Mr Steven J Sherman  
Chairman  
International Valuation Standards Board  
41 Moorgate  
London EC2R 6PP  
United Kingdom

Dear Mr Sherman

**Discussion Paper Valuation Uncertainty**

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the International Valuation Standards Board (IVSB) on the International Valuation Standards Council’s (IVSC) Discussion Paper: *Valuation Uncertainty*.

HoTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee is comprised of the senior accounting policy representatives from all Australian States, Territories and the Australian Government.

HoTARAC is supportive of the IVSC’s consideration of enhanced and more transparent disclosure of valuation uncertainty, given the aftermath of the Global Financial Crisis. However, HoTARAC believes that it would be more appropriate and productive if the IVSC conducted this project jointly with the International Accounting Standards Board (IASB) given the synergies and the IASB’s own measurement uncertainty disclosure project (IASB ED 2010/7 Measurement Uncertainty Analysis Disclosure for Fair Value Measurements). HoTARAC has therefore attached its own submission to IASB ED 2010/7 to assist the IVSC in its deliberation of the discussion paper.

Comments by HoTARAC on the discussion paper are attached.

If you have any queries regarding HoTARAC’s comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on 612 6215 3551.

Yours sincerely

[Signature]

Grant Hehir  
CHAIR  
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE  
20 December 2010
HoTARAC Response to IVSC DP Valuation Uncertainty

General Comments/Notes

HoTARAC would like the IVSC to note in reviewing this response that the International Valuation Standards (IVSs) are adopted as national standards by valuers in Australia.

HoTARAC is supportive of the IVSC’s consideration of enhanced and more transparent disclosure given issues that were heightened by the Global Financial Crisis (GFC). As highlighted by the IVSC in the introduction to the discussion paper, a lack of adequate information regarding material uncertainties of valuations has been identified by a number of global institutions as a contributory factor to the GFC. Appropriate and adequate disclosure requirements may alleviate such a factor from contributing to a future crisis.

HoTARAC acknowledges that the IVSC are seeking to define what should be in valuation reports, not just for financial statements. However, HoTARAC believes that the IVSC should be careful to not have competing Standards covering valuation uncertainty disclosure (i.e. those of the International Accounting Standards Board (IASB) and those of the IVSC) given that accountants and auditors would use the information about uncertainty that would be contained in some of the valuation reports. Therefore, HoTARAC encourages the IVSC and the IASB to work together to develop requirements for the disclosure of valuation uncertainty. HoTARAC noted the importance of this in its response to the IASB ED 2010/7 Measurement Uncertainty Analysis Disclosure for Fair Value Measurements (attached for your reference). An example of a possible approach to bring the IVSC and IASB together is for both bodies to collaborate to jointly issue educational material to bridge the gap between IFRS requirements and the Valuation Standards.

Additionally, HoTARAC suggests that IVSC would find it beneficial to liaise with other professional associations, such as actuaries and possibly quantity surveyors, who also determine monetary amounts for items under conditions of uncertainty. Any future requirements on valuation uncertainty disclosure would benefit immensely from the synergies between the IVSC, the IASB, and other professional associations.
IVSC Questions

1 Do you agree that it is only when material, or abnormal, uncertainty attaches to a valuation on a specific time or date that 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.

HoTARAC does not agree with providing such disclosure for all material/abnormal uncertainty ("blanket disclosure"). Other factors should also be considered before a disclosure is made, such as the nature of the uncertainty/abnormality and the usefulness of the disclosure to readers.

HoTARAC also regards that an uncertainty statement should not be provided in all cases. This would be onerous and would not provide valuable or useful information, and may actually reduce confidence in valuations.

HoTARAC notes that the term ‘abnormal’ is no longer used in Accounting Standards and has been replaced with ‘material’ or ‘significant’.

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.

HoTARAC agrees with the sources identified in paragraph 12 as being sources of uncertainty, but note that the first two identified in paragraph 12 (‘status of valuer’ and ‘scope of work’) could (and should – if circumstances allow) be mitigated/controlled to varying degrees (i.e. only use suitably qualified/experienced independent valuers). Therefore, HoTARAC is uncertain as to whether those sources should be grouped with ‘market uncertainty’, ‘model uncertainty’ and ‘input uncertainty’ as ‘principal’ sources of uncertainty.

