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International Valuation Standards Board
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Our ref MT/288
Contact Mary Tokar

23 December 2010

Dear Sirs

Discussion Paper: Valuation Uncertainty

We appreciate the opportunity to comment on the Discussion Paper *Valuation Uncertainty* (the "DP") issued by the International Valuation Standards Board ("IVSB" or the "Board"). We have consulted within the KPMG network in respect of this letter, which represents the views of the KPMG network, including its Global Valuations practice. We have set out responses to the questions raised in the DP in Appendix 1 as well as other comments related to specific elements of the DP in Appendix 2. We offer general comments on the DP below.

We support the objective of identifying and communicating valuation uncertainty to valuation users. We believe that disclosure of material valuation uncertainties would enhance the usefulness of valuation reporting to users.

However, we believe that the IVSB should provide a clearer statement of the objectives of valuation uncertainty disclosures, taking into account the views expressed by users of valuations and others including the groups referenced in the DP: the Financial Stability Board, the G20, the Basel Committee for Banking Supervision, the UK's Financial Services Authority and the International Accounting Standards Board ("IASB"). Clear objectives would facilitate an evaluation of whether proposed disclosures meet the stated objectives.

Valuation Uncertainty Disclosures in Financial Reporting

We note that the IASB and the Financial Accounting Standards Board ("FASB") have issued exposure drafts (the "EDs") which propose measurement uncertainty analysis disclosures in financial statements for certain fair value measurements.[1] While we understand that guidance issued by accounting standard setters and valuation bodies apply in different circumstances – the former to financial statements, the latter to valuation reporting – we believe that it is worthwhile noting our response to these EDs as the views that we expressed in that response also relate to the issue of communicating valuation uncertainty.

We indicated in our response to the FASB and the IASB that on balance we support quantitative disclosures of measurement uncertainty as providing useful information for users. However, our response also acknowledged constituents' concerns with respect to the costs associated with implementing quantitative disclosures. We encouraged the FASB and the IASB to consider whether the objective of sensitivity disclosures alternatively could be achieved through disclosures that are qualitative in nature.

Notwithstanding concerns that the IVSB may have with the approaches proposed or ultimately adopted by the IASB, we believe that valuation reports prepared for financial reporting purposes should be sufficiently comprehensive to allow reporting entities to meet disclosure requirements set out by the IASB and FASB, including quantitative disclosures, if adopted. Specifically, if the results of a valuation are to be used in financial reporting, the valuation report should provide sufficient information to allow a preparer of financial statements meet financial reporting disclosure requirements.

As part of their joint project on Fair Value Measurement, the IASB and FASB have an ongoing effort to develop relevant fair value disclosures, which includes consideration of user and preparer input. The IASB and FASB's research and conclusions should be considered by the IVSB in establishing its own requirements.

Suggested Criteria for when Valuation Uncertainty Disclosures Would be Required

The criteria used to evaluate when additional disclosures would be required should be clarified. For example, the DP suggests that disclosure of valuation uncertainty would be required when the degree of uncertainty in a valuation falls outside the normally expected and accepted range of uncertainty for the applicable market. However, the factors that a valuer should consider in evaluating whether the uncertainty present is normal or abnormal are not discussed. We believe that an approach that requires uncertainty disclosures only when there is abnormal uncertainty for an asset may not result in consistent disclosures for a number of assets on the basis that the

[1] FASB Proposed Accounting Standards Update, *Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*; IFRS Exposure Draft: *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements* (ED/2010/7). Responses to these EDs are currently being considered by the IASB and the FASB.

valuer believes that there is large inherent uncertainty. Moreover such uncertainty may be important to users even if it is usual for that type of asset and its applicable market, e.g., the uncertainty associated with an asset may be normal for that type of asset but still material. For example, it is normal for the values of unquoted equity investments to be subject to a relatively high level of uncertainty compared to many other types of assets; however, we believe that such elevated levels of uncertainty should be disclosed, even if they are not abnormal for the particular type of asset concerned. Auditing standards provide guidance on assessing materiality and estimation uncertainty which should be considered by the IVSB in establishing a valuation uncertainty disclosure framework to be consistently applied by valuers.

As another example, there is also a reference to whether uncertainty falls within the range that would be expected by market participants. However, users of valuations, including indirect users of valuations who are users of financial statements, may not be market participants. We note that users often may have a less sophisticated understanding of a specific market than the valuer.

