September 13, 2016

International Valuation Standards Council
1 King Street
LONDON EC2V 8AU, UK

Reference: ***IVS 101, Scope of Work; IVS 102, Investigations & Compliance; IVS 103, Reporting; IVS 200, Businesses & Business Interests; IVS 300, Plant & Equipment; IVS 400, Real Property Interests; IVS 410, Development Property; IVS 500, Financial Instruments***

Dear Technical Director:

Duff & Phelps is pleased to provide a response to the above-referenced Exposure Drafts comprising IVS 2017. Duff & Phelps is the premier global valuation and corporate finance advisor with expertise in complex valuation, dispute and legal management consulting, M&A, restructuring, and compliance and regulatory consulting. Our valuation advice is sought by hundreds of global clients annually as we work with them in developing pragmatic solutions for applying fair value techniques.

We support the idea of a set of harmonized global valuation standards and we appreciate the Board's effort in revising, improving and augmenting IVS.

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The comments provided below should be read in conjunction with the comments we have previously provided on the Exposure Drafts of IVS 2017, *Introduction & Framework*; IVS 104, *Bases of Value*; IVS 105, *Valuation Approaches & Methods*; IVS 210, *Intangible Assets.*

IVS 101: Scope of Work

a) Do you agree that it is the valuer's responsibility to communicate the scope of the assignment to all parties to the valuation engagement? If not, why?

Response

We believe that the valuer's responsibility is to define the scope of the valuation engagement based on *communication with the client.* As part of the same communication, the valuer has a responsibility to identify the intended users of the valuation report (other than the client him/herself). However, it is customary, and it is in the best interest of the valuer for the *client of record*[1] *to arrange communication with other intended users*, both with respect to the valuation results and the underlying scope of the engagement.

The valuer's obligations to other intended users, such as auditors or tax advisors, often do impose additional development and reporting requirements in the assignment, and it is imperative that the valuer develop a clear understanding of the needs of all intended users *through discussions with the client of record*. We think that the purpose of the engagement and the intended use of the valuation opinion would govern the appropriate scope of work that is deemed to produce credible results.

b) Do you agree that a written scope of work for each valuation engagement is not always possible or necessary? If not, why?

Response

Since there may be multiple intended users of a valuation engagement/report, to ensure that the client and all intended users agree with the scope of the assignment, a written record such as an engagement letter, or a memo for an in-house valuation, should be required in all assignments.

While it is true that some aspects of scope of work may be addressed in standing engagement instructions, master services agreements, or a company's internal policies and procedures, a written scope of work provides a document that the client and all intended users can read, refer to and rely on. A written engagement letter and scope also provides a framework for the valuer and the engagement team as they navigate the valuation assignment.

Additionally, if the scope changes, addendums/supplements to the original written scope of work will allow for everyone involved in the valuation assignment, as well as the client and the intended users, to be apprised of scope changes and the reasons for the scope changes. This ensures that the valuation assignment remains on track and is meeting the needs of the client and other intended users.

Key Observations

Communications with the Client

As noted in our responses to the above questions, the standard needs to clarify the importance of the communication between the valuer and the client of record. The client of record, together with the valuer, plays a key role in establishing the basis of value appropriate for the engagement (as stated in our former comments to IVS 104), and in establishing and updating the valuation scope. Further, the client of record plays a central role in communicating with other intended users of the valuation engagement (also consistent with the notion of client confidentiality), subject to any required consents for the

[1] While we realize that the term/description *client of record* is not in IVS, it may be a useful clarification to make somewhere in the standard.

release of the valuation report that may be required by the valuer per the engagement letter, at which point the valuer would typically correspond directly with the third party seeking release of the report. This needs to be elaborated upon in the standard.

Written Documentation

In addition to our specific comments below, documentation of the scope of work initially, as well as any supplements or addendums to the original scope of work, are critical to be made in writing in order to facilitate communication with the client and other intended users of the valuation engagement and report. In addition, a written scope of work doubles as a roadmap for execution by the valuation team and developing the final report.

Miscellaneous Comments by Paragraph

- **Paragraph 10.1 and 20.3** appear to be conflating items normally described as *scope of work* with various *terms of engagement*. In other words, the "terms of engagement" (referred to in par. 10.1) describe a broader notion than the scope of work[2].

- **Paragraph 20.3 (c):** With regard to communicating the scope of work to all parties prior to the completion of the assignment, it should be noted that *any communication with intended users other than the client should be conducted through the client of record only*.

- **Paragraph 20.3 (d):** Replace references to "assets" being valued in the lead in with "subject", or a similar reference, as the list below mentions a liability, a group of assets and liabilities, etc.

- **Paragraph 20.3 (j) and (k):** With regard to the nature and sources of information that the valuer relies upon, and the assumptions and special assumptions, it should be noted that sometimes the above are not all known at the date the engagement is scoped and the engagement letter is signed, and therefore the engagement letter must be supplemented thereafter. (We did notice that there is a discussion of changes to the scope of work in section 30, but the references are not pointing back to par. 20.3.)

- **Paragraph 20.3 (m):** We suggest adding that the intended users other than the client, that are known at the inception of the engagement (i.e., that have pre-authorized access to the report), must be identified to ensure all relevant parties are included in the communication, and also to limit distribution of the assignment results to parties other than the intended users.

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[2] For example, USPAP STANDARD 9: BUSINESS APPRAISAL, DEVELOPMENT states "In developing an appraisal of an interest in a business enterprise or intangible asset, an appraiser must identify the problem to be solved, determine the scope of work necessary to solve the problem, and correctly complete the research and analyses necessary to produce a credible appraisal."

- **Paragraph 20.4:** Currently, the drafting language implies that it is routine to not have a clearly established scope at the outset of the engagement. While at times, specifics such as timing or number of properties may not be fully known - especially if undertaking pre-acquisition valuations of the target – generally, the basics of the scope are known, and should be communicated. Alternatively, the Board should specifically describe the circumstances in which the general scope may not be clear at the start of the engagement.

- **Paragraph 20.5:** We believe that a written scope of work should be mandated for all valuations, even for in-house valuations. There needs to be documentation as to the scope and any changes to the scope so that the client and intended users (including in-house intended users) are aware of the progress of the engagement.

- **Paragraph 20.6:** Standing engagement instructions and Master Services Agreements are general documents with basic terms, but the specifics (e.g., the subject being valued) of each valuation usually change. As such, these types of documents require an update or an addendum with the scope of work and other particulars for each new valuation assignment.

- **Paragraph 30.1:** As stated earlier, there should be a base written scope to start the assignment and, as the scope changes throughout the assignment, the scope would be amended or supplemented. Please note that the references in section 30 are not pointing back to par. 20.3.

- **Paragraph 30.2:** We think it should be clarified that due to the fact that there are intended users other than the client, written documentation of work changes over time is essential.

IVS 102: Investigations and Compliance

c) Do you agree that a valuer must perform sufficient investigations and procedures to assess the appropriateness of all inputs and assumptions? If not, why?

