



International Valuation Standards Council

IVS 2017 Proposed Revisions Exposure Draft

**Issued: 16 July 2018
Comments Due: 19 October 2018**

**IVS 2017 Proposed Revisions
Exposure Draft**



Notice to Recipients of This Exposure Draft

The IVSC Standards Review Board invites feedback on all matters in this Exposure Draft. We request comments by the 19th of October 2018 by emailing comments to aaronsohn@ivsc.org, File Reference IVS 2017 Proposed Revisions.

All comments received are part of the IVSC's public file and are available at www.ivsc.org.

A copy of the IVS 2017 Proposed Revisions is also available at www.ivsc.org.

Copyright © 2018 International Valuation Standards Council. All rights reserved. No part of this publication may be translated, reprinted or reproduced or utilised in any form either in whole or in part or by any electronic, mechanical or other means, now known or hereafter invented, including photocopying and recording, or in any information storage and retrieval system, without permission in writing from the International Valuation Standards Council. Please address publication and copyright matters to: International Valuation Standards Council, 1 King Street, LONDON EC2V 8AU, United Kingdom.
Email: contact@ivsc.org Visit: www.ivsc.org.



Letter from Mark Zyla

Chairman, IVSC Standards Review Board



MARK ZYLA

CHAIRMAN, IVSC STANDARDS REVIEW BOARD

Dear All

Further to the publication of IVS 2017 the Standards Review Board together with the Business Valuation Board and the Tangible Assets Board have decided to publish targeted revisions to IVS 2017 based on feedback received during the agenda consultation process conducted in 2017 and 2018.

The IVSC is planning to publish revisions as needed based on market feedback. The consultation process for the IVS 2017 Proposed Revisions is now open. Accordingly, the Standards Review Board encourages participation within the three month consultation period ending the 19th of October 2018 from all individuals and organisations. The IVSC is committed to a fully open and collaborative consultation process. Thus, all comments received as part of the consultation process will be published on the IVSC website.

We look forward to your participation in the IVS 2017 Proposed Revisions Exposure Draft and incorporating the views and recommendations from practitioners, valuation professional organisations, academics, corporations and regulators, among others.

Kind Regards

Mark Zyla, Chair

Standards Review Board of the IVSC



Contents

1. Introduction	5
a. Purpose of the IVS 2017 Proposed Revisions Exposure Draft	5
b. Background	5
c. Structure of this Exposure Draft	6
d. Other Ongoing Projects and Updates	6
2. IVS Glossary	7
a. Background and scope	7
b. Proposed Changes to IVS 2017 Glossary	8
c. Glossary Excerpts	8
d. Questions for respondents	8
3. IVS 102 – Investigations and Compliance	10
a. Background and scope	10
b. Proposed Changes to IVS 102	10
c. Questions for Respondents	10
4. IVS 105 – Valuation Approaches and Methods	11
a. Background and scope	11
b. Proposed Changes to IVS 105	12
c. Questions for Respondents	16
5. IVS 200 – Business and Business Interests	17
a. Background and scope	17
b. Proposed Changes to IVS 200	18
c. Questions for Respondents	22
6. IVS 410 – Development Property	23
a. Background and scope	23
b. Proposed Changes to IVS 410	23
c. Questions for Respondents	24



Introduction

Purpose of the IVS 2017 Proposed Revisions Exposure Draft

Stakeholders are invited to comment on all revisions in the IVS 2017 Proposed Revisions Exposure Draft. In addition, questions related to each specific valuation topic are included at the end of section together with a summary of all questions at the end of this section. In addition to revisions and questions, the IVSC welcomes general feedback from respondents on any matters in IVS 2017.

Background

IVS 2017 was issued in January 2017 and became effective on 1st of July 2017. Since that time, the IVSC Boards (collectively Standards Review, Business Valuation, and Tangible Asset Boards) issued the Invitation to Comment (ITC) on the 15th of May 2017. On the basis of IVSC's "Gap Analysis" and other input from stakeholders submitted as part of the IVS 2017 consultation process, the ITC included the following major valuation topics:

1. Non-Financial Liabilities
2. Discount Rates
3. Early Stage Valuation
4. Biological Assets
5. Extractive Industries
6. Inventory

Based on the feedback gathered during the ITC process the Boards prioritized certain topics, which are the subject of the IVS 2017 Proposed Revisions contained in this Exposure Draft. Those topics addressed within the ITC include revisions to existing IVS 2017 standards on discount rates, as well as new standards on complex capital structures that is broadly applicable to early stage company valuations. Meanwhile other topics are ongoing and may be subject to separate exposure drafts, such as non-financial liabilities and inventory. While finally, the Boards are still undergoing market



engagement to determine next steps for the topics of biological assets and extractive industries.

