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International Valuation Standards Council
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Dear IVSC Members

**IVSC Exposure Draft: *"Valuations of Specialised Public Service Assets"***

Ernst & Young welcomes the International Valuation Standards Council (IVSC) issuing a draft Technical Information Paper (TIP) on valuations of specialised public service assets.

From a valuation perspective, specialised public service assets can – in many cases – be owned and used by other parties not in the public sector, using the asset in an alternative way. Therefore, we encourage the IVSC to highlight this third party view in the guidance to indicate potential classic ways for the valuation of the respective assets. For example, administration buildings could be used as offices by a company outside the public sector because of the layout and location of the building. In this way, we believe that many specialised public service assets are capable of be valued using a standard valuation approach, like the income-approach, with observable parameters for rents, operating costs etc. In our opinion, such a third-party's view or comparison procedures to non-public properties should be outlined more explicitly within the guidance.

Generally, all properties that have the potential to earn (rental) income from third parties, or for which a sale-and-lease-back-scenario could be considered, are capable of being valued using the income approach or, if an observable market exists, the comparison approach (market approach). If there is no alternative use for the public asset and no market exists for trading (comparable) assets, the cost approach may be more reliable.

Adding a *social* value component to the *economic* value (market or investment value) of a specialised public service asset could be problematic from a valuation perspective. In particular, a reliable and verifiable quantification of the social value component could be practically challenging to determine.

In addition to these considerations, we believe it would be helpful to further acknowledge the interaction between accounting and valuation standards, when valuations are performed for financial reporting purposes. As discussed in paragraphs 51-61 of the exposure draft, entities that hold public service assets may be applying International Public Sector Accounting Standards (IPSAS), International Financial Reporting Standards (IFRS) or local accounting standards. The measurement objectives in these accounting standards can vary and, therefore, the extent to which characteristics of an asset and entity-specific factors can be considered in a valuation for financial reporting purposes will depend on the accounting standards the entity applies. We would encourage the IVSC to caveat the guidance it provides in the final TIP to clarify that, if valuations of such assets are prepared for financial reporting purposes, valuers should ensure assumptions used are consistent with the requirements of the financial reporting standards to which the entity is subject.

In addition to these general comments, we include, in the attached appendix, our responses to the specific questions raised in the exposure draft.

Should you wish to discuss the contents of this letter with us further information, please contact Sven Schieszl (sven.schieszl@de.ey.com) or Philipp Lindenmayer (philipp.lindenmayer@de.ey.com).

Yours faithfully

Ernst & Young

**Appendix: Responses to the specific questions in the Exposure Draft**

***Q1:*** *Some of the challenges that arise in valuing specialised public service assets result from similar assets being cash-generating when owned by a for-profit entity and non-cash-generating when owned by a not-for-profit or public benefit entity. The Board's initial view is that it is the characteristics of an asset and the service it provides that are relevant to its valuation. Others argue that the status of the owner can be a significant factor that impacts on the value of an asset as in many cases there is circularity between the for-profit or not-for-profit status of the owning entity and the cash-generating status of the assets.*

***Which of these views do you support?***

In general, we support the view expressed by the Board that the characteristics of an asset and the way it is used are relevant to its valuation. However, while the asset's current use is relevant for the valuation, in our view, alternative uses a potential third party-purchaser could also influence the value of the property. As an example, an administration building, which is currently used as a public registry office (e.g., for registering births, deaths and marriages) could potentially be used as an office building by a company outside the public sector because of the structure and design of the building. Another example is a town hall, which could be a mixed-use property (e.g., possible retail area on the ground floor, with office space in the upper stories) in a prime location, with no direct reference to the (potential) user of the property. However, we also note the following:

- There is merit in the alternative view that suggests the status of the owner can be a significant factor. The two views are not necessarily opposing or mutually exclusive. Both views highlight that the status of the owner can often, at least indirectly, provide a clearer indication of the owner's intentions in respect of the use of the asset. However, in our view, the status of the owner, on its own, would not be sufficient to classify the asset as cash-generating or non-cash generating.

  Ownership status can also be categorised into economic and societal. Under the economic ownership status, the asset is maintained for the purposes of yielding economic benefits. When the ownership status is societal, it means that the asset is maintained for social benefits.