Response

We believe that while the valuer should investigate the appropriateness of inputs and assumptions, as provided by management or other parties specific to the subject of the valuation, management is ultimately responsible for the inputs, assumptions and information provided to the valuer.

Investigation and procedures to assess the appropriateness of material inputs and assumptions in very complex client models, especially models incorporating projected financial information, can be extremely time-consuming. In addition, the valuer may not have all the source documents or access to source data. In this type of situation, the valuer must determine how best to investigate appropriateness of inputs and assumptions and must document such within the work papers, schedules and the report.

As indicated in the Basis for Conclusions of IVS 102, the valuer is not required to audit information they have gathered from independent/unbiased sources, but the valuer must have a reasonable belief that reliance on the source is appropriate, and which must be documented. For example, consider the information and assumptions used in developing the growth rate in perpetuity: the valuer should investigate the appropriateness of such an input and document within the work papers, schedules and the report the source and the rationale for use of such input.

IVS 102 should also clarify (in its Basis for Conclusions or elsewhere) that the valuer's investigations and procedures on information provided by clients or other interested parties also does not amount to an audit, even if it requires relatively more effort to assess the its appropriateness compared to information gathered by the valuer.

d) Do you agree that significant limitations that impair a valuer's ability to assess the appropriateness of the inputs and assumptions should result in a valuation not being in compliance with IVS? If not, why?

Response

First, we think that whether the limitations on the valuer are significant, such that the valuer would not be able to render a valuation opinion, is a matter of judgment. We believe that IVS 102 should emphasize this element of **professional judgment** first and foremost, as well as the notion of **professional skepticism** in the investigation process.

Further, we believe that IVS 102 should also clarify that in some cases, significant limitations on the valuer and the valuer's investigations may result in a valuation that is not in compliance with IVS – in that it is not a "complete valuation analysis" – because of such limitations. In this regard, we think that IVS 102 (and possibly IVS 101) should address the distinction between a *complete valuation analysis*, which results in a conclusion of value by the valuer, after considering all relevant factors, and the concept of a *calculation engagement*[3,4] or similar *limited scope engagements/procedures*[5], which do not include all of the procedures required for a complete valuation analysis.

Fundamentally, IVS needs to succinctly define what constitutes a valuation analysis. The Board should also explicitly state that a limited scope analysis in connection with a calculation or similar engagement[6] is not compliant with IVS, which seems to presume a complete valuation analysis – assuming this is in fact what the Board intends.

However, this also raises the question as to whether a limited scope engagement would fall within any of the guidance of IVS 2017, and if so, how. If no single aspect of a limited scope engagement is required to comply with the applicable sections of IVS, then it seems that there would be no standards governing the quality of this class of engagements.

These fundamental distinctions between classes of engagements are necessary, because in practice, there could be various degrees of limitations that the valuer might be subject to, which may not necessarily give rise to non-compliance with IVS. For example:

- A valuer may be limited as to his/her ability to assess appropriateness of inputs and assumptions provided by management, but as IVS 102, par. 20.3 acknowledges, limits may be agreed on the extent of the valuer's investigations, and any such limits should be noted in the scope of work. These should also be documented in the work papers, schedules and the report.

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[3] SSVS No. 1 defines a **calculation engagement** as follows: "an engagement to estimate value wherein the valuation analyst and the client agree on the specific valuation approaches and valuation methods that the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of a subject interest. A calculation engagement generally does not include all of the valuation procedures required for a valuation engagement. If a valuation engagement had been performed, the results might have been different. The valuation analyst expresses the results of the calculation engagement as a calculated value, which may be either a single amount or a range." SSVS 1 stands for *Statement on Standards for Valuation Services 1, Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*. SSVS No. 1 was issued by the AICPA Consulting Services Executive Committee in June 2007.

[4] Footnote 2 in the Exposure Draft of the Mandatory Performance Framework states the following: "Note that SSVS No. 1 addresses the concept of **calculation engagements** (and reports), that do not include all of the procedures required for complete valuation engagement. Similarly, USPAP's Scope of Work Rule addresses the required extent of research and analysis, and further references Appraisal Reports (more thorough content and information) and Restricted Appraisal Reports (less thorough content and information)." Refer to footnote 8 in this letter for a description of the Mandatory Performance Framework ED.

[5] See prior footnote

[6] As a background, it may help to clarify that a limited scope analysis may be such from the very start, as agreed upon in the scope established with the client; or, an engagement may turn into such in the process of its execution, if becomes clear that there are significant limitations on the investigations of the valuer. We understand that in either case, the results would not rise to the level of an engagement that is compliant with IVS under the current wording of IVS 102.

- Infrequently, a valuer may be limited as to the assessment of other inputs and assumptions obtained by the valuer from independent, third party sources. In this case, we think that the valuer may need to assess if the sources are credible, and likewise document the procedures in the work papers, schedules and the report[7].

Thus, it is essential that the Board also introduce and emphasize the point of adequate documentation of the investigation process, and the valuation analysis overall.

In regard to all points raised in this section, we think that the Proposed Mandatory Performance Framework for the Fair Value Quality Initiative in the U.S. ("MPF ED")[8] can greatly inform the Board's further discussions and drafting of IVS 102. As an illustration, we would also like to bring the following excerpt from the MPF ED to the Boards' attention:

> "2.27.12 **Limitations on the Scope of Research and Analysis**
>
> In circumstances where the valuation professional does not have access to information that is significant and relevant to a supportable conclusion of value, the valuation professional must determine whether to continue with the engagement or withdraw from the engagement. An example may include direction by the client to not value inventory. If inventory valuation would normally result in a step-up, the valuation professional should advise the client of this during the engagement contracting process. If the client insists that inventory not be valued, the valuation professional must decide whether to: a) withdraw from the engagement, or b) prominently disclose in the report that the inventory was not valued at the direction of the client, and had the inventory valuation resulted in a step-up in basis, this step-up in basis would affect the fair value of the other subject interests of the business.
>
> 2.27.13 **Disclosure of limitations**
>
> If the valuation professional elects to continue with the engagement, he or she must clearly disclose in the valuation report, at a minimum, the:
>
> i. limitations placed on the extent of research and analysis and the circumstances for the limitations,
>
> ii. a statement that the limitation might have affected the conclusion of value, and the possible directional impact on that conclusion if known,
>
> iii. rationale for continuing with the engagement, and
>
> iv. steps taken by the valuation professional to compensate for the limitations."

7 Allowance may need to be made for situations in which an information source is used on a firm-wide basis, across multiple engagements, in which case it may not be efficient to re-document this assessment in every work file.

8 The Exposure Draft of the Proposed Mandatory Performance Framework for the Fair Value Quality initiative was prepared by AICPA, ASA, and RICS and issued for comment on May 24, 2016.

Also note the following excerpt from the MPF ED:

> “2.27.9 **Reliance on client-provided information**.
>
> When the valuation professional relies on other client-provided information (this includes information prepared by third-party specialists retained by the client), and does not assess or evaluate it for reasonableness (for example, reviewing for accuracy and completeness), the valuation professional must clearly describe in the valuation documentation the information he or she relied on and the rationale for the reliance.
>
> **Important**: When the client provides information (for example, prospective financial information) to the valuation professional, the valuation professional must use his or her professional skepticism and judgment to assess the relevance and reliability of the information and the extent to which he or she will rely on the information in the assessment of fair value.”

