

April 19, 2021

International Valuation Standards Council
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Dear Board Members:

AICPA appreciates the invitation to comment on the International Valuation Standards Council (IVSC) Financial Instruments Board's IVS 500, *Financial Instruments* Exposure Draft, issued December 11, 2020. The American Institute of Certified Public Accountants ("AICPA") is a professional organization of approximately 431,000 members in 130 countries. Our constituency actually exceeds that number. That is because, under various state accountancy laws, AICPA professional standards also encompass practicing CPAs who are not AICPA members.

AICPA members represent many areas of practice, including business and industry, public practice, government, education and consulting. The AICPA sets ethical standards for its members and U.S. auditing standards for private companies, nonprofit organizations, federal, state and local governments. It develops and grades the Uniform CPA Examination, offers specialized credentials, builds the pipeline of future talent and drives professional ethics and competency development to advance the vitality, relevance and quality of the profession.

The Forensic and Valuation Services Executive Committee ("FVSEC") is a senior technical committee of the AICPA. The FVSEC is empowered to issue forensic and valuation standards for our members and to comment on forensic- and valuation-related topics on behalf of the AICPA. In 2007, the AICPA issued valuation standards, Statement on Standards for Valuation Services ("VS Section 100" or "SSVS").

This letter presents the FVSEC's comments and responses to questions for respondents raised in the IVS 500 Financial Instruments Exposure Draft (henceforth, variously the "Exposure Draft" or "IVS 500").

Question 1: Do you agree with the proposed objective? Why or why not? If you agree with only parts of the proposed objectives, please specify what you agree and disagree with. If you disagree with the proposal, please explain what you propose instead and why.

The FVSEC has two primary concerns with the proposed objectives of the Exposure Draft. First, it appears to be written from the perspective of larger entities, namely global banks. This may pose a problem for adoption of IVS 500, because it excludes many other types of entities, including audit firms. For example, the roles and responsibilities described in the Governance section appear to be written from the perspective of certain market participants, but not others. IVS 500 will be more useful if it can be adopted by all financial instrument valuation practitioners.

Second, the IVSC, as an independent global standard setter for the valuation profession, has entered with this Exposure Draft into an array of topics beyond that which is typically seen in valuation practice or found within valuation standards provided by Valuation Professional Organizations. Generally speaking, topics such as governance and controls, while extremely important, are traditionally the purview of regulators and accounting and auditing standard setting organizations, and as such, are outside the direct control of practitioners and entities involved in the valuation of financial instruments. The breadth of topics within the Exposure Draft therefore leads the FVSEC to question whether the focus of the Exposure Draft should be limited exclusively to the valuation of financial instruments, rather than addressing other important but non-valuation subjects.

As noted in several other responses below, these opinions permeate other comments provided by the FVSEC.

Question 2: The Exposure Draft is focused on the requirements that have to be met for two elements, Governance, and Data, of the proposed standard in order for an entity to arrive at a fit-for-purpose valuation of financial instruments. Do you agree that the requirements are clear, complete and provide adequate guidance to ensure compliance? Why or why not? If you agree with only parts of the requirements, please specify what you agree and disagree with. If you disagree with the requirements, please explain what you propose instead and why. If you think the requirements are incomplete, please explain what you propose should be included and why.

Governance and data are both essential considerations for a robust valuation process. The Exposure Draft introduces certain concepts within Governance that are new to IVS which warrant further consideration and explanation.

It is not clear that financial instrument valuation, per se, requires rules on governance and data which would be unique only to the valuation of financial instruments and not also apply to other areas of valuations covered by the IVS. While the FVSEC does not conceptually object to these elements for valuation, the FVSEC believes they should be considered within a broader standard rather than within a standard specifically and exclusively intended to address the valuation of financial instruments.

The FVSEC also found the guidance in paragraph 50.4.3 of the Exposure Draft to be unclear. The FVSEC would encourage the Financial Instruments Board to reconsider the paragraph. For example, it is not clear what is meant by the term “delegation” as used within 50.4.3 and elsewhere, (such as, within 50.4.7.2, which mentions the “...*degree* of delegation...”) and what impact, if any, it would have on financial instruments valuation. Moreover, the use of terms such as “...insignificant, liquid, and non-complex...” also imply *degree* of magnitude, and as presented, these terms and similar terms are not well defined for purposes of IVS and may inhibit uniform adoption of the guidance. The FVSEC recommends adding relevant terminology to the IVS

Glossary or providing clearer parameters for these definitions within the appropriate sections of IVS.

The FVSEC further recommends that IVS 500 focuses only on aspects unique to the valuation of financial instruments and outlines recommendations, rules, principles, and guidance that is clear and precise enough to be actionable.

