THE CANADIAN
INSTITUTE OF
CHARTERED BUSINESS
VALUATORS

Sent Via Email to: CommentLetters@ivsc.org

January 12, 2011

International Valuation Standards Board
41 Moorgate
London EC2R 6PP
United Kingdom

Dear Sirs:

Re: Comments on the Discussion Paper Valuation Uncertainty

The Canadian Institute of Chartered Business Valuators (CICBV) is pleased to comment on the above noted IVSC Discussion Paper and related Questions for Respondents.

We commend the International Valuation Standards Board for the comprehensive body of work that it has prepared on the subject of valuation uncertainty.

Our comments are organized as follows:

(a) General Comments;
(b) Specific Comments; and,
(c) Responses to the Questions for Respondents contained in the Discussion Paper.

General Comments

1. The Discussion Paper would provide greater clarity if it included specific criteria, factors, and/or guidelines as to when valuation uncertainty disclosures would be required and/or when valuation uncertainty would be outside the range of "normal" valuation uncertainty.

2. Consideration could be given to defining the terms "materially", "normal", and "abnormal" to assist in the application of this Discussion Paper in practice (i.e., "materially", "normal", and "abnormal" are terms that lend themselves to varying degrees of subjectivity, which could result in a wide array of interpretations by valuers and users, including securities commissions and accounting and valuation organizations). We also note that the Discussion Paper does not discuss "normal" uncertainty that could potentially be material, which may also require separate disclosures.

3. Quantitative disclosures may be appropriate in certain circumstances (i.e., certain users may prefer to see ranges of values based on certain key assumptions, which would not be best addressed through qualitative disclosures). The Discussion Paper would provide greater clarity if it included a discussion of this issue.

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4. The Discussion Paper is very broad in its scope. Additional clarity with respect to the specific types of valuations and/or financial instruments that are relevant would assist valuers and users in its application.

Specific Comments

1. *Paragraph 1:* This paragraph discusses "growing calls from financial regulators for the better identification and communication of uncertainty in valuations." However, as the Discussion Paper does not include discussion as to the specific purposes for which such disclosures would be appropriate, we presume that there is an all-encompassing need to disclose valuation uncertainty whereas such a need may only exist for the valuation of complex financial instruments. Clarification of the need for identification and communication of uncertainty in valuations would be useful if our presumption is not correct.

2. *Paragraph 6:* In our view, valuation uncertainty disclosures should also be based on the degree or extent (perhaps based on materiality, or some other relevant measure) that the valuation may differ from market prices. For example, differences in value with a high probability of occurrence may not be material.

3. *Paragraph 5:* This paragraph discusses a "range" of uncertainty and levels of "abnormal" and "material" uncertainty, which can differ depending on the users and/or preparers of the valuation. As such, additional clarity as to the basis/perspective from which "abnormal" and "material" uncertainty should be assessed in determining whether uncertainty disclosures are required would be helpful.

4. *Paragraph 6:* This paragraph states that a valuation estimate may differ from price, which is typically the case when a valuation estimate is done without identifying "special buyers". This implies that most business valuations would require uncertainty disclosures. If this is what is intended, it would be useful for the Discussion Paper to provide greater clarity.

5. *Paragraph 7:* The reference to "maximum expected loss" can have various meanings. For example, "maximum loss" can be different from "expected loss" (i.e., "expected loss" is more of a most likely scenario while "maximum loss" is more of a worst case scenario). Consideration should be given to further clarifying what is intended.

6. *Paragraphs 9 to 11:* In our view, the example used in these paragraphs could be improved by basing it on a relevant financial instrument, rather than paintings, as the use of concepts related to liquidity and comparable transactions in the context of paintings is potentially inappropriate (i.e., paintings are relatively unique and may not be the best example for liquidity and comparability).

7. *Paragraph 12:* While the Board has identified five principle sources of valuation uncertainty, "status of the valuer" and the "scope of work" are related to professional valuation standards and the procedures

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followed in determining value, which will ultimately determine the amount of assurance provided and/or type of report to be issued, instead of the measurement of value. As such, in our view, these items should not be included as principle sources of valuation uncertainty in determining the required related disclosures.

8. *Paragraph 22:* This paragraph would be more useful if it distinguished how materiality should be determined (i.e., market or book value of assets, liabilities, net assets, revenues, expenses, earnings, etc,) and which users should be considered in determining the level of materiality (i.e., materiality can differ depending on the users).

9. *Paragraph 30:* In our view, if a material uncertainty is present in “Level 1” inputs, these inputs would no longer be considered to be “Level 1” inputs for financial reporting purposes.

10. *Paragraph 35:* While it is noted that unbiased and qualified valuers should be used, the main objective of the valuation of uncertainty disclosures should be related to value measurements and not to the procedures followed in determining value.