Key Observations

Parallel to Mandatory Performance Framework Exposure Draft

Given that the MPF ED is the first of its kind to address “performance standards”, and that it reflects current trends in response to both market and regulatory developments, we recommend that the Board consider aligning the principles and concepts in IVS 102 to the MPF ED (and to the eventual final MPF document that will be issued) as closely as possible. While the MPF ED is intended to address public interest valuations for U.S. SEC registrants, we believe that the framework it sets out is relevant and can be applied to valuation engagements for many different purposes.

Valuation Record

We believe that the final valuation file should contain only the *final report* transmitted to the client and any data, inputs, analyses, and references supporting such final report. A draft report should not be retained as it may not reflect the final valuation conclusions and/or procedures, information and assumptions that were deemed most appropriate to use in the facts and circumstances. We believe that par. 30.1 should be amended to reflect this.

Also note the following excerpt from the MPF ED:

> “2.24 The *final valuation report* represents the planning, execution, and conclusion of the valuation professional’s services for a client. For purposes of the MPF, valuation professionals must prepare their work file, which includes the *final valuation report*, in accordance with the guidance provided in this section for all engagements to estimate fair value used to support management assertions made in financial statements issued for public interest reporting purpose.” [emphasis added]

IVS 103: Reporting

e) Do you agree with moving from a prescriptive to a principle-based reporting format? If not, why?

Response

A principle-based format does allow for variations pursuant to client-specific requests. This also allows for fee flexibility depending upon the scope of the project. However, caution is suggested when there are multiple intended users other than the client of record, or when the client of record is unfamiliar with valuations.

In certain circumstances, such as litigation, a narrative report with footnoting, etc., may be more appropriate given the ultimate use of the report. Yet certain courts prefer PowerPoint over narrative so that the report can be shared with the courtroom.

In summary, the reporting format is facts- and circumstances- specific, and scope, purpose, and valuer judgement must be taken into consideration.

f) Do you accept that a report can take any form providing it sets out a clear and accurate description of the scope of the assignment, its purpose and intended use and discloses of significant inputs assumptions? If not, why?

Response

We concur that a report can take any form, an oral report[9,10], a PowerPoint presentation, narrative report or possibly a series of schedules, providing it sets out a clear and accurate description of the scope of the assignment, its purpose and intended use, and also discloses significant inputs and assumptions, and the identity of the valuer.

Schedules in and of themselves can constitute a report, however, adequate verbiage should be added that addresses the scope, purpose and use, and that requires that the assumptions and inputs are documented in such schedules.

[9] For example, USPAP allows an oral report; however, it also recognizes that most reports are written and most clients mandate written reports. Per USPAP, oral report requirements are included to cover court testimony and other oral communication of an appraisal or an appraisal review. (USPAP Standards Rule 10-4 addresses the substantive matters of an oral report.)

It should also be noted that under the USPAP Record Keeping Rule, an appraiser must prepare a work file for each appraisal or appraisal review assignment; a work file must be in existence prior to the issuance of any report; and a written summary of an oral report must be added to the work file within a reasonable time after the issuance of the oral report.

[10] We think that the Board should consider whether an oral report, if subject to the type of guidance outlined in USPAP, would constitute an IVS-compliant report.

Key Observations

Report Format

Taking both of our responses above into consideration, we do express concern that the lack of definition of what a report should look like may cause some confusion by the users of valuation reports, especially given the range of possible report formats and content. Allowing for variations in report form does require the valuer to explain to the client various report forms, usage of certain report formats, etc. We suggest that this should also be clarified in the standard.

In addition, we noticed that nowhere in the standard was there a reference to schedules, only a report. The Board should clarify if a written report is intended to include supporting schedules (albeit not at the same level of detail as those that might be contained in the work file).

Baseline Report Content

Paragraph 20.2 of IVS 102 states: “Compliance with this standard does not require a particular form or format of report, however, the report must be sufficient to communicate to the intended users the scope of the valuation assignment, the work performed, and the conclusions reached.”

We recommend that the purpose of the valuation and the key assumptions made also be included on this “shortlist”.

Reference to Subject of Valuation

The references in paragraph 30.1 should be changed to “an interest” or “subject interest” rather than “an asset or assets”, as the language in the standard need to accommodate the valuation of businesses and business interests.

IVS 200: Businesses and Business Interests

a) In IVS 2013, all substantive portions of IVS 200 Business and Business Interests were labelled as “commentary” (except for scope and effective date). This label seems to have created some confusion amongst stakeholders as to whether the standard was mandatory. The Board’s position is that all aspects of IVS 2017 should be mandatory and this Exposure Draft has removed the “commentary” label for clarity. Do you agree with the removal of the commentary label?

Response

We agree with the removal of the commentary label.

b) The Board believes that the standard presented in this Exposure Draft can be applied in the valuation of business and business interests regardless of the purpose of the valuation (acquisitions, mergers and sales of businesses, taxation, litigation, insolvency proceedings and financial reporting). Do you agree? If not, for what purpose(s) do you believe this standard cannot be applied? Why?

Response

The standard is written on a sufficiently high level and we do not see a reason at this time why the standard could not be applied for various purposes. However, it would be very helpful if the Board elaborated further on differences that would impact the business valuation assumptions (cash flows, discount rates, etc.), depending on the basis of value selected, as the basis of value is essentially a reflection of a valuation for a particular purpose. This discussion can be addressed in an Appendix or application examples.

c) Are there any further topics or special considerations that you feel the Board should add or remove from IVS 200 Business and Business Interests? If so, what are they and what is your rationale?

Response

Please see our detailed comments in the following pages.

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Key Observations

Cross-references to IVS 105, *Valuation Approaches and Methods*

IVS 200 makes multiple references to IVS 105. However, given the current content of IVS 105, many of these references are not helpful, if not misleading. For example, par. 70.2 of IVS 200 refers the reader to the cost approach discussion in IVS 105, but much of this discussion is geared to tangible and intangible assets (recreating of the asset; utility; obsolescence, etc.), such that the references are not relevant and confusing. The Board should consider either refining these cross references though additional discussion (i.e., put more discussion in IVS 200 and be more specific in the cross-references), or alternatively, refining the underlying IVS 105, or both. As a general comment, at this time, given the way IVS 105 is structured, such broad cross-references between IVS 105 and IVS 200 are not very helpful.

Sharper Focus on Business Valuation

IVS 200 appears to have discernible undertones that speak to real estate valuation. For example, the discussion in 60.7 and 60.8 seems to put the emphasis on making adjustments to historical performance rather developing projections and reflecting expectations. This invokes a real estate valuation scenario in which adjustments are made to historical income before a cap rate is applied. In another example (par. 110.1), the list of economic factors discussed is heavily influenced by location. Compared to real estate valuations, there are more important factors affecting business valuation other than location.