HoTARAC acknowledges that IVSC has considered the uniqueness of the asset; however, it still refers in its example to a situation where a market exists. It is HoTARAC’s view that the IVSC should also include an example of input uncertainty where no market exists for unique assets. This is often the case for specialised assets and for Public Sector assets in particular – in this instance, depreciated replacement cost is used as a substitute methodology that is generally accepted.

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)?

HoTARAC agrees.

Furthermore, HoTARAC would like the IVSC to note HoTARAC’s response to IASB ED 2010/7 (although this focused only on the disclosure for level 3 measurement uncertainty): “HoTARAC consider the [IASB’s] proposed disclosures would highlight the volatility and subjectivity of recognised fair values ... therefore, without information about the likelihood of alternative values
being more representative, HoTARAC suggest[s to the IASB] that disclosing ranges of possible values may reduce confidence in the recognised figures.” For that reason, HoTARAC would consider it useful to have a qualitative statement.

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?

‘To not be ambiguous or misleading’ is very much a principles-based approach but does not clearly explain to a preparer of such report whether or how their report might be ‘ambiguous or misleading’; therefore, HoTARAC considers that this might not be sufficient. If the IVSB’s intention is for the report to disclose material uncertainty, then this should be clearly stated; rather than relying on a preparer’s interpretation of ‘ambiguous and misleading’.

In addition, note HoTARAC’s response to question 1.

Alternatively, to keep the proposed IVS 105 principles-based and aligned with HoTARAC’s response to question 1, the IVSB could indicate that a source of an ambiguous or misleading report might include the uncertainty of the valuation and provide guidance for disclosure on this. Any such disclosure should be done in a way that would be of benefit to the reader, rather than reduce the reader’s confidence on the valuation provided.

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 qualitative statement that you believe would be useful.

Quantitative statements, without a qualitative discussion, are just numbers that would not assist in understanding valuation uncertainty. Rather, HoTARAC views such isolation could reduce confidence and would not provide users with, for example, why an entity chose one valuation model/method over another. Therefore, HoTARAC supports the IVSC’s statement to the IASB that providing alternative numbers confuses, rather than assists, readers, and is not consistent with “the concept of fair value as a price that would be agreed between market participants” (IVSC comments on IASB ED 2010/7 Question 1).

Additionally, refer to HoTARAC’s comments to question 3.

HoTARAC supports IVSC’s proposal to primarily rely on qualitative statements to provide useful information to users on valuation uncertainty.
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.

HoTARAC agrees that it would be helpful for the IVSC to develop such guidance, but would encourage IVSC to do so in consultation with IASB. It is likely, if the IASB proceeds with its proposal, in many cases, professional valuers will be responsible for providing the information required for quantitative disclosure under the IASB’s requirements.

Conclusion

Overall, HoTARAC supports the IVSC’s proposals.

Given the relationship of this Discussion Paper to that of the IASB’s ED 2010/7 (and also the IVSC’s own inclusion of its response to the IASB ED into the DP), HoTARAC considers that the IVSC and IASB should work together on the disclosure of valuation uncertainty to ensure consistency between the IVSC’s valuation standards and the IASB’s accounting standards.

HoTARAC’s own submission to the IASB on the ED 2010/7 is attached as this may assist the IVSC with the Discussion Paper.
Sir David Tweedie  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
LONDON EC4M6XH  
UNITED KINGDOM  

Dear Sir David  

EXPOSURE DRAFT 2010/7 MEASUREMENT UNCERTAINTY ANALYSIS DISCLOSURE FOR FAIR VALUE MEASUREMENTS  

The Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to provide comments to the International Accounting Standards Board on Exposure Draft 2010/7 Measurement Uncertainty Analysis Disclosure for Fair Value Measurements.  

HoTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee is comprised of the senior accounting policy representatives from all Australian States, Territories and the Australian Government.  

Comments by HoTARAC on questions from the Exposure Draft are in Attachment 1.  

HoTARAC considers the meaning of "the effect of correlation between unobservable inputs" is unclear. Therefore, HoTARAC is uncertain of the added benefits such an assessment would provide to a sensitivity analysis disclosed in general purpose financial statements.  

