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INTERNATIONAL VALUATION
STANDARDS COUNCIL

EXPOSURE DRAFT
PROPOSED NEW INTERNATIONAL
VALUATION STANDARDS

Comments to be received by 3 September 2010





EXPOSURE DRAFT

Proposed New International Valuation Standards

published June 2010

This Exposure Draft of the proposed new International Valuation Standards is published by the International Valuation Standards Board which is the independent standard-setting body of the International Valuation Standards Council.

Comments on this Exposure Draft are invited before 3 September 2010. All replies may be put on public record unless the respondent requests confidentiality. Comments may be sent as email attachments to CommentLetters@ivsc.org, or by post to the International Valuation Standards Board, 41 Moorgate, LONDON EC2R 6PP, United Kingdom. The Board is particularly interested in receiving responses to the questions included in the accompanying document *Overview and Questions for Respondents*.

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International Valuation Standards

Ninth Edition

Introduction

1. The International Valuation Standards Board (IVSB) is the standard-setting body of the International Valuation Standard Council (IVSC). The IVSB members are appointed by the IVSC Trustees having regard to criteria set out in the By Laws of the organisation and the IVSB has autonomy in the development and approval of the International Valuation Standards (IVS).
2. Valuations are widely used and relied upon in the financial and other markets, whether for inclusion in financial statements, for regulatory compliance or to support secured lending and transactional activity. The objective of the IVSB is to contribute to the efficiency of those markets by providing a framework for the delivery of credible and consistent valuation opinions. The IVSB achieves this objective by developing and maintaining the IVS and promoting the use of those standards.
3. The IVS are designed to:
 - (a) promote consistency and aid the understanding of valuations of all types by identifying or developing globally accepted principles and terminology,
 - (b) identify and promulgate common principles for the undertaking of valuation assignments and the reporting of valuations,
 - (c) identify the appropriate valuation objectives and solutions for the major purposes for which valuations are required,
 - (d) identify specific issues that require consideration when valuing different types of assets or liabilities,
 - (e) promote the convergence of existing valuation standards that are in use in different sectors and states.
4. The material in these standards meets at least one of the above criteria.
5. Where a statement is made that a valuation will be or has been undertaken in accordance with these standards, it is implicit that all relevant individual standards are complied with. Where a departure is necessary to comply with any legislative or regulatory requirements, this should be clearly explained.

6. In developing the IVS, the IVSB:
 - (a) follows due process in the development of any new standard that involves consultation with providers and users of valuation services, and public exposure of all new standards and material alterations to existing standards,
 - (b) liaises with other bodies that have a standard setting function for valuation within a defined geographic area or for a defined sector or group of individuals,
 - (c) is subject to oversight by the Board of Trustees of the IVSC to ensure that it acts in the public interest.

7. IVSC is the successor body to the International Valuation Standards Committee, which from the early 1980s until 2007 developed and published the IVS. In 2006 and 2007, the outgoing Committee established a Critical Review Group with a remit of considering how the standards could be improved to meet the requirements of the evolving market for valuation. The report of the Critical Review Group was published and comments invited on its recommendations. The IVSB has accepted the major recommendations of the Critical Review Group in developing this, the ninth edition of the standards. This has resulted in major changes to the scope and presentation of the standards.

Assets and Liabilities

8. The standards apply to assets and liabilities. To assist the legibility of these standards, the words asset or assets are deemed to include liability or liabilities, except where it is expressly stated otherwise, or is clear from the context that liabilities are excluded.

Structure

9. In this new edition, the standards are organised as follows:

100 Series – General Standards

10. The General Standards have general application for all valuation purposes, subject only to specified variations or additional requirements in standards that are appropriate to specific applications or to specific types of asset or liability.

IVS 101 – General Concepts and Principles

IVS 102 – Valuation Approaches

IVS 103 – Bases of Value

IVS 104 – Scope of Work

IVS 105 – Valuation Reporting

200 Series – Application Standards

11. The Application Standards describe common different purposes for which valuations are required, relate these to the IVS general standards and set out any specific valuation requirements for each purpose.

IVS 201.01 – Fair Value under International Financial Reporting Standards

IVS 201.02 – Valuations for Depreciation

IVS 201.03 – Valuations for Lease Accounting

IVS 201.04 – Valuations for Impairment Testing

IVS 201.05 – Valuations of Property, Plant and Equipment in the Public Sector

IVS 202.01 – Valuations of Property Interests for Secured Lending

300 Series – Asset Standards

12. The Asset Standards describe matters that influence the value of different types of asset, how the principles in the General Standards are applied to their valuation and any variations or additional requirements to these principles.

IVS 301.01 – Valuations of Businesses and Business Interests

IVS 301.02 – Valuations of Intangible Assets

IVS 302.01 – Valuations of Plant and Equipment

IVS 303.01 – Valuations of Property Interests

IVS 303.02 – Valuations of Historic Property

IVS 303.03 – Valuations of Investment Property under Construction

IVS 303.04 – Valuations of Trade Related Property

IVS 304.01 – Valuations of Financial Instruments

IVS 305.01 – reserved for future standard on valuing non financial liabilities

IVS 306.01 – reserved for future standard on Biological Assets

IVS 307.01 – reserved for future standard on Extractive Industries

The Glossary

13. The Glossary contains definitions of those words or phrases italicised and used throughout the IVS. Definitions that are only used in the context of a particular standard are only defined in that standard.

Changes from Previous Editions

14. The IVS set a framework for valuation practice and explain high level principles and terminology to help valuers achieve consistency and users understand valuations that are received. They do not give instructions on how to estimate value on a case by case basis, study different methods in detail or contain other educational material on valuation.

15. Accordingly material in the previous editions that fell into the above categories has been removed. Separately from the IVS, IVSC is in the process of developing Technical Information Papers that will update and expand on some of this material, together with several new projects.

International Valuation Standard 101

General Concepts and Principles

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This standard describes generally accepted valuation concepts and principles that underlie the International Valuation Standards and assist in their application.

Price, Cost and Value

1. Price is a term used for the amount asked, offered or paid for a good or service. Because of the financial capabilities, motivations or special interests of a given buyer or seller, the price paid for goods or services may be different than the value which might be ascribed to the goods or services by others. Price is factual and, generally, an indication of a relative value placed upon the goods or services by the particular buyer or seller under specific circumstances.
2. Cost is the amount required to create or produce the good or service. When that good or service has been completed, its cost is a fact. Price is related to cost because the price paid for a good or service becomes its cost to the buyer.

3. Value is not a fact but an estimate of the likely price to be paid for goods and services in an exchange or a measure of the economic benefits of owning those goods or services. Value in exchange is a hypothetical price and the hypothesis on which the value is estimated is determined by the valuation objective. The value to the owner is an estimate of the benefits that would accrue to a particular owner or beneficiary of the goods or services.
4. The word valuation can be used to refer to the estimated value (the valuation conclusion) or to refer to the preparation of the estimated value (the act of valuing). In these standards it should generally be clear from the context which meaning is intended. Where there is potential for confusion or a need to make a clear distinction between the alternative meanings, additional words are used.

The Market

5. A market is the environment in which goods and services trade between buyers and sellers through a price mechanism. The concept of a market implies that goods or services may be traded among buyers and sellers without undue restriction on their activities. Each party will respond to supply-demand relationships and other price-setting factors as well as to their own understanding of the relative utility of the goods or services and individual needs and desires.
6. In order to undertake valuations based on the estimated price that would be paid for an asset, it is of fundamental importance to understand the extent of the market in which that asset would trade. This is because the price that can be obtained will depend upon the number of buyers and sellers in the particular market on the material date. To have an effect on price, buyers and sellers must have access to that market. A market can be defined by various criteria. These include:
 - (a) the goods or services that are traded, eg, the market for motor vehicles is distinct from the market for gold
 - (b) scale or distribution restraints, eg, a manufacturer of goods may not have the distribution or marketing infrastructure to sell to end users and the end users may not require the goods in the volume at which they are produced by the manufacturer.
 - (c) geography, eg, the market for similar goods or services may be local, regional, national or international.

7. However, although at any point in time a market may be self contained and be little influenced by activity in other markets, over a period of time markets will influence each other. For example, on any given date the price of a commodity in one state may be higher than could be obtained for an identical asset in another. If any possible distorting effects caused by government trading restrictions or fiscal policies are ignored, suppliers would, over time, increase the supply of the commodity to the state where it could obtain the higher price and reduce the supply to the state where the price was lower, thus bringing about a convergence of prices.
8. Unless otherwise clear from the context, references in IVS to the market mean the market in which the asset or liability being valued is normally exchanged on the date of valuation and to which most participants in that market, including the current owner, normally have access.
9. Markets rarely operate perfectly with constant equilibrium between supply and demand and an even level of activity, due to various imperfections. Common market imperfections include disruptions of supply, sudden increases or decreases in demand or asymmetry of knowledge between market participants. Because market participants react to these imperfections, at a given time a market is likely to be adjusting to any change that has caused disequilibrium. A valuation that has the objective of estimating a price in the market has to reflect the conditions in the relevant market on the *valuation date*, not an adjusted or smoothed price based on a supposed restoration of equilibrium.

Market Activity

10. The degree of activity in any market will fluctuate. Although it may be possible to identify a normal level of activity over an extended period, in most markets there will be periods when activity is significantly higher or lower than this norm. Activity levels can only be expressed in relative terms, eg, the market is more or less active than it was on a previous date. There is no clearly defined line between a market that is active or inactive.
11. When demand is high in relation to supply, prices would be expected to rise which tends to attract more sellers to enter the market and therefore increased activity. The converse is the case when demand is low and prices are falling. However, different levels of activity are a response to price movements rather than the cause of them. Transactions can and do take place in markets that are currently less active than normal and, just as importantly, prospective buyers will have in mind a price at which they would be prepared to enter the market.

12. It is sometimes argued that price information from an inactive market is not good evidence of value because the only sellers would be “forced sellers”. This is a significant over simplification. A period of falling prices is likely to see both decreased levels of activity and an increase in sales that can be termed forced. However, there are sellers in falling markets that are not acting under duress and to dismiss the evidence of prices realised by such sellers is to ignore the realities of the market.

Market Participants

13. References in IVS to market participants are to the whole body of individuals, companies or other entities that are involved in actual exchanges or who are contemplating entering into an exchange. The willingness to trade and any views attributed to market participants are typical of those of the majority of buyers and sellers, or prospective buyers and sellers, active in a market on the date of valuation, not to those of any particular individual or entity.
14. In undertaking a market based valuation, the factual circumstances of the current owner are not relevant because the willing seller is a hypothetical entity with the attributes of a typical market participant. The conceptual framework for *market value* excludes any element of *special value* or any element of value that would not be available to the generality of market participants.

Entity Specific Factors

15. The factors that are specific to an entity and not available to market participants generally are excluded from the inputs used in a market based valuation. Examples of entity specific factors that may not be available to the generality of market participants include the following:
- (a) additional value derived from the existence or creation of a portfolio of similar assets
 - (b) synergies between the asset and other assets owned by the entity
 - (c) legal rights or restrictions
 - (d) tax benefits or tax burdens
 - (e) an ability to exploit an asset that is unique to that entity.
16. An asset may not normally be transacted as a stand-alone item and any synergies related with a group of related assets would transfer to market participants along with the transfer of the entire group. Whether such factors are specific to the entity or would be available to others in the market generally is determined on a case by case basis.

17. If the *basis of value* is not *market value*, entity specific factors may be considered. If the objective of the valuation is to determine the value to a specific owner, entity specific factors are reflected in the valuation of the asset. Situations in which the value to a specific owner may be required include the following examples:
- (a) testing assets or groups of assets for impairment under IFRS by reference to their value in use
 - (b) supporting investment decisions
 - (c) reviewing the performance of an asset.

Aggregation

18. The value of an individual asset is often dependent upon its association with other related assets. Examples include:
- (a) offsetting assets and liabilities in a portfolio of financial instruments
 - (b) a portfolio of properties that complement each other by providing a prospective buyer with either a critical mass or a presence in strategic locations
 - (c) a group of machines in a production line, or the software required to operate a machine or machines
 - (d) recipes and patents that support a brand.
19. Where a valuation is required of assets that are held in conjunction with other complementary or related assets it is important to clearly define whether it is the group or portfolio that is to be valued or the individual assets. If the latter, it is also important to establish whether each asset is assumed to be valued as part of the whole group or portfolio, as an individual item but assuming that the other assets are available or as an individual item but assuming that the other assets are not available.

Valuation and Judgement

20. These standards set out principles for undertaking valuations. Applying these principles to specific situations will require the exercise of judgement. That judgement must be applied properly and should not be used to overstate or understate the valuation result. The proper exercise of judgement should always have regard to the stated objectives of the standards applicable to the valuation.

Independence and Objectivity

21. Many valuations are undertaken for purposes where either the commissioning party or a third party will expect or need the valuation to be free from bias. The process of valuation involves making judgements as to the weight to be given to different factual data or assumptions in arriving at a conclusion. For a valuation to be credible, it is important that those judgements can be seen to have been made in an environment that promotes transparency and minimises the influence of any subjective factors influencing the process.
22. Many states have laws or regulations as to who may value particular classes of assets for various purposes. Many professional bodies and valuation providers have ethical codes that require the identification and disclosure of potential conflicts of interest. The purpose of these standards is to set internationally recognised procedures and definitions for the preparation and reporting of valuation opinions. They are not concerned with the relationship between those commissioning valuations and those undertaking them, and matters relating to the conduct and ethical behaviour of valuers is for professional bodies or other bodies that have a regulatory role over valuers..
23. While conduct rules for valuers are outside the scope of these standards, it is nevertheless a fundamental expectation that appropriate controls and procedures are in place to ensure the appropriate degree of independence and objectivity in the valuation process so that the results can be seen to be free from bias. Where the purpose of the valuation requires the valuer to have a specific status, or disclosures confirming the valuer's status to be made, the requirements are set out in the appropriate standard.

Competence

24. Because valuation requires the exercise of skill and judgment, it is a fundamental expectation that valuations are prepared by an individual or firm having the appropriate technical skills, experience and knowledge of the subject of the valuation, the market in which it trades and the purpose of the valuation. For complex or large multi asset valuations it is acceptable for the valuer to seek assistance from specialists in certain aspects of the overall assignment, providing this is disclosed in the scope of work (see IVS 104 *Scope of Work*).

Effective Date

25. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 102

Valuation Approaches

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This standard identifies the three main generally accepted valuation approaches. Variations or adaptations of these approaches are used in the valuation of most types of asset.

Overview

1. One or more valuation approaches may be used in order to arrive at the valuation objective defined by the appropriate *basis of value* (See IVS 103). The three main approaches described and defined in this standard encompass all the significant methods used in valuation. They all are based on the economic principles of price equilibrium, anticipation of benefits or substitution. The methods used to apply the principles of these three valuation approaches to different asset types are discussed in the relevant standard.

Direct Market Comparison Approach

2. The *direct market comparison approach* is a comparative approach that considers the sales of similar or substitute assets and related market data. In general, an asset being valued is compared with similar items that have been transacted in the market or that are listed or offered for sale, with appropriate adjustment to reflect different properties or characteristics.

Income Approach

3. The *income approach* considers the income that an asset will generate over its remaining useful life and estimates value through a capitalisation process. This process applies an appropriate yield, or discount rate, to the projected income stream to arrive at a capital value. The income stream may be derived under a contract or contracts, or be non-contractual, eg, the profit generated from either the use of or holding of the asset.
4. Two commonly used methods that fall under the *income approach* are income capitalisation, where an all risks yield is applied to a fixed income stream, or discounted cash flow where the cash flows for future periods are discounted to a present value. The *income approach* can be applied to liabilities by considering the cash flows required to service a liability until it is discharged.

Cost Approach

5. The *cost approach* applies the basic economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility, whether by purchase or by construction. Unless undue time, inconvenience, risk or other factors are involved, the price that a buyer would pay for the asset being valued would not be more than the cost to acquire or construct a modern equivalent. Often the asset being valued will be less attractive than the cost of a modern equivalent because of age or obsolescence; where this is the case, adjustments will need to be made to the cost of the modern equivalent. This adjusted figure is known as the *depreciated replacement cost*.

Hierarchy of Approaches

6. Where directly observable prices for identical or similar assets are available at or close to the *valuation date*, the *direct market comparison approach* is generally preferred. Where this approach cannot be applied reliably because of either an absence of price information or because the asset is unique or has features that make it materially different to other assets of a similar type that are being transacted at or close to the *valuation date*, the *income approach* or the *cost approach* may be more appropriate.

Methods of Application

7. Each of these principal valuation approaches includes different detailed methods of application. Various methods that are in common use for different asset classes are discussed in the Asset Standards in the 300 series of IVS. The *basis of value* that is required, market practice and the data available to provide valuation inputs combine to determine which method or methods is the most appropriate.

Use of Multiple Approaches and Methods

8. In some cases it will be appropriate to use more than one approach or method in order to arrive at the valuation estimate, especially where there are insufficient factual or observable inputs to fully support the use of one method. Where alternative approaches and methods are used, these should be weighed and reconciled into a final value estimate.

Valuation Inputs

9. Valuation inputs refer to the data and other information that is used in any of the valuation approaches described. These inputs may be actual or assumed.

Examples of actual inputs include:

- prices achieved for similar or identical assets
- actual income generated by the asset
- the actual cost of an asset

Examples of assumed inputs include:

- estimated or projected cash flows
- the estimated cost of a hypothetical asset
- market participants' perceived attitude to risk.

10. Greater weight should normally be given to actual inputs; however, where these are less relevant, eg, where the evidence of actual transactions is stale or the actual cost information historic, assumed inputs may carry greater weight.
11. The nature and source of the valuation inputs should reflect the valuation objective. For example, various approaches and methods may be used to estimate *market value* providing they are based on market derived data. Direct market comparisons inevitably are market derived. The *income approach* should be applied using cash flows as would be determined by market participants and market derived rates of return. If applying the *cost approach*, construction costs and depreciation should be determined by reference to an analysis of market based estimates of costs and accumulated depreciation. Although data availability and circumstances relating to the market or the asset being valued will determine which valuation methods are most relevant and appropriate, the outcome of using any of the foregoing procedures should be *market value* if each method is based on market derived data.

12. Valuation approaches and methods are generally common to virtually all types of valuations. However, valuation of different types of assets involves different sources of data that appropriately reflect the market in which the assets are to be valued. For example, the underlying investment of *real estate* owned by a company will be valued in the context of the relevant *real estate* market in which the *real estate* trades, whereas the shares of the company itself will be valued in the context of the market in which the shares trade.

Effective Date

13. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 103

Bases of Value

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This standard describes different types of valuation objective and defines and provides commentary on those that are recognised and used in these standards.

