



INTERNATIONAL VALUATION STANDARDS COUNCIL

EXPOSURE DRAFT

The Role of the Professional Valuer in the Audit Process

A Practical Guide for Professional Valuers

Comments on this Exposure Draft are invited before 15 September 2012.

All replies may be put on public record unless confidentiality is requested by the respondent. Comments may be sent as email attachments to: CommentLetters@ivsc.org or by post to **IVSC, 41, Moorgate, London EC2R 6PP, United Kingdom.**

June 2012

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This document contains extracts from the ISA 620 Using the Work of an Auditor's Expert contained in the Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements – 2010 Edition of the International Auditing and Assurance Standards Board, published by the International Federation of Accountants (IFAC) in April 2010 and is used with permission of IFAC

Introduction to Exposure Draft

Today's business world has created some significant challenges for preparers of financial statements, auditors and professional valuers. The complexity and speed of innovation in business practices is unprecedented. The volume and pace of change of regulation and professional standards is also daunting, even for the most well-resourced organisation. All of this is compounded by the increasing demands from investors and other users of financial statements for additional information that is transparent and meaningful.

Valuation measurements are required by many financial reporting standards particularly under the International Financial Reporting Standards (IFRSs). Accordingly the valuation of assets, liabilities and equity interests require careful consideration by preparers of financial statements and their auditors, who are responsible for forming an opinion on the financial statements. Professional valuers may be involved in assisting a reporting entity, by reporting the value of certain assets and liabilities for use in the financial statements, or in assisting the auditor of the entity's statements in determining whether the values reported by the entity are reasonable and well supported.

Against this background the IVSC Professional Board has identified the need for:

- professional valuers to have a better understanding of the role of the auditor and the regulatory environment under which auditors operate
- guidance for professional valuers on how they can most effectively assist both auditors and entities during the audit process.

The views of professional valuers, reporting entities and auditors on this Exposure Draft are especially welcome.

The assistance of the International Federation of Accountants (IFAC) and the International Auditing and Assurance Standards Board (IAASB) in the preparation of this guide is gratefully acknowledged.

Questions for Respondents

The IVSC Professional Board invites responses to the following questions. Not all questions need to be answered but to assist analysis of responses received please use the question numbers in this paper to indicate to which question your comments relate. Further comments on any aspect of the Exposure Draft are also welcome. If you disagree with any of the proposed guidance, please indicate why and what alternative you consider appropriate.

Notes for respondents:

- 1 Responses should be made in letter format, where appropriate on the organisation's letter heading. Unless anonymity is requested, all comments received may be displayed on the IVSC website.
- 2 Comments should not be submitted on an edited version of the Exposure Draft.
- 3 It is most helpful if comment letters are submitted by email in an unlocked pdf format file so that comments can be extracted for analysis. Documents will be secured before being placed on the IVSC web site.

Questions

- 1 The Board has identified two principal areas where professional valuers may need guidance on the role or the auditor and the audit process. The first is when acting as an auditor's expert; the second is when acting for an entity in providing valuations that will be included in a financial statement that will be subject to audit.

a) Do you agree that these are the only two roles in respect of which valuers need guidance on audit procedures? If not please identify the additional roles of which you are aware.

b) Do you consider that the distinction between the two roles is clearly explained?

- 2 In paragraph 15 an extract from ISA 620 is provided which explains that an auditor's expert may be either internal (ie a partner or member of staff in the auditor's firm or of a network firm) or external. The draft Guide proposes that no distinction is necessary between these roles, and that the guidance provided is applicable to both situations.

Do you agree with this conclusion? If you believe that distinction can be drawn, for example that some of the guidance may not be applicable to a valuer acting as an internal expert, please identify the distinction and if you believe that additional guidance specific to each role should be provided.

- 3 In the section "Planning the Assignment" (paras 21-24) the proposed guidance recommends close liaison with the auditor and that a valuer appointed as an auditor's expert should regard themselves as a member of the auditors team and be prepared to accept direction from the auditor. The Board is aware that some professional valuers believe that close liaison with a client, whether it be an auditor or not, may threaten their independence and objectivity. The Board does not consider this to be the case given that both the auditor and any experts the auditor appoints are required to provide an independent and objective view of the reasonableness of the valuation measurements provided by the entity's management.

Do you agree with the Board's view? If not please give an example of how a professional valuers objectivity may be compromised through close cooperation with an auditor when acting as an auditor's expert.

- 4 Paragraph 25 indicates that if a professional valuer follows the IVSs and any relevant Technical Information Papers or other guidance issued by the IVSC or other organisations it assists the auditor in verifying that the work is in accordance with applicable standards. The reference to "other organisations" was included because the Board recognises that IVSC is not the exclusive provider of valuation guidance, and that guidance issued by other organisations may be accepted by consensus under certain circumstances. However, it has been argued that an unqualified reference to "other organisations" may appear to mandate the use of guidance that is inconsistent with IVSC pronouncements and seems to encourage, rather than reduce, diversity.