In addition to revisions to discount rates and new standards on complex capital structures, the IVS 2017 Proposed Revisions also provides an update to the definition of Development Value, and other minor adjustments.

Structure of this Exposure Draft

The Boards determined that there was no need to republish the entirety of IVS 2017, but rather have highlighted the substantive changes and other related paragraphs as needed for context. However, respondents are requested to review these changes in the context of the relevant Chapters of IVS 2017. All draft additions are shown in *dark red*, while deletions are shown in *dark red* and ~~*crossed through*~~.

The structure of this technical review is as follows:

1. IVS Glossary
2. IVS 102 – Investigations and Compliance
3. IVS 105 – Valuation Approaches and Methods
4. IVS 200 – Businesses and Business Interests
5. IVS 410 – Development Property

Other Ongoing Projects and Updates

The Boards are continuing to advance other topics from the ITC including non-financial liabilities and inventory. The Boards expect to issue exposure drafts on these topics later this year. Furthermore, the IVSC are in the process of setting up the Financial Instruments Board, which expects to begin meeting at the 2018 AGM in Dubai.



1. IVS Glossary

Summary

Background and scope

Further to comments received by stakeholders in the ITC consultation process, and additional comments received from direct market engagement with relevant stakeholders, the Boards acknowledged that the definitions of the terms of Price, Cost, and Value as contained in IVS 2013 were useful to some stakeholders particularly within emerging markets. As such, the Boards reviewed the previously defined terms and revised to incorporate prior feedback from the consultation process.

The Boards discussed the context of additional definitions within IVS 2017, and whether such definitions represent universal terms to be utilised across all specialisms and jurisdictions, or whether these terms are specific to IVS. Given the differences in defined terms published by other regulators and standard setters, the Boards determined that in order to facilitate these revisions it was necessary to define these terms in the context of IVS at this time. However, the Boards continue to engage with stakeholders to drive harmonization in the defined terms across disciplines and jurisdictions.

Furthermore, the Boards felt that it was necessary to include a definition for *Valuation*, and as with the additional terms, this is defined for use within IVS although could apply for other purposes. The Boards also explored the inclusion of a definition for *Calculation* and *Calculation Engagement*. The Boards determined that at this point in time there was insufficient stakeholder consensus to agree a definition for these terms. Furthermore, the Boards acknowledged the broad implications of defining such terms as it relates to claiming compliance with IVS. For example, the Boards were concerned that certain *valuers* could mistakenly believe that calculations (such as those derived from automated valuation models "AVMs") are compliant with IVS. Furthermore, as previously outlined in the ITC the Boards are planning a future project on AVMs and chose to defer additional definitions until market engagement and research can be performed. In this respect the Boards have included questions below for stakeholder feedback.



Proposed Changes to IVS 2017 Glossary

Glossary Excerpts:

The IVSC Boards have proposed the following changes to the Glossary in order to provide additional clarification:

"10.2 This glossary is only applicable to IVS 2017, and does not attempt to define basic valuation, accounting or finance terms, as valuers are assumed to have an understanding of such terms (see definition of "valuer")."

"20.4 Cost

The word "cost" refers to the amount required to acquire or create the asset as of a particular date."

"20.9 Price

The word "price" refers to the amount received to sell an asset or paid to transfer a liability. Because of the financial capabilities, motivations or special interests of a given buyer or seller, the price paid may be different from the value which might be ascribed to the asset by others."

"20.14 Valuation

A "valuation" refers to the act or process of determining an estimate of value of an asset or liability by applying IVS."

"20.17 Value

"The word "value" refers to an opinion of the valuer of the estimated amount consistent with one of the Bases of Value set out in IVS 104, ~~or in instances in which value and price are equivalent, the word "value" refers to a fact.~~"

Questions for Respondents

Question 1: Do you believe that IVS should define the terms Price, Cost, and Value? If so, please discuss why you think the additional definitions are necessary.



Question 2: Do you believe IVS should define *Calculation* and *Calculation Engagement*? Please explain why.

Question 3: Should a *Calculation* be IVS compliant, and if so, what differences in the scope of work and disclosures outlined in IVS should be required by the *valuer*?