Basis of Value

1. A *basis of value* is a statement of the fundamental measurement assumptions of a valuation.
2. It describes the fundamental assumptions on which the reported value will be based, eg, the nature of the hypothetical transaction, the relationship and motivation of the parties and the extent to which the asset is exposed to the market. The appropriate basis will vary depending on the purpose of the valuation. A *basis of value* should be clearly distinguished from:
 - (a) the approach or method used to estimate value
 - (b) the type of asset being valued
 - (c) the actual or assumed state of an asset at the point of valuation
 - (d) any additional assumptions or special assumptions that modify the fundamental assumptions to specific circumstances.

3. IVS recognises and defines bases of value in each of three principal categories
 - (a) The first is to estimate the price that would be achieved in a hypothetical exchange in a free and open market. *Market value* as defined in this standard falls into this category.
 - (b) The second is to estimate the benefits that an entity enjoys from ownership of an asset. The value is specific to that entity, and may have no relevance to market participants in general. *Investment value* and *special value* as defined in this standard fall into this category.
 - (c) The third is to estimate the price that would be reasonably agreed between two specific parties for the exchange of an asset. Although the parties may be unconnected and negotiating at arm's length, the asset is not necessarily exposed in the market and the price agreed may be one that reflects the specific advantages or disadvantages of ownership to the parties involved rather than the market at large. *Fair value* as defined in this standard falls into this category.
4. Many valuations may require the use of different bases of value that are defined by statute, regulation, private contract or other document. Although such bases may appear similar to the bases defined in these standards, unless unequivocal reference is made to IVS in the relevant document, their application may require a different approach from that described in IVS. Such bases have to be interpreted and applied in accordance with the provisions of the source document. Examples of bases of value that are defined in other regulations are the various valuation measurement bases found in International Financial Reporting Standards.
5. The *basis of value* to be used and its source, whether IVS or another document, should be recorded in both the scope of work and the valuation report (See IVS 104 *Scope of Work* and IVS 105 *Valuation Reporting*).

Market Value

6. *Market value* is the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

7. The definition of *market value* should be applied in accordance with the following conceptual framework:
- a) “*the estimated amount*” refers to a price expressed in terms of money payable for the asset in an arm’s length market transaction. *Market value* is measured as the most probable price reasonably obtainable in the market on the date of valuation in keeping with the *market value* definition. It is the best price reasonably obtainable by the seller. This estimate specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, special considerations or concessions granted by anyone associated with the sale, or any element of *special value*.
 - b) “*an asset should exchange*” refers to the fact that the value of an asset is an estimated amount rather than a predetermined amount or actual sale price. It is the price at which the market expects a transaction that meets all other elements of the *market value* definition should be completed on the date of valuation.
 - c) “*on the date of valuation*” requires that the estimated *market value* is time-specific as of a given date. Because markets and market conditions may change, the estimated value may be incorrect or inappropriate at another time. The valuation amount will reflect the actual market state and circumstances as of the effective *valuation date*, not as of either a past or future date. The definition also assumes simultaneous exchange and completion of the contract for sale without any variation in price that might otherwise be made.
 - d) “*between a willing buyer*” refers to one who is motivated, but not compelled to buy. This buyer is neither over eager nor determined to buy at any price. This buyer is also one who purchases in accordance with the realities of the current market and with current market expectations, rather than in relation to an imaginary or hypothetical market that cannot be demonstrated or anticipated to exist. The assumed buyer would not pay a higher price than the market requires. The present owner is included among those who constitute “the market”.
 - e) “*and a willing seller*” is neither an over eager nor a forced seller, prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market. The willing seller is motivated to sell the asset at market terms for the best price attainable in the open market after proper marketing, whatever that price may be. The factual circumstances of the actual owner are not a part of this consideration because the willing seller is a hypothetical owner.

- f) “*in an arm’s length transaction*” is one between parties who do not have a particular or special relationship, eg, parent and subsidiary companies or landlord and tenant, that may make the price level uncharacteristic of the market or inflated because of an element of *special value*. The *market value* transaction is presumed to be between unrelated parties, each acting independently.
 - g) “*after proper marketing*” means that the asset would be exposed to the market in the most appropriate manner to effect its disposal at the best price reasonably obtainable in accordance with the *market value* definition. The method of sale is deemed to be that most appropriate to obtain the best price in the market to which the seller has access. The length of exposure time is not a fixed period but will vary according to the type of asset and market conditions. The only criterion is that there must have been sufficient time to allow the asset to be brought to the attention of an adequate number of market participants. The exposure period occurs prior to the *valuation date*.
 - h) “*wherein the parties had each acted knowledgeably, prudently*” presumes that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the asset, its actual and potential uses and the state of the market as of the date of valuation. Each is further presumed to act for self-interest with that knowledge and prudently seek the best price for their respective positions in the transaction. Prudence is assessed by referring to the state of the market at the date of valuation, not with benefit of hindsight at some later date. For example, it is not necessarily imprudent for a seller to sell assets in a market with falling prices at a price that is lower than previous market levels. In such cases, as is true for other exchanges in markets with changing prices, the prudent buyer or seller will act in accordance with the best market information available at the time.
 - i) “*and without compulsion*” establishes that each party is motivated to undertake the transaction, but neither is forced or unduly coerced to complete it.
8. The concept of *market value* presumes a price negotiated in an open and competitive market where the participants are acting freely. The market for an asset could be an international market or a local market. The market could consist of numerous buyers and sellers, or could be one characterised by a limited number of market participants. The market in which the asset is exposed for sale is the one in which the asset being exchanged is normally exchanged, (see IVS 101 *General Concepts and Principles* para 8).

9. The *market value* of an asset will reflect its *highest and best use*. The *highest and best use* is the use of an asset that maximizes its productivity and that is possible, legally permissible and financially feasible. The *highest and best use* may be for continuation of an asset's existing use or for some alternative use. This is determined by the use that a market participant would have in mind for the asset when formulating the price that it would be willing to bid.
10. The determination of the *highest and best use* involves consideration of the following:
 - (a) To establish whether a use is possible, regard will be had to what would be considered reasonable by market participants.
 - (b) To reflect the requirement to be legally permissible, any legal restrictions on the use of the asset, eg, zoning designations, need to be taken into account.
 - (c) The requirement that the use be financially feasible takes into account whether an alternative use that is physically possible and legally permissible will generate sufficient return to a typical market participant, after taking into account the costs of conversion to that use, over and above the return on the existing use.

Transaction Costs

11. *Market value* is the value of an asset without regard to the seller's costs of sale or the buyer's costs of purchase and without adjustment for any taxes payable by either party as a direct result of the transaction.

Investment Value

12. *Investment value* is the value of an asset to the owner or a prospective owner.
13. This is an entity specific *basis of value*. Although the value of an asset to the owner may be the same as the amount that could be realised from its sale to another party, this *basis of value* reflects the benefits received by an entity from holding the asset and, therefore, does not necessarily involve a hypothetical exchange. *Investment value* reflects the circumstances and financial objectives of the entity for which the valuation is being produced. It is often used for measuring investment performance. Differences between the *investment value* of an asset and its *market value* provide the motivation for buyers or sellers to enter the market place.

Fair Value

14. *Fair value* is the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.
15. The definition of fair value in International Financial Reporting Standards (IFRS) is different from the above and is generally consistent with *market value*.¹ The definition and application of fair value under IFRS are discussed in IVS 201.01.
16. For purposes other than use in financial statements, *fair value* can be distinguished from *market value*. *Fair value* requires the assessment of the price that is fair between two identified parties taking into account the respective advantages or disadvantages that each will gain from the transaction. In contrast, *market value* requires any advantages that would not be available to market participants generally to be disregarded.
17. *Fair value* is a broader concept than *market value*. Although in many cases the price that is fair between two parties will equate to that obtainable in the market, there will be cases where the assessment of *fair value* will involve taking into account matters that have to be disregarded in the assessment of *market value*, such as any element of *special value* arising because of the combination of the interests.
18. Examples of the use of *fair value* include:
 - (a) estimating a price that is fair for a shareholding in a non quoted business, where the holdings of two specific parties may mean that the price that is fair between them is different from the price that might be obtainable in the market
 - (b) estimating the price that would be fair between a lessor and a lessee for either the permanent transfer of the leased asset or the cancelation of the lease liability.

Special Value

19. *Special value* is an amount that reflects particular attributes of an asset that are only of value to a *special purchaser*.
20. A *special purchaser* is a particular buyer, or a restricted class of buyers, for whom a particular asset has *special value* because of advantages arising from its ownership that would not be available to general purchasers in the market.

¹ This assumes that the definition in the 2009 IASB Exposure Draft "Fair Value Measurement" remains substantially unchanged in any final standard issued by the IASB.

21. *Special value* can arise where an asset has attributes that make it more attractive to a particular buyer than to the general body of buyers in a market. These attributes can include the physical, geographic, economic or legal characteristics of an asset. *Market value* requires the disregard of any element of *special value* because at any given date it is only assumed that there is a willing buyer, not a particular willing buyer. When *special value* is reported, it should be clearly distinguished from *market value*.
22. The attributes of an asset that could be of value to a *special purchaser* include any element of *synergistic value* that would be generated by its acquisition.
23. *Synergistic value* is an additional element of value created by the combination of two or more interests where the value of the combined interest is worth more than the sum of the original interests.

Additional Assumptions

24. Often it is necessary to add an assumption or multiple assumptions to the *basis of value* to clarify either the state of the asset in the hypothetical exchange or the circumstances under which the asset is assumed to be exchanged as these can have a significant impact on value.
25. Examples of additional assumptions in common use include:
 - an assumption that the entire business is exchanged as a complete operational entity
 - an assumption that assets employed in a business are exchanged without the business, either individually or as a group.
 - an assumption that an asset is exchanged together with other complementary assets (see IVS 101 General Concepts and Principles)
 - an assumption that an owner occupied property is vacant when exchanged.
26. Where an additional assumption is made that changes the facts pertaining at the *valuation date* it becomes a *special assumption* (see IVS 104 *Scope of Work*).

Forced Sales

27. The term “forced sale” is often used in circumstances where a seller is under compulsion to sell and a proper marketing period is not available. The price that could be obtained in these circumstances will depend upon the nature of the pressure on the seller and the reasons why proper marketing cannot be undertaken. It will also reflect the consequences for the seller of failing to sell within the period available. Unless the nature of and the reason for the constraints on the seller are known, the price obtainable in a forced sale cannot be realistically estimated. The price that a seller will accept in a forced sale will reflect its particular circumstances rather than those of the hypothetical willing seller in the *market value* definition. The price obtainable in a forced sale has only a coincidental relationship to *market value* or any of the other bases defined in this standard. A “forced sale” is a description of the situation under which the exchange takes place, not a distinct valuation basis.
28. If the value obtainable under a forced sale is required, it will be necessary to clearly identify the reasons for the constraint on the seller including the consequences of failing to sell in the specified period by setting out appropriate assumptions. If these circumstances do not exist at the *valuation date* these must be clearly identified as special assumptions.

Effective Date

29. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 104

Scope of Work

Contents	Paragraphs
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Minimum Requirements	2
Recording Scope of Work	3
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Effective Date	5

This standard sets out the minimum matters that should be addressed at the outset of a valuation assignment. Some types of engagement may have additional or more specific requirements, which can be found in the relevant IVS standard.

General Principle

1. A valuation must be appropriate for its intended purpose. It is also important that the recipient of a valuation understands what is to be provided and any limitations on its use. It is therefore important that a scope of work is determined between the valuer and client that sets out the purpose of the valuation, the procedures that will be adopted, assumptions that will be made and the limitations, restrictions and conditions that will apply before the valuation and report are finalised.

Minimum Requirements

2. The scope of work shall include the following matters as a minimum. For certain applications or for certain asset classes, additional matters may need to be considered or included. These are referred to in the appropriate Application Standards and Asset Standards in the 200 and 300 series of IVS.
 - a) Identification of the valuer and confirmation of competence

The valuer can be an individual or a firm. A statement confirming the competence of the valuer to undertake the valuation should be included (see IVS 101 General Concepts and Principles). If the valuer needs to seek assistance from others in relation to any aspect of the engagement, the nature of such assistance and the extent of reliance shall be recorded.

b) Identification of the client and any other intended users

Confirmation of those for whom the valuation is being produced is important when determining the form and content of the valuation report to ensure that it contains information relevant to their needs.

Any restriction on those who may rely upon the valuation shall be recorded.

c) Purpose of the valuation

The purpose of the valuation determines the valuation objective and, in turn, the *basis of value*. For example, IVS 202.01 *Valuations of Property Interests for Secured Lending* states that valuations for secured lending shall be on the basis of *market value*; other valuation purposes may require an entity specific basis.

d) Identification of the asset or liability to be valued

Clarification may be needed to distinguish between an asset and an interest in or right of use of that asset.

If the valuation is of assets that are utilised in conjunction with other assets, it will be necessary to clarify whether those assets are included, excluded but assumed to be available or excluded and assumed not to be available (, see “Aggregation” IVS 101 *General Concepts and Principles*).

e) Basis or bases of value

This shall be appropriate for the purpose. The source of the definition of any *basis of value* used should be cited. The valuation bases recognised by IVS are discussed in IVS 103 *Bases of Value*. It may also be necessary to determine the currency in which the valuation will be reported.

f) Valuation date

The *valuation date* is defined in IVS as the date on which the estimate of value applies. This may be different from the date of the valuation report or the date on which investigations are to be undertaken or completed.

g) Extent of investigation

It is necessary to gather sufficient evidence by such means as inspection, inquiry, computation and analysis to ensure that the valuation is properly supported. When determining the extent of evidence necessary, professional judgment is required to ensure the information to be obtained is adequate having regard to the purpose of the valuation. As a matter of practical expediency, it is normal for limits to be agreed on the extent of the valuer’s investigations. Any such limits shall be recorded in the scope of work.

If relevant information is not available because the circumstances of the engagement restrict the investigation, such restrictions and any necessary assumptions or special assumptions should be recorded.

h) Nature and source of the information to be relied upon

In the course of the valuation process, it may be necessary to rely on information provided by the client or third parties. For example, it may be agreed to accept information provided regarding legal title to the asset without the valuer being under any duty to verify. The nature and source of any information that is to be relied upon in the valuation process without specific verification should be recorded.

i) Assumptions and any special assumptions

Assumptions are matters that are reasonable to accept as fact in the context of the valuation engagement without specific investigation or verification. They are matters that, once stated, are to be accepted in understanding the valuation.

A *special assumption* is an assumption that either assumes facts that differ from the actual facts existing at the *valuation date* or that would not be made by a typical market participant in a transaction on the *valuation date*.

Special assumptions are often used to illustrate the effect of changed circumstances on value. An example of a *special assumption* would be a proposed building being valued as if complete on the *valuation date*.

j) Publication restrictions

Where it is necessary or desirable to restrict the use of the valuation or those relying upon it, this should be recorded.

It is important that valuations are not used out of context or for purposes for which they are not intended. It should be made clear that the valuation report will be subject to restrictions on its publication or reproduction without the valuer's consent.

k) Confirmation that the valuation will be undertaken in accordance with the IVS

While confirmation of conformity with IVS is required, there may be occasions where the purpose of the valuation requires a departure from IVS. Any such departure must be identified together with justification for that departure. A departure would not be justified if it results in a valuation that is misleading.

l) Description of report

Confirmation of the degree of detail to be provided over and above the minimum contents specified in this standard. If no explanation of the approach used or other reasons are to be provided this shall be recorded.

Recording of Scope of Work

3. The scope of work requirements can be contained in a single document issued at the outset or in a series of documents prepared throughout the course of the engagement.

Changes to Scope of Work

4. Determining the scope of work is an ongoing process. Information or conditions discovered during the course of an assignment might cause reconsideration of the scope of work.

Effective Date

5. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 105

Valuation Reporting

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This standard sets the minimum information that should be included in a valuation report. Some valuation applications may have additional requirements in respect of matters to be reported upon or specific disclosures to be included. These are found in the relevant IVS standard.

General Principle

1. The final step in the valuation process lies in communicating the value to the commissioning party and any other intended users. It is essential that the valuation report communicates the information necessary for proper understanding of the valuation. A valuation report shall not be ambiguous or misleading and shall provide the intended reader with a clear understanding of the valuation provided.
2. To provide comparability, relevance and credibility, the valuation report shall set out a clear and accurate description of the scope of the assignment, its purpose and intended use, confirmation of the *basis of value* used and disclosure of any assumptions, special assumptions or limiting conditions that directly affect the valuation.
3. This standard applies to all valuation reports whether printed on paper or transmitted electronically.

Report Contents

4. The purpose of the valuation, the complexity of the asset being valued and the users' requirements will determine the level of detail appropriate to the valuation report.

5. All valuation reports shall contain the information listed below as a minimum. Items (a) to (k) in this list relate to matters that are recorded in the scope of work (see IVS 104 *Scope of Work*).
- a) Identification of the valuer and confirmation of competence

The valuer can be an individual or a firm. A statement confirming the competence of the valuer should be included (see IVS 101 *General Concepts and Principles*). If the valuer has obtained assistance from others in relation to any aspect of the engagement, the nature of such assistance and the extent of reliance shall be recorded in the report.
 - b) Identification of the client and any other intended users

The party commissioning the valuation shall be identified together with any other parties whom it is intended may rely on the valuation, see also (j), Publication restrictions, below.
 - c) Purpose of the valuation

The purpose of the valuation shall be clearly stated.
 - d) Identification of the asset or liability to be valued

Clarification may be needed to distinguish between an asset and an interest in or right of use of that asset.

If the valuation is of assets that are utilised in conjunction with other assets, it will be necessary to clarify whether those assets are included, excluded but assumed to be available or excluded and assumed not to be available (see “Aggregation” in IVS 101 *General Principles and Concepts*).
 - e) Basis or bases of value

This shall be appropriate for the purpose. The definition and source of any *basis of value* used should be cited. The valuation bases recognised by IVS are discussed in IVS 103 *Bases of Value*.
 - f) Valuation date

The *valuation date* is defined in IVS as the date on which the estimate of value applies. This may be different from the date of the valuation report or the date on which investigations are to be undertaken or completed. Where relevant, these dates should be clearly distinguished in the report.
 - g) Extent of investigation

The extent of the valuer’s investigations undertaken, including the limitations on those investigations set out in the scope of work should be recorded in the report.

- h) Nature and source of the information relied upon
The nature and source of any information relied on in the valuation process without specific verification by the valuer should be recorded.
- i) Assumptions and any special assumptions
All assumptions and any special assumptions made should be clearly stated.
- j) Publication restrictions
Where it is necessary or desirable to restrict the use of the valuation or those relying upon it, this should be recorded.
- k) Confirmation that the valuation has been undertaken in accordance with the IVS
While confirmation of conformity with IVS is required, there may be occasions where the purpose of the valuation requires a departure from IVS. Any such departure must be identified, together with justification for that departure.
- l) Valuation approach and reasoning
To understand the valuation figure in context, the report shall make reference to the approach or approaches adopted and the key reasons for the conclusions reached. This requirement does not apply if it has been specifically agreed and recorded in the scope of work that a non reasoned valuation report shall be provided.
- m) Amount of the valuation or valuations and the applicable currency.
- n) Date of the valuation report
The date on which the report is issued should be included. This may be different from the *valuation date*, see (e) above.