  An example of an economic asset is a government owned parking facility which charges market parking rates. An example of a societal asset is a government owned preserved historic building aimed to bring societal benefits to its citizens like a museum. It is also possible for a government to change the use/purpose of an asset - from economic to societal (or vice versa).

- For valuations prepared for financial reporting purposes, the extent to which the characteristics of an asset and entity-specific factors can be considered in the valuation will depend on the requirements and measurement objectives of the applicable accounting standards the entity applies.

***Q2:** The draft contrasts the concepts of market value and investment value (as defined in the IVS Framework and this draft). Market value should give the same result as fair value as defined in IFRS 13 as the differences between the two do not affect specialised public service assets. It is therefore frequently used as a basis when specialised public service assets are valued for financial reporting. Investment value is specific to the owner and can reflect criteria that would either not be relevant or available to market participants, such as measures relating to the public benefit created by or accruing to the asset.*
***Do you consider that these distinctions are clearly explained?***

In general, the definitions of market and investment value are clearly explained. Nevertheless, the distinctions could be clearer in order to illustrate the difference between an entity-specific approach to valuation and a fair value measurement as contemplated in IFRS 13, which includes taking a market participant approach and considering the highest and best use of an asset. If such guidance is developed, we would encourage that it be done in conjunction with the International Accounting Standards Board (IASB).

Furthermore, the draft guidance on market value in the exposure draft is not wholly consistent with fair value as defined in IFRS 13. The draft guidance indicates that entity-specific factors have been taken into account in market value. IFRS 13 takes a market participant approach, which necessarily excludes factors that market participants generally cannot consider when pricing an asset. The approach outlined in the draft guidance could result in valuations that significantly exceed fair value as defined in IFRS 13. This is because many specialised public sector assets have limited capacity to generate net cash inflows. Hence, if entity-specific factors are taken into account – in particular, the asset's capacity to provide goods or services to meet the public service objectives of the entity instead of its capacity to provide monetary benefits – the resulting valuation may not be consistent with fair value measured in accordance with IFRS 13.

In addition, as noted in our cover letter, entities that hold public service assets may be applying IPSAS, IFRS or local accounting standards. We understand that the International Public Sector Accounting Standards Board (IPSASB) is currently undertaking a project on measurement as part of its Conceptual Framework (Phase 3). In our view it would be helpful for the final TIP to reflect all measurement bases that are acceptable in the public sector and provide guidance to valuers on the similarities and differences between those bases and market value and investment value. We would, therefore, encourage the IVSC to consider this IPSASB project in the process of finalising the TIP.

***Q3:*** *The proposed guidance makes a distinction between measuring the value of the asset and measuring the social value, ie the impact of that asset on either other assets or the wider community. It excludes the latter from the scope of the proposed TIP on the grounds that social value of an asset is not directly correlated with the value of the owner's interest in that asset.*
***a) Have you had experience of the impact that a specialised public service asset has on the value of other assets or the wider community being used as a measure of the value of that asset?***
***b) If so, please explain the purpose for which the valuation was required.***

a) Although our practical experience in valuing assets by taking into account their impact on the wider community as a measure of value is limited, we do not think that doing so would yield reliable results. Consider, for example, a recreational public park; it would be almost impossible to reliably measure the benefit of such a facility to the broader community as a proxy for its 'real' value. Using, for example, an income approach to estimate such a (social) value, one would have to estimate an entrance fee for individuals, on average, would be willing to pay for entering this park (as a proxy for his or her utility) and an average occupancy level of visitors as a basis for this valuation. As an auditor, one would question the reliability of such a valuation, as, particularly, the collection of reliable and verifiable data regarding the individual willingness to pay might be critical.

b) No comments.

***Q4:** Many specialised public service assets such as roads, town squares, footpaths, public parks and gardens, informal recreational areas, etc are assets for which public users make no direct payment for access or use. Some regard such "assets" as being incapable of reliable measurement because: i) neither the historic nor the current cost normally has any relevance or correlation to a measureable benefit to the owner and ii) there are no actual or implied revenues, such as a reliable proxy or cost saving, that can be attributed the asset.*
***a) Do you consider that all specialised public service assets are capable of reliable valuation, or that some such assets should be declared as incapable or unsuitable for valuation?***
***b) If you have experience of valuing assets such as those identified in this question, please describe the type of asset valued and briefly describe the method or methods used.***