Furthermore, much of the current discussion in the income approach seems irrelevant to DCF valuations or possibly misplaced from what would be a market approach discussion.

We think that the Board needs to remove these and other nuances, and revise the discussion in IVS 200 with purely a business/business interest valuation mindset.

Basis of Value Considerations

We think that a more robust discussion should be provided in those areas of IVS 200 that would be most impacted by different bases of value. For example, the discussion regarding the rights and obligations inherent in the business interest versus those of a particular shareholder in paragraph 90.3 can be framed as a function of the basis of value selected.

This would be very useful in better communicating the principles, and applying the standard. The Board might also consider using appendices for further implementation guidance in this area.

Miscellaneous Comments by Paragraph

Please note that the miscellaneous comments provided below do not represent an exhaustive list of potential areas for improvement of IVS 200:

Par. 20.3 (a): Note that there are different definitions of Enterprise Value. The Board should debate which is most appropriate to include in IVS 200. Generally, variations exist in practice as to how operating and excess cash is addressed and how non-operating assets and liabilities are treated.

Par. 40.1: This paragraph refers to the three principal valuation approaches that are applied to assets (or securities, as the case may be), or to liabilities. IVS 105 seemed to focus on these three principal approaches (market, income, cost). However, in the case of a business, the Net Asset Value method (known by several different names) can also be applied. The value of the business is determined by the sum of the net assets, each of which may be valued by one or more of the three principal valuation approaches. This point should be made clear. Also see our comments regarding the Summation Method in IVS 105.

Par. 50.1: Please refer to our relevant comments to IVS 105 sections 20 and 30 in our prior feedback to IVS 105.

Par. 50.2 (b): Note the following edit: "the acquisition market in which entire businesses<u>, or controlling interests in businesses,</u> are bought and sold,.."

Par. 50.3 (c): Add "and orderly" transaction.

Par. 50.4: Reference is made to par. 50.8, which does not exist (50.6?)

Par. 50.5 – 50.6: There is no discussion (here or in IVS 105) about other adjustments that need to be made in computing multiples – excess cash and other non-operating assets; leases; employee stock options; pensions, etc. Also, emphasis should be placed on forward-looking multiples.

Par. 50.6: Clarify that only the relevant requirements should be followed, as not all requirements of IVS 105 are applicable (e.g., considerations related to material/physical characteristics are not relevant).

Par. 60.1: Reference is made to IVS 105, par. 40.2 and 40.3. Even though businesses generally meet the criterion in IVS 105, 40.2 (a) ("the income-producing ability of the asset is the critical element affecting value from a market participant perspective..", it would not necessarily be the primary basis for a business valuation (as the above-referenced IVS 105 paragraph states), and most likely a market approach would be applied as well. Therefore, this should be explained either in IVS 200, or the language in IVS 105 should be relaxed. The discussion in IVS 105 40.3 does not seem sufficient in this regard.

Par. 60.2: Reference is made to IVS 105, sections 40, 50 and 60. Please see our comments to these sections in our response to the IVS 105 ED.

Par. 60.3: Since a statement is made that the DCF can be performed on a pre-tax or post-tax basis, there should be a discussion of when a pre-tax basis is appropriate. Note that this no longer concerns a theoretical or a broad based discussion of the income approach, as may be the case in IVS 105. Since IVS 200 focuses on businesses and business interests, if the above statement is made, the situations that may call for a pre-tax approach should be addressed.

Also, while we are aware of the IAS 36 pre-tax analysis requirement in the case of financial reporting, note that the implementation guidance in IAS 36 itself speaks of employing a practical approach where the DCF is performed on an after-tax basis, and then based on this result, the implied pre-tax discount rate is backed into for disclosure purposes. Thus, we do not consider the requirement in IAS 36 a true example of a situation in which a pre-tax analysis is required.

Par. 60.5: Reference is made to IVS 105, par. 60.9-60.11. Please see our comments to these paragraphs in our response to the IVS 105 ED. Additionally, the reference to market participants makes the statement specific to only certain bases of value, when the guidance in this paragraph is presumably intended to have broader applicability. In this particular case, the guidance may cause a mismatch between the discount rate and the selected basis of value in certain situations.

Also note that this is a *general comment* - as there are other instances in IVS 2017 that discuss market participants when the guidance should apply to various bases of value.

Par. 60.8: The discussion is largely focused on making adjustments to historical performance rather than reflecting expectations. The focus should be on projected performance instead.

Par. 60.8 (b): The adjustments mentioned in par. 60.8 (b) of IVS 200 seem more appropriate for the market approach rather than the income approach, which is where these have been currently placed.

Par. 60.8 (c): Need to clarify that the reference to “non-arm’s-length transactions” here may actually be to non-arm’s length contracts that the business has entered into, to the extent they can be renegotiated based on current commercial rates, as opposed to the reference to any non-arm’s length transactions discussed under the market approach.

Par. 60.8 (f): This paragraph infers that the absolute amount of depreciation should be adjusted to be consistent with similar businesses regardless of the actual fixed asset base.

Further, this statement seems to be referencing adjustments to depreciation methods and should be located in the market approach discussion rather than the income approach.

Also, if part of this discussion remains in the income approach section, consider adding something along these lines: "...and if the business valuation is performed pursuant to a transaction, to reflect the stepped-up basis of assets, and related depreciation, if such would be available in the circumstances"

Par. 60.8 (g): Once again the comparison here invokes a market approach rather than an income approach.

Par. 60.9: The discussion here regarding a market value balance sheet may be more appropriate for inclusion (or should also be included) in the discussion of the market approach, or in the application of Net Asset Value method.

Par. 60.10: It should be emphasized that a controlling or non-controlling interest perspective can also be reflected in the cash flows, rather than though a discount for lack of control or a control premium. In fact, it may be preferable to have the attribute of the ownership interest be reflected in the cash flows.

In addition, this paragraph mentions discounts in the context of the DCF method, but in the market approach section there is no mention of this.

Par. 60.11: The current discussion blurs the distinction between an exit multiple applied to enterprise-level cash flows and a multiple applied in the context of the market approach.

Par. 70.1 (b): Please see our comments on the summation method to the IVS 105 ED.

Par. 70.2: Reference is made to IVS 105, sections 70 and 80. Please see our comments to these sections in the IVS 105 ED.

Also, much of this discussion is geared to tangible and intangible assets (recreating the asset; utility; obsolescence, etc.), and as such, this is the most difficult section to simply cross reference to in IVS 105 when valuing a business or business interest. The Board should consider either refining these cross references, or refining IVS 105.

Also, see our prior comment on the summation method.

Par 80.1: The references in these sections to paragraphs later in the document are off.

Par. 90: Perhaps it should be clarified that this section does not apply to an enterprise valuation, but only to the valuation of equity interests.

Par. 90.1: Please elaborate on the potential impact of this statement - "In some situations, it may also be necessary to distinguish between legal and beneficial ownership."

Par. 90.3: This paragraph should further discuss that the basis of value for which the analysis is performed will have an impact on which of the attributes of the interest vs. the attributes of specific shareholder(s) are reflected in the valuation.