Effective Date

- 6. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

Introduction to IVS 200 Series

Application Standards

This section of the International Valuation Standards contains standards for valuations undertaken for specific purposes.

Each standard provides guidance on the background and particular valuation requirements. It also identifies any matters additional to those in the General Standards that should be considered when settling the scope of work, undertaking and reporting the valuation.

IVS 201.01 – 201.04 inclusive are concerned with different valuation requirements under International Financial Reporting Standards (IFRS), published by the International Accounting Standards Board (IASB). The IFRS collectively comprise individually numbered standards. Those standards originally published before 2001 are denoted IAS (International Accounting Standards). Those published subsequently are denoted IFRS.

The references to IFRSs and other IASB publications are to those in issue as at May 2010. IFRSs and their interpretation change over time. Accordingly these references are liable to become out of date and this document should not be used as substitute for referring to current IFRS and interpretations published by IASB and IASCF. More information on IFRS and other related publications can be obtained from www.iasb.org

The International Federation of Accountants' International Public Sector Accounting Standards Board (IPSASB) develops accounting standards for public sector entities, referred to as International Public Sector Accounting Standards (IPSAS). IVS 201.05 provides guidance on the valuation of property plant and equipment in the public sector.

The references to IPSAS standards are to those in issue as at May 2010 and are liable to change. This document should not be used as a substitute for referring to current IPSAS as published by IFAC. The current versions of IPSAS can be obtained from www.ifac.org/PublicSector

International Valuation Standard 201.01

Fair Value under International Financial Reporting Standards

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This standard provides an overview of fair value under the International Financial Reporting Standards and sets out requirements additional to those in the General Standards in order to provide valuations that are suitable for use in preparing fair value estimates for use in financial statements.

International Financial Reporting Standards

1. Fair value is either the required measurement basis or a permitted option for many types of asset or liability under IFRS. This IVS explains principal objectives of fair value, how these relate to IVS generally and sets out the specific steps that are required to produce valuations that are suitable for use by those preparing financial statements under IFRS.
2. This standard does not comment on the required accounting treatment for different types of asset and liability. When undertaking valuations to support the preparation of financial statements under IFRS, the valuer should be aware of the basic accounting requirements to ensure that the context of the valuation is understood, that appropriate assumptions are made and that the report contains all necessary information and disclosures. A list of individual IFRSs that use fair value measurements is included as Annexe 1 to this standard.

Fair Value Measurement

3. At the time of publishing this exposure draft, the IASB is in the process of deliberating a new IFRS on “Fair Value Measurement.” This document reflects the contents of the IASB Exposure Draft published in 2009¹ (“the FVM Exposure Draft”) and subsequent tentative decisions made by the IASB. However, it is recognised that changes may be required to this document pending the conclusion of the IASB project.
4. The FVM Exposure Draft proposes the following definition of fair value: “Fair Value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.” It is intended that this definition will replace earlier definitions appearing in various existing IFRS.
5. This definition and the associated commentary in the FVM Exposure Draft clearly indicate that fair value under IFRS is a different concept to fair value used for purposes other than financial reporting and as defined and discussed in IVS 103 *Bases of Value*. The commentary in the FVM Exposure Draft and, in particular, the references to market participants, an orderly transaction, the transaction taking place in the principal or the most advantageous market and to the highest and best use of an asset, make it clear that fair value under IFRS should be consistent with the concept of *market value* as defined and discussed in IVS 103 *Bases of Value*. For most practical purposes, therefore, *market value* under IVS will meet the fair value measurement requirement under IFRS.

Aggregation

6. Fair value under IFRS applies to the “unit of account” for an asset or liability as specified in the relevant standard. This is usually the individual asset or liability, but in some circumstances can apply to a group of related assets. The FVM Exposure Draft proposes that, in the case of assets, it is necessary to determine whether the maximum value to market participants would be to use the asset in combination with other assets and liabilities as a group or to use the asset on a stand alone basis. This requirement to state how individual assets are assumed to be aggregated with other potentially complementary assets is consistent with the requirements of IVS 104 *Scope of Work* and IVS 105 *Valuation Reporting*.

¹ IASB ED/2009/5 Fair Value Measurement

Valuation Hierarchy

7. The Exposure Draft includes a “Fair Value Hierarchy” that classifies valuations according to the nature of the available inputs. In summary, the three levels of the hierarchy are:
- Level 1 inputs are “quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access on the measurement date”.
 - Level 2 inputs are “inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie, as prices) or indirectly (ie, derived from prices)”.
 - Level 3 inputs are “inputs for the asset or liability that are not based on observable market data (unobservable inputs)”.
8. The FVM Exposure Draft requires the level in the hierarchy of any asset or liability to be disclosed in the financial statements. There are additional accounting requirements in relation to valuations produced using Level 3 inputs.
9. The IVS do not stipulate a hierarchy of valuation based on inputs. Valuations that require the use of one of the primary approaches described in IVS 102 *Valuation Approaches* will normally fall into either Level 2 or Level 3 of the IFRS fair value hierarchy, the exception being liquid and homogenous assets that are traded at publicly available prices, eg, stock in a listed company.

Application to Liabilities

10. The FVM Exposure Draft provides that the measurement of a liability assumes that it is transferred to a market participant on the measurement date; it is not assumed to be settled with the counterparty or otherwise extinguished. Where there is not an observable market price for the liability, it is stated that its value should be measured using the same method as the counterparty would use to measure the value of the corresponding asset. The fair value of a liability reflects the non-performance risk associated with a liability, but deems this to be the same before and after the assumed transfer. Non-performance risk may include the effect of the entity’s own credit risk.
11. There are special provisions in the FVM Exposure Draft relating to situations where there is no corresponding asset for a liability, as is the case with many non-financial liabilities. There is also a requirement to ignore any contractual or other restrictions on an entity’s ability to transfer a liability in assessing its fair value.

Scope of Work

12. In addition to the minimum requirements in IVS 104 *Scope of Work*, the following matters should receive specific consideration when an estimate of fair value is commissioned for use in financial statements prepared under IFRS:

(d) Identification of the asset or liability to be valued:

The accounting treatment of identical or similar assets or liabilities under IFRS often differs according to how they are used by an entity. For example:

- The treatment of a building owned by an entity may differ depending on whether it is occupied for the purpose of the entity's business, is held as an investment, is surplus to requirements or, in the case of a development company, is treated as stock in trade.
- Financial instruments that are held to collect contractual cash flows that consist solely of payments of the principal and interest may be treated differently to other forms of instruments.
- Intangible assets acquired by a business merger or acquisition may be treated differently from similar assets already owned by an entity.

The scope of work should therefore identify not only the nature of the asset being valued but also how it is used or classified by the reporting entity. It may also be necessary to identify the appropriate unit of account for valuation purposes as provided by the relevant IFRS standard.

(i) Assumptions and any special assumptions:

Different valuation assumptions may be appropriate depending on the classification of the asset or liability. The assumptions that are applicable to each class of asset should be included in the scope of work. For example, if the highest value of an asset to a market participant would be as part of a group of complementary assets, it may be appropriate to state that the asset will be valued on the assumption that it is part of a sale of the associated group. Complementary assets may be different types of assets in the same physical location, eg, an industrial property and the installed plant within it or individual machines forming a single production line. In other situations identical or similar assets may attract a higher value in aggregate if they allowed market participants to achieve economies of scale through achieving a critical mass.

Where the effect on value is material, it may be appropriate to provide valuations on the basis of alternative assumptions, eg, the asset is sold as an individual item or as part of a sale of a group of assets to enable the preparer of the financial statements to make decisions as to the most appropriate accounting treatment under IFRS.

IAS 1 para 23 provides that financial statements are produced on the assumption that the entity is a going concern unless management either intends to liquidate the entity or cease trading, or has no realistic alternative but to do so. The valuation should normally include an assumption that the asset or assets will continue to be used as part of the business of which they form part, except in cases where it is clear that there is either an intention to dispose of a particular asset or that option of retirement and disposal of the asset has to be considered.

It would not normally be appropriate for a valuation prepared for inclusion in a financial statement to be made on the basis of a *special assumption*.

Valuation Reporting

13. In addition to the minimum requirements in IVS 105 *Valuation Reporting*, a valuation report on a fair value estimate under IFRS shall include comment on such of the following as is relevant to the purpose of the valuation:
 - (a) Sufficient information on the approach used, the material inputs and the reasoning of the valuation should be provided to enable the preparer of the financial statements to determine into which level of the fair value hierarchy referred to in the FVM Exposure Draft the asset or assets should be placed.
 - (b) Regard should also be had to any specific disclosures that the entity may be required to make in order to comply with IFRS. Some examples are provided below, but this is not an exhaustive list and reference should be made to the relevant IFRS.²

IAS 16 Property Plant & Equipment (para 77):

- (a) whether an independent valuer was involved
- (b) the methods and significant assumptions applied,

² The FVM Exposure Draft proposes that some of these specific disclosures be replaced with generic disclosures in the draft.

- (c) the extent to which the values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms, or were estimated using other valuation techniques.

IAS 40 - Investment Property (para 75):

- (a) the methods and significant assumptions applied in determining the fair value of *investment property*, including a statement whether the determination of fair value was supported by market evidence or was more heavily based on other factors (which the entity should disclose) because of the nature of the property or a lack of comparable market data.
- (b) the extent to which the fair value of *investment property*, as measured or disclosed in the financial statements, is based on a valuation by an independent valuer, who holds a recognised and relevant professional qualification and who has recent experience in the location and category of the *investment property* being valued.

- 14. When a valuation for inclusion in a financial statement is prepared using the *cost approach*, the report should include a caution that the reported value is subject to the asset or assets not being impaired. This is because an entity would not replace an impaired asset with a modern equivalent, which is the underlying premise of the *cost approach*.

Effective Date

- 15. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

Annexe to IVS 201.01

The following individual IFRS either require fair value measurements or allow them as an option.

IAS 2	Inventories
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 28	Investments in Associates
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IAS 41	Agriculture
IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IFRS 9	Financial Instruments ³

Copies of individual standards or of the complete set of IFRS may be obtained directly from IASCF, 30 Cannon Street, London EC4M 6HX, United Kingdom, E-mail: publications@iasb.org.uk

³ IFRS 9 is being developed in phases and is intended to eventually replace IAS 39 in its entirety.

International Valuation Standard 201.02

Valuations for Depreciation

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This standard summarises the requirements of the International Financial Reporting Standards for the depreciation of property, plant and equipment and the valuations required to support these requirements.

Depreciation

1. IAS 16 includes a requirement for an entity to account for the depreciation of property, plant and equipment. Depreciation is a charge made against income in the financial statements to reflect the consumption of the item over its useful life to the entity. There is also a requirement to depreciate separately components of an asset that have a cost that is significant in relation to the whole and that have a materially different useful life. In the case of property, land is not normally depreciated. Valuations are often required to support the calculation of the depreciable amount.
2. The term depreciation is used in different contexts in valuation and in financial reporting. In the context of valuation, depreciation is often used to refer to the adjustments made when using the *cost approach* to the cost of reproducing or replacing the asset to reflect obsolescence in order to estimate the value of the asset when there is no direct sales evidence available, see IVS 102 *Valuation Approaches*. In the context of financial reporting, depreciation refers to the charge made against income to reflect the systematic allocation of the depreciable amount of an asset over its useful life to the entity.
3. In order to assess the depreciation charge to be made, the “depreciable amount” has to be determined. This is the difference, if any, between the “carrying amount” of the asset

and its “residual value”. In order to determine the “residual value”, the “useful life” of the asset has also to be determined. These terms are defined in IAS 16 as:

- Depreciable amount is the cost of an asset or other amount substituted for cost in the financial statements, less its residual value.
 - Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation or amortisation and accumulated impairment losses thereon.
 - Residual value is the estimated amount that an entity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.
 - Useful life is (a) the period over which an asset is expected to be available for use by an entity; or (b) the number of production or similar units expected to be obtained from the asset by an entity.
4. It should be noted that the carrying amount may be based on either historic cost or fair value, less accumulated depreciation (amortisation) and accumulated impairment losses. The residual value and the useful life have to be reviewed at least at every financial year end.

Property

5. IAS 16 para 58 recognises that land normally has an unlimited useful life, which means that it should be accounted for separately and not depreciated. The first step in establishing the depreciable amount attributable to a property, or a part of a property, is therefore to establish the value of the land component. The *market value* of the land at the date of the relevant financial statement is established and deducted from the carrying amount for the property interest, ie, the land and buildings combined, in order to establish a notional value for the building component.
6. Having established a notional value for the building component, the residual value of the building needs to be estimated. In order to do this, the useful life needs to be established. It is important to note that this may not be the same as the remaining economic life as would be recognised by a typical market participant. If the property would not be available to the entity for the whole of its life or if the entity determines that the building will be surplus to its requirements in a shorter period, this will be the useful life.

7. The residual value is a value current as of the date of the financial statement but on the assumption that the asset was already at the end of its useful life and in a condition commensurate with that assumption. Buildings will have an economic life that extends beyond the period for which they will be available to or required by the entity and, therefore, may have a significant residual value.

Plant and Equipment

8. The useful life of an item of plant or equipment is more likely to coincide with the economic life of the item as rates of obsolescence are generally higher than for buildings, with the result that economic lives are shorter. However, the distinction between the useful life to the entity and remaining economic life should still be considered.

Componentisation

9. Any element of a property or an item of property, plant or equipment which has a cost that is significant in relation to the total cost of the item has to be depreciated separately. Where parts have a similar useful life and will depreciate at a similar rate, they may be grouped in determining the depreciation charge. Where the carrying amount is based on historic cost, the cost of those elements that both have a significant cost in relation to the total and that have a materially different useful life should be readily identifiable.
10. Where the carrying amount is based on the fair value of the item, an allocation will need to be made of the fair value of the item between the components. Although it may be possible to determine the value attributable to a component of an item of plant or equipment if there is an active market for those components, in other cases the components will not be actively traded. The latter is normally the case with components of a building, eg, buildings are rarely sold without the mechanical and electrical services needed for heating, lighting and ventilation, and the installed plant could not be sold without the building. Where the value of the individual components cannot be reliably determined, the value attributable to the whole is apportioned to the components. The ratio of the cost of the item to the cost of the whole may be an appropriate basis for such an apportionment.

Scope of Work

11. In addition to the minimum requirements in IVS 104 *Scope of Work*, the following matters should receive specific consideration where the residual value or the allocation of value to different components is to be provided:

- (d) Identification of the asset or liability to be valued:

If the value needs to be allocated to the components of the asset and the components are deemed to have materially different useful lives, appropriate provisions for the allocation should be included in the scope of work.

- (i) Assumptions and any special assumptions:

Where a residual value is required, assumptions may be required in order to establish the useful life of the asset.

Valuation Reporting

12. In addition to the minimum requirements in IVS 105 *Valuation Reporting*, a valuation report on the calculation of depreciation under IFRS shall state that the figures provided are hypothetical allocations of the value of the whole item, prepared solely for calculating the appropriate rate of depreciation in the entity's financial statements, and should not be relied upon for any other purpose.

Effective Date

13. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 201.03

Valuations for Lease Accounting

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Leases are subject to specific accounting requirements under International Financial Reporting Standards and valuations may be required to support these. This standard provides a summary of the relevant accounting requirements and the appropriate valuation procedures to respond to these.

Lease Types

1. Under IAS 17, leases have to be classified for inclusion in financial statements as either operating leases or finance leases. If a lease is classified as a *finance lease*, the asset and liability are recorded by the entity on its balance sheet. These lease types are defined in IAS 17 as follows:
 - A *finance lease* is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not be eventually transferred.
 - An operating lease is a lease other than a *finance lease*.
2. For leases of property special rules apply; other than for *investment property*, the land and buildings elements of a property interest have to be considered separately for classification as either a *finance lease* or an operating lease. The provisions in respect of *investment property* are described in paras 15 to 17 of this standard.

3. IAS 17 does not apply to biological assets as defined in IAS 41.
4. Valuations may be required to assist in classification of a lease as either a *finance lease* or an operating lease or to establish the value of an asset held under a *finance lease*.

Lease Classification

5. The classification test depends on the substance rather than the form of the contract. For example, a contract between two parties for the use of an asset in return for a payment may not be termed lease but if the conditions set out in IAS 17 are met, then it will be necessary to account for the contract as a lease.
6. The following examples are listed in IAS 17 at paras 10 to 11 as situations that could be indicative of a *finance lease*, either individually or in combination. These are not absolute tests but illustrations.
 - (a) the lease transfers ownership of the asset to the lessee by the end of the lease term,
 - (b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised,
 - (c) the lease term is for the major part of the economic life of the asset even if title is not transferred,
 - (d) at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset,
 - (e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications,
 - (f) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee,
 - (g) gains or losses from the fluctuation in the fair value of the residual accrue to the lessee,
 - (g) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than *market rent*.

7. IAS 17, para 12, emphasises that the criteria listed are examples and indicators and may not be conclusive. If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, this may be the case if ownership of the asset transfers at the end of the lease for a variable payment equal to its then value, or if there are regular reviews of the rent, to the then market level or by reference to an inflation index.
8. Lease classification is made at the inception of the lease. If the lessee and the lessor subsequently agree to change the provisions of the lease in a manner that would have resulted in a different classification of the lease had they been in place at its inception, the revised agreement is regarded as a new lease over its term. However, changes in factors such as the economic life or of the residual value of the leased property, or changes in circumstances, such as default by the lessee, are not grounds for reclassification.
9. Classification involves an assessment of the degree to which economic benefits are transferred by a lease. In many cases a qualitative assessment of the lease terms will quickly indicate the correct classification without the need for detailed calculation of the value of the different lease interests. However, valuations may be required to help establish benefits accruing to the lessor and lessee respectively, eg, in estimating the residual value at the end of the lease to establish if the lease is for a major part of the asset's economic life.

Classification of Property Leases

10. Where a lease is of land and a building or buildings together, IAS 17, para 15A, requires that the two elements be considered separately for the purposes of classification. If it appears that the element of the lease attributable to the building could be a *finance lease*, it will be necessary to make an allocation of the initial rent based on the relative fair values of the leasehold interests in each element at the inception of the lease, IAS 17, para 16.
11. For most property leases the interest in the land and buildings reverts to the lessor at the end of the lease. There are also often provisions for the rent to be reviewed periodically to reflect changes in the value of the property, and frequently an obligation on the lessee to hand the buildings back to the lessor in good repair. These are all indicators that the lessor did not transfer substantially all the risks and rewards of ownership of either the buildings or the land to the lessee when the lease was granted.