2. IVS 102 – Investigations and Compliance

Summary

Background and scope

As part of the feedback received from the ITC, a number of respondents asked for clarification on limitations and related compliance with IVS. The Boards discussed in depth what valuations are compliant with IVS. The Boards felt that it was necessary to further highlight that in certain instances the limitations placed on the *valuer* may be so significant that the valuation could not claim compliance with IVS.

As noted above, the Boards are engaged in discussions on AVMs and chose to defer additional clarification on this topic until further market engagement and research can be performed.

Proposed Changes to IVS 102

The Boards have proposed the following change to IVS 102 in order to provide additional clarification:

“20.7 If, during the course of an assignment, it becomes clear that the investigations included in the scope of work will not result in a credible valuation, or information to be provided by third parties is either unavailable or inadequate, or limitations on investigations are so substantial that the valuer cannot sufficiently evaluate the inputs and assumptions, the valuation assignment will not comply with IVS.”

Questions for Respondents

Question 4: Should IVS provide examples of “substantial” limitations? If so, please provide examples of such limitations.



3. IVS 105 – Valuation

Approaches and Methods

Summary

Background and scope

Discount Rate Revisions:

As outlined in the ITC, “The assessment of an appropriate discount rate is a significant and highly subjective assumption often required to be made by *valuers*. The Boards and Stakeholders have noted significant diversity in practice and the absence of sufficient documentation supporting the rationale for discount rate assumptions. IVS 105 Valuation Approaches and Methods, paragraph 50.29 through paragraph 50.31, outlines various methods *valuers* may use and certain items a *valuer* should consider; however, stakeholder feedback has noted a relative lack of specificity within the current Standards. Such factors suggest that additional standards related to discount rate derivation would be helpful toward improving consistency and quality in the marketplace.”

Based on the findings from the ITC, the Boards determined that additional standards were required on the derivation of discount rates. In particular, feedback from the ITC noted persistent failure of *valuers* to provide their rationale or perform requisite diligence on the projected cash flow forecast as well as the unsubstantiated adjustments (e.g. Alpha or Company Specific Risk Premiums) to the discount rate. The proposed changes seek to address the diversity in practice in these areas.

Additional Clarifications:

In addition to the proposed changes regarding discount rates, the Boards propose several other minor revisions to IVS 105. In particular, the Boards felt the additional text in 10.5 regarding OPMs etc. related more to business valuation and thus have been addressed in IVS 200 rather than the general section that applies to all asset classes.



With regard to 10.9 and 10.10, further to the comments contained in Section 102 above, the Boards felt additional information on valuation limitations was required in order to provide further clarification.

In respect to 50.6 the Boards felt that with the additional language within the Discount Rate discussion, further clarification on expected versus most likely value of cash flows was needed.

Discount Rate Revisions:

Based on stakeholder feedback it was felt that further standards were needed to address the significant diversity in practice in the derivation of discount rates. In particular, it was felt that further detail regarding consideration of projected cash flows and the relationship to the discount rate was needed. Given its inclusion in the general standards, the proposed revisions to the Discount Rate section apply to all disciplines.

The Board performed significant market engagement and considered various options on how to address the diversity in practice, including the creation of an additional chapter and substantial additions to the standards. However, to continue to provide principle based standards, the Boards determined that the following additions to the existing IVS 2017 section were sufficient and appropriate.

Additional Clarifications:

The Boards have proposed the changes outlined below to provide additional clarification.

Proposed Changes to IVS 105

IVS 105 Excerpts:

The Boards have proposed the following changes to IVS 105 in order to provide additional clarification:

"10.5 While this standard includes discussion of certain methods within the Market, Income, and Cost approaches, it does not provide a comprehensive list of all possible methods that may be appropriate. ~~Some of the many methods not addressed in this standard include option pricing methods (OPMs), simulation/Monte Carlo methods and probability-weighted expected return methods (PWERM).~~ It is the valuer's responsibility to choose the appropriate method(s) for each valuation engagement. Compliance with IVS may require the valuer to use a method not defined or mentioned in the IVS."