Par. 90.4 (b) Recommend briefly addressing why a controlling interest may have a higher value than a non-controlling interest (i.e., expand the first sentence).

This paragraph also mentions control premiums and discounts for lack of control. We recommend that the discussion be expanded on how these attributes can be reflected in the PFI for the subject interest. Reflecting these attributes in the cash flows is generally considered more supportable. In addition, discounts for lack of control infer the potential for disproportionate returns to minority shareholders, and this notion should be discussed.

Par. 110 (general): The list of economic factors is limited to locations. This may be far more relevant to real estate than to the valuation of a business.

Par. 110: Consider including tax and legal considerations as well.

Par. 110.1: Consider if legal entity structure should also be mentioned.

Par. 110.1 (c) and (d): Consider addressing factors such as currency risk, political risk, etc., directly.

Par. 120: Non-operating liabilities (also known as debt equivalents or nonequity financial claims, for example, unfunded pensions) should also be addressed in this section.

Par. 120.1: The description of non-operating assets in this paragraph should be improved. Additionally, note that non-operating assets can also be income-producing, but they are not essential to the operations of the company.

Par. 120.2: Expand the discussion in this paragraph by noting that if comparable traded companies have non-operating assets or non-operating liabilities, they would be reflected in the price. Therefore, one has to ensure that appropriate adjustments for non-operating assets and non-operating liabilities have been made to both the subject company and the comparable companies as part of the analysis.

Par. 120.3: "Businesses may have unrecorded assets and/or liabilities that are not reflected on the balance sheet." This statement does not belong in the non-operating assets section.

Par. 130: We think that this section of IVS 200 should address the "waterfall" method, the OPM and the PWERM method in a greater level of detail.

Par. 130.2: The valuation of debt should be discussed both in a transactional and non-transactional (ordinary course of business) setting.

Par. 130.3: This paragraph states that if the value of debt doesn't equal book value then one is to "use a method that appropriately allocates value to debt and any equity securities such as a probability weighted expected return method or an option-pricing model." The leap to this conclusion is confusing. Please elaborate.

IVS 300: Plant and Equipment

1) In IVS 2013, all substantive portions of IVS 220 Plant and Equipment were labelled as “commentary” (except for scope and effective date). This label seems to have created some confusion amongst stakeholders as to whether the standard was mandatory. The Board’s position is that all aspects of IVS 2017 should be mandatory and this Exposure Draft has removed the “commentary” label for clarity. Do you agree with the removal of the commentary label?

Response

We agree with the removal of the commentary label. However, with raising the bar to set *mandatory standards* there is an increased obligation and expectation to ensure that the views and guidance included in IVS have been properly developed and vetted. This comment pertains to all IVS standards. With respect to plant and equipment, we have provided some specific comments below and have highlighted guidance that we believe is incorrect. We urge the Board to address these issues and rectify the guidance accordingly.

2) The Board believes that the standard presented in this Exposure Draft can be applied in the valuation of plant and equipment regardless of the purpose of the valuation (secured lending, sales of plant and equipment, taxation, litigation, insolvency proceedings and financial reporting etc.). Do you agree? If not, for what purpose(s) do you believe this standard cannot be applied? Why?

Response

We do not currently see issues with the application of this standard to a wide array of purposes.

3) Are there any further topics that you feel the Board should add or remove from IVS 300 Plant and Equipment? If so, what are they and what is your rationale?

Response

We believe that the guidance on the use of the cost-to-capacity method to determine economic obsolescence should be removed. Please see our comments below.

Key Observations

Use of Cost–to-Capacity Method to Measure Economic Obsolescence

We fundamentally disagree with the cost-to-capacity method as a way to measure economic obsolescence. The use of the cost-to-capacity formula to determine economic obsolescence leads to an outcome inconsistent with what economics and finance would imply. While a material drop in the utilization of an asset from one period of time to the next may be an indication of the presence of economic obsolescence, this is not a measure of economic obsolescence itself, and as a result, the formula does not fully measure economic obsolescence.

For example, a drop in market demand (which is external to the asset) may be described as economic obsolescence because the cause is external to the asset. In response, one would just be reducing the RCN of an asset to a lower capacity to serve the reduced demand; arguably, this is an adjustment for economic (external) obsolescence.

However, this approach does not address the economics of the business. There may be additional economic obsolescence that is not fully addressed and that can only be fully quantified by the use of the income and/or market approach at some level. Ultimately, the presence of economic obsolescence manifests itself in an *insufficient level of income produced by an asset* for a certain reason. Meanwhile, viewing obsolescence on a percentage of capacity basis, disconnects it from the very essence of what economic obsolescence is, namely, a *constrained ability to earn economic returns, due to factors external to the current use or condition of the asset.*

Thus, only in *very limited circumstances*, the cost to capacity method may be used to quantify *a form of* economic obsolescence. In those cases, a reduction to RCN is the outcome due to the valuer's conclusion that the asset is overbuilt in terms of capacity. (Note that some valuers may also call this a form of functional obsolescence). Also, if the cost to capacity method is used to estimate a hypothetical reduction to RCN, the profitability of a smaller asset may actually be less due to the economies of scale associated with the larger asset.

Fundamentally, the cost to capacity method does not assess the profitability of an asset(s) from a cash flow perspective, which must be done to ensure that all forms of economic obsolescence have been addressed. Adjustments founded on modifying the productive capacity to meet current market demand are entirely focused on the fixed costs of production and achieving a specific unit volume level. While it is true that unit volume would likely be reduced in a challenging economic environment, this does not represent the full extent of the economic impact, by any means.

For example, reduced pricing and increased marketing or delivery costs resulting from growing competitive pressures likewise have a significant impact on the extent of economic obsolescence. Therefore, inferring that the cost-to-capacity method is an adequate means to measure economic obsolescence is misleading, at best. As such, if the Board decides to retain the relationship between the cost-to-capacity and economic obsolescence, it should be made explicitly clear in 70.6 (b), where the use of the cost-to-capacity method is discussed[11], that such a measure of economic obsolescence would *rarely capture the full extent of the impact of economic obsolescence*.

Additionally, it should be explained that economic obsolescence is marked by an expectation of permanence in the manner it affects the utility of the subject asset, rather than reflecting expected temporary changes - such as periodic ebbs and flows related to cyclicality/seasonality, or extraordinary but transitory market disruptions.

Finally, we would like to point out that in addition to the Board clarifying the guidance on the cost-to-capacity method per above, requiring some form of economics and finance education for M&E appraisers should help stem or mitigate the practice issue discussed above.

Miscellaneous Comments by Paragraph

- **Paragraph 20.3 (a) 2:** We think that “physical“ life should be replaced with “economic“ life, as the latter is more encompassing.

- **Paragraph 20.3 (a) 4:** If an asset is going to be moved and reinstalled in another location, someone has to pay for the removal and transport; hence, a discount to value will arise. But this bullet point is silent on the fact that any costs associated with the asset’s existing in-place location (installation, testing, etc.) will have no value once it is removed. This must be taken into consideration if one is going to use a **cost approach** and use the asset’s installed original cost as a starting point in the valuation.

