Submission of W B Liley

Introduction

Unfortunately, the deadline for submissions on the ED has come around too fast. The first few weeks of the year are a very busy time for active forest valuers, and despite my intentions I have not been able to spend sufficient time on it. The deadline to respond to the ED has arrived in the same manner as the deadline accompanying the Council’s decision to distribute it. The document was released in a form where it failed to adequately address the rudiments of forest valuation, let alone any complexities.

My comments are made as one who has to spend a great deal of time explaining the principles and processes of forest valuation. Over the last 20 years, staff within the Auckland office of what is now Indufor Asia Pacific have conducted forest valuations in Australia, New Zealand, Brazil, Uruguay, Chile, Colombia, Suriname, Guatemala, South Africa, Tanzania, Malaysia, Indonesia, Fiji, Papua New Guinea, Solomon Islands, Vanuatu, China and other places. The volume of our activity has been increasing with approximately 30 valuations of sizeable resources conducted each year.

An encouraging finding has been that the same approaches to forest valuation have worked well across all of these locations, despite their seeming diversity.

Over the passage of time, the sophistication expected from forest valuations has escalated substantially and with it a requirement to provide:

- Detail
- Disclosure
- Disclaimers

As could be expected, a significant driver of the advancing practice has been the questions and feedback of the clients. The most evident querulousness may come in the intense environments offered by due diligence processes, surrounding preparation of bid values. Here, aspiring purchasers have to satisfy themselves, their fellow investors and financiers that outlays of large sums are indeed justified. This is the coalface at which market value takes its definition.

It would be preferable to be able to observe that a significant driver of forest valuation rigour has been the scrutiny and attention from auditors. Unfortunately, this has not been the case. Instead, our more general finding is that we need to explain ourselves to a new crop of forest naïfs within audit teams each year. Herein, especially lies the danger. In casting about at short notice for some recommendations on a subject of which they have had virtually no previous exposure, the auditors are inclined to turn to “standards”. They will cheerfully embrace any hint of prescriptive practice, this absolves them of the need to understand the commercial activity they are dealing with.

Regrettably we find that the same can be the case in other parts of the accountancy profession.

We are conscious that our valuations are getting heightened scrutiny from auditors thus far this year. A significant source of the extra attention arises from the attempted record settlement from E&Y to class action claimants re Sino-Forest. This case, among others highlights the problems that
can arise when the valuer’s and auditor’s respective responsibilities are not understood nor adequately communicated.

The Exposure Draft:

- Does not provide adequate treatment of the tree crop/land interface, despite this being given a high priority for attention in the original Terms of Reference for the Commercial Forestry Project
- Does not give sufficient attention to forest rents – whether actual or notional, and concepts of lessor and lessee interest
- Does not adequately distinguish issues and treatment of systematic and non-systematic risk, nor provide sufficient guidance on the acknowledgement of catastrophic risk
- Does not provide examples that are sufficiently developed. A forest valuer who provided the examples demonstrated to a client in New Zealand or Australia would be disciplined by the respective professional forestry organisations
- Does not discuss how taxes of various types need to be recognised in the valuation process
- Does not give guidance on the role of finance-explicit modelling
- Offers no useful explanation of the principles and role of forest estate modelling and the relationship of this to bottom-up approaches
- Offers insufficient development of concepts of optimum economic rotation age. It thereby risks leaving users under the misapprehension that standing stock approaches are sufficient.
- Provides insufficient development of the selection of units of comparison in the analysis of comparable sales
- Does not offer sufficient guidance on the incorporation of real cost and price movement. This should include warnings for the unwary
- Provides insufficient development of the concepts of market absorption of forest produce
- Provides insufficient development on the handling of negative contributions from 2R+
- Provides insufficient development of cashflow timing issues in which forests have some special features
- Provides insufficient discussion of the development of harvesting strategy as a basis for projected cashflows
- Provides insufficient guidance on the treatment of forest roads.

We find as forest valuers that certain features of forests may prove a source of initial bewilderment and frustration to those from other professions. If this is the case, such matters deserve attention in explanatory material accompanying the TIP. Forests are:

- Characteristically large – it is not for instance possible to see much of them in a short space of time
- Heterogenous
- Dynamic
- Long-lived

All of these features warrant statistical and modelling treatments that deserve the attention of specialists. Even with such attention, it is a futile aspiration to expect that the tree crops can be
described with precision. The valuation methods must accordingly be those which accommodate, acknowledge and explain the imprecision.

**Conclusion**

The ED in anything resembling its current form should not be released.