Do you agree that reference should be made to the existence of other organisations guidance or other pronouncements in this Guide? If so do you consider that either some qualification or limitation should be provided, or a list of other organisations deemed to issue appropriate valuation guidance be included?

- 5 The section "Scope of Work" (paras 25-32) indicates that a valuer acting as an auditor's expert may only be required to review aspects of a valuation provided by either management or a valuer appointed by management. IVS 101 Scope of Work allows significant flexibility in defining the extent of investigation and valuation advice to be provided. If any of the report contents specified in IVS 103 are not required those excluded just need to be identified in the scope of work document,

Do you consider that the guidance provided in the "Scope of Work" section of this document for a valuer undertaking a limited review of a reporting entity's valuation when acting as an auditor's expert is sufficient? If not what aspects do you consider merit further attention?

- 6 Appendix 1 "Resources" contains a list of other documents that are relevant to this guidance and which provide further reading on this topic.

Do you consider that there are other relevant and useful documents that could be included?

- 7 The proposed guidance is intended to be capable of global application across different jurisdictions. The intention is to focus on broadly applicable principles and to avoid detailed descriptions of aspects of either the role of the auditor or a valuer involved in the audit process.

Do you believe that the guidance contains an appropriate level of detail for a global audience? If not, please specify where you consider more or less detail is required, or any omissions that you consider to be material.

EXPOSURE DRAFT

The Role of the Professional Valuer in the Audit Process

A Practical Guide for Professional Valuers

Preamble

The International Valuation Standards Council (IVSC) is an independent, not-for-profit, private sector organisation that has a remit to serve the public interest. The IVSC's objective is to build confidence and public trust in the valuation process by creating a framework for the delivery of credible valuation opinions by suitably trained valuation professionals acting in an ethical manner.

The IVSC achieves this objective by:

- creating and maintaining the International Valuation Standards (IVSs),
- issuing technical guidance for professional valuers, and
- promoting the development of the valuation profession and ethical practices globally.

This Guide has been prepared by the IVSC Professional Board in order to explain the role of the professional valuer in the audit process. It examines the relevant sections of the International Standards on Auditing (ISAs) and relates these to requirements in the IVSs. In particular, IVS 300 Valuations for Financial Reporting provides guidance on a number of accounting purposes for which valuation may be required under the International Financial Reporting Standards (IFRSs).

The proposals in the Exposure Draft are not intended to alter or amend the requirements of these standards.

Reading this guidance is not a substitute for reading the IVSs or ISAs, and professional valuers should determine whether and how to respond to the situations described based on the facts of a specific engagement or project.

Contents

	<i>Paragraphs</i>	<i>Page</i>
Purpose of this Guide	1 - 5	3
The Financial Reporting Environment	6 - 10	4
The Role of the Independent Auditor	11	5
The Auditor's use of An Expert	12 - 20	5
Planning the Assignment	21 - 24	7
Scope of Work	25 - 32	8
Review of the auditor's expert's work by the auditor	33 - 36	10
Special Considerations	37	11
Professional Valuers Engaged as Management's Expert	38 - 45	13
Appendix 1: <i>Resources</i>		15
Appendix 2: <i>Considerations for Agreement between the Auditor and an Auditor's External Expert</i>		16
Appendix 3: <i>Auditor's Assessment of the Professional Valuer</i>		18
Appendix 4: <i>Developing the Scope of Work</i>		19

Purpose of this Guide

- 1 The increasing use of valuation measurements in financial reporting standards creates situations where professional valuers are required to provide advice on the appropriate values to include in financial statements. This may involve assisting the reporting entity in estimating the value of the assets, liabilities or equity interests or assisting the entity's auditor in determining whether the values provided by management are reasonable and well supported. This guide is primarily concerned with the latter although it is also helpful to professional valuers engaged by a reporting entity to understand the audit process to enable them to provide a service that anticipates the requirements of the auditor.
- 2 Where the valuation measurements in financial statements are significant or complex, effective interaction between the professional valuer, acting as the auditor's expert and the independent auditor is a critical factor in ensuring that the audit progresses smoothly and without undue delay.
- 3 Effective interaction requires mutual understanding of the respective responsibilities of each professional involved in the audit process. For the professional valuer engaged by the auditor, there needs to be an appreciation of:
 - 1 the types of information that the auditor might request or discuss with the professional valuer,
 - 2 the factors that significantly affect whether the professional valuer's work will be adequate for the auditor's purposes, and
 - 3 the evaluations that the auditor is required to make on the professional valuer's work.
- 4 Most auditors are required to follow auditing standards, and increasingly these are the International Standards on Auditing (ISAs). If an auditor engages a professional valuer as an auditor's expert, the International Standard on Auditing ("ISA") 620, *Using the Work of an Auditor's Expert*, issued in March 2009¹ is relevant. This sets out certain steps that an auditor should take in relation to the engagement of an expert in a subject other than auditing or accounting (such as a valuation expert), including evaluating whether the expert has the necessary competence, capabilities and objectivity for the auditor's purposes.
- 5 This Guide is designed to build mutual understanding between the professional valuer, an entity's management and the auditor so that they can work together effectively.

