IVS: Basis for Conclusions

Reflecting changes introduced to IVS (effective 31 January 2022)

International Valuation Standards Council

Basis for Conclusions

IVS Additional Technical Revisions 2021

&

IVS 230 Inventories

International Valuation Standards Council

- Changes from previous editions of International Valuations Standards are shown in red or ~~crossed out~~.

Please address publication and copyright matters to:
International Valuation Standards Council, 20 St Dunstan's Hill, LONDON, EC3R 8HL, UK
United Kingdom Email: contact@ivsc.org www.ivsc.org

ISBN: 978-0-9931513-6-1

Typeset and printed by Page Bros, Norwich

Contents

General Consultation Overview

As part of ongoing efforts to improve its standard-setting process and consistent with the goals in the IVSC *Purpose and Strategy Document*, the IVSC believes that it should be "operating in an open and transparent way." The IVSC believes that this document outlining the basis for many changes made in IVS (effective 31 January 2022) is a critical part of a transparent standard-setting process, consistent with the practices of other standard-setters around the world.

This *Basis for Conclusions* does not form part of IVS but has been drafted to provide the reader with the rationale behind certain technical revisions made within IVS (effective 31 January 2022). The IVS *Additional Technical Revisions 2021 Exposure Draft* was in consultation from 29 January 2021 to 30 April 2021 and the IVS 230 *Inventories Exposure Draft* was in consultation from 28 February 2020 to 30 June 2020. This document provides bases for conclusions for certain technical revisions made to IVS as a result of these consultations. The IVSC believes that this *Basis for Conclusions* document provides important insights into the standard-setting process and historical context for these standards, which may be considered in the interpretation of these standards and in future standard-setting activities.

As part of the consultation process, the IVSC Boards (collectively Standards Review, Business Valuation, Financial Instruments and Tangible Asset Boards) received a wide range of comment letters for both the IVS *Additional Technical Revisions 2021* and the IVS 230 *Inventories Exposure Drafts*. Many of the consultation responses were written by organisations representing hundreds or thousands of stakeholders and many of the comment letters were written by committees of individuals. The IVS *Additional Technical Revisions Exposure Draft* and the IVS 230 *Inventories* chapter contained within this document and within the IVS (effective 31 January 2022) were made as a result of these comment letters. This *Basis for Conclusions* document is not intended to address the reasons behind every minor change made to IVS (effective 31 January 2022). Rather, the following sections focus on more significant changes and the reasoning behind those changes and/or feedback that led to them.

The Boards note that there was wide diversity in views related to the appropriate depth and level of IVS *Additional Technical Revisions 2021*. The majority of respondents agreed with the level of detail and depth in the IVS *Additional Technical Revisions 2021*. However, some respondents believed that more detail would be helpful and that the standards should address additional topics not currently covered in the proposed revisions. Other stakeholders believed the IVS *Additional Technical Revisions 2021* were too detailed for standards. The Boards discussed all stakeholder views in depth. Ultimately, the Boards felt that the level of detail in the proposed revisions were appropriate and met the immediate needs of the IVSC and its stakeholders. However, the Boards noted that additional topics could be addressed in future standard-setting and will continue to issue IVS *Agenda Consultation 2020* for stakeholders to highlight the need for additional standards.

The Boards noted that there was also a wide diversity of views related not only to the appropriate depth and level of proposed additional technical revisions, but also in relation to the inclusion of glossary definitions for “Automated Valuation Model”, “Model”, “Social Asset”, “Social Value”, “Valuation Assignment” and “Valuation Engagement”, as well as the inclusion of the new sections on “Data Management” and “Governance”. The Boards further noted that much of the diversity of views were across specialisms (Business Valuation, Financial Instruments and Tangible Assets) and as such engaged in further market outreach with key IVS stakeholders, member organisations, and the IVSC Advisory Forum Working Group to fully examine and explore the issues raised as part of the consultation process.

As a consequence of this outreach the Board decided to delay inclusion of the definitions for “Automated Valuation Model”, “Model”, “Social Asset”, “Social Value”, “Valuation Assignment” and “Valuation Engagement”, as well as the inclusion of the new sections on “Data Management” and “Governance”. until further investigations could be made to ensure these proposed revisions to the General Standard could work across all specialisms.

In addition, the Boards made some further minor text revisions to the section on “Allocation of Value” to ensure this section not only applied to all specialisms but also to enable more detailed asset specific standards on “Allocation of Value” to be incorporated within the IVS Asset Standards in future editions of IVS.

In respect of IVS 230 *Inventories* there were a wide range of consultation responses received from IVS stakeholders and members and based on stakeholder feedback, the Business Valuation Board determined that for purposes of IVS 230 *Inventory*, inventory “*broadly includes goods which will be used in future production processes (ie, raw materials, parts, supplies), goods used in the production process (ie, work-in-process), and goods awaiting sale (ie, finished goods). should be defined as those liabilities requiring a non-cash performance obligation to provide goods or services.*” The Business Valuation Board have therefore excluded real property from the scope of IVS 230 *Inventory*, and the numerous and varied aspects of real property inventory were not considered or contemplated in the preparation of this standard.

The IVS *Additional Technical Revisions 2021* and new chapter on *Inventories* contained within this *Basis of Conclusions* will be effective from 31 January 2022, though early adoption is encouraged. Further to Board and additional discussions with IVSC Trustees it was agreed that all future IVSC standards should be referred to as IVS with reference to the effective date for each new version. For example, IVS (effective 31 January 2022).

IVS Introduction

The Appraisal Institute of Canada (AIC), the International Valuation Standards Council (IVSC) and The Appraisal Foundation (TAF) met in Washington DC on 29 and 30 August 2018 to discuss the further alignment of the Canadian Uniform Standards of Professional Appraisal (CUSPAP) and the Uniform Standards of Professional Appraisal Practice (USPAP) with International Valuation Standards (IVS).

During the meeting, representatives of the standard setting bodies discussed initial steps toward alignment. As part of this process, IVSC began incorporating some CUSPAP and USPAP definitions such as "intended use" and "intended user" within the IVS Glossary. In the same spirit, the AIC and TAF have agreed to use the terms "valuer" and "valuation practice" in their documents in lieu of the more familiar appraiser and appraisal practice.

A follow-up meeting of the working group was held on 31 May 2019. During this meeting CUSPAP, IVS and USPAP representatives agreed that whichever valuation standard was used, the valuer should produce credible results.

Furthermore, the representatives agreed that, although the different valuation standards may adopt slightly different requirements at different times, ultimately the requirements followed would be more or less the same. This is the same parallelism that is already demonstrated in the bridging document *A Bridge from USPAP to IVS 2018: A Guide to Producing IVS-Compliant Appraisals (the Bridge)*.

TAF and AIC representatives felt that it was neither advisable nor feasible to adopt IVS text. This is because CUSPAP and USPAP are widely adopted in their marketplaces for tangible assets valuations and, in the case of USPAP, they are responsible for setting congressionally authorised standards and qualifications for real estate appraisers. The representatives also felt that a medium-term goal should be to align the wording of CUSPAP, USPAP and IVS where possible.

In addition, it was felt that the high degree of harmonisation that already exists amongst the three standards should be recognised. It is believed that CUSPAP, USPAP and IVS are founded on the same core principles and are also strikingly similar in terms of the ongoing management of each existing standard.

It was felt that memorialising these core principles of valuation and the core principles of valuation standards would not only demonstrate the harmonisation already in existence but also clarify vital expectations for all standard setters.

As part of this process the Boards recommended the incorporation of the following "*Core Principles of Valuation Standard Setting*" and "*Core Principles of Valuation*" within IVS.

The IVSC Standards Boards have taken into account the following core principles when drafting the International Valuation Standards.

Core Principles of Valuation Standard Setting

1. Purpose (Objective)

The purpose of valuation standards is to promote and maintain a high level of public trust in valuation practice by establishing appropriate requirements for valuers.

IVS Introduction

2. Valuation Standards

Valuation Standards should be principle based and adequately address the development of a credible opinion of value and the communication of that opinion to the intended user(s).

3. Development and Revisions of Standards

Standards are to be created and revised, when necessary, by way of a transparent process after appropriate exposure.

4. Jurisdiction

Departures from the standards to comply with legislative and regulatory requirements that are in conflict with the standards are allowed.

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.