Question 3: Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

The FVSEC favors standards that have limited exceptions. We do not believe there should be a different standard for the listed exceptions. We believe that the standard should apply to *all* financial instruments. Only where necessary and for a limited number of cases, explain why some products are excluded.

Question 4: Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

As mentioned elsewhere among the responses, the FVSEC believes that the context of the definitions could also reasonably be applied to several types of valuations beyond that which pertains exclusively to financial instruments. Therefore, such definitions may be more appropriate in the IVS' General Standards rather than exclusively in IVS 500.

The FVSEC also believes that paragraphs 30.6, 30.7, and 30.8 are incomplete. Specifically, as articulated in paragraph 30.6, the factors contributing to valuation risk appear to be only a portion

of the potential issues which market participants would consider. There are however other potential factors which may contribute to valuation risk, and should be considered. For example, the United States Securities and Exchange Commission states in its Good Faith Determinations of Fair Value that valuation risks include: 1) potential market or sector shocks or market dislocations; 2) the extent to which fair value methodology uses unobservable inputs; 3) reliance on service providers that have more limited expertise in relevant asset classes; 4) the use of fair value methodologies that rely on inputs from third-party service providers; 5) the risk that the methods for determining and calculating fair value are inappropriate or that such methods are not being applied consistently or correctly; 6) and, material conflicts of interest.

In addition, while the FVSEC acknowledges that valuation methods and models are to be addressed in a subsequent IVS exposure draft, it nonetheless should be stated that valuation risk also includes the use of an incorrect valuation model.

Further, while only discussed briefly in paragraph 60.6.6.9, back-testing is a commonly used industry method to evaluate valuation risk and assess the historical reliability of valuation measurements. For instance, Chapter 11 of the AICPA's *Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies* (PE-VC Guide), is entirely devoted to the topic. The FVSEC therefore encourages the Financial Instruments Board to leverage the extant thought leadership to ensure its proposed standard is aligned with accepted published guidance, and to prevent unnecessary divergence in practice.

Relative to paragraph 30.7, valuation uncertainty is defined as a component of valuation risk and represents that there exists a range of equally reasonably estimated values for a financial instrument. However, valuation uncertainty is broader and includes market uncertainty, model uncertainty and input uncertainty. The IVSC should consider other elements of uncertainty and how they impact paragraph 30.7.

Relative to paragraph 30.8, valuation risk appetite is defined as the level of valuation risk that an entity is prepared to accept in pursuit of the objective of developing a fit-for-purpose valuation

before action is deemed necessary to reduce this risk. The valuation risk appetite will be determined based upon the intended use of the valuation.

The FVSEC believes that to be effective, a valuation risk management framework must ensure that all valuation dimensions are seamlessly integrated. An effective framework achieves this objective at least in part by providing clarity on risk definitions and appetite as well as controls and reporting. However, the term “valuation risk appetite” is not well explained. A clear definition of valuation risk appetite will facilitate the creation of measurable thresholds and limits of valuation risks. In addition, the IVSC may also consider addressing whether valuation risk appetite should include non-financial risks such as operational and compliance risks, loss limits, correlation and similar types of risks in order for the valuation risk appetite to be determined. In summary, the Exposure Draft provides no guidance on a standard process for measuring valuation risk appetite. The valuation risk taxonomy should clearly and comprehensively define risks and articulate a process for determining valuation risk appetite.

The IVSC should acknowledge that the risks identified are not intended specifically for this Exposure Draft, and are not a comprehensive list of all possible sources of valuation risk, but rather a subset of examples which may help inform financial instrument valuation practitioners who may endeavor to adopt the IVSCs.

Question 5: Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

Proportionality is also among the concepts introduced in this Exposure Draft which, if relevant to financial instruments valuation, would also be relevant to other types of valuations. The FVSEC notes that in this area, the Exposure Draft omits the concept of materiality. It is also not clear why

proportionality, as defined in the Exposure Draft, should be a function of an entity's valuation risk appetite.

For example, an entity may engage in a transaction with high valuation risk (for any number of reasons – unique transaction, paucity of data, lack of comparables, use of a new model, et cetera) and that entity may also have a high valuation risk appetite. The Exposure Draft appears to suggest that this entity may expend less effort than a separate entity with a low valuation risk appetite undertaking a similar transaction, which stands in contrast to the proposal in paragraph 30.8, which states that, “The valuation risk appetite will be determined *based upon the intended use of the valuation*”. The FVSEC recommends that the Financial Instruments Board revise this proposal to better clarify the source(s) and situations which give rise to valuation risk appetite.