¹ See "Resources" page 14

The Financial Reporting Environment:

- 6 The use of valuation measurements in financial reporting has become more widespread, especially as more countries adopt the International Financial Reporting Standards (IFRSs), although they have been a feature of other accounting regimes for many years. Depending on the financial reporting framework, valuations may be used for the measurement in financial statements of many types of asset. The valuations may be required of the assets of an acquired business following a business combination, to test assets for impairment, to calculate depreciation or determine the amount of an asset or liability to be recorded on the balance sheet. The Commentary to IVS 300 *Valuations for Financial Reporting* describes the common purposes for which valuations are required under the IFRSs and the appropriate enquiries and assumptions for each of those purposes. Preparers of financial statements, auditors and professional valuers alike need to understand the accounting requirements relating to valuation measurements for different accounting purposes, including the required disclosures, and to give appropriate consideration to their application.
- 7 The nature and reliability of information available to support a valuation can vary widely. For some types of asset, for example, listed securities, the reporting entity can normally determine the value required at the reporting date without undue difficulty, and this can be verified by the auditor. However, for assets for which prices are not readily observable in an active market, an auditor will expect the reporting entity to demonstrate that the reported values are reasonable and well supported. To assist in this, the reporting entity may appoint a professional valuer to provide valuations suitable for use in the financial statements, or the auditor may appoint their own expert.
- 8 The disruption of markets caused by the financial crisis of 2008 created greater uncertainty around valuations and with it an increased risk of material misstatement in financial statements. This in turn has led to greater scrutiny of valuations appearing in financial statements by regulatory bodies.
- 9 This increased attention on reported measurements supported by valuations is matched by increased oversight of the audit process generally. For example, following some high profile corporate failures in the USA the Sarbanes Oxley Act of 2002 established the Public Company Accounting Oversight Board (PCAOB) to oversee the audits of publicly listed companies in the USA. Similar bodies have been established in other countries, and a global body, the International Forum of Independent Audit Regulators (IFIAR) established to promote collaboration in regulating audit activity was established in 2006. Given this environment, an increasing trend of scrutiny of audits and valuations in financial statements can be expected around the world. This will necessitate an enhanced understanding by professional valuers of:
 - the relevant accounting, valuation and auditing standards to ensure that the valuation process and report meets their requirements,
 - the respective roles of the independent auditor and the professional valuer as an auditor's expert, including the scope of assignments undertaken,

- the need for clear, open and effective communication between the professional valuer and the independent auditor (when engaged as an auditor's expert) and reporting entity's management (when engaged as a management expert).

10 This guide is aimed at providing a better understanding of these matters.

The Role of the Independent Auditor

11 The role of an independent auditor is to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting standards and present a true and fair view of the entity's financial position and performance. This is achieved through obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high, but not absolute, level of assurance, and hence the concept of materiality is very important in the gathering of sufficient appropriate audit evidence to support the auditor's report². It is important that the auditor be independent of the reporting entity being audited. Users of the reporting entity's financial information, such as investors, government agencies, and the general public, rely on an independent auditor to present an unbiased audit report.

The Auditor's use of an Expert

12 The International Auditing and Assurance Standards Board (IAASB) is responsible for the ISAs. In 2009 the IAASB completed a project to clarify and enhance the various ISAs. The following ISAs and International Auditing Practice Notes (IPANs) are of particular relevance to this Guide as they contain requirements and guidance for auditors in relation to either the use of experts or the audit of accounting estimates made in preparing the financial statements.

- ISA 500, *Audit Evidence*,
- ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*,
- ISA 620 *Using the Work of an Auditor's Expert*,
- IPAN 1000 *Special Considerations in Auditing Financial Instruments*

Appendix 1 provides details of where these documents can be found.

13 In an audit conducted in accordance with the ISAs, the auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert. Nonetheless, if the auditor using the work of an auditor's expert concludes that the expert's work is adequate for the auditor's purposes, the auditor may accept the auditor's expert's findings or conclusions in the auditor's expert's field as appropriate audit evidence.