12. Consequently, many leases of land and buildings are readily identifiable as operating leases. Finance leases of land and buildings will generally arise only where the lease is clearly created as a way of funding the eventual purchase of the property by the lessee, eg, by means of an option to acquire the lessor's interest for a nominal sum after the specified rental payments have been made. Occasionally, leases that are not clearly structured as finance agreements may meet some of the criteria of a *finance lease*, eg, where the rental payments do not reflect the underlying value of the property. In such cases, a more detailed analysis of the value of the risks and benefits transferred from lessor to lessee may be required in order to determine the correct classification.
13. Where a lease is of a parcel of land and a building is constructed upon it, allocating the rent to each element is a task that can be undertaken reliably where there is an active market for land for similar development in the locality. In other situations, eg, where the lease is of part of a multi-let building with no identifiable land attributable to any particular lease, reliable allocation may be impossible. IAS 17, para 16, makes the proviso that where a reliable allocation cannot be made, the whole lease should be treated as a *finance lease*, unless it is clear that both elements are operating leases. If it were clear that both elements were operating leases from the outset, the allocation exercise would not be necessary.
14. In practice, leases of part of a multi-let building will normally be operating leases and the whole property will be classified as *investment property* by the lessor. In such cases, allocation will be unnecessary. In cases where the building element is clearly a *finance lease*, the land element is likely to be identifiable. It will be comparatively rare for the building element to meet the criteria for classification as a *finance lease* and for the land element not to be clearly identifiable. However, if such a case is identified, an allocation between the land and the building element should not be attempted based on unreliable criteria. In such circumstances, the whole of the leased property should be accounted for as a *finance lease*.

Investment Property

15. Under IAS 17, para 18, it is not necessary to make an allocation between the land and buildings elements of an *investment property* held under a lease and accounted for using the fair value model.
16. *Investment property* is frequently held by an investor under a lease, eg, a long lease of land on which it has developed buildings, which are then leased as an investment. Because land does not normally depreciate, a lease of land would appear to be correctly classified as an operating lease. However, in recognition of the fact that many substantial investment properties are held on this basis, IAS 40, para 25 provides that at initial recognition an *investment property* held under a lease shall be accounted for as though it were a *finance lease* under IAS 17, para 20.

17. Although the foregoing provisions mean that questions of classification and allocation do not generally arise in relation to *investment property*, another potential anomaly remains. The value of the investor's interest in a leasehold *investment property* reflects the difference between the payments under the superior lease and the receipts or potential receipts under the sub lease or leases, see IVS 304.01 *Valuation of Property Interests*. However, IAS 17, para 23 provides that it is not appropriate for the liabilities for leased assets to be presented in the financial statements as a deduction from the leased assets. In order to comply with this requirement, IAS 40 para 50(d) provides that where a valuation of a leasehold *investment property* is net of all payments expected to be made, it is necessary to add back any recognised lease liability to arrive at the carrying amount. It must be noted that this is an accounting adjustment only and should neither be reflected nor anticipated in the valuation of the investor's interest.

Valuing the Asset or the Liability

18. Where a lease is identified as a *finance lease*, lessees are required to account for the asset and liability based on either the fair value of the leased asset or the present value of the minimum lease payments, whichever is lower, each determined as at the inception of the lease.
19. In the context of IAS 17 the value of the asset is considered separately from any liability created by the lease. When accounting for a lessee's interest in a *finance lease* it is therefore necessary to measure the asset by assessing the value of the benefit that a market participant would accrue from the right to use the asset for the duration of the lease. When dealing with leases of property, other than *investment property*, it is important to note that this is not the same as the value of the lessee's leasehold interest (see IVS 303.01 *Valuation of Property Interests*), as the latter reflects the lease liability as well as the value of the asset.
20. The minimum lease payments are defined in IAS 17. In summary, they are the payments over the lease term that the lessee is required to make, excluding any contingent rent, taxes and amounts paid to the lessor for services. The minimum lease payments include any residual value guaranteed by the lessee to the lessor. Since contingent rents are excluded from the calculation of the minimum lease payments and the payments should be clear from the face of the lease, valuations will not normally be required.
21. IAS 17, para 20, provides that the present value of the minimum lease payments should be calculated using a discount rate equivalent to the "interest rate implicit in the lease" or, if this is not practicably determinable, the lessee's "incremental borrowing rate". The calculation of the interest rate implicit in the lease requires the fair value of the unencumbered leased asset at the date of the lease inception and its residual value at the end of the lease.

22. The depreciation requirements in IAS 16 also apply to leased assets and, therefore, IVS 201.02 *Valuations for Depreciation* may also be relevant.

Scope of Work

23. In addition to the minimum requirements addressed in IVS 104 *Scope of Work*, the following matters should receive specific consideration when valuations are being provided to support lease accounting requirements under IAS 17.

(f) Valuation date:

If an estimate of the value of the asset or liability at the inception date of the lease is required, it will be necessary to confirm that date.

(i) Assumptions and any special assumptions:

As discussed in para 19 above, except in the case of *investment property*, estimating the value to the lessee of the asset or liability for lease accounting purposes is not the same as estimating the value of the lessee's legal interest, as the liabilities under the lease are accounted for separately. It may therefore be necessary to make it clear that the valuations will be provided on the *special assumption* that the actual lease was not in place on the *valuation date*.

Valuation Reporting

24. In addition to the minimum requirements in IVS 105 *Valuation Reporting*, a valuation report on lease accounting shall state that the values provided are based on the specific assumptions required by the relevant financial reporting standards and should not be relied upon for any other purpose.

Effective Date

25. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 201.04

Valuations for Impairment Testing

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This standard describes the impairment test under International Accounting Standard 36, relates the required valuation tests to the International Valuation Standards and sets out additional matters to be considered in addition to the General Standards.

Impairment

2. Under IAS 36 - Impairment of Assets, an entity is required to review at each balance sheet date whether there is any indication that an asset may be impaired. Impairment might be indicated by a reduction in the value of the asset because of market or technological changes, obsolescence of the asset, asset underperformance in comparison to the expected return, or an intention to discontinue or restructure operations. Impairment arises where the carrying amount¹ of an asset exceeds the amount that can be recovered from either its continued use or the sale of the asset.
3. The requirement to review for impairment does not apply to:
 - (a) financial assets within the scope of IFRS 9,
 - (b) *investment property* measured at fair value in accordance with IAS 40,

¹ Carrying amount is the amount at which an asset is recognised in the balance sheet after deducting any accumulated depreciation and accumulated impairment losses.

- (c) biological assets related to agricultural activity measured at fair value less costs to sell in accordance with IAS 41,
 - (d) inventories,
 - (e) assets arising from construction contracts,
 - (f) deferred tax assets,
 - (g) assets arising from employee benefits,
 - (h) assets classified as held for sale, or included in a disposal group that is classified as held for sale.
4. If impairment is considered to have arisen, the carrying amount of the asset, whether derived from either historic cost or a previous valuation, should be written down to the “recoverable amount”. This is the higher of the asset’s “value in use” or its “fair value less costs to sell”.

Value in Use

5. Value in use is the present value of the future cash flows expected to be derived from the asset or cash-generating unit. The cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.
6. Value in use is specific to the entity as it reflects the cash flows that the entity expects to obtain from continuing use of an asset over its anticipated useful life, including any proceeds from its ultimate disposal. It is therefore similar to *investment value*, see IVS 103 *Bases of Value*.
7. IAS 36 provides that the following shall be reflected in the calculation of an asset’s value in use:
- (a) an estimate of the future cash flows the entity expects to derive from the asset,
 - (b) expectations about possible variations in the amount or timing of those future cash flows,
 - (c) the time value of money, represented by the current market risk free rate of interest,
 - (d) the price for bearing the uncertainty inherent in the asset,
 - (e) other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

8. The expected cash flows have to be tested for reasonableness by ensuring that the assumptions on which the entity's projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate. Cash flows are estimated for the asset in its current condition and therefore the expected cash flows should not reflect any increase due to any restructuring or reconditioning of the asset to which the entity is not currently committed.
9. The appropriate discount rate will reflect the return that market participants would require for an investment that would generate cash flows of amounts, timing and risk profile equivalent to those that the entity expects to derive from the asset.
10. IAS 36, paras 30 to 57 and Appendix A, set out detailed considerations for assessing value in use.

Fair Value less Costs to Sell

11. The fair value less costs to sell of an asset or cash-generating unit is the amount obtainable from its sale in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. Except where the owning entity is compelled to sell on the *valuation date* without adequate time for exposure to the market, it is not a forced sale. Fair value in this context is consistent with *market value* as defined in IVS 103 *Bases of Value*.
12. The costs to sell are the costs directly attributable to the transaction, eg legal fees, marketing costs, removal costs, unrecoverable transaction taxes and any costs directly incurred in preparing the asset or cash generating unit for sale. They exclude consequential costs, eg, those involved in reorganising the business following the disposal.

Recoverable Amount

13. The recoverable amount is the higher of the value in use and fair value less costs to sell. It is not always necessary to determine both these amounts; if either exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount. If the fair value less costs to sell cannot be reliably determined, eg, because there is no basis for estimating the price that could be obtained on disposal, then the value in use may be used as the recoverable amount. Conversely, if there is no reason to expect that the value in use is in excess of fair value less costs to sell, the latter figure may be used as the recoverable amount.

Scope of Work

14. In addition to the minimum requirements in IVS 104 *Scope of Work*, the following matters should receive specific consideration when either the value in use or fair value less costs to sell is required for impairment testing under IAS 36.

- (d) Identification of the asset or liability to be valued:

The scope of work shall record whether the valuations are to be of an individual asset or of a defined cash-generating unit.

- (g) Extent of Investigation and, (h) Nature and source of information to be relied upon:

Where estimating value in use, the extent and source of the estimated cash flows generated from continued use of the asset or cash generating unit should be recorded, and the extent of the valuer's duty to either verify or validate the information shall be discussed and recorded.

Where estimating the fair value less costs to sell, enquiry should be made to establish any abnormal but directly attributable costs that would be incurred in a sale.

- (i) Assumptions and any special assumptions:

Any material assumptions to be made in forecasting the future expected cash flows in an estimate of the value in use shall be recorded.

Valuation Approaches

15. Value in use, see paragraphs 5-10 above, is estimated using a method that falls under the *income approach*. Fair value less costs to sell will normally be estimated using the *direct market comparison approach*. It is inappropriate to use the *cost approach* in order to estimate either or both elements of the recoverable amount. If an asset is impaired the entity would not replace it with a modern equivalent, see also paragraph 13(c) of IVS 201.01.

Valuation Reporting

16. In addition to the minimum requirements in IVS 105 *Valuation Reporting*, a valuation report for impairment testing under IAS 36 shall include comment on such of the following as are relevant :

(a) In respect of value in use:

Sources of information used to support estimates of future cash flows and investigations undertaken to verify those cash flows

The discount rate used and the key factors reflected in selecting that rate

(b) In respect of fair value less costs to sell:

The approach used to estimate fair value;

Details of the estimated costs of sale, with a explanation of any extraordinary costs included.

Effective Date

17. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 201.05

Valuations of Property, Plant and Equipment in the Public Sector

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This standard highlights matters within International Public Sector Accounting Standards that are relevant to the valuation of property, plant and equipment held primarily for service delivery, and the valuation approaches that are appropriate.

International Public Sector Accounting Standards

1. These provisions should be applied in the context of the accounting provisions in International Public Sector Accounting Standards (IPSAS) generally, of IPSAS 17 Property, Plant and Equipment and IPSAS 21 Impairment of Non-Cash-Generating Assets in particular.
2. IVS 201.01 *Fair Value under International Financial Reporting Standards* addresses the application of fair value generally under IFRS and valuation bases to accounting principles in the context of IFRS. These principles can also be generally applied to valuations of public sector assets. However, many types of property, plant and equipment held by public sector bodies are specialised for the delivery of a particular service rather than as a means of generating cash flows and are rarely, if ever, exchanged in a market transaction. This standard identifies specific provisions within IPSAS that affect the application of fair value to such assets.

Types of Public Sector Assets

3. Property in the public sector comprises conventional cash-generating and non-cash-generating property assets as well as *specialised property* assets, including heritage and conservation assets, infrastructure assets, public buildings, public utility plants, and recreational assets. As with private sector assets, public sector assets fall into operational and non-operational categories. Non-operational assets include investment and surplus assets. These categories are accounted for in different ways.
4. Many “heritage assets” are held in the public sector. A heritage asset is an asset having some cultural, environmental or historical significance. Heritage assets may include historical buildings and monuments, archaeological sites, conservation areas and nature reserves, and works of art. Heritage assets often display the following characteristics, although these characteristics are not necessarily limited to heritage assets:
 - their economic benefit in cultural, environmental, educational and historic terms is unlikely to be fully reflected in a financial value based purely on market price,
 - legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale,
 - they are often irreplaceable and their economic benefit may increase over time even if their physical condition deteriorates,
 - it may be difficult to estimate their useful lives, which in some cases could be hundreds of years.

Operational Property, Plant and Equipment

5. Like its IFRS counterpart, IAS 16, IPSAS 17 Property, Plant and Equipment permits two models for the recognition of operational assets in the balance sheet: a cost model and a fair value model. Where the fair value model is applied, a current revaluation of the asset is required. Where an entity adopts the fair value revaluation option, the assets are included in the balance sheet at their fair value. IPSAS 17 stipulates the following:
 6.
 - “45 The fair value of items of property is usually determined from market based evidence by appraisal. The fair value of items of plant and equipment is usually their market value determined by appraisal.”
 - “47 If no market evidence is available to determine the market value in an active and liquid market of an item of property, the fair value of the item may be established by reference to other items with similar characteristics, in similar circumstances and location.”

“48 If there is no market-based evidence of fair value because of the specialised nature of the item of plant and equipment, an entity may need to estimate fair value using ... *depreciated replacement cost*, or the restoration cost or service units approaches...”

7. Although there is no IPSAS equivalent of the IFRS Fair Value Measurement Exposure Draft, in line with the established policy of convergence between IPSAS and IFRS fair value should be estimated in a manner that is consistent with IFRS.

Absence of Market Evidence

8. For some public sector assets, it may be difficult to establish their value because of the absence of market transactions for these assets. Some public sector entities may have significant holdings of these assets. IPSAS 17, para 47, gives the following guidance:

“If no market evidence is available to determine the market value in an active and liquid market of an item of property, the fair value of the item may be established by reference to other items with similar characteristics, in similar circumstances and location. For example, the fair value of vacant government land that has been held for a long period during which time there have been few transactions may be estimated by reference to the market value of land with similar features and topography in a similar location for which market evidence is available. In the case of specialised buildings and other man-made structures, fair value may be estimated by using *depreciated replacement cost*, or the restoration cost or the service units approach (see IPSAS 21). In many cases, the *depreciated replacement cost* of an asset can be established by reference to the buying price of a similar asset with similar remaining service potential in an active and liquid market. In some cases, an asset’s reproduction cost will be the best indicator of its replacement cost. For example, in the event of loss, a parliament building may be reproduced rather than replaced with alternative accommodation because of its significance to the community”.

9. Because of the lack of evidence of comparable market transactions for many public sector assets, the *direct market comparison approach* often cannot be used. The above paragraph sanctions the use of alternative valuation methods to measure the fair value of an asset, all of which fall within the *cost approach* described in IVS 202 *Valuation Approaches*. IPSAS 21 below contains some guidance on these methods.

Impairment

10. IPSAS 21 Impairment of Non-Cash-Generating Assets, contains similar provisions to IAS 36, see IVS 201.04 *Valuations for Impairment Testing*. The test for a non-cash-generating asset for impairment, which will include most property, plant and equipment held for the provision of a public service, requires the carrying amount to be adjusted to the higher of its fair value less costs to sell or its value in use. IPSAS 21, para 14, provides that the value in use of a non-cash-generating asset is the present value of the asset's remaining "service potential". The standard then gives further guidance on methods for assessing the remaining service potential as follows:
- (a) Depreciated Replacement Cost Approach – IPSAS 21, paras 41 to 43,
- “41 Under this approach, the present value of the remaining service potential of an asset is determined as the *depreciated replacement cost* of the asset. The replacement cost of an asset is the cost to replace the asset's gross service potential. This cost is depreciated to reflect the asset in its used condition. An asset may be replaced either through reproduction (replication) of the existing asset or through replacement of its gross service potential. The *depreciated replacement cost* is measured as the reproduction or replacement cost of the asset, whichever is lower, less accumulated depreciation calculated on the basis of such cost, to reflect the already consumed or expired service potential of the asset.”
- 42 The replacement cost and reproduction cost of an asset are determined on an 'optimized' basis. The rationale is that the entity would not replace or reproduce the asset with a like asset if the asset to be replaced or reproduced is an oversized or overcapacity asset. Oversized assets contain features which are unnecessary for the goods or services the asset provides. Overcapacity assets are assets that have a greater capacity than is necessary to meet the demand for goods or services the asset provides. The determination of the replacement cost or reproduction cost of an asset on an optimized basis thus reflects the service potential required of the asset.
- 43 In certain cases, standby or surplus capacity is held for safety or other reasons. This arises from the need to ensure that adequate service capacity is available in the particular circumstances of the entity. For example, the fire department needs to have fire engines on standby to deliver services in emergencies. Such surplus or standby capacity is part of the required service potential of the asset.”

- (b) Restoration Cost Approach – IPSAS 21, para 44,
 - “44 Restoration cost is the cost of restoring the service potential of an asset to its pre-impaired level. Under this approach, the present value of the remaining service potential of the asset is determined by subtracting the estimated restoration cost of the asset from the current cost of replacing the remaining service potential of the asset before impairment. The latter cost is usually determined as the depreciated reproduction or replacement cost of the asset whichever is lower. Paragraphs 41 and 43 include additional guidance on determining the replacement cost or reproduction cost of an asset.”
 - (c) Service Units Approach
 - “45. Under this approach, the present value of the remaining service potential of the asset is determined by reducing the current cost of the remaining service potential of the asset before impairment to conform with the reduced number of service units expected from the asset in its impaired state. As in the restoration cost approach, the current cost of replacing the remaining service potential of the asset before impairment is usually determined as the depreciated reproduction or replacement cost of the asset before impairment, whichever is lower.”
11. IPSAS 17 recognises that some heritage assets have service potential other than their heritage value, eg, an historic building being used for office accommodation. In these cases, they may be recognised and measured on the same basis as other items of property, plant and equipment. For other heritage assets, their service potential is limited to their heritage characteristics, eg, monuments and ruins. The existence of alternative service potential can affect the valuation approach adopted.

Scope of Work

12. In addition to the minimum requirements in IVS 104 *Scope of Work*, the following matters should receive specific consideration when valuing property, plant or equipment in the public sector. Reference should also be made to IVS 201.01 *Fair Value under International Financial Reporting Standards*.

- (d) Identification of the asset or liability to be valued:

The classification of the asset or assets, eg, whether operational, held for investment, infrastructure or held for disposal shall be recorded. It may also be necessary to identify the appropriate unit of account for valuation purposes.