~~"10.9 In certain circumstances, the valuer and the client may agree on the valuation approaches and methods the valuer will use or the extent of procedures the valuer will perform. Depending on the limitations placed on the valuer and procedures performed, such circumstances could be better characterised as a calculation of value and thus may not be an IVS compliant valuation."~~

~~"10.10 A valuation may be limited or restricted where the valuer is not able to employ the valuation approaches and valuation methods that a reasonable and informed third party would perform, and it is reasonable to expect that the effect of the limitation or restriction on the estimate of value could be material."~~

"50.6 When selecting the appropriate type of cash flow for the nature of asset or assignment, valuers must consider the factors below. In addition, the discount rate and other inputs must be consistent with the type of cash flow chosen.

(a) Cash flow to whole asset or partial interest: Typically cash flow to the whole is used. However, occasionally other levels of income may be used as well, such as cash flow to equity (after payment of interest and principle on debt) or dividends (only the cash flow distributed to equity owners). Cash flow to the whole asset is most commonly used because an asset should theoretically have a single value that is independent of how it is financed or whether income is paid as dividends or reinvested.

(b) The cash flow can be pre-tax or post-tax: If a post-tax basis is used, the tax rate applied should be consistent with the basis of value and in many instances would be a participant tax rate rather than an owner-specific one.

(c) Nominal versus real: Real cash flow does not consider inflation whereas nominal cash flows include expectations regarding inflation. If expected cash flow incorporates an expected inflation rate, the discount rate has to include the same inflation rate.

(d) Currency: The choice of currency used may have an impact on assumptions related to inflation and risk. This is particularly true in emerging markets or in currencies with high inflation rates.

~~(e) Expected versus most likely values: Typically a cash flow forecast that represents expected values is used. However, occasionally other forecasts may be used in certain circumstances, such as most likely values."~~

The IVSC Boards have proposed the following significant changes to IVS 105 section on Discount Rates in response to market feedback over inconsistency in market practices:



"50.30 The rate at which the forecast cash flow is discounted should reflect not only the time value of money, but also the risks associated with the type of cash flow and the future operations of the asset."

"50.31 The discount rate must be consistent with the type of cash flow (see paras 50.6 to 50.8)."

"50.32 Valuers may use any reasonable method for developing an appropriate discount rate. While there are many methods for developing a discount rate or determining the reasonableness of a discount rate, a non-exhaustive list of common methods includes:

- (a) a capital asset pricing model (CAPM),*
- (b) a weighted average cost of capital (WACC),*
- (c) observed or inferred rates/yields,*
- (d) a build-up method (generally used only in the absence of market inputs)."*

"50.33 Valuers should consider corroborative analyses when assessing the appropriateness of a discount rate. A non-exhaustive list of common analyses could include:

- (a) an internal rate of return (IRR),*
- (b) a weighted average return on assets (WARA)"*

~~*"50.34 In developing a discount rate, a valuer should consider:*~~

- (a) the type of asset being valued. For example, discount rates used in valuing debt could be different to those used when valuing real property or a business,*
- (b) the rates implicit in comparable transactions in the market,*
- (c) the geographic location of the asset and/or the location of the markets in which it would trade,*
- (d) the life/term and/or maturity of the asset and the consistency of inputs. For example, the maturity of the risk-free rate applied will depend on the circumstances, but a common approach is to match the maturity of the risk-free instrument to the duration of the cash flows being considered,*
- (e) the bases of value being applied."*



"50.35 In developing a discount rate, a valuer must:

(a) disclose the method used for developing the discount rate, including support for its use and

(b) provide evidence for the derivation of the discount rate, including the identification of the significant inputs and support for their derivation or source."

"50.36 Valuers must consider the purpose for which the forecast was prepared and whether the cash flow assumptions are consistent with the basis of value being applied. If the cash flow assumptions are not consistent with the basis of value, it could be necessary to adjust the forecast or discount rate (see para 50.39)."

"50.37 Valuers must consider the risk of achieving the forecast cash flow of the asset when developing the discount rate. Specifically, the valuer must evaluate whether the risks underlying the forecast cash flow assumptions are captured in the discount rate."

"50.38 While there are many ways to assess the risk of achieving the forecast cash flow, a non-exhaustive list of common procedures includes:

(a) Identify the key components of the forecast cash flow and compare the forecast cash flow key components to:

- Historical operating and financial performance of the asset,*
- Historical and expected performance of comparable assets,*
- Historical and expected performance for the industry, and*
- Expected near term and long term growth rates of the country or region in which the asset primarily operates,*

(b) ~~Confirm whether the forecast cash flow represents expected values, as opposed to most likely values, of the asset,~~

(c) Compare prior forecasts of the asset to actual results to assess the accuracy and reliability of managements' estimates, and

(d) Consider qualitative factors."