² For a discussion on Materiality see para 37 b)

14 ISA 620 covers the actions that an auditor should take in relation to the engagement of an expert in a subject other than auditing or accounting (See Appendix 2). In summary it:

- guides the auditor in determining when to use the work of an expert,
- requires the auditor to have a rigorous process for agreeing the nature, scope and objectives of the work to be performed by the expert,
- requires the auditor to evaluate the adequacy of such work for the auditor's purposes.

15 An auditor's expert may be internal or external to the auditing firm. ISA 620 distinguishes between the two.

**Auditor's expert– An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's expert may be either an auditor's internal expert (who is a partner or staff, including temporary staff, of the auditor's firm or a network firm), or an auditor's external expert.*

16 The topics discussed in this document, with respect to the relationship between the auditor and the auditor's expert, apply to both situations.

17 To assist auditors in determining when an expert should be appointed ISA 620, (para A6) provides the following guidance:

If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required to be satisfied that the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the audit engagement. Further, the auditor is required to ascertain the nature, timing and extent of resources necessary to perform the engagement. The auditor's determination of whether to use the work of an auditor's expert, and if so when and to what extent, assists the auditor in meeting these requirements. As the audit progresses, or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's expert.

18 Once an auditor has decided to appoint an expert, ISA 620 (para 9) requires the auditor to ensure that the proposed auditor's expert is qualified to fulfil the role (See Appendix 3).

The auditor shall evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purposes. In the case of an auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity.

- 19** Once the auditor's expert has reported to the auditor the auditor is required to evaluate the adequacy of the expert's work. ISA 620 (paras A32 – A 40) provides guidance on steps that an auditor may take to satisfy themselves as to the adequacy of the work. This guidance includes checking that the methods, models and assumptions made are consistent with those generally accepted in the expert's field of work, and that the expert's conclusions are presented in accordance with any standards of the expert's profession or industry.
- 20** This Guide now examines the steps that a professional valuer can take to ensure that valuation advice provided in the capacity of an auditor's expert will assist the auditor in complying with the requirements of ISA 620.

Planning the assignment

- 21** Before undertaking any valuation assignment, in order to comply with the IVSs a professional valuer has to consider and later confirm³:
- i the identity of the valuer. The valuer may be an individual or firm;
 - ii that the valuer is in a position to provide an objective and unbiased valuation;
 - iii whether the valuer has any material connection or involvement with the subject of the valuation or the party commissioning the valuation;
 - iv that the valuer is competent to undertake the valuation. If the valuer needs to seek material assistance from others in relation to any aspect of the assignment, the nature of such assistance and the extent of reliance shall be agreed and recorded.
- 22** In order to comply with (ii) and (iii) above professional valuers will need to be able to demonstrate that they are either subject to, or voluntarily comply with, the IVSC *Code of Ethical Principles for Professional Valuers*, or an equivalent code of conduct issued by another professional or regulatory body. In order to comply with (iv) the valuer will need to be able to demonstrate familiarity with the asset class and the valuation requirements under the relevant financial reporting standards.
- 23** Having established that they are able to accept an assignment to act, auditor's experts are recommended to spend time in planning the assignment. An auditor's expert should regard themselves as part of the auditor's team. While they are required to provide objective and unbiased advice, this does not mean that they also have to maintain a state of independence from the auditor and should be prepared to work with and be supervised by the auditor. Effective mutual communication between the auditor and a professional valuer before the appointment of the latter as the auditor's expert is important to ensure that the scope of the expert's work assists the auditor in the discharge of their responsibilities. The professional valuer can help the auditor identify areas where there is material risk of misstatement of values and agree the appropriate processes and procedures to ensure that the auditor has sufficient information to form an opinion as to whether the reporting entity has presented values that are reasonable and supportable.

³ IVS 101 Scope of Work 2(a)

24 In planning the valuation assignment the professional valuer and the auditor should aim to ensure that there is proper integration with other work on the audit, and that the respective responsibilities of valuer and auditor are clear.

Scope of Work

25 If the professional valuer acting as an auditor's expert complies with the IVSs, and also has regard to any relevant Technical Information Papers or other relevant guidance issued by the IVSC, or other organisations, it assists the auditor in being able to verify that the work is in accordance with applicable standards in the valuation profession and that the methods, models and assumptions are consistent with generally accepted valuation practice.

26 IVS 101 *Scope of Work* requires a professional valuer to prepare a scope of work and confirm this in writing before the valuation and report are finalised. IVS 101 sets out twelve matters that must be addressed in a scope of work for any valuation under the IVSs. IVS 300 *Valuations for Financial Reporting* contains specific requirements that must be considered in relation to the requirements of IVS 101 when undertaking a valuation for use in a financial statement. These include:

- confirming the Financial Reporting Standards that are applicable to the assignment,
- identifying the accounting purpose for which the valuation is required,
- how the asset is used or classified by the reporting entity and,
- how the unit of account is to be defined.

