International Valuation Standards Council (IVSC)

Discussion paper

Liabilities

Response of the
Royal Institution of Chartered Surveyors (RICS)

Contact:
Alexander Aronsohn FRICS
RICS Associate Director Valuation Professional Group
aronsohn@rics.org

Ben Elder FRICS
RICS Global Head of Valuation
belder@rics.org
Introduction

The Royal Institution of Chartered Surveyors (RICS) has noted the publication of the Discussion Paper – Liabilities – produced by the International Valuation Standards Council (IVSC) in February 2013 and welcomes the opportunity to comment.

About RICS

RICS is the global leading organisation for professionals in real estate, land, construction and related environmental issues as well as working in the personal property and business assets sectors.

Over 120,000 RICS members, who are Chartered Surveyors, exist globally and operate out of 146 countries, supported by an extensive network of regional offices (detailed on our website) located in every continent. RICS Headquarters is based in London and our international work is supported by a network of regional offices and national associations.

RICS members play a vital role throughout the entire asset life cycle – from initial inspection and measurement, development through to investment in, and the use of physical structures and other assets, as well as financial and business interests. In the valuation field our members’ expertise covers a very wide range of disciplines, including business valuation. We also provide impartial advice to governments, policymakers and non-Government organisations.

RICS is an independent professional body, which was established in 1868 and has a UK Royal Charter. It is committed to setting and upholding the highest standards of excellence and integrity, providing impartial and authoritative advice on key land and asset issues affecting businesses and society.

RICS is a regulator of both its individual members and firms enabling it to maintain the highest standards and providing the basis for unparalleled client confidence in the sector.

The general ethical principles for all RICS regulated members and firms are set out in our professional and ethical standards to which the following is an extract:

Act with integrity – Be honest and straightforward in all that you do.

Always provide a high standard of service - Always ensure your client, or others to whom you have a professional responsibility, receive the best possible advice, support or performance of the terms of engagement you have agreed.

Act in a way that promotes trust in the profession - Act in a manner, both in your professional life and private life, to promote you, your firm or the organisation you work for in a professional and positive way.
Treat others with respect - Treat everyone with courtesy, politeness and respect and consider cultural sensitivities and business practices.
Take responsibility - Be accountable for all your actions - don’t blame others if things go wrong, and if you suspect something isn’t right, be prepared to take action.

RICS and Valuation Standards

A significant proportion of our members are involved in valuation practice on all manner of assets. The first RICS Valuation Standards publication was produced in 1976 and the current standards are the “RICS Valuation – Professional Standards” effective from 30th March 2012. The standards are commonly known as “the Red Book” and contain mandatory rules and best practice guidance for valuations of real estate and other assets.

RICS adopts the International Valuation Standards (IVS) 2011. The adoption of IVS in the Red book provides an implementation and practice framework for the application of IVS globally, ensuring that RICS members follow consistent methodologies throughout the world.

The Red Book is mandatory for all RICS members and regulated firms worldwide when carrying out Red Book specific valuations. It is also widely referred to by non-RICS valuers.

The global section of the Red Book comprises a broad ethical framework which can be applied to valuations of any asset type in any jurisdiction, in harmony with national legislation. They comprise a framework for the following:

- Compliance, competence, independence and ethical requirements;
- Terms of engagement;
- Valuation bases (global);
- Valuation applications;
- Investigations, inspections and verification of information; and
- Valuation reports.

More specifically the standards relating to application, competence, independence and objectivity are set out in Valuation Standards VS1.2-1.9.

The global standards are accompanied by detailed national standards.

For more information please visit [http://www.ricsvaluation.org/](http://www.ricsvaluation.org/)
You have requested that responses to this discussion paper are set out as answers to specifically posed questions.

Question 1

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.

RICS supports the current mention of Assets and Liabilities as it stands, which is simple and sufficiently clear to cater for the broader needs of the global market which it serves.

Though we accept that the preliminary investigations by the IVSC Board have established a lack of guidance specifically related to the valuation of liabilities, we believe this lack is due to the complexity of this issue. This complexity is further illustrated by the fact the IASB decided to delay any further definition of liabilities due the diversity of opinion they had received in response to their 2010 Exposure Draft, which proposed certain amendments to the existing IAS37 on ‘Provisions, Liabilities and Contingent Assets.’

