

# VALUE ADDED

THE RELEASE OF THE LATEST STANDARDS ON ASSET VALUATION OFFER REAL CLARITY, SAYS CHRIS THORNE

As a financial activity, valuation is often taken for granted or even overlooked despite its use as the basis for many significant investment decisions, for measuring performance and increasingly as a measurement basis of required disclosure in financial reporting.

Valuation has perhaps suffered from being a 'grudge purchase'. Few people who commission a valuation do so because they want it in its own right; it is normally a means to an end, for example to obtain authorisation for a loan, to comply with an accounting standard or to offer support to a litigation claim.

The result of this lack of recognition of the importance of valuation has resulted in a fragmented professional and regulatory landscape when viewed from a global perspective. In contrast with accountancy, where over the past 30 years the International Federation of Accountants has been able to promote and strengthen a cohesive worldwide profession, there are few strong and well-established professional institutes that accredit and regulate valuers and many more have a small membership focusing on a limited sector or geographic area, resulting in considerable variation in training and practice.

Most of the professional infrastructure that exists for valuation has been built up around real estate. This is true also for state regulation, where the collapse of various real estate bubbles over the past 50 years or so has prompted government intervention, although once again there is little consistency in the regulations imposed and some are of questionable benefit.

## BUILDING PRESSURE

There are only a handful of professional institutes that accredit and regulate valuers outside the real estate sector and historically there have been few state-imposed restrictions on who may value assets as diverse as business interests, intangible assets or financial instruments. However, pressure is building for change.

Many of the inquests into the 2008 financial crisis discovered the importance of valuation. At its April 2009 meeting, the G20 identified the need to improve standards for valuation, although, in a move symptomatic of valuation's lack of recognition as a distinct professional discipline, they called upon

the accounting standard-setters to do it. However, both the IASB and FASB have made it clear that, while they are both enthusiastic about the use of fair value measurements in financial reporting, their role is to determine when value is a valid measurement basis and to set the criteria for such measurements, not to stipulate how valuations are undertaken generally.

The credibility of value measurements in financial statements depends upon them being a reflection of how assets and liabilities are priced and valued in the marketplace. If it ever became the case that the 'accounting value' differed from the 'real value', then the measure would cease to have any validity.

The recent IFRS 13 *Fair Value Measurements* makes it clear in the introduction that it explains how to measure fair value for financial reporting but is not intended to establish valuation standards or affect valuation practices outside financial reporting.

Neither is the need for improved standards for valuation confined to financial reporting since, as stated earlier, valuations are required for many purposes in the wider financial markets, including pricing units in collective investment schemes, macro-prudential regulation of banks and loan security, to name but a few.

## EFFECTIVE REGULATION


In the EU, the recent Alternative Investment Fund Managers' Directive requires states to put in place regulations for the regular valuation of assets that are held in many types of investment fund.

Although some may consider that it is not before time, it appears that valuation is now well and truly recognised as an important element of the financial markets and that proper standards and effective regulation are necessary for improved financial stability. So who deals with standards for valuation in the wider context?

The International Valuation Standards Council (IVSC) was set up 30 years ago, when a group of professional bodies concerned with real estate valuation issues started to try to reach a cross-border consensus.

By 2000, its standards had started to become more influential and the organisation started to embrace the valuation

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of assets other than real estate. After a significant restructuring of the IVSC in 2000 to increase the independence of the standard-setting boards and improve oversight of their activities, it is now registered as a not-for-profit corporation in the US and headquartered in London. A Board of Trustees appoints members to two operational boards, the Standards Board and the Professional Board. The organisation is funded by a mixture of membership subscriptions from professional valuation organisations and sponsorship from valuation firms and valuation users.

In 2009, the IVSC Standards Board started a project to review and improve the existing International Valuation Standards (IVS). This project was recently completed, with the publication of 12 new IVS in July 2011, with an effective date of January 2012. It considered an independent critical review of the previous standards, reviewing more than 60 comment letters on the exposure draft, discussions with invited stakeholders in New York, Hong Kong and London and one-to-one discussion with other stakeholders, including accounting standard-setters.

### CONSISTENT PRINCIPLES

The new standards are simplified when compared with previous versions and their scope has been extended. By focusing on those principles that are capable of global application and eliminating detail that could have limited applicability outside a specific sector or state, the new standards are designed to be more accessible and relevant to user needs. Included for the first time is a standard on valuing financial instruments.

The overriding objective of the new standards is to increase the confidence of the users of valuation services. This is done by promoting consistent principles and definitions, setting requirements for transparency throughout valuation assignments and reducing diversity of practice by enabling the convergence of valuation standards currently used in specific sectors or states. The new IVS are designed to be of benefit to the operation and regulation of markets generally by increasing understanding of the valuation process. They contain high-level explanations of factors that need to be considered when valuing different types of asset and of the valuation techniques generally employed.

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