

# AGENDA PAPER

IFRS Advisory Council Meeting

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TOPIC *Interaction of International Valuation Standards and IFRSs*

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This paper has been prepared for discussion at a public meeting of the IFRS Advisory Council. The views expressed in this paper are those of the authors. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS.

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## **Interaction of International Valuation Standards and IFRSs**

1. Presentation from the International Valuation Standards Council is attached.



## **INTERNATIONAL VALUATION STANDARDS COUNCIL**

Presentation for the meeting of the IFRS Advisory Council on 14 and 15 October 2013.

**The paper is in two parts:**

**Part 1** An Introduction to the IVSC

**Part 2** Interaction of IFRS and International Valuation Standards

## Part 1

# An introduction to the International Valuation Standards Council (IVSC)

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 has the following roles:

- to develop globally recognised and accepted standards for valuation for all classes of assets and liabilities
- to foster the development of the valuation profession globally.
- to collaborate and cooperate with other international organisations involved in financial regulation; and
- to serve as the international voice for the valuation profession.

The overriding objective behind all of these activities is to protect the interests of the direct and indirect users of valuation services.

## IVSC technical work programme

Acting in the public interest, the IVSC produces both technical and professional standards for valuation. Technical standards include generally accepted principles of valuation and procedures for the undertaking of valuations. Professional standards include establishing codes and benchmarks for the conduct and competency of professional valuers.

Recent publications issued by the Boards include:

- 2013 edition of the International Valuation Standards (IVSs)
- Supporting Technical Information Papers on Discounted Cash Flow, Cost Approach for Tangible Assets, and Valuation of Intangible Asset
- Code of Ethical Principles for Professional Valuers
- Competency Framework for Professional Valuers
- Discussion Paper 'Establishing International Professional Standards for Professional Valuers'

Projects in the current technical work plan include:

**Valuation Uncertainty** – Identification and disclosure of uncertainty affecting valuation conclusion

**Derivatives** – commonly accepted valuation methods and their use

**Extractive Industries** – updating and harmonisation of valuation practice

**Trade Related Property** – the valuation of real property designed for a specific type of business

**Specialist Public Sector Property** – valuation of specialist assets held for public service rather than commercial purposes

**Credit and Debit Valuation Adjustments** – identifying best practice in measuring adjustments to reflect changes in counterparty and own credit risk

**Forestry** – establishing best practice for the valuation of commercial forestry assets

**Liabilities** – establishing best practice in the valuation of liabilities other than those arising under a contract such as a financial instrument

**Investment Property** – updating and harmonisation of valuation practice

**An Audit Guide for Valuers** – guidance for valuers on the audit process and procedures for working with auditors

**Development of International Professional Standards** – establishing common competency and behavioural requirements for professional valuers between different professional bodies

**Illustrative Examples** – a series of examples to illustrate the proper application of the principles in the IVSs in different contexts

## Collaboration and cooperation

The IVSC maintains a dialogue with other organisations involved in financial regulation in order to monitor emerging trends that could affect valuation practice, to ensure that the role of valuation is properly understood and to identify areas where cooperation is mutually beneficial. Examples include:

- The IVSC has regular contact with the World Bank and IMF. In June 2013, the IMF hosted a meeting between the IVSC and the other major national valuation standard setters to discuss progress towards the objective of a single set of international valuation standards.
- Between 2007 and 2010 the IVSC was a member of the FASB “Valuation Resource Group” set up to advise on practical implementation issues arising from the introduction of FAS 157 Fair Value Measurement. The IVSC was the only non US firm or body represented on this group, and was invited because the FASB recognised the need to ensure that its work on fair value measurements had both a global perspective and consistency with recognised valuation practice outside the field of financial reporting.
- The IVSC maintains regular contact with global financial regulatory bodies, including IOSCO and the Basel Committee on Banking Supervision. It also engages with regional bodies such as the European Banking Authority and the European Securities and Markets Authority as well as with individual national regulators.
- The IVSC currently has memoranda of understanding with the International Federation of Accountants, the Appraisal Foundation and the International Private Equity Valuation Board, each identifying specific objectives where cooperation will achieve mutual benefits and enhance the understanding and practice of valuation.
- The 2013 Report on Capacity Building Measures to Strengthen and Develop Financial Systems issued by the Advisory Group on APEC Financial System Capacity-Building for consideration at the APEC Finance Ministers meeting recognises the contribution of valuation to the development and stability of financial systems and the work of the IVSC. The Advisory Group is now considering how it can support the development of high quality valuation, ethical, educational and related quality assurance and disciplinary standards based on global benchmarks.

## **IVSC strategic agenda**

Currently our three major strategic objectives are:

- 1 to promote the use and rigorous application of a single set of globally accepted International Valuation Standards;
- 2 to enhance the standards by the development of guidance on the valuation of financial instruments; and
- 3 to encourage the development of the valuation profession globally.

### **Adoption of the IVSs**

The IVSC is engaged in a programme to actively promote the wider recognition and adoption of its standards, or where statutory standards exist, to secure convergence of these with the IVSs. An initial meeting of the major valuation professional standard setters and institutes was held in June 2013 when all agreed in principle to the goal of a single set of global valuation standards. A second meeting is to be held in October to examine any differences between existing standards that could create obstacles to achieving this goal.

### **Financial Instruments**

Given the widely recognised role that either inappropriate valuation practice or poor understanding of valuation practice had in the 2008 crisis and the absence of recognised valuation standards in this sector, the IVSC Trustees have been actively seeking the support of the Financial Stability Board and other bodies concerned with financial regulation and stability for an initiative aimed at increasing the recognition of both the need for valuation standards and that these should be consistent internationally.