We would suggest that the production of standards or guidance on the valuation of liabilities should wait until the proposed amendments to IAS37 are completed. We would also be concerned that any attempt to define liabilities further would cause confusion in the market, as we already see with the two different definitions of Fair Value (IVSC and IFRS).

Question 2

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.

RICS believes that the proposed definition is a little too truncated and would suggest the following definition for liabilities:

An obligation for which the holder is responsible the settlement of which could result in an outflow of resources from that holder.

Question 3

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

Although there may be aspects that require specific treatment, RICS does not agree that liabilities arising under a financial instrument should be excluded from the scope of this project. RICS feels that by excluding various types of liability the paper will be fairly limited in its scope. This is probably a matter of interpretation but given that the guidance is intended to relate to all types of liability RICS thinks that all should be identified in order that borderline cases can be recognised and properly considered (for instance, by way of practical example, payment on obtaining a planning permission could be specifically a fixed amount – therefore excluded, as
per para 8 of the paper, or only defined in approach, as per para 11 of the paper). If all types are mentioned the detail could be referenced to more specific guidance.

Question 4

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

RICS would refer you to its response in relation to Question 3 and does not agree that other liabilities such as rental payments, pension liabilities, insurance liabilities and deferred tax should also be excluded from the scope of this project. RICS feels that though these are special areas of work they still merit consideration in the Draft and feels that by excluding various types of liability the paper will be fairly limited in its scope.

Question 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.

RICS would once again refer to its response in relation to Question 3 – it considers that all types of contingent liability should be included. However it does not follow that quantification is necessarily straightforward or indeed practical in every case – see the response to Question 6 below.

Question 6

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

Again, RICS considers that potential litigation liabilities should not be excluded from the project – whether they can realistically be quantified ie valued will necessarily depend on individual facts and circumstances.

Both for contingent and (potential) litigation liabilities, quantification may be subject to assumptions which by their prospective nature are contractual or hypothetical. If contractual, and terms are fully disclosed, these may be quantifiable under certain standards. Otherwise, it is difficult to see how contingent and litigation liabilities could, in many if not most instances, be legitimately quantified.

Question 7

For what purposes are you aware of liabilities being valued?

RICS would see this question directed more to market participants if particular examples are sought.
Question 8

What basis or bases of value do you normally encounter?

See comment under Question 7 above.

Question 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?

RICS would agree that the bases that are appropriate objectives for a valuation of liabilities will fall within one of the three categories (the Market Approach, the Income Approach and the Cost Approach) described in the IVS Framework, with the proviso that the Framework properly uses the term “principal” in describing them – it may be difficult to cover every situation that arises globally without this recognition of possible exceptions.

Question 10

Do you agree that it may be necessary 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.

RICS agree that it may be necessary to modify some of the valuation bases definitions in the Appendix in order for them to be applied to liabilities as opposed to assets. This may be better addressed after the responses to Questions 1 to 9 have first been analysed.

Question 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.

See comment under Question 7 above.

Question 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.

See comment under Question 7 above.

Question 13

For the example given for question 12, please indicate the source of the projected financial information used in the cash flow forecast.
See comment under Question 7 above.

Question 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.

See comment under Question 7 above.

Question 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.

See comment under Question 7 above.

Question 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.

See comment under Question 7 above.

Question 17

Please indicate whether you agree that in calculating the value of a liability based on the cost of fulfillment 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.

See comment under Question 7 above.

Question 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.

See comment under Question 7 above.

Question 19

Do you agree with the Board’s proposed approach?
RICS believe that due to the proposed exclusions and uniqueness of each case, the need for full guidance is rather borderline, though if all liability types are at least referred to then a high level paper is justified. Whilst, a discussion on the application of the various bases/methods could help the non-expert in this field, RICS would respectfully point out that the approach to a valuation must always reflect the particular circumstances and so there are limitations on what can be achieved beyond reiterating IVS generally.

Yours faithfully

Ben Elder BA BSc FRICS ACIArb
Global Director of Valuation
RICS Professional Groups

T +44 (0) 20 7695 1695
F +44 (0) 20 7334 3712
E belder@rics.org
www.rics.org