- (i) Assumptions and any special assumptions:

Different valuation assumptions may be appropriate depending on the classification of the asset or liability. For example, for property that is operational, it is normally appropriate to make an assumption that it will continue to be occupied for the purpose of service delivery. The assumptions that are applicable to each class of asset should be included in the scope of work.

Valuation Reporting

13. In addition to the minimum requirements in IVS 105 *Valuation Reporting*, a valuation report on property, plant and equipment in the public sector shall include comment, where relevant, on the following matters. Reference should also be made to IVS 201.01 *Fair Value under International Financial Reporting Standards*:

- (l) Valuation approach and reasoning:

For operational property held for service delivery, there will frequently be a lack of direct market evidence. The approach adopted, see paragraphs 6 - 8 above should be indicated together with the significant valuation inputs.

Effective Date

14. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 202.01

Valuations of Property Interests for Secured Lending

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This standard sets out matters that should be considered in the valuation of property interests offered as collateral for secured lending and additional matters that should be included in the valuation report.

Loans Secured by Property Interests

1. Loans from banks and other financial institutions are often secured by the collateral of the borrower's property interests. The lending may be by way of a mortgage or other forms of fixed or floating charge. The common factor is that the lender has the power to recover the loan by taking control of the collateral in the event of default by the borrower. Different types of property may be offered as collateral.

Scope of Work

2. In addition to the minimum requirements in IVS 104 *Scope of Work*, the following matters should receive specific consideration in the valuation of property interests:

- (a) Identification of the valuer and confirmation of competence:

Lenders normally require a valuation that is independent of the borrower. The scope of work should include disclosures of any material involvement that the valuer has with either the property to be valued, the borrower or a prospective borrower. The materiality of existing or past involvement is a matter of professional judgment for the valuer but the principal criteria is whether the involvement would be likely to give rise to doubts in the mind of a reasonable person as to the ability of the valuer to provide an impartial valuation if it were discovered after the valuation had been carried out.

- (d) Identification of the asset or liability to be valued:

At the outset of an engagement, the property interest that is to serve as the security should be identified. Care should be taken where the interest is not absolute, eg, it is a lease interest or it is subject to leases to third parties, see IVS 303.01 *Valuations of Property Interests*.

Caution is required where property offered as security is subject to a lease to a party related or connected with the borrower. If this lease has a more favourable income stream than would be obtainable in the market, it may be appropriate to disregard the existence of the lease in a valuation of the property as security.

- (e) Basis or bases of value:

In valuations of property for secured lending purposes, the appropriate basis is normally *market value*. The manner in which property ordinarily trades in the market will determine the applicability and relevance of the various approaches to assessing *market value*.

There may be circumstances where an alternative basis to *market value* is appropriate for secured lending purposes. A lender may request a valuation on a basis other than *market value*. IVS 103 *Bases of Value* addresses other bases of valuation recognised in IVS.

Some lenders request valuations on the assumption of a forced sale or impose a time limit for the hypothetical disposal of the property, see IVS 103 Bases of Value. Because the impact on price of any constraint on the marketing period will depend upon the circumstances at the time that sale takes place, it is not realistic to speculate on the price that could be obtained without knowledge of those circumstances. A valuation may be provided on the basis of defined special assumptions recorded in the scope of work. In such cases, a statement should be made that the value will be valid only at the *valuation date* and may not be achievable in the event of a future default, when both market conditions and the sale circumstances may be different.

(i) Assumptions and any special assumptions:

Valuations for secured lending are often required on the *special assumption* that there has been a change in the state or condition of the property, eg, the assumed development of a new building, an upgrade of a building or achievement of a specified occupancy level. Use of the term *market value* without an appropriate *special assumption* in these circumstances would be misleading. The term “market value as if complete” or “market value at a specified occupancy level” are examples of special assumptions that can be used to qualify *market value* in these circumstances.

Valuation Approaches

3. All valuation approaches used for estimating *market value* are based on market observations. Although all three approaches identified in IVS 102 *Valuation Approaches* can be used to support the *market value* for secured lending, if the property is so specialised that there is insufficient evidence to use either the *direct market comparison* or income approaches, it is unlikely that the property would be regarded as suitable security. Therefore, the *cost approach* is seldom used in valuations for this purpose except as a check on the reasonableness of the value determined using another approach.

Property Types

4. Different types of property have different characteristics as security and a valuation of the relevant interest should address these in order to provide the lender with adequate information on the suitability of the property as security and the risk factors associated with the property over the duration of the loan.

Investment Property

5. *Investment property* is usually valued for lending purposes on an asset by asset basis, although some lenders may lend against the value of a defined portfolio. In such instances, the distinction needs to be made between the value of the individual *investment property*, assuming it is sold individually, and its value as part of the portfolio.
6. Although consideration is given to the expected demand and marketability of the property over the life of the loan, it is normally outside the scope of the valuation engagement to advise on the ability of a tenant to meet future lease obligations beyond reflecting the information available on the tenant that would be normally be available to market participants.
7. If the income from a property is critically dependent on a tenant or tenants from a single sector or industry or some other factor which could cause future income instability, the impact should be considered in the valuation process. In certain cases, an assessment of the value of the property based on an alternative use, assuming vacant possession, may be appropriate.

Owner-Occupied Property

8. An owner-occupied property valued for lending purposes will normally be valued on the assumption that the property is transferred unencumbered by the owner's occupancy, ie, the buyer is entitled to full legal control and possession. This does not preclude consideration of the existing owner as part of the market, but it does require that any special advantage attributable to the owner's occupancy, which may be reflected in a valuation of the business, be excluded from the valuation.

Specialised Property

9. A *specialised property* may have significant value only as part of the business of which it is part. In valuations for secured lending, such properties will normally be valued on the assumption that the business has ceased and therefore the underlying security will reflect the value for an alternative use. The valuation will involve consideration of the costs and risks that would be involved in achieving that use.
10. A valuation may be required of a *specialised property* where the property is part of a going concern business. In such circumstances, the value is dependent on the continuing profitability of the business. In such circumstances, the distinction between the value of the property as part of the business and the value of the property if the business had vacated or closed should be made.

Trade Related Property

11. The value of *trade related property* normally reflects its income generating potential due to the buildings or other structures only being suitable for a specific type of trade, see IVS 303.04 *Valuations of Trade Related Property*. The specialised nature of such property means that there may be a significant difference in its value as part of an operating concern and its value if there was no business in occupation. If the business had ceased, any buyer intending to trade would need time to re-establish a new business in the property and would incur start up and other costs in equipping the property, obtaining any necessary permits and licenses, etc. Where a lender is relying on the underlying value of the property interest as security, a valuation for loan security should comment on the impact on the value of the property interest of the cessation of any existing business in occupation. In some cases, the value for an alternative use may represent the *market value*, see paragraph 9 above.

Development Property

12. Properties held for development or sites intended for development of buildings are valued taking into account existing and potential development entitlements and permissions. Any assumptions as to zoning issues and other material factors need to be reasonable.
13. The approach to the valuation of development properties will depend on the state of development of the property at the date of valuation and may take into account the degree to which the development is pre-sold or pre-leased. Additional considerations may include, but are not limited to, the following:
 - (a) estimating the development period from the date of valuation,
 - (b) determining the effect of additional development requirements on costs and revenues, using present value discounting where appropriate,
 - (c) evaluating as far as is possible at the date of valuation, market performance during the period of the development,
 - (d) assessing the risks associated with the development,
 - (e) considering any special relationships between the parties involved in the development.

Wasting Assets

14. Specific considerations arise in relation to the valuation of a wasting asset for secured lending, ie, one which will generally depreciate in value over time. Examples include mines or quarries. The estimated life and the rate of value erosion over that life should be identified and clearly stated in report.

Valuation Reporting

15. In addition to the minimum requirements in IVS 105 *Valuation Reporting*, a valuation report on valuations of property interests for secured lending shall include comment on such of the following as is relevant to the purpose of the valuation:
- current activity and trends in the relevant market,
 - historic, current and anticipated future demand for the property in the market area,
 - the potential and likely demand for alternative uses,
 - the current marketability of the property and the probability of this changing ,
 - any impact of foreseeable events during the period of the loan on the value of the security,
 - where the *market value* is provided subject to a *special assumption*, the report should include:
 - an explanation of the *special assumption*,
 - a comment on any material difference between *market value* and the *market value* subject to the *special assumption*
 - a comment that such value may not be realisable at a future date unless the factual position is as described in the *special assumption*.
16. Where the proposed loan is to support a purchase of a property interest, there will normally be a sale price agreed or confirmed. Enquiries should be made to establish this price and the result of those enquiries referred to in the report. Where there is a difference between a recent or pending transaction price and the valuation, the report should comment on the reasons for this difference.

17. It is not uncommon for a seller of property, especially a property developer or trader, to offer incentives to buyers. Examples of such incentives include rental income guarantees, contributions to the buyer's removal or fitting out costs, or the supply of furnishings or equipment. *Market value* ignores any price inflated by special considerations or concessions. Where such exist, it is appropriate to comment on the effect that any incentives being offered have on the actual selling prices achieved.

Effective Date

18. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

Introduction to IVS 300 Series

Asset Standards

While the General Standards, IVS 101 – 105, contain high level principles and standards that can generally be applied to the valuation of most types of asset or liability the Board recognises that these need to be supplemented by additional material that addresses valuation issues that are specific to different asset classes.

This section of the International Valuation Standards contains standards that identify particular valuation considerations for different classes of asset. They provide a basic description of the type of assets covered, the characteristics that typically impact on value and provide guidance on how the principles set out in the General Standards may be applied to the type of asset in question. Asset Standards identify and briefly explain the nature of commonly accepted valuation approaches and methods used in the valuation of different types of asset but do not provide detailed methodology or guidance on how to value.

The Asset Standards should be read in conjunction with the General Standards, which apply except where specifically varied by an Asset Standard..

International Valuation Standard 301.01

Valuations of Businesses and Business Interests

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This standard identifies the principal characteristics of businesses relevant to value, commonly accepted valuation approaches and particular considerations required in the valuation of complete businesses or of interests in a business.

Definitions

1. In the context of this standard, the following definitions apply.
 - (a) Enterprise value – the total value of a business including its interest bearing debt and its equity components.
 - (b) Equity value – the value of a business to all of its shareholders after deducting its liabilities.

- (c) Redundant assets – assets not necessary to the ongoing operations of a business, also referred to as non-operating assets
- (d) En bloc value - the value of the ownership interests viewed as a whole.

Businesses

- 2. A business is a commercial, industrial, service or investment activity. A valuation of a business may either comprise the whole of the activity of an entity or a part of the activity. It is important to distinguish between the value of a business entity and the value of the individual assets or liabilities of that entity. If the purpose of the valuation requires the value of individual assets or liabilities and where these are separable from the business and are capable of being traded independently, those assets or liabilities are valued in isolation and not by apportionment of the value of the entire business. Before undertaking a valuation of a business, it is important to establish whether the valuation is of the entire entity, shares or a shareholding in the entity, a specific business activity of the entity or of specific assets or liabilities.
- 3. Valuations of businesses are required for different purposes including acquisitions, mergers and sales of businesses, taxation, litigation and insolvency proceedings, and financial reporting.
- 4. The following matters may require consideration depending on the context and purpose of the valuation and the nature of the business or the business interest being valued.

Ownership Rights

- 5. The rights, privileges or conditions that attach to the ownership interest, whether held in corporate or partnership form, require consideration in the valuation process. Ownership rights are usually defined by legal documents such as articles of association, clauses in the memorandum of the business, articles of incorporation, bylaws, partnership agreements and shareholder agreements.
- 6. The documents may contain restrictions on the transfer of the interest and may contain provisions governing the *basis of valuation* that has to be adopted in the event of transfer of the interest. For example, the documents may stipulate that the interest to be transferred should be valued as a pro rata fraction of the en bloc value of the entire issued share capital, even though the interest to be transferred represents a minority interest. In each case, the rights of the interest being valued and the rights attaching to any other class of interest needs to be considered at the outset.

Business Information

7. Although the value on a given date reflects the benefit of future ownership, the history of a business is valuable in that it may give guidance as to the expectations for the future.
8. Awareness of relevant economic developments and specific industry trends is essential for business valuation. Matters such as political outlook, government policy, exchange rates, inflation, interest rates and market activity may affect businesses that operate in different sectors of the economy quite differently.
9. The valuation of an ownership interest in a business is only relevant in the context of the financial position of the business at a point in time. It is important to understand the nature of assets and liabilities of the business and to determine which items are used in the income producing process and which ones are redundant to the business at the *valuation date*.

Intangible Assets

10. Businesses may have assets that are not reflected on the balance sheet. Such assets could include patents, trademarks, copyrights, brands, know-how and proprietary databases. *Goodwill* is a residual value after all tangible and intangible assets have been taken into account. Standards for the valuation of intangible assets are addressed in IVS 301.02 *Valuations of Intangible Assets*.

Voting Control

11. There are different levels of control or lack of control resulting from differences in the size of ownership interests that need to be reflected in any valuation. In some instances, effective control may be obtained with less than 50% of the voting rights. Even if one person owns more than 50% of the voting rights and has operational control, there may be certain actions, such as winding-up the business that may require more than 50% affirmative vote, and may require an affirmative vote of all owners. The legal restrictions and conditions regarding voting control will vary between jurisdictions.

Prior Transactions and Offers

12. It is important to consider any prior transactions or offers for any component of the business. Such transactions and offers may be an indicator of value.

Scope of Work

13. In addition to the minimum requirements in IVS 104 *Scope of Work*, the following matters should receive specific consideration in the valuation of businesses and business interests:
- (d) Identification of the asset or liability to be valued:

The asset subject to valuation needs to be clearly defined. In a business valuation, there can be various components of a business or various classes of shares subject to valuation. A complete description of the shares, the assets, the liabilities or the interest in the business should be recorded at the outset.
 - (g) Extent of investigation:

The extent of the independent verification of information will depend upon the purpose of the valuation and the extent of reliance on the valuation conclusion. In many instances, it will be beyond the scope of service to perform a complete verification of all data sources. Where material matters are not specifically verified as part of the valuation process, assumptions on which the valuation is based should be recorded.
 - (h) Nature and source of the information to be relied upon:

The valuation process of a business entity frequently requires reliance upon information received from a client, representatives of the client and other experts. A common example of reliance upon other experts is a valuation conducted by a *real estate* property valuer for the *real estate* components owned by a business entity. The source of the information which is to be relied upon as part of the business valuation process is identified and recorded in the scope of work.

Valuation Approaches

14. The *direct market comparison* and the income approaches described in IVS 102 *Valuation Approaches* can be applied to the valuation of a business or business interest. The *cost approach* cannot normally be applied except in the case of early stage or start up businesses where profits and/or cash flow cannot be reliably determined.
15. The value of certain types of businesses, eg, an investment or holding business, can be derived from a summation of the assets and liabilities. This is sometimes called the “net asset approach” or “asset approach”. The value of the individual assets and liabilities are derived using one or more of the principal valuation approaches described in IVS 102 *Valuation Approaches*.

Direct Market Comparison Approach

16. The *direct market comparison approach* compares the subject business to similar businesses, business ownership interests and securities that have been exchanged in the market.
17. The three most common sources of data used in the *direct market comparison approach* are public stock markets in which ownership interests of similar businesses are traded, the acquisition market in which entire businesses are bought and sold, and prior transactions in or offers for the ownership of the subject business.
18. There needs to be a reasonable basis for comparison with and reliance upon similar businesses in the *direct market comparison approach*. These similar businesses should be in the same industry as the subject business or in an industry that responds to the same economic variables. Factors to be considered in whether a reasonable basis for comparison exists include the following:
 - similarity to the subject business in terms of qualitative and quantitative business characteristics,
 - amount and verifiability of data on the similar business,
 - whether the price of the similar business represents an arm's length transaction.
19. A comparative analysis of qualitative and quantitative similarities and differences between similar businesses and the subject business should be made.
20. Through analysis of the publicly traded businesses or actual transactions, valuation ratios, usually price divided by some measure of income or net assets, are calculated. In calculating and selecting these ratios, consideration is given to the following matters:
 - (a) The ratio should provide meaningful information about the value of the business.
 - (b) Adjustments may need to be made to render the similar businesses and the subject business more comparable. Examples include adjustments for unusual, non-recurring, non-operating items and differences in risk and expectations of the similar businesses and the subject business.
 - (c) Adjustments may be required for differences in the subject ownership interest and interests in the similar businesses with regard to control, lack of control, marketability or lack of marketability. By way of example, market prices that reflect public trading are from transactions for minority holdings. The price for the acquisition of an entire business represents 100% of the business.

21. Anecdotal valuation “rules” are frequently used by market commentators. However, value indications derived from the use of such rules should not be given substantial weight unless it can be shown that buyers and sellers place significant reliance on them.
22. The market prices of publicly traded stocks or partnership interests, acquisition prices for business interests or businesses engaged in the same or similar lines of business are often used as a reasonableness check on the business valuation conclusion derived under an another approach. However, adequate information is often difficult to obtain. While the actual transaction price may be known, the terms of the transaction, including warranties and indemnities given by the seller, are often not known, making it difficult, if not impossible, to make a valid comparison.

Income Approach

23. Various methods are used to estimate value under the *income approach*. Those methods include the capitalised cash flow or earnings method and the discounted cash flow method.
24. In theory, income and cash flow can be measured under a variety of definitions. The income or cash flow measured is usually post-tax. The capitalisation or discount rate applied must be appropriate for the definition of income or cash flow used.
25. The *income approach* requires the estimation of a capitalisation rate when capitalising income or cash flow and a discount rate when discounting cash flow. In estimating the appropriate rate, factors such as the level of interest rates, rates of return expected by investors on similar investments and the risk inherent in the anticipated benefit stream are considered.
26. In capitalisation methods that employ discounting, expected growth may be explicitly considered in the forecasted income or cash flow. In capitalisation methods that do not employ discounting, expected growth is normally reflected in the capitalisation rate. When the forecasted income or cash flow is expressed in nominal terms, ie, current prices, nominal rates should be used. When the forecasted income or cash flow is expressed in real terms, ie, level prices, real rates should be used.
27. Enterprise value is typically derived through the capitalisation of profits or cash flows through the application of a capitalisation rate or discount rate before debt servicing costs. The capitalisation or discount rate applied is the weighted average cost of capital of an appropriate mix of debt and equity. The actual interest bearing debt is deducted from the enterprise value to determine the equity value.

