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IVSC Standards Board
International Valuation Standards Council
41 Moorgate
LONDON EC2R 6PP
United Kingdom
By email: CommentLetters@ivsc.org

Ladies and Gentlemen,

This letter of comment is submitted on behalf of the International Association of Consultants, Valuators and Analysts (IACVA), a member of the International Valuation Standards Council (IVSC) and the World Association of Valuation Organizations (WAVO). We are a knowledge transfer and credentialing organization with Charters covering the 55 countries listed in the Appendix and serving about 10,000 members who are mainly involved in business valuation and fraud deterrence.

As a worldwide organization, we are extremely concerned with the development of the standards related to valuation especially in Canada (an IFRS country), where we are incorporated, as well as in the United States, which has, at the moment, a majority of our members.

We appreciate the opportunity to comment on the Exposure Draft of a Technical Information Paper *"Valuation Uncertainty".* Our views are as follows:

1. The proposed TIP defines valuation uncertainty at para 7 as:

> *The possibility that the estimated value may differ from the price that could be obtained in a transfer of the same asset or liability taking place at the same time under the same terms and within the same market environment.*

Do you agree with this definition? If not, how do you think that it could be improved?

We agree in principle with the definition but think, as all fair value measurements are estimates, that it can be improved by including some quantitative possibilities as follows:

> "The probability that the estimated values, expressed as a range, will not include the prices that could be obtained in a transfer of the same asset (or liability) taking place at the same time under the same terms in an identical market environment."

2. Various prudential regulatory authorities either have or are contemplating introducing disclosure requirements for assets that are deemed to be subject to “valuation uncertainty” and to apply different risk weightings to these in capital adequacy regulations for banks and other financial institutions. The Board has decided to exclude prudential valuation adjustments for valuation uncertainty from the scope of this guidance. The reason is that the IVSC is only concerned with proper valuation practice, not with how valuations are then used by the recipient in complying with other standards, laws or regulations.
Do you agree with the Board’s decision to exclude prudential valuation adjustments for valuation uncertainty from the scope of this guidance?

We concur with the IVSC Standards Board’s decision to exclude from its scope of work, potential adjustments by prudential regulating authorities.

3. The proposed TIP provides guidance on the distinction between valuation uncertainty as defined in the paper and risk, in particular between market uncertainty and market risk. It was clear from comments received on the Discussion Paper and made elsewhere that the concepts are regularly confused. Some believe that the brief explanation of market risk in paras 16 and 17 is not needed given that the focus of the paper is on uncertainty rather than risk. Others consider that the inclusion of a brief illustration of market risk helps readers understand the distinction between this and market uncertainty.
Which of these views do you support?

We believe that the inclusion of an explanation of market risk is essential to understanding valuation uncertainties. Therefore, the text of paragraphs 15 and 16, together with the related graph, should be expanded to accentuate the nature of market risks and the difference between them and “Valuation Uncertainty” which may or may not be related.

4. The paper identifies three main sources of valuation uncertainty: market uncertainty, model uncertainty and input uncertainty.
Do you agree that these three categories represent the main sources or causes of valuation uncertainty as defined? If not please explain why, and in particular identify any other source of uncertainty that is not mentioned.

Paragraph 11 sets out the Board’s three categories of uncertainties: market, model and input. As discussed in paragraph 12, market uncertainty relates to external changes in the market for the subject whose Fair Value is being estimated. In our view, the concept of valuation uncertainty covers all types of assets and liabilities, some, but not all of which, have markets. We prefer the phrase “market disruption” rather than “market uncertainty” as one source of valuation uncertainty. Active markets have little uncertainty but may be disruptive such as in a “flash crash”.

We concur that market disruption is a major cause of valuation uncertainty, especially with models that are not being constantly recalibrated against active transactions. We also suggest that the input uncertainty be subdivided into assumptions and data categories. Estimating Fair Value involves trying to determine what assumptions would be made by “market participants” in undertaking the measurement of an asset or liability. This process involved obtaining suitable data (which may often be subject to subsequent adjustment) and based on that, as well as discussions with outside financial analysts, developing several plausible, supportable assumptions.

When there are several sets of internally consistent plausible supportable assumptions the valuator has to select one of them as being the most representative. The reasons for the choice are usually set out in detail as part of the Valuation Report.

5. The proposed guidance indicates that because market uncertainty arises when the impact of events on value is unknown it is identifiable but not measureable. In contrast, model and input uncertainty can be both observable and measureable.
Do you agree with this position?

