Agenda Item 14

IVSC STANDARDS BOARD

Board meeting 5 June 2013

Valuation of Liabilities

The Board is invited to consider the attached report on the comment letters received on the Discussion Paper published in February 2013 and to approve the next steps in the project.

Summary Report on Responses to Discussion Paper on the Valuation of Liabilities

1. During the course of its IVS Improvements Project between 2009 and 2011 it became apparent to the IVSC Standards Board that there was a lack of standards or guidance specifically relating to the valuation of liabilities.

2. Within the field of financial reporting, the IASB's IFRS 13 Fair Value Measurements specifically includes liabilities within its scope, but stipulates that specific assumptions be made that are directed at achieving a consistent accounting measurement of liabilities. Some of these assumptions, eg that a transfer has to be assumed even where fulfilment or cancellation are more likely, or that in absence of quoted prices a liability is to be valued from the perspective of the counterparty holding the corresponding asset may or may not be appropriate when establishing the value of a liability for purposes other than financial reporting.

3. For liabilities also need to be valued for other purposes, eg in when they are to be transferred to another party as part of a corporate transaction or on a standalone basis. They can also be relevant in the assessment of the current value of an asset, eg where there are obligations on the owner of the asset when it is retired or reaches the end of its useful life.

4. In June 2011 the Board agreed to progress a project on the valuation of liabilities. It agreed that this project should exclude liabilities created by financial instruments because these have distinct characteristics and would in any event be covered in the proposed projects on financial instrument valuation. It was also proposed that pension liabilities would be excluded, as would rental payments under leases.

5. A Working Group of experts was established to consider some of the issues. Following input from this group a Discussion Paper (DP) was prepared and published for public comment on 1 February 2013. The comment period closed on 30 April.

6. Fifteen comment letters were received. The types of respondent can be categorised as follows:

Professional Bodies	8
Valuation Firms	2
Global Consulting Firms	2
Trade Associations	1
Other	2
	15

7. The comment letters are displayed on the IVSC web site. Annexed is a table summarising the responses, in particular the answers to the questions asked in the DP. Not all comments are referenced. The purpose of this summary is to identify common themes.

8. The responses to the questions in the DP are analysed below.

* * * * *

1 Do you agree with that the IVSC should produce a standard or guidance on the valuation of liabilities as defined above? If not please explain why.

Agree or mostly agree	Disagree or mostly disagree	Answer unclear or not given
13	1	1

Summary of Comments

There is clear support from nearly all respondents to the IVSC providing standards or guidance on this topic. Most referred to the need for guidance and a few specifically stated that they felt guidance rather than a standard was required. Two respondents expressed the view that it might be better for the IVSC to wait until the IASB had completed its review of the accounting treatment for liabilities under IFRS, although one of these also indicated that they would support interim guidance. One valuation firm indicated that future IVSC guidance should only produce guidance for purposes where no existing guidance existed and should reference such other guidance as existed.

The one organisation opposed did so on grounds that IVSC should wait until IASB had completed its review of the accounting treatment of liabilities.

2 Do you agree that the possible definition of a liability given above is both clear and adequate? If not any alternative suggestions would be welcome.

Agree or mostly agree with definition	Disagree or mostly disagree with definition	Answer unclear or not given
6	7	2

Summary of Comments

Six respondents indicated that they either agreed with or mostly agreed with the definition proposed. One professional organisation stated that it was "clear and adequate". However, a number of those who broadly supported the definition suggested minor amendments, with two suggesting that the word "could" was inappropriate and should be replaced with either ""is expected to" or "is likely to". A couple also disliked the reference in the preamble to the "holder" of a liability, with "obligor" or "issuer" being suggested as alternatives.

Of those who were opposed, three believed the IVS should use the same definition as in IFRS, although one indicated an alternative would be to explain why the IFRS definition was not being used. Two others offered alternative definitions, and one considered that the definition should clarify whether the obligation was in the present or future, whether it arose from past present or future events and how it differed from an expense. One considered IVSC should not define a liability at all because for all purposes for which liabilities fall to be valued there are existing definitions in place.

3 Do you agree with that liabilities arising under a financial instrument should be excluded from the scope of this project?

Agree or mostly agree	Disagree or mostly disagree	Answer unclear or not given
7	6	2

Summary of Comments

A few of those who agreed with the exclusion expressly stated that the specialised nature of FIs warranted separate treatment. One supported exclusion but pointed out the need for consistency in the principles between any guidance in this project and that produced for FIs.

Of those opposing the exclusion of financial instruments the most common reasoning was that the principles would be similar for all liabilities. It was clear that at least two of those who indicted disagreement were not aware of the fact that IVSC is developing separate guidance on the valuation of FIs. A couple of those who thought FIs should be included mentioned that the definition of FIs could include a number of other liabilities identified in the DP and that there could be a problem at the margins in deciding whether a liability was in or out of scope.

4 Do you agree that other liabilities such as rental payments, pension liabilities, insurance liabilities and deferred tax should also be excluded?

Agree or mostly agree	Disagree or mostly disagree	Answer unclear or not given
9	5	1

Summary of Comments

Of the clear majority who supported the exclusion of the above liabilities from the scope of the paper a couple indicated that this support was conditional upon their being other guidance issued for these.

Those opposed generally indicated that the principles were common for the valuation of all liabilities.

5 Do you consider that contingent liabilities as described above should be included? Please also indicate if there are any other types of contingent liability that should be included.

Agree or mostly agree	Disagree or mostly disagree	Answer unclear or not given
11	1	3

Summary of Comments

Of those supporting the inclusion of contingent liabilities other types of liability suggested for inclusion were: site remediation, contingent consideration (earn outs), guarantees, legal liabilities, and warranties.