HoTARAC considers the proposed disclosures would highlight the volatility and subjectivity of recognised fair values categorised within Level 3 of the fair value hierarchy. Therefore, without information about the likelihood of the alternative fair values being more representative, HoTARAC suggests that disclosing ranges of alternative values may reduce confidence in the recognised figures.  

HoTARAC believes it is difficult to fully assess the consequences of this proposal in isolation from the latest IASB thinking on other related aspects of the previous Fair Value Measurement Exposure Draft, such as the fair value hierarchy and valuation techniques. Specifically, HoTARAC is concerned that the IASB has not adequately addressed the circumstances of non-financial assets, particularly where there is no active market, and the relationship between the fair value hierarchy and valuation techniques. As a result, HoTARAC is unclear how the disclosure proposal applies to valuation techniques that predominantly use Level 3 inputs, which HoTARAC suspects may often be the case with the depreciated replacement cost technique.
Public sector entities are likely to be impacted by these proposals to a greater extent than other reporting entities, as they would have relatively more Property, plant and equipment, such as major infrastructure, and Heritage and cultural assets that would use of Level 3 fair value inputs. Therefore, the concerns expressed in Attachment 1 are regarded to be more significant for public sector entities.

If you have any queries regarding HoTARAC's comments, please contact Ms Sue Highland from Queensland Treasury on +61 7 3405 6064.

Yours sincerely

D W Challen
CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

August 2010

Encl
COMMENTS FROM HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE HoTARAC RE IASB ED/2010/7
MEASUREMENT UNCERTAINTY ANALYSIS DISCLOSURE FOR FAIR VALUE MEASUREMENTS

Question 1 Are there circumstances in which taking into account the effect of the correlation between unobservable inputs (a) would not be operational (eg for cost-benefit reasons) or (b) would not be appropriate? If so, please describe those circumstances.

(a) HoTARAC has a number of concerns with the ED's proposals, as set out below.

Effect of correlation

HoTARAC considers there is a lack of clarity about the "effect of correlation between unobservable inputs", and how this is intended to impact on the disclosure required by the rest of Paragraph 2(a) of the ED.

HoTARAC notes that, in Paragraph BC21, the IASB acknowledges the practical considerations, and judgement required, in determining whether unobservable inputs are correlated, and what effect any such correlation has on the fair value measurement. HoTARAC questions whether the IASB's objectives for the proposed disclosure will be met consistently when such judgement is required in assessing and dealing with correlation between inputs.

Illustrative Example 1 does not assist preparers in understanding this matter. In respect of information for users, it is difficult to see what use can be made of the figures in the two columns headed "Difference in fair value from using different unobservable inputs that could have reasonably been used". To be of use, information on the likelihood of the "true" fair value varying from what was actually recognised would be required. Also, there is no indication of the relative influence each of the factors under "Significant unobservable inputs" has in determining the disclosed fair value. Paragraph IE5 refers to disclosing the "relative subjectivity and limitations of the unobservable inputs", but this would best be demonstrated in Illustrative Example 1 itself.

A further issue with Illustrative Example 1 is that it includes line items relating to investment properties, for which adjustments have been made to comparable property values. Since this Example deals only with Level 3 fair value measurements, HoTARAC questions the appropriateness of including assets for which the measurement inputs may be closer to Level 2 inputs, assuming the "comparable property values" are observable in a market, and along the lines of Paragraph 51(d) of IASB ED/2009/5. Therefore, HoTARAC has a strong preference that the investment property line items be replaced with a highly specialised piece of plant and equipment that can only be manufactured by the entity itself and therefore, would require substantial use of Level 3 inputs, and that a non-financial liability also be included in the example.
The only reference to "correlation" in Illustrative Example 1 is the wording in brackets towards the top of the table under the heading "Significant unobservable inputs", but this does not give any indication of how the correlation influenced the disclosed figures. Contrary to what is inferred in the last sentence of Paragraph BC28, HoTARAC has not been able to identify any requirement within IAS 36 Impairment of Assets regarding disclosure of the effect of correlation between inputs in respect of recognised fair values.

