**8 June 2010**

**To: Members of the Hong Kong Institute of CPAs**
**All other interested parties**

## INVITATION TO COMMENT ON IVSC EXPOSURE DRAFT *PROPOSED NEW INTERNATIONAL VALUATION STANDARDS*

***Responses to be received by 20 August 2010***

The Hong Kong Institute of Certified Public Accountants' (Institute) Financial Reporting Standards Committee (FRSC) is seeking comments from constituents to the International Valuation Standards Council (IVSC) Exposure Draft on its proposed International Valuation Standards (IVS) which can be downloaded from the Institute's website at: http://www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/exposure-drafts/.

The IVSC project to improve its standards follows calls from global and national regulators for the standards of international valuation practice to be raised.

The proposed IVS cover valuations for most types of asset, including for the first time a proposed standard for financial instruments. The standards also reflect current developments in the International Financial Reporting Standards, which increasingly require assets and liabilities to be valued.

The proposed IVS are not endorsed by the International Accounting Standards Board or otherwise authoritative. However, IVS may become increasingly important in valuations and are being promoted as a source of authority and consistency in valuations.

--- An overview and questions for respondents is set out in the Appendix.

Comments are invited from any interested party, which should be supported by specific reasoning and should be submitted in written form.

To allow your comments to be considered, they are requested to be received by the Institute on or before **20 August 2010**.

Comments may be sent by mail, fax or e-mail to:

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Comments may be made available for public review unless otherwise requested by the contributor.

June 2010

**APPENDIX**

# INTERNATIONAL VALUATION STANDARDS COUNCIL

EXPOSURE DRAFT

PROPOSED NEW INTERNATIONAL VALUATION STANDARDS

## Overview and Questions for Respondents

Comments to be received by 3 September 2010

IVSC

INTERNATIONAL VALUATION STANDARDS COUNCIL

# Exposure Draft of Proposed New International Valuation Standards

# Overview and Questions for Respondents

## Chairman's Overview

On behalf of the International Valuation Standards Board (IVSB) I have pleasure in introducing this Exposure Draft of the proposed new International Valuation Standards (IVS).

This proposed new edition of the IVS is in fact the ninth edition, but those familiar with earlier versions will quickly notice that it is quite radically different in appearance, layout and structure. The more significant changes are discussed later, but for the benefit of those new to the IVS I first describe the principal objectives of the standards.

One of the first matters that the IVSB considered at the start of this rewrite project was for whose benefit are the IVS produced? The existing IVS are quite clearly aimed at "the valuer", with many instructions as to what that person should or should not do. This makes many parts of the current standards read like a professional body's rule book, in spite of the fact that the IVSC is not a professional body, has no individual members and no regulatory powers of its own. The Board agreed that the prime beneficiaries of standards are those who rely on valuation, for example investors, lenders etc. Also, of increasing importance in the wake of the recent financial crisis have been state and other regulators in the financial markets; valuation, or more accurately the lack of proper understanding of valuation, was identified as a significant contributory factor to the crisis and there is a need to demonstrate that there are effective and robust standards in place that are widely recognised and accepted.

In the light of this the focus of the new standards has been subtlety changed to address the subject of valuation rather than who does valuation. The objective is to make them accessible not only to valuation practitioners but also to their clients and any third parties who may rely on valuations. The new IVS aim to set out a clear specification of what matters should be addressed in the valuation process, provide some high level guidance on factors that influence value in different sectors and identify matters that need specific consideration when valuing for different purposes. If the IVS promote a wider understanding of good practice, those making financial decisions based on valuations can do so with greater confidence.

The IVS may be likened to a navigation chart. The chart will show the crew of a ship the starting and finishing point of the voyage; it will also show the safe channel and of hazards such as reefs and wrecks. However, it will not tell them exactly which course they must steer. That is still a matter for their skill and judgment depending upon their observations of variables such as the weather conditions on the day and the movements of other ships. Just as no chart will tell them how to react to these variables, the IVS cannot instruct valuers how to value within the overall framework that is set. Valuers must be able to react to the variables on a case by case basis.