"50.39 If the valuer determines that certain risks included in the forecast cash flow for the asset have not been captured in the discount rate, the valuer must 1) Adjust the forecast, or 2) Adjust the discount rate to account for those risks not already captured.



(a) When adjusting the cash flow forecast, the valuer should provide the rationale for why the adjustments were necessary, undertake quantitative procedures to support the adjustments, and disclose the nature and amount of the adjustments;

(b) When adjusting the discount rate, the valuer should document the circumstances that did not permit adjustments to the cash flow forecast, provide the rationale for why such risks are not otherwise captured in the discount rate, undertake quantitative procedures to support the adjustments, and document the nature and amount of the adjustment."

Questions for Respondents

Question 5: Do you agree with the suggested changes to IVS 105 section on Discount Rates? If not, please provide details of the additional information you think should be included or excluded from this section.



4. IVS 200 – Business and Business Interests

Summary

Background and scope

As part of the ITC process the Boards and stakeholders noted significant diversity in practice for the valuation of early-stage companies resulting in a lack of transparency and market confusion. Both the Boards and stakeholder feedback initially indicated that there are certain issues that arise in the valuation of early stage companies that are unique, and therefore may not be covered in current IVS. Further to discussion amongst the Boards it was felt that many of the issues were shared with other valuations undertaken with limited information or high uncertainty, and therefore there was no need for an additional new chapter on the topic with the exception of complex capital structures which required additional standards. The Boards also noted consistent feedback from stakeholders with regard to a lack of standards related to complex capital structure considerations and that complex capital structures had itself been identified as a separate topic for consideration within IVSC's gap analysis. Instead of preparing a separate chapter to provide additional standards on complex capital structure methods and considerations, the Boards decided to expand upon the existing Capital Structure Considerations section within IVS 200.

Additionally, the AICPA recently released its first working draft entitled *Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies*. The Boards are actively monitoring and communicating with the Task Force, and where applicable and appropriate, plan to ensure consistency between IVS and the AIPCA handbook.

The Boards discussed inclusion of the changes within IVS 105. However, further to discussions it was felt that the techniques and methods were more applicable to business valuation than to other asset classes. As such, it was considered more appropriate to include the changes in IVS 200.



Proposed Changes to IVS 200

IVS 200 Excerpts:

The Boards have proposed the following changes to IVS 200 in order to provide additional clarification:

“130.1 Businesses are often financed through a combination of debt and equity. However, in many cases, valuers could be asked to value only equity, particular class of equity, or some other form of ownership interest. While equity or a particular class of equity can occasionally be valued directly, more often the enterprise value of the business is determined and then that value is allocated between the various classes of debt and equity.”

“130.2 While there are many ownership interests in an asset which a valuer could be asked to value, a non-exhaustive list of common interests includes:

- (a) Bonds*
- (b) Convertible debt*
- (c) Partnership interest*
- (d) Minority interest*
- (e) Common equity*
- (f) Preferred equity*
- (g) Options*
- (h) Warrants”*

“130.3 When a valuer is asked to value only equity, or determine how the business value as a whole is distributed among the various debt and equity classes, a valuer must determine and consider the different rights and preferences associated with each class of debt and equity. Rights and preferences can broadly be categorized as economic rights or control rights. A non-exhaustive list of such rights and preferences may include:

- (a) dividend or preferred dividend rights,*
- (b) liquidation preferences,*
- (c) voting rights,*
- (d) redemption rights,*
- (e) conversion rights,*
- (f) participation rights,*
- (g) anti-dilution rights*
- (h) registration rights, and*
- (i) put and/or call rights.”*



"130.4 For simple capital structures that include only common stock and simple debt structures (such as bonds, loans and overdrafts), it is typically possible to estimate the value of all of the common stock within the enterprise by directly estimating the value of debt, subtracting that value from the enterprise value, then allocating the residual equity value pro rata to all of the common stock."

"130.5 For complex capital structures, being those that include a form of equity other than just common stock, valuers may use any reasonable method to determine the value of equity or a particular class of equity. In such cases, typically the enterprise value of the business is determined and then that value is allocated between the various classes of debt and equity. Three methods that valuers could utilize in such instances are discussed in this section, including:

- (a) Current value method (CVM);*
- (b) Option pricing method (OPM); and*
- (c) Probability-weighted expected return method (PWERM)."*

"130.6 While the CVM is not forward looking, both the OPM and PWERM estimate values assuming various future outcomes. The PWERM relies on discrete assumptions for future events and the OPM estimates the future distribution of outcomes using a lognormal distribution around the current value."