27 In most cases the auditor may not require the appointed expert to provide an independent opinion of the value, but to comment only on the methods, models and, assumptions used by either management or the management's expert. In such cases a valuation report wholly in accordance with IVS 103 *Reporting* may not be required. Nevertheless the remaining IVSs are applicable to such assignments and the advice to be provided, and the form in which it is to be provided, should be recorded in the scope of work under IVS 101 2(l). Particular attention should also be paid by both the professional valuer and auditor to defining the limitations on the expert's investigations and the matters to be reported upon. The dialogue encouraged in para 23 above will assist in this.

28 ISA 620 (para 11) requires the auditor to agree, in writing when appropriate, the following matters with any appointed expert:

- a) The nature, scope and objectives of the auditor's expert's work;
- b) The respective roles and responsibilities of the auditor and the auditor's expert;
- c) The nature, timing and extent of communication between the auditor and the auditor's expert, including the form of any report to be provided by the auditor's expert; and
- d) The need for the auditor's expert to observe confidentiality requirements.

29 The Appendix to ISA 620 also includes a list of matters that the auditor may consider for inclusion in any agreement with the appointed expert. This Appendix is reproduced as Appendix 2 to this Guide.

30 The requirements of the IVSs as regards a scope of work for a valuation for financial reporting and those of ISA 620 for agreeing the terms of an expert's appointment are complementary. For example, a professional valuer complying with the IVSs will need to address the nature, scope and objective of the valuation assignment, including the format of the report, all matters that the auditor needs to address in order to comply with ISA 620. Accordingly, agreeing a common document to record the terms of engagement that enables each party to comply with the IVSs and the ISAs should normally be possible and is recommended as good practice.

31 It is often the case that the auditor will require the expert they have appointed to examine, comment on or verify valuations provided either by the reporting entity's management or an external expert appointed by management. In such cases it will be necessary for the auditor to agree with management the degree of access that the auditor's expert can have to the files and data relied upon in the preparation of the original valuations, and for the auditor and auditor's expert to agree on the extent to which this information can be relied upon or has to be independently verified by the auditor's expert or by other members of the audit engagement team.

32 Other matters that may need to be considered in order to determine the appropriate scope of work to be undertaken by a professional valuer acting as an auditor's expert include:

- the significance of the valuation in the context of the overall audit, and any potential risks associated with it (see para 37 c)),
- whether the auditor's expert will have access to sensitive or confidential information held by the entity,
- any additional requirements arising because the work is covered by multiple disciplines (see para 37 d)),
- What is the auditor's determination of materiality, and how should this be taken into account by the professional valuer? (see para 37 b)).

Review of the auditor's expert's work by the auditor

33 ISA 620 requires auditors to undertake an evaluation of a professional valuer's work and therefore it is important to anticipate the need for further dialogue between the two parties after the expert has reported. In cases where there are assumptions that have to be made about critical inputs to the valuation it may be appropriate to plan for the contingency that additional work by may be required if additional information becomes available in respect of those inputs.

34 The explanatory material in ISA 620, Para A35 states:

When the auditor's expert's work is to evaluate underlying assumptions and methods, including models where applicable, used by management in developing an accounting estimate, the auditor's procedures are likely to be primarily directed at evaluating whether the auditor's expert has adequately reviewed those assumptions and methods. When the auditor's expert's work is to develop an auditor's point estimate or an auditor's range for comparison with management's point estimate, the auditor's procedures may be primarily directed at evaluating the assumptions and methods, including models where appropriate, used by the auditor's expert.

35 A professional valuer acting as an auditor's expert should therefore document their findings in such a manner that an experienced auditor can follow and understand. Where the expert is required to report a valuation the provisions of IVS 103 Reporting apply, together with the supplementary provisions in IVS 300 Valuations for Financial Reporting: The latter include:

- appropriate references to the matters required to be addressed in the Scope of Work by IVS 300 (see para 26 above),
- any disclosures about the valuation that are required by the relevant financial reporting standards,
- the effect of any material assumption on the reported value.

36 Where a professional valuer is engaged to evaluate the method, models or assumptions used a valuation is not required and therefore IVS 103 is not applicable. However, it is recommended that the report has regard to such of the general principles of IVS 103 as are applicable, ie it sets out a clear and accurate description of the scope of the assignment, its purpose and intended use, the investigations or testing undertaken, the facts found, any assumptions made and the rationale for the professional valuer's conclusion.