Paragraph BC21 refers to the Board not providing guidance on making assessments about the effect of correlation. However, HoTARAC believes that if, such assessments are expected to influence the financial statement disclosure, a certain amount of guidance is necessary. In particular, the disclosure requirement needs to be supplemented by an Illustrative Example that demonstrates how to determine the existence of relevant correlation between inputs. Also, the IASB needs to demonstrate how this ED’s proposal fits with the entire package of proposals arising from the Fair Value Measurement ED, that is inputs, valuation techniques, fair value hierarchy and disclosures.

**Variability**

While the proposed disclosure requirements in Paragraph 2(a) of the ED appear to relate only to variability in amounts used for the measurement inputs actually used, other references in the ED appear to contradict this interpretation, and require classification. For example:

- the relevant heading in Illustrative Example 1 refers to using “different unobservable inputs that could have reasonably been used”, which implies that different inputs, not just different amounts, have been used;

- the final sentence of Paragraph BC18 refers to users needing to know the effect of correlation to assess the extent to which the use of a different unobservable input would effect the recognised fair value. This implies that the disclosure needs to take into account inputs that weren’t used for the recognised fair value; and

- the second sentence of Paragraph BC20 refers to an entity determining whether the use of different combinations of unobservable inputs would result in a significantly higher or lower fair value. Does this imply that the disclosure needs to take account of inputs that weren’t used for the recognised fair value, or does it refer to differences in amounts used in respect of the same group of inputs?

HoTARAC notes that Paragraph 2(a) refers to a "significantly higher or lower fair value measurement", rather than a "materially higher or lower fair value measurement", which implies that "significance" and "materiality" have different meanings. As the concept of "significance" is central to the proposed disclosure requirement, more clarity is needed about how to gauge "significance", as distinct from "materiality". Otherwise, HoTARAC recommends that Paragraph 2(a) refers to "materially" rather than "significantly".
Subject to clarification of the intent of Paragraph 2(a) of the ED, HoTARAC recommends that disclosures only be required to deal with the effects of amounts at the limits, highest and lowest, of a range of reasonably possible amounts, similar to Paragraph B18(b) of IFRS 7 Financial Instruments: Disclosures. Further, HoTARAC recommends that the Paragraph 2(a) requirements take account of the economic environment in which the entity operates, as well as the timeframe that the assessments relate to, similar to Paragraph B19 of IFRS 7.

Practicalities

HoTARAC has reservations about the practicalities of undertaking a sensitivity analysis in accordance with Paragraph 2(a) of the ED in respect of all types of valuation techniques, particularly those involving a current replacement cost approach, which are likely to involve substantial use of Level 3 inputs. Given the nature of Level 3 inputs, HoTARAC considers that correlation between such unobservable inputs would generally not be reliably determinable and/or may not have any effect on the fair value. In such circumstances, HoTARAC questions the benefit of the proposed disclosure.

HoTARAC believes that the recognised fair value should reflect the most reasonable inputs available, as well as the most reasonable amounts, and relevant correlation between the inputs used. On this basis, HoTARAC considers that assessments of the correlation between inputs, and the use of alternative amounts for those inputs and possibly, alternative inputs, would be more effectively incorporated into the actual measurement requirements and guidance of the eventual Fair Value Measurement Standard. HoTARAC questions the benefits of supplementing a recognised fair value with disclosures about less reasonable inputs/amounts.

HoTARAC considers the proposed disclosures would highlight the volatility and subjectivity of recognised fair values categorised within Level 3 of the fair value hierarchy. Therefore, without information about the likelihood of alternative values being more representative, HoTARAC suggests that disclosing ranges of possible values may reduce confidence in the recognised figures.

Overall views

Due to the uncertainties outlined above, HoTARAC is unable to estimate the likely costs that would be incurred by preparers and operational implications in analysing information for this disclosure. Subject to addressing the issues described above, increased use of inputs in a fair value calculation makes it more impractical and costly for an entity to re-calculate that fair value in light of numerous alternative combinations of amounts and, possibly, inputs, and to assess the significance of the difference in fair value resulting from each possible combination.

