

IVSC Liabilities 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 (IVSB) has agreed to undertake a project to examine the valuation of liabilities. The scope of the project will include all liabilities except those created under the terms of a financial instrument. It will therefore examine both contractual and non-contractual obligations eg product warranties, obligations to repair or restore and asset and environmental and decontamination obligations. The project will consider the need for a new IVS and/or revised guidance and then to develop the necessary documents following the IVSC Due Process procedures.

This paper describes the background to the project, identifies matters that Board believes need to be addressed and identifies other standard setting bodies in the sector that may have an interest in outcome.

The IVSC wishes to form a working group to progress the project. This will ideally include individuals with different perspectives on the valuation of liabilities other than those created through financial instruments, for example:

- expertise in preparing valuations of liabilities
- users of valuations (including preparers and auditors of financial statements that include valuations of liabilities),
- having a regulatory or oversight interest in valuations.

Nominations for membership of the working group are invited. An application form and further details can be obtained from the IVSC Technical Director, Chris Thorne by email to cthorne@ivsc.org.

BACKGROUND

The IVSB has agreed to progress a project on the valuation of liabilities. It has been further agreed that this will exclude liabilities created by a financial instruments because these have distinct characteristics and would in any event be covered in the proposed projects on financial instrument valuation. It was also agreed that pension liabilities would be excluded, as would rental payments under leases.

Preliminary investigations by the Board have established a lack of standards or guidance specifically relating to the valuation of liabilities. Within the field of financial reporting, the IASB's IFRS 13 *Fair Value Measurements* specifically includes liabilities within its scope, but stipulates that specific assumptions be made that are directed at achieving a consistent accounting measurement of liabilities. Some of these assumptions, eg that a transfer has to be assumed even where fulfilment or cancellation are more likely, or that in absence of quoted prices a liability is to be valued from the perspective of the counterparty holding the corresponding asset may or may not be appropriate when establishing the value of a liability for purposes other than financial reporting. The Board therefore considers that there is a need for standards or guidance on the valuation of liabilities in a wider context.

In 2010 the IASB issued an Exposure Draft¹ which proposed certain amendments to the existing IAS37 *Provisions, Contingent Liabilities and Contingent Assets*. The responses received to this draft illustrated a significant diversity of opinion, not only on when a liability should be recognised in a financial statement but also how it should be measured. The IASB liabilities project is currently inactive as priority is being given to those projects identified as being important in achieving the convergence of IFRS and US GAAP. If the IVSC can identify generally accepted valuation principles and practice for liabilities this could help inform decisions on the most appropriate measurement basis in any future project by the IASB.

THE IVSC PROJECT

The Board has noted that the valuation of liabilities includes the need to consider a number of factors that either do not arise when valuing assets or where different considerations are necessary. These will include, but be not limited to:

- Whether the approach to valuing a liability depends on whether it is more likely to be either transferred, fulfilled or cancelled.
- How the purpose of the valuation and the nature of the liability dictates the appropriate basis of value;
- Whether and, if yes, how the principle of the lowest of the transfer, fulfilment and cancellation prices/values should be established .
- How to reflect the uncertainty in quantifying the current value of liabilities contingent upon future events;
- The extent to which non-performance risks (including an entity's own credit risk) and changes thereto should be considered in the valuation process.

¹ ED/2010/1 Measurement of Liabilities in IAS 37

- If a future liability can be discounted to a present value, the criteria that should be used in selecting the discount rate, eg whether it is related to the return on the corresponding asset (if any), reflect a risk free rate, or be otherwise determined?
- When and how an allowance for a profit margin should be included in the calculation of the costs of fulfilment, settlement or transfer.

Liabilities that the project will consider include but are not limited to:

- Contractual liabilities to repair or restore an asset, either current or future;
- Product warranties;
- Statutory or other non-contractual obligations, eg site remediation or decontamination obligations.

Consideration may also be required to the estimation of possible future legal damages under litigation, although the extent to which valuation techniques can be applied to quantify such a potential future liability is a matter for debate.

Excluded from the scope of this project are liabilities arising under a contract to pay a specific sum of money on a future date, whether contingent or fixed. It therefore excludes all financial instruments, pensions, rental payments under leases or contingent consideration arrangements in other contracts.

The overall brief of the project is to:

1. Consider the need for an IVS standard for liabilities other than financial instruments. If the need is identified, to develop an appropriate standard.

The standard would be similar in structure the existing IVS 200 series and consists of a standard and a commentary. The standard would set 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 different types of liabilities. The commentary would provide additional background information on the characteristics of each liability type that influences value and identify 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 education or training.

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

- The need to create a standard supplementary to the current IVS to reflect the particular factors that require consideration when valuing liabilities other than financial instruments.
- Identifying valuation methods used in to value liabilities other than financial instruments, developing guidance on those methods and matters that need to be considered in their application.
- The need for guidance on how to deal with uncertainties associated with the probability of future events affecting the value of the liability.
- Identifying any known valuation practices that are considered inappropriate.
- 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.

Ends