Special Considerations

37 The following matters warrant special consideration when a professional valuer is appointed to work as an auditor's expert: a) Documentation and Working Papers; b) Materiality; c) Confidentiality; d) Working with Professional Valuers across Multiple Disciplines; and e) Disclosure of the work of the auditor's expert. The following highlights relevant practical planning considerations regarding these matters.

a) Documentation and Working Papers

The guidance in ISA 620, Paragraph A29 states:

Agreement on the respective roles and responsibilities of the auditor and the auditor's expert may also include agreement about access to, and retention of, each other's working papers. When the auditor's expert is a member of the engagement team, that expert's working papers form part of the audit documentation. Subject to any agreement to the contrary, auditor's external experts' working papers are their own and do not form part of the audit documentation.

The auditor's expert needs to understand that if the scope of work requires a brief report, the detail regarding their reasoning and analysis must be located in the work file and available for the auditor to assess. The scope of work should include provision for the auditor's access to the work files.

b) Materiality

Materiality is an accounting as well as an audit concept (ISA 320, Materiality in Planning and Performing an Audit). The IASB's Conceptual Framework (QC11) states that information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report.

From the auditor's standpoint, materiality is relevant when the nature, timing and extent of evidence-gathering procedures are determined, and when assessing whether the subject matter information is free of misstatement. Materiality is considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and extent of the effect of these factors on the evaluation or measurement of the subject matter, and what factors might influence the decisions of the intended users. The assessment of materiality and the relative importance of quantitative and qualitative factors in a particular engagement are matters for the auditor's professional judgment.

There are no "bright lines" as to whether an issue is deemed material or not. There are certain guidelines, but the materiality of a specific issue is dependent on various facts and circumstances. The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the information needs of users of the financial statements. The question of materiality needs to be considered when agreeing the scope of the professional valuer's work as it is fundamental to determining the appropriate extent of that work.

The fact that a valuation appearing in financial statements may be deemed material does not mean that extensive investigation thereof is warranted by an auditor's expert if the auditor, if necessary acting on advice from the expert, concludes that the risk of the valuation being misstated is low.

c) Confidentiality

The guidance in ISA 620, Paragraph A31 states:

It is necessary for the confidentiality provisions of relevant ethical requirements that apply to the auditor to also apply to the auditor's expert. Additional requirements may be imposed by law or regulation. The entity may also have requested that specific confidentiality provisions be agreed with auditor's external experts.

A professional valuer will be subject to either the IVSC Code of Ethical Principles for Professional Valuers, or an equivalent code. The IVSC Code contains similar confidentiality provisions to those to which the auditor is likely to be subject, for example those appearing in the code issued by the International Ethics Standards Board for Accountants.

d) Working with Professional valuers across Multiple Disciplines

A financial report may include valuations in relation to many different classes or types of asset. As a result, it may be necessary for more than one professional valuer to be engaged as an auditor's expert or the auditor's expert may need to ensure involvement of additional valuation specialists on the engagement team. In such situations the need for effective planning; communication; and appropriate scoping of the roles of each valuation specialist as an auditor's expert is important.

e) Disclosure of the work of the auditor's expert

ISA 620 (para 14) states:

The auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor shall indicate in the auditor's report that the reference does not reduce the auditor's responsibility for the auditor's opinion

Disclosure of the auditor's expert's opinion is only likely therefore in the case of a statutory requirement or where the auditor feels it is necessary to explain a modification of the auditor's opinion. To comply with IVS 101 a professional valuer has to consider and record in the documentation of the scope of work any restrictions on the use of a valuation report having regard to the purpose for which it is required. The possibility of an auditor needing to make reference to the professional valuer's work should therefore be considered at the outset of the assignment, and it is recommended that the professional valuer reserve the right to approve the form and context of any reference to the work in the auditor's report.

Professional Valuers Engaged as Management's Expert

- 38** The IVSs are applicable to any valuation undertaken for financial reporting purposes by a professional valuer engaged by a reporting entity. In order to comply with the IVSs the valuer will need to be able to confirm that they meet the requirements of IVS 101 2(a), (see para 21 of this Guide), before accepting any assignment.
- 39** Although management is responsible for the valuation measurements and disclosures included in the financial statements, it is important that a professional valuer appointed by the reporting entity has an understanding of the work of the auditor as it relates to the valuations required, and is therefore able to produce a report that is more likely to satisfy the auditor's requirements (see para 45).
- 40** In many jurisdictions, especially in complex cases, it is common for a reporting entity to request its valuation expert to liaise with its auditor, both when developing the scope of work that is necessary and to respond to any questions on the valuation advice provided that the auditor, or an auditor's expert, might have in the process of developing the audit opinion.
- 41** Such communication can considerably reduce the time and complexity of the audit process, and therefore is to be encouraged. However, a professional valuer appointed by the reporting entity has no duty to any party other than the reporting entity, including the entity's auditor, unless it is expressly agreed in the terms agreed with the entity. Indeed, without the instructing entity's express consent a professional valuer would be in breach of the duty of confidentiality if the valuation assignment was discussed with the entity's auditor. It is therefore recommended that a professional valuer discusses the desirability of communication with the auditor with the reporting entity, and makes appropriate provision in the terms recorded in the scope of work document.
- 42** Appendix 4 provides a guide to the key topics that may need to be considered when agreeing the scope of an assignment to provide valuation advice to an auditor or a reporting entity.
- 43** As required by IVS 101 Scope of Work, and IVS 300 Financial Reporting, the purpose of the valuation, the relevant financial reporting standards, the extent of the professional valuer's investigations and the matters to be addressed in the valuation report should all be discussed and recorded in writing before the valuation is finalised.