Responses to the Questions for Respondents contained in the Discussion Paper

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.**

   Conclusions of notional value, in a business valuation context, are based on assessment of many valuation parameters. While the objective of the valuator is to use those valuation parameters that are the most likely to occur, business valuations are subject to risks of variation that could result in a materially different value conclusion. Business valuations are fundamentally based on assumptions of most probable future outcome such as prospective cash flows or earnings; as such the level of uncertainty associated with such projected future outcomes has the potential to be significant. Business valuation report conclusions are not as a matter of course qualified because of this uncertainty. In this regard, the concepts “materiality”, “normal”, and/or “abnormal”, as described in the Discussion Paper, do not provide a foundation that is sufficient for the appropriate determination of when additional disclosures related to valuation uncertainty are required. In addition, disclosures based on an assessment of materiality using a range of possible values may not address the qualitative and/or quantitative needs of users, as certain users may prefer quantitative disclosures instead of, and/or in conjunction with, qualitative disclosures, irrespective of materiality (i.e., materiality can differ among users, depending on a given user’s view of the underlying assumptions, as well as the context used for the determination of materiality). In addition, the Discussion Paper would add clarity if it defined materiality in the context of the overall subject financial statements and/or in relation to the given subject assets, liabilities, and/or equity interests being valued.

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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.

The most significant type of uncertainty associated with a business valuation relates to estimates of future outcomes such as projected future cash flows or earnings as such projections are an essential element of all business valuations that are based on an income approach. These elements of uncertainty are not covered in the examples given in paragraph 12.5 of the Discussion Paper which seems to be focused on observable prices and consensus data. The risk associated with making assumptions about prospective outcomes seems to be a different type of risk than is being portrayed in paragraph 12.5.

We are also generally of the view that market uncertainty, model uncertainty, and input uncertainty are the principal sources and types of valuation uncertainty. However, status of the valuer and scope of work are factors that impact the quality and/or reliability of the valuation, rather than being factors specific to uncertainty itself. Moreover, factors related to the status of the valuer and scope of work are best addressed in valuation standards related to reporting and disclosure requirements of the applicable valuation organization that a given valuation is being prepared under, rather than as specific factors used to assess valuation uncertainty. In addition, the sections in the Discussion Paper related to market uncertainty, model uncertainty, and input uncertainty would be improved it they differentiated between the most relevant/appropriate (e.g., direct market information, which is typically the best indicator of value) as compared to least relevant/appropriate (e.g., non-market and/or indirect market information), irrespective of valuation uncertainty.

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)?

In our view, both quantitative and qualitative disclosures are required to provide useful information to users. The facts and circumstances of a given valuation may require differing levels of quantitative and qualitative information, which would need to be assessed on a case-by-case basis.

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?

Disclosure of all elements relevant to a business valuation for which variation could lead to a variation in the value estimate that could be material should not be a requirement. Users of business valuation reports

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need to be aware that valuation conclusions are based on assumptions pertaining to future events. The problem with attempting to quantify such uncertainty is that it would only be useful to a user if the valuator were able to attach a measure of likelihood to the possible future events that give rise to such uncertainty. Such measurement would be very subjective and any measure of uncertainty in the value conclusion that would flow from such an attempt at measurement would at best be speculative. The most the profession can offer is not to associate itself with conclusions as to value that it knows or ought to know are misleading because they are premised on unreasonable or unlikely assumptions. As a result, where material uncertainties exist and/or can reasonably be identified, such material uncertainties should be disclosed for financial reporting purposes.

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.**

   There could be circumstances were it is difficult to differentiate the level of uncertainty between two or three possible future outcomes. In these circumstances the business values associated with each of the possible outcomes might form part of the conclusion on value. These circumstances would be unusual as a valuator is generally able to identify the most likely set of assumptions on which to premise value. However, for specific situations where a quantitative statement would be useful for users in assessing valuation uncertainty, such a quantitative statement should be made, which should include the key factors, assumptions, and/or sensitivities that a user would need to make a reasonableness assessment of the 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.**

   We are of the view that to be most useful and/or relevant, the quantification of the impact of uncertainties on valuation conclusions should be made in conjunction with qualitative disclosures. As such, any disclosure requirements related to valuation uncertainty should include both qualitative and quantitative disclosures, which should be based on the given facts and circumstances. General and specific factors to consider in making such an assessment and deciding on which specific disclosures are required would increase the usefulness of the Discussion Paper.

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Conclusion

We hope that this submission is helpful to you. If you have any questions regarding our comments, please do not hesitate to contact Robert H. Boulton, CA, CBV, CICBV Director, Education and Standards.

Yours truly,

Gordon G. McFarlane, CA, CBV
Chair, Professional Practice and Standards Committee

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