The professional organisation opposed considered that the focus should be on simple liabilities. One professional body that did not indicate a clear view suggested that many contingent liabilities exhibited similar characteristics to insurance liabilities, which it considered should be out of scope.

6 Please indicate whether you believe potential litigation liabilities can or should be valued and whether they should be included in this project.

Agree or mostly agree should be included	Disagree or mostly disagree with inclusion	Answer unclear or not given
10	2	3

Summary of Comments

Of the majority who consider that litigation liabilities are capable of valuation and should be included, a number stated that they were required to be valued for financial reporting, although one valuation firm indicated that in their experience this was rare. A couple made the point that it was often preferable (and more reliable) to value a portfolio of claims rather than an individual claim. A number of those who supported the inclusion also pointed out the potential problems arising from disclosure of a valuation to the claimant other legal considerations, and also the distinction between the settlement figure and a valuation of the liability. One global consultancy considered that guidance was needed around this issue.

The two organisations that opposed did so on the grounds that estimating the settlement amount involved needless speculation, or that a reserve to cover damages does not represent the "value" of the liability.

7 For what purposes are you aware of liabilities being valued?

Summary of Comments

The following purposes were identified by one or more respondent: Financial reporting, product or service design and pricing, management decision making, mergers and acquisitions, litigation, bankruptcy and restructuring, settling of claims, tax, asset retirement obligations, and remediation obligations.

8 What basis or bases of value do you normally encounter?

Summary of Comments

The following valuation bases were identified by one or more respondent: fair value (for financial reporting), market value, definitions in tax legislation, special value, investment value, expected value (which is a probability weighted basis)

9 Do you agree that the bases that are appropriate objectives for a valuation of liabilities fall within one of the three categories described in the IVS Framework?

Agree or mostly agree	Disagree or mostly disagree	Answer unclear or not given
6	1	7

Summary of Comments

It appears that this a number of respondents did not understand this question. Some confused the three "categories" of value referred to in para 15 of the DP with the individual bases within those categories and commented on these, which was the objective of the next question.

10 Do you agree that it may be necessary modify some of valuation bases definitions in the Appendix in order for them to be applied to liabilities as opposed to assets? If so it would be helpful to indicate any changes you believe appropriate.

Summary of Comments

This produced a wide variety of responses. Six respondents indicated that they did not favour different bases of value for assets and liabilities, but six considered that the bases listed in the Appendix to the DP (fair value, market value, investment value and special value) had limited or no application to liabilities. Of those in the former group, the main reason given was that they did not support a proliferation of bases.

Two respondents considered that the concept of "investment value" had no application to liabilities, whereas the International Actuarial Association considered that this basis was the one that most closely approximated to the basis normally used. Another considered that while the entity specific nature of investment value was relevant to the valuation of liabilities, they disliked the term because people do not "invest" in liabilities. At least three respondents suggested that a basis that reflected the cost to the holder/obligor of fulfilment was required given that many liabilities cannot be transferred.

11 If you have experience of using the market approach to value liabilities, please indicate the nature and types of liabilities where this is used.

Summary of Comments

Most respondents indicated that either they had little or no experience of using the market approach to value liabilities or that it had little application in valuing liabilities. Of the three respondents who indicated that they had some experience of its application, the liabilities they considered it could be applied to were publicly traded debt, private debt with the characteristics of publicly traded debt, structured debt, insurance liabilities and "contingent value rights". Most of these are categories of liability which a small majority of respondents considered should be outside the scope of this project.

A few indicated that market based inputs were used in an income approach (DCF).

12 Please give an example of a type of liability where you have encountered or used a DCF method and indicate the purpose for which the valuation was required.

Summary of Comments

A least four respondents indicated that DCF was the method used for valuing the majority (in one case the "vast "majority) of liabilities. Among the types of liability listed by other respondents were included debt instruments, contingent consideration, insurance and reinsurance contracts, and asset retirement obligations.

13 For the example given for question 12, please indicate the source of the projected financial information used in the cash flow forecast.

Summary of Comments

Most respondents who responded indicated that prospective financial information is typically sourced from the entity's management or a contract creating the liability, although others referred to sourcing market or independent data, where available.

14 For the example given for question 12, indicate what risk factors you reflected and whether these were reflected by probability weighting the cash flows or the discount rate.

Summary of Comments

At least half the respondents indicated that probability weighted cash flows were the norm. Only two expressed the view that that the risks should normally be reflected in the discount rate. Most indicated that they were aware of both probability weighting of cash flows and discount rate adjustment depending on the type of liability and the purpose of the valuation.

15 Do you consider that a "risk free" rate should be used when estimating the current value of a future liability? If not please indicate how you derive the rate and the rationale to support it.

Should generally be used	Should not generally be used	Answer neutral or no answer given
1	6	8

Summary of Comments

The only one who indicated that they normally used a risk free rate also indicated that they normally use probability weighted cash flows. Those who gave a neutral answer generally made the comment that it was only appropriate to use a risk free rate if the cash flows were probability weighted. Among those who considered a risk free rate was never, or rarely, appropriate were some who considered that the discount rate should always reflect the holder's cost of debt. The replies of more than one respondent indicated that they considered that the greater the risks involved in holding the liability the higher the discount rate should be.

16 Please indicate if you have used or encountered option pricing in estimating the value of liabilities. If so please indicate the nature of the liability and the purpose for which the valuation was required.

Have had experience	Have not had experience	Answer unclear or not given
6	4	5

Summary of Comments

Of those who have encountered option pricing for liabilities most gave contingent consideration as an example of a liability that could be valued by this method. Others indicated that it could only be applied to liabilities that were traded in markets, which excluded most "non financial" liabilities.