In relation to the question on "Are there any revisions or additions that you would make to the Core Principles of Valuation Standard Setting? If yes, please provide full details of the recommended revisions or additions, together with your reasoning for the proposed changes" most respondents agreed with the core principles of standard setting. Some respondents recommended a few minor changes to the core principles of standard setting but further to review by the Boards it was felt that no further changes were needed, particularly as any changes to these agreed principles would affect the harmonisation process.

In relation to the question on "Are there any revisions or additions that you would make to the Core Principles of Valuation? If yes, please provide full details of the recommended revisions or additions, together with your reasoning for the proposed changes" most respondents agreed with the core principles of valuation, although a few respondents, once again, recommended some minor changes. Further to review by the Boards it was felt that no further changes were needed.

Glossary

Further to the publication of IVS (effective 31 January 2020) which included the USPAP definitions for *Assignment*, *Client*, *Confidential Information*, *Intended Use*, *Intended User* and *Purpose* the Boards have continued to review the definitions contained within IVS.

In April 2020 the IVSC Standards Review Board set up a working group to review the IVS Glossary and the working group were tasked with the following aims;

1. Review definitions within the existing glossary such as “valuation”, “value” and “valuer” to ensure applicability across all specialisms (business valuation, financial instrument valuation and tangible assets valuation),

2. Consider the inclusion of additional definitions within IVS such as “calculation”, “cost”, “model” and “price”.

Further to the working group recommendations the Boards discussed the context of additional definitions within IVS (effective 31 January 2022), and whether such definitions represent universal terms to be utilised across all specialisms and jurisdictions, or whether these terms are specific to IVS (effective 31 January 2022). The Boards agreed that not only did these additional definitions work across all specialisms, but also felt that the inclusion of these terms would help drive harmonisation across disciplines and jurisdictions.

The Boards noted that there was a wide variety of responses in relation to the proposed definitions. Several respondents felt that the glossary should only include the definitions of terms that are used within IVS and questioned the inclusion of definitions for “AVM”, “social asset” and “social value” on this basis. Further respondents felt that the requirements for “limited scope engagements” varied on a regional basis and so the definition should not be included. Other respondents commented that the nomenclature for “model” should be changed to “valuation model”.

The Boards further noted that the overview of the Glossary stated as follows;

> 10.1. This glossary defines certain terms used in the International Valuation Standards.
>
> 10.2. This glossary is only applicable to the International Valuation Standards and does not attempt to define basic valuation, accounting or finance terms, as valuers are assumed to have an understanding of such terms (see definition of “valuer”).

On this basis the Board decided not to include the following definitions within IVS as these terms were not contained within IVS (effective 31st January 2022);

- Automated Valuation Model (AVM)
- Limited Scope Engagement
- Social Asset
- Social Value

In respect of the proposed definition of “model” a number of respondents felt that the nomenclature for this definition was incorrect and should be changed to “valuation model”. Respondents further felt that all references to a “model” within IVS should be changed to a “valuation model”.

The Boards discussed this proposal and felt that, though the change in nomenclature was valid, further investigation was required prior to the inclusion of this definition within IVS to ensure that this definition equally applied to financial instruments valuation, where the use of models and valuation models was quite prevalent.

In order to assist in this process, the Boards have set up a cross specialism AVM, Data and Modelling working group to review this and other definitions and to give additional consideration to the proposed section on data handling and data control. The Boards are planning to include a revised definition of “valuation model” when the next edition of IVS incorporating a new IVS 500 *Financial Instruments* chapter is completed.

In relation to the question on whether IVS should define “valuation assignment” and “valuation engagement” the majority of respondents felt that the inclusion of these terms was unnecessary and over complicated the standard. Further respondents commented that the distinction between these terms would not easily translate across other languages. The Boards also pointed out that the reference to an employed or engaged valuer was already included in the definition of valuer and therefore the inclusion of these additional definitions was unnecessary. As a result of the responses received the Boards decided not to include these terms within the glossary.

In respect of the inclusion of the proposed definitions for “basis of value”, “cost”, “discount rate”, “equitable value”, “fair market value”, “fair value”, “liquidation value”, “market value”, “price”, “synergistic value”, “valuation approach” and “valuation method”, the majority of respondents were in accordance with these revisions. The Boards further noted that the majority of these definitions were already included in IVS 104 *Bases of Value* and IVS 105 *Valuation Approaches and Methods* and therefore approved the inclusion of these definitions within IVS.

Regarding the definition of “valuer” already contained within IVS the Board made the following minor revisions to provide additional clarification:

> **Valuer**
>
> A “valuer” is 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. In some jurisdictions, licensing is required before one can act as a valuer.

The Boards also reviewed the comments in relation to the proposed definitions of “valuation” and “value” and noted that there was a wide range of views in relation to these key definitions with the majority of respondents agreeing with the proposed definitions or suggesting minor revisions to the proposed definitions.

The Boards discussed these definitions at length and determined that whereas the definition of valuation related to the process the definition of value related to the resultant value produced by this process. Further to discussion and the responses received the Boards revised the definitions as follows;

> **Valuation**
>
> The act or process of determining an opinion or conclusion of value of an asset on a stated basis of value at a specified date in compliance with IVS.
>
> **Value (noun)**
>
> The opinion resulting from a valuation process that is compliant with IVS. It is an estimate of either the most probable monetary consideration for an interest in an asset or the economic benefits of holding an interest in an asset on a stated basis of value.

Finally, in respect of the inclusion of the definitions of “investment value” and “worth” a number or respondents commented that as both these terms had the same meaning the inclusion of separate definitions for these terms within the Glossary was confusing. The Boards reviewed these comments and decided to only to include the definition of “investment value” as this was a more commonly used term and the definition of “worth” should not repeat the definition of “investment value” but should just refer to “investment value (ie, see investment value)”.

IVS *Framework*

As part of the feedback received from the IVS 2017 *Proposed Technical Revisions Exposure Draft* consultation process, clarification was required on whether the framework equally applied to individual valuers as well as groups of individuals. Some respondents also felt that in order for the framework to be equally applicable to financial instruments valuers section 20 Assets and Liabilities would also need to include reference to "*present and future claims on assets and liabilities*" (see section 20 Assets and Liabilities as follows). Furthermore, the Boards also received a number of comments on section 60 Departures, with a number of respondents feeling that the current standards in relation to departures was too wide and it was potentially possible for any valuation to be compliant with IVS (effective 31 January 2020) providing the departure was due to "*specific legislative, regulatory or other authoritative requirements*". The Boards therefore decided to revise the departures section in order to narrow the scope for departures and to provide further clarification in relation to departures. (see section 60 as follows).

The Boards also discussed Limited Scope Engagements and whether the "*act or process of determining and indication of Value with limitations in analyses, procedures or scope*" was compliant with IVS (effective 31 January 2020). Further to discussions the Boards felt that it was unlikely for an engagement of this nature to be fully compliant with IVS (effective 31 January 2020). The Boards also felt that Limited Scope Engagements were similar to Departures and therefore have not only changed the nomenclature of this section to Departures and Limited Scope Engagements but have also included the requirement for the valuer to disclose the "*significant ways in which they differ from the requirements of IVS*".

As part of the IVS *Additional Technical Revisions Exposure Draft* consultation stakeholders were asked whether IVS should change section 10 Compliance with Standards to provide additional clarification.

10. Compliance with Standards

10.1. When a statement is made that a valuation will be, or has been, undertaken in accordance with the IVS, it is implicit that the valuation has been prepared in compliance with all relevant standards issued by the IVSC.

10.2. In order for a valuation to be compliant with IVS the valuer must comply with the requirements contained within IVS.

10.3. A valuer can only depart from an IVS standard as described in section 60, below.

The majority of respondents supported this change and felt that the additional clarification was helpful, and the Boards therefore approved this change.

Further to the IVS *Additional Technical Revisions Exposure Draft* consultation stakeholders were also asked whether IVS should change section 20 Assets and Liabilities to incorporate present and future claims on assets and liabilities as shown below and if not to provide their reasons.

> **20. Assets and Liabilities**
>
> 20.1. The standards can be applied to the *valuation* of both *assets* and liabilities and present and future claims on *assets* and liabilities. To assist the readability of these standards, the words *asset* or *assets* have been defined to include liability or liabilities and groups of *assets*, liabilities, or *assets* and liabilities, except where it is expressly stated otherwise, or is clear from the context that liabilities are excluded.

The majority of respondents had no comment or agreed with the proposed revision to section 20 Assets and Liabilities to incorporate present and future claims on asset and liabilities. Further to discussions the Boards approved this change and have revised section 20 on Assets and Liabilities accordingly.