### **Developing the Profession**

The greatest challenge is the lack of strongly developed professional infrastructure for valuation specialists in many sectors. Real estate and other tangible assets are reasonably well served but there are relatively few professional bodies primarily concerned with the valuation of businesses and intangibles. There are virtually no professional bodies focussed on the valuation of derivatives and other financial instruments. With no recognised common benchmark for becoming a professional valuer in many jurisdictions, individuals or firms with no formal training or credentials can describe themselves as such. A lack of any professional infrastructure – whether self-regulated or based on statutory requirements – creates a significant risk for those who rely on valuations for decision making.

The IVSC Professional Board is engaging with the established valuation professional organisations with the aim of bringing about harmonisation of core education requirements, professional conduct and ethics and effective self-regulation and to encourage common accreditations. It is also developing material to help new professional organisations develop in sectors or countries where there is currently little or no professional infrastructure.

## IVSC governance

The IVSC is a not-for-profit corporation, registered in Illinois and, with the support of the City of London Corporation, with its headquarters in London. It is a membership-based organisation with various categories of member. The Board of Trustees is responsible for governance of the organisation, for its strategic direction and for the appointment of the members of the Standards Board and Professional Board. The Trustees otherwise have no part in the decisions of these Boards.

The diagram in Appendix 1 gives an overview of the structure of the IVSC.

Membership of the IVSC is open to a wide range of stakeholders including professional institutes, valuation providers, standard setters, regulators of valuation services and academia. The IVSC currently has 74 member bodies from 54 countries including some accounting bodies whose members provide valuation services such as the Institute of Chartered Accountants in England and Wales, Institute of Cost Accountants of India, Instituto de Censores Jurados de Cuentas de España, and Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili. An application by the American Institute of Certified Public Accountants will be submitted for approval at the IVSC 2013 Annual General Meeting in November.

A number of global accounting networks provide financial sponsorship to the IVSC. These include E&Y, Deloitte, KPMG, and Grant Thornton.

Further information on the IVSC is available on its website – [www.ivsc.org](http://www.ivsc.org)

## Part 2

# Interaction of IFRS and International Valuation Standards (IVSs)

Reliable and consistent valuation is critical for improved financial reporting. It is equally important as a starting point for establishing the capital adequacy of financial institutions, supporting lending decisions, pricing units in collective investment schemes and supporting corporate and other transactions. Inconsistent valuation practice and terminology creates uncertainty for those who rely on valuations and can lead to misunderstandings or inappropriate reliance being placed on valuations. Use of IVSs contributes to minimising this uncertainty and reducing risk thus contributing to wider financial stability.

Good and consistent financial reporting under IFRS requires good and consistent valuation. By adopting IFRS, countries addressed inconsistency in financial reporting standards and by doing so they exposed the next layer of inconsistency – valuation standards.

The IASB and FASB have produced aligned standards for fair value measurement. However, there is still a need for improved quality and consistency in the way in which the necessary valuations are undertaken. Global valuation standards support global accounting standards by ensuring that fair value measurements are produced consistently thus increasing cross border comparability and reducing risk of investors being misled by unfamiliar practices or terminology.

The Public Company Accounting Oversight Board in the USA reported that of 77 audits found to be deficient during 2010, 54 concerned fair value measurements. Other national audit regulators have reported similar concerns over apparent inconsistencies or questionable practice in the fair value estimates appearing in financial statements. The International Forum of Independent Audit Regulators has issued a summary report of audit inspections undertaken by its members across 46 different jurisdictions during 2012. This involved inspecting the audits of over 1000 public companies and financial institutions by over 100 different audit firms. This survey found that the most common theme that gave rise to adverse reports on the audit concerned fair value measurements.



Improved and more comprehensive valuation standards should assist auditors in the consistent application of IFRS. For example ISA 500 Audit Evidence recommends that one indicator of the reliability of any valuation submitted by an expert engaged by management is whether the expert is “subject to technical performance standards or other professional or industry requirements.”<sup>1</sup>

The IVSC believes that it is for the IASB to determine when fair value is a valid accounting measurement and to establish the basic criteria on which the estimate is to be prepared. However, the IVSC is the body best placed to determine how valuations should be undertaken due to its remit extending to valuations for many purposes other than financial reporting. It would be detrimental to the credibility of fair value measurements in accounting if it could ever be perceived that the figures were an artificial construct that applied only for financial reporting and that they did not reflect how values and prices were determined in the real world.

The IVSC and IASB staffs have been working increasingly closely together, keeping each other aware of progress on projects in which there is mutual interest. These currently include the valuation of financial instruments, liabilities, forestry and extractive industries. The IVSC also looks forward to working with IASB on the post-implementation review of IFRS 3 Business Combinations.

At present the IVSC perceives that there is confusion as to where accounting ends and valuation begins, and vice versa. It is clear from comment letters that the IVSC receives that many only see valuation in the context of financial reporting and cannot understand that the fundamental economic concepts of valuation apply for many other purposes. Others criticise the IVSC for producing standards that they see as inconsistent with provisions in the IFRSs, even if the intended purpose has nothing to do with financial reporting.

The IVSC is also aware that some of the IASB’s constituents are criticising it for not producing more to explain how fair value measurements are undertaken, being apparently unaware that many of these issues have been extensively debated and resolved by valuation professionals over many decades. As a result of this pressure, the IASB fair value measurement team, as part of the IASB’s education initiative, is developing educational material to support IFRS 13 with the assistance of a valuation expert group. Staffs are working to ensure consistency of any pronouncements made by either organisation, as is the vice chairman of the IVSC Standards Board who is a member of the group in his personal capacity.

The IVSC believes that there is a need for clarity as to the respective roles of the two organisations, how these complement one another and to confirm the areas of cooperation.

<sup>1</sup> ISA 500 Audit Evidence – para A36.

APPENDIX 1