HoTARAC strongly recommends that the IASB consult with a representative of the valuation profession, such as the International Valuation Standards Council, about the practical aspects of this proposal. In many cases, professional valuers will be responsible for providing the information required for this disclosure.
(b) Due to the uncertainties described in (a) above, HoTARAC is unable to comment on whether there are any circumstances in which it would not be appropriate to take into account the effect of correlation.

Question 2 If the effect of correlation between unobservable inputs were not required, would the measurement uncertainty analysis provide meaningful information? Why or why not?

HoTARAC is uncertain of any added benefit from requiring correlation between inputs to be taken into account in the measurement uncertainty disclosure, given:

- the uncertainty HoTARAC has about the intention of assessing the "effect of correlation between unobservable inputs"; and

- there is no guidance as to how to assess the existence and extent of correlation between inputs.

Subject to those issues, HoTARAC considers that, if the fourth sentence of Paragraph 2(a) of this ED was excluded, the proposed expansion of the rest of that Paragraph would still constitute an improvement in wording, and would still result in a meaningful disclosure.

It is acknowledged that some users have requested this additional information. However, HoTARAC considers that the users who may benefit from this information are likely to be specialist users with particular information needs, not mainstream users of general purpose financial statements. For those users who do require this extra information, the relevance of what is disclosed is likely to be outweighed by the complexity of the disclosure.

Question 3 Are there alternative disclosures that you believe might provide users of financial statements with information about the measurement uncertainty inherent in fair value measurements categorised within Level 3 of the fair value hierarchy that the Board should consider instead? If so, please provide a description of those disclosures and the reasons why you think that information would be more useful and more cost-beneficial.

To avoid imposing an unwarranted burden on preparers, and to ensure faithful representation of all assets and liabilities recognised at fair value, HoTARAC strongly believes that the disclosure requirements should focus on high-level principles.

HoTARAC believes external auditors play an important role in forming opinions about whether there is faithful representation of material asset values. This audit work involves forming opinions about the valuation methodology, and relevance and reliability of data used to determine recognised figures. In HoTARAC's view, such audit responsibilities are a more cost-effective, and less confusing, approach to convey to users the level of confidence they can have regarding recognised asset values.
As per the views of the IASB’s Expert Advisory Panel about better practice disclosures for financial instruments, any fair value disclosures should provide more information about the high-level control and governance arrangements surrounding the determination of fair values. HoTARAC considers such information would be a more cost effective substitute to undertaking, and disclosing details of analyses of values, particularly due to the expected limited number of users who would be able to interpret and use such information.

Another approach for the IASB to consider is to:

- not require the disclosures proposed by Paragraph 2(a) of the ED;
- not require entities to undertake alternative value calculations; and
- instead, require entities to disclose more detail about the range of amounts that could be used for the various data inputs, that is, an expansion of what is set out in Paragraph 2(b) of the ED. Sophisticated users who demand such information can undertake their own alternative fair value calculations, including making their own assessments of the reliability of fair values that predominantly use Level 3 measurement inputs.

Other issues

To assist with the interpretation of these requirements, HoTARAC suggests that the IASB more clearly distinguish between the meaning of "sensitivity analysis" and "measurement uncertainty".

A number of references appear throughout the ED, such as, at the bottom of page 4, and Paragraphs BC12 and BC23, regarding the potential of another IFRS to specify that the proposed requirement in Paragraph 2(a) of this ED may not be required for a particular asset or liability. However, this qualification does not actually appear in either the body of this ED or the previous ED on Fair Value Measurement. Therefore, HoTARAC believes, if the IASB's intention is to be effective, that such a qualification should be directly incorporated into the body of the eventual Standard.

HoTARAC notes that certain liabilities, particularly those in respect of employee benefits, have well established disclosure requirements to supplement the recognised fair values. HoTARAC further notes that ED/2009/5 did not exempt entities from compliance with disclosure requirements in other specific Standards. Therefore, HoTARAC believes the IASB needs to review the inter-relationship between the proposed new disclosures and those that already exist under other specific Standards, and ensure there is no overlap in requirements. In this regard, HoTARAC notes that the recent IASB ED/2010/3 Defined Benefit Plans includes proposed disclosure requirements about sensitivity analyses.

Editorial matter

A small correction to the spelling of “volatility” towards the bottom of Illustrative Example 1, right hand column, is needed.