In addition stakeholders were also asked whether IVS should change section 30 Valuer to incorporate employed and engaged valuers as shown below and if not to provide their reasons.

> **30. Valuer**
>
> 30.1. Valuer is defined as an individual, or group of individuals, whether employed or engaged, possessing the necessary qualifications, ability and experience to undertake a *valuation* including the handling of data in an objective, unbiased and competent manner. In some *jurisdictions*, licensing is required before one can act as a valuer. Because a *valuation reviewer must* also be a *valuer*, to assist with the legibility of these standards, the term *valuer* includes *valuation reviewers* except where it is expressly stated otherwise or is clear from the context that *valuation reviewers* are excluded.

The majority of respondents had no comment or agreed with the proposed revisions although some respondents either did not understand the distinction between an employed an engaged valuer or felt that the distinction was unnecessary as the term valuer covered both employed and engaged valuers. Other respondents felt that the distinction between an employed and engaged valuer would not easily translate into other languages.

The Boards discussed the responses received and felt that this distinction was necessary to aid the integration of the future IVS 500 *Financial Instruments* chapter, particularly as the majority of financial instrument valuers work within entities and therefore are employed valuers.

Furthermore, the Boards felt that this section needed further revisions to be aligned to the revised definition of valuer contained within the IVS Additional Revisions Exposure Draft. As a result of these deliberations the Boards revised section 30 as follows;

> **30. Valuer**
>
> 30.1. *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. In some *jurisdictions*, licensing is required before one can act as a *valuer*. Because a *valuation reviewer must* also be a *valuer*, to assist with the legibility of these standards, the term *valuer* includes *valuation reviewers* except where it is expressly stated otherwise, or is clear from the context that *valuation reviewers* are excluded.

As part of the consultation stakeholders were asked whether section 30 should be revised to include "*individuals or groups of individuals, whether employed or engaged*".

> **50. Competence**
>
> 50.1. Valuations must be prepared by an individual or groups of individuals, whether employed or engaged, 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.

The majority of respondents agreed with this change or had no comment, though as with the revisions to section 30 Valuer, some correspondents felt that the distinction between an employed and engaged valuer was unnecessary.

Further to Board discussion the Board have revised this section as follows to incorporate the revisions to the definition of "valuer".

> **50. Competence**
>
> 50.1. *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*.

The Boards discussed the responses received and once again felt that this distinction was necessary for the future integration of the IVS 500 *Financial Instruments* chapter.

Finally, the Boards noted that from market feedback and previous consultations the Boards had received a number of comments on section 60 Departures, with a number of respondents feeling that the current standards in relation to departures was too wide and it was potentially possible for any valuation to be compliant with IVS (effective 31 January 2020) providing the departure was due to "*specific legislative, regulatory or other authoritative requirements*".

The Boards also discussed Limited Scope Engagements and whether the "*act or process of determining and indication of Value with limitations in analyses, procedures or scope*" was compliant with IVS (effective 31 January 2020). Further to discussions the Boards felt that it was unlikely for an engagement of this nature to be fully compliant with IVS (effective 31 January 2020) and therefore have not included Limited Scope Engagements within IVS.

The Boards therefore decided to revise to the departures section in order to narrow the scope for departures and to provide further clarification in relation to Departures as shown below;

60. Departures

60.1. A "departure" is a circumstance where specific legislative, regulatory or other authoritative requirements *must* be followed that differ from some of the requirements within IVS.

60.2. As required by IVS 101 *Scope of Work*, para 20.3 (n) and IVS 103 *Reporting*, para 10.2 the nature of any departures must be identified (for example, identifying that the *valuation* was performed in accordance with IVS and local tax regulations). If there are any departures that *significantly* affect the nature of the procedures performed, inputs, data, and assumptions used, and/or valuation conclusion(s), a *valuer* must also disclose the specific legislative, regulatory or other authoritative requirements and the ways in which they differ from the requirements of IVS (for example, identifying that the relevant *jurisdiction* requires the use of only a market approach in a circumstance where IVS would indicate that the income approach *should* be used).

60.3. Some Valuation Professional Organisations or regulatory regimes may allow procedures which deviate from IVS. In such circumstances, except as described in preceding paras 60.1 and 60.2, the resultant *valuation* would not be compliant with IVS.

The Boards noted that there was a wide variety of responses in relation to this question many of which were in relation to the inclusion of "Limited Scope Engagement" within IVS.

The Boards further noted that a number of respondents expressed concern in relation to the inclusion of 60.3 as they felt that this clause went outside the IVSC remit and that was more an issue for Valuation Professional Organisations and regulatory regimes to decide.

Further to discussion the Boards felt that the Departures section warranted further discussion amongst the Boards, particularly as the Boards need to also consider the integration of financial instruments valuation within the existing Departures section.

As a result of these discussions the Boards have decided not to change the nomenclature for this section and to delay any revisions to the Departure section until the next edition of IVS, which will include the new IVS 500 *Financial Instruments* chapter.

General Standards

IVS 101 *Scope of Work*

As part of the feedback received since the publication of IVS (effective 31 January 2020) and from the IVS 2017 *Additional Technical Revisions Exposure Draft* consultation process, some respondents questioned whether the use of the term "valuation engagement" within para 10.1 was appropriate as it implied that this section only related to engaged valuers.

Further to Board discussion it was felt that the term "valuation assignment" was more appropriate and provided additional clarification that this section applied to both employed and engaged valuers.

In addition, and in order to provide consistency across the general standards the sections within parentheses for 10.2(a) and 10.2(b) from referring to in-house valuations and third-party valuations have been changed to refer to employed and engaged valuers.

The IVSC Boards therefore proposed the following changes to IVS 101 *Scope of Work* in order to provide additional clarification to terms used within IVS (effective 31 January 2020):

> **10. Introduction**
>
> 10.1. A scope of work (sometimes referred to as terms of engagement) describes the fundamental terms of a valuation assignment or valuation engagement, such as the *asset(s)* being valued, the *purpose* of the *valuation* and the responsibilities of parties involved in the *valuation*. The requirements for a scope of work can be met using the supporting documentation that is used to provide a *valuation* as either an engaged or employed valuer.
>
> 10.2. This standard is intended to apply to a wide spectrum of valuation engagements and assignments, including:
>
> (a) *valuations* performed by *valuers* for their own employers (employed)
>
> (b) *valuations* performed by *valuers* for *clients* other than their employers (engaged); and,
>
> (c) valuation reviews where the reviewer *may* not be required to provide their own opinion of *value*.

The Boards noted that there was a wide variety of responses in relation to question over whether IVS (effective 31 January 2020) should change section 10.1 to refer to valuation assignment and valuation engagement. Furthermore, a number of respondents commented that they felt that the distinction between "valuation assignment" and "valuation engagement" were confusing and would not necessarily translate into other languages where the same term is often used for both.

Further to discussion the Boards felt that valuation was a more appropriate term to use in section 10.1 as it could apply to both "valuation assignments" and "valuation engagements" but would also avoid any market confusion between these two terms.

In relation to the question of whether IVS (effective 31 January 2020) should change the words in parentheses within section 20.1 (a) and (b) to refer to employed and engaged valuers the majority of respondents approved or had no comment in relation to this change.

Further to the consultation comments received and in order to create a consistent use of terms throughout IVS the Boards have revised section 10 Introduction as follows;

10. Introduction

10.1. A scope of work (sometimes referred to as terms of engagement) describes the fundamental terms of a *valuation* ~~engagement~~, such as the *asset(s)* being valued, the *purpose* of the *valuation* and the responsibilities of parties involved in the *valuation*.

10.2. This standard is intended to apply to a wide spectrum of valuation assignments, including:

(a) *valuation*s performed by *valuers* for their own employers ~~("in-house valuations"~~ employed),

(b) *valuation*s performed by *valuers* for *clients* other than their employers (~~"third-party *valuations*"~~ engaged), and

(c) valuation reviews where the *valuation reviewer may* not be required to provide their own opinion of *value*.

IVS 102 *Investigations and Compliance*

As part of the feedback received from the IVS 2017 *Proposed Technical Revisions Exposure Draft* consultation process and further to discussions amongst the IVSC Boards it was felt that the following section on Compliance with other standards was repetitive and unnecessary as the requirements were already contained within the IVS *Framework*.