28. Under the *income approach*, the historical financial statements of a business entity are often used as guide to estimate the future income or cash flow of the business. Determining the historical trends over time through ratio analysis provides the necessary information to assess the risks inherent in the business operations in the context of the industry and the prospects for future performance.
29. In order to estimate the expected income or cash flow of a business, adjustments should be made to the historical financial statements for items that are relevant and significant to the valuation process. Adjustments may be appropriate for the following matters:
- (a) to adjust revenues and expenses to levels that are reasonably representative of expected continuing operations,
 - (b) to present financial data of the subject business and guideline comparison businesses on a consistent basis,
 - (c) to adjust the carrying value of an asset on the balance sheet to its *market value*,
 - (d) to adjust for non-operating assets and liabilities and the related revenue and expenses,

If non-operating items are included in the historical financial statements, they are typically removed from the financial statements and valued separately from the operating assets at the *valuation date*. Such non-operating assets and liabilities are generally referred to as redundant or surplus.
 - (e) to adjust non-arm's length transactions to commercial rates,

Cost of items leased, rented or otherwise contracted from related parties may need to be adjusted to reflect amounts reflective of transactions between arm's length parties.

Compensation of the owner may need to be adjusted to reflect the market cost of replacing the service provided by the current owner.
 - (f) to eliminate the impact of non-recurring events from the revenue and expense items,

Adjustments may be required for historical events that are not likely to recur with regularity. Examples of non-recurring items include losses caused by strikes, new plant start-up and weather phenomena.
 - (g) to adjust the reported depreciation and tax basis to an estimate that compares to depreciation used in similar businesses,

- (h) to adjust the inventory accounting to compare to similar businesses, whose accounts may be kept on a different basis from the subject business or to more accurately reflect economic reality,

Inventory adjustments may be different when considering the income statement and when considering the balance sheet. For example, a first-in-first-out method of costing inventory may most accurately represent the value of the inventory when constructing a *market value* balance sheet. When examining the income statement, a last-in-first-out method of costing inventory may more accurately represent the income level in times of inflation or deflation.

- (i) to adjust for the degree of control held by the ownership interest under valuation.

Some adjustments that would be made in the context of valuation of the entire business might not be made in the context of valuation of a non-controlling interest in that entity since the non-controlling interest would not have the ability to exert an influence that would warrant adjustment.

Valuation Reporting

- 30. A valuation report of a business or of an interest in a business shall contain the minimum matters set out in IVS 105 *Valuation Reporting* .

Effective Date

- 31. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 301.02

Valuations of Intangible Assets

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This standard identifies the principal types of intangible assets, appropriate valuation approaches, typical inputs and particular considerations required in valuing this type of asset.

Intangible Assets

1. An *intangible asset* is a non-monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and economic benefits to its owner.
2. An *intangible asset* is distinguishable from *goodwill*. *Goodwill* is any future economic benefit arising from a business or a group of assets which is not separable from the business or group of assets in its entirety.

3. Valuations of intangible assets are required for many different purposes including acquisitions, mergers and sales of businesses or parts of businesses, purchases and sales of intangible assets, reporting to tax authorities, litigation and insolvency proceedings, and financial reporting.
4. An *intangible asset* can be either identifiable or unidentifiable. An *intangible asset* is identifiable if it either:
 - (a) is separable, ie, capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so, or
 - (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
5. Any unidentifiable *intangible asset* associated with a business or group of assets is generally termed *goodwill*.
6. The principal classes of intangible assets are as follows:
 - marketing related,
 - customer or supplier related,
 - technology related,
 - artistic related.
7. Identifiable intangible assets may be contractual or non-contractual. Within each class, assets may be either contractual or non-contractual.
8. Marketing related intangible assets are used primarily in the marketing or promotion of products or services. Examples include, but are not limited to, the following intangible assets:
 - trademarks, trade names, service marks, collective marks and certification marks,
 - trade dress, eg, unique colour, shape or package design,
 - internet domain names,
 - non-compete agreements.

9. Customer or supplier related intangible assets arise from relationships with or knowledge of customers or suppliers. Examples include, but are not limited to, the following intangible assets:
- advertising, construction, management, service or supply agreements,
 - licensing, royalty and standstill agreements,
 - servicing contracts,
 - order books,
 - employment contracts,
 - use rights, such as drilling, water, air, timber cutting and airport landing slots,
 - franchise agreements,
 - customer relationships,
 - customer lists.
10. Technology related intangible assets arise from contractual or non-contractual rights to use patented technology, unpatented technology, databases, formulae, designs, software, processes or recipes.
11. Artistic related intangible assets arise from the right to benefits such as royalties from artistic works such as plays, books, films and music, and from non-contractual copyright protection.

Characteristics of Intangible Assets

12. Specific intangible assets are defined and described by characteristics such as their ownership, function, market position and image. These characteristics differentiate intangible assets from one another. The differentiating characteristics are illustrated in the following examples:
- Confectionery brands may be differentiated through differing taste, source of ingredients and quality.
 - Computer software products will typically be differentiated by reference to their functional specifications.
13. Although similar intangible assets within the same class will share some characteristics with one another, they will also have differentiating characteristics that will vary according to type of *intangible asset*.

Goodwill

14. *Goodwill* is any future economic benefit arising from a business or a group of assets which is not separable from the business or group of assets in its entirety.
15. Examples of benefits that are reflected in *goodwill* include:
 - company specific synergies following a business combination, eg, a reduction in operating costs or economies of scale,
 - growth opportunities, eg, expansion into different markets,
 - organisational capital, eg, the benefits accruing from an assembled network.
16. In general terms the value of *goodwill* is the residual amount remaining after the values of all identifiable tangible, intangible and monetary assets, adjusted for actual or potential liabilities, have been deducted from the value of a business.

Scope of Work

17. In addition to the requirements in IVS 104 *Scope of Work*, the following matters should receive specific consideration in the valuation of intangible assets:
 - (d) Identification of the asset to be valued:

The assets to be valued should be clearly defined with reference to the types and characteristics discussed in this standard.
 - (g) Extent of investigation and, (h) the nature and source of the information to be relied upon:

The source of any information which is to be relied upon and the extent of independent verification required should be identified and recorded. Examples of matters requiring consideration under these headings include current and historic financial information, projected or prospective financial information ownership, and patent rights.

- (i) Assumptions and any special assumptions:

Where material matters are not to be specifically verified as part of the valuation process, the assumptions on which the valuation is to be based should be recorded.

Examples of special assumptions that could be made when valuing an *intangible asset* include that a patent has been granted when none exists at the *valuation date* or that a competing product had entered or had left the market.

Valuation Approaches

18. The three principal valuation approaches described in IVS 102 *Valuation Approaches* can all be applied to the valuation of intangible assets.
19. Because of the heterogeneous nature of intangible assets, there is often difficulty in identifying sufficient market data to rely on only one valuation approach. It is therefore common to seek to use more than one approach to validate the valuation conclusions reached.
20. All methods of valuing intangible assets require an estimate of the remaining useful life. For some assets, this may be a finite period limited by either contract or typical life cycles in the sector. Other assets may effectively have an indefinite life. Estimating the remaining useful life will include consideration of legal, technological, functional and economic factors. As an example, an asset comprising a drug patent may have a remaining legal life of five years before expiry of the patent, but a competitor drug with expected improved efficacy may be expected to reach the market in three years. This might cause the remaining useful life of the first product to be assessed as only three years.

Direct Market Comparison Approach

21. Under the *direct market comparison approach*, the value of an *intangible asset* is determined by reference to market activity, eg, transaction bids or offers involving identical or similar assets.
22. The heterogeneous nature of intangible assets means that it is rarely possible to find market evidence of transactions involving identical assets. If there is market evidence at all, usually the only available evidence is in respect of assets that are similar, but not identical.

23. The required inputs for the *direct market comparison approach* are:
- prices and/or valuation multiples in respect of identical or similar intangible assets,
 - adjustments, as required, to such transaction prices or valuation multiples to reflect the differentiating characteristics of the subject *intangible asset* and the intangible assets involved in the actual transactions.
24. Even where transactions can be identified and information regarding prices paid is available, it can be difficult to determine the appropriate adjustments either to the prices or the valuation multiples necessary to reflect the differentiating characteristics of the subject *intangible asset* and the assets involved in the transactions. Such adjustments may only be determinable at a qualitative, rather than quantitative, level. Situations giving rise to qualitative adjustments include the following examples:
- the brand being valued may be considered to command a more dominant position in the market than those involved in the transactions,
 - a drug patent being valued may have greater efficacy and fewer side effects than those involved in the transactions.

Income Approach

25. Under the *income approach*, the value of an *intangible asset* is determined by reference to the present value of income, cash flows or cost savings generated by the *intangible asset*.
26. Valuation methods under the *income approach* are reliant on prospective financial information.
27. The principal valuation methods under the *income approach* used in the valuation of intangible assets are:
- relief-from-royalty method, sometimes referred to as royalty savings method,
 - premium profits method, sometimes referred to as incremental income method,
 - excess earnings method.
28. Each of these methods involve the discounting of forecast cash flows using either discounted cash flow techniques or, in simple cases, the application of a capitalisation multiple to a constant amount.

Relief-From-Royalty Method

29. Under the relief-from-royalty method, the value of an *intangible asset* is determined by reference to the value of the hypothetical royalty payments that would be saved through owning the asset, as compared with licensing the *intangible asset* from a third party. The hypothetical royalty payments over the life of the *intangible asset* are adjusted for tax and discounted to present value at the *valuation date*.
30. The hypothetical royalty rate is usually derived from market based royalty rates for comparable or similar transactions. In some cases, royalty payments may include an initial payment in addition to periodic amounts based on a percentage of the revenues or some other financial parameter. Prerequisite for this method is the existence of comparable intangible assets that are licensed at arm's length on a regular basis. Some or all of the following valuation inputs are considered in the relief-from-royalty method:
- the royalty rate and corresponding financial parameter, such as a percentage of revenues, that would hypothetically be paid in an arm's length transaction by a willing licensee to a willing licensor for the rights to use the subject *intangible asset*,
 - projections for the financial parameter, eg, revenues that the royalty rate would be applied to over the life of the *intangible asset* together with an estimate of the life of the *intangible asset*,
 - rate at which tax relief would be obtainable on hypothetical royalty payments,
 - the cost of marketing and any other costs that would be borne by a licensee in utilising the asset,
 - an appropriate discount rate or capitalisation multiple to capitalise the projected hypothetical royalty payments to a present value.
31. Royalty rates can often vary significantly in the market for apparently similar assets. It could be useful to benchmark the assumed royalty input by reference to the operating margin that a typical operator would require from sales generated from use of the asset.

Premium Profits Method

32. The premium profits method involves comparing the forecasted profits or cash flows that would be earned by a business using the *intangible asset* with those that would be earned by a business that does not use the *intangible asset*.

33. Having established the difference in the profits that will be generated, an appropriate discount rate is applied to convert forecasted incremental periodic profits or cash flows to a present value or a capitalisation multiple to capitalise constant incremental profits or cash flows.
34. The premium profits method can be used to value both intangible assets whose use will save costs and those whose use will generate additional profits or cash flows.

Excess Earnings Method

35. The excess earnings method determines the value of an *intangible asset* as the present value of the cash flows attributable to the subject *intangible asset* after excluding the proportion of the cash flows that are attributable to other assets. The excess earnings method is typically used in the valuation of customer contracts, customer relationships and in process research and development projects.
36. The excess earnings method can either be applied using a single period of forecast cash flows, referred to as the “single period excess earnings method”, or using several periods of forecast cash flows, referred to as the “multi period excess earnings method”. The multi period excess earnings method is more commonly used as intangible assets normally bring monetary benefits over an extended period.
37. The excess earnings method involves forecasting the cash flows expected to arise from the business or group of assets that uses the subject *intangible asset*. From this forecast of cash flows, a deduction is made in respect of the contribution to the cash flows that is made by tangible, intangible and financial assets, and the workforce, other than the subject *intangible asset*.
38. The inputs that are considered when applying the excess earnings method include the following items:
 - forecasted cash flows obtainable from the business to which the subject *intangible asset* contributes, by allocating both income and expenses appropriately to the smallest business or group of assets of the entity that includes all the income derivable from the subject *intangible asset*,
 - the contribution to cash flows made by all other assets in the business, including other intangible assets,
 - an appropriate discount rate or capitalisation multiple to capitalise forecasted profits or cash flows attributable to the subject *intangible asset*.

39. In practice, the method is generally used for intangible assets with the biggest impact on the cash flows where the effect of uncertainty on the contribution of related assets is minimal.

Cost Approach

40. The *cost approach* is mainly used for internally generated intangible assets that have no identifiable income streams. Under the *cost approach*, the replacement cost of a similar asset or one with similar service potential is estimated in one of the following methods:
- identifying the price of a replacement asset in the market,
 - determining the cost of developing or building a similar asset.
41. The types of intangible assets for which the *cost approach* is typically used include the following:
- self developed software, as the price of software with the same or similar service capacity can sometimes be obtained in the market
 - web sites, as it may be possible to estimate the cost of constructing the web site
 - an assembled workforce through determining the cost of building up the workforce.
42. The inputs that are considered when applying the *cost approach* include the following items:
- the cost of developing or purchasing an identical asset with the same production or service potential,
 - the cost of developing or purchasing a similar asset with the same or similar production or service potential,
 - in the case of the cost of a similar, rather than identical, asset with the same or similar production or service potential being identified, the adjustments required, including amortisation if appropriate, to that cost in order to reflect the specific characteristics of the subject asset.

Tax Amortisation Benefit

43. It may be appropriate to increase the *intangible asset* value to take account of any tax relief available on amortisation of the capitalised asset. Such an adjustment, known as the tax amortisation benefit, reflects the fact that the income derivable from an asset includes not only the income directly achievable from its use but also the reduction in tax payable by a business using the asset. The tax amortisation benefit is dependent on the applicable tax jurisdiction.
44. If a tax amortisation benefit is available to the majority of market participants, then it is appropriate to reflect it when the objective is to determine *market value*. However, if the benefit is specific to an entity's own tax profile, then it should only be reflected if undertaking an entity specific valuation.

Valuation Reporting

45. In addition to the minimum requirements in IVS 105 *Valuation Reporting*, a valuation report on intangible assets shall include comment on such of the following as is relevant to the purpose of the valuation:
- whether an *intangible asset* has been valued on a stand-alone basis or in conjunction with other assets
 - if the *intangible asset* has been valued in conjunction with other assets, an explanation as to why it was necessary to aggregate the subject *intangible asset* with other assets, including a description of the other assets with which the subject *intangible asset* has been aggregated.

Effective Date

46. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 302.01

Valuations of Plant and Equipment

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This standard identifies the characteristics of plant and equipment relevant to their valuation and the particular considerations required in their valuation.

Plant and Equipment

1. Plant and equipment collectively constitute a class of tangible assets that are:
 - (a) held by an entity for use in the production or supply of goods or services, for rental by others or for administrative purposes and
 - (b) expected to be used over a period of time.
2. The categories of plant and equipment assets are:
 - (a) plant - assets that are inextricably combined with others and that may include specialised structures, machinery and equipment,
 - (b) machinery - an apparatus used for a specific process in connection with the operation of an entity,
 - (c) equipment - other assets that are used to assist the operation of an enterprise or entity.

3. Plant and equipment assets have characteristics that distinguish them from the land and buildings in or on which they are located and that influence both the approach to and reporting of their value. Plant and equipment assets are normally capable of being moved or relocated without significant damage or disruption to the land or buildings, and usually will have a significantly shorter useful life. Title of ownership of plant and equipment assets can also be separated from the land and buildings.
4. Frequently, the value of an item of plant and equipment will differ depending on whether it is valued in combination with other assets within an operational unit or whether it is valued as an individual item for exchange. The value may also differ depending on whether the plant or equipment is considered as either in-situ, ie, in place, or for removal.

Features of Plant and Equipment Affecting Value

5. When undertaking a valuation of plant and equipment assets, the following considerations may be appropriate depending on the nature of the plant and equipment assets and the purpose of the valuation:
 - costs of installation and commissioning where plant and equipment assets are valued in situ,
 - costs of decommissioning, removal, and possible reinstatement following removal, and which party is to bear those costs where plant and equipment assets are valued for removal,
 - finite sources of raw materials,
 - limited life of the buildings in which the assets are situated,
 - limited tenure of the land and buildings housing the plant,
 - statutory restrictions,
 - environmental legislation.

Intangible Assets

6. Intangible assets fall outside the classification of plant and equipment assets. However, an *intangible asset* may have an impact on the value of plant and equipment assets. For example, the value of patterns and dies is often inextricably linked to associated intellectual property rights. Operating software, technical data, production records and patents are further examples of intangible assets that can have an impact on the value of plant and equipment assets, depending on whether or not they are included in the valuation. In such cases, the valuation process will involve consideration of the inclusion of intangible assets and their impact on the valuation of the plant and equipment assets.

Financing Arrangements

7. An item of plant and equipment may be subject to a financing arrangement, such as a *finance lease*. Accordingly, the asset cannot be sold without the lender or lessor being paid any balance outstanding under the financing arrangement. This payment may or may not exceed the unencumbered value of the item. Items of plant and equipment subject to such arrangements are normally separately identified from assets that are unencumbered, and their values separately reported.
8. Items of plant and equipment that are subject to operating leases are the property of third parties and therefore not included in a valuation of the assets of the lessee. However, such assets may need to be recorded as their presence may impact on the value of owned assets used in association.

Scope of Work

9. In addition to the minimum requirements in IVS 104 *Scope of Work*, the following matters should receive specific consideration in the valuation of plant and equipment assets:

- (d) Identification of the asset or liability to be valued:

Some plant and equipment assets connected with the supply or provision of services to a building will normally be included in any exchange of the *real property*. Examples include plant for the supply of electricity, gas, heating, cooling or ventilation and equipment such as elevators. Although the value of these items would normally be reflected in the value of the property interest, for certain purposes it may be necessary to value these items separately. When different valuation engagements are undertaken to carry out valuations of the *real property* interest and plant and equipment assets at the same location, care is necessary to avoid either omissions or double counting.

(i) Assumptions and any special assumptions:

Because of the diverse nature and transportability of much plant and equipment, additional assumptions will normally be required to describe the state and circumstances in which the assets are valued. In certain circumstances, it may be appropriate to report on more than one set of assumptions, eg, in order to illustrate the effect of business closure or cessation of operations on the value of plant and equipment.

Examples of assumptions that may be appropriate in different circumstances include:

- that the plant and equipment assets are valued as a whole, in place and as part of the business considered as a going concern,
- that the plant and equipment assets are valued as a whole, in place but on the assumption that the business is closed,
- that the plant and equipment assets are valued as individual items for removal from their current location

Forced Sales

10. Plant and equipment assets can be particularly susceptible to forced sale conditions, see IVS 103 *Bases of Value*. A common example is where the assets have to be removed from a property in a time frame that precludes proper marketing because a lease of the property is being terminated. The impact of such circumstances on value needs careful consideration. In order to advise on the value likely to be realised it will be necessary to consider any alternatives to a sale from the current location, such as the practicality and cost of removing the items to another location for disposal. .

Valuation Approaches

11. The three principal valuation approaches described in IVS 102 *Valuation Approaches* can all be applied to the valuation of plant and equipment assets.

