CPA MALAYSIA

The Malaysian Institute of Certified Public Accountants

(Institut Akauntan Awam Bertauliah Malaysia) (3246-U)

June 21, 2013

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

Via email
(Commentletters@ivsc.org)

Attn: Mr Chris Thorne

Dear Sir,

COMMENTS ON IVSC DISCUSSION PAPER
VALUATION OF LIABILITIES

We refer to the Discussion Paper, *Valuation of Liabilities*, recently issued by the International Valuation Standards Council ("IVSC").

In this regard, we are pleased to attach the Institute's comments as set out in **Appendix I** for your consideration.

Please do not hesitate to contact the undersigned or the Institute's Senior Technical Manager, Ms Hoh Kim Hyan, at +603-2698 9622 should you require any clarification.

Thank you.

Yours faithfully,

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THE MALAYSIAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
(INSTITUT AKAUNTAN AWAM BERTAULIAH MALAYSIA)

Comments from
Accounting and Auditing Technical Committee

International Valuation Standards Council

Discussion Paper
Valuation Liabilities

Key Definitions and Concepts (Pg 3)

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.

> **MICPA Response:**
>
> Agree.
>
> This is in view that businesses are getting increasingly complex, and as such, certain business arrangements may result or imply new obligation / liability from the financial reporting perspective which needs to be measured at fair value at each reporting date.

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.

Extract from IVSC Discussion Paper:

4. … A possible definition for a liability in a future IVSC standard or guidance could be:

An obligation which could result in an outflow of resources.

> **MICPA Response:**
>
> Disagree.
>
> MICPA notes that the intention for this definition is to provide a wider scope of valuation approach and to not just be restricted to IFRS requirements. However, MICPA is of the view that it would be useful to align the definition with that in IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.
>
> IAS 37 defines "liability" as 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.
>
> In addition, the proposed definition of liability which uses the term "could" may be misinterpreted as a "contingent liability", which is defined in IAS 37 as:
>
> (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
>
> (b) a present obligation that arises from past events but is not recognised because:
>
> (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
>
> (ii) the amount of the obligation cannot be measured with sufficient reliability.

Project Scope (Pgs 4 – 7)

Question 3

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

MICPA Response:

Agree.

MICPA is of the view that such liabilities should be excluded from the scope of this project.

MICPA recommends instead that these should be dealt with in a separate project, given the complexity of financial instruments.

Question 4

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

MICPA Response:

Agree.

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.

Extract from IVSC Discussion Paper:

11. *Some liabilities other than those arising under a financial instrument are contingent on a future event. Typical examples include:*

- *a contract for the transfer of a business may provide for the buyer to pay an additional sum to the seller if a specified revenue or profit target is reached within a stated period.*
- *a contract for the transfer of the asset may provide for the buyer to pay an additional sum to the seller upon the future grant of a permission or license by a statutory authority.*

Although the buyer's liability arises under a contract and the sum is known it differs from other contracted payments because it is conditional on a future event, which presents a particular valuation challenge. The Board is interested in views on whether such contingent liabilities should be included in the scope of the project.

MICPA Response:

Yes, MICPA is in support of including contingent liabilities as described above.

MICPA is of the view that it would be useful to have some guidance on such valuation as a significant level of judgement is required in determining the assumptions e.g. probability of liabilities materialising, discount rate and discounting period, etc.

In addition, it would also be useful to discuss the valuation of contingent consideration. In a typical merger and acquisition ("M&A") transaction, the seller may receive additional payments from the buyer based on achievement of financial and / or non-financial goals. Currently, there is limited guidance to estimate the value of such liability in the buyer's financial statements.

Question 6

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

MICPA Response:

Yes, MICPA is in support of including guidance on the valuation of potential litigation liabilities in this project.

This is in view that this can be a difficult subject due to its subjectivity which is dependent on the potential outcome of the litigation process. The guidance should discuss factors to be considered in determining valuation assumptions and information to be obtained from legal advisor in determining such assumptions.

Nevertheless, MICPA recommends that the guidance should also discuss the limitations of such valuation because it could be contingent upon too many unknown factors.

Bases of Value (Pgs 5 – 7)

Question 7

For what purposes are you aware of liabilities being valued?

MICPA Response:

MICPA is aware of, but is not restricted to, the following purposes:

- Financial reporting
- Legal settlement
- Financial obligation
- Business combination or M&A
- Business planning

Question 8

What basis or bases of value do you normally encounter?

MICPA Response:

The following bases of value are normally encountered:

- Fair value (mainly for financial reporting)
- Investment value, Market value and Special value for the purposes of M&A

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?

Extract from IVSC Discussion Paper:

15. The IVS Framework identifies three principal categories into which a basis of value can fall. First is the most probable price that could be obtained in a hypothetical exchange in the market, second is the value or benefit that a specific party can derive from ownership and third is a price that would be reasonable between two specific parties having regard their respective positions. Market value, investment value, special value and fair value3 are bases defined in the IVS Framework in each of these categories. The Board considers that the concepts underlying these three categories can all be used when valuing liabilities….

MICPA Response:

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.

MICPA Response:

Agree.

In this regard, MICPA wishes to highlight that for asset valuation, it is common to apply present value.

With regard to liability valuation, it would be reasonable and common to claim, from a commercial perspective, that a long term borrowing / liability is worth less than the book value or the total outstanding amount as per the financing agreement due to the time value of money. In practice, the impact to liability arising from time value of money would carry less weight unless the difference is material. However, a different outcome would be arrived at if the valuation were to be made for the purpose of a legal settlement.

As such, MICPA wishes to emphasise that it is crucial to take into consideration that different bases of valuation would be applied for different purposes, thereby resulting in different valuations.

Valuation Methods – General

Market Approach (Pg 8)

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.

MICPA Response:

MICPA wishes to highlight that liability is usually company specific.

Income Approach (Pgs 8 – 9)

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.

MICPA Response: No comment.

Question 13

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

MICPA Response: No comment.

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.

MICPA Response: No comment.

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.

MICPA Response: No comment.

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.

MICPA Response: No comment.

Cost Approach (Pgs 9 – 10)

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.

MICPA Response:

No comment.

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.

MICPA Response:

MICPA wishes to highlight that the Cost Approach has not been adopted in estimating the current value of a future liability thus far.

Valuations for Financial Reporting (Pgs 10 – 11)

Question 19

Do you agree with the Board's proposed approach?

MICPA Response:

MICPA agrees with the Board's approach to provide a wider scope for valuation liabilities and to not just restrict this to financial reporting purposes.

However, MICPA is of the view that it would be useful to relate this to the requirements under the International Financial Reporting Standards (IFRS).