

The IVSC: the challenge of developing global valuation standards

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1 Introduction

Observation of last year's events gives rise to the following question: If there had been robust valuation standards and if they had been applied globally in recent years, would the crisis have been so intense?

It could in fact be argued that in such circumstances the events of recent months would have been less extreme. This does not mean that the existence of internationally accepted and uniformly applied valuation standards can be an antidote to economic crises. Crises are inherent to economic evolution: the existence of economic cycles of varying length and severity is well known. However, the extent and seriousness of the latest crisis, whose origin should be traced to malfunction in the financial system, poses many questions related to financial stability and how it should be maintained. It is in this context that the urgent need arises to make up for the lack of quality in the valuation process of a whole range of assets and liabilities.

There are various reasons justifying the need to put into place quality valuation standards that are rigorously and universally applied.

In a global world with increasingly open markets for goods, services and capital, financial information must be rigorous, understandable and universal if markets are to function properly and the economy is to be given the conditions in which to grow. If the contrary is true, i.e. if the information is scarce, inexact or asymmetrical, the participating agents take decisions that may result contrary to their own interests. As a result, the markets become less efficient and economic resources - whether physical, human or financial - are badly allocated. In the best of cases this affects economic growth by reducing its potential; in general, it undermines the confidence of economic agents: this is in fact what happened at the start of this century with scandals such as Enron, Worldcom and Parmalat. But in the worst case scenario, defective financial information may combine with other factors to lead to periods of financial instability and economic recession. The current economic crisis is, unfortunately, a good example of this.

The need to use a common financial language in a global world has led to a wide variety of initiatives in recent years. Among the most notable are the development of international accounting standards (IAS) in the accounting field and bank solvency standards, known as Basel II, in prudential supervision. Nevertheless, the market and regulatory flaws that have surfaced in the recent financial and economic crisis demonstrate that there are still aspects on which reforms should be undertaken. In particular, there is the area of valuation.

There are numerous examples of the lack of a solid framework for valuation: problems and debates relating to the concept and application of fair value; the discussion on how to value multiple financial assets when the markets collapse; problems that have arisen in various countries relating to granting mortgage loans; conflicts concerning the valuations of companies that are initially admitted to trading, etc. In this context, globally applied IAS will be of little use if there is no clear and universally applied set of valuation rules on which to rely. Accounting standards and valuation

standards are two different (though in many ways similar) sets that interconnect in various aspects.

Valuations also have multiple applications in the economy. The following are just some of these: financial reporting of all kinds of companies and mutual funds; real estate transactions; investment in a wide variety of financial assets; company transactions; securitization operations; payment of taxes and duties; financial regulation and supervision; settlement of inheritance or other disputes covering a variety of goods; and measurement of the level of collateral in public and private loan transactions. Valuations are the basis of important economic decisions taken in developed countries, where more weight is given to the concept of value than cost when making investment decisions or when measuring risk or determining solvency requirements.

This article deals with the importance of valuation and is divided into two sections. The first explains the benefits of having international valuations standards; the second deals with the role of the International Valuation Standards Council (IVSC) and its organization. Finally, by way of conclusion, it sets out the future challenges faced by the IVSC.

2 The benefits of international valuation standards

The existence of a basic set of globally accepted valuation standards would provide multiple benefits for all the world's economies. Among them are the following.

First, investment risks would be reduced. Currently, investors are obliged to take decisions in a world with many different sets of regulations. Sometimes these are inconsistent or overlap, which can generate significant costs in terms of time and effort. Applying international valuation standards would reduce this uncertainty and minimize the risks incurred by investors.

Second, it would increase the reliability and trustworthiness of financial information. Standards can help increase confidence in financial information to the extent that they increase confidence in the estimated value of assets and liabilities. Fair-value estimates are critical in many aspects of market transactions, such as the acquisition of companies or the lending used to finance it. They even have effects on financial stability. The application of independent valuations based on a set of common and internationally accepted standards is essential for constructing a reliable body of financial information that reflects corporate reality.

Another of the benefits of applying common standards is that they would improve the trustworthiness and straightforwardness of audits carried out under the International Accounting Standards (IAS). The IAS provide globally accepted standards under which valuations may be easily measured and audited. A valuation that has not been carried out in accordance with reliable standards and procedures may complicate the work of auditing or end up being rejected. This increases auditing costs and may even mean that the financial report is insufficiently precise.

Fourth, the standards would provide a more consistent analysis of portfolios and of asset valuations. In our globalized economy, there are an increasing number of actors who are active in different markets. Multinational companies need internation-

al valuation standards that provide them with an ordered process for valuing their portfolios and assets. In addition, the increasing use of complex financial instruments backed by real-estate assets (shares and securitizations) increases the need for uniform and transparent valuation standards.

