



15 February 2013

Our ref: ICAEW Rep 28/13

Your ref:

IVSC
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CommentLetters@ivsc.org

Dear Ms Castaneda

Proposed Revisions to IVSC Exposure Draft: Valuation Uncertainty

ICAEW is pleased to respond to your request for comments on *the IVSC Exposure Draft of a proposed Technical Information Paper (TIP) on Valuation Uncertainty*.

ICAEW welcomes this initiative by the IVSC and is keen to play an active role in this project. The ICAEW Valuation Group Committee and the Financial Reporting Faculty would welcome a meeting for further discussion on this matter as a whole or in relation to specific points raised in the attached response.

I look forward to hearing from you.

Yours sincerely

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ICAEW REPRESENTATION

PROPOSED REVISIONS TO IVSC EXPOSURE DRAFT: VALUATION UNCERTAINTY

Memorandum of comment submitted in February 2013 by ICAEW, in response to IVSCs Exposure Draft of a proposed Technical Information Paper (TIP) on *Valuation Uncertainty* published in November 2012.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the IVSC exposure draft of a proposed TIP on *Valuation Uncertainty* published on 12 November 2012, a copy of which is available from this [link](#)

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. The Valuation Group is the voice of Valuers within ICAEW, and the committee includes representatives from the business and practice communities. It draws together professionals engaged in valuation and its 850 members receive a range of services including an annual conference, quarterly newsletters, and regular seminars providing technical insight and practical guidance.
5. The Financial Reporting Faculty is committed to providing members with practical help in today's complex world of financial reporting. Members can access the specialist online resources range from technical briefings and factsheets, to webcasts, blogs, and IFRS and UK GAAP standards trackers. The Faculty also provides assistance across a spectrum of financial reporting issues, keeping members up to date with changing regulations and standards.

MAJOR POINTS

ICAEW welcomes this initiative by the IVSC and is keen to play an active role in this project.

6. The proposed TIP adopts the solution of proposing narrative reporting by valuers to clients where most uncertainty exists. We agree that in some cases it would be helpful for a valuer to communicate uncertainties with the various different users of the valuation. However, in those circumstances where the users are compilers or auditors of financial statements, we are concerned that this extra communication should not lead to the disclosures required by IFRS 13 in financial statements being made more lengthy or complex. After all, the IFRS 13 Level 3 disclosure is relatively compact, informative and well used (particularly if large quantities of Level 3 assets exist, or for example, the user has received a clear warning on valuation subjectivity). We therefore consider that in finalising the TIP further thought should be given to the objective of the valuer's report, the primary users to whom it is directed, and the purposes for which it is envisaged this information will be used. In particular it may be useful for the valuer to distinguish in his report between the information which the company may find helpful in making its decisions regarding the disclosures it chooses to give to comply with the requirements of IFRS 13, and that information which is given in order to communicate the uncertainties inherent in the valuation to compilers and auditors. Indeed, as the TIP will have wider application than just financial reporting it may be desirable to reduce the number of references it makes to IFRS 13.
7. The definition of "Valuation Uncertainty" includes the phrase "within the same market environment". We are concerned that this is capable of being interpreted too widely. We consider that the language of IFRS 13, which has been well developed for this purpose, might

be preferable. IFRS 13 refers to the ‘principal market’ or, failing that, the ‘most advantageous market’. We suggest that this phraseology should be used in the definition.

8. We do not entirely agree with the concepts surrounding the definition of “Market Uncertainty”: any concept that markets are unstable or erratic implies that markets will at some stage achieve perfect stability. It is our view that markets have a tendency to be unstable.

RESPONSES TO SPECIFIC QUESTIONS

Q1: The proposed TIP defines valuation uncertainty at para 7.

Do you agree with this definition? If not, how do you think that it could be improved?

9. We do not agree with the distinction between the definitions of “Valuation Uncertainty” and “Uncertainty Risk”. We consider that “Valuation Uncertainty” as defined includes “Uncertainty Risk” for the valuer and the users of the valuation.

We also do not agree with the definition of Valuation Uncertainty in para 7; the term ‘market environment’ is ambiguous and we suggest it might be better for this definition to be more closely linked to the market definition in IFRS13 (which is principal market or alternatively the most advantageous market). The valuer is engaged to provide his opinion on the value based on the actual market environment. IFRS 13 does provide guidance regarding the choice of market when there is more than one.