44 The auditor may rely on the work of management's expert in the gathering of appropriate audit evidence. However, the auditor needs to carry out certain procedures in order to establish a basis for reliance. ISA 500 Paragraph 8 states:

If information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes: (a) evaluate the competence, capabilities and objectivity of that expert; (b) obtain an understanding of the work of that expert; and (c) evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

45 It is important that the reporting entity's management and their expert understand the need for auditors to often request additional information, subsequent to the receipt of a valuation report. The more information provided in the valuation report regarding the process; approaches and methods used; assumptions and sources of key data, the lesser the information that may be requested by the auditor.

APPENDIX 1

Resources

Standards governing the responsibilities of the valuation professional are contained in the International Valuation Standards and other pronouncements of the IVSC. Specific national standards and guidance relevant to the valuation professional's responsibilities may also exist in different jurisdictions.

The following IVSC publications will be relevant to readers of this Guide:

- The International Valuation Standards
- The IVSC Code of Ethical Principles for Professional Valuers

These publications may be downloaded or purchased from www.ivs.org

The IAASB Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements includes the complete set of clarified International Standards on Auditing (ISAs) and International Standard on Quality Control (ISQC) 1, and the IAASB's standards on review, other assurance, and related services, a glossary, and a preface to the international standards.

A variety of other publications and tools also exist and are designed to explain key features of the ISAs to help facilitate effective implementation and raise awareness in a timely manner of significant new or emerging issues or other noteworthy circumstances. Specific ISAs and other IAASB pronouncements relevant to this Guide include:

- *ISA 320, Materiality in Planning and Performing an Audit*
- *ISA 500, Audit Evidence*
- *ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*
- *ISA 620, Using the Work of an Auditor's Expert*
- *International Auditing Practice Note (IAPN) 1000, Special Considerations in Auditing Financial Instruments*

Copies of the ISAs and other IAASB pronouncements may be downloaded or purchased from www.ifac.org

Considerations for Agreement between the Auditor and an Auditor's External Expert⁴

This Appendix lists matters that the auditor may consider for inclusion in any agreement with an auditor's external expert. The following list is illustrative and is not exhaustive; it is intended only to be a guide. Whether to include particular matters in the agreement depends on the circumstances of the engagement. The list may also be of assistance in considering the matters to be included in an agreement with an auditor's internal expert.

Nature, Scope and Objectives of the Auditor's External Expert's Work

- The nature and scope of the procedures to be performed by the auditor's external expert.
- The objectives of the auditor's external expert's work in the context of materiality and risk considerations concerning the matter to which the auditor's external expert's work relates, and, when relevant, the applicable financial reporting framework.
- Any relevant technical performance standards or other professional or industry requirements the auditor's external expert will follow.
- The assumptions and methods, including models where applicable, the auditor's external expert will use, and their authority.
- The effective date of, or when applicable the testing period for, the subject matter of the auditor's external expert's work, and requirements regarding subsequent events.

The Respective Roles and Responsibilities of the Auditor and the Auditor's External Expert

- Relevant auditing and accounting standards, and relevant regulatory or legal requirements.
- The auditor's external expert's consent to the auditor's intended use of that expert's report, including any reference to it, or disclosure of it, to others, for example reference to it in a modified auditor's report, if necessary, or disclosure of it to management or an audit committee.
- The nature and extent of the auditor's review of the auditor's external expert's work.
- Whether the auditor or the auditor's external expert will test source data.
- The auditor's external expert's access to the entity's records, files, personnel and to experts engaged by the entity.
- Procedures for communication between the auditor's external expert and the entity.
- The auditor's and the auditor's external expert's access to each other's working papers.
- Ownership and control of working papers during and after the engagement,

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APPENDIX 2

including any file retention requirements.

