April 2013

International Valuation Standards Council
68 Lombard Street
LONDON EC3V 9LJ
United Kingdom

RE: Comments on the International Valuation Standards Council's Discussion Paper, "Valuation of Liabilities" ("Discussion Paper") – Reply Date: 30 April 2013

Mesdames/Gentlemen:

The Business Valuation Committee ("BVC") of the American Society of Appraisers ("ASA") has reviewed the Discussion Paper and is pleased to have this opportunity of responding to the invitation of the International Valuation Standards Council ("IVSC") for comment.

KEY DEFINITIONS AND CONCEPTS—PAGE 3

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

A. While the BVC agrees that guidance on the valuation of liabilities, as they are defined in the Discussion Paper, would be helpful, we do believe that such guidance need not be elevated to the status of a standard. The main purpose of valuation standards is to provide practitioners with a conceptual framework and overarching principles of the valuation theory, regardless of whether a subject interest of the valuation analysis is an asset or a liability. Current lack of guidance and differences of opinion regarding the measurement of liabilities is an issue of implementation of existing standards; hence, the best way to address this is through development of best practices, practice aids, or similar guides.

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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.**

A. Given bullet 6 on page 3, the definition of a liability might read “an obligation that could result in an outflow of resources or a requirement to take a specified action.”

PROJECT SCOPE—PAGES 4 AND 5

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

A. The BVC disagrees that liabilities arising under a financial instrument should be excluded from the scope of this project. The nature (or type) of a liability simply suggests potential method or methods that could be used to value the liability. In addition, if IVSC ultimately decided to issue a standard, exclusion of certain liabilities, such as liabilities arising under a financial instrument, could make the scope of such standard too narrow.

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

A. Same comment as for Question 3 above.

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.**

A. Any future guidance on valuation of liabilities should include contingent liabilities. Potential litigation liabilities are types of contingent liabilities; hence, they can be valued applying the generally accepted valuation methods (which could be augmented or enhanced by the application of probabilistic or option-pricing approaches).

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

A. Same comment as for Question 6 above.

BASES OF VALUE—PAGES 5 TO 7

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

A. Liabilities can be valued for income tax and financial reporting purposes. In the United States, the standard setters for tax valuations are the Internal Revenue Service and tax courts. The Financial Accounting Standards Board promulgates valuation standards for financial reporting purposes (for example, ASC §820 Fair Value Measurements and Disclosures, a standard similar to the International Accounting Standards Board's International Financial Reporting Standard ("IFRS") 13, Fair Value Measurement). Although the value definitions used in tax and financial reporting valuations in the U.S. are somewhat different, they are nevertheless closely aligned with the definition of "market value" in the International Valuation Standards ("IVSs"), i.e., the price which a holder of a liability would have to pay to transfer the liability to a third party in the market.

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

A. Same comment as for Question 7 above.

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?**

A. The BVC agrees that the existing three bases of value in the IVS Framework are appropriate and sufficient objectives for the valuation of liabilities. We do not agree that a modification of existing bases of value or an introduction of new ones specific to liabilities is necessary.

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.**

A. Same comment as for Question 9 above.

VALUATION METHODS—GENERAL

Market Approach—Page 8

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.**

A. While it is true that an application of the market approach may at times be problematic in the valuation of liabilities, it is often not because liabilities do not have market "comparables", but that appraisers do not have access to information, such as specialized databases and other data sources. The information may be available, but access to it could be prohibitively expensive, particularly for small firms and sole practitioners. As business appraisers, our members have valued non-traditional liabilities, such as structured notes and settlement claims, based on broker quotes, data provided by, for example, MarkIt,[1] and previous transactions involving similar obligations.

(1) Markit is a global financial information services company. It provides independent data, valuations and trade processing across all asset classes in order to enhance transparency, reduce risk and improve operational efficiency.

Income Approach —Pages 8 and 9

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.**

A. Some examples of liabilities that our members have valued applying the DCF method include loans and similar debt instruments, as well as settlement claims. The purposes of valuations were income taxation, financial reporting, and restructuring. In general, the projected financial information ("PFI") that have been used in these valuations emanated from management or legal counsel. The risk factors that were considered included systematic (e.g., yields on Treasury instruments, spreads between Treasury yields and appropriate market benchmark yields, etc.) and unsystematic ones (e.g., a debtor's creditworthiness and the ability to satisfy an obligation). In some cases, the unsystematic risk factors were incorporated in the cash flows (particular in situations where PFI indicated that the obligor would have difficulties meeting the cash outflow). Generally, decisions as to where to incorporate the risk — the cash flow or a discount rate — were based on specific facts and circumstances. In general, a "risk-free" rate is not an appropriate discount rate to value a liability and may be applied only in very limited circumstances (one such circumstance may be when a liability is short-term and, say, significantly over-collateralized with liquid assets). To derive a discount rate for a liability, the debtor's creditworthiness is typically evaluated and a synthetic credit rating is determined based on the ratio analysis and published credit rating benchmarks. A market yield is then based on quoted prices and yields of obligations having similar credit, duration, and other characteristics. Finally, the discount rate determined is based on the selected market yield, which is adjusted for specific characteristics of the subject liability. Many practitioners generally favor this approach for determining a discount rate for liabilities because it (a) is based on supportable market data, and (b) considers the debtor's ability to meet an obligation.

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

A. Same comment as for Question 12 above.

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.**

A. Same comment as for Question 12 above.

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.**

A. Same comment as for Question 12 above.

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.**

A. In practice, our members have generally not encountered an application of option-pricing methodologies to value liabilities, although, conceivably, there might be cases when the application of such methodologies may be appropriate.

Cost Approach—Pages 9 and 10

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.**

A. At present, the BVC has no opinion regarding the inclusion of "profit margin". We have not encountered an application of the cost approach to value liabilities.

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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.**

A. Same comment as for Question 17 above.

VALUATIONS FOR FINANCIAL REPORTING — PAGES 10 AND 11

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

A. Yes, the BVC agrees with the Board's proposed approach.

The Business Valuation Committee of the ASA remains available to discuss the foregoing comments with you at your convenience.

Respectfully submitted,

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Chair, Business Valuation Committee
American Society of Appraisers

cc: Daniel R. Van Vleet, ASA
International President
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