

Monday, 14 October 2019

IPSASB
277 Wellington Street West
Toronto, ON M5V 3H2
Canada

Dear Sir/Madam,

Re: Consultation Paper – Measurement

Liquid Pacific is a valuation practice that specialises in the provision of asset valuations for inclusion in financial statements. Our primary client base is Government at all levels across Australia. We are practicing members of the Australian Property Institute and the Royal Institution of Chartered Surveyors.

We thank the IPSASB for the opportunity to provide a submission on this topic. On reading the 'measurement' consultation paper, our concern was immediately drawn to the topic of fair value and market value. In sections 2.19 to 2.24, the paper raises a number of queries regarding the concepts of market value and fair value. The inference from these sections is that market value and fair value are different as fair value forces the analyst to consider only the value of an asset from the sellers perspective (exit price).

We disagree with the IPSASB assertion that market value and fair value are different from each other and that the primary point of difference is that IFRS 13 mandates an exit price. In the valuation profession, **market value has always been an exit price**. The underlying assumption in the definition for market value, as with the fair value definition, is that both parties to the transaction accept the selling price is the market value.

Market Value – International Valuation Standards

“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.”

In layman’s terms, market value has always been ‘the most likely selling price’. Further, it is generally accepted by the valuation profession, in Australia at least, fair value and market value are one in the same.

As acknowledged, previous definitions of fair value were aligned with the market value definition. When IFRS 13 was introduced to Australia as AASB 13, we queried the Australian Accounting Standards Board as to why the wording in the definition of fair value had changed from its obvious market value similarity. We were advised the IASB wanted to stress to the accounting/finance industry and users of financial statements that fair value did not reflect a buy-in price, so the use of the term *‘the price that would be received to sell’* in the current definition (i.e. the selling price, not the purchase cost) was introduced.

As explained to us, it was evidenced the initial definition contained in IAS 16 (AASB 116) was being misunderstood and incorrectly applied.

As the fair value definition simply stated *the amount for which an asset could be exchanged between ... willing parties*, many practitioners and users of financial statements automatically assumed themselves to be the buyer of an asset in the market and immediately defaulted to a replacement cost approach, potentially ignoring secondary markets where assets might be traded.

The intention, as we were advised, was not to change the meaning of fair value as it equates to market value, but rather strengthen the definition as a market value in an attempt to plug the conceptual gap which was being created by the accounting profession.

In instances where assets are readily traded, the entry price concept still provides a market value as long as the analyst refers to the correct markets. We stress, the term 'entry price' does not exist in the valuation industry and for the reason stated above, market value is an exit price.

The issue then arises for the public sector when not all assets, due to their uniqueness, can be purchased in trading markets. Thus IFRS 13 went one step further to expressly state fair value has to be the selling price, and where markets don't exist, assume they do and adopt the same considerations willing buyers and willing sellers would if they also existed in that hypothetical market. In simple terms, the approach to valuation for unique assets is to establish the cost to replace the asset, and then adjust that cost if necessary to reflect what market participants would consider when transacting the asset (i.e. willing buyer, willing seller). This approach is referred to as the cost approach.

For the valuation profession, the cost approach is the least desirable approach to valuation as it relies on a general interpretation of the market, rather than direct transactions of same or similar properties. However, the cost approach is a market-based approach and as with the direct comparison approach and the income approach, its objective is to reflect an asset's market value.

The valuation profession centres around the principle an asset has a value which can be formulated using one (or a combination) of three valuation approaches and, under the same assumptions, an asset can have only one market value at the time of valuation.

There are three primary approaches to valuation. The choice of valuation method is intended to reflect the type of asset being valued and the market in which it exists. This is not always an easy task and it can take years of experience before valuers gain the market insights required to get this combination correct.

The following is a fundamental concept of the valuation profession.

Market Value = Direct Comparison* = Income Approach = Cost Approach

* The IVSC refers to direct comparison of transactions as the 'market value approach'.

Theoretically, all valuation approaches are expected to produce the same valuation outcome, remembering that at any point in time and using the same assumptions, there can only be one market value for an asset. Each method requires different inputs but in a perfect world of full knowledge, the valuer would be able to identify all the relevant inputs for each method and arrive at exactly the same opinion of value. Because this does not happen does not mean there is more than one market value, simply the valuer has not been able identify all the relevant inputs required of each method used. In the valuation profession, it is best practice to use more than one method of valuation (back-up method) to justify your valuation. In fact, many lending institutions will insist on it.

IPSASB – Measurement

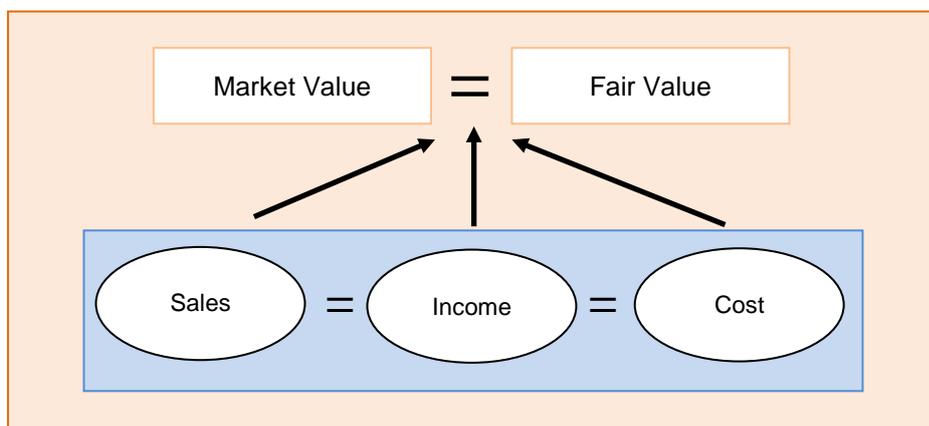
Invitation to Comment

As an example, a valuation of an office may utilise the income approach to valuation deriving a capitalisation rate (or discount rate for DCF analysis) with reference to initial yields of similar properties which have recently sold. Further, the valuer may also adopt the direct comparison approach as their back-up methodology, analysing the sale rate per square metre of the improvements for transactions of similar properties. It is most probable, at the first attempt; the two approaches will have different outcomes. **This does not mean there are two market values**, simply that one or both of the approaches adopted have not incorporated all the relevant inputs.

It then falls to the valuer to analyse further the market in an attempt to refine existing inputs or to uncover other inputs which may impact value and explain the differences. If this is ultimately not achievable, the valuer may adopt one of the valuation outcomes as the most appropriate value or make adjustments to both values to firm their opinion.

Having regard to our comments above, Liquid Pacific is of the opinion there exists no difference between the concepts of market value and fair value, and consequentially the approach to the valuation of each is identical. This leads us to the following valuation conclusion.

Fig 1. Valuation Conceptual Framework



Again, thank you for allowing us to provide our thoughts on what is a very important topic, not just for the public sector but all reporting entities. We would welcome further discussion on this matter and encourage any interested party to contact us at their convenience.

Yours faithfully

.....
Martin Burns

Director: Liquid Pacific
Chartered Valuer, RICS,
Certified Practising Valuer, AAPI

.....
Position