To continue the analogy, any passengers on the ship can look at a copy of the chart and see that it gives enough information on how the ship can get to their desired destination safely by identifying hazards and setting other criteria for their safe arrival at port. That gives them confidence to step aboard. However, they cannot sail the ship; they are still reliant on the skill and experience of the crew to get them to their destination. The framework provided by the IVS is designed to give users of valuations sufficient understanding to provide them with confidence that a valuation is produced within recognised norms. However, the standards are not a training manual and the skill and experience of the valuer is still a vital component in ensuring that the result is as accurate as possible.

Because valuation often involves the use of mathematical techniques and has a result that is expressed as a number, some regard it as an empirical discipline and expect a set of standards to contain lists of approved methods and formulae to help people arrive at the "right" value in any given situation. However, while a vibrant debate on the merits of different methods is essential for the valuation profession as a whole, it would be wholly wrong for the IVS to endorse or approve one method in preference to another. Valuation techniques reflect market practices and market practices evolve. While the IVSC will publish technical papers and other education material to aid valuers, valuation methodology is outside the scope of these standards.

So what are the principal characteristics of a valuation standard? The standards in this proposed new edition generally meet have one or more of the attributes discussed below.

**Transparency of Process**

Identifying and then selecting the most appropriate inputs into a valuation model requires the exercise of judgement. The credibility of the result depends upon the recipient of the valuation believing that judgement has been properly exercised; in turn that requires an understanding of the key criteria used to inform the judgement and where subjective assessments have been made. The IVS therefore set requirements for transparency and disclosure from the outset of the valuation task to its conclusion. These are aimed at ensuring the most appropriate valuation hypothesis and procedures are used so that those reliant on the valuation have a better understanding of what it represents and the degree of confidence that can be attached to it.

**Defining the hypothesis**

In spite of the fact that mathematical tools are widely used in the valuation process, all valuations are ultimately based on a hypothesis. Setting the parameters of that hypothesis is an essential first step; the most sophisticated valuation tool will still fail to give the right answer if it is used to address the wrong question. One of the roles of the IVS is to identify different valuation hypotheses and their suitability for different valuation purposes.

**Promoting common terminology**

Because valuation techniques and skills have grown out of practices in diverse and fragmented markets, one of the major roles if the IVS is to identify and set commonly accepted valuation terms and promote their usage globally. In a global economy the potential harm to investors caused by inconsistent use of key valuation terms and concepts across both national and market sector boundaries is significant.

Although these characteristics have also been key components of previous editions of the IVS, it had become increasingly apparent that many of the key messages were becoming obscured as a degree of “mission creep” had allowed other topics into the standards. These new standards follow closely the recommendations made by the Critical Review Group that was set up by the former IVSC Standards Board in 2006-07 to look at ways in which the standards should be improved.

Apart from the change of focus referred to above, the major change that experienced users of the IVS will notice is that the volume of the proposed new standards is significantly reduced, something that many had been asking for. How has this reduction been achieved? The Board’s brief for the proposed new standards included the following changes:

**Eliminating repetition:**
In previous editions every time a defined word or term was used in an individual standard the definition was repeated. At most a definition will now only appear twice, once in standard which introduces and discusses the term and if, and only if, it is used in more than one standard, in the Glossary. Merging material that currently appears in different parts of the book, for example the discussions on market value appearing in GAVP and IVS 1, also revealed significant repetition of the same concepts.

**Eliminating Methodology:**
Two Guidance Notes in the current standards on the Cost Approach and Discounted Cash Flow are discussions on the use and application of specific valuation techniques that clearly fall outside the definition of standards. These papers are being reviewed by project teams set up by the IVSC Professional Board with the intention that updated and improved Technical Information Papers will be published later in the year.

**Eliminating the Code of Ethics**
The Critical Review Group recognised that the IVSC is not a professional body accrediting or regulating valuers and therefore cannot impose a behavioural code on individuals. Indeed, valuers in different sectors are regulated to a greater or lesser degree in different ways, sometimes by state licensing schemes, sometimes by self-regulating professional bodies, sometimes by their employers and sometimes by a combination of these. Including a Code of Ethics in the IVS sent a confused message to those outside the valuation profession as to what the standards represented. The Code of Ethics has therefore been eliminated – although the IVSC Professional Board has the development of a model Code of Ethics to assist the development of the profession in emerging economies as part of its agenda.