"130.7 A valuer may utilize the results of one method for purposes of corroborating the results of another."

Current Value Method (CVM)

"130.8 The current value method (CVM) allocates the enterprise value to the various debt and equity securities assuming an immediate sale of the enterprise. Under the CVM, the obligations to debt holders, or debt equivalent securities, is first deducted from the enterprise value to calculate residual equity value (valuers should consider if the enterprise value includes or excludes cash, and the resulting use of gross or net debt for allocation purposes). Next, value is allocated to the various series of preferred stock based on the series' liquidation preferences or conversion values, whichever would be greater. Finally, any residual value is allocated to any common equity, options, and warrants."

"130.9 A limitation of the CVM is that it is not forward looking and fails to consider the option-like payoffs of many share classes."



“130.10 The CVM should only be used when 1) a liquidity event of the enterprise is imminent, 2) when an enterprise is at such an early stage of its development that no significant common equity value above the liquidation preference on any preferred equity has been created, 3) no material progress has been made on the company’s business plan, or 4) no reasonable basis exists for estimating the amount and timing of any such value above the liquidation preference that might be created in the future.”

“130.11 Valuers should not assume that the value of debt, or debt-like securities, and its book value are equal.”

Option Pricing Method (OPM)

“130.12 The OPM values the different share classes by treating each share class as an option on the cash flows from the enterprise. The OPM is often applied to capital structures in which the payout to different share classes changes at different levels of total equity value. For instance, where there are convertible preferred shares, management incentive units, options, or other classes of shares that have certain liquidation preferences.”

“130.13 The OPM considers the various terms of the stockholder agreements that would affect the distributions to each class of equity upon a liquidity event, including the level of seniority among the securities, dividend policy, conversion ratios, and cash allocations.”

“130.14 The starting point for the OPM is the value of total equity for the asset. The OPM is then applied to allocate the total equity value among equity securities.”

“130.15 The OPM (or a related hybrid method) is suited to circumstances where specific future liquidity events are difficult to forecast or the company is in an early stage of development.”

“130.16 The OPM most frequently relies on the Black-Scholes option pricing model to determine the value associated with distributions above certain value thresholds.”

“130.17 When applying the OPM, a non-exhaustive list of the steps valuers should perform includes:

- (a) Determine the total equity value of the asset,*
- (b) Identify the liquidation preferences, preferred dividend accruals, conversion prices, and other features attached to the relevant securities that influences the cash distribution,*
- (c) Determine the different total equity value points (breakpoints) in which the liquidation preferences and conversion prices become effective,*



- (d) *Determine the inputs to the Black-Scholes model:*
 - 1. *Determine a reasonable time horizon for the OPM,*
 - 2. *Select a risk free rate corresponding to the time horizon,*
 - 3. *Determine the appropriate volatility factor for the equity of the asset, and*
 - 4. *Determine the expected dividend yield.*

- (e) *Calculate a value for the various call options and determine the value allocated to each interval between the breakpoints,*
- (f) *Determine the relative allocation to each class of shares in each interval between the calculated breakpoints,*
- (g) *Allocate the value between the breakpoints (calculated as the call options) among the share classes based on the allocation determined in step f and the value determined in step e,*
- (h) *Consider additional adjustments to the share classes as necessary, consistent with the basis of value. For example, it may be appropriate to apply discounts or premiums.”*

“130.18 When determining the appropriate volatility assumption valuers should consider 1) the development stage of the asset and the relative impact to the volatility when compared to that observed by the comparable companies, and 2) the relative financial leverage of the asset.”

“130.19 In addition to the method as discussed above, the OPM can be used to back solve for the value of total equity value when there is a known price for an individual security. The inputs to a back solve analysis are the same as above. Valuers will then solve for the price of the known security by changing the value of total equity. The back solve method will also provide a value for all other equity securities.”

Probability-Weighted Expected Return Method (PWERM)

“130.20 Under a PWERM, the value of the various equity securities are estimated based upon an analysis of future values for the asset, assuming various future outcomes. Share value is based upon the probability-weighted present value of expected future investment returns, considering each of the possible future outcomes available to the asset, as well as the rights and preferences of the share classes.”



