IACVA
INTERNATIONAL ASSOCIATION
of Consultants, Valuators and Analysts

International Association of Consultants, Valuators and Analysts

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International Valuation Standards Council
41 Moorgate
LONDON EC2R 6PP
United Kingdom
By email: CommentLetters@ivsc.org

Ladies and Gentlemen,

This letter of comment is submitted on behalf of the International Association of Consultants, Valuators and Analysts (IACVA), a member of your organization as well as the World Association of Valuation Organizations (WAVO). We are a knowledge transfer and credentialing organization with Charters covering 55 countries, listed in the appendix, serving about 10,000 members who are mainly involved in business valuation and fraud deterrence.

As a worldwide organization, we are extremely concerned with the development of guidance and standards related to valuation. We appreciate the opportunity to comment on the Discussion Paper "*Valuation of Liabilities*". Our responses to the questions are as follows:

Questions
1 Do you agree with that the IVSC should produce a standard or guidance on the valuation of liabilities as defined above? If not please explain why.

We agree that the IVSC should supply guidance on the valuation of liabilities.

2 Do you agree that the possible definition of a liability given above is both clear and adequate? If not any alternative suggestions would be welcome.

We believe that the IVSC, rather than establishing its own definition of liabilities, should adopt that of IASB:

"A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits."

3 Do you agree that liabilities arising under a financial instrument should be excluded from the scope of this project?

We believe all forms of liabilities, as defined by our answer to Question 2, should be considered, especially financial instruments; some of those, at various times, may be either an asset or a liability.

4 Do you agree that other liabilities such as rental payments, pension liabilities, insurance liabilities and deferred tax should also be excluded?

As set out in our answer to Question 3, we believe all liabilities actual or contingent should be covered.

5 Do you consider that contingent liabilities as described above should be included? Please also indicate if there are any other types of contingent liability that should be included.

We believe that all contingent liabilities should be covered. Examples other than earn-outs include put-options, insurance payouts, coupon, warrantees and guarantees.

6 Please indicate whether you believe potential litigation liabilities can or should be valued and whether they should be included in this project.

This matter has received significant scrutiny by accounting standard setters. In our view, great care should be taken to avoid needless speculation or conclusions that could be highly detrimental if they are found to be inaccurate. The valuation profession should avoid any endorsement of such processes and therefore they should not be dealt with in this document.

7 For what purposes are you aware of liabilities being valued?

In our experience, liabilities are valued normally for preparing financial statements or as part of a settlement process, as well as allocations required under purchase price allocation.

8 What basis or bases of value do you normally encounter?

The most common types are Market Value, Fair Value and occasionally, Special Value. See answer to Question 9.

9 Do you agree that the bases that are appropriate objectives for a valuation of liabilities fall within one of the three categories described in the IVS Framework?

With respect to types of value on page 6 of the Discussion Paper, it states:

> "The Board considers that the concepts underlying these three categories can all be used when valuing liabilities. For example:
>
> - Market Value represents the price which a holder of a liability would have to pay to transfer the liability to a third party in the market.
> - Investment value represents the cost to a holder of fulfilling the liability. This may differ from the price that they would have to pay to a market participant to accept a transfer.
> - Special value represents an incremental amount over and above the market value that holder with a special interest in extinguishing the liability would pay.

- Fair value represents the price that a holder of the liability would have to pay to settle the liability with a specific party. It may differ from market value, for example where the transferee had a special reason for accepting the liability that was not shared by market participants in general."

We believe that in the quotation set out above there are in reality, four, not three, types of value. In addition, to avoid confusion, in our view the term Fair Value should always adopt the definition put forward by FASB and IASB and that in all IVSC publications, especially for the purpose of this project and the Discussion Paper, the phrase be replaced by "Specific Value" which we consider more descriptive.

10 Do you agree that it may be necessary to modify some of valuation bases definitions in the Appendix in order for them to be applied to liabilities as opposed to assets? If so it would be helpful to indicate any changes you believe appropriate.