Valuation Reporting

12. In addition to the requirements in IVS 105 *Valuation Reporting*, a valuation report on plant and equipment assets shall include comment on such of the following as is relevant to the purpose of the valuation:
- the impact on the value of the *real property* if the plant and equipment assets connected with the provision of services to a building are valued separately? from the *real property*
 - the impact on the value of the plant and equipment assets attributable to the existence of any intangible assets.

Effective Date

13. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 303.01

Valuations of Property Interests

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This standard identifies types of property interest, appropriate valuation approaches, typical valuation inputs and matters that require specific consideration when valuing these interests.

Property Interests

1. A property interest is the right of ownership, control or occupation of *real estate*. There are three basic types of property interest:
 - (a) A freehold interest is the superior interest in any defined area of land. The owner of this interest has an absolute right of possession and control of the land and any buildings upon it in perpetuity.
 - (b) A leasehold interest gives the holder rights of exclusive possession and control of a defined area of land or buildings for a defined period under the terms of a lease contract.
 - (c) A right to use land or buildings but without a right of exclusive possession or control, eg, a right to pass over land or to use it only for a specified activity.

2. Although different terms are used to describe these basic property types in different states, the basic concepts of an unlimited absolute right of ownership, an exclusive interest for a limited period or a non exclusive right for a specified purpose are common to most jurisdictions. The immovability of land and buildings means that it is the right that a party holds that is transferred in an exchange, not the physical *real estate*. The value, therefore, attaches to the property interest rather than to the physical land and buildings.

The Hierarchy of Interests

3. These different types of property interest are not mutually exclusive. A freehold interest may be subject to one or more subordinate interests. The owner of the freehold interest may grant a leasehold interest in respect of part or all of his interest. Lease interests granted directly by the owner of the freehold interest are “head leasehold” interests. Unless prohibited by the terms of the lease contract, the holder of a head leasehold interest can grant a lease of part or all of that interest to a third party, which is known as a sub-leasehold interest. A sub-leasehold interest will always be shorter than the head leasehold from which it is created, even if only by one day.
4. These property interests will have their own characteristics, as illustrated in the following examples:
 - (a) Although a freehold interest provides outright ownership in perpetuity, it may be subject to the effect of subordinate interests. These subordinate interests could include leases, restrictions imposed by a previous owner or restriction imposed by statute.
 - (b) A leasehold interest will be for a defined period, at the end of which the property reverts to the holder of the superior interest out of which it was created. The lease contract will normally impose obligations on the leaseholder, eg, the payment of rent and other expenses. It may also impose conditions or restrictions, such as in the way the property may be used or any transfer of the interest to a third party.
 - (c) A right of use may be held in perpetuity or may be for a defined period. The right may be dependent on the holder making payments or complying with certain other conditions.
5. When valuing a property interest it is therefore necessary to identify the nature of the rights accruing to the holder of that interest and reflect any constraints or encumbrances imposed by the existence of other interests in the same land or building. The sum of the values of different individual interests in the same land or building will frequently differ from the value of the unencumbered freehold interest.

6. Property interests are normally defined and regulated by state law. Before undertaking a valuation of a property interest, an understanding of the relevant legal framework that affects the interest being valued is essential.

Rent

7. When valuing a freehold interest that is subject to a lease or a leasehold interest, it is necessary to reflect the *market rent*, the contract rent or both.
8. *Market rent* is the estimated amount for which a property would be leased on the *valuation date* between a willing lessor and a willing lessee on appropriate lease terms in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.
9. The commentary given for the similar definition of *market value* in IVS 103 *Bases of Value* can be applied to assist in the interpretation of *market rent*. In particular, the estimated amount excludes a rent inflated or deflated by special terms, considerations or concessions. The "appropriate lease terms" are terms that would typically be agreed in the market for the type of property on the *valuation date* between market participants. A *market rent* should only be provided in conjunction with an indication of the principal lease terms that have been assumed.
10. The contract rent is the rent payable under the terms of an actual lease. It may be fixed for the duration of the lease or variable. The frequency and basis of calculating variations in the rent will be set out in the lease and must be identified and understood in order to establish the total benefits accruing to the lessor and the liability of the lessee.

Scope of Work

11. In addition to the minimum requirements in IVS 104 *Scope of Work*, the following matters should receive specific consideration in the valuation of property interests:

- (d) Identification of the asset or liability to be valued:

The property interest subject to valuation needs to be clearly defined, together with any superior or subordinate interest or interests that affect the interest to be valued.

- (g) Extent of investigation and, (h) the nature and source of the information to be relied upon:

Where specific investigations are to be undertaken as part of the valuation process, the nature of those investigations shall be recorded. Where specific investigations are not to be made, the source of any information which is to be relied upon is to be identified and recorded. Examples of matters requiring consideration under these headings include:

- information on the property interest,
- the extent of any site inspection,
- information on the site area and any building floor areas,
- the specification and condition of any building,
- existence, specification and adequacy of services,
- ground conditions,
- actual or potential environmental risks.

- (i) Assumptions and any special assumptions:

Where material matters are not to be specifically verified as part of the valuation process, the assumptions on which the valuation is to be based should be recorded.

Examples of special assumptions frequently made when valuing a property interest include:

- that a defined physical change had occurred, eg, a proposed building is valued as if complete at the *valuation date*,
- that there had been a change in the status of the property, eg, a vacant building had been leased or a leased building had become vacant at the *valuation date*.

Valuation Approaches

12. The three principal valuation approaches described in IVS 102 *Valuation Approaches* can all be applied to the valuation of a property interest. This standard describes matters that need to be considered and the typical inputs that are needed when applying these approaches to the valuation of property interests.

Direct Market Comparison Approach

13. Unlike some other asset classes, property interests are not homogeneous. Even if the land and buildings to which the interest being valued relates have identical physical characteristics to others being exchanged in the market, the location will be different. However, the *direct market comparison approach* is commonly applied for the valuation of property interests.
14. In order to compare the subject of the valuation with the price of other property interests that have been recently exchanged or that may be currently available in the market, it is usual to adopt a suitable unit of comparison. Units of comparison that are commonly used include analysing sale prices by calculating the price per square metre of a building or per hectare for land. Other units used for price comparison where there is sufficient homogeneity between the physical characteristics include a price per room or a price per unit of output, eg crop yields. A unit of comparison is only useful when it is consistently selected and applied to the subject property and the comparable properties in each analysis and is one used by participants in the relevant market.
15. Before a unit of comparison obtained by analysing price information relating to another property interest can be used to value the subject, the weight that can be applied to it in the valuation process is determined by comparing various characteristics of the property providing the price information with the property being valued. These characteristics will include considering any differences between the following:
 - the interest providing the price evidence and the interest being valued,
 - the respective location,
 - the respective quality of the land or the specification of buildings,
 - the ages of buildings,
 - the permitted use or zoning at each property,
 - the circumstances under which the price was determined and the basis, of value required,
 - the effective date of the price evidence and the required valuation date.

Income Approach

16. Various methods are used to estimate value under the general heading of the *income approach*, all of which share the common characteristic that the value is based upon an actual or estimated cash flow that either is or could be generated by an owner of the interest. In the case of an *investment property*, that income could be in the form of rent; in an owner occupied building, it could be an assumed rent based on what it would cost the owner to lease equivalent space. Where a building is specialised and suitable for only a particular type of trading activity, that income may be the actual or assumed earnings that would accrue to the owner of that building, eg, a *trade related property* discussed in IVS 303.04 *Valuations of Trade Related Property*.
17. The income stream identified is then used to estimate the value by a process of capitalisation. An income stream that is likely to remain constant can be capitalised using a single multiplier, known as the capitalisation rate or yield. This figure represents the return that an investor, or the notional return in the case of an owner occupier, would expect reflecting the time cost of money and the risks and rewards of ownership. This method, often known as the all risks yield method, is quick and simple but cannot be reliably used where the income is expected to change in future periods or where a more sophisticated analysis of risk is required. In such cases, various forms of discounted cash flow models can be used. These vary significantly in detail but share the basic characteristic that the net income for a defined future period is adjusted to a present day value using a discount rate. The sum of the present day values for the individual periods represents the capital value. As in the case of the all risks yield method, the discount rate in a discounted cash flow model will be based on the time cost of money and the risks and rewards attaching to the income stream in question.
18. The yield or discount rate discussed above will be determined by the objective of the valuation. If this is to establish the value to a particular owner or potential owner based on their own investment criteria, the rate used may reflect their required internal rate of return or the weighted average cost of capital. If it is to estimate the *market value*, the rate will be derived from observation of the returns implicit in the price paid for property interests traded in the market between market participants.

19. The appropriate discount rate should be determined from analysis of the yields implicit in transactions in the market for similar interests in similar properties. Where this is not possible, an appropriate discount rate may be built up from a typical “risk free “ return available on a AAA rated bond and then adjusted for the additional risks and opportunities specific to the particular property interest. These can include:
- prospects for future income growth,
 - risks arising from differences between actual income received and that which could be obtained under market conditions on the date of valuation, the risk of interruption of income, eg, due to tenants quitting or defaulting,
 - the rate at which buildings will depreciate.
20. The appropriate yield or discount rate will also depend on whether the income inputs or cash flows used are based on current levels or whether adjustments have been made to reflect anticipated future inflation or deflation.

Cost Approach

21. This approach is generally only used in the valuation of property interests when there is either no evidence of transaction prices for similar property or no identifiable actual or notional income stream that would accrue to the owner of the relevant interest. Its use is mainly confined to the valuation of *specialised property*, which is a property that is rarely if ever sold in the market, except by way of sale of the business or entity of which it is part.
22. The *cost approach* involves the calculation of an appropriated *depreciated replacement cost* for the asset being valued. It is applied to the valuation of a property interest by estimating the cost of a modern equivalent building or structure at the relevant *valuation date*. This is the replacement cost and needs to reflect all incidental costs that would be incurred, eg, for design, delivery, installation and commissioning of a new building or structure. The modern equivalent of each building or structure will have a similar function and equivalent productive capacity to the building or structure being valued but will be of a current design and constructed using current materials and techniques. The cost of acquiring land suitable for the development of this modern equivalent facility in the market should be included, together with the cost of all improvements that would be required to the land.

23. The cost of the modern equivalent buildings and any site improvements is then subject to adjustment for depreciation, by comparing the modern equivalent with the buildings and other site improvements at the interest being valued. The objective is to estimate how much less valuable the subject building would be to a potential buyer than the modern equivalent. Depreciation consists of three possible elements:
- (a) Physical deterioration reflects the deterioration of the subject building or structure arising from wear and tear over time, including any lack of maintenance.
 - (b) Functional obsolescence reflects the effect of any advances in technology or changes in occupier requirements that render features of the subject building or structure either wholly or partially redundant.
 - (c) External obsolescence reflects external factors that impact on the value of the subject property interest, including economic factors such as a change in the supply or demand for goods used or produced at the property, or the changes to the local infrastructure that affect its operations.
24. When valuing *specialised property*, it is not appropriate to depreciate the cost of replacing the land element.

Valuation Reporting

25. In addition to the minimum requirements in IVS 105 *Valuation Reporting*, a valuation report on property interests shall include comment on such of the additional matters referred to in the Scope of Work, para 11, as are relevant to the purpose of the valuation.

Effective Date

26. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 303.02

Valuations of Historic Property

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Effective Date	19

This standard identifies characteristics of historic property relevant to its value and additional matters that should be considered in its valuation.

Historic Property

1. An historic property is *real property* that is publicly recognised or officially designated by a government body as having cultural or historic importance because of its association with an historic event or period, with an architectural style or with a nation's heritage. The characteristics common to historic property include the following:
 - its historic, architectural and/or cultural importance,
 - the statutory or legal protection to which it may be subject,
 - restraints and limitations placed upon its use, alteration and disposal,
 - the frequent obligation in some jurisdictions that it be accessible to the public.

2. Historic property is a broad term, encompassing many property types. Some historic property is restored to its original condition, some is partially restored, eg, the building façade, and others are not restored. Historic property also includes properties partially adapted to current standards, eg, the interior space, and properties that have been extensively modernised.

Protection of Historic Property

3. Historic property may have legal or statutory protection because of its cultural and economic importance. Many governments have enacted measures to safeguard specific historic property or to protect whole areas of special architectural or historic interest.
4. The UNESCO¹ Glossary of World Heritage Terms defines cultural heritage and cultural property as follows:

“Cultural Heritage. Three groups of assets are recognised:

- (a) Monuments: architectural works, works of monumental sculpture and painting, elements or structures of an archaeological nature, inscriptions, cave dwellings and combinations of features, which are of outstanding universal value from the point of view of history, art or science;
- (b) Groups of buildings: groups of separate or connected buildings which, because of their architecture, their homogeneity or their place in the landscape, are of outstanding universal value from the point of view of history, art or science; and
- (c) Sites: works of man or the combined works of nature and man, and areas including archaeological sites, which are of outstanding universal value from the historical, aesthetic, ethnological or anthropological point of view.”²

“Cultural Property is property inscribed in the World Heritage List after having met at least one of the cultural heritage criteria and the test of authenticity”³.

5. Not all historic property is necessarily recorded in registers of officially designated historic properties. Many properties having cultural and historic importance also qualify as historic property.

¹ UNESCO is the United Nations Educational, Scientific and Cultural Organization

² World Heritage Convention, Article I, UNESCO, 1972

³ World Heritage Convention, Article II, UNESCO, 1972

Features of Historic Property Affecting Valuations

6. The valuation of historic property requires consideration of a variety of factors that are associated with the importance of these properties, including the legal and statutory protections to which they are subject, the various restraints upon their use, alteration and disposal, and possible financial grants, tax rate or tax exemptions to the owners of such properties in some jurisdictions.
7. When undertaking a valuation of an historic property, the following matters should be considered depending upon the nature of the historic property and the purpose of the valuation:
 - (a) The costs of restoration and maintenance may be considerable for historic property and these costs, in turn, affect the value of the property.
 - (b) Legal measures to safeguard historic property may limit or restrict the use, intensity of use or alteration of an historic property. Examples include the following:
 - restrictive covenants that apply to the land regardless of the owner,
 - preservation easements that prohibit certain physical changes, usually based on the condition of the property at the time the easement was acquired or immediately after proposed restoration of the property
 - conservation easements that limit the future use of a property so as to protect open space, natural features or wildlife habitat.
8. The valuation of historic property involves special considerations dealing with the nature of older construction methods and materials, the current efficiency and performance of such properties in terms of modern equivalent assets, the appropriateness of methods used to repair, restore, refurbish or rehabilitate the properties, and the character and extent of legal and statutory protections affecting the properties.
9. The land or site upon which an historic property stands may be subject to constraints upon its use. In turn, any such constraints will affect the overall value of the historic property.

10. Some historic property may be incapable of reliable valuation because there is no relevant market evidence, no potential for generating income and no demand to warrant replacement. An example would be a partially ruined building with no income generating potential; although it may well have historic significance, this could not be replicated or replaced.

Scope of Work

11. In addition to the minimum requirements in IVS 104 *Scope of Work*, reference should be made to the additional requirements in IVS 303.01 *Valuations of Property Interests*.

Valuation Approaches

12. The three principal valuation approaches described in IVS 102 *Valuation Approaches* can all be applied to the valuation of an historic property.

Direct Market Comparison Approach

13. In applying the *direct market comparison approach*, the historic nature of the property may change the order of priority normally given to attributes of comparable properties. It is especially important to find comparable properties with historic features similar to those of the subject historic property. Criteria for the selection of comparable properties include architectural style, property size, specific cultural or historic associations of the subject property and similarity in location as regards zoning, permissible use, legal protection and concentration of historic properties. A variety of adjustments may have to be made to the comparable sales. These involve differences in location, costs of restoration or rehabilitation, or specific encumbrances. Adjustments are normally made in the following situations:

- when costs must be incurred to restore or rehabilitate the subject property, but not the comparable sales,
- where the specific encumbrances upon the subject property, eg, restrictive covenants or preservation easements, differ from those upon the comparable properties.

Income Approach

14. Historic property having a commercial use is often valued by means of the *income approach*. Where the distinctive architecture and ambiance of an historic property contribute to its drawing power under an income producing use, it is particularly important to reflect the cost of any work necessary to restore, adapt or maintain the historic property. Where work is required, allowances should be made for the time and cost involved in obtaining any necessary statutory consents.

Cost Approach

15. When applying the *cost approach* to the valuation of an historic property, consideration is given to whether the historic features of a building would be of intrinsic value in the market for that property. Some historic buildings will be of value simply because of their symbolic status. For example, an historic building used for a famous art gallery could be just as or more important than the function it fulfils. In this situation, the service potential of such a building is inseparable from its historic features. The modern equivalent of such properties would need to reflect either the cost of reproducing a replica, or if this is not possible because the original materials or techniques are no longer available, the cost of the modern building with a similarly distinctive and high specification.
16. In many cases, the historic features will either add no value or be viewed as an encumbrance by a purchaser, eg, a hospital operating in an historic building. In such cases, the modern equivalent would reflect the cost of a new building constructed to a conventional modern specification.
17. In all cases, the adjustments for physical deterioration and functional obsolescence will need to reflect factors such as the higher cost of maintenance associated with the historic property and the loss of flexibility for adapting the building to the changing needs of an occupier.

Valuation Reporting

18. In addition to the minimum requirements in IVS 105 *Valuation Reporting*, a valuation report for historic property shall include comment on such of the additional matters referred to in para 25 of IVS 303.01 *Valuations of Property Interests*, as is relevant to the purpose of the valuation.

Effective Date

19. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 303.03

Valuations of Investment Property under Construction

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This standard examines the matters to be considered when valuing investment property that is in the course of construction on the valuation date and identifies appropriate valuation approaches.

Investment Property

1. *Investment property* is property that is land or a building, or part of a building, or both, held by the owner to earn rentals or for capital appreciation, or both, rather than for:
 - (a) use in the production or supply of goods or services or for administrative purposes, or
 - (b) sale in the ordinary course of business.
2. The owner may hold a freehold or a leasehold interest in *investment property*, see IVS 303.01 *Valuations of Property Interests* for the principles to be applied in valuing such interests. This standard is concerned with the situation where an *investment property* is in the course of construction on the *valuation date*.

3. Valuations of partially completed *investment property* may be required for different purposes including:

- acquisitions, mergers and sales of businesses or parts of businesses,
- loan security,
- litigation,
- financial reporting.

Scope of Work

4. In addition to the minimum requirements in IVS 104 *Scope of Work* and IVS 303.01 *Valuations of Property Interests*, the following matters should receive specific consideration in the valuation of *investment property* under construction:

(g) Extent of investigation and, (h) the nature and source of the information to be relied upon:

The extent of the enquires that are to be made, in particular into establishing the estimated cost to complete the project, including any documents or third party specialist reports that may be relied upon, shall be recorded.

Valuation Approaches

5. This standard examines the principles that should be observed in estimating the *market value* of *investment property* under construction. *Market value* is discussed in detail in IVS 103 *Bases of Value* but in summary the objective is to estimate the price that would be paid and received in a hypothetical exchange of the partially completed property in the market as of the date of valuation.

