

Relationship between Auditors and Valuers in Financial Reporting

Auditors and valuers are both professionals in their own areas of expertise: the former are experts possessing special skill, knowledge and experience in the field of accounting and auditing, while the latter possess qualifications in valuation. Guided by different sets of professional standards, conflicting situations seem unavoidable. This paper aims at explaining the work of both parties and suggests ways to maintain a better relationship between the two without depriving the independency of the same.

Professional Standards

Due to the recent rapid development of trade-related business assets and new financial instruments, accounting standards are being revised and updated from time to time to cope with the increasing complicated business environment. In accounting aspect, the Hong Kong Institute of Certified Public Accountants (HKICPA) has published and administered the professional accounting standards for guiding the practice of its members. Meanwhile, The HKIS Valuation Standards on Properties (2005 edition) and The HKIS Valuation Standards on Trade-Related Business Assets (2004 edition) published and administered by the Hong Kong Institute of Surveyors (HKIS) are professional standards and guidance for the observance and compliance by valuers.

Different Roles for both Parties

The role of the auditors is to give a fair presentation of company's performance in the corresponding financial year in the format of an audit report while the major role of the valuers is to give their opinion on the fair value of the company's assets. As auditors and valuers are two different kinds of professionals having independent roles in nature, unavoidable conflicting situations may arise from

misunderstanding and insufficient knowledge of the other party's work and requirements. Communication and understanding of each other's standards and reporting requirements are critical for a win-win situation of both parties.

The work of valuers is to share the risks of the auditor by providing specific industry expertise in valuing company's assets. In preparing their valuation reports, they normally give details of the assets under valuation together with background information about the valuation methodologies applied, data sources and any underlying assumptions. Sometimes, the standards are only broad guidelines; hence the valuers have to use their own judgment to arrive at an opinion of value. The figures are only acceptable if the assumptions are clearly explained and they fall within a reasonable range.

On the contrary, the work of an auditor is to evaluate the appropriateness of the valuers' work as audit evidence regarding the assertion being considered and make inquires regarding any procedures undertaken to establish whether the source data is relevant and reliable and then review or test the data used. In preparing the audit opinion, the auditors will have a heavy reliance on the opinion from valuers on the fair values of the company's assets under such circumstances that the company's assets form a material portion in the company's balance sheet. As

a result, the reliability of valuation figures will be highly concerned by the auditors who bear the sole responsibility to rely on such figures in producing their audit opinion.

Independence & Integrity without Compromise

Equipped with professional competence, valuers are qualified persons to conduct valuations. They must exercise independent judgments not subject to any direction or influence from any person and discharge their duties owed to their clients with integrity in accordance with the highest standard of professional ethics. In performing any work, valuers must not act in a manner which compromise or impair.

Theoretically, there should not be any definite right or wrong answers for valuation given the subjectivity of the assumptions and methodologies involved. However, valuers' work is sometimes subject to challenge when the auditors feel "uncomfortable" about the valuers' figures. Under such circumstances the auditors may question the valuers extensively on the supporting to the valuation figures and may even challenge the basis, methodology and underlying assumptions adopted in the valuations, in particular when there are material discrepancies between the fair values and the net book values resulting in substantial gain or loss in the company's accounts. However, such queries or challenge from auditors should not constitute any undue influence on the valuers' work to revise the figures which have been prepared under proper valuation procedures.

It must be understood that auditors do not often have the same expertise as the valuers. Therefore, the valuers' assumptions and methods should not be challenged in the first place. If and only if the independence of the valuers is being affected, for example, by not having clear instructions from the company, by not permitting to exercise their own

professional judgment on key issues and by having pressure from the company regarding the selection of the methodology or assumptions, then the auditors have valid reasons to doubt the reliability of the valuation reports. Otherwise, the auditors are beyond the scope of their powers to question the report and have to rely on the figures provided.

Recommendations

To reduce the conflicts as stated above, auditors and valuers have to work closely with each other. A basic understanding of each other's professional work is the starting point to enhance cooperation and resolve conflicts between the two parties. Some kinds of "cooperation" must be maintained to better communicate during the valuation process even as early as the pre-transaction stage to eliminate confrontation. It is preferable to have a tri-party (i.e. the company, auditors and valuers) pre-engagement meeting to agree on the scope of work, valuation methodologies and the extent of review that the auditors will have to do so that the valuers can take precautions and preparations for it.

While maintaining independence of each other, auditors and valuers can discuss the methodologies and underlying assumptions to be used before carrying out the valuation process. Being part of science and part of art, the resulting valuation figures should then not be rejected within reasonable and acceptable range given that explainable assumptions and methodologies were provided. In case where the valuation figures are so material to affect the company's performance that special attention should be taken, the valuers can submit their work papers or data to the auditors to facilitate their review and work flow. It should be noted that such submission should be subject to the consent of the client in order to avoid a breach of confidentiality agreement made and the potential litigation risk, etc.

Also, an agreement can be made with the company on the working relationship with the auditors to state clearly the way and the extent of releasing work papers and data to avoid unnecessary disputes.

Besides the recommendations already mentioned, it must be emphasized that professional judgments of each party should be highly respected. Valuers should understand that their work are complementary to the work of auditors who cross-check their methods and assumptions, so no hostility feeling should exist when their report figures are being inquired. Instead of providing unreasonable bargains and requests, auditors should provide constructive comments to enhance efficiency and understanding in turn. Both parties must recognize and respect the work of the other professions so as to build up a sound checks-and-balance system leading to high quality valuation reports beneficial to the company, auditors, valuers and their own professions.

Both parties should bear in mind that they must maintain the highest quality and reliability and enhance credibility of the reports. So, auditors may need to strike a balance and maintain a consistently high level of diligence. Auditors and valuers need to understand the objectives of their work aiming to protect the interests of the client. Though guided by different sets of professional standards, the common objective of both auditors and valuers is to form a fair presentation on company's performance. For this reason, auditors and valuers should maintain a better cooperation in work without taking away of their own independency.

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