Fifth, the application of common international standards would help minimize risk to the banking system. Efficient supervision of banking activity and its capital needs calls for robust valuation standards. The banking system is a basic provider of finance for economic activity around the world, particularly to large financial institutions. Thus its capacity to measure risk is critical and should be based on valuations which may be applied consistently at an international level. Basel II needs international valuation standards if it is to avoid regulatory inconsistencies that could eliminate or reduce the advantages of harmonized global banking legislation.

Sixth, the quality of valuation services provided by valuation, auditing and consultancy firms would improve. This would reduce costs by minimizing duplication, conversion and reconciliation. It would also allow more comprehensive services to be provided for clients.

Finally, the standards would enable markets and supervisors to operate properly. Securities markets need issuers of securities to provide clear and comparable financial information if they are to act efficiently. Thus the standards would contribute to achieving the basic objectives of any financial market supervisor: market transparency, correct price formation and investor protection. Obviously, the tasks of prudential supervision and solvency would also be enhanced.

In short, international valuation standards are a desirable goal for all the agents participating in economic activity and an essential part of a solid financial system that is capable of tackling the challenges presented by our global economy.

Now, the next question is: who will develop these standards? Will they be compulsory, and what degree of international harmonization can be achieved? The answer to the first question is the IVSC; in answer to the second, it would be desirable for them to be compulsory, but there is some way to go to achieve this, and the IVSC (although not alone) will also have to play a key role here.

3 The IVSC project

The International Valuation Standards Council (IVSC) was founded in 1981 as The International Assets Valuation Standards Committee (TIAVSC). It is now incorporated as a not-for-profit organization in Chicago, Illinois, although its operating headquarters are in London. Until 2007, it was called the International Valuation Standards Committee.

The IVSC defines itself as a non-profit non-governmental organization with Roster Status at the UN since 1985. Its main objective is to work in the general interest by creating and publishing valuation standards and procedural guides for asset valuation to be used in preparing financial statements, as well as promoting their acceptance and use throughout the world. A second objective is the harmonization of standards within the field of valuation at a global level.

To achieve these objectives, the IVSC works with its member states and with international organizations such as the World Bank, The International Monetary Fund,

the OECD, the International Federation of Accountants, the International Organization of Securities Commissions, the International Accounting Standards Board (IASB) and other private institutions.

Membership of the IVSC is through national valuation associations and institutions representing their respective countries. These professional bodies must recognize the IVSC objectives in terms of asset valuation and have a sufficient number of members capable of carrying out professional valuations. In Spain this role is carried out by the Asociación Profesional de Sociedades de Valoración (ATASA).

3.1 The International Valuation Standards (IVS)

Since its foundation in 1981, the IVSC has published eight editions of its International Valuation Standards (IVS). The continuing development of the IVS reflects the commitment of the IVSC to ensure that the basic definitions and approach in the valuation field are always up-to-date in our changing world.

The IVS aim to provide best valuation practices, or generally accepted valuation practices, also called Generally Accepted Valuation Principles. The idea is that the non-enforceable IVS should complement the national standards of the respective member states, which are mostly enforceable.

How are the IVS structured at present?

The latest publication, IVS 2007, retains the basic structure of earlier editions. It is divided into seven sections, with a glossary and analytical index. The IVS are prepared in English¹. The seven sections are as follows:

- 1 General introduction on the background to the IVSC and the IVS
- 2 General Valuation Principles
- 3 Code of Conduct for the sector
- 4 The bases for valuation of the different kinds of assets, i.e.:
 - real property
 - personal property
 - businesses
 - financial assets
- 5 Standards
- 6 Applications
- 7 Guidance notes

The standards are considered a basic and fixed part of the publication, and serve as a basis for the applications, whereas the guidance notes offer suggestions on specific matters of valuation and on how the standards should be applied in specific sectors. The guidance notes complement and extend the standards and applications.

¹ There are clear advantages to having a single official version. The problem is that it has to be translated into other languages and this is not easy. We should be extremely grateful for the work carried out by ATASA and some professional Spanish-speaking professionals in the sector who have translated the IVS.

Currently there are three standards and an introduction to each. They deal with: 1) the market value basis of valuation; ii) valuation bases other than market value; and iii) valuation reporting.

The applications are also divided into three. They deal with valuation for financial reporting, valuation for lending, and valuation of public-sector assets for financial reporting.

Finally, the fifteen guidance notes are divided into four groups. The first group (with four notes) deals with the valuation of different types of property (real property, leasing, plant and equipment and personal property). The second group (a further three) includes those dealing with property or assets that are valued according to cash flow (intangible assets, businesses and specialized trading property). The third group offers guidance on the application of valuation approaches (a cost approach for financial reporting and discounted cash flow analysis). Finally, there are six more guidance notes that deal with a variety of questions (hazardous and toxic substances, reviewing valuations, mass appraisal for property taxation and historic property).