The terms “Market Uncertainty” (if it is to be included) “Model Uncertainty” and “Input Uncertainty” are needed in the list of definitions. There are also several places in the text where the defined term is being used but there is a lack of clarity as it is not capitalised in the text. Examples are in paragraphs 17 and 18.

Q2: Various prudential regulatory authorities either have or are contemplating introducing disclosure requirements for assets that are deemed to be subject to “valuation uncertainty” and to apply different risk weightings to these in capital adequacy regulations for banks and other financial institutions. The Board has decided to exclude prudential valuation adjustments for valuation uncertainty from the scope of this guidance. The reason is that the IVSC is only concerned with proper valuation practice, not with how valuations are then used by the recipient in complying with other standards, laws or regulations. Do you agree with the Board’s decision to exclude prudential valuation adjustments for valuation uncertainty from the scope of this guidance?

10. We are in agreement with the Board’s decision to exclude prudential valuation adjustments for valuation uncertainty from the scope of this guidance.

Q3: The proposed TIP provides guidance on the distinction between valuation uncertainty as defined in the paper and risk, in particular between market uncertainty and market risk. It was clear from comments received on the Discussion Paper and made elsewhere that the concepts are regularly confused. Some believe that the brief explanation of market risk in paras 16 and 17 is not needed given that the focus of the paper is on uncertainty rather than risk. Others consider that the inclusion of a brief illustration of market risk helps readers understand the distinction between this and market uncertainty. Which of these views do you support?

11. The illustration is a helpful tool to understand the distinction. Indeed, further explanation would be helpful.

12. We do not agree with the concept of separating Market Risk and Market Uncertainty. We do not consider that the definitions of Market Risk and Market Uncertainty are helpful – if a fixed income bond is illiquid, is this Market Risk or Market Uncertainty? Market Risk should be reflected in the price.

The distinction between the definition of Uncertainty Risk and Valuation Uncertainty is also not clear.

To reduce the prospect of confusion in terminology we suggest that several of the definitions should be reconsidered: for example, if the distinction between Market Uncertainty and Market Risk is to be retained, these could perhaps be defined as “Present Market Risk” and “Future Market Risk” as this appears to be the distinction between the two.

Q4: The paper identifies three main sources of valuation uncertainty: market uncertainty, model uncertainty and input uncertainty.

Do you agree that these three categories represent the main sources or causes of valuation uncertainty as defined? If not please explain why, and in particular identify any other source of uncertainty that is not mentioned.

13. As mentioned above, Market Uncertainty is defined in the proposed TIP as arising when markets are “disrupted”. Allowing for the inability to predict the future, we believe that markets have a tendency to be unstable. A market can be relatively volatile for the reasons set out in the proposed TIP, but the prices paid might still be considered relevant market data on which a valuer should rely. All market conditions should be considered including prices and risks, and . refer to the volatility inherent in the market. This would assist the valuer in assessing how a buyer would factor future fluctuations into the price. In fact considering the impact that a less volatile market would have on value might be a way to quantify this particular uncertainty. We are concerned that the proposed TIP leads a valuer away from the underlying market transactions that should support all valuations.

Q5: The proposed guidance indicates that because market uncertainty arises when the impact of events on value is unknown it is identifiable but not measureable. In contrast, model and input uncertainty can be both observable and measureable.

Do you agree with this position?

14. We agree with this position, but disagree with the concepts surrounding Market Uncertainty (as explained above under paragraphs 8, 12 and 13).

Q6: The requirement in IVS 103 is to disclose any material uncertainty that affects the valuation. Paras 29-39 of the proposed TIP provide guidance on identifying when uncertainty is material, with reference to the requirement in IFRS 13 for valuations for financial reporting and more general guidance where valuations are for other purposes.

Do you find the guidance on materiality to be helpful? Are there any improvements or other considerations that you would suggest be included?

15. Paragraphs 31 and 32 are not helpful. We do not support use of the word “material”, as not only could this be confused with audit materiality (which is not part of the valuer’s scope of work) but also it could require the valuer to understand fully the impact of the uncertainty on the user of the valuation. “Significant” might be a better term than “material”. Whichever term is used, we are also concerned that asking the valuer to consider the effect of any uncertainty on the users adds significant risk to the valuer without the valuer being aware of the full context for the valuation. It is useful for the report to distinguish uncertainty that is fundamental to the valuation due to its incidence or magnitude. Any valuation undertaken using Level 3 inputs is likely to incorporate considerable uncertainty. The reporting of fundamental uncertainty

therefore should be in respect of matters which fall outside the normal uncertainties inherent in a valuation using Level 3 inputs.