In the absence of additional clarification, different valuers may arrive at different conclusions as to whether or not the additional disclosure requirements related to valuation uncertainty are applicable to a specific valuation. While valuations inevitably require significant judgement, guidance should seek to ensure that valuers approach similar factual circumstances using a similar framework and that decisions are made in a consistent manner.

In summary, we believe that the IVSB should clarify the criteria for when valuation uncertainty disclosures would be required. The objective should be to secure disclosure of material uncertainties that are relevant and decision useful to users of valuation reports. The criteria established should provide a framework to achieve consistent disclosures. The nature and form of required disclosures should consider user input, leveraging research and discussions of other financial groups.

Additional Disclosure Requirements

We believe that the IVSB's International Valuation Standards ("IVS") should include an explicit discussion on the communication of valuation uncertainty in valuation reports and when it is appropriate for additional disclosures to be made.

As currently written we believe that the suggested disclosure requirements – of the nature and cause of the uncertainty and its effect on the valuation process and valuation opinion – may be too narrow in scope and may not include all relevant, decision useful information. We believe that there are circumstances in which quantitative disclosures may be appropriate. For example, understanding the range of possible values may provide clarity to users in understanding the variability of possible outcomes. We encourage the Board to consider not only requiring certain quantitative disclosures to augment the required qualitative disclosures, but also the development of technical guidance on quantitative measures of uncertainty.

Please contact Patrick Coady at +1 613 212 2841, or Mary Tokar or Jim Calvert at +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours faithfully

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Appendix 1

Question 1

Do you agree that it is only when material, or abnormal, uncertainty attaches to a valuation on a specific time or date that specific disclosure is necessary when the valuation is reported? If not please explain why you consider that an uncertainty statement should be provided in all cases.

We believe that the approach discussed which is based, in part, on evaluating whether the uncertainty present in a valuation is normal or abnormal, is insufficient as a basis for determining whether additional disclosures are required. We do not agree that a high level of uncertainty should be characterized as "immaterial" based only on it falling within an expected range that would be expected by most market participants given the level of the uncertainty inherent in the market for the underlying asset, liability or equity interest. In this regard, we note that users of a valuation report may not be market participants in respect of the subject asset, liability or equity interest. As a result, we believe that a requirement for disclosure based on this approach is too narrow to address the needs of users in understanding a valuation. We also believe that the IVSB's current approach may be inconsistently applied in practice.

We believe that current references to material uncertainty in the DP may be confusing to users as users might interpret materiality either in the context of financial statements, for which the concept is considered explicitly, or as related to the valuation of a specific asset, liability or equity instrument for which consideration of materiality historically has not been explicit. Moreover, paragraph 22 refers to consideration of uncertainty in the context of a portfolio of assets or liabilities of the entity. This is different to abnormal or material uncertainty in the context of the market for a particular asset or the valuation assignment, as described in paragraph 5.

We believe that uncertainties that are material to the valuation of the asset, liability or equity interest should be communicated in a valuation report. We believe that further research is required on the nature and form of relevant disclosures.

Question 2

Do you believe that the Board has identified all major sources and types of material valuation uncertainty? If not please identify what additional causes of uncertainty exist and how often you encounter these in practice.

Of the five sources of valuation uncertainty listed in the DP, we agree that market uncertainty, model uncertainty and input uncertainty, subject to our comments below, generally include the principal sources and types of valuation uncertainty. However, we believe that the issues listed as 'status of valuer' and 'scope of work' do not represent core sources of valuation uncertainty though they may affect the quality of a valuation. Consistent with this, we note that the Board does not address in the DP how valuation uncertainty resulting from 'status of valuer' and 'scope of work' issues should be communicated.

Valuation uncertainties exist even when the valuer has the requisite experience, is free of bias and the scope of the engagement is appropriate. Moreover, these issues are addressed elsewhere in IVS, as adopted or as proposed. For example, in the proposed IVS[2], the Board acknowledges "a fundamental expectation that appropriate controls and procedures are in place to ensure the appropriate degree of independence and objectivity in the valuation process so that the results can be seen to be free from bias." Further proposed IVS 104 *Scope of Work* ("IVS 104") includes a minimum requirement that a statement confirming the competence of the valuer to undertake the valuation be provided to the client. IVS 104 also would require that the extent of investigation be such that sufficient evidence is gathered to ensure that the valuation is supported properly. As such, we would presume that the scope of work in a valuation compliant with the proposed IVS would be sufficient to arrive at a reasonable estimate of value. With regard to reporting, proposed Valuation Standard 105 *Valuation Reporting* ("IVS 105") would require that the valuation report provide, among other items, a clear and accurate description of the scope of the assignment as well as the disclosure of any assumptions, special assumptions or limiting conditions that affect the valuation directly.