17 Please indicate whether you agree that in calculating the value of a liability based on the cost of fulfilment at a future date a "profit margin" (or risk premium) should be included to reflect the risks to the holder of the cost estimate proving inadequate. If so, please give an example.

Agree or mostly agree	Disagree or mostly disagree	Answer unclear or not given
5	0	10

Summary of Comments

Although some disagreed with or disliked the reference to a "profit margin" they all accepted that the risks to a transferee of a liability would be reflected in the price. Among those who expressed no clear view were a few who indicated that they would prefer the term risk premium to profit margin. Others indicated that it would depend on the valuation purpose and the basis used. A few indicated that it would be perverse for a holder of a liability to add a "profit margin" to the cost of fulfilment form its own resources if this reduced the profit from its other activities.

At least three respondents pointed out that a transferee's profit margin is required by IFRS 13 para 41(a)

18 If you use or are familiar with the Cost Approach, please indicate in your experience how the cost of fulfilling, transferring or settling/cancelling an equivalent liability is determined.

Summary of Comments

Five respondents did not answer this question. Of the ten answers given about half indicated that they did not consider the cost approach applicable to liabilities, one making the point that the principle of substitution on which the cost approach is based could not be applied to a liability. The other answers indicated that the respondents were considering the cost approach to be a reference to the costs of fulfilment, which are inputs into the DCF approach which the majority indicate is the most prevalent method.

19 Do you agree with the Board's proposed approach?

Agree or mostly agree	Disagree or mostly disagree	Answer unclear or not given
8	2	5

Summary of Comments

The two who disagreed did so on the grounds that they had inferred the intention was either not to include valuations for financial reporting or that inadequate reference would be made. That was not the intention expressed in the DP. Those who gave unclear responses seemed to believe that this question related to the whole paper not just to the preceding paras explaining the proposed approach to valuations for financial reporting.

General Observations:

The responses to the Discussion Paper confirm that there is considerable diversity of views and practice in the way in which liabilities are valued.

As is often the case, those respondents who mostly encounter valuations for financial reporting seem concerned that IVSC is suggesting that a different definition of a liability to that appearing in IFRS is desirable, notwithstanding that the scope is intended to cover a wider range of applications and purposes. These concerns are also reflected in the comments regarded the respective weight that should be given to financial reporting as opposed to other purposes, although between them the respondents identified a range of other purposes for which liabilities are regularly valued.

There are nearly as many respondents in favour of including financial instruments in the scope of this project as there are who support their exclusion. Some of those who did not want instruments excluded seemed to be under the misapprehension that IVSC was not intending to produce any guidance on financial instruments. However, others made the point that the definition of financial instruments is broad and could encompass many agreements involving share payments or even leases. Another point made was that the principles should be consistent for the valuation of all types of liability.

While there was less support for the inclusion of insurance contracts and pensions, a significant minority considered that these should also come within the scope, with a couple of respondents considering that there was little difference between these and contingent liabilities, which the majority want to see included.

A clear majority also supported the inclusion of litigation liabilities, although many also expressed the need for care in not confusing this with potential settlement figures, and a need for awareness of the practical and legal implications of such advice.

Some of the diversity seems to stem from whether the respondent is mostly familiar with valuing a liability from the perspective of the current holder, ie what it would cost to fulfil or transfer to another party or from the perspective of a market participant who is willing to accept responsibility for a transferable liability in return for a payment. Both perspectives are valid for different purposes and future guidance will need to be aware of this and make the distinction clear.

There was a roughly even split between the respondents who considered that the bases already defined in the IVSs could be applied to liabilities, and who were opposed to new or modified bases for liabilities, and those who considered strongly that bases designed for assets could not be applied to liabilities and that new or modified basis required. The alternative identified by a number was some form of “fulfilment basis” which could be an entity specific basis broadly equivalent to Investment Value for assets.

Staff Recommendations for Board:

That the Working Group be invited to develop a Technical Information Paper providing guidance on the valuation of liabilities for consideration by the Board, reflecting the following:

- If the Board confirms that financial instruments are out of scope, to more precisely define the type of instrument excluded, eg derivatives, and clarify that these are the subject of other guidance.
- That while it is recommended that insurance and pension liabilities be excluded from the scope, discussion should take place with the International Actuarial Association to examine

what standards or guidance may be in place already. There should be consistency of principles with whatever has been published in this sector.

- That the discussions with the International Actuarial Association also explore the potential for more general collaboration on the development of a TIP.
- That litigation liabilities be included, with appropriate cautions and caveats over the provision of such advice.
- That the guidance examines liabilities from the perspective of both the value to the existing holder and a prospective transferee, and that the distinction and the purposes for which each value is required made clear.
- That consideration be given to developing a “fulfilment” basis of value.
- Such other points arising from the comment letters as it considers appropriate.