- The auditor's external expert's responsibility to perform work with due skill and care.
- The auditor's external expert's competence and capability to perform the work.
- The expectation that the auditor's external expert will use all knowledge that expert has that is relevant to the audit or, if not, will inform the auditor.
- Any restriction on the auditor's external expert's association with the auditor's report.
- Any agreement to inform the auditor's external expert of the auditor's conclusions concerning that expert's work

Communications and Reporting

- Methods and frequency of communications, including:
 - How the auditor's external expert's findings or conclusions will be reported (written report, oral report, ongoing input to the engagement team, etc.).
 - Identification of specific persons within the engagement team who will liaise with the auditor's external expert.
- When the auditor's external expert will complete the work and report findings or conclusions to the auditor.
- The auditor's external expert's responsibility to communicate promptly any potential delay in completing the work, and any potential reservation or limitation on that expert's findings or conclusions.
- The auditor's external expert's responsibility to communicate promptly instances in which the entity restricts that expert's access to records, files, personnel or experts engaged by the entity.
- The auditor's external expert's responsibility to communicate to the auditor all information that expert believes may be relevant to the audit, including any changes in circumstances previously communicated.
- The auditor's external expert's responsibility to communicate circumstances that may create threats to that expert's objectivity, and any relevant safeguards that may eliminate or reduce such threats to an acceptable level.

Confidentiality

- The need for the auditor's expert to observe confidentiality requirements, including:
 - The confidentiality provisions of relevant ethical requirements that apply to the auditor.
 - Additional requirements that may be imposed by law or regulation, if any.
 - Specific confidentiality provisions requested by the entity, if any.

Auditor's assessment of the Professional Valuer

Under ISA 620 paragraph 9, the auditor is required to evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purposes. In the case of an auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to the auditor's expert's objectivity.

The following are examples of matters that a professional valuer can expect to be questioned about by auditors prior to being engaged as an auditor's expert:

- 1 Membership of a professional body, licensing body or equivalent
- 2 Compliance with specified professional standards and or a code of ethics
- 3 Disclosure of any matters that could impair the professional valuer's objectivity and, if appropriate, steps taken to safeguard against these threats.
- 4 Confirmation that the professional valuer has appropriate experience in subject of proposed assignment.
- 5 Confirmation of familiarity with relevant accounting and auditing requirements

Developing the Scope of Work

This Appendix provides an example of matters that a professional valuer may find it helpful to consider when developing a scope of work in connection with an appointment to provide valuation advice acting as either an auditor's or management's expert. While a valuer may have received a detailed brief from the prospective client containing this information, in many cases it will be necessary to make enquiries before the professional valuer can confirm that they have the necessary competence and capacity to undertake the work required.

1 Accounting Purpose:

It is important to identify the accounting purpose for which the valuation is required, see IVS 300 *Valuations for Financial Reporting*. Common accounting purposes for which valuations are required include impairment reviews, business combinations or the valuation of different components of an asset for calculating depreciation. The professional valuer will need to be aware of the valuation requirements under the relevant accounting standard, and if needs be, seek clarification from the auditor or other client.

2 Assets to be Valued:

Identifying the range of assets that need to be valued. The type of asset that will require valuation will depend upon the accounting purpose for which the valuation is required. The list that follows is typical for a multinational manufacturing company that is accounting for a recent business combination. All the examples relate to the acquired company. For other accounting purposes not all of these assets may need to be valued.

- i Real property
- ii Plant and equipment
- iii Developed product technology
- iv Trade names and trademarks
- v Manufacturing patents
- vi In-process research and development projects
- vii Customer relationships

In each case the professional valuer will need to establish the number, scale and location of the different assets. Not all identifiable assets will necessarily warrant either separate valuation or the same degree of investigation and therefore the valuer is advised to make enquiries to establish those that are material in the context of the accounting objective so that the appropriate level of investigation for different assets can be agreed.

As well as identifying the assets to be included in the assignment, it is often as important to identify those assets, or liabilities, that are to be excluded.

APPENDIX 4

3. Other Services

In addition to valuations of the identified assets it is advisable to establish whether the professional valuer is required to provide other advice using the information gathered during the valuation investigations, eg, an IRR analysis or the remaining useful life of the assets.

4. Project Plan and Timetable

It is important for the professional valuer to establish not only the required date for completion of the assignment but also a project plan that allows sufficient time for key stages. It is normally advisable to plan for an initial meeting with either the auditor or management, each as appropriate, to confirm the procedures and clarify the arrangements for access to sites or other information. There may also need to be meetings with key personnel involved in specific parts of the business in order for the professional valuer to gain a proper understanding of the associated assets or liabilities.

It is common practice for the professional valuer to provide a draft report before finalising the valuation. This draft may or may not include provisional valuation figures, but the principal purpose is for the instructing party to verify that the facts on which the final valuation is to be based are current, an important consideration when the professional valuer's investigations have taken place over a period of weeks.

After the final report is delivered there may need to be a further meeting or meetings to discuss the conclusions with management or the auditor.