We believe that value for liabilities other than Fair Value (as defined by IASB) should be based on the cost to satisfy or fulfill, rather than that to transfer.

11 If you have experience of using the market approach to value liabilities, please indicate the nature and types of liabilities where this is used.

Our members have significant experience in valuing liabilities for financial reporting under both IFRS 3 and IFRS 13.

12 Please give an example of a type of liability where you have encountered or used a DCF method and indicate the purpose for which the valuation was required.

For financial reporting purposes, our members nearly always use DCF methods for valuing the liability portion of a convertible debt instrument as well as when dealing with above or below market rates on mortgage and other non-callable real estate obligations.

13 For the example given for question 12, please indicate the source of the projected financial information used in the cash flow forecast.

Usually the projected financial information is obtained from the issuer of the debt.

14 For the example given for question 12, indicate what risk factors you reflected and whether these were reflected by probability weighting the cash flows or the discount rate.

In valuing liabilities, a number of risk factors are normally considered. Those include variability of cash flows, asset coverage and probability of default. They are often combined into a synthetic corporate rating (from BBB downwards) that can be used to determine a market based interest rate for a similarly quoted debenture. A final adjustment to the discount rate is then made for lack of marketability.

15 Do you consider that a "risk free" rate should be used when estimating the current value of a future liability? If not please indicate how you derive the rate and the rationale to support it.

None of our members indicate they use a risk-free rate to discount any obligations. The most common method of establishing a suitable rate is that set out in the answer to Question 14.

16 Please indicate if you have used or encountered option pricing in estimating the value of liabilities. If so please indicate the nature of the liability and the purpose for which the valuation was required.

We have not encountered the use of Option Pricing Models in valuing liabilities.

17 Please indicate whether you agree that in calculating the value of a liability based on the cost of fulfilment at a future date a "profit margin" (or risk premium) should be included to reflect the risks to the holder of the cost estimate proving inadequate. If so, please give an example.

We concur that a risk premium should be built in to any long-term projections of costs to fulfill an existing obligation.

For example, a mine has eight years of remaining productive life. The estimated cost of the required remediation on closure is $22.5 million. Current (one year) inflation is 2.1%. At this rate, in eight years the cost is expected to increases to $26,570,000. This amount has a present value of $11,953,000 at 10.5% the mine's Weighted Average Cost of Capital. Based on uncertainties in the expected inflation rate, a margin of error of about 5% would be added to give a Fair Value of $12.6 million for the liability for financial reporting purposes.

18 If you use or are familiar with the Cost Approach, please indicate in your experience how the cost of fulfilling, transferring or settling/cancelling an equivalent liability is determined.

We do not have experience in the application of the Cost Approach to liabilities.

19 Do you agree with the Board's proposed approach?

We do not agree with the Board's approach and think that the most common task relating to liabilities, determining Fair Value for financial reporting should be at the top of the agenda.

Should a Standards Board or staff member wish to discuss this matter further, they may contact me during normal business hours (Eastern Time) at 416-865-9766.

Respectfully submitted on behalf of IACVA
Per

James P. Catty, MA, CA•CBV, CPA/ABV, CVA, CFA, CGMA, CFE
Chair

Appendix

IACVA List of Countries

Americas

Bahamas
Canada
Grenadine Islands
Guatemala
United States
Mexico
Puerto Rico
Argentina
Brazil

Africa

Ghana
Kenya
Nigeria
South Africa
Uganda

Europe

Austria
Germany
Netherlands
Switzerland
Romania
Ireland
United Kingdom

Asia/Pacifica

China
Taiwan
Japan
South Korea
Hong Kong
Singapore
Malaysia
Thailand
Australia
India

Middle East

Lebanon
Egypt
Syria
Jordan
Kuwait
United Arab Emirates
Saudi Arabia
Israel
Bahrain

Commonwealth of Independent States

Armenia
Azerbaijan
The Republic of Belarus
Kazakhstan
Kyrgyzstan
Moldova
Russia
Tajikistan
Turkmenistan
Ukrain
Uzbekistan
Georgia
Estonia
Latvia
Lithuania