**Reducing the Glossary**
In the current edition of the IVS the Glossary accounts for over a quarter of the book. Apart from terms being included that did not appear in the standards, the Board also considered that the existing standards suffered from over definition. A consequence of this was to create drafting problems when the best words to use to describe a situation had already been defined in a restricted way elsewhere in the standards meaning that alternative words had to be used that compromised clarity. Another feature was the many superfluous definitions where the IVS definition was no different to the common dictionary meaning of the word or words.

To be a defined term in the proposed new standards a word or phrase has to be used in the standards in a special or restricted way that differs from its normal usage. Such defined terms appear only in the standard to which they relate unless they appear in more than one standard; where this is the case they will also appear in the Glossary. Applying this rule has reduced the Glossary from over ninety pages to less than three.

**Reducing Prescription**

In the existing standards there has been a tendency in some parts to descend into a level of detail, for example on reporting requirements, that is inappropriate in a set of standards that are intended for global application across a wide range of valuation practice. The new standards are intended to be principles based, setting high level requirements that are both applicable globally and that can be applied globally.

**Other Changes**

Because of the radical restructuring of the content it is not practical to provide a detailed list of the changes made in this new edition. Those familiar with the current IVS will recognise large sections of the text, although it has now been organised in a totally different way. However some of the more significant changes on a section by section basis are summarised below:

| **Existing IVS** | **Proposed new edition** |
|---|---|
| Concepts Fundamental to Generally Accepted Valuation Principles (GAVP) | The generic valuation principles have been carried forward into the proposed IVS 101. Other material discussing market value and land and property has been merged into IVS 103 and IVS 303.01. |
| Code of Conduct | Removed – see above. |
| Property Types | Not directly replicated. Some elements included in individual asset standards. |
| Introduction to IVS 1,2,3 | Not directly replicated. Elements included in IVS 101,103 and 105. |
| IVS 1 Market Value and IVS 2 Other Bases of Value | Merged into new IVS 103. |
| IVS 3 Valuation Reporting | Principles carried forward into IVS 105. |
| IVA 1 Valuations for Financial Reporting | Now included in IVS 201.01 to 201.04. Material updated and extended to reflect developments in IFRS. |
| IVA 2 Valuations for Secured Lending | Made specific to property and most material carried forward to IVS 202.01. |
| IVA 3 Valuation of Public Sector Assets for Financial Reporting | Title changed to reflect content and carried forward to IVS 201.05. |
| GN1 Real Property Valuation and GN2 Lease Interests | Elements carried forward and merged into IVS 303.01. |

| Existing IVS | Proposed new edition |
|---|---|
| GN3 Valuation of Plant and Equipment | Updated and carried forward to IVS 302.01. |
| GN4 Valuation of Intangible Assets | This was replaced by a revised and extended GN4 published in February 2010. This contained comprehensive guidance on intangible assets. The proposed new standard IVS 301.02 is based on the revised GN4, but the more detailed guidance has been omitted. This will be incorporated into a future Technical Information Paper. |
| GN5 Valuation of Personal Property | It is not proposed to carry this forward into the new edition. The definition of personal property in the existing standards is very broad and covers many asset classes that are now the subject of more specific standards. |
| GN6 Business Valuation | Updated standards for business valuation are in IVS 301.01 |
| GN7 Consideration of Hazardous and Toxic Materials | This is not a valuation standard and the topic is one of many topics that influence value. No others are highlighted in the current IVS. Not carried forward |
| GN8 Cost Approach and GN9 Discounted Cash Flow | These are discussions on valuation methods and do not meet the criteria for inclusion in the standards. IVSC have working groups addressing these topics with a few to issuing updated Technical Information Papers |
| GN10 Valuation of Agricultural Property | Not being carried forward as it contains no valuation procedures that differ from other property types. A new project on biological assets is proposed which may result in a new standard. |
| GN11 Reviewing Valuations | The scope and limitations on any valuation assignment are now covered generically in IVS 104. Not carried forward |
| GN12 Valuation of Trade Related Property | Updated and carried forward as IVS 303.04 |
| GN13 Mass Appraisal for Property Taxation | Not being carried forward as it contains no valuation procedures that differ from the General Standards |
| GN14 Valuations of Properties in Extractive Industries | Not carried forward. A comprehensive project on valuations in the Extractive Industries is about to commence and will probably lead to a new standard. |
| GN15 Valuation of Historic Property | Carried forward as IVS 303.02 |

I hope that this overview of the rationale behind the new IVS and the reasons for the many changes proposed is helpful to your understanding of the Exposure Draft.