We consider that if valuers are required to give an opinion on materiality to the users and to provide an upper and lower end of a materiality range, this would add a significant amount of time to the work involved. We are also concerned (for the reasons given in the proposed TIP) with providing such a range of value. We wonder to what extent clients will be willing to pay for this additional time, not only for the valuers but also for the auditors reviewing those valuations. We question what will be served by providing such a wide range in addition to a point value. In light of these difficulties it may be better to simply remove paragraphs 30 to 32.

We recognise that paragraph 93(h)(ii) of IFRS 13 requires disclosure of the effects of a “reasonably possible alternative assumption”. In practice it is our experience that valuers provide a point value to the client, possibly together with a matrix showing the sensitivities of differing assumptions. We have not encountered situations in which the valuers have been required to provide the additional information needed for a reasonably possible alternative assumption.

Q7: Para 42 sets out matters that it is recommended be included in a qualitative disclosure of uncertainty.

Do you agree that this identifies the matters that should normally be included in a disclosure of uncertainty? If not please indicate any additional matters that you consider should be included or any matters mentioned that should be excluded.

16. We do not agree that this communicates matters that are normally included in a disclosure of uncertainty.

Quantitative vs. qualitative measures; we do not believe that qualitative disclosures are particularly helpful. The quantitative measures suggested will add a significant amount of work and risk to the valuer as they will not only have to opine on a value, but also the top and bottom end of a “material” range, if opinions are to be given on the range in addition to the point value. In communicating uncertainty it might be better for the approach used by actuaries (when reporting on liabilities in defined benefit pension schemes) to be followed. This would entail the valuer stating the effect on value of a set percentage (say 5 or 10%) change for each input and will require only a calculation for information purposes rather than an explicit opinion.

Valuers should not be expected to give opinions on what might be a “material range”.

Q8: Para 47 suggests that model and input uncertainty may be more readily measureable for financial instruments than for other types of asset.

Do you have experience of quantitative measures of valuation uncertainty for tangible or intangible assets being disclosed in reports? If so please indicate the types of asset and the techniques used to quantify the uncertainty.

17. For tangible fixed assets the key quantitative measures that are subject to uncertainty are depreciation rates and shape (curves, lines or other) and useful economic lives.

Q9: Para 51 sets out proposed principles for quantitative measures of uncertainty.

Do you agree with this list? If not please indicate any additional principles that you believe should be included or any listed that you believe are inappropriate.

18. As mentioned above, we do not consider that it is helpful to users for the valuer to give opinions on quantitative measures.

19. We consider that there is recognition of relative uncertainty within IFRS 13, within the hierarchy of Level 1, Level 2 and Level 3 Inputs. Therefore any valuation for financial reporting purposes undertaken using Level 3 Inputs carries with it the uncertainties that are inherent in the use of such inputs. The valuer could perhaps communicate the generic uncertainty by emphasising the level of inputs that is being used (as referred to in the answer to Q7 (paragraph 16)).
20. A further point worth noting is that in those situations where a valuation is being carried out for IFRS 13 purposes, it is important that this is consistent with the 'unit of account' for financial reporting purposes (IFRS 13.69). In this context, the last bullet of para 51 of the exposure draft alludes to valuation of a portfolio. However we note that IAS 39/IFRS 13 normally sets the unit of account as each individual investment. Only in limited cases would the unit of the account become the portfolio (IFRS 13.48).

Q10: It is proposed that the final TIP will include a few simple illustrative examples of uncertainty disclosures to assist readers understanding how the guidance may be applied in practice. The Board has decided not to develop these until it has received comments on the principles in this draft. The Annexe to this draft contains an indication of situations for which examples are being considered.

Do you agree with the Board's proposal to include illustrative examples of typical disclosures? If so, please indicate the situation for which you consider an example would be most useful.

If you have an example of either a disclosure or measurement of valuation uncertainty that you would like the Board to consider for inclusion in the final paper, please include this with your response.

21. Yes, this was the most helpful part of the proposed TIP. We believe it would be useful for more examples to be given.

This is the type of sensitivity table that we are most familiar with:

		Terminal Growth Rate								
		1.50%	2.00%	2.50%	3.00%	3.50%	4.00%	4.50%	5.00%	5.50%
2011-2014 Annual Growth Rate	1.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value
	2.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value
	3.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value
	4.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value
	5.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value
	6.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value
	7.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value
	8.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value
	9.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value
	10.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value
	11.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value
	12.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value
	13.00%	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value	#Value

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