We believe that market uncertainty relates to a lack of market activity between willing market participants on the measurement date for identical items. In such circumstances, the uncertainty arises from whether the conclusion reached by a valuer for a hypothetical transaction results in an estimate that is consistent with the price that would be achieved in a transaction between market participants on the measurement date. The IVSB's discussion of market uncertainty in paragraph 12.3 of the DP includes both inactive markets and certain active markets. While we agree that inactive markets increase valuation uncertainty, we are concerned with the broad suggestion that certain active markets may not reflect market value. While arguably prices in some active markets may drift from other bases of value, such as intrinsic value, such prices likely are indicative of the amount for which an asset should exchange on that date, i.e., market value. Further, we believe that the distinction between volatility and measurement uncertainty should be clarified. Markets with panic buying and selling or excessive speculative activity may be described at volatile markets; however, these represent active markets and the measurement uncertainty associated with the price at a given point in time is not increased by the price volatility before or after the point in time of the valuation.

We believe that the IVSB should provide a more comprehensive definition of model uncertainty reflecting greater consistency with the use of the term in practice to avoid creating unnecessary confusion. Generally accepted aspects of model uncertainty include, but are not limited to, the model's theoretical soundness, mathematical integrity, ability to replicate similar results and consistency with market pricing.

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[2] IVSB Exposure Draft: *Proposed New International Valuation Standards*

We agree with the concept of input uncertainty as a source of valuation uncertainty. However, we believe that the list of examples in paragraph 12.5 of the DP should be expanded to include inputs that are not market based, e.g. cash flow projections, reproduction costs, etc.

Question 3

Do you agree with the Board's conclusion that an explanation of any abnormal uncertainty identified and an explanation of the impact this has on the valuation (a qualitative statement) is more helpful to users in understanding the valuation than a purely numeric expression of the range of possible values created by the uncertainty (a quantitative statement)?

We believe that quantitative assessments are most useful to users when augmented by qualitative statements. We believe that further consideration is required of the nature, form and level of disclosures that would provide useful information to users of valuations.

Question 4

Do you think the IVSB should include an explicit requirement in the proposed IVS 105, Valuation Reporting, to disclose any material uncertainty or is the principle that requires valuation reports not to be ambiguous or misleading sufficient?

We believe that an explicit requirement to disclose material uncertainties should be added to promote consistency in valuation reporting.

Question 5

Do you consider that there are cases where a qualitative statement of the causes and impact of uncertainty on the valuation is inadequate and should be either augmented or replaced by a quantitative statement? If so please

a. state the circumstances and assets classes where you believe that quantitative statements are more helpful to users and,

b. provide a brief explanation or example of the type of quantitative statement that you believe would be useful.

We note that the quantitative disclosures required under IFRS 7 *Financial Instruments: Disclosures* for certain financial instruments have been received positively by users of financial statements. We believe that the IVSB should consider the objectives of disclosures of valuation uncertainty as well as user input in determining disclosure requirements. The IASB's and FASB's projects in this regard may provide useful information.

Question 6

Do you consider that it would be helpful if IVSC developed guidance on methods for making a quantitative disclosure of uncertainty under specific circumstances? If so please indicate the circumstances and any methods that you either use or encounter in your market.

As stated in our cover letter, we believe that there are circumstances for which quantitative disclosures may be appropriate. For example, understanding the range of possible outcomes may provide clarity to users in understanding the variability of possible values. We encourage the Board not only to consider requiring certain quantitative disclosures to augment the required qualitative disclosures, but also to develop technical guidance on developing quantitative measures of uncertainty.

Appendix 2

- The DP includes references to the IASB and IFRSs but not to the FASB or US GAAP. Is it intended that the IVS and/or valuation uncertainty disclosures not be applied in the context of US GAAP or other financial reporting?

- Paragraph 6: We believe that the importance of communicating valuation uncertainty relates not only to the probability, but also to the extent to which the valuation estimate may differ from market prices, i.e., small differences in value, even if they have a relatively high probability, may be immaterial. We note that market risk relates to potential positive or negative movements in an asset so it relates not only to the loss an asset can face, but also potential gains over a given interval of time due to changes in market conditions over that period.