C Thorne

IVSC Technical Director

May 2013

Annexe

Summary of Comment Letters

001	American Appraisal Associates	1	Yes.
		2	In para 2 not all liabilities have a beneficiary, ie an entity to which the obligation is owed. Suggest "An obligation which **is expected** to result in an outflow of resources.
		3	n/a
		4	Lease obligations and deferred tax liabilities are also the subject of existing or proposed standards and guidance for financial reporting purposes.
		5	Contingent liabilities such as those described in paragraph 11 should be included in the guidance. The project should also cover such contingent liabilities as proposed site remediation obligations, and litigation liabilities
		6	There are legal and procedural problems associated with estimating liabilities attributable to a specific suit, but where a number of suits are face d a collective estimate of the total potential liability is sometimes provided.
		7	Typically for financial reporting
		8	Fair value (see 7)
		9	Only market value is appropriate for financial reporting (as generally equivalent to FV)
		10	Concept of HABU does not apply to liabilities, as no holder of an obligation looks to maximize their potential pay-out. The terms "Investment Value" and "Special Value" have no relevance when valuing liabilities. The valuation of liabilities should be based simply on the lowest amount at which the holder could satisfy, settle, or transfer the obligation.
		11	Market approach can be used for publicly traded debt or debt that is not publicly traded but having similar characteristics.
		12	DCF typically used for contingent consideration for financial reporting under IFRS 3.
		13	PFI is sourced from management of the acquiring company.
		14	WACC is starting point but may be adjusted for projection risks. Contingent consideration is probability weighted before discounting.
		15	No. Even in cases when the future pay-out is certain, such a deferred consideration payment, the appropriate discount rate would be at least the entity's cost of debt.
		16	Have used option pricing to estimate the current value of contingent consideration when the pay-out amount is tied to the future value of the shares of the acquirer.
		17	The cost quoted by a contractor would include a profit margin but if the entity can settle with internal resources no profit margin should be allowed. Discount rate should not include a risk premium as this would reduce the PV of the obligation.
		18	In estimating the value of a liability, an entity should consider all the possible ways to fulfill, transfer, settle, or cancel an obligation, and determine the most cost-effective approach.

			An estimate of the most cost-effective approach is then determined currently. This cost should then be inflated to the date of the settlement, and then discounted to present value at the cost of debt to the entity.
		19	Yes.
002	Hong Kong Association of Banks	1	Yes
		2	Broadly yes but suggest definition be expanded to include words “from the obligor” to make it clear that valuation is only from perspective of party that holds liability not any beneficiary with a vested interest. Would prefer use of “obligor” rather than “holder” for clarity and consistency with IFRS.
		3	Yes.
		4	Yes.
		5	Support including contingent liabilities
		6	Would like to see litigation liabilities included as required for financial reporting and for management information. A valuation expert could more probably estimate maximum amount of plaintiff’s loss rather than amount of settlement which may reflect other factors.
		7	Financial reporting and for management decision making. The “value” of a liability may be different under settlement, transfer or fulfilment and valuation advice can help inform the strategy.
		8	Many different bases. Fair value often used for financial reporting, but not exclusively so.
		9	Do not think term “Investment Value” is appropriate for liabilities because people do not invest in liabilities. However, consider that this entity specific basis could be a different figure to the market value in a transfer as some entities may not sue their resources efficiently in fulfilling obligations. Suggest “fulfilment “or “settlement” value instead.
		10	In addition to above, all references to assets in definitions should be removed.
		11	Only experience in market based approaches for valuation of liabilities is in the context of non-financial liabilities
		12	Liabilities within a business under IFRS 13 and for management decision making for liabilities such as warranty obligations, asset retirement obligations, customer loyalty programmes.
		13	Past experience, internal estimates, cost of resources required, third party data on inflation, interest rates etc, information from peers and competitors.
		14	Typically reflect by probability weighting cash flows rather than in discount rate.
		15	Support the use of a risk free rate when estimating the current value of a future liability. Financial risks like the credit standing of the counterparty and foreign exchange risks are often valued and accounted for separately. Similarly, non-financial risks are reflected in the underlying projected cash

			flows.
		16	Simplified option pricing used for liabilities which are binary, eg will beneficiary exercise a right or not, and more advance models for liabilities such as share based payments.
		17	In the context of measuring a liability at fair value for financial reporting purposes, a profit margin would be included as this is required by IFRS 13 #41(a).
		18	Relate cost approach to cash flow required to reflect cost of fulfilling obligation.
		19	Disagree with statement that not all liabilities are required to be valued under IFRS although accept measurement basis is not always fair value. Consider it important that valuations for FR are included in scope and that guidance can be related to IFRS as necessary.
003	Board of Valuers of Malaysia	1	Agree
		2	Agree
		3	Agree
		4	Agree
		5	Yes, we do consider that contingent liabilities as described should be included.
		6	Consider potential litigation liabilities should be included.
		7	Insurance liabilities and other contingent liabilities
		8	Market Value
		9	Yes
		10	Do not agree that bases need modifying
		11	Insurance and other contingent liabilities
		12	Insurance or other contingent liabilities
		13	Usually from the contract itself or from the entity but crossed checked
		14	Generally look at **the** certainty of the cash flows and we select an appropriate discount rate.
		15	A risk free rate can be used when there is a high certainty in the cash flow. If we are using a cash flow without probability weighting then we will use an appropriate market derived discount rate
		16	No
		17	n/a
		18	n/a
		19	Agree with Boards approach
004	RICS	1	No. The production of standards or guidance on the valuation of liabilities should wait until the proposed amendments to IAS37 are completed. We would also be concerned that any attempt to define liabilities further would cause confusion in the market
		2	No. Suggest alternative: *An obligation for which the holder is responsible the settlement of which could result in an outflow*

