LATEST UPDATES ON INTERNATIONAL VALUATION STANDARDS

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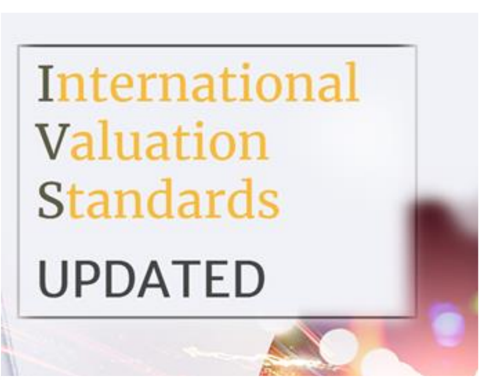
A RECENT UPDATE

The International Valuation Standards Council (IVSC) has issued an updated version of the suite of International Valuation Standards (IVSs). They become effective from 31 January 2022, however, the IVSC encourages early adoption from the date of publication.

The latest edition of the International Valuation Standards (IVS) marks an important milestone towards harmonizing valuation practice worldwide.



IVSC International Valuation Standards Council

INTRODUCTION

The International Valuation Standards Council (IVSC) issued an updated version of International Valuation Standards (IVS) and its Basis for Conclusions (BC) in July and August 2021. From 31 January 2022, the latest updated IVS will become effective. Adoption before the effective date is allowed.

As explained in the IVS, these are the "standards for undertaking valuation assignments using generally recognized concepts and principles that promote transparency and consistency in valuation practice."

IVS comprises five 'General Standards' and six 'Asset-specific Standards'. The General Standards set requirements for the conduct of all valuation assignments including establishing the terms of a valuation engagement, bases of value, valuation approaches and methods, and reporting.

The Asset Standards include requirements related to specific types of asset valuation, including background information on the characteristics of each asset type that influence value and additional asset-specific requirements regarding common valuation approaches and methods used. The assets standards cover:

- Businesses and Business Interests (IVS 200)
- Intangible Assets (IVS 210)
- Plant and Equipment (IVS 300)
- Real Property Interests (IVS 400)
- Development Property (IVS 410)
- Financial Instruments (IVS 500)

Among various updates, several major changes are described below:

- Core Valuation Principles
- New Section on Allocation of Value (IVS 104)
- Revised scope for Business and Business Interests (IVS 200)
- New chapter on Inventories (IVS 240)
- Revised Scope for IVS 400 Real Property Interests

CORE VALUATION PRINCIPLES

The latest IVS identified the following Core Principles of Valuation:

1. Ethics	Valuers must follow the ethical principles of integrity, objectivity, impartiality, confidentiality, competence and professionalism to promote and preserve the public trust.
2. Competency	At the time the valuation is submitted, valuers must have the technical skills and knowledge required to appropriately complete the valuation assignment.
3. Compliance	Valuers must disclose or report the published valuation standards used for the assignment and comply with those standards.
4. Basis (ie, Type or Standard) of Value	Valuers must select the basis (or bases) of value appropriate for the assignment and follow all applicable requirements. The basis of value (or bases) must be either defined or cited.
5. Date of Value (ie, Effective Date/Date of Valuation)	Valuers must disclose or report the date of value that is the basis of their analyses, opinions or conclusions. Valuers must also state the date they disclose or report their valuation.
6. Assumptions and Conditions	Valuers must disclose significant assumptions and conditions specific to the assignment that may affect the assignment result.
7. Intended Use	Valuers must disclose or report a clear and accurate description of the intended use of the valuation.
8. Intended User(s)	Valuers must disclose or report a clear and accurate description of the intended user(s) of the valuation.
9. Scope of Work	Valuers must determine, perform, and disclose or report a scope of work that is appropriate for the assignment that will result in a credible valuation.
10. Identification of Subject of Valuation	Valuers must clearly identify what is being valued.
11. Data	Valuers must use appropriate information and data inputs in a clear and transparent manner so as to provide a credible valuation.
12. Valuation Methodology	Valuers must properly use the appropriate valuation methodology(ies) to develop a credible valuation.
13. Communication of Valuation	Valuers must clearly communicate the analyses, opinions and conclusions of the valuation to the intended user(s).
14. Record Keeping	Valuers must keep a copy of the valuation and a record of the valuation work performed for an appropriate period after completion of the assignment.

According to the BC, the inclusion of the Core Principles is to align the IVS with the Canadian Uniform Standards of Professional Appraisal (CUSPAP) and the Uniform Standards of Professional Appraisal Practice (USPAP).

The IVSC consider this:

> *"Would not only demonstrate the harmonization already in existence but also clarify vital expectations for all standard setters."*

GLOSSARY

Latest IVS added and revised the definitions of various terminology. Some of them were taken from the USPAP such as "assignment", "client", "confidential information", "intended use", "intended user" and "purpose". Some other additions to the glossary were already included in other sections such as IVS 104 Bases of Value and IVS 105 Valuation Approaches and Methods.

The latest IVS also revised the definition of "valuer" by removing the word "firm" in the definition, together with the relating stipulation in other paragraphs.

	Current version (effective 31 Jan 2020)	**Latest update** (effective 31 Jan 2022)
IVS Framework **30.1**	Valuer has been defined as "an individual, group of individuals, or a firm possessing the necessary qualifications, ability and experience to undertake a valuation in an objective, unbiased and competent manner. …	Valuer has been defined as "an individual, group of individuals, or a firm individual within an entity, regardless of whether employed (internal) or engaged (contracted/external), possessing the necessary qualifications, ability and experience to undertake a valuation in an objective, unbiased, ethical and competent manner. …
IVS Framework **50.1**	Valuations must be prepared by an individual or firm having the appropriate technical skills, experience and knowledge of the subject of the valuation, the market(s) in which it trades and the purpose of the valuation.	Valuations must be prepared by an individual, group of individuals or individual within an entity, regardless of whether employed (internal) or engaged (contracted/external), possessing the necessary qualifications, ability and experience to execute a valuation in an objective, unbiased, ethical and competent manner and having the appropriate technical skills, experience and knowledge of the subject of the valuation, the market(s) in which it trades and the purpose of the valuation.