3.2 The current organization of the IVSC

The IVSC has led the development of valuation standards at a global level for more than 25 years. Its origins lie in the attempt to converge the valuation standards of the United Kingdom and the United States.

Currently, the IVSC has 61 members representing 54 countries. This figure will increase after the new IVSC is established, as described below.

Given the increasing, or even critical, importance of the valuation of goods and assets in extremely varied fields and the growing need to harmonize valuation standards, in 2005 the IVSC proposed to reform its structure in order to increase the relevance and sustainability over time of both the standards and the organization itself. Thus in September 2006 a working group was set up to identify the challenges to be tackled by the IVSC.

Specifically, it pointed out that the IVS do not have the force of law: they are only adopted on a voluntary basis, and harmonization between countries is limited; the IVSC has been operating using volunteers on loan from their respective member associations; the standards should be issued by an independent organization; the valuation profession was not properly represented at an international level; there is a growing demand for consistent definitions, standards and methodologies; and finally, that training is a basic aspect in valuation.

In April 2007 an ambitious restructuring plan was approved. This established the IVSC's mission as to contribute to the establishment and maintenance of high-quality international valuation standards and to the development of the valuation profession around the world.

The following strategic lines of action were approved in compliance with this mission.

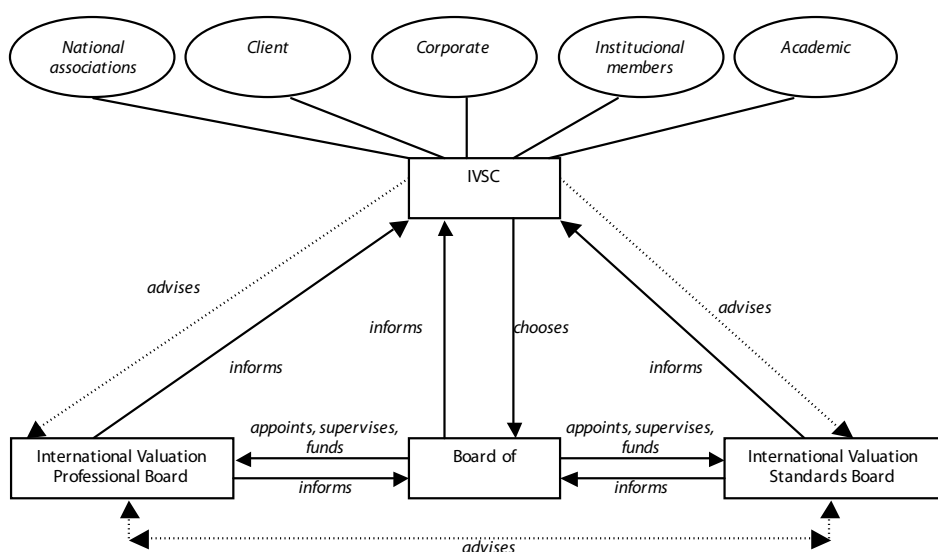
First, it was agreed to develop and maintain an effective and comprehensive set of understandable and practical international valuation standards. This was to be done through an efficient process that balanced rigour with effectiveness, and was

capable of serving the valuation profession worldwide as well as all the other interested parties. Second, it was decided to assist the development of the valuation profession worldwide; and it was also agreed that the IVSC should be the international spokesperson for the profession. Finally, it was established that the governance and operation of the IVSC had to continue to improve.

The structure of the IVSC was modified to achieve these aims. The basic changes introduced can be summed up as follows:

- The IVSC acronym was maintained, but instead of a Committee it became a Council.
- The criteria for membership were extended beyond the national valuation associations. It now includes valuation service clients, corporate members, institutional members (public bodies) and academic members (universities).
- A Board of Trustees was also created to oversee IVSC funding and strategic planning. However, it is not involved in the technical aspects of the standards.
- It was agreed that the Standards Board (IVSB) would be an independent decision-making body. The IVSB is responsible for preparing the IVS and associated details. All decision-making involves a broad process of professional and public consultation with all the interested parties (regulators, professional associations, companies, etc.).
- An International Valuation Professional Board (IVPB) was also created to develop guides for good practices. The role of the IVPB is crucial, not only as a way of ensuring compliance with the IVS but also to organize and develop the valuation profession in all countries, particularly those in which standards are still far from acceptable.
- It was decided that the funding of the IVSC should come from three different sources: membership fees; income from sales of the documentation related to the IVS; and, most importantly, sponsors.
- Finally, it was determined that transparency would be a priority for the institution. Thus the agendas and minutes of most of the meetings of the IVSC boards will be made public. The processes of public consultation will also be given more dissemination.

Figure 1 shows the current IVSC structure.



Source: IVSC.