- **Paragraph 20.3 (a) 5:** While we generally agree with what is stated here, this is not always the case. Consideration should be given to lease renewal options and other end-of-lease possibilities.

- **Paragraph 20.3 (b):** The items in the list are common sense and will ultimately be resolved by measuring economic obsolescence through projected cash flows.

- **Paragraph 20.3 (c) 1:** Replace “running costs” with “operating costs”.

- **Paragraph 20.3 (c) 2:** Insert “product manufactured by the plant”.

- **Paragraph 20.3 (c) 3:** Highest and best use should always be considered (it is relevant for most bases of value), and this should be pointed out. We think the Board should refer to the concept of an asset group here, when highest and best use is “in use”, together with other assets as part of a group.

- **Paragraph 20.4:** Replace “item of plant and equipment” with “asset”.

[11] Par. 70.6 (b) states: “…as a means of measuring the penalty for the lack of utility to be applied as part of an economic obsolescence adjustment…”

- **Paragraph 20.4, last paragraph:** The discussion of the availability of complementary assets runs to the "asset group" concept. Assets for which the highest and best use is "in use", as part of the same group, should all be valued using consistent assumptions; this is an important point that should be included in the standard.

- **Paragraph 20.4, last paragraph**: Is the reference to par. 20.3 herein a typo?

- **Paragraph 60.1:** We strongly recommend adding the following edit "Use of the income approach is not normally practical for many individual items of plant or equipment<u>; however, it should be utilized in assessing the presence of economic obsolescence for an asset or asset group</u>."

- **Paragraph 60.2:** We do not necessarily agree with the reference to salvage value in the parenthetical. If an asset is to be sold at the end of its life, then the term salvage value may be appropriate. However, assets are often still in service well beyond the valuation or economic life assumed. In that case, the asset is still in continued use and will not be sold. Usually the terms *floor* or *residual value* are used in that context.

- **Paragraph 60.2:** We strongly recommend that the Board strike the last part of this sentence as follows: "The value of the asset at the end of its life might be ….. ~~or a liability (sometimes called an asset retirement obligation or ARO)~~. Please note the following issues:

    - First, it does not read well (essentially it says that the value of an asset… is a liability).

    - Second, it introduces unit of account issues that confuse the discussion. In particular, the discussion suddenly shifts to valuing an asset subject to a remediation liability. In that case, the "gross" view would consider two units of account, an unencumbered asset and a separate remediation liability. The "net" view would consider a single unit of account, an encumbered asset, which would reflect the price paid for the asset if it is transferred subject to the liability. Nonetheless we believe the discussion in the paragraph noted above is confusing as currently laid out, as it does not recognize the fact that the appropriate unit of account would be specified as part of the engagement and would depend on the purpose of the valuation. Additionally, unit of account issues are important and should be addressed more fully elsewhere in the IVSs.

    - Third, the mention of an ARO invokes accounting whereby an asset is set up opposite a remediation liability, which is purely an accounting construct. There is no such "asset" economically. AROs should not be mentioned here.

- **Paragraph 70.2 (b):** Please clarify what is meant by this last sentence: "In addition, for some bases of value, some amount of profit margin on costs incurred may be appropriate."

- **Paragraph 70.3:** Please make the following edit "deductions must be made to reflect the physical, functional, technological and economic obsolescence of the subject asset".

- **Paragraph 70.4:** Please see our comments under Key Observations in this letter.

- **Paragraph 70.6 (b):** It should be noted that it is very possible that the actual capacity of an asset will operate below its design capacity for a given period for a number of reasons: 1) peak demand needs; 2) needed redundancy (e.g, in place-spares to be used in case of failures, often the case with data/phone networks, etc.); 3) conscious decision by management to produce less quantity of a product because of pricing concerns; 4) cost concerns about adding another shift; etc. Even if an asset is 100% "utilized" by any agreed upon definition of full utility, there can still be economic obsolescence (e.g. most utility plants).

IVS 400: Real Property Interests

1) **In IVS 2013, all substantive portions of IVS 230 Real Property Interests were labelled as "commentary" (except for scope and effective date). This label seems to have created some confusion amongst stakeholders as to whether the standard was mandatory. The Board's position is that all aspects of IVS 2017 should be mandatory and this Exposure Draft has removed the "commentary" label for clarity. Do you agree with the removal of the commentary label?**

   Response

   We agree that the term "commentary" may lead to confusion and should be removed from IVS 2017.

2) **Do you agree with Section 20.5, which states it is the valuers responsibility to state the extent of the investigation and source of the information to be relied on? If not, why not?**

   Response

   We agree that the valuer should be responsible for stating the extent of the investigation and source of the information to be relied on. It is appropriate and customary for the valuer to investigate these items as a part of the valuation procedures. As such, it should be incumbent upon the valuer to appropriately note these items in the *Scope of Work* discussion.

   However, regarding *(e) the extent of investigation into the nature, specification and adequacy of services,* this statement is not entirely clear. We suggest that the Board clarify this statement, specifically, what is meant by the term "services". For example, is this specific to local utility services, or would this include other property-related services such as grounds maintenance, janitorial services, third party management, etc.?

3) **The Board believes that the standard presented in this Exposure Draft can be applied in the valuation of real property interests regardless of the purpose of the valuation (secured lending, sales of real property, taxation, litigation, insolvency proceedings and financial reporting. etc.). Do you agree? If not, for what purpose(s) do you not believe this standard can be applied? Why?**

   Response

   In general, we agree.

4) **Are there any further topics that you feel the Board should add or remove from IVS 400 Real Property Interests? If so, what are they and what is your rationale?**

Response:

None noted at this time.

Miscellaneous comments by Paragraph

Par. 60.6: The reference to “present day value” in this par. needs to be conformed to the rest of the document which refers to “present value”. (There may be other instances in IVS 2017 where the language needs to be conformed throughout.)

Par. 70.7: Please insert reference to “technological” obsolescence as well in the discussion of obsolescence adjustments.

IVS 410: Development Property

1) **In IVS 2013, all substantive portions of IVS 233 Investment Property Under Construction were labelled as "commentary" (except for scope and effective date). This label seems to have created some confusion amongst stakeholders as to whether the standard was mandatory. The Board's position is that all aspects of IVS 2017 should be mandatory and this Exposure Draft has removed the "commentary" label for clarity. Do you agree with the removal of the commentary label?**

   Response

   We agree that the term "commentary" may lead to confusion and can be removed from IVS 2017.

2) **The Board believes that the standard presented in this Exposure Draft can be applied in the valuation of both commercial and residential development property regardless of the purpose of the valuation (ie. establishing whether proposed projects are economically viable, loan security, acquisition, taxation, litigation, financial reporting etc.). Do you agree? If not, for what purpose(s) do you not believe this standard can be applied? Why?**

   Response

   In general, we agree.

3) **Are there any further topics that you feel the Board should add or remove from IVS 410 Development Property? If so, what are they and what is your rationale?**

   Response

   None noted at this time.