In a webinar hosted by the IVSC explaining the update, a speaker explained that the removal of the word "firm" is to facilitate the future adoption of financial instrument valuation standards. As financial instruments are usually valued by in-house professionals among i-banks, the word "entity is used in place of "firm" in the definition of the valuer.

ALLOCATION OF VALUE (IVS 104)

An "allocation of value" section is added in IVS 104 Bases of Value. Under IVS, allocation of value is the separate apportionment of the value of an asset(s) on an individual or component basis. Allocation of value has been applied for valuation purposes in valuation for financial reporting. Under HKFRS/IFRS 3 Business Combinations, a purchase price allocation is performed to allocate the cost of acquisition into fair values of assets and liabilities of an acquisition target. The values of convertible debts are allocated to the equity, host debt, and embedded derivatives (subject to accounting policy choices and specific debt terms. The inclusion of allocation of value into IVS to ensure that this section is applied to all specialisms (business valuation, financial instruments valuation, and tangible assets valuation) and could be contained within the General Standards.

BUSINESSES AND BUSINESS INTERESTS (IVS 200)

The latest IVS describes in detail what constitute a business or business interest for valuation purpose. According to the IVS, "generally, a business would include more than one asset (or a single asset in which the value is dependent on employing additional assets) working together to generate economic activity that differs from the outputs that would be generated by the individual assets on their own.

Individual intangible assets, or a group of intangible assets might not constitute a business but would nonetheless be within the scope of this standard if such assets generate economic activity that differs from the outputs that would be generated by the individual assets on their own.

The commercial, industrial, service or investment activity of the business may result in greater economic activity (i.e., value) than those assets would generate separately. The excess value is often referred to as going concern value or goodwill. This excess value may constitute a separate asset under certain bases of value in certain situations. The absence of excess value does not automatically mean that the asset or group of assets does not constitute a business. In addition, economically, substantially all of the value of assets within a business may reside in a single asset."

In other words, the notion of business under IVS generally refers to assets working together and generate values greater than those assets would generate separately. Value-added, or the capacity to do so, seems to be a key element of a business under IVS.

In contrast, the IFRS/HKFRS 3 also defined a business from an input-process-output perspective. Under IFRS/HKFRS 3:

"A business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. The three elements of a business are defined as follows (see paragraphs B8–B12D for guidance on the elements of a business):

(a) **Input**: Any economic resource that creates outputs or has the ability to contribute to the creation of outputs when one or more processes are applied to it. ...

(b) **Process**: Any system, standard, protocol, convention, or rule that when applied to an input or inputs, creates outputs or has the ability to contribute to the creation of outputs. …

(c) **Output**: The result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income (such as dividends or interest) or generate other income from ordinary activities."

INVENTORY (IVS 230)

The inventory valuation section under IVS recommended two primary methods used to determine the value of inventory: the Replacement Cost Method (the "Bottom-Up Method") and the Comparative Sales Method (the "Top-Down Method").

The Bottom-Up Method, as confirmed by the exposure process, is commonly used to value raw materials, estimates the cost that the buyer would have incurred in acquiring the same amount and type of inventory in the marketplace. The components of cost under this method may include purchasing, handling, transporting, and storing the inventory. The cost basis is then adjusted for other relevant factors, such as obsolescence and compensation to the seller for a return on expenditures.

The Top-Down Method, as confirmed by the exposure process, is commonly used to value WIP and finished goods, values inventory at a base cost equivalent to the actual or expected selling price to customers in the ordinary course of business. The base cost is then adjusted for various factors, such as expenses incurred in disposition, profit commensurate with the degree of risk and amount of investment, and the time/cost required to dispose of the inventory.

On the other hand, under IAS/HKAS 2 (unless otherwise stipulated in the other IFRS/HKFRS), inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

IAS/HKAS 2 Inventories also explained the difference between net realisable value and fair value: "Net realisable value refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business. Fair value reflects the price at which an orderly transaction to sell the same inventory in the principal (or most advantageous) market for that inventory would take place between market participants at the measurement date. The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell."

REAL PROPERTY INTERESTS (IVS 400)

The chapter IVS 400 Real Property Interests has been revised to provide additional clarification for land and buildings held in informal, traditional, undocumented and unregistered manner. The introduction of this chapter has now incorporated the valuation of agricultural, unregistered and communal land.

In normal circumstances, property interests in different states or individual jurisdictions are managed and regulated by national or local legislations. The interests like legitimate individual, communal/community and/or collective rights over real estate should be held in a way that follow the traditional and official manner. However, the property interests may lack of registration or proper formality that deviate the ordinary regulatory approach in some particular instances. Valuers must understand the related legal framework of the nation or jurisdiction where the property is located before conducting a valuation.

Real property interest includes the right of ownership, control, use or occupation of land and buildings. Informal right can also be regarded as real property interest, such as informal tenure rights for communal/ community and/or collective or tribal land and the informal settlements or transition economies in urban or rural region, that can take the form of possession, occupation and right to use.

REFERENCE:

IVSC (2021), International Valuation Standards Effective 31 January 2022 and red line version

IVSC (2021), IVS: Basis for Conclusions - Reflecting changes introduced to IVS (effective 31 January 2022)

IVSC (2021), Latest Updates to IVS (effective January 2022) - webinar replay

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