The FVSEC also notes that the definitions of both valuation risk and proportionality include reference to the *entity's processes and controls*. Since proportionality is a function of valuation risk this seems to introduce an element of circularity among the two definitions.

As such, materiality, as defined within various auditing standards, may be a better measure for consideration of the amount of effort that entity should expend, based on the intended users of the valuation.

Question 6: Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

As stated at the outset and elsewhere in this response, the FVSEC believes that principles of governance, within the context of financial instrument valuation processes, should be applicable to all valuation practitioners. These proposals reflect the perspective of the entity and should be reconsidered with the objective of all financial statement valuation practitioners in mind.

Question 7: Do you agree with the principles outlined in paras 60.5.1 to 60.5.3 regarding the development of a data taxonomy? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

ASC 820 and IFRS 13 describe this process in a much more efficient manner. Specifically, it states a reporting entity need not undertake all possible exhaustive efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. In addition, fair value maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Paragraphs 60.5.1 to 60.5.3 can be simplified by simply adopting ASC 820 and IFRS 13 language.

Question 8: Paras 60.6.2 to 60.6.8 outline the specific requirements for the data-types listed above. Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

The requirements for the various data types are too specific. Instead of detailing specific requirements, the FVSEC encourages the Financial Instruments Board to first consider broad principles that clearly outline the origin of the pricing data and the order in which each data type should be used (highest and most observable first, followed by less observable inputs) and then apply those principles to the data-type proposals described in 60.6.2 to 60.6.8 of the Exposure Draft.

Question 9: Paragraphs 60.7.1 to 60.7.6 outline the principles for controlling and aggregating data across an organisation. Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

Paragraph 60.7.1 focuses on “outsourced and internally generated data”. However, the data used in valuation is generally market data and company data. It is not clear whether or not 60.7.1 considers market data to be part of “outsourced data.” The FVSEC believes that it should be clearly stated that this guidance applies to both market data and company data, either of which can be outsourced or generated internally, with the primary focus being on the clear acknowledgement, understanding, and documentation of the ultimate origin of the data, regardless of source.

In addition, paragraph 60.7.1 appears to be written for larger entities that have pricing committees and/or boards of directors. This poses a problem for adoption of IVS 500, because it excludes many other types of entities, including audit firms. Moreover, not all entities will have pricing committees and/or director boards, and not all valuations are performed directly by entities: Many valuations are outsourced to third party valuation providers which perform the work in entirety. Therefore, the FVSEC believes that the standard should be broadened to address fair value valuation practitioners who may not have pricing committees and director boards. Further, although third-party valuation providers are mentioned elsewhere in IVS 500 (within the context of Section 50.4 “Roles and responsibilities...”, for example), the FVSEC also recommends that the Exposure Draft specifically describes the involvement of third-party valuation providers within Section 60.7 by clearly indicating how the information and guidance contained in paragraphs 60.7.1 through 60.7.6 would apply to those third-party providers.

Paragraph 60.7.2 mentions “limitations”. It is unclear what the standard means by “limitations”.

Relative to 60.7.5, Accuracy and Integrity, the FVSEC is concerned that little guidance is provided about data validation over third party market data providers (such as Capital IQ, Thompson Reuters, and Bloomberg, for example). In the United States, it is typical for professionally

prepared valuation reports to include a disclaimer that the third-party valuation providers did not validate data provided by these external data sources.

A paragraph on calibrating unobservable market inputs to the transaction price should be added, or at the least, a reference made to deeper consideration of such in the forthcoming exposure draft, “Methods and Models”. For example, in the United States, the Financial Accounting Standards Board (FASB) guidance in ASC 820 requires that all unobservable inputs used in the subsequent measurement dates must be calibrated to the original transaction price.

Paragraph 60.7.5.6.1 states that “...valuation should be based on contemporaneous valuation data”. The FVSEC finds this paragraph unclear in its use of “contemporaneous”. Elsewhere in the same paragraph, the phrase, “...the stated observation date for the valuation” is also unclear. Valuation should be based on the information known and knowable as of the valuation date. Historical valuation should not be based on current (contemporaneous) data. The FVSEC suggests paragraph 60.7.5.6.1 be clarified to “...valuation should be based on contemporaneous data available as of the valuation date”, and recommends changing the phrase, “the stated observation date for the valuation” to simply “the stated valuation date”. This would clarify the paragraph and reduce the risk of confusion and misapplication.

Finally, we thank the IVS Financial Instruments Board for its consideration of our comments and for its continued service to the valuation profession.

Very truly yours,

A handwritten signature in blue ink, appearing to read "Annette Stalker".

Annette Stalker, CPA/CFF

Chair, AICPA Forensic and Valuation Services Executive Committee