Australian Government

Australian Accounting Standards Board

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Chris Thorne
Chairman
International Valuation Standards Board
41 Moorgate
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Submitted to: CommentLetters@ivsc.org

Dear Chris

AASB comments on IVSC Exposure Draft
Proposed New International Valuation Standards

The Australian Accounting Standards Board (AASB) is pleased to provide comments on the International Valuation Standards Board (IVSB's) June 2010 Exposure Draft *Proposed New International Valuation Standards* (ED).

The global financial crisis highlighted weaknesses in valuations used in financial markets. Therefore, the AASB supports the work being undertaken by the IVSB to address concerns raised by the G-20 to develop robust International Valuation Standards (IVSs) that can be easily understood and consistently applied.

The AASB believes that the proposals in this ED effectively increase transparency of the valuation process and allow users to place greater confidence on valuation outcomes being reported. We particularly support the accent on ensuring that valuations are attuned to the purposes of the valuation when carried out in the context of financial reporting.

However, the AASB believes that the following points should be addressed in the IVSs or in future technical guidance papers.

Inconsistent definitions

The AASB notes that there are instances throughout the proposed IVSs where defined terms for valuation purposes are inconsistent with the accounting terminology (for example, the definition of intangible assets). The proposed IVS 301.02 *Valuations of Intangible Assets* suggests that goodwill is an unidentifiable intangible asset, whereas IAS 38 *Intangible Assets* excludes goodwill from the definition of intangible asset.

The AASB is particularly concerned about the proposed definition of fair value. The AASB acknowledges the IVSB's decision to amend the definition of fair value to more clearly articulate its intended meaning. However, given that valuations are undertaken for a variety of purposes, the AASB believes that it is not helpful to develop a broad-purpose definition of fair value, because it could lead to confusion and it will be difficult to develop a definition that can be applied in all contexts.

Instead, the AASB believes that the IVSC should ensure that when valuers are required to prepare a valuation, other than a market valuation – for example, determining fair value for accounting purposes – they should be directed to the appropriate definition in the International Financial Reporting Standards (IFRSs). The following wording (from paragraph 5.2 of the current version of International Valuation Guidance Note No. 1 *Real Property Valuation*) should be incorporated into the standards or technical guidance papers:

> "Where a type of value other than Market Value is the purpose of a valuation, the Valuer shall apply the appropriate definition of value and shall follow IVS 2 and applicable GNs. It is the responsibility of the valuer to avoid potential misunderstandings or misapplications of the valuation estimate in situations where a value other than Market Value is the purpose of the assignment. Proper disclosures, identification and definition of terms, and stated limitations on the applicability of the valuation and the Valuation Report normally ensure compliance."

However, if the IVSB is to retain its definition of fair value, the AASB believes that the definitions of fair value and market value should be reconciled with the definition of fair value for IFRS purposes (particularly with the proposed revised definition of fair value) to help minimise any confusion with their intended meaning.

Determining own credit risk

The AASB notes that IVS 304.01 *Valuations of Financial Instruments* considers the incorporation of credit risk in assessing the value of debt instruments. Paragraph 11 notes that the credit risk of the issuer is relevant and should be incorporated into the valuation of an entity's financial liabilities. However, the proposed Standard does not go into detail about the methods that can be employed to determine the impact of own credit risk on the value of financial liabilities. Paragraph 11 notes that, where it is appropriate to assume a transfer of the liability, potential sources for determining own credit risk include the yield curve for the entity's own bonds or credit default swap spreads. Most entities do not have access to credit default swap spreads in order to separate and accurately value the change in their own credit risk from other market factors. Therefore, determining the impact of own credit risk on the fair value of an entity's financial liabilities is often extremely difficult.

In addition, paragraph 11 does not provide guidance on how to determine the impact of changes in an entity's own credit risk where the issuer of a liability does not have the ability to transfer the liability and can only settle with the counter party.

The IASB issued Exposure Draft ED/2010/4 *Fair Value Option for Financial Liabilities* earlier in the year, proposing separate presentation in other comprehensive income (OCI) of changes in the fair value of financial liabilities due to changes in own credit risk for financial liabilities designated at fair value through profit or loss. ED/2010/4 proposes to retain the methodology that is currently included in IFRS 7 *Disclosures* as a proxy for measuring the change in fair value due to own credit risk. The IASB acknowledges that the IFRS 7 methodology poses practical difficulties for determining the effect of changes in credit risk specific to the entity because in most instances the amount determined as 'own credit risk' will incorporate the impact of other market factors that also lead to changes in interest spreads, including demand and supply for the financial instrument (liquidity), market sentiment and traded volumes.

The FASB rejected the IFRS 7 methodology as a proxy for determining the impact of own credit risk on the fair value of financial liabilities in its Exposure Draft of proposals to replace the financial instruments requirements. Instead, the FASB identified other methods that can be employed, but did not want to prescribe a methodology. Instead, the FASB places the onus on the entity to find a suitable method for determining the impact of own credit risk.

Given the complexity of determining own credit risk and the concerns that have been raised about the IFRS 7 methodology, the AASB believes that the IVSB could play a useful role in providing guidance on the methods for determining own credit risk in the valuation of financial liabilities. This would be particularly appropriate if the FASB approach were adopted of providing broad parameters within which the impact of own credit risk must be determined, but without giving guidance. Accordingly, the AASB strongly encourages the IVSB to work closely with the IASB and the FASB in this area to develop guidance. This may increase the chance of a converged outcome between the Boards.

References to IFRSs

The AASB notes that a number of the proposed IVSs paraphrase/summarise IFRS requirements. The AASB believes that it would be preferable for IVSs to have direct (ambulatory) references to the relevant IFRSs that valuers should consider in undertaking the specific valuation, rather than paraphrasing, because this can often result in unintentionally changing the meaning of the requirements. In addition, given the number of projects in the IASB's work program, the AASB believes it would be arduous for the IVSB and its constituents to maintain IVSs for changes to IFRSs, which could result in out of date information in IVSs.

If you have any queries regarding any matters in this submission, please contact me or Natalie Batsakis (nbatsakis@aasb.gov.au).

Yours sincerely

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Kevin M. Stevenson
Chairman and CEO