We agree in part with the Board's view that model and input (in our terminology, data and assumption) uncertainties can be both observable and measurable. In cases of data uncertainties their extent may not be fully measurable. The same is true of market disruptions, which are always observable and sometimes, but not usually, quantifiable. We suggest that the texts of paragraphs 18 and 19 be rewritten.

6. The requirement in IVS 103 is to disclose any material uncertainty that affects the valuation. Paras 29-39 of the proposed TIP provide guidance on identifying when uncertainty is material, with reference to the requirement in IFRS 13 for valuations for financial reporting and more general guidance where valuations are for other purposes.
Do you find the guidance on materiality to be helpful? Are there any improvements or other considerations that you would suggest be included?

We find the discussion on Marketability (paragraphs 29 to 39) useful but rather vague. In particular, the term significant is used in paragraph 30 without any indication of the actual size involved. Is it a variance of 10%? or 25%? We believe that an Estimate of Value should generally be expressed as a range with the midpoint usually selected as the chosen figure. Such a range would normally be less than +/- 10% of its mean. Any figure outside that level would be considered to have a significant effect.

7. Para 42 sets out matters that it is recommended be included in a qualitative disclosure of uncertainty.
Do you agree that this identifies the matters that should normally be included in a disclosure of uncertainty? If not please indicate any additional matters that you consider should be included or any matters mentioned that should be excluded.

We do not agree that paragraph 42 identifies the matter that should normally form part of a disclosure of uncertainty. In particular, we strongly believe that the phrase "a clear and accurate description" used in IVS 3 must involve both qualitative (clear) and quantitative (accurate) material relating to the valuation uncertainty involved in any fair value measurement of an asset or liability.

The discussions in paragraphs 43 and 44 need to be rewritten to reflect that quantitative material should always be included if and when it is available. We also differ strongly with paragraph 45 as:

- Nearly all estimates of fair value are developed by more than one method and therefore are often expressed as a range. Should a single figure be required, it would be the most likely amount inside the spread.

- Even if the extremes of the appropriate range are unobtainable, an experienced valuator will usually be able to establish 90% or 95% probability figures that can outline the range.
- The text of the valuation report should make it clear that the chosen figure is the most probable rather than one with spurious accuracy.
- The text should also indicate, when possible, how the probability that the "correct" figure falls within the chosen range was determined.

8. Para 47 suggests that model and input uncertainty may be more readily measureable for financial instruments than for other types of asset.
Do you have experience of quantitative measures of valuation uncertainty for tangible or intangible assets being disclosed in reports? If so please indicate the types of asset and the techniques used to quantify the uncertainty.

Our members have been involved in the valuation of many intangible assets. Items of tangible and intangible assets, where quantitative measures of valuation uncertainty have been included in a valuation report, include: brand names, office buildings, pulp & paper mills, and software programs. In each case, at least two generally accepted valuation approaches have been involved, for example market and cost, to establish ranges for the final conclusion.

9. Para 51 sets out proposed principles for quantitative measures of uncertainty.
Do you agree with this list? If not please indicate any additional principles that you believe should be included or any listed that you believe are inappropriate.

We believe that paragraph 51 requires revision as in our view, every conclusion of value involves quantitative as well as qualitative elements.

- Any quantitative measures should always be accompanied by an explanatory narrative.
- In quantifying valuation uncertainty, management's "best" and "worst" case sets of financial projections may well be helpful if a Discounted Cash Flow valuation method is involved. The worst case (in view of management) is not likely to be a stress test at all.
- The objective of any uncertainty analysis should be disclosed.
- An adjustment for any correlation of significant inputs should be made when practical; however this is not often the case. We believe it is better to overstate, rather than understate, any valuation uncertainty resulting from the absence of any correlations involved.
- We do not believe that the ability to net financial assets and liability in any way reflects their Fair Value.

10. It is proposed that the final TIP will include a few simple illustrative examples of uncertainty disclosures to assist readers understanding how the guidance may be applied in practice. The Board has decided not to develop these until it has received comments on the principles in this draft. The Annexe to this draft contains an indication of situations for which examples are being considered.

Do you agree with the Board's proposal to include illustrative examples of typical disclosures? If so, please indicate the situation for which you consider an example would be most useful.

We concur with the Board on the need to include illustrative examples and suggest they should include the following items.

- Level 3 financial instruments
- Investment properties
- Operating facilities (specifically Property, Plant & Equipment)
- Brand Names
- Internally development software
- Customer relationships

If you have an example of either a disclosure or measurement of valuation uncertainty that you would like the Board to consider for inclusion in the final paper, please include this with your response.

Should a Board or staff member wish to discuss this matter further, they may contact me during normal business hours (Eastern Time) at 416-865-9766.

Respectfully submitted on behalf of IACVA
Per

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Chair