There was a wide range of responses on the question in relation to "*moving section 40 Compliance with Other Standards to the IVS Framework*", with a number of respondents feeling that the *Framework* deals with compliance with IVS, whereas IVS 102 *Investigations and Compliance* section 40 deals with compliance with other standards. Other respondents felt that "*given the core nature of this section and considering that it refers to compliance, it may be better to repeat the Framework section or at least cross reference it.*"

The Boards considered the responses received and accepted that the IVS Framework dealt with compliance to IVS whereas this section dealt with compliance with other standards. The Boards therefore decided that further consideration and discussion was needed in relation to compliance prior to making any changes to this section on compliance with other standards.

In response to the question on whether there are "*any requirements within newly titled IVS 102 Investigations and Governance, section 40 Governance that you feel should be revised, added or removed*" there was also a wide range of responses.

Some respondents fully agreed with the inclusion of a new section 40 on Governance whereas other respondents felt that "*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 profession.*"

Other respondents commented that the proposed section on Governance was wrongly placed within IVS and should form part of the framework as good governance was to a certain extent a prerequisite of both IVS membership and providing an IVS compliant valuation.

Further respondents questioned this section as it contained "*requirements for a wide range of matters including how a business should be organized, how business should be conducted, reviews, record-keeping, etc*" and as the IVS has no regulatory powers they did not believe this section should form part of the standard as it could not be enforced.

Further to discussion amongst the Boards there was general agreement that good Governance applied to all specialisms (*business valuation*, *financial instruments valuation and tangible assets valuation*) and was a prerequisite for any valuation.

Furthermore, the Boards noted that with the Increasing development of Environmental, Social and Governance (ESG) and the increasing market need to not only quantify ESG as a whole but also to quantify the separate components, the issue of Governance has become more prevalent within the valuation process.

In light of the comments received and Board discussions the Boards have decided to delay inclusion of the Governance section within IVS, while they further consider the requirements of good governance and the placement of these overarching principles within IVS.

IVS 103 *Reporting*

Further to discussions amongst the Boards and in order to create further alignment with financial instrument valuers, who are for the most part undertaking valuations for their own employers (employed), the Boards have recommended the following change to the introduction to make this chapter more applicable to financial instruments valuers.

> **10. Introduction**
>
> 10.1. It is essential that the valuation report and/or supporting documentation communicates the information necessary for proper understanding of the *valuation* or valuation review. A report must provide the *intended users* with a clear understanding of the *valuation*. For the purposes of this section report also means supporting documentation that is used to provide a valuation as either an engaged or employed valuer.

The Boards noted that though the majority of respondents agreed with this change, a number of respondents had concerns in relation to this change and commented that this change "*may result in the unintended consequence of the standard implying that the valuation report or the supporting documentation does not need to provide the necessary information to understand the valuation.*"

Other respondents commented that "*a "report" and the "file documentation" are very different things and should not be equated*" or that "*a narrow reading of this section might infer that there is an option to include necessary information in either the report or supporting documentation, which is presumably not the case.*"

Further to discussions amongst the Boards there was a concern that the proposed additions could be misinterpreted in developing markets and could unintentionally lead to a lowering of current reporting requirements.

As a result of these discussions the Boards have decided to delay any revisions to this section and further consider how this section can be revised to incorporate financial instrument valuations which are largely undertaken by employed valuers, who may not have the same reporting requirements as engaged valuers.

In addition to the above proposed revision the Boards reviewed valuation reporting requirements and further to the inclusion of definitions for "*intended user(s)*" and "*purpose*" within IVS (effective 31 January 2022) have made the following revisions to provide additional transparency and clarity to reporting requirements.

30. Valuation Reports

30.1. Where the report is the result of an assignment involving the *valuation* of an *asset* or *assets*, the report *must* convey the following, at a minimum:

(a) the scope of the work performed, including the elements noted in para 20.3 of IVS 101 *Scope of Work*, to the extent that each is applicable to the assignment,

(b) the *intended use*,

(c) the intended user(s)

(d) the *purpose*

(e) the approach or approaches adopted,

(f) the method or methods applied,

(g) the key inputs used,

(h) the assumptions made,

(i) the conclusion(s) of value and principal reasons for any conclusions reached, and

(j) the date of the report (which *may* differ from the valuation date).

30.2. Some of the above requirements may be explicitly included in a report or incorporated into a report through reference to other documents (engagement letters, scope of work documents, internal policies and procedures, etc).

IVS 104 *Bases of Value*

Further to the publication of IVS 2017 *Additional Technical Revisions Exposure Draft* and feedback received during the consultation process the Boards continued to discuss revisions to the proposed section on Allocation of Value to ensure that this section applied to all specialisms (business valuation, financial instruments valuation, and tangible assets valuation) and could be contained within the General Standards.

As part of the standards setting process the IVSC Standards Review Board also reviewed other standards on Allocation of Value provided by various standard setters such as the Financial Accounting Standards Board, who have written the following standard in relation to allocation of value:

"*Allocations shall be performed on a reasonable and consistent basis using a methodology appropriate in the circumstances. Facts and circumstances, such as relevant characteristics of [item(s) being valued], must be considered when making this allocation. Generally, the allocation method should be consistent with the overall valuation premise/basis.*[1]"

Further to several working group calls and review by the Boards to ensure that the proposed section worked from both a "top-down" and "bottom-up" approach the proposed section on Allocation of Value has been revised to meet the needs of all specialisms.

As part of the consultation process the Boards asked the following questions;

Question 7.1: Section 220.1 states that allocation of value is the separate apportionment of value of an asset(s) on an individual or component basis. Do you agree with this statement? If not, please provide your reasoning and suggested revision to this section.

Question 7.2: Section 220.2 provides requirements for the valuer when allocating value. Do you believe that any requirements should be added or removed from this list? Please provide details of any suggested revisions together with your reasoning.

Question 7.3: Should the valuer expressly state the primary reason for the sum of the value of the individual allocated components differing from the value of the assets on an aggregate basis as stated in 220.3? If not, please provide your reasoning.

Question 7.4: Section 220 has been drafted to apply to all specialisms. Should additional Information be included within the Assets Standards for Business Valuation, Financial Instruments or Tangible Assets? If yes, please provide examples of the initial information to be include.

In respect of Question 7.1 the majority of respondents agreed with this statement or had no comment and though a few respondents recommended some minor revisions the Boards felt that the revisions proposed by respondents were too specialism specific for the IVS General Standards which needs to apply to all specialisms.

---

[1] *FASB ASC 820-10-35-18F*

In relation to Question 7.2 the majority of respondents agreed with or had no comment in relation to the requirements contained within this section though a few respondents suggested some minor revisions. Some other respondents commented that this section veered too far away from a principle based standard.

The Boards reviewed the comments received felt that the requirement to "*use a reasonable and consistent basis*" was unnecessary as this was an overarching principle of IVS. The Boards also discussed the ordering of these requirements and further to discussion have revised the order shown in paragraph 220.2.

Regarding Question 7.3 most respondents had no comment or agreed with the requirement, although a number of respondents questioned this section as within their specialisms it was unlikely that this would ever be the case as most business and financial instruments valuers would adopt a top-down approach when allocating value.

The Boards discussed this issue further and accepted that this section was incorporated to provide further details to tangible assets valuers, who sometimes allocate value for portfolios and other valuations such as plant and machinery using a bottom-up approach.

Further to discussion the Boards felt that this section was too specific to be included within the General Standards and would be better placed within the relevant Asset Standards contained within IVS 330 *Plant and Equipment* and with IVS 400 *Real Property Interests*.

Finally, in relation to Question 7.4 the majority of respondents had no comment or felt that no additional information on allocation of value was needed within the Asset Standards.

However, some respondents felt that for tangible assets valuation it would be useful to incorporate a section on portfolio valuation and a section on the apportionment between land and buildings for financial reporting purposes within IVS 400 *Real Property Interests*.

Further to the consultation, the Boards carried out additional outreach and discussion with the IVSC Advisory Forum Working Group, IVSC members and other stakeholders. As a result of this consultation and the responses to question 7.3 and question 7.4 the IVSC Tangible Assets Board (TAB) are considering including additional sections in apportionment for financial reporting purposes and for portfolio valuation within IVS 300 *Plant and Equipment* and within IVS 400 *Real Property Interests*.

Further to these conversations, the Boards have revised the section on Allocation of Value as follows:

> **220. Allocation of Value**
>
> 220.1. Allocation of value is the separate apportionment of *value* of an *asset(s)* on an individual or component basis.

