PROPERTY INSTITUTE Turning Professionals into Leaders

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IVSC Standards Board
International Valuation Standards Council
41 Moorgate
LONDON EC2R 6PP

Dear Sirs,

Discussion Paper – Valuation of Liabilities

On 1 February 2013 the IVSC announced the release of a Discussion Paper seeking views on the need for improved standards for the valuation of Liabilities. This was a response to the increasing need to value liabilities other than those arising under a financial instrument or lease. The initial research revealed a diversity of valuation approaches.

The document was issued seeking a response from interested parties by 30 April 2013.

The Property Institute of New Zealand Valuation and Property Standards Board comments (red) in response to the questions are detailed below:

Question 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.

Valuers would undoubtedly benefit from guidance on valuation of liabilities. However, as illustrated by the difficulties the IASB has encountered in respect of liabilities in both the Conceptual Framework project and the research project on revision of IAS 37 Provisions, Contingent Liabilities and Contingent Assets, the topic is complex with many difficult issues. Therefore, at this stage it would seem sensible either to wait for the IASB to complete its projects or for the IVSC to adopt an evolutionary approach, that is, develop a Technical Information Paper and in the light of experience with its application and the emergence of IASB guidance, move to issue of a new IVS.

Question 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.

The definition appears simple but is actually very wide. It is not specific as to whether the obligation currently exists or is contingent and appears to embrace a full range of outcomes starting from zero as to the amount to satisfy the obligation.

Question 3:

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

Yes as valuation of financial instruments is likely to involve a significant range of factors specific to that type of liability.

Question 4:

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

Yes, for the same reason as given in response to Question 3.

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.

At this stage it would seem most productive to have the main focus on simple liabilities as indicated by the examples in paragraph 10 that are not contingent on future events.

Question 6:

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

Yes, they should be included in this project. They can be valued but the estimate may be subject to significant uncertainty.

Question 7:

For what purposes are you aware of liabilities being valued?

In a wide range of contexts. For example, mergers & acquisitions and various financial reporting requirements.

Question 8:

What basis or bases of value do you normally encounter?
Market value and Investment value

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?

Agree

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.

Investment value would seem to have limited potential for application to liabilities.

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.

No experience.

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.

NA.

Question 13:

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

NA.

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.

This question appears to suggest an inappropriate approach to valuation. Valuation should result from discounting expected (that is probability weighted) cash flows at a risk adjusted discounted rate or discounting certainty equivalent cash flows at a risk free rate.

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.

The intended meaning of “current value” is not clear. A risk free rate could be estimated from the market yield on government stock.

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.

Some examples: financial option pricing to value the equity of a company as an option on the assets of a company and real option pricing is common in mining and many other contexts.

Question 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.

The valuation should proceed as indicated in response to Question 14.

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.

NA.

Question 19:

Do you agree with the Board’s proposed approach?

Yes, we agree with the approach outlined in paragraph 40 which is consistent with the evolutionary approach outlined in response to Question 1.

Yours faithfully,

Chris Stanley
Chairman
Valuation and Property Standards Board