6. In practice, few investment properties are transferred between market participants in a partially completed state, except as either part of a transfer of the owning entity or where the seller is either insolvent or facing insolvency and therefore unable to complete the project. Even in the unlikely event of there being evidence of a transfer of another partially completed *investment property* close to the *valuation date*, the degree to which work has been completed would almost certainly differ, even if the properties were otherwise similar.

7. In the absence of directly comparable sales evidence, the value has to be estimated using one or more market based valuation approaches. Such approaches may use information from a variety of sources, including:
- sales evidence of comparable properties in different locations or in a different condition with adjustments made to account for such differences,
 - sales evidence of comparable properties transacted in different economic conditions with adjustments made to account for such differences,
 - discounted cash flow projections or income capitalisation supported by comparable market data on construction costs, lease terms, operating costs, growth assumptions, discount and capitalisation rates and other key inputs.
8. The *market value* of a partially completed *investment property* will reflect the expectations of market participants of the value of the property when complete, less deductions for the costs required to complete the project and appropriate adjustments for profit and risk. The valuation and all key assumptions used in the valuation should reflect market conditions at the *valuation date*.
9. It is inappropriate to estimate the *market value* of a partially completed *investment property* solely by reference to the project plan or feasibility study produced at the commencement of the project. Once the project has commenced, this is not a reliable tool for measuring value as the inputs will be historic. An approach based on estimating the percentage of the project that has been completed prior to the *valuation date* is therefore unlikely to be relevant in determining the current *market value*.
10. If the time required from the *valuation date* to complete construction of a new *investment property* is such that the anticipated cash flows will occur over a period of time, and if the time cost of money is likely to be a significant factor, it would be appropriate to use a discounted cash flow method that reflects the probable timing of those cash flows.
11. A valuation of *investment property* under construction may be undertaken using either a growth-implicit model, which uses current cost and value inputs, or a growth-explicit model which uses estimated future cost and value inputs. In either model, the objective is to estimate the value on the *special assumption* that the property is complete, from which appropriate deductions are then made in order to estimate the value of the property in its present condition. The more appropriate of these alternatives will be the one prevailing in the market for the class of property on the *valuation date*. Inputs from one model should not be used in the other, and the report should make clear which approach is being adopted.

Valuation Inputs

12. The exact valuation inputs used will vary with the valuation model being used but will normally include those listed in this section. The inputs will also vary depending on whether a growth implicit or growth explicit model is being used, see para 10. Typical inputs include:
- (a) Completed property
If a growth implicit model is used, this will reflect the value of the *investment property* as if complete, ie, its value on the assumption that on the *valuation date* it had already been completed in accordance with the current specification. If a growth explicit model is used, this will reflect the projected value of the property upon completion, ie, the expected value of the property on the date when it is anticipated to be complete.
 - (b) Leasing
If lessees for the property after completion have still to be identified, allowance will need to be taken of the time and cost, including any incentives and fees, that it would be realistic to allow for stabilised occupancy to be reached, ie, the period required to reach realistic long term occupancy levels. The income from anticipated future leases may be based on current market rents if a growth implicit model is used or anticipated future rents if a growth explicit model is used. If there are leasing agreements in place that are conditional on the project, or a relevant part, being completed, these should be reflected in the valuation.
 - (c) Construction costs
The benefit of any work carried out prior to the *valuation date* will be reflected in the current value, but will not determine that value. Similarly, previous payments under the actual building contract prior to the *valuation date* are not relevant to current value. In contrast, the sums remaining to be paid under any binding construction contract in existence at the *valuation date* are often the best evidence of the construction costs required to complete. However, if there is a material risk that the contract may not be fulfilled, eg, due to a dispute or insolvency of one of the parties, it may be more appropriate to reflect the cost of engaging a new contractor to complete the outstanding work. If there is no fixed price contract in place and a growth explicit model is being used, then it may be appropriate to use prospective cost, ie, reflecting the reasonable expectation of market participants on the *valuation date* of costs on the dates when they are likely to be incurred.

(d) Finance costs

These represent the cost of finance for the project from acquisition through to the anticipated repayment of the loan. As the lender may perceive the risks during construction to differ substantially from the risks following completion of construction, the finance cost during each period should be considered separately. Even if the entity is self funding the project, appropriate market rates of interest should be allowed to reflect those which would be obtainable by a typical buyer of the property in the market at the date of valuation.

(e) Other costs

These will include legal and professional costs that would be reasonably incurred by a buyer in completing the construction and in letting the *investment property*. Except where there are leasing agreements in place, allowance will also need to be made for the reasonable costs of marketing. However, any costs that would be incurred in an actual transfer of the property on the date of valuation should be ignored.

(f) Risk

All significant risks should be identified and evaluated. Typical risks associated with any partially completed construction project will include variations in construction cost, finance costs and the construction programme. Additional risks associated with *investment property* under construction include fluctuations in the value of the completed project between inception and completion, and the time that will be required to secure lessees and a stabilised income. The risks associated with generating income from the property after completion should be identified and evaluated separately from the risks associated with completing construction. If a growth implicit model is used, the valuation inputs will reflect current values and costs so the risk of these changing between the *valuation date* and the anticipated completion date should be evaluated. If a growth explicit model has been used based on prospective values and costs, the risk of those projections proving to be inaccurate should be evaluated.

(g) Buyer's return

Allowance should be made for the return that would be required by a buyer of the partially completed *investment property* in the market place. This should reflect the risks associated with the completion of the construction programme and in achieving the anticipated income or capital value on the date of valuation. The buyer's return can be expressed as a target profit, either a lump sum or a percentage return on cost or value.

Alternatively, if a discounted cash flow method is used to produce the valuation, it may be the minimum rate of return that would be required by a typical buyer in the market. The profit anticipated by the entity at the commencement of the development project is irrelevant to the valuation of its interest in the project once construction has commenced. The valuation should reflect those risks remaining at the *valuation date* and the discount or return that a buyer of the partially completed project would require for bringing it to a successful conclusion.

(h) Other considerations

In situations where there has been a change in the market since a project was originally conceived, the project under construction may no longer represent the highest and best use of the land. In such cases, the costs to complete the project originally proposed may be irrelevant as a buyer in the market would either demolish any partially completed structures or adapt them for an alternative project. The value of the *investment property* under construction would need to reflect the current value of the alternative project and the costs and risks associated with completing that project.

Special Considerations under IAS 40

13. IAS 40 (para 38) provides that the fair value of *investment property* shall reflect market conditions at the end of the reporting period. Para 39 further provides that the value is time-specific as of a given date. As indicated in IVS 201.01 *Fair Value under International Financial Reporting Standards*, fair value under IFRS is consistent with *market value* in IVS.
14. Financial statements are produced on the assumption that the entity is a going concern unless management either intends to liquidate the entity or cease trading, or has no realistic alternative but to do so (IAS 1 para 25). It is therefore normally appropriate to assume that any contracts, eg, for the construction or letting of the property on completion, would pass to the buyer in the hypothetical exchange, even if those contracts may not be assignable in an actual exchange. An exception would be if there was evidence of a higher than normal risk of default by a contracted party on the date of valuation.

Special Considerations for Secured Lending Valuations

15. As indicated in IVS 202.01 Valuations of Property Interests for Secured Lending, a valuation of a partially completed *investment property* for secured lending produced in accordance with these standards will have *market value* as its objective. However, many contracts are either void or voidable in the event of one of the parties becoming subject to formal insolvency proceedings. Therefore, an assumption that a buyer of the partially completed project may have the benefit of existing building contracts and any associated warranties and guarantees may be inappropriate in valuations for this purpose. Likewise, care should be taken in assuming that any agreement for lease entered into by the borrower acting as lessor would be transferable to a buyer.

Valuation Reporting

16. In addition to the minimum requirements in IVS 105 *Valuation Reporting*, a valuation report on *investment property* under construction shall include comment on such of the following as is relevant to the purpose of the valuation:
- a statement that the project is under construction,
 - a description of the project,
 - a description of the stage of development reached,
 - the key inputs to the valuation and the assumptions made in determining those inputs,
 - a summary of the status of any outstanding, major contracts, if relevant.
17. In particular, the valuation report should identify and, where possible, quantify the remaining risks associated with the project and how these have been reflected in the valuation. In quantifying such risks, distinction should be made between risks in respect of generating rental income and construction risks.

Effective Date

18. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 303.04

Valuations of Trade Related Property

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This standard describes the valuation approaches for valuing the property interest where the buildings are specifically designed for a specific type of business activity. It does not apply to the valuation of any business in occupation. Valuations of the business are the subject of IVS 301.01 Valuations of Businesses and Business Interests. The principles in IVS 303.01 Valuations of Property Interests also apply to trade related property.

Trade Related Property

1. *A trade related property* is any type of *real property* designed for a specific type of business where the property value reflects the trading potential for that business. Examples include hotels, fuel stations, restaurants, casinos, cinemas and theatres. The essential characteristic of this type of property is that it is designed, or adapted, for a specific use and the resulting lack of flexibility means that the value of the property interest is normally intrinsically linked to the returns that an owner can generate from that use. The value therefore reflects the trading potential of the property. It can be contrasted with generic property that can be occupied by a wide range of different business types, such as standard office, industrial or retail property. Another feature is that the ownership of the property interest often transfers as part of the sale of the whole business in occupation, referred to in this standard as the “operational unit”.
2. The value of such property reflects the trading potential, rather than the actual level of trade under the existing ownership. The assumed level of trade assumes that which could be achieved by a reasonably efficient operator, ie, a typical market participant for the property.

3. Where a *trade related property* is currently trading, the value of the entire operational unit may include various components. These typically include:

- the property interest,
- furniture,
- equipment,
- stock,
- operating licenses and permits,
- *goodwill*.

If the valuation is of the entire business, these elements will need to be valued and reference should be made to IVS 301.01 *Valuations of Businesses and Business Interests*.

Scope of Work

4. In addition to the minimum requirements in IVS 104 *Scope of Work*, the following matters should receive specific consideration in the valuation of *trade related property*:

(d) Identification of the asset or liability to be valued:

The assets subject to valuation need to be clearly defined, including whether assets other than the property interest that form part of the operational unit, eg, furniture, equipment, stock, licenses and permits, are to be either included in the valuation, excluded but assumed to be present or excluded and assumed not to be present.

(e) Extent of investigation and, (h) nature and source of the information to be relied upon:

The sources of information on current and historic levels of trade and other financial information should be confirmed together with the valuer's duty to investigate or verify.

(i) Assumptions and any special assumptions:

Where the property is trading and the trade is expected to continue, it is normally appropriate to make the assumption that the property interest is valued as part of a fully equipped operational unit and has either been trading or is capable of trading.

Examples of *special assumptions* include:

- In the case of a property that is not trading, eg, because it is under development or where trading has only recently commenced, a *special assumption* can be made that a defined level of trading performance had been reached on the date of valuation.
- Where the purpose of the valuation requires an illustration of the effect on value of business closure, a *special assumption* can be made that the current business had been closed, specified trade equipment removed and any necessary licences or permits were not available to a buyer.

Valuation Approaches

5. The *direct market comparison* and the income approaches described in IVS 102 *Valuation Approaches* can be applied to the valuation of a *trade related property*. The *cost approach* is not normally appropriate.

Direct Market Comparison Approach

6. If using the *direct market comparison approach*, reference should be made to the matters discussed in IVS 303.01 *Valuations of Property Interests*. Additional matters that should be considered concern the different features of the comparable property and the property being valued that would impact upon the level of trade that could be generated. Because this type of property is normally designed for a specific type of trade, the main influence on value will often be the trading potential in a particular location rather than the physical characteristics of the building. Two physically similar properties may have totally different levels of trade potential due to their location. The *direct market comparison approach* is often a less reliable indicator of value than the *income approach*.

Income Approach

7. The *income approach* is applied to a *trade related property* by estimating the amount that a reasonably efficient operator could afford to pay as rent for the property after deducting other operating expenses and a reasonable profit margin for the operator from the gross income that can be generated from the property. This estimated rent can be used to calculate the capital value of the property interest by application of an appropriate capitalisation rate or by inputting into a discounted cash flow model, see IVS 303.01 *Valuations of Property Interests*.

8. Where the property is currently trading, the actual trading performance of the current operator may be used as a starting point for assessing the trading potential of the property. However, because of the need to reflect the level of trade that might be achieved by a reasonably efficient operator, adjustments may be required to reflect atypical revenues and costs, eg:
- additional revenue attaching to the brand or personal reputation of a current operator that would not transfer to a buyer of the property interest,
 - advantageous or disadvantageous supply contracts that would not transfer to a buyer of the property interest.
9. In the case of a vacant property, or a new *trade related property* that is planned or under construction, the trading potential will need to be determined by comparison with the trading performance of other similar properties. Depending on the purpose of the valuation, it may be necessary to provide a valuation on the *special assumption* that a defined level of turnover had been achieved by the *valuation date*.
10. Although the buildings associated with a *trade related property* are by definition designed for the specific requirements of the related trade, it may be appropriate to undertake a cross check to see whether the land may have a higher value if the existing buildings were redeveloped for an alternative use.

Valuation Reporting

11. In addition to the minimum requirements in IVS 105 *Valuation Reporting*, a valuation report on a *trade related property* shall include comment on such of the following as is relevant to the purpose of the valuation:
- clarification as to whether the property interest has been assumed to be transferred as part of an operational unit or not,
 - clarification of what has been included and excluded in the valuation.

Effective Date

12. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

International Valuation Standard 304.01

Valuations of Financial Instruments

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This standard identifies major characteristics of financial instruments that influence value, discusses different valuation approaches and identifies the principles that should be applied in their valuation.

Financial Instruments

1. A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. A financial instrument will create rights or obligations between specified parties to receive or pay cash or other financial consideration. The contract may require the receipt or payment to be made on or before a specific date or be triggered by a specified event. An equity instrument is any contract that creates a residual interest in the assets of an entity after deducting all of its liabilities.

2. Valuations of financial instruments are required for many different purposes including, but not limited to:
 - acquisitions, mergers and sales of businesses or parts of businesses,
 - financial reporting,
 - regulatory requirements, in particular banking solvency requirements,
 - internal risk and compliance procedures,
 - establishing the net asset value of insurance company funds,
 - pricing and performance measurement of investment funds.
3. Financial Instruments can be broadly divided into either “cash instruments”, which include loans, deposits, securities and bonds, or “derivative instruments”, which derive a return from one or more underlying assets.
4. A thorough understanding of the instrument being valued is required to identify and evaluate the relevant market information available for identical or similar instruments. Such information includes, for example, prices from recent transactions in the same or a similar instrument, quotes from brokers or pricing services, indices or any other inputs to the valuation process, such as the appropriate interest rate curve, or pricing volatility.

Markets for Financial Instruments

5. Liquid instruments, such as stock in a major company, a government bond or a futures contract for a recognised commodity, are traded on major exchanges and real time prices are readily available, both to active market participants and through various media outlets. Some liquid derivative instruments, eg, forward stock options or commodity futures, are also traded on exchanges. The process of estimating value for such instruments is an illustration of the *direct market comparison approach* defined in IVS 102 *Valuation Approaches* in its simplest form. A unit price on the date of valuation is directly observable and can normally be applied to the asset being valued without adjustment.
6. Many types of instruments, including many types of derivatives or non-liquid cash instruments, are not traded on public exchanges and have varying degrees of illiquidity. Trades of these instruments are negotiated in what is termed the over the counter (OTC) market.

7. Although the overall size of the market for OTC traded instruments is many times greater than that for instruments traded on public exchanges, the volume of trades for each type of issued instrument is typically very much lower. For some bespoke swaps, there is usually no trade at all after the initial deal is struck, either because the terms of the contract prohibit assignment or because there is no market for that class of instrument.
8. Valuation techniques are most likely to be required for instruments that are traded in the OTC markets or that are normally traded on a public exchange but where that market has become inactive. It is these situations that are the main focus of this standard.

Credit Risk

9. Understanding the credit risk is an important aspect of valuing any debt instrument. It is necessary to reflect the credit quality and financial strength of both the issuer and any credit support providers. Some of the more common factors are as follows:
 - collateral asset quality,

The assets to which the holder of an instrument has recourse in the event of default must be considered. In particular, it needs to be understood whether recourse is to all the assets of the issuer or only to specified assets. The greater the value and quality of the assets to which an entity has recourse in the event of default, the lower the credit risk of the instrument.
 - netting agreements,

Where derivative instruments are held between counter parties, credit risk may be reduced by a netting or offset agreement that limits the obligations to the net value of the transactions, ie, if one party becomes insolvent, the other party has the right to offset sums owed to the insolvent party against sums due under other instruments.
 - subordination,

Establishing the priority of an instrument is critical in assessing the default risk. Other instruments may have priority over an issuer's assets or the cash flows that support the instrument.

- default protection

Many instruments contain some form of protection to reduce the risk of non-payment to the holder. Protection might take the form of a guarantee by a third party, an insurance contract, a credit default swap or more assets to support the instrument than are needed to make the payments. The default risk is also reduced if subordinated instruments take the first losses on the underlying assets and therefore reduce the risk to more senior instruments. When protection is in the form of a guarantee, an insurance contract or a credit default swap, it is necessary to identify the party providing the protection and assess that party's creditworthiness. Considering the credit worthiness of a third party involves not only the current position but also the possible effect of other guarantees or insurance contracts that it might have written. If the provider of a guarantee has also guaranteed many correlated debt securities, the risk of its non-performance might increase significantly.

10. For entities for which limited information is available, it might be necessary to look to information available for entities with similar risk characteristics. Credit indices are published that may assist this process. If secondary trading in structured debt exists, there might be sufficient market data to use the structured debt market. Entities take into account the varying sensitivities of different liabilities to credit risk in evaluating which source of credit data provides the most relevant and representationally faithful information. The credit spread applied is based on the amount a market participant would require for the particular instrument.

Own Credit Risk

11. Because the credit risk associated with a liability is important to its value, some argue that if valuing the interest of the issuer of a liability the credit risk of the issuer is relevant to its value. However, in many cases the issuer of a liability will not have the ability to transfer the liability and can only settle with the counter party. Where it is appropriate to assume a transfer of the liability, there are various potential sources for reflecting own credit risk in the valuation of liabilities. These include the yield curve for the entity's own bonds or other debt issued and credit default swap spreads.

12. When adjusting for own credit risk, it is also important to consider the nature of the collateral available for the liabilities being valued. Collateral that is legally separated from the issuer normally reduces the credit risk. If liabilities are subject to a daily collateralisation process, there might not be a material own credit risk adjustment because the counterparty is protected from loss in the event of default. However, collateral provided to one counterparty is not available to other counterparties. Thus, although some collateralised liabilities might not be subject to significant credit risk, the existence of that collateral might affect the credit risk of other liabilities.

Liquidity and Market Activity

13. Financial instruments range from those that are normally regularly traded on public exchanges in high volumes to bespoke instruments agreed between