220.2. When apportioning *value*, the allocation method must be consistent with the overall valuation premise/basis and the *valuer must*:

(a) follow any applicable legal or regulatory requirements,

(b) set out a clear and accurate description of the *purpose* and *intended use* of the allocation,

(c) consider the facts and circumstances, such as the relevant characteristic(s) of the items(s) being apportioned,

(d) adopt appropriate methodology(ies) in the circumstances.

IVS 105 *Valuation Approaches and Methods*

From discussions amongst the Boards, it was understood that many valuation models used for financial instruments valuation may not be easily classified using the classification system contained within IVS 105 *Valuation Approaches and Methods* as many financial instrument models use a mix of the Market Approach, Income Approach and Cost Approach.

Further to discussions amongst the Boards and in order to create further alignment with financial instrument valuers, the Boards have suggested the inclusion of the Hybrid Approach as a fourth valuation approach within this chapter. The Boards felt that the inclusion of the Hybrid Approach would not only assist financial instruments valuers but would also assist other specialisms where other hybrid valuation methodologies such as the residual method are unable to be easily classified under the Market, Income Approach or Cost Approach.

As a result of these discussions the Boards have proposed the following changes (shown in red below) to IVS 105 *Valuation Approaches and Methods* in order to provide further alignment with financial instruments valuations.

10. Introduction

10.1. Consideration *must* be given to the relevant and appropriate valuation approaches. The four approaches described and defined below are the main approaches used in *valuation*. They are all based on the economic principles of price equilibrium, anticipation of benefits or substitution. The principal valuation approaches are:

a. market approach,

b. income approach,

c. cost approach, and

d. hybrid approach.

80. Hybrid Approach

80.1. The Hybrid Approach uses one or more of a combination of the Market Approach, Income Approach and Cost Approach but cannot be easily categorised as one of the existing valuation approaches.

As part of the consultation process the Boards asked the following question;

Question 8.1: Do you think that IVS 105 *Valuation Approaches and Methods* should include a section on the Hybrid Approach? If not, please provide your reasoning.

In respect of Question 8.1 there was a wide diversity of responses however a large number of respondents felt that the Hybrid Approach should not be included.

Some respondents commented that the market, income and cost approach are globally established as the three main valuation approaches and the inclusion of an additional approach would create market confusion. Furthermore, others commented that the inclusion of a fourth approach would create an inconsistency with other standard setters, who used only three approaches and other bases of value such as IFRS 13 Fair Value, which considered only three valuation approaches.

Several respondents also commented that the inclusion of the "hybrid approach" as a fourth approach was unnecessary as there was no requirement for valuers to outline when more than one approach and method is used.

Other respondents felt that "*referring to a "Hybrid Approach" as a major class of within the valuation approaches could also confuse readers with the "hybrid method" applied when estimating the value of equity securities in complex capital structures.*"

The Boards discussed this issue further and consulted with the IVSC Advisory Forum Working Group, IVSC members and other stakeholders. Further to consultation The Boards agreed that rather than including the hybrid approach the introduction should be revised to clarify that one or more valuation approaches can be used to provide an IVS compliant valuation. As a result of these deliberations the Boards have not included the Hybrid Approach within IVS but have revised the introduction as follows;

> **10. Introduction**
>
> 10.1. Consideration *must* be given to the relevant and appropriate valuation approaches. *One or more valuation approaches may be used in order to arrive at the value defined by the appropriate basis of value.* The three approaches described and defined below are the main approaches used in valuation. They are all based on the economic principles of price equilibrium, anticipation of benefits or substitution.
>
> The principal valuation approaches are:
>
> (a) market approach,
>
> (b) income approach, and
>
> (c) cost approach.

Further to the publication of IVS 2017 *Additional Technical Revisions Exposure Draft* where it was stated that "*in due course the Boards are planning to include standards on data management within the General Standards*" and the publication of section 100 on Valuation Model the Boards have been discussing the inclusion of an additional section on data management.

The Boards also set up an IVS 101 to IVS 105 working group to review the existing General Standards and to draft a section on Data Management to be contained within IVS 105 *Valuation Approaches and Methods*.

As a result of these deliberations the Boards have also proposed the following addition (shown in red below) to IVS 105 *Valuation Approaches and Methods* in order to provide further clarification on the valuer's requirements in relation to data management.

100. Data Management

100.1. Valuation models require the use of data inputs, and the reliability of the valuation output is directly correlated to the accuracy and appropriateness of data inputs. The *valuer* should perform a professional opinion as to the reliability of:

a. the source of the data

b. the independence of the data

c. the reliability of the source

d. the appropriateness of the use of the data for the specific valuation context; and

e. any risks or limitations of the use of the data in this context

100.2. Data sources should be applied in order of appropriateness and level of confidence.

100.3. *Valuers* involved with work that includes data must conform and demonstrate compliance to the materially relevant legislation, regulatory or other relevant authoritative requirements for the handling of such data in the context of the valuation assignment.

As part of the consultation process the Boards asked the following questions;

Question 8.2: Do you think that IVS (effective 31 January 2020) should include a section within the General Standards on Data Management? If not, please provide your reasoning.

Question 8.3: Do you think that valuers should consider the elements contained within section 100.1 on Data Management in order to ensure the accuracy and appropriateness of the data? Are there any elements that you feel should be added or removed? Please provide your reasoning.

Question 8.4: Section 100.2 provides examples of valuation data. Are there any examples that you feel should be added or removed from this list? Please provide your reasoning.

Question 8.5: Section 100.3 states that "Valuers involved with work that includes data must conform and demonstrate compliance to the appropriate legislative, regulatory or other relevant authoritative requirements for the handling of such data." Are there any instances where you feel that this is not the case, if so, please provide examples?

In respect of Question 8.2 there was a wide range of responses in relation to this question with the majority of respondents providing no comment or agreeing with the the inclusion of this section. Some respondents agreed with the inclusion of the section on Data Management but felt that it would be better placed in other chapters within the IVS General Standards such as the IVS Framework or IVS Reporting. Further respondents disagreed with the inclusion of this section or felt that the current wording for this section was inappropriate and unworkable and the inclusion of this section "*expands the scope of work and increases the responsibilities of an engaged valuer to a level that may not be commercially undertaken or professionally warranted.*"

In relation to Question 8.3 the majority of respondents agreed with or had no comment in relation to the elements contained within 100.1 though some respondents felt that that these requirements would be better contained within IVS 104 section 90 Valuation Model. Further respondents recommended some minor revisions or questioned whether it was in the valuer's remit to provide "*a professional opinion on the data.*" Some respondents felt some rewording of phrases such as "*the independence of the data*" to provide additional clarity or suggested the inclusion of other requirements such as "*the level of precision of the data*".

Regarding Question 8.4 the Boards noted that this question had been incorrectly worded as the Boards had decided that it was inappropriate to include examples of data at this point in time. The Boards noted that the majority of respondents felt that no examples were needed, or the inclusion of examples would be inappropriate as any examples would be incomplete and could lead to market confusion.

Finally in relation to Question 8.5 the majority of respondents had no comment, agreed with this requirement or suggested some minor revisions to this section to provide additional clarification. Further respondents commented that the requirement to "*conform and demonstrate compliance to the materially relevant legislation, regulatory or other relevant authoritative requirements*" was unnecessary as this was an overarching requirement for all valuations and was already contained within IVS *Framework* Departures section.

Further to the consultation, the Boards reviewed the responses received and carried out additional outreach and discussions with the IVSC Advisory Forum Working Group, IVSC members and other stakeholders.

As a result of these deliberations, the Boards felt that the inclusion of the proposed section on data management was premature, particularly as the forthcoming revised IVS 500 Financial Instruments would include further requirements in relation to data management, data handling and data. The Boards also discussed the nomenclature for this section and whether additional sections on data management should also be included within the Asset Standards. Further to these discussions the Boards have decided to delay the inclusion of this section until next year in order to give the Boards and the working groups sufficient time to consider the comments and perspective emanating from both the consultation process and additional outreach.

Asset Standards

IVS 200 *Businesses and Business Interests*

As part of the feedback received from the IVS 2017 *Proposed Technical Revisions Exposure Draft* consultation process and further to discussions amongst the Business Valuation Board (BVB) and other stakeholders who were unclear as to what constituted a business or business interest the BVB have proposed the following revisions to provide additional clarification on the scope of this chapter.