			of resources from that holder.
		3	No. Do not agree that liabilities under financial instrument should be excluded. Prefer generic guidance.
		4	No. If excluded paper will be narrow in scope.
		5	All types of contingent liability should be included.
		6	Potential litigation liabilities should not be excluded from the project
		7	n/a
		8	n/a
		9	Agree that appropriate bases will fall in one of three categories
		10	Agree that it may be necessary to modify some of the valuation bases in the Appendix in order for them to be applied to liabilities
		11	n/a
		12	n/a
		13	n/a
		14	n/a
		15	n/a
		16	n/a
		17	n/a
		18	n/a
		19	Response does not address question.
005	International Actuarial Association	1	Agree useful to formulate a set of sound basic principles
		2	Believe definition as stated is clear and adequate
		3	Agree financial instruments should be excluded
		4	Agree pension and insurance liabilities should be excluded.
		5	Believe that it is appropriate to include contingent liabilities within the scope of this project, but note that external constraints or context may preclude their recognition.
		6	Believe that some (but not all) liabilities arising from litigation are subject to reliable estimation. The measurement of the financial effect of litigation liabilities is already being performed by those involved with the insured portion of such liabilities. Our experience indicates that such liabilities are more frequently reliably estimable when viewed as a portfolio of similar liabilities, not as individual claims on a reporting entity's assets.
		7	Financial reporting, product or service design and pricing, management decision making, mergers and acquisitions, litigation, bankruptcy, settling of claims.
		8	DCF most often encountered which includes appropriate adjustments for risk and uncertainty associated with the cash flows being valued. (subsequent comment indicates term bases of value not understood)
		9	Consider "Investment Value is bases normally used for

			liabilities. Believe other bases as defined by the IVSC are heavily driven by asset valuation. It is important to note (as stated in paragraph 23 of the DP) that certain liabilities are generally not transferable, at least not without the consent of the counterparty.
		10	Investment Value - suggest using "Fulfillment Value": The value of a liability to its holder, assuming that obligation will be fulfilled with the resources of the holder. Fair Value and Special Value could be applied to liabilities transferred with the consent of the entitled party (not a market price), as well as direct settlement with the entitled party. It might be useful to differentiate these
		11	n/a
		12	We use DCF using mean (expected value in a statistical sense) values in the vast majority of our work.
		13	The entity estimates fulfillment cost based on its own past experience, adjusted for expected changes in the future (such as, in some estimates, from inflation). In the case of product warranties, there is often sufficient experience data available to enable a statistical estimate of the future fulfillment cost to be developed.
		14	See 15
		15	Discount rate should be consistent with cash flows being used. If all of the provision for risk has been reflected by adjusting the probabilities or cash flows and the cash flows do not depend on the performance of assets or the level of interest rates, then a “risk free” rate (potentially also adjusted for illiquidity) may be appropriate for discounting.
		16	Believe it is only appropriate to apply option pricing when the risks born are traded in markets. Most non-financial liabilities will not include such risks. In those cases, it is necessary to apply a valuation technique based on discounted cash flows with a provision for the risk related thereto, reflecting the expected variability in the cash flows
		17	The valuation of a liability should reflect the risks and uncertainties inherent in the cash flows (both in terms of their amount and timing aspects). Such reflection of risk and uncertainty can be viewed as an opportunity cost, which reflects the risk-equivalent to the cost without considering risk and uncertainty
		18	The cost approach is not suitable for the measurement of most liabilities. But it can be expressed in a way that could be applied to liabilities, such as: “A valuation approach based on the economic principle that a holder will pay no more for a liability than the cost to transfer, settle or fulfill the liability
		19	Agree **General Comment:** • Principles developed in the IVSC project should be consistent with the principles developed by others for reporting the liabilities excluded in questions 3 and 4. They should only diverge if sufficient justification for their divergence can be articulated. • Much of the work done by actuaries is the valuation of

			certain kinds of contingent liabilities. We suggest meeting with representatives of your organisation to discuss this and ensure we don't accidentally duplicate each other's efforts. • The measurement approach to the valuation of uncertain cash flows is often best dealt with using expected present values in the statistical sense (i.e. the mean value of all possible probability-weighted outcomes). This type of measurement approach will also deal with potential outflows of resources that are either infrequent or remote. • It would be appropriate to develop a general framework to measure both assets and liabilities, which describes corresponding Bases of Value and corresponding Valuation Methods. Fundamental differences in conceptual and practical measurement between assets and liabilities mean that a framework for the valuation of assets needs to be translated into the world of liabilities • Would welcome the opportunity to work with the IVSC in developing such a framework for valuation.
006	CICBV	1	Agree.
		2	A definition closer to the IFRS definition would be more appropriate.
		3	No. It would be helpful if paper could be more general and address all types of liabilities.
		4	Agree should be excluded but should have their own guidance issued.
		5	Contingent liabilities should be included.
		6	Potential litigation liabilities can be and should be valued where the appropriate thresholds are met in terms of likelihood and measurability, but caution over disclosure.
		7	Taxation, financial reporting, mergers and acquisitions, and restructurings.
		8	Fair value or market value
		9	Agree that bases fall within categories in IVS
		10	Think bases should be the same for assets or liabilities.
		11	Market approach not generally used. However market based inputs can be used in income approach.
		12	Most commonly used – see purposes under question 7.
		13	Normally projections by entity or sourced from contracts.
		14	Aware of both probability weighting of cash flows and adjusting discount rate
		15	If the cash flows are truly risk adjusted then the discount rate would normally be the risk free rate. If the discount rate is to be risk adjusted then the risk-free rate is just the starting point for the discount rate used in the valuation of a future liability and would represent the absolute lowest risk that could be used.
		16	Option pricing models are often used to value contingent

