

IVSC Commercial Forestry Project

The International Valuation Standards Council (IVSC) is an independent, not-for-profit, private sector organisation that has a remit to serve the public interest. The IVSC's objective is to build confidence and public trust in the valuation process by creating a framework for the delivery of credible valuation opinions by suitably trained valuation professionals acting in an ethical manner.

The IVSC achieves this objective by:

- (a) creating and maintaining the International Valuation Standards (IVS);
- (b) issuing technical guidance for professional valuers; and
- (c) promoting the development of the valuation profession and ethical practices globally.

The IVSC Standards Board has resolved to undertake a project to consider the need for a new IVS and/or revised guidance and then to develop the necessary documents following the IVSC Due Process procedures. The proposed scope will include the valuation of standing timber and land for the growing of timber. It will generally exclude matters that are the subject of an existing IVS except where there are additional or different considerations that are specific to forestry operations.

This paper describes the background to the project, identifies some matters that Board believes need to be addressed the proposed brief for the project.

The IVSC wishes to form a working group to progress the project. This will ideally include individuals with different perspectives on the valuation of commercial forestry assets, for example:

- expertise in preparing valuations of interests in commercial forestry,
- experience of standard setting in the sector,
- users of valuations (including preparers and auditors of financial statements that include valuations),
- having a regulatory or oversight interest in valuations.

Nominations for membership of the working group are invited no later than 12 August 2011. An application form and further details can be obtained from the IVSC Technical Director, Chris Thorne by email cthorne@ivsc.org.

At its meeting in October 2010 the IVSC Standards Board agreed that it would undertake a project to consider the development of an International Valuation Standard and associated guidance for commercial forestry. The project has been held pending the completion of the Standards Improvement Project but the Board now wishes to proceed.

BACKGROUND

Institutional investors are becoming increasingly attracted to forest land as an asset class, seeing such assets as offering an alternative and sustainable long-term investment strategy. Forestry is attracting new strategic investor interest as wood-based biomass is seen as a vital renewable energy resource.

In 2009 PricewaterhouseCoopers (PwC) issued a report on a study it had undertaken, *Application Review of IAS 41, Agriculture: the Fair Value of Standing Timber*. This report found that in the five years that had passed since IAS 41 *Biological Assets* had been in use major questions had arisen about how the standard is being applied to forest assets. Fair value implies a market based value and whilst there are markets around the world for the harvested products of forest, markets for standing timber are limited in comparison with the total volume of standing forest.

The PwC study highlighted various approaches to the application of the fair value requirements of IAS 41 to standing timber, and in related disclosure practices. Several companies make extensive disclosures which supports transparency to the users of the financial statements. However, often the reasons for the fair valuation approach selected are not explicitly discussed, meaning that users may not appreciate the judgments and related uncertainties that are inherent in the valuation of forest assets.

The report concluded that there is room for further improvement with regard to the level of the transparency of critical valuation assumptions especially given that the overwhelming majority of standing timber valuations are site specific. It recommended an enhanced discussion in financial reports on price assumptions used in DCF calculations and sensitivity analysis as regards the most significant value driving assumptions.

The Association of Consulting Foresters of Australia (ACFA) published an 'Australian Standard for Valuing Commercial Forests' in 2004 and updated this again in 2009. The Australian Standard was based on an earlier standard produced by the New Zealand Institute of Forestry. Initial research suggests that these are the most comprehensive standards and guidance produced specifically for commercial forestry.

The Australian standard is stated to be for valuations including, but not restricted to, forest valuations required under the Corporations Act 2001, and forest valuations which require adherence to the AASB's accounting standards. The ACFA standard makes no reference to IVS. It is heavily orientated towards financial reporting with a lengthy discussion on the requirements in Australian Accounting Standards, which are effectively the same as IFRS. It also contains a description of and discussion on the use of different methods. Although similar to methods described in IVS, there are differences in terminology. There is also a considerable section on "present value calculation" which includes guidelines on applying the methods identified.

THE IVSC PROJECT

It is anticipated that valuations in the sector will be found to present some unique challenges when compared with other asset classes. These will include, but be not limited to:

- Trees grow thus potentially increasing the yield over time.
- Management of the forest has a material effect on yield.
- The evaluation of risks that can impact on yield, eg climate fluctuations, disease, pests etc
- Costs of regeneration and/or restoration of woodlands after felling.
- Impact of environmental legislation on production and demand of timber products.
- Identifying common metrics for quantifying extent of resource.
- Allocation of value between land and trees (required for accounting purposes)
- Differences in land quality and suitability
- Impact of potential alternative uses for land on value of trees.

The overall brief of the project is to:

1. Consider the need for and if appropriate develop an Asset Standard for commercial forestry.

An IVS Asset Standard consists of a standard and a commentary. The standard sets out requirements that either modify or augment the IVS General Standards and include illustrations of how the principles in the General Standards are generally applied to the particular asset class. The commentary provides additional background information on the characteristics of each asset type that influence value and identifies common valuation inputs, approaches and methods.

2. Consider the need for and develop any associated guidance to support the standard and publish as a Technical Information Paper (TIP).

An IVSC TIP provides authoritative but non-mandatory guidance designed to be of assistance to valuation professionals and informed users of valuations alike. It can examine methods identified in a Standard in greater depth and illustrate their application. A TIP guides rather than instructs. It does this by providing information that is helpful to practitioners in exercising the judgements they are required to make during the valuation process, but should avoid anything that would restrict the proper exercise of that judgement by the imposition of inappropriate rules. A TIP should not direct or require the use of a particular method in specific circumstances but can include discussion of factors that should be considered when deciding which method it is appropriate to use. A TIP should also focus on practical issues rather than underlying theory and as such is not intended to provide comprehensive training or be an educational document.

It is suggested that the first stage of the project should involve the Working Group considering the following:

- Identifying characteristics of commercial forests that create the need for specific valuation considerations, enquires or techniques.
- Whether there is consensus on acceptable valuation assumptions and input data verification procedures for different valuation purposes.
- An examination of existing national codes such as those produced by the ACFA, the New Zealand Institute of Forestry and any other nationally focused standards on the topic to identify matters that may usefully be carried forward into either a future IVS Standard or TIP.
- Identifying common valuation methods used in the sector, developing guidance on those methods and matters that need to be considered in their application.
- Identifying any known valuation practices that are considered inappropriate.
- The need to create a standard supplementary to the current IVS to reflect the particular challenges of valuation in the sector.
- Developing a skeleton of a possible new IVS Standard and a possible new TIP for referral to the IVSC Standards Board.

The first task of the Working Group will be to review this proposed scope and make any recommendations for significant changes considered appropriate to the Board.