20. Introduction

20.1. The definition of what constitutes a business *may* differ depending on the purpose of a *valuation*, but generally involves an organisation or integrated collection of *assets* engaged in commercial, industrial, service or investment activity. 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. A collection of Plant and Equipment (IVS 300 *Reporting*) and/or Real Property Interests (IVS 400 *Real Property Interests*) without the presence of other *assets*, or intangible components such as a workforce, would typically not be a business.

20.2. 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. If the *assets* do not meet these criteria, a *valuer* should defer to IVS 210 *Intangible Assets* and IVS 220 *Non-Financial Liabilities*.

20.3. The commercial, industrial, service or investment activity of the business may result in greater economic activity (ie, *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*.

20.4. Businesses can take many legal forms, such as corporations, partnerships, joint ventures and sole proprietorships. However, businesses could take other forms such as a division, branch, line of business, segment, cash generating unit, and asset group that can consist of parts of one or more legal entities.

20.5. Interests in a business (eg, securities) can also take many forms. To determine the *value* of a business interest, a *valuer* should first determine the *value* of the underlying business by applying these standards. In such instances, business interests should be within the scope of this standard but depending on the nature of the interest certain other standards may be applicable.

20.6. Valuers must establish whether the valuation is of the entire entity, shares or a shareholding in the entity (whether a controlling or non-controlling interest), or a specific business activity of the entity. The type of value being provided must be appropriate to the purpose of the valuation and communicated as part of the scope of the engagement (see IVS 101 *Scope of Work*). It is especially critical to clearly define the business or business interest being valued as, even when a valuation is performed on an entire entity, there may be different levels at which that value could be expressed. For example:

(a) Enterprise value: Often described as the total value of the equity in a business plus the value of its debt or debt-related liabilities, minus any cash or cash equivalents available to meet those liabilities.

(b) Total invested capital value: The total amount of money currently invested in a business, regardless of the source, often reflected as the value of total assets less current liabilities and cash.

(c) Operating Value: The total value of the operations of the business, excluding the value of any non-operating assets and liabilities.

(d) Equity value: The value of a business to all of its equity shareholders.

20.7. Valuations of businesses are required for different purposes including acquisitions, mergers and sales of businesses, taxation, litigation, insolvency proceedings and financial reporting. Business valuations may also be needed as an input or step in other valuations.

As part of the consultation process the Boards asked the following questions;

Question 9.1: Do you agree with the revised scope of IVS 200 Businesses and Business Interests? If not, please provide your reasoning.

Question 9.2: Do you think there are any other businesses or business interests that should be added to this scope? If so, please provide your reasoning.

In respect of Question 9.1 most respondents had no comment or agreed with the revised scope of IVS 200 *Businesses and Business Interests*. However both the Tangible Assets Board and some respondents had some concerns in relation to the following last sentence within 20.1 as the inclusion of these sentences could cause difficulties for plant and machinery, real estate and trade related property valuers, who would normally not consider the intangible elements within a valuation.

“A collection of Plant and Equipment (IVS 300 Reporting) and/or Real Property Interests (IVS 400 Real Property Interests) without the presence of other assets, or intangible components such as a workforce, would typically not be a business.”

Further to discussions between it was agreed that this sentence would be removed for the time being and a joint BVB/TAB working group would be set up to discuss and agree the differences between business valuation and trade related property valuation.

Regarding Question 9.2 most respondents had no comment or did not think that there any other businesses or business interests that should be added to this scope. Further to the comments received the BVB have made no further revisions.

IVS 230 *Inventories*

The Boards conducted a robust process on the valuation of inventories, which culminated with the issuance of IVS 230 *Inventories*. Central to this process was the issuance of the IVS 230 *Inventories Exposure Draft*, which was in consultation between 28 February 2020 and 30 June 2020. The Boards have carefully considered all the comments received during the consultation process in order to finalise IVS 230 *Inventories*.

Through the exposure process, the Business Valuation Board confirmed that the most common context for the valuation of inventory is financial reporting related to a business combination. In this context, the definition of inventory includes raw materials, work-in-process (WIP) and finished goods. Although Statements of Financial Accounting Standards No 141 has been superseded, in many ways current practice remains consistent with its guidance.

Although the respondents did indicate some diversity in nomenclature, the exposure process confirmed the 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.

When considering IVS the valuer must consider proportionality when applying IVS and as stated in IVS 102, 20.2 “*when determining the extent of evidence necessary, professional judgement is required to ensure the information to be obtained is adequate for the purpose of the valuation*.” In relation to inventories this means that the valuer does not need to go into the lowest level of detail or granularity but must use his professional judgement to weigh the sensitivity of the analysis, the availability and reliability of data, and the relative precision required by the valuation.

In consultation with the Tangible Asset Board, it was determined that real property inventory is already covered by IVS 410 *Development Property*. This approach was confirmed by stakeholder responses. As such, this standard focuses on valuation of inventory of physical goods that are not real property, as the numerous and varied aspects of real property inventory were not considered or contemplated in the preparation of this standard.

Feedback from stakeholders was positive. The Business Valuation Board determined that no major changes were needed to the exposed draft IVS 230 but did make a number of minor updates to IVS 230. The updates were to clarify language and harmonise terminology.

Additionally, based on feedback, the Business Valuation Board elected to make substantive changes per below:

- Additional language within para 20.5 for adjustment considerations when valuing other intangible assets.
- Additional language within para 60.5(a) to ensure alignment of cost basis and forecasted profit basis.
- Additional language within para 60.7 to strike the term "*functionally apportionment*" and clarify with additional detail.
- Addition of para 60.10 within the Top-Down Method to discuss the relative expected step between work-in-process and finished goods.
- Additional language within para 90.5 for adjustment considerations when valuing other intangible assets.
- Additional language within para 90.6 on the relative marketing spend for a pull-model.
- Strike para 120.3 within Unit of Account.

IVS 230 Inventory

10. Overview

10.1. The principles contained in the General Standards apply to *valuations* of inventory and *valuations* with an inventory component. This standard contains additional requirements for *valuations* of inventory.

20. Introduction

20.1. Inventory broadly includes goods which will be used in future production processes (ie, raw materials, parts, supplies), goods used in the production process (ie, work-in-process), and goods awaiting sale (ie, finished goods).

20.2. This standard focuses on *valuation* of inventory of physical goods that are not real property, as the numerous and varied aspects of real property inventory were not considered or contemplated in the preparation of this standard. The *valuation* of real property is covered in IVS 400 *Real Property Interests*.

20.3. While the book value of inventory only includes historical costs, the profits earned in the production process, which reflect returns on the *assets* utilised in manufacturing (including working capital, property, plant, and equipment, and intangible assets), are not capitalised into book value. As a result, the *market value* of inventory typically differs from, and is usually higher than, the book value of inventory.

20.4. As inventory is seldom transacted at an interim stage (eg, work-in-process) or *may* not be frequently sold to a third party to conduct the selling effort (eg, finished goods sold via distributor networks), the valuation techniques and considerations for inventory frequently vary from those of other *assets*.

20.5. Inventory valuations are performed for a variety of *purposes*. It is the *valuer's* responsibility to understand the *purpose* of a *valuation* and whether the inventory *should* be valued, whether separately or grouped with other *assets*. A non-exhaustive list of examples of circumstances that commonly include an inventory valuation component is provided below:

(a) For financial reporting *purposes*, *valuations* of inventory are often required in connection with accounting for business combinations, asset acquisitions and sales, and impairment analysis.

(b) For tax reporting *purposes*, inventory valuations are frequently needed for transfer pricing analyses, estate and gift tax planning and reporting, and ad valorem taxation analyses.

(c) Inventory valuation *may* be the subject of litigation, requiring valuation analysis in certain circumstances.

(d) *Valuers* are sometimes asked to value inventory as part of general consulting, collateral lending, transactional support engagements and insolvency.

30. Bases of Value

30.1. In accordance with IVS 104 *Bases of Value*, a *valuer must* select the appropriate *basis(es) of value* when valuing inventory.

30.2. Often, inventory valuations are performed using *bases of value* defined by entities/organisations other than the IVSC (some examples of which are mentioned in IVS 104 *Bases of Value*) and the *valuer must* understand and follow the regulation, case law, and other interpretive guidance related to those *bases of value* as of the valuation date.

40. Valuation Approaches and Methods

40.1. The three valuation approaches described in IVS 105 *Valuation Approaches* can all be applied to the *valuation* of inventory. The methods described below simultaneously exhibit elements of the cost approach, market approach, and income approach. If necessary for the *valuer* to classify a method under one of the three approaches, the *valuer should* use judgement in making the determination and not necessarily rely on the classification below.

