January 31, 2013

International Valuation Standards Council
41 Moorgate,
London EC2R 6PP
United Kingdom

Gentlemen:

Re: Comments on the IVSC Exposure Draft of TIP - The Valuation of Forests

In general, we support the publication of this Technical Information Paper (TIP). Please find the following comments to the questions that were raised.

1. Do you consider that the principles discussed in this TIP could have wider application beyond the indicated scope? If so, please indicate the additional purposes to which the TIP could be applied.

Comment/s: On the contrary the scope is still a little broad. It may be good to further restrict it to only the biological asset, i.e., trees and stands. Land valuation must be done separately and under a different standard. Highest and best use (HABU), especially at the level of the standard, should not just be swept aside.

A whole forest enterprise valuation is an entity or business valuation already. It can include machines and equipment, forest roads, laboratories, intangible assets and even liabilities in addition to land. These must not be covered in just a single standard.

2. In para 15 it is indicated that discussion of techniques for the measurement and sampling of the tree crop (forest inventory) are outside the scope of this TIP but that there may be standards or guidance applicable in specific markets. The Board wishes to know if there is a predominant measurement and sampling approach that IVSC could reference as an example in this TIP, while recognising that variations may be applicable in certain jurisdictions or for certain species.

i) Please indicate your experience of different standards or techniques that are applied in preparing forest inventory, and the markets in which these are applied.

Comment/s: The discipline or faculty of Statistics and proper research methodologies have already provided for this. There is no need for IVS to delve into it anymore.
Randomness of the sample plots, availability of reliable volume and/or density information, and total planting data are important. Estimating all three depends on the employment of proper statistical procedures and appropriate research methodologies.

ii) Do you believe that it would reduce diversity of valuation practice if the IVSC gave more information on common sampling and measurement techniques?

Comment/s: Of course. But, this is a TIP on valuation. IVS might unduly be overextended to inventory. IVSC may not be in a position to relentlessly be on the lookout on developments in inventory procedures.

3. The proposed guidance indicates at para 28 that all three approaches described in the IVS Framework are applicable to the valuation of forests. The discussion that follows indicates some of the strengths and weaknesses of methods under each approach in the context of valuing forestry interests.

Please indicate which of the methods discussed you most commonly encounter in the valuation of forestry interests. If you encounter more than one on a regular basis please indicate whether there is clear tendency to use different methods under different circumstances, eg:

i) the stage of maturity of the tree crop

ii) whether the valuation is of a single stand or multiple stands

Comment/s: The Income Approach is most commonly used because it can be used to custom model proper views of values over the time horizon. Interestingly, however, regardless of the stage of maturity of the tree crop and whether the valuation is for a single stand or multiple stands, the Cash Flow Method can be used for both of the Income and the Cost Approaches. Compounding is used in the Cost Approach, while in the Income Approach continuous discounting is employed.

As appropriately pointed out in the draft TIP and by IAS 41, the cost approach appropriately reflects the value of a tree or stand before maturity or commercial age.

Stump prices, while not frequent, still are data for the Market Approach.

4. The draft discusses the use of the market approach, income approach, and cost approach. Are there any other valuation approaches or methods used for valuing interests in forestry with which you are familiar? If so, please describe the method and the circumstances under which it is applied.

Comment/s: One is Realisation Value of Current Timber Content, Realisation Value, Standing Stock Method, Lump Sum Method or Immediate Liquidation Method; and another is Option Based Methods.
The Realisation Value of Current Timber Content, Realisation Value, Standing Stock Method, Lump Sum Method or Immediate Liquidation Method assumes that all the forest can be liquidated or sold at the point of valuation. The forest value is calculated by determining the stumpage (or royalty) value of standing merchantable volume. The underlying assumption is that all merchantable stands in a forest can be liquidated immediately and sold at current stumpage prices.

**Option Based Methods** can be considered as extension of the Present Value method. A forest owner has the option of when to harvest a stand. In theory the owner has the option to halt log production when prices are low and increase production when prices are high. The ability to defer the harvest has a value.

5. The Board is aware of some significant diversity in the length of the explicit forecast period that is used when using a discounted cash flow model to value a forestry interest. The proposed guidance has avoided giving specific guidance on the length of the period.

i) In your experience what is a typical range of forecast period for valuing forestry interests, and what criteria are used to determine how long this should be on a case by case basis?

**Comment/s:** For longer gestation crops, one rotation maybe enough. But for crops with gestation shorter than ten years, five years can be acceptable and ten-years explicit forecast period maybe enough as most of the values are within the ten years period.

ii) Do you consider that it would be helpful for the IVSC to provide specific guidance on the length of the forecast period?

**Comment/s:** Yes, I suggest ten years or one cycle, even if only five years is presented in the report.

6. The discount rate to be used in a discounted cash flow is discussed in paras 45-49. This supplements the more detailed discussion of the DCF method in TIP 1. The Board has received evidence that in some parts of the world inappropriate reliance is being based on models such as the Capital Asset Pricing Model or the Weighted Average Cost of Capital where there is insufficient data to provide reliable evidence of either the risk premium or cost of equity that would be typical for a market participant. In order to address this issue the proposed guidance emphasises the need to give greatest weight to market based inputs.

