The International Valuation 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 welcome.

1 It is proposed that this Exposure Draft will replace the current GN8 “The Cost Approach for Financial Reporting - (DRC)”. As the name suggests GN8 only covers the use of the cost approach for financial reporting purposes. This exposure draft proposes that a properly applied cost approach can be applied in a wide variety of circumstances.

Do you agree with the argument that the cost approach, if properly applied, can be used as a method to arrive at market value for a variety of purposes other than financial reporting?

Yes - the cost approach is used widely to establish market value for specialised properties, plant and equipment and for purposes other than just financial reporting. Notwithstanding this, it is commonly applied as a secondary approach.

2 This Exposure Draft identifies depreciated replacement cost as the most common method of valuation under the Cost Approach. An alternative view is that this is the only method of applying the cost approach.

Which of these views do you support? If you believe that there are other valuation methods that fall under the Cost Approach, please describe them.

While the Depreciated Replacement Cost is the most common method of valuation, there are other alternatives, particularly in relation to plant and machinery, albeit these alternatives might simply be better described as hybrid approaches of DRC methodology. In the plant and machinery sector, the cost approach can be utilised in comparing an off the shelf machine with a bespoke custom built one for comparative evaluation purposes. Also, while DV or SL methods are most commonly used, double declining balanced depreciation can be appropriate and also the production units method is sometimes appropriate for individual machines or groups of machines. We take the view that the TIP should not be overly prescriptive and should allow a variety of ways to apply the cost approach.

3 GN8 in the 2007 edition of IVS identifies the three main types of deduction for obsolescence as physical deterioration, functional obsolescence and external obsolescence. In this Exposure Draft external obsolescence has been replaced with economic obsolescence. Supporters of the proposed change argue that the term economic obsolescence is most commonly used to describe this form of obsolescence.

Those who support the existing definition argue that the term external obsolescence more clearly requires all factors that arise from changes to the environment in which the asset operates to be considered, regardless of whether they have a direct economic impact.

Which of these views do you support?

We prefer the term economic obsolescence on two grounds. The first is that "economic obsolescence" is the most commonly used and recognised term. The second is that although "external obsolescence" may capture a broader field of factors, the reality is that in a valuation, it is only the economic impact of these factors that affects the value. Therefore
"economic obsolescence" is a better term. As a corollary, if there is a form of "external obsolescence" that has no economic impact, then it has no relevance in the valuation.

4 The exposure draft provides that where the purpose of the valuation is governed by regulations that preclude adjustment for all forms of obsolescence, for example valuations for tariff setting purposes of regulated monopoly assets, the outcome does not represent market value and should not be described as such.

Do you agree that a cost approach valuation that does not identify and quantify all forms of obsolescence is not a measure of market value?

We take the view that a cost approach based valuation that does not identify all forms of economic obsolescence may or may not represent market value and should not be called market value without qualification. If the test for "economic obsolescence" has not been applied, this needs to be disclosed and a valuation should be clearly qualified as market value subject to adequate profitability (or potential profitability) of the business that owns/operates the assets.

A problem can arise in that the person with the expertise to complete the cost approach valuation of specialised plant and equipment is not necessarily the same person who can value the entire business in order to complete the test for "economic obsolescence", and it might be appropriate for the TIP to suggest in such instances that the valuation team include the necessary skill sets to ensure that all forms of economic obsolescence have been canvassed.