A Provisional Board of Trustees was in place from February 2008 until the General Assembly held in Kuala Lumpur in October 2008. It was responsible for supervising the IVSC restructuring process and completed its work with the appointment of members of the Board of Trustees, of the IVSB and the IVPB².

The first intense and productive meetings of the new boards were held between 21 and 23 January this year in London. They were aimed at achieving solid and internationally accepted IVS, thanks to the reconstituted IVSC.

3.3 The challenges ahead for the IVSC

Finally, it is worth pointing to the main challenges ahead for the IVSC and to indicate the situation in Spain.

a) More precise definition of the standards

International standards of any kind suffer from the intrinsic difficulty of having to establish minimum but demanding levels to serve as a reference around the world. At present, in the field of valuation, the IVS are a set of very basic valuation principles that can be applied in any economic system. However, the world economic system urgently demands a more precise definition of many aspects of the standards: for example, the valuation of financial instruments in markets where there is little or no liquidity.

b) Harmonization

Although important steps have been taken to create a set of core global valuation standards, the goal of providing different countries with international standards of reference that can be reflected in their own legislation is still some way

2 The IVSC website (www.ivsc.org) provides information on the composition of the boards, as well as the current valuation standards, guidance notes and applications during the period of public consultation, etc.

away. In some countries, such as Spain, legislation in general complies with, complements and adapts the IVS to the idiosyncrasy of its economic system, and thus gives them a firm foundation. However, neighbouring countries such as France and Italy, or other markets with close links to ours, such as Argentina and Colombia (to cite just a few examples) only have a few unconnected laws in place and/or laws that are not yet sufficiently founded on the IVS. This gives rise to significant difficulties in terms of comparing valuation reports. The IVS should be firm and clear if national regulations are to achieve a high level of harmonization³.

c) Professionalism

A key aspect in the effective application of a set of high-quality universally applicable valuation standards is the presence of valuation professionals and firms with a high level of technical and ethical preparation. Spain is not badly prepared in this respect thanks to its model of valuation firms. Under this model, the firms are obliged to invest in training, research and development and extend the scope of their work beyond the real-estate world. In addition, the Spanish legislation on valuation establishes requirements for harmonization, independence, incompatibility and secrecy that are applicable to both professionals and the firms responsible for the valuation work.

d) Regulation and supervision

As has been demonstrated by this crisis, self-regulation may be necessary, but it still does not ensure that the markets function properly. A reasonable level of regulation is required in the field of valuation. Supervisory bodies have to exist to ensure that the rules are complied with and to sanction behaviour that breaches these rules. In Spain, although the supervisory activity of the Bank of Spain, the CNMV and the General Directorate of Insurance and Pension Funds could be improved, it has laid foundations in the sector that are still lacking in other countries.

e) Relationship with multilateral bodies

If it is to tackle all the challenges outlined above, the IVSC will have to reinforce and expand its contacts with other international bodies. Among them are the OECD, the World Bank, the International Monetary Fund, the Financial Stability Fund, the Bank for International Settlements and the European Commission. In particular, the IVSC should work with the IASB, the IFAC (International Federation of Accountants) and the IOSCO. There is much work to be done on this front.

f) More active participation in public dissemination and the public consultations on the IVS

The IVSC should become increasingly involved in the public consultations organized by the bodies mentioned above as a way of making questions related to valuation better known. But it should also aim for greater participation in the consultations that it organizes itself, which will obviously become more numerous in the future.

³ I hope that the day is not far of when, for example, the European Union approves a Directive based on the IVS, such as that by which the EU implemented the IAS.

4 Conclusions

Throughout this article the aim has been to show the importance of valuations in the modern world and the urgent need to have a set of robust and internationally accepted valuation standards. At the same time, it has been a presentation of the IVSC, which it considers the best organization to carry out this task, having led the development of valuation standards around the world for more than 25 years.

There are a number of challenges faced by the IVSC if it is to meet its objectives. The IVSC has carried out an important restructuring plan to strengthen the institution and give it the infrastructure it needs to be able to contribute to the establishment and maintenance of quality international valuation standards and to the development of the valuation profession around the world.

For these objectives to be achieved, the IVSC now has to carry out the difficult and challenging task of extending its mission, vision and activities. Obviously, the way ahead for the IVSC is not easy. Financial and human resources are required. Above all, there is need for determined will and hard work on the part of professionals in the world of valuation, their clients and public bodies to bring the project to a successful conclusion. Nevertheless, the task of the IVSC appears clearer in the light of the lessons that are being learned from the economic crisis. The benefits to be gained by all from achieving these objectives are worth the effort. As we well know, regulators around the world have given the matter pride of place in their agendas.

5 Bibliography

International Valuation Standards (IVSC), 8th Edition, 2007 (ISBN. 978-0-922154-94-4)⁴.

4 This is the official version in English. The Spanish version is available on www.atasa.com