Do you agree with this guidance? If you have experience of how appropriate discount rates can be derived for use in a DCF of a forestry interest please indicate if this differs from the proposed guidance.

**Comment/s:** The guidance on the “build-up” method is acceptable. But, the guidance to use cost of equity only seems faulty. For as long as market and not individual entity’s WACC is used, the discount rate should be appropriate.
7. The proposed guidance in para 52 is that the cost approach is mostly applicable to recently planted forests because the physical and possible economic changes that occur as a forest matures mean that other methods become more reliable. The Board is aware that some argue that the cost approach cannot be applied to commercial forests under any circumstances and others argue that it can be reliably applied to mature forests.

Please indicate if you agree with the proposed guidance on the applicability of the cost approach. If not please explain why by reference to practice in the markets with which you are familiar.

Comment/s: Yes, I agree. Although, there is also the attendant issue of how recent is recent which has to be addressed. Commercial age is when the biological asset achieves merchantable value already.

8. It has been reported to the Board that some valuations of forestry are being presented in financial statements prepared for statutory purposes that show significant changes from those previously submitted solely due to the adopted valuation method changing. The Board considers that this is contrary to the IVSs, in particular the definition and conceptual framework for market value, or where prepared under IAS 41, the requirements of IFRS 13 Fair Value Measurements. The method adopted should be that appropriate to achieve the required basis of value, it should not dictate or change the basis of value. The draft ED recommends in paras 55 - 58 the need to consider the use of more than one approach and the reconciliation of the results as means of avoiding a misrepresentation of the value by over reliance on a single approach, and the appearance that value can change simply because a different method is used.

i) Please indicate if you have encountered a similar problem to that described and, if so, any reason or justification given for the change in value?

Comment/s: No, none yet.

ii) Do you consider that the guidance provided on the need to consider an alternative method in the Exposure Draft addresses this issue?

Comment/s: Yes.

9. An interest in a forest can consist of the rights to the land, the tree crop and all other improvements to the land or it can be in only some of these components, eg the land only or the tree crop only. For most valuation purposes the benefits attaching to the subject interest, eg the right to receive certain cash flows can be readily identified. For valuations for financial reporting under the IFRSs a value has to be attributed to the "biological asset", ie the tree crop, regardless of whether the crop and the land are held in the same ownership. This can create difficulties where there is no direct evidence of the value of the tree crop only. The proposed guidance in para 71 refers to the suggested approach in IAS 41 which is that the value of the "raw land" be deducted from the value of the combined asset, with the residual representing the value of the
biological asset. However, it is argued by some that this is over simplistic as the value of "raw land" is not the same as the value of land supporting a mature forest and the evidence the price of bare land ready for planting is of limited relevance. Proponents of this view argue that the interdependence of the tree crop and the land mean that the land makes a significant contribution to the value of the tree crop, and therefore deducting only the value of the bare land from the value of the whole forest overstates the value of the biological asset.

Please indicate if you have experience of a separate value being ascribed to the "biological asset" in a forest for financial reporting purposes and, if so, the method or methods that you are most familiar with to arrive at this value.

Comment/s: Yes. Value indications for the biological assets were derived using the Discounted Cash Flow (DCF) and Immediate Liquidation methods. The land, on the other hand, was valued using comparables for sale and for rent. Value indications for the concession right to the land were derived using the Market and Income approaches. Good land attributes for raising biological assets can and should be appropriately reflected in the value of the land as adjustments.

10. Para 71 refers to the guidance in IAS 41 that the value of the biological asset, in the case of forests the living trees, may be derived at by deducting the value of the land from the value of the value of the combined asset. It also points out the difficulty that arises if the land were worth more for an alternative use. The proposed TIP indicates that while this might suggest that the biological asset has a negative or zero value, if the trees will generate income to the entity when it is harvested then the biological asset will have a positive value and should be recognised as an asset regardless of the value of the land. Some disagree and argue that if the trees are preventing a more valuable alternative use then they can have no value.

In the context of the requirement to ascribe a fair value to the biological asset as required by IAS 41, which of these views do you support?

Comment/s: As can be gleaned on the answers to questions 1 and 9, above, I support the view in TIP ED.

11. The Illustrative Examples included with this draft are intended to illustrate the application of some of the principles discussed in this draft and in other IVSC pronouncements. They are deliberately simplified and are not designed to be applied to real life situations without modification to reflect the facts and circumstances.

i) Do you consider that these examples will be helpful in reducing diversity in practice?

Comment/s: Yes.
ii) Are there any other subjects that you consider would benefit from an illustrative example?

Comment/s: No more for the moment. The examples should already be enough in the meantime.

12. The objectives of the TIP are set out at the beginning of the Exposure Draft.

i) Please indicate whether you believe that the draft meets these objectives. If you disagree please indicate why and how the guidance could be improved.

Comment/s: Yes, but differences with the IFRS must be brought to the attention of IASB.

ii) Are there any additional matters that you believe should be addressed? If so please indicate what these are.

Comment/s: Yes. How about carbon credits?

Very truly yours,

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Dean