Miscellaneous Comments by Paragraph

Par. 20.1: This paragraph defines development property, in part, as follows:

> "A Development Property can generally be defined as any property, which has development potential and where its existing use value is below the market value."

This issue is that the above definition uses the term "market value", which is a defined term in IVS 104[12]. Is the intent of the Board to link the above definition to an IVS basis of value? Or is the term "market value" used with a more general, casual meaning - but in that case, how would the two terms be distinguished, and would it still be confusing to have both?

Additionally, the Board may consider rewording this part of the definition along these lines:

> "A Development Property can generally be defined as any property, which has development potential and where its value under existing use ~~value~~ is believed to be below that of an improved property ~~the market value~~."

Other General Comments

Special Considerations for Various Valuation Applications

We think that the discussion of *Special Considerations for Financial Reporting* and *Special Considerations for Secured Lending* in par. 110 – 120.1, while helpful, is much more suited to be included in application guidance rather than in a standard. As we have previously recommended, the Board should consider using appendices for this purpose.

Note that the above comment on the placement of the "special considerations" within the standards' discussions is also a general comment on IVS 2017.

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[12] IVS 104 *Bases of Value* states the following:

> "**30. IVS-Defined Basis of Value – Market Value**
>
> 30.1. Market Value is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion."

IVS 500: Financial Instruments

a) In IVS 2013, all substantive portions of IVS 500 Financial Instruments were labelled as "commentary" (except for scope and effective date). This label seems to have created some confusion amongst stakeholders as to whether the standard was mandatory. The Board's position is that all aspects of IVS 2017 should be mandatory and this Exposure Draft has removed the "commentary" label for clarity. Do you agree with the removal of the commentary label?

Response

We agree that the term "commentary" may lead to confusion and should be removed from IVS 2017.

b) The Board believes that the standard presented in this Exposure Draft can be applied in the valuation of financial instruments regardless of the purpose of the valuation (acquisitions, mergers and sales of businesses or parts of businesses, financial reporting, regulatory requirements, internal risk and compliance procedures and regulatory requirements). Do you agree? If not, for what purpose(s) do you believe this standard cannot be applied? Why?

Response

In general, we agree, subject to our specific comments below.

c) Are there any further topics that you feel the Board should add or remove from IVS 500 Financial Instruments? If so, what are they and what is your rationale?

Response

We suggest removing the discussion of the cost approach for financial instruments, as noted in our specific comments below.

We recommend making a mention of the unit of account, determined in conjunction with the appropriate basis of value, which can have a material impact on the inputs, assumptions and approaches used in the valuation of financial instruments.

We also think that IVS 500 should acknowledge the need to apply professional judgment in the evaluation of the various inputs, assumptions, approaches and methods, as well as in arriving at a valuation conclusion. While there may be a *relative* abundance of market data underlying financial instruments as an asset class compared to intangible assets, as an example, the role of professional judgment in using this data is nonetheless critical. As such, the notion of judgment needs to be woven into the appropriate paragraphs of IVS 500.

The Board should also consider how to reflect or provide a cross-reference (in an appendix or otherwise) to the IPEV Valuation Guidelines, as well as to the AICPA Private Equity/Venture Capital Valuation guide (currently in development), serving as examples of specific industry application. The IVSC has a Memorandum of Understanding with IPEV, whereby IPEV is the designated provider of valuation guidance for the Private Equity industry.

Miscellaneous Comments by Paragraph

Page 4: Reference is made in point (b) to plant and equipment.

Par. 20.1: The Board should indicate the source of the definition of a financial instrument shown in this paragraph. Also, our concern is that in attempting to come up with a broad definition that has a presumably wide application, inconsistencies or conflicts may arise with existing definitions for specific valuation purposes. For example, the definition of a financial instrument in the Master Glossary of FASB's Accounting Standards Codification is different from that in par. 20.1, and this difference may not be inconsequential.

Perhaps the Board needs to clarify, both here and in other cases where definitions are provided in IVS, that any existing definitions specific to a purpose for which a valuation is performed would take precedence over the IVS definitions.

Par. 20.3: Consider adding the following purposes: fairness opinions, solvency opinions, compliance with loan covenants.

Par. 20.3: Quotes form brokers or pricing services are not sufficient without taking the additional step of understanding whether such prices are "contemporaneous and actionable."

Also, consider making the following edit "~~such as~~ for example, the appropriate interest rate curve", as this would more clearly convey the idea that this is one of a multitude of potential inputs into the valuation process.

Further, with respect to "appropriate", depending on the basis of value applied, its appropriateness could differ, and the assumptions used could also differ.

Par. 20.5 (general): This paragraph should also address the unit of account, determined in conjunction with the appropriate basis of value.

Par. 20.5 (b): Consider adding the concept of a "pool" to the already existing references to individual instruments or a portfolio, as a pool captures the idea of a group of homogeneous instruments.

Par. 20.6 (b): This bullet is not clearly written – suggest revising the language.

Additionally, when the required basis of value calls for the use of market participant assumptions, just because there is a contract related to a financial term, it does not necessarily mean that a market participant would always take it into account and ascribe value to it. For example, additional factors that may be considered at the measurement date include, but are not limited to: economic expectations, whereby a legal/contractual right may or may not have an economic impact on value; likelihood of exercise of a contractual right; anticipated future changes in the structure of the investment/instrument which may materially impact value.

Par. 20.6 (b): Calibration should also be performed to the arm's-length, orderly transaction price for the subject instrument, when such price is available (not just to prices of similar instruments). Calibration is a necessary tool in ensuring the internal consistency and robustness of subsequent valuations of the subject financial instrument.

Par. 20.7 (general): This section of the standard should clarify (or perhaps reiterate) that the discussion of suggested disclosure items only concerns the valuation report, which is only shared with the client of record and any authorized users, per the engagement letter. In the case of valuations used for external reporting purposes, there may be additional disclosure requirements that the client would have to provide as part of their filing. Furthermore, concepts such as materiality, uncertainty, complexity and comparability may take on a different color when financial reporting is concerned.

Also, consider revising the statement "This will differ for different categories of financial instruments".

Par. 20.7(a) *Materiality*: This is may be a function of the purpose of the valuation, and is typically determined by parties other than the valuer (e.g., auditors, regulators, courts). Furthermore, some consider materiality to be a legal concept.

Par. 20.7(b) *Uncertainty*: The discussion of uncertainty herein is insufficient. Also, it is unclear how this will be applied in practice.

Par. 20.7(c) *Complexity:* We think that complexity can be judged not only by reference to the features of the instrument, but also by the type of valuation methodology employed. The two do not necessarily go hand-in-hand, and thus the Board should consider a discussion of both.

Par. 20.7(d) *Comparability*: Questions arise as to the usefulness of such a disclosure in a (presumably recurring) valuation assignment and report. For example, with the passage of time, the remaining term on fixed income instruments would decrease. Is comparability then governed by focusing on the remaining term of the instrument and seeking comparability to instruments with similar attributes at the valuation date, or is the objective of comparability to compare to the same instrument from the prior period - which is no longer comparable as its attributes have changed as of the valuation date? It seems that par. 20.7(d) is suggesting the latter, however, please note the issue we described above.