			consideration or in deriving the split between common and preferred shares, bifurcation of debt and equity etc.
		17	A profit margin should not be included to reflect the risks to the holder of the cost estimate proving inadequate, but rather, a profit margin should be included to reflect the incentive the transferee would require to assume the liability, over-and-above the costs to fulfill.
		18	We are aware that the cost of fulfilling, transferring, or cancelling an equivalent liability can be determined based on: (i) the operating costs required to fulfill the liability,. (ii) operating costs of comparable companies providing the same product, service, or function required to fulfill the liability being valued.
		19	Agree with Boards approach from a financial reporting perspective. **General Comments:** • The term "financial instruments" is used through the document, but some of the items specifically included in the scope of the Discussion Paper can also be considered as financial instruments. A solution might be to include all liabilities under the scope of this Discussion Paper by making it more generic and applicable to all liabilities, given that the main objective is to ensure that liabilities are defined under IVS. • Throughout the Discussion Paper, there are references to "monetary" or "pay" in reference to valuing or settling liabilities. It is recommended that all such references be replaced in consideration of the IFRS definition of liabilities which defines settlement as "an outflow from the entity of resources embodying economic benefits". • Throughout the Discussion Paper, there are references to "beneficiary" – a beneficiary can be different than a counter-party. As such, it is recommended that all references to "beneficiary" be replaced with "counter-party". • A number of specific comments on wording in DP are included.
007	PricewaterhouseCoopers	1	Agree
		2	Do not agree with definition as existing definitions exist for purposes for which liabilities typically need to be valued.
		3	No. The principles of valuation are similar
		4	No. If there was a need to value these liabilities, the same principles should apply as for other liabilities. However, believe primary focus should be liabilities for which a fair value needs to be determined for financial reporting purposes.
		5	Guidance on the valuation of contingent liabilities should be included. Contingent liabilities would include contingent consideration, legal liabilities, guarantees, financial instruments, and asset retirement obligations.

		6	The valuation methods used to value litigation liabilities would be consistent with methods that would be used to value other liabilities. Notwithstanding the difficulties in valuing potential litigation liabilities due to the potential significant variance between the fair value estimate and the final settlement, believe that litigation liabilities can be valued and that they should be included in this project.
		7	Financial reporting, tax, and litigation.
		8	Fair value for financial reporting and definitions contained in relevant tax legislation.
		9	Do not support multiple bases given that bases normally defined by legislation or regulations governing purpose.
		10	Repeat above.
		11	Not familiar with liabilities which trade on markets. A possible exception to this is the original issuance of debt.
		12	DCF methods when valuing debt, warranties, guarantees, insurance contracts, and contingent consideration. In each case, the purpose of the valuation was financial reporting.
		13	Management normally provides PFI.
		14	In debt valuations, it is most common to reflect the risk factors in the discount rate as they can be observed in a public market (in the form of yield to maturity for debt instruments). In certain cases, the risk can be fully reflected in the projections so that a risk free rate can be used. In most discounted cash flow valuations for liabilities, there is a component of risk found in the projections and the discount rate.
		15	It is more common to reflect risk in the discount rate as well as in the underlying cash flows. The determination of the discount rate may be performed in a similar manner to the discount rate determination of an asset.
		16	Option pricing used in the valuation of convertible debt, debt, contingent consideration and guarantees.
		17	It is generally appropriate to include a "profit margin" for the party that fulfills the liability. It may be appropriate to consider additional compensation for assuming a liability if the range of future outcomes is not symmetrical. See for example IFRS 13 paragraphs IE35 to IE39
		18	Not used cost approach for liabilities. Not sure how principle of substitution can apply to liabilities.
		19	Support the Board's overall objective to provide guidance on the valuation of liabilities; however our concern is that the approach is too general. Multiple definitions of value are being considered. While we understand that the goal is to have a document that is appropriate to the valuation of all liabilities for all purposes, we are concerned that such an approach would yield a standard/guidance that is so general that it would not address valuation specifics that would be useful to those who would use it as a guide to value liabilities
008	IACVA	1	Agree
		2	Prefer IVSC to adopt IAS 37 definition.

		3	No. All forms of liability should be included.
		4	No. All forms of liability should be included.
		5	Yes. All forms of liability should be included. Examples include earn outs, put-options, insurance payouts, coupon, warrantees and guarantees.
		6	No. Estimating amount of settlement involves needless speculation.
		7	Financial statements or as part of a settlement process
		8	Market Value, Fair Value and occasionally, Special Value
		9	DP list four not three categories (it list four bases which come within three categories in Framework)
		10	For purposes other than financial reporting basis should reflect cost to satisfy or fulfill, rather than to transfer.
		11	Answer does not address question.
		12	For financial reporting purposes, our members nearly always use DCF methods for valuing the liability portion of a convertible debt instrument as well as when dealing with above or below market rates on mortgage and other non-callable real estate obligations
		13	Obtained from issuer of debt.
		14	Variability of cash flows, asset coverage and probability of default. They are often combined into a synthetic corporate rate (from BBB downwards) that can be used to determine a market based interest rate for a similarly quoted debenture. A final adjustment to the discount rate is then made for lack of marketability
		15	No. Risk free rates not used.
		16	No.
		17	Agree risk premium should be built into long term projections of costs.
		18	No experience of CA being used.
		19	Do not agree with the Board's approach and think that the most common task relating to liabilities, determining Fair Value for financial reporting should be at the top of the agenda
009	American Society of Appraisers	1	Agrees guidance necessary but does not need standard.
		2	Suggest change to "an obligation that could result in an outflow of resources or a requirement to take a specified action."
		3	No. Exclusion of certain liabilities, such as liabilities arising under a financial instrument, could make the scope of such standard too narrow.
		4	No. Should be included.
		5	Yes. Contingent liabilities should be included.
		6	Yes. Potential litigation liabilities should be included.
		7	Tax and financial reporting purposes
		8	Although the value definitions used in tax and financial