40.2. When selecting an approach and method, in addition to the requirements of this standard, a *valuer must* follow the requirements of IVS 105 *Valuation Approaches*, including para 10.3.

50. Market Approach

50.1. The market approach, ie, reference to market activity involving identical or similar goods, has only narrow direct application for the *valuation* of inventory. Such applications typically include 1) inventory of commoditised products, or 2) inventory in which a market exists for the inventory at an interim stage in the production process. For non-commodity traded products or products that a market exists at an interim production stage, such selling prices *must* be adjusted downward to account for the disposal effort and related profit.

50.2. While the market approach is not directly applicable in most instances, *valuers should* consider market-based indications to determine the selling price as an input for other methods.

50.3. Other observable markets *may* provide insights on the returns attributable to the manufacturing and disposition of *assets* that can also be leveraged for inputs into other methods. Such returns are typically considered to exclude returns attributable to intellectual property. For example:

(a) Distributor profit margins represent a meaningful market proxy for returns on the disposition process, if an appropriate base of comparable companies is identified.

(b) Contract manufacturers, to the extent available, *may* provide a proxy for margins earned through the manufacturing process.

50.4. *Valuers must* comply with paras 20.2 and 20.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the market approach to the *valuation* of inventory. In addition, *valuers should* only apply the market approach to value inventory if both of the following criteria are met:

(a) information is available on arm's length transactions involving identical or similar inventory on or near the valuation date, and

(b) sufficient information is available to allow the *valuer* to adjust for all *significant* differences between the *subject* inventory and those involved in the transactions.

50.5. Where evidence of market prices is available, *valuers should* make adjustments to these to reflect differences between the *subject* inventory and those involved in the transactions. These adjustments are necessary to reflect the differentiating characteristics of the *subject* inventory and those involved in the transactions. Such adjustments may only be determinable at a qualitative, rather than quantitative, level. However, the need for *significant* qualitative adjustments *may* indicate that another approach would be more appropriate for the *valuation* (see IVS 105 *Valuation Approaches and Methods*, paras 10.1-10.10).

60. Income Approach

60.1. The *valuation* of inventory using the income approach requires the allocation of profit (value) contributed pre-valuation date versus the profit (value) contributed post-valuation date.

60.2. *Valuers must* comply with paras 40.2 and 40.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the income approach to the *valuation* of inventory.

Top-Down Method

60.3. The top-down method is a residual method that begins with the estimated selling price and deducts remaining *costs* and estimated profit.

60.4. The top-down method attempts to bifurcate the efforts, and related value, that were completed before the measurement date versus those efforts that are to be completed after the measurement date.

60.5. The key steps in applying the top-down method are to:

(a) Estimate the selling price. The *valuer should* rely on direct observations of selling prices when the information is available. However, such data is often not available and the selling price is often estimated by applying an appropriate gross profit margin to the net book value of finished goods at the product level or aggregate level. Typically, the projected gross profit margin in the period the inventory will be sold is used.

(b) Estimate the *costs* to complete (for work-in-process only). Completion costs *should* include all of the expenditures directly or indirectly remaining to be incurred post-valuation date in bringing the work in progress inventory to its finished condition. *Costs* to complete *should* be adjusted to remove expenses benefitting future periods.

(c) Subtract the *costs* of disposal. *Costs* of disposal represent *costs* that would be incurred post-valuation date in order to deliver the finished goods to the end customer. *Costs* of disposal *should* be adjusted to remove expenses benefitting future periods. Disposal costs generally include selling and marketing expenses while procurement and manufacturing expenses have typically already been incurred for finished goods inventory. In order to properly determine *costs* of disposal, each expense in the inventory cycle (including indirect overhead) *should* be categorised as having been incurred and, therefore, contributed to the *value* of the finished goods inventory or remaining to be incurred during the disposal process.

(d) Subtract the profit allowance on the completion effort (for work-in-process only) and the disposal process. An initial starting point *may* be to utilise the operating profit of the company. However, this methodology assumes the profit margin would be proportional to the *costs* incurred. In most circumstances there is rationale to assume profit margins which are not proportional to *costs* (see section 90).

(e) Consider any necessary holding costs. Holding costs *may* need to be estimated in order to account for the opportunity cost associated with the time required to sell the inventory. Additionally, the *valuer should* consider the risk born during the holding period when determining the required rate of return. Risks *may* be a function of the length of inventory life cycle and the contractual arrangements with end customers (eg, manufacturer bears the risk of fluctuation in *costs* of completion and disposal). Holding costs *may* be immaterial if the inventory turnover is high and/or the borrowing rate is low.

60.6. When determining the *cost* to complete, *costs* of disposal and profit allowance, the *valuer should* identify and exclude any expenses that are intended to provide future economic benefit and are not necessary to generate the current period revenue. Examples of future-benefit expenses *may* include research and development (R&D) related to new product development; marketing for a new product; recruiting to increase the size of the workforce; expansion into a new territory; depreciation of an R&D facility dedicated to future research; or restructuring costs.

60.7. Internally developed intangible assets *should* either be modelled as 1) a *cost* as if they were hypothetically licensed, and therefore included in either the *cost* of production or disposal, or 2) considered as part of a functional apportionment when determining the appropriate profit allowance.

60.8. When utilising the top-down method, *valuers should* consider whether sufficient data are available to appropriately apply the key steps. If sufficient data is not available, it *may* be appropriate to apply other methods or techniques.

60.9. The *valuer may* use the bottom-up method (see para 60.10) to corroborate the *value* derived from the top-down method (see paras 60.3 to 60.9).

Bottom-Up Method

60.10. The key steps in applying the bottom-up method are to:

(a) Determine the book value of the *subject* inventory. The book value *may* need to be adjusted for multiple considerations (see para 70.4 and section 110).

(b) Add any *cost* of buying and holding already incurred.

(c) Add any *cost* toward completion already incurred. Such *costs* typically include procurement and manufacturing expenses

(d) Add profit on total *costs* already incurred. An initial starting point *may* be to utilise the operating profit of the company. However, this methodology assumes the profit margin would be proportional to the *costs* incurred. In most circumstances there is rationale to assume profit margins which are not proportional to *costs* (see section 90).

60.11. When determining the *costs* already incurred, *valuers should* consider internally developed intangible assets that have contributed toward the completion effort.

70. Cost Approach

70.1. The primary method to value inventory is the replacement cost method. Raw materials inventory is typically valued using the current replacement cost method.

70.2. *Valuers must* comply with paras 60.2 and 60.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the cost approach to the *valuation* of inventory.

Current Replacement Cost Method

70.3. The current replacement cost method (CRCM) *may* provide a good indication of *market value* if inventory is readily replaceable in a wholesale or retail business (eg, raw materials inventory).

70.4. The *market value* of raw materials and other inventory *may* be similar to the net book value as of the valuation date but certain adjustments *should* be considered.

(a) The book value *may* need to be adjusted to FIFO basis.

(b) If raw material prices fluctuate and/or the inventory turnover is slow the book value *may* need to be adjusted for changes in market prices.

(c) The book value of raw materials *may* also be decreased to account for obsolete and defective goods.

(d) The book value *may* also need to be decreased for shrinkage, which is the difference between inventory listed in the accounting records and the actual inventory due to theft, damage, miscounting, incorrect units of measure, evaporation, etc.

(e) The book value *may* need to be increased for any *costs* incurred in connection with raw material preparation (eg, purchasing, storage and handling).

80. Special Considerations for Inventory

80.1. The following sections address a non-exhaustive list of topics relevant to the *valuation* of inventory.

(a) Identification of value-added processes and returns on intangible assets (section 90).

(b) Relationship to other acquired assets (section 100).

(c) Obsolete inventory – reserves (section 110).

(d) Unit of account (section 120)

90. Identification of Value-Added Processes and Returns on Intangible Assets

90.1. The *valuation* of inventory involves an allocation of profit between the profit earned pre-measurement date and the profit earned post-measurement date. In practice, profit earned *may* not be proportional to expenses. In most cases the risks assumed, value added, or intangibles contributed to the inventory pre-measurement date are not the same as those contributed post-measurement date.