- Paragraph 7: With respect to market risk, reference is made to “maximum expected loss”. We note that maximum loss and expected loss have two distinct meanings. In particular, expected loss generally refers to a probability-weighted amount. Accordingly, we believe that the appropriate terminology in the context of the paragraph is “maximum loss”. Reference also is made in this paragraph to “successive buyers and sellers having different views of the price of the stock on different dates”. We believe that the statement would be clearer to readers if “price” were replaced with “fundamentals”. Reference also is made to “prices *significantly* differing”. Related to our point on the prior paragraph, paragraph 6 refers to uncertainty as relating to a probability of differences without regard to the significance of such differences.

- Paragraph 8: We believe that the distinction made in the DP between valuation uncertainty and market risk is useful. However, we question whether the graph shown in paragraph 8 reflects how value-at-risk (VAR) is used in practice. For example, a large number of asset prices in the graph lie outside the VAR line, while VAR is intended to measure the risk that losses will not exceed a particular level, at a specified confidence level.

- Paragraphs 9, 10 and 11: We suggest that the Rembrandt painting example be replaced with an example of a financial instrument, given that this is more likely to be encountered in practice. We also note that the DP states that Rembrandt’s work is liquid because it is readily saleable. However, many definitions of liquidity refer to the ability to sell an asset without affecting the market price. Given that the market price of a Rembrandt is not known, the effect of selling the picture on the market value cannot be known. As such, use of such a painting to illustrate liquidity may be misleading. Further, recent sales of other Rembrandt paintings are not comparable, as each painting is unique. This lack of comparability to items trading in active markets is the key source of valuation uncertainty.

- Paragraph 12.5: Reference is made to the “degree of veracity” that can be attached to the data inputs. We believe that “reliability” is a more appropriate term.

- Paragraph 19: In the second bullet, relative to quantifying valuation uncertainty, the DP states that "when choosing alternative assumptions to measure uncertainty, selection needs to be made among possibilities that are not located in the tail of the distributions (where events are very unlikely to happen) but rather in their central areas (where events are likely to occur)." In the third bullet the DP states: "Valuation uncertainty measurement is not forward looking." We note that this appears to refer to market risk, e.g. exposure to potential changes in price over time. We believe that a more appropriate discussion of valuation uncertainty would frame the discussion in terms of consideration of alternative approaches, techniques or inputs that a market participant may consider in pricing an asset on the measurement date. While a valuation uncertainty measurement is not a forward estimate, we note that valuations are forward looking in that investors' expectations regarding the future are captured in the price or value as of the valuation date.

- Paragraph 22: Reference is made to judging the materiality of uncertainty on the basis of the impact that the valuation of the asset has to the total assets or liabilities of the entity; it is unclear as to whether the IVSB intended to refer to the market value or the book value of the total assets or liabilities of the entity in making this assessment. Moreover, while this may be appropriate for users of the financial statements of an entity, other users of the valuation may be interested in valuation uncertainty at the level of the item itself being valued.

- Paragraph 27: IFRS 7 *Financial Instruments: Disclosures* originally was issued by the IASB in August 2005 not in December 2009. Further, it initially became effective for annual periods beginning on or after 1 January 2007.

- Paragraph 29: Relative to the IVSB's comments on the IFRS Exposure Draft: *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements* (ED/2010/7), we disagree with the statement that "there is no explicit requirement for the nature or causes of uncertainty to be explained". Specifically, if adopted ED/2010/7 will require disclosure of the techniques and inputs for all fair value measurements and for Level 3 fair value measurements disclosure of how the quantitative measurement uncertainty disclosures were calculated; IAS 1 *Presentation of Financial Statements* requires disclosure of sources of estimation uncertainty including the nature of the assumption or other estimation uncertainty (paragraph 125 of IAS 1).

- Paragraph 30: Relative to the IVSB's comments on the IASB's proposed valuation hierarchy, we disagree with the statement that "material uncertainty may still arise in Level 1"; if a material uncertainty is present in prices then those market prices are no longer Level 1 inputs.

- Paragraph 31: The Board references "reasons that are discussed earlier in this discussion paper", without referencing those reasons or where in the DP they were discussed. We find this reference to be unclear.

- Paragraph 35: Reference is made to using unbiased and qualified valuers; we also believe that valuations should be free from bias but we believe that the primary objective of the bodies previously referenced is the communication of the inherent uncertainty of certain value measurements, independent of the process in which this measurement occurs.

- Paragraph 38: Reference is made somewhat dismissively to quantitative disclosures only being useful in scoring uncertainty. However, understanding such uncertainty is the objective of such disclosures. Given that a valuation is a quantitative measure, alternative quantitative measures may be a useful means of communicating valuation uncertainty.