a) We believe that most public service assets are capable of reliable valuation, based on the cost the entity would incur to replace that asset so as to continue to provide the required level of service to the public. The value of footpaths, roads, town squares, etc would be of relevance to the users of financial statements and should be valued. However, there are certain assets for which, due to their nature, the replacement cost cannot be measured reliably. This is likely to be the case for heritage assets with <u>no alternative use</u> other than to serve the public (this may not include buildings with monument protection that are used for office, retail or residential purposes for example).Determining a replacement value for such assets (beyond its actual value in use) might be impracticable and would add little information from a financial reporting perspective. In general, assets with no database on which a cost approach can be relied on (such as, monuments or recreational parks) <u>and</u> with no market for a 'free' sale or letting out (such as, bridges) are questionable for a proper valuation. One potential valuation alternative for this kind of asset might be the use (if available) of insurance values as a proxy for market values.

b) We have experience in valuing traffic space (comparable to roads), which was part of a production site. For that purpose, a cost-approach, based on a reduced land value (derived out of a market approach), was chosen. A reduced land value was used due to the fact that this traffic zone could not be used for the construction of new buildings. As a result, a discount on the regular land value was applied. However, this approach does not seem suitable for the derivation of public roads as the private development of a production site and roads like this are not comparable to public roads.

   Furthermore, we have experience in relation to transactions for public administration buildings acquired by a company outside the public sector. After acquisition, the intended use of the buildings was partly public and partly private (i.e., to be rented to other for-profit organisations). The bidder derived the value of the portfolio based on a classic income approach applying expected income streams, i.e. expected rents. No differentiation was made between the public and non-public buildings.

   Valuations prepared for accounting purposes may also give indications of methods used to value specialised public service assets. In certain jurisdictions (for example, in South Africa), municipalities are required to value all of their roads, footpaths, pavements, parks, and other community and infrastructure assets. These valuations, historically, were normally based on an engineers' assessment of depreciated replacement cost.

***Q5:*** *It is proposed that the current Annexe to IVS 230 Historic Property be included in this TIP and deleted from the IVS. The rationale is that many historic and heritage properties are used for providing a public service. The historic features are a form of specialism as they can often limit or constrain the use of these properties. As a consequence it is felt that many of the valuation considerations that apply to specialised public service assets also apply to historic and heritage properties and that it is more appropriate to present the guidance here than as an adjunct to IVS 230.*
***Do you agree with this proposal?***

We do not agree with the approach proposed in the exposure draft. The valuation of historic properties is not an exclusive topic in the context of specialized *public* service assets, but also impacts property owned by private, for-profit organisations.

For example, in many historic centres (e.g. Hamburg) most of the main-street buildings are not held by public authorities, but are historic buildings with monument protection. As such, the potential for an asset to have historical value of the building or monument protection is not limited to the public sector.

***Q6:*** *Paragraph 36 of the draft proposes that four principal categories of specialised public service assets can be identified, and provides examples of types of asset that fall within each of these categories.*
***a) Do you agree with the categorisation proposed?***
***b) Do you find the categorisation and examples to be helpful?***
***c) Do you consider that there are either any significant omissions or asset types that should be excluded?***

a) We generally agree with the categorisation proposed.

b) Yes, we consider these examples to be very helpful, but note the following:
   - We encourage the IVSC to explicitly include further infrastructural examples, for assets such as tunnels and bridges

c) It does not seem appropriate to include “water” and “wastewater” as infrastructure assets. Water is generally considered to be inventory in a financial reporting context. Presumably what is meant here is the infrastructure (pipes, pumps, sewers, etc) relating to the different kinds of water and not the water itself? Perhaps this could be clarified.

   In general, we encourage the IVSC to challenge the inclusion of assets where no real market is available, no costs comparable to an independent market can be derived from the past and for which there is only a social value (e.g. parks, public gardens or natural reserves). In our view, it is unlikely that reliable and verifiable values could be derived for such assets. Consider, for example, a park, where the municipality either has owned the land for a considerable period of time or purchased the land recently, not for the price of bare land or agricultural land (often very cheap), but for a price that was based on the comparable price for a square-meter of development land (e.g., comparable land zoned for office or residential buildings).The historic costs, in this example, are unlikely to reflect a comparable market view. Furthermore, there would be no market for this kind of land because of legal restrictions would likely prohibit development on the site with buildings suitable for making money out of it.