Par. 40.3: Please see our comment on the use of the cost approach in our discussion of par. 70 below.

Par. 50.1: We have the following comments on this paragraph:

- Exchange-traded may not necessarily signify an *active market* with the meaning of this term in IFRS and U.S. GAAP; therefore, the application of the guidance in this paragraph may result in an inappropriate conclusion for financial reporting purposes.

- Suggest revising “recent relevant transactions” to better describe the Board’s intended meaning.

- Suggest adding a discussion of calibration.

Par. 60.2: We have the following comments on this paragraph:

- A significant item that is missing from the list is the impact of current market conditions (and the change in market conditions) on the concluded discount rate.

- The type of cash flow (e.g., expected, contractual) also has to be considered in determining the discount rate

- It is not clear whose assumptions should be used to determine the return for the time value of money and the risks -- the asset holder’s or the asset buyer’s? Value may likely be different depending on whose assumptions are used. Thus, the discount rate should also consider the appropriate basis of value.

- Calibration needs to be addressed as well, since it also impacts the estimation of the discount rate.

- Last, but not least, since more items than currently described in par. 60.2 can play a role in the selection of the discount rate, we recommend that the end of the introductory sentence be amended as follows: “it is necessary to assess the return that would be required on the instrument to compensate for the time value of money and risks ~~related to~~ including, but not limited to:…”

Par. 60.3: We recommend that this paragraph be relocated before par. 60.2, as the nature of the cash flows used is a critical consideration in determining the discount rate. Typically, one starts by assessing the nature of the projections, and then determines the appropriate discount rate.

Also, the discussion in this paragraph should go beyond a reference to only expected cash flows. Contractual or promised cash flows are conceptually different from expected cash flows and should also be addressed.

Par. 60.4: We recommend the following edit to the first sentence, or an edit along the following lines: "Depending upon the purpose of the valuation, the inputs and assumptions made into the cash flow model will need to reflect ~~either~~ those that would be made by the current or potential holder of the instrument, consistent with the basis of value required in the valuation ~~market participants, or those that would be based on the holder's current expectations or targets~~." The current reference to market participants makes the statement specific to only certain bases of value, and we understand that the guidance in this paragraph is intended to have broad applicability. We think that the suggested language is able to address a wide array of situations and valuation requirements.

Par. 70 (in the aggregate): While we agree that a replication method can be employed in some cases, ultimately, the components of a replicated position are valued by either a market or an income approach. The same could be said of hedging – ultimately this breaks down into an application of the market or income approach, or both. Therefore, we do not think that the cost approach is relevant for financial instruments.

Traditionally, the cost approach relies heavily on concepts such as depreciated replacement cost, various forms of obsolescence adjustments, and where appropriate, adjustments for a developer's profit and opportunity costs. None of these are pertinent to financial instruments. Furthermore, a hallmark of financial markets is their volatility, often causing a valuation mark to become outdated very quickly. This is in turn addressed by refreshing the marks - by obtaining either market prices, or various other market data underlying the application of market approach or the income approach.

Additionally, we are aware that in a private equity/venture capital context, some think of the last round of financing as using a "cost" approach. We think that the price of the last round of financing is most appropriately described as a "market" approach: while the amount paid by the investor is a cost to the investor, it also represents a *transaction price*, which is unequivocally an input into the market approach.

Thus, we find the section of the cost approach for financial instruments to be a largely semantic discussion, clouding the pragmatic aspect of the actual valuation exercise. We suggest that the Board simply state that the cost approach is not relevant for financial instruments, and the discussion of replication of an instrument or a portfolio can be relocated under the section *Special Considerations for Financial Instruments* in IVS 500, or elsewhere, without a reference to the cost approach.

Par. 90.1, 90.3 and 90.4: Broker quotes should be considered only if contemporaneous and actionable.

Par. 100: A discussion of calibration would make identifying and measuring risk at inception easier.

Par. 100.1: This paragraph should make it clearer that the list presented is not exhaustive.

Par. 120.3: We think this paragraph can further raise the bar on the independent verification of valuations from an independent department of the entity to an independent third party, as a recommended approach. This is also consistent with current best practices. A reference to external experts is already made in par. 120.4 (d).

Separately, in the investment industry, it is not always possible to achieve separation of function as this also depends on the size of the investment manager.

Par. 120.4: Suggest adding reference to a “third party valuation validator"[13]. And, consistent with our prior comment, this reference can also be inserted in par. 120.3.

Other General Comments

Drafting Language

We think that the Board should revisit the drafting language of IVS 500 (*as well as IVS 2017 in its entirety*) and decide on a consistent tone to use throughout the standards. As a specific example, consider the use of the word “shall” in par. 20.4 through 20.7, and the use of “should be” and “need to be” in the remainder IVS 500.

In addition to the nuanced meanings of these words – from absolute requirements to goals/non-mandatory provisions - the Board needs to consider 1) whether each of these words is properly paired with the specific guidance they are used with (i.e., whether something is suitable to be required or can just be encouraged, in order to comply with IVS); 2) whether the goal of setting high level principles in IVS is being achieved through the use of drafting language; and 3) how all this reconciles with the IVS standards being mandatory, as the Board has intended.

Discounts for Lack of Control and Control Premiums

We noticed that IVS 500 does not make any mention of discounts for lack of control and control premiums (DLOM and CP), but we are unsure if it is intentional. We think that if DLOM and CP end up being addressed in IVS 500, it should only be in the context of calibration and market participant assumptions. The main purpose of this would be to ensure there is no double counting of the economic effects of any DLOM and CP.

Equity investments are one touchpoint for the business valuation standard (IVS 200) and the financial instruments standard (IVS 500), with potentially varying implications for DLOM and CP. Equity investments are considered financial instruments, but they are also business interests:

- If they are valued based on transaction price(s) - as one example - the price presumably captures any DLOM or CP (even liquidity considerations), as would

[13] For example, AICPA TIS 2220 states: “…[T]he reporting entity might consider the following key factors relating to the valuation received from the investee fund manager… - The use of independent third party valuation experts to augment and validate the investee fund’s procedures for estimating fair value.”

subsequent calibrations to such price, applied in the context of market participant assumptions.

- If, however, the valuation is performed from a business enterprise perspective and total equity is valued, a DLOM or CP may be appropriate depending on the specific facts and circumstances.

Thus, a different approach to valuing the same financial instrument may or may not consider DLOM or CP.

Separately, there are also unit of account considerations at play. Using the same equity interest as an example, the specific valuation purpose for which the analysis is performed may require that the equity interest to be viewed as an aggregation of individual shares, as opposed to a “block” or a whole “interest”. This also has an impact on DLOM and CP.

We recommend that the Board consider if and how these issues would be addressed in IVS.

***

We would be pleased to further discuss our comments with the IVSC staff. Please direct any questions to either of us via the contact information set forth below.

Sincerely,

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