90.2. *Valuers* typically *should* not simply allocate profit in proportion to disposition and manufacturing costs. This assumption can misallocate profit, as it presupposes that a company's production process earns profit on a pro-rata basis based on *costs* incurred. For manufacturers, this method is inappropriate if the *costs* of materials represent an initial outflow without significant efforts. Such an assumption also fails to recognise the contribution of internally-generated intangible assets with minimal associated costs.

90.3. *Valuers should* distinguish between value-added costs and those that are not value-added. The materials portion of COGS may not be a value-added cost because it does not contribute any of the profit to the inventory.

90.4. For a company that owns internally developed intangible assets that contribute to an increase in the level of profitability, the return on and of those intangible assets would be included in the total profit margin of the business. However, whether intangible assets are owned or licensed, the *market value* of the inventory *should* be the same.

90.5. The *valuer should* determine the extent to which the technology, trademarks, and customer relationships support the manufacturing and distribution processes and whether the returns are applicable to the entire base of revenue. If the intangible asset has been utilised to create the inventory (eg, a manufacturing process intangible), then the *value* of the inventory would be increased. Conversely, if the intangible asset is expected to be utilised in the future, at the time of disposal, the *value* of the inventory would be decreased.

90.6. For marketing intangibles, the determination of whether the intangible is an attribute of the inventory *may* be difficult. To assist with the determination, the *valuer may* consider how the inventory would be marketed by a market *participant* to its customers – pull vs push model. A push model requires significant disposal efforts for inventory and is less reliant on marketing intangibles, while a pull model depends on strong brand development and recognition to pull customers to the product.

90.7. A non-exhaustive list of other considerations for evaluating when intangible assets are contributed *may* include the amount of marketing spend, whether products are sold through a distributor, level of attrition for customer relationships, and any legal rights associated with the intangible assets.

90.8. In some cases, the intangible asset may consist of several elements that contribute to various aspects of the value creation, such as a pharmaceutical product intangible asset that is comprised of technology and tradename. This requires an assessment of how the overall profit related to each element of the intangible asset *should* be apportioned to manufacturing the inventory versus in the disposal effort.

90.9. Similarly, although a single intangible asset may only contribute to either the manufacturing or disposal effort, it is possible for a portion of the intangible to be contributed pre-measurement date and a portion contributed post-measurement date. For example, when assessing the contribution of symbolic IP for finished goods, although the product bears the respective branding associated with the symbolic IP, the related right to sell the branded product *may* not be conveyed with the transfer of inventory. As such, it *may* be appropriate to consider such rights in the *costs* of disposal.

100. Relationship to Other Acquired Assets

100.1. The *valuer should* maintain consistency, as appropriate, between assumptions used in the inventory valuation relative to *valuation* of other *assets* or liabilities.

110. Obsolete Inventory Reserves

110.1. The *valuer should* account for obsolete inventory reserve balances. The inventory reserve balances *should* be applied to the inventory in which the reserve applies, rather than netted against the entire inventory balance.

110.2. Typically, the obsolete inventory adjusted for the inventory reserve would not be valued as it has been adjusted to net realisable value. However, the *valuer may* need to consider further write-downs if *market value* is lower than net realisable value.

120. Unit of Account

120.1. For *purposes* of inventory valuation, it is often appropriate to assume inventory is one homogenous set of *assets*. However, it is possible for the profit margins, risk, and intangible asset contributions to vary by product or product group.

120.2. If the profit margins, risk, and intangible asset contributions vary by product or product group, and the relative mix of inventory being valued does not match the assumed sales mix used to develop the assumptions for the *valuation*, the *valuer should* assess the different groups of inventory separately.

As part of the consultation process the Boards asked the following questions;

1. Please provide any comments or suggested edits to the draft standard for consideration by the Boards.

2. Are you aware of additional applicable guidance not cited in this Exposure Draft?

3. Are you aware of additional methods or best practices to value inventory not cited in this Exposure Draft?

4. Do you believe that the addition of IVS 230 *Inventories* to IVS will help reduce diversity in practice and enhance practice with regard to the valuation of inventory?

5. Do you agree with the classification of the Top-Down Method and Bottom-Up Method under the Income Approach? If not, do you believe they would be more appropriately classified under the Market or Cost Approach, or under a new category such as the Hybrid Approach?

6. Do you agree that real property assets should be excluded from the scope of IVS 230 *Inventories*?

IVS 400 *Real Property Interests*

As part of the feedback received from the IVS 2017 *Proposed Technical Revisions Exposure Draft* consultation process and further to discussions amongst the Tangible Assets Board (TAB) and other stakeholders who were unclear as to whether this chapter included the valuation of agriculture and land the TAB have proposed the following revisions to provide additional clarification on this matter.

In addition, the TAB has also been engaged in discussions with both the World Bank and the UN in relation to the valuation of unregistered and communal land. Further to these discussions the TAB has revised the hierarchy of interests contained within this chapter to incorporate the valuation of unregistered and communal land.

The TAB have proposed the following change to IVS 400 *Real Property Interests* in order to provide additional clarification that this chapter includes the valuation of agriculture and land and to incorporate the valuation of unregistered and communal land:

20. Introduction

20.1. Property interests are normally defined by state or the law of individual *jurisdictions* and are often regulated by national or local legislation. In some instances, legitimate individual, communal/ community and/or collective rights over land and buildings are held in an informal, traditional, undocumented and unregistered manner ~~outside of a modern land administration and governance system~~. Before undertaking a *valuation* of a real property interest, a *valuer* must understand the relevant legal framework that affects the interest being valued.

20.2. A real property interest is a right of ownership, control, use or occupation of land and buildings. A real property interest includes informal tenure rights for communal/community and or collective or tribal land and urban/rural informal settlements or transition economies, which can take the form of possession, occupation and rights to use.

There are three main types of interest:

a. the superior interest in any defined area of land. The owner of this interest has an absolute right of possession and control of the land and any buildings upon it in perpetuity, subject only to any subordinate interests and any statutory or other legally enforceable constraints,

b. a subordinate interest that normally gives the holder rights of exclusive possession and control of a defined area of land or buildings for a defined period, eg, under the terms of a lease contract; and/or,

c. a right to use land or buildings but without a right of exclusive possession or control, eg, a right to pass over land or to use it only for a specified activity.

20.6. To comply with the requirements to state the extent of the investigation and the nature and source of the information to be relied upon in IVS 101 *Scope of Work*, para 20.3.(j) and IVS 102 *Investigations and Compliance*, the following matters ~~*must*~~ *should* be considered:

a. the evidence, if available, required to verify the real property interest and any relevant related interests,

b. the extent of any inspection,

c. responsibility for information on the site area, site characteristics and ~~any~~ building floor areas,

d. responsibility for confirming the specification and condition of any building,

e. the extent of investigation into the nature, specification and adequacy of services,

f. the existence of any information on ground conditions and ~~foundation~~ soil conditions,

g. responsibility for the identification of actual or potential environmental factors ~~risks~~,

h. legal permissions or restrictions on the use of the property and any buildings, as well as any expected or potential changes to legal permissions and restrictions.

As part of the consultation process the Boards asked the following questions;

Question 10.1: Do you agree with including the valuation of unregistered and communal land within IVS 400 *Real Property Interests*? If not, please provide your reasoning.

Question 10.2: Do you agree with the proposed changes to section 20.6 to provide additional clarification on the valuation of agriculture and land? If not, please provide your reasoning.

In relation to question 10.1 most respondents had no comment or agreed with including the valuation of unregistered and communal land within IVS 400 *Real Property Interests*. However, a few respondents recommended some minor revisions. Further to discussions amongst the Boards it was agreed that the phrase "outside of a modern land administration and governance system" should be deleted as it did not add any further requirements to this section and may not be well received in developing markets.

As a result of these discussions section 10.1 has been revised as follows;

> 20.1. Property interests are normally defined by state or the law of individual *jurisdictions* and are often regulated by national or local legislation. In some instances, legitimate individual, communal/ community and/or collective rights over land and buildings are held in an informal, traditional, undocumented and unregistered manner ~~outside of a modern land administration and governance system~~. Before undertaking a *valuation* of a real property interest, a *valuer must* understand the relevant legal framework that affects the interest being valued.

Regarding Question 10.2 most respondents had no comment or agreed with the proposed changes to section 20.6 to provide additional clarification on the valuation of agriculture and land. As a result of the comments received the Board approved these changes.

International Valuation Standards

International Valuation Standards Council,
20 St Dunstan's Hill, London EC3R 8HL,
United Kingdom

Email: contact@ivsc.org   Web: www.ivsc.org

International Valuation Standards Council