			reporting valuations in the U.S. are different, they are closely aligned with the definition of "market value" in the International Valuation Standards ("IVSs"), i.e., the price which a holder of a liability would have to pay to transfer the liability to a third party in the market.
		9	Agree existing bases are appropriate for liabilities. Do not agree introduction of new ones specifically for liabilities.
		10	No. See above.
		11	Application problematic, mainly lack of market data, or access to such data. Members have valued liabilities such as as structured notes and settlement claims, based on broker quotes, data provided by, for example, Markit, and previous transactions involving similar obligations.
		12	Loans and similar debt instruments, as well as settlement claims. The purposes of valuations were income taxation, financial reporting, and restructuring
		13	Management or legal counsel.
		14	Risk factors considered include systematic (e.g., yields on Treasury instruments, spreads between Treasury yields and appropriate market benchmark yields, etc.) and unsystematic (e.g., a debtor's creditworthiness and the ability to satisfy an obligation). In some cases, the unsystematic risk factors were incorporated in the cash flows (particular in situations where PFI indicated that the obligor would have difficulties meeting the cash outflow). Generally, decisions as to where to incorporate the risk — the cash flow or a discount rate — are based on specific facts and circumstances
		15	In general, a "risk- free" rate is not an appropriate discount rate to value a liability and may be applied only in very limited circumstances. To derive a discount rate for a liability, the debtor's creditworthiness is typically evaluated and a synthetic credit rating is determined based on the ratio analysis and published credit rating benchmarks. A market yield is then based on quoted prices and yields of obligations having similar credit, duration, and other characteristics. Finally, the discount rate determined is based on the selected market yield, which is adjusted for specific characteristics of the subject liability.
		16	Our members have generally not encountered an application of option- pricing to liabilities.
		17	Not encountered application of CA to liabilities.
		18	n/a
		19	Agree with Board's proposed approach.
010	KPMG	1	Agree
		2	Preferable for IVS to use IFRS definition unless there is a specific reason why the definition is believed to be inappropriate for IVS. It would be useful to explain any differences between the definition in IVS and the definition in financial reporting, so that valuers and users can understand the practical effects of such differences.
		3	Agree.

		4	Agree
		5	Agree contingent liabilities should be included.
		6	Valuations of litigation liabilities may be required in certain circumstances, e.g., for financial reporting. It would be useful to develop guidance. By outlining best practices for such items, the facts and circumstances in a particular case can be assessed to determine whether a liability can or should be valued. It would also be useful to clarify the difficulties associated with valuing litigation liabilities.
		7	Financial reporting, as part of a broader negotiation of contractual terms between parties, litigation and property valuation
		8	Fair value for financial reporting, and fair market value (as defined in US tax regulations).
		9	Agree that the valuation of liabilities can be addressed by one of the three categories
		10	Believe it is best if the same definition could be used for both assets and liabilities.
		11	Can be applied to deferred revenue when standalone prices for performance obligations is available but direct market approach is often difficult to apply.
		12	Asset retirement obligations, deferred revenue and contingent consideration.
		13	Management estimates or engineering studies.
		14	Answer refers to profit margin – see Q 16.
		15	Do not believe that the risk free rate should be used in estimating the fair value of a liability unless certainty equivalent cash flows are used, which we believe is rare. The cost of secured and unsecured debt, the cost of equity and the WACC may be a good starting point depending on the nature of the liability and the risk profile (e.g., how the risk of the subject liability compares to the risk of the underlying business)
		16	Not for “non financial” liabilities
		17	Agree that profit margin is appropriate if a market participant would apply such a margin. We believe that a transferee who assumed the risk of adverse price changes would generally want to be compensated for bearing that risk through an increased margin.
		18	Answer indicates costs used in income approach.
		19	Notwithstanding the guidance section in IFRS 13 there remains uncertainty for the valuation of liabilities that are not traded in markets. As such, guidance from the IVSC would be useful. We believe that it is important that where the IVSC adopts a different approach than that followed in IFRS, it should be fully explained **General Comments:** • A few detailed drafting comments on DP.

011	Organismo Italiano di Valutazione		Questions not answered. **General Comments:** #10 The use of “not defined” may create a conceptual problem that might be avoided by replacing with “uncertain” or “not known” or “exposed to uncertainty”.- Something that is not defined cannot be valued, that which is uncertain can be valued. #29 mention at least two ways of reflecting risks in cash flow, eg option pricing or probability weighting. #30 Option pricing and Monte Carlo not mutually exclusive. # 33 better to use “risk premium” than “profit margin”.
012	Yvon Sauvageau	1	Agrees but guidance rather than standard required.
		2	Agree but could use more specific word than “obligation” as definition does not link between obligation and utilisation of resources to fulfil it.
		3	Does not agree. (Reasoning suggests that IVS excluding FIs altogether)
		4	No. Actuaries don’t have and should not have the monopoly of the global valuation of insurance liabilities.
		5	Agree should be included.
		6	While a valuation might be required to support or defend a claim, this is not a measure of the defendant’s liability on any given date. No view as to whether should be included in scope.
		7	Assumption and reinsurance agreements and pension funds.
		8	Answer unclear.
		9	No. Does not agree with concept of “settling a liability” with another party, we can only settle with the contracting party. The utilisation of the concept of market participant is an element of fiction; it is easy to identify precisely something that does not exist.
		10	Bases of value used for assets should not be used for liabilities. Agree that it may be necessary to produce alternative definitions to enable the concepts to be more readily applied to the valuation of liabilities
		11	Market approach has little application to the valuation of liabilities.
		12	Assumption and reinsurance agreements and pension liabilities
		13	Actuaries and portfolio manager
		14	For Assumption and reinsurance agreements probability weighted cash flows used.
		15	Consider “risk free rate” a theoretical concept. Generally seems to disagree with its use.
		16	Discussion on Black Scholes but question not answered.
		17	Preference would be to recognize the” profit” only during the life of the product not at the time of issue, but performing both