Although the Board has deliberated the changes proposed in the Exposure Draft at length, we now need to hear your views and suggestions.  There follow questions about issues that the Board has identified as being of particular interest, but any other comments are welcome.  The IVS can only succeed in their objectives if they represent a consensus of the majority of users, clients and practitioners and your feedback is therefore an essential part of this process.

**Chris Thorne**
Chairman – International Valuation Standards Board

## EXPOSURE DRAFT

## PROPOSED NEW INTERNATIONAL VALUATION STANDARDS

### QUESTIONS FOR RESPONDENTS

**The International Valuation Standards Board invites responses to the following questions. Not all questions need to be answered but to assist analysis of responses received please use the question numbers in this paper to indicate to which question your comments relate.**

**Additional comments are also welcome. Please clearly identify the IVS number, title and relevant paragraph number to which your comment relates.**

### GENERAL QUESTIONS

**1.** The proposed new edition of IVS follows the recommendations of the Critical Review that was commissioned by the old IVSC in 2007. Among the key recommendations of this review was that in future editions of the standards the term “International Valuation Standards” should apply to all pronouncements, not just to a limited number, and that all pronouncements should carry equal weight. In this draft the previous distinction between “standards”, “applications” and “guidance” in the titles of various documents has been removed. However, the Board recognises that standards still fall into different categories and has identified these as General Standards, Application Standards and Asset Standards, and grouped these together.

**Do you find the new structure of the Standards to be logical and easy to follow? If not, what alternative would you propose?**

**2.** The Application Standards contain some information on the background to the valuation requirement and the Asset Standards information on the asset type in question and the characteristics affecting value. They also identify particular actions that should be taken in order to apply the principles in the General standards to the particular valuation purpose or when valuing the particular type of asset.

**Do you consider that the combination of background information and specific directions to be helpful? Would you prefer all background information and explanatory information on asset classes to be removed from the standards so that only the specific directions applicable to each application or asset type remained?**

3. It is currently proposed that the final version of the Standards will be published both in hard copy and be available for downloading from the IVSC website.

**Which delivery method for the new edition of the standards are you or your organisation likely to use?**

**IVS 101- GENERAL CONCEPTS AND PRINCIPLES**

4. This Standard is intended to explain fundamental concepts and principles that are referred to throughout the remainder of the standards to assist in their application. Some of the material has been carried forward from previous editions of IVS and some new concepts have been introduced, for example the discussions on market activity and market participants.

**Do you consider that this objective has been met? Do you consider that there are any additional valuation concepts and principles that should be considered and discussed in this standard?**

5. As indicated in paragraph 4, the word *valuation* can be used with two distinct meanings. Where the word is used in the Exposure Draft the Board believes that it is generally clear from the context which sense is intended and has only added words to emphasise whether the reference is to the process of estimating value or to the valuation result itself where there is scope for ambiguity.

**Are you in agreement with this approach or would you prefer the word "valuation" either not to be used at all or always used with qualifying words to indicate the intended meaning, for example "valuation process" or "valuation result"?**

**IVS 102- VALUATION APPROACHES**

6. Previous editions of IVS have identified the principal valuation approaches listed in this proposed standard.

**Do you agree that these three approaches encompass all methods used in the assets or liabilities that you value? If not, please describe what approaches you feel have been omitted.**

7. Paragraph 6 of the draft sets out a proposed hierarchy of approaches which indicates that the direct market comparison approach is generally to be preferred where there are observable prices for similar assets available at the valuation date.