"130.21 Typically, the PWERM is used when the company is close to exit and does not plan on raising additional capital."

"130.22 When applying the PWERM, a non-exhaustive list of the steps valuers should perform includes:

- (a) Determine the possible future outcomes available to the asset,*
- (b) Estimate the future value of the asset under each outcome,*
- (c) Allocate the estimated future value of the asset to each class of debt and equity under each possible outcome,*
- (d) Discount the expected value allocated to each class of debt and equity to present value using a risk-adjusted discount rate,*
- (e) Weight each possible outcome by its respective probability to estimate the expected future probability-weighted cash flows to each class of debt and equity,*
- (f) Consider additional adjustments to the share classes as necessary, consistent with the basis of value. For example, it may be appropriate to apply discounts or premiums."*

"130.23 Valuers should reconcile the probability-weighted present values of the future exit values to the overall asset value to make sure that the overall valuation of the enterprise is reasonable."

"130.24 Valuers can combine elements of the OPM with the PWERM to create a hybrid methodology by using the OPM to estimate the allocation of value within one or more of the probability-weighted scenarios."

Questions for Respondents

Question 6: Do you agree that the methods are more relevant to business valuation and the placement in IVS 200 is appropriate? If no, please explain why.

Question 7: Are there additional methods that should be included in the proposed revisions, for example the Hybrid Method? If yes, please discuss the additional methods to consider.

Question 8: Are there additional topics within Early Stage Company Valuation that you feel should be included in IVS or explored further by the Boards? Please provide an outline for any topics suggested.

5. IVS 410 – Development Property

Summary

Background and scope

Development valuations is one of the biggest risk areas for financial stability particularly as many market valuations include the special assumption that the development has been completed, even though at the time of valuation the development may comprise undeveloped land. The Boards received feedback from stakeholders that though the valuation process used is often correct when the development valuation gets used for secured lending purposes the lenders don't always fully understand the risk implications contained within the report. This is partly because a development valuation may build in future price increases within the valuation process. Further to discussion the Boards felt that a solution to this issue would be to mandate an additional value within the report such as the "As Is Value" so the report would not be misleading in relation to the risks and the assumptions made. Furthermore, when carrying out a Development Valuation for secured lending purposes the valuer must carry out a minimum of two appropriate valuation methods and must be able to justify the selection of the one reported.

The scope of the proposed changes is related to development property, and does not apply to other chapters of IVS.

Proposed Changes to IVS 410

IVS 410 Excerpts:

The Boards have proposed the following changes to IVS 410 in order to provide additional clarification:

"20.5 This sensitivity also applies to the impact of significant changes in either the costs of the project or the value on completion ~~of the current value~~. If the valuation is required for a


purpose where significant changes in value over the duration of a construction project may be of concern to the user (e.g., where the valuation is for loan security or to establish a project's viability), the valuer must highlight the potentially disproportionate effect of possible changes in either the construction costs or end value on the profitability of the project and the value of the partially completed property. A sensitivity analysis may be useful for this purpose provided it is accompanied by a suitable explanation. "

"90.1 The residual method is so called because it indicates the residual amount after deducting all known or anticipated costs required to complete the development from the anticipated value of the project when completed after consideration of the risks associated with completion of the project. This is known as the residual value. ~~The residual value, derived from the residual method, may or may not equate to the market value of the development property in its current condition.~~"

"90.35 In order to arrive at an indication of the value of the development property on the valuation date, the residual method requires the application of a discount rate to all future cash flows in order to arrive at a net present value. This discount rate may be derived using a variety of methods (see IVS 105 Valuation Approaches and Methods, paras 50.30-50.39)."

*"120.2 To demonstrate an appreciation of the risks involved in valuing Development Property for secured lending or other purposes, the valuer must apply a minimum of two appropriate and recognised methods to valuing Development Property for each valuation project **and must be able to justify the selection of the valuation approach(es) reported.** The valuer must also provide an "As Is" and an "As Proposed" value for the Development Property and record the process undertaken and a rationale for the reported value."*

Questions for Respondents

Question 9: Do you feel that the inclusion of the "As Is" and "As Proposed" value for the Development Property will reduce the risks in relation to the valuation of development property? If no, what additional information would you like to see included? 

Question 10: Should the *valuer* be compelled to state the method of valuation they have used in their calculation of market value and report the assumed (or calculated) Developers Profit when reporting market value? If no, please explain why not? 