			calculations would provide better information
		18	n/a
		19	Agrees that the project should address the valuation of liabilities for any purpose and not address only the requirements of the financial reporting
013	Property Institute of New Zealand	1	Guidance would be beneficial but may be better to wait until IASB has completed review of IAS 37 or to evolve guidance to reflect final outcome
		2	The definition appears simple but is actually very wide. It is not specific as to whether the obligation currently exists or is contingent and appears to embrace a full range of outcomes starting from zero as to the amount to satisfy the obligation.
		3	Yes.
		4	Yes
		5	No. It would be most productive to have the main focus on simple liabilities as indicated by the examples in paragraph 10 that are not contingent on future events
		6	Yes, they should be included in this project. They can be valued but the estimate may be subject to significant uncertainty
		7	Mergers & acquisitions and various financial reporting requirements.
		8	Market value and Investment value
		9	Agree
		10	Investment value would seem to have limited potential for application to liabilities.
		11	No experience.
		12	n/a
		13	n/a
		14	Valuation should result from discounting expected (that is probability weighted) cash flows at a risk adjusted discounted rate or discounting certainty equivalent cash flows at a risk free rate
		15	Answer does not address question.
		16	Valuing the equity of a company as an option on the assets of a company and real option pricing is common in mining
		17	Question not addressed
		18	n/a
		19	Agree with approach in para 40 – consistent with evolutionary approach suggested in Q1.
014	Canadian Institute of Actuaries	1	Agree useful to produce guidance.
		2	Suggest using “likely to” or “is expected to” in place of “could”
		3	Agree FIs should be excluded.
		4	Agree.
		5	Liabilities that are similar in substance to insurance or

			pension liabilities should be excluded – many of these are contingent
		6	Litigation liabilities should be excluded form valuation standard. A reserve to cover damages is not intended to represent the "value" of the liability.
		7	Providing information to the public
		8	Agree.
		9	n/a
		10	n/a
		11	n/a
		12	n/a
		13	n/a
		14	n/a
		15	n/a
		16	n/a
		17	n/a
		18	n/a
		19	n/a
015	Duff & Phelps	1	Generally agree but recommend future IVSC guidance should: a) provide references to suitable guidance and resources resident elsewhere that its constituents can apply for particular liability valuation purposes, and b) focus its own guidance on areas for which no guidance exists and is not being developed elsewhere, or where there is diversity of practice.
		2	The definition can be improved further. For example, it is not clear whether the obligation is future or present; whether it arises from past, present or future events; or more generally, where the line is to be drawn to distinguish a liability from an expense.
		3	Agree providing liabilities under FI included in project on FO valuation.
		4	Answer unclear – seem to agree providing pensions and insurance covered in other guidance which can be referenced.
		5	No view expressed on inclusion. Other contingent liabilities mentioned are guarantees and indemnities. Draw attention to TAF project on Contingent Consideration.
		6	Litigation liabilities can be and are valued for litigation strategy (or settlement negotiation), financial planning, and M&A purposes. It is less common to value litigation liabilities for purposes that might entail public disclosure, such as for financial reporting. Guidance on the valuation of litigation liabilities would need to be considered in light of its purpose and the needs of its users, while also understanding the nature and limitations posed by any privilege concerns of

			outside and in-house counsel, and any legal consequences
		7	Financial reporting, tax, M&A (in connection with transaction pricing when, for example, material environmental liabilities, warranties and contractual obligations may be present), solvency opinions, ordinary course of business (for management planning and analysis) and dispute.
		8	Fair value for financial reporting, “fair market value” as defined in US tax laws, expected value (probability weighted) for management planning.
		9	Generally yes. The common labels that some IVS definitions share with definitions used for specific valuation purposes which have distinct meanings despite the similarity implied in the label, may cause confusion in practice.
		10	In general we do not support a proliferation of definitions, including specific definitions for bases of value exclusive to liabilities. We would prefer that any incremental guidance be provided through the interpretation of existing definitions and their application to liabilities.
		11	A few types of liabilities are actively traded, for example Contingent Value Rights (CVRs), and the market approach can be used to value these. In general, the commercial insurance market can be used as a benchmark for the cost of transferring a contingent liability to a market participant when there is not an observable market for such transfers.
		12	List most types of liability for most purposes
		13	Historical company or industry data, management assessments, independent expert assessments, and market-derived information
		14	Best practice is to reflect material quantifiable uncertainty in the cash flows (use expected (probability-weighted) cash flows). The discount rate will generally reflect the time value of money and, depending on the purpose, the entity's risk of non-payment or other market-priced risks. To the extent that the uncertainty is correlated with the market (i.e. there is non-diversifiable systematic risk, for example for contingent consideration tied to revenues or profits), it may be appropriate to adjust the discount rate accordingly.
		15	Do not believe that a risk free rate is appropriate.
		16	Used option pricing methodologies in measuring the fair value of liabilities only for financial reporting purposes. This situation arises frequently, for example, in valuing contingent consideration with minimum targets or caps on payments
		17	If the premise of value is that the liability is transferred to a third party, then a profit margin for the relevant third party might be included. On the other hand, if the premise of value is an orderly transaction between market participants and there is a natural market, then a profit margin might not be included. For example, for contingent consideration the relevant market may be the M&A market. In this case, the fair value of the contingent consideration liability would be the same as the fair value of the contingent consideration asset – i.e. it generally would not include a profit margin.

		18	Would largely depend on the way the liability would be fulfilled and the required basis of value.
		19	Disagree because they seem to believe proposal is to exclude valuation for financial reporting from future guidance. Also point to dangers of IFRS changing.
			General Comments: Various paragraph by paragraph drafting comments on DP.