**Do you agree with this hierarchy and do you consider it helpful? If not explain if you would prefer to see no reference to a hierarchy or would prefer an alternative hierarchy.**

**8.** In the current edition of IVS, the term “Sales Comparison Approach” is used to describe the process of estimating value by comparison with the prices of identical or similar assets in the market. The Board received representations that this term was too restrictive as it seemed to preclude market evidence that was not related to an actual sale. Some advocate the use of the term “Market Approach”; however, others find this confusing as both the income and cost approaches can use market based inputs. The Board also received evidence that some believed that only a “market approach” could be validly used to determine market value. After deliberation the Board has proposed the term “Direct Market Comparison Approach” in this edition of the standards.

**Do you find this change of terminology to be helpful? If not please explain what alternative you would prefer and why.**

## IVS103 - BASES OF VALUE

**9.** Basis of value is defined in the draft as a statement of the “fundamental measurement assumptions of a valuation”. In the current edition of IVS it defined as a statement of the “fundamental measurement principles of a valuation”. Supporters of the proposed change believe that the word “assumptions” is more precise. It is self evident that a basis of value is a principle but IVS needs to explain the nature of that principle. The bases of value defined in IVS all consist of a set of assumptions that define the underlying hypotheses on which the value is based. The fundamental assumptions within a defined basis can then be used in conjunction with additional assumptions or special assumptions as explained in IVS 103 and 104. . Others prefer to retain the use of the word “principles”, while some consider that a basis of value is more precisely described as a statement of the measurement objectives of a valuation.

**Do you agree with the proposed change to the definition? If not indicate what alternative you prefer and why.**

**10.** A change is proposed to the definition of Investment Value. The Board had received representations that some are confused by the distinction between Investment Value and Special Value in the current edition of IVS. The Board has proposed to amend the definition so that it only reflects the value to the owner, not the value to prospective purchasers. The rationale is that a prospective purchaser for whom an asset had value in excess of that to market participants generally could also be described as a special purchaser, which is separately defined. A reciprocal change is proposed to the definition of “special purchaser” to make it clear that it can include a single buyer with a special interest or a restricted class of buyers that can realise additional value not available to the market participants at large.

**Do you agree with this proposed change? If not, please explain why and what you believe the distinction is between investment value to a prospective purchaser and special value to a prospective buyer who can realise that special value to be?**

**11**. The Board has considered alternative names to "Investment Value" for the basis of value that describes value to a particular entity. Alternatives suggested include "Entity Specific Value", "Owner Value", "Value to Owner", or "Invested Value". Critics of Investment Value consider that the term is insufficiently precise; although it is a measure of the value of the investment in an asset to a particular party, it can also be interpreted as being the sum required to buy an investment in the market. Others consider that the term is sufficiently broadly understood that any change would cause confusion.

**Do you support the continued use of the term "Investment Value" or would you prefer an alternative? If so, what would that alternative be?**

**12.** In IVS highest and best use (HABU) is treated as an inherent feature of market value. This follows the economic theory that the price of an asset which is fully exposed to all potential buyers will sell for a price reflecting the most efficient or productive use of that asset. Other literature that has been published recently presents highest and best use as a separate concept from the price that would be paid in a hypothetical exchange between market participants.

**Do you agree with the approach taken in IVS? If not, explain why not and give examples where you believe the highest and best use may be different from the market value.**

**13.** In the existing IVS a clear distinction is made between fair value in general use and fair value as defined in IFRS. Some found this confusing since the definition of fair value in IVS was identical to that currently appearing in IAS16. Although the IASB is likely to change the definition of fair value in IFRS in its proposed new Fair Value Measurement Standard, in this draft the definition of fair value in general use has been changed to emphasise the distinction from the usage of the term in IFRS.

**Do you consider this proposed change in the definition to be helpful? If not, please indicate how you believe it could be improved.**

## IVS 104 - SCOPE OF WORK

**14.** Previous editions of IVS did not have a standard relating to scope of work, although the need to record the valuation instruction in writing was included under the heading of "Code of Conduct". The Board considers that a more specific standard is required to detail the minimum acceptable scope of work. This reflects established best practice in many markets and provides the necessary foundation for the valuation process to begin.

**Do you:**

**a) Agree with the inclusion of a standard for scope of work in IVS?**

**b) That the minimum contents identified in the draft are proportionate and represent a realistic minimum standard?**

**If you disagree, please explain why.**

## IVS 105- VALUATION REPORTING

**15**. This proposed standard is significantly less prescriptive than the equivalent standard IVS 3 in the current IVS. The proposed changes reflect the general recommendation of the Critical Review Group that the standards should contain less prescription and focus on principles. It also reflects the need to ensure that these standards can be applied to a wider sector of asset classes than previously.

**Do you agree with the changes that have been made? If not, please explain what provisions of the current IVS3 you believe should be carried forward into the new standard.**

## APPLICATION STANDARDS

**16**. The standards in the 200 series relate to valuations for specific purposes. They provide guidance on the background for the valuation requirement before setting out specific matters that should be reflected or considered when applying the principles in the General Standards. Some consider that the fundamental principles of valuation should remain unchanged regardless of the purpose for which it is being prepared and therefore these application standards are superfluous. Others consider that it is important that valuation standards highlight factors that could be relevant to determining the appropriate valuation hypothesis for different purposes, and to set down criteria to ensure that reports contain the appropriate information.

**Which view do you support? If you consider that future IVS should contain application standards, do you consider that the degree of detail of those in the draft is appropriate and help the better understanding of the valuation requirements?**

**17.** The series 201.01 - 201.04 inclusive are all concerned with valuations under IFRS. With the exception of 201.01, which addresses the current IASB Fair Value project, the topics covered all appear in IVA 1 in the current edition of IVS, although in this draft the text has been updated and some additional detail included to address issues of particular relevance to the valuation task. There are opposing views as to the extent and how IVS should address valuation issues under IFRS.

View (a) is that IVS should not refer to valuations under IFRS at all because the IASB is in the process of producing its own fair value standard that will clearly set out the valuation criteria for all valuation measurements required under IFRS and if parallel valuation standards are produced in IVS these will have no relevance. Supporters of this view also argue that limited references to the accounting requirements under IFRS can be misleading and lead to misinterpretation.

View (b) is that valuation measurements under IFRS are intended to reflect market reality and are not a special type of valuation reserved for financial statements. It is therefore important that the requirements under IFRS are properly related to wider valuation principles and practice through cross references in IVS. Supporters of this view also believe that limited references to IFRS are necessary to help those who are valuers rather than accounting experts understand the required criteria and assumptions so that appropriate valuations can be provided.

**Which of these views do you support?**

## ASSET STANDARDS

**18.** The proposed standards in the 300 series are all concerned with the application of the General Standards to specific asset types. Each standard contains some high level guidance as to the characteristics of each asset type that are relevant to value, a discussion on the principal valuation approaches and methods used and sets down specific matters that should be addressed in settling the scope of work or when reporting. Many of the asset classes included in this Exposure Draft are the subject of “Guidance Notes” in previous editions of IVS and much of the material has been drawn from these. Question 2 asked for your views on whether this combination of background information and specific directions was appropriate or whether you would prefer a clear separation.

**Do you have any other comments on the general structure of the Asset Standards**

**18.** All the asset classes covered in Guidance Notes in the current edition of IVS are carried forward into this Exposure Draft. There are no equivalents for GN5 Personal Property, GN 10 Agricultural Property or GN14 Extractive Industries. Agricultural Property is to be included in the scope of a proposed new project on Biological Assets. A new project is also proposed on Extractive Industries. Personal Property has not been carried forward as the Board considered that the definition of what constitutes personal property in the current IVS is too widely drawn, with the result that much of the subject matter in the current GN5 is more specifically covered in other proposed standards.

**Do you consider that a class of "personal property" can be identified that is not already covered by the proposed new asset standards? If so, do you consider that it has distinct characteristics that need to be considered in valuations that would benefit from a new IVS asset standard being developed?**

**19**. The Board is proposing a project to produce a new standard on valuing non financial liabilities, i.e. liabilities that are not attached to a financial instrument.

**Do you agree that a standard on valuing non financial liabilities is required and what topics should it cover?**

**20.** The Board would welcome suggestions for additional asset (and liability) types that are not already the subject of a proposed new standard or project.

**Please identify any additional types of asset or liability that you believe should be considered for future inclusion in IVS, together with an indication of the benefits that you consider a new standard would bring.**