. Therefore, if the market values obtained by applying several methods, generally referred to as common valuation approaches, are different, we can conclude that the differences are exclusively due to the lack of sufficient valuation inputs market data and/or use of subjectively assumed inputs data.. The resulting differences of value cannot be otherwise justified as they are *de facto* only fictional.

On the other hand, assigning relative weights to the various values obtained is completely subjective and beyond any justification since the three approaches mirror three completely different states of the valuation perspective, namely:

- direct market comparison approach – current position;
- income approach – future; and
- cost approach – past.

As a result of the explanations afore we propose introduction of three phrases of the following types:

- “When the purpose of valuation is financial reporting, under IFRS requirements, use of one single valuation approach is allowed provide that this approach is the most appropriate and reliable and is supported by sufficient available market data”;
- “When the purpose of valuation is another one than financial reporting (eg. sale of assets and business units or business interests, secured lending, etc.) whenever possible, methods included in all three common approaches must be used”.
- “Reconciliation of the resulting values consists rather in selection of one value reached using the most appropriate and credible valuation method and which relies on sufficient available and verifiable market data at valuation date”

To conclude, the words “weighted”, “weighting”, “greater weight” (included in paragraph 10, both in the beginning and the end of the phrase forming this paragraph), as well as the wording “substantial weight” (from paragraph 21 of IVS 301.01– Valuations of Businesses and Business Interests) have to be either eliminated or replaced with other words such as “importance”, “relevance”, “credibility”, or “reliability”; otherwise these ambiguous words have to be given a definition, accompanied by a short explanation of their meaning, in valuation reconciliation context.

2. The issue of applying a control premium and of discount for lack of control and of discount for lack of marketability is on the current agenda in Romania, in particular in case of valuating the minority interests of the governmental authorities, about to be sold very soon. As several economic laws include but one single phrase, namely “valuations are carried-out

under International Valuation Standards, edited by IVSC”, and application of these standards is a statutory obligation of all ANEVAR members, the state authorities and other users of valuations do not currently recognize application of any discounts and of the control premium as these adjustments of the **final value of equity** were improperly and ambiguously worded in GN 6 of IVS, eighth edition, 2007. The same situation is to be found in IVS 301.01, draft, ninth edition 2010, too.

The logical solution and, consequently proposal of ANEVAR, is introduction in IVS 301.01–Valuations of Businesses and Business Interests, of a **new section titled “Control Premium and Discounts to the final value of equity”**, before the section on “Valuation Reporting”, by taking-over and compiling the wording spread in three different paragraphs, namely:

- paragraph 11 – “Voting Control” (to be removed);
- paragraph 20 letter (c); and
- paragraph 29 letter (i)

3. Since about 50% of real estate valuations undertaken by ANEVAR members regard land valuation, the lack of a proper list of and explanations regarding the six recognized land valuation methods will cause big problems for real estate valuers as they have no official references about these methods to be used to support their findings to the clients and users of valuation reports. Of course, valuers could refer the clients and users to real estate valuers training courses, based on various manuals, to convince them the land valuation reports are accurate. But the logical, simpler and more convincing is to refer to 1 or 2 pages of IVS 303.01–Valuations of Property Interests, including this recognized land valuation methods.

Consequently, we insist upon introduction in IVS 303.01–Valuations of Property Interests of a separate section – “Land valuation methods”, with several paragraphs containing description of the 6 land valuation methods. The argument that description of certain valuation methods is not covered by the IVS scope is not standing as IVS 301.02 – Valuations of Intangible Assets describes at large the specific valuation methods for this class of assets, which is both good and necessary in our opinion. A logical and consistent thing to do is to proceed similarly in the case of the specific methods of land valuation too.

Another proposal is that para. 15 of IVS 303.01–Valuations of Property Interests to include the 10 basic elements of comparison, presented in *GN 1 Real Property Valuation* (International Valuation Standards, Eighth Edition 2007). The reason is the coherence with the practice and with the training materials issued by Appraisal Institute.

4. The review of the valuation reports is requested by more and more clients. The draft IVS 2010 includes no reference whatsoever to this reviewing, as an important activity for all valuers.

Consequently, we propose introduction in IVS 105 – Valuation Reporting of a section titled “Review of Valuation Reports”, presenting briefly the requirements for a reviewing valuer.

5. Market comparison approach applied in businesses, intangible assets and trade related properties valuations, consist in application of either the multiples of market value of invested capital (MVIC) and/or the multiples of market value of equity to the appropriate representative financial variables, eg. EBITDA, EBIT, cash flows, sales, net assets, etc. (see book of Shannon P. Pratt, *Market Approach to Valuing Businesses*, John Willey&Sons Inc, 2005).

Thus, the term “ratios”, which is very general and even ambiguously defined, has to be replaced with the terms „multiples of market value of invested capital” and „multiples of market value of equity”, at the same time with a listing of these two categories of multiple. This proposal targets the following three standards: IVS 301.01–Valuations of Businesses and Business Interests, IVS 301.02 –Valuations of Intangible Assets, and IVS 303.04–Valuations of Trade Related Property, but with the adequate particularizations.

## **Second part – Proposals of specific modifications**

- the following definitions shall be introduced in IVS 301.01–Valuations of Businesses and Business Interests:
  - invested capital (identical with enterprise value);
  - equity net cash flows
  - invested capital net cash flows
  - discount rate

- capitalization rate
  - capitalization factor
  - yield
  - WACC
  - CAPM
- the phrase “Inventory adjustments may be different when considering the income statement and when considering the balance sheet. For example, a first-in-first-out method of costing inventory may most accurately represent the value of the inventory when constructing a market value balance sheet. When examining the income statement, a last-in-first-out method of costing inventory may more accurately represent the income level in times of inflation or deflation” will be removed from IVS 301.01–Valuations of Businesses and Business Interests, paragraph 29, letter (h) as the last-in-first-out method of costing inventory was eliminated from IFRS and IAS 2 respectively..
- the following definitions shall be introduced in IVS 303.01–Valuations of Property Interests:
    - all risks yield (including its formula)
    - all risks yield method
    - easement
- in several IVS words “types of assets” must be replaced with “classes of assets”, to be consistent with IFRS expression (word “types” is appropriate only for “property types”);
  - in several IVS word “judgment” must be replaced with “professional judgment”, to be consistent with expression “professional valuer” ;
  - in IVS 101 – General Concepts and Principles word “valuer” must be replaced with “professional valuer”, to be consistent with expression “professional valuer” from proposed Discussion Paper – Definition of a Professional Valuer.
- the following definitions shall be introduced in IVS 301.02 –Valuations of Intangible Assets:
    - capital charge
    - WARA
    - invested capital components or parts

- IVS 104 and IVS 105 contain a small error, namely the first section is called “Overview” (in Contents) and then, in the body of the text, “General Principle”;
- to keep everywhere the expression “basis/bases of value” and not “basis/bases of valuation”, because terms “value” and “valuation” are different meaning;
- standard 303.03, para. 12, refers to para. 10, instead of 11;
- standard 201.04 starts with para. 2, instead of 1.

To conclude, we propose including certain terms which are very important for the valuers in the Glossary of Term so that they wouldn't represent only a take-over of some definition already found in IVS, equivalent of a formal role, but also an useful reference for valuers (see for example International Glossary of Business Valuation Terms provided by 5 valuation bodies: AICPA, ASA, CICBBA, NACVA and IBA).

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