ICAEW REPRESENTATION 46/14

RESPONSE TO IVSC EXPOSURE DRAFT: ILLUSTRATIVE EXAMPLES: CHAPTER 1 – BASES OF VALUE

ICAEW welcomes the opportunity to comment on the exposure draft: *Illustrative Examples: Chapter 1 – Bases of Value* published by IVSC in January 2014, a copy of which is available from this link.

This ICAEW response of 31 March 2014 reflects consultation with the ICAEW Valuation Group, which is the voice of valuers within ICAEW and draws together views of valuation experts from the business and public practice communities.

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MAJOR POINTS

1. We consider that the term 'fair value', with different meanings under IFRS, English Law and these standards, will be a source of ongoing confusion regardless of the clarity of explanation offered within these examples. We would welcome an opportunity to participate in any debate to resolve this and express hope that the IVSC will open up the question in due course.

2. We recognise that the definitions within the Framework of 'Special Value' and 'Synergistic Value' are dealing with particularly complex matters. While we consider that the theoretical bases put forward within the IVS are clear and explained well in the Illustrative Examples, we consider that the relationship between these bases of value and a concept prescribing that value based on the optimal use for an asset within the wider market such as Highest and Best Use (H&BU) would benefit from some examples that included both ideas. In certain cases we can see that the optimal use for an asset will frame the market negotiation being envisaged in the IVS. In other cases different uses will motivate different buyers within the market negotiation. In the former, H&BU (or equivalent) is not a factor in determining either Synergistic Value or Special Value. In the latter, the idea of H&BU (or equivalent) may be part of Special Value. For example, the current owner may use the asset as an industrial site, but the buyers would use the asset for a residential development.

3. The examples shown do not consider what would happen if the investment value to the seller is higher than the market value, including the market synergies. Following the document it is difficult to envisage a theoretical transaction between a willing buyer and a willing seller occurring under these circumstances, but in practice we do face this situation. We consider that an example setting out this potential occurrence would be useful.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Do you consider the differences among the IVS bases of value have been adequately illustrated? If not, what additional illustrations might be helpful?

4. With the addition of the points noted above, it is our opinion that the different bases appear to have been adequately explained. For completeness we set out below our understanding of what is meant by each of the terms following a review of the Illustrative Examples. If we are mistaken in any of these, then the examples may need amendment or further explanation.

   - **Investment Value** = Value to seller or Value to acquirer
   - **Price** = Price Paid but not necessarily equal to Market Value
   - **Market Value** = Value available to a body of market participants (eg, if market synergies of 10 and Seller **Investment Value** = 100, **MV**=110. This 10 equals **Synergistic Value**. If the acquirer has an extra 20 of synergies unique to it, its **Investment Value** is 130). Market Value is very similar to IFRS fair value save for specific rules prescribed by IFRS (para 29)
     - The extra 20 of unique synergies is the **Special Value**
     - If in the deal, a price was agreed so 5 of the potential **Special Value** were paid away the Price = 115 (ie, Market Value of 110 + 5 synergies paid away), and the **Special Value** element of the transaction is 5, being the 5 of unique synergies, but MV would remain as 110.
   - In an actual arm's length transaction **Fair Value (IVS) = Price**
   - In the absence of an actual transaction, **Fair Value** is a hypothetical value that falls in a range of values starting at the Investment Value of the owner and ending at the Investment Value to the buyer; it is for the valuer to determine where that may lie (please note our query on this point in response to Question 5 below).

   Paragraph 1 of Example 1 lists a number of market data points that a valuer might gather. As a minor point, while the list is not meant to be exhaustive, it omits what we might consider to be a key data point – sales of equivalent assets in the market.

Q2: Do you perceive any issues or unintended consequences arising from any of the illustrations? If you do, please explain what these are.

5. As noted above, we consider that the inter-relationship between e.g. H&BU (especially where buyers and sellers have different use for the asset), the market participant synergies, and special value deserves an extended analysis.

Q3: Do you consider that there are any other differences between Market Value and IFRS 13 Fair Value that should be discussed and illustrated?

6. We consider that it is helpful to identify the three issues raised in paragraph 29 of the Exposure Draft. However, as noted above we would like to see a move to harmonise the terms to avoid inevitable confusion outside of the accountancy and valuation professions.

Q4: Does the term 'arm's length' in the Market Value definition need explanation?

7. It is our opinion that this term is used sufficiently broadly to be generally understood. We therefore do not consider that further explanation is needed.

Q5: Do you find the graphics in the document helpful in understanding the relationships between the bases of value and other pertinent concepts?

8. We would like further clarity on figure 3. This appears to suggest that Fair Value (IVS) could lie anywhere from nil to the Investment Value to buyer (arrow on LHS). We read from the examples that the lower limit for Fair Value (IVS) would be set by the lower limit of Investment Value to owner and Market Value. If we are correct in our interpretation of the standards then we consider Figure 4 needs amending. (We note that if Fair Value is seen as potentially lying below Investment Value to owner (because, for example, the buyer was exceptionally good at negotiating, or the owner was not aware of the value of their asset), then it is just as valid to assume that Fair Value could exceed Investment Value to buyer just as easily.)

9. We do not understand the point being made in figure 4 and we do not find figure 4 to be helpful.

Q6: Below are examples of other topics within the scope of the Illustrative Examples project which the Board is planning to cover in future chapters:

- **Market Participants**
- **Market**
- **Proper Marketing**
- **Forced Sales**
- **Assumptions and Special Assumptions**
- **Aggregation and Unit of Account**
- **Highest and Best Use**
- **Transaction Costs**
- **Valuation Date**

Please indicate the perceived priorities from this list and if there are any additional concepts or issues within the IVS Framework that you believe it would be helpful to address.

10. Within the idea of Forced Sales, we think that sales of distressed assets merit extended analysis. We also note again our view that a description of the relationship between optimal use and the bases described in the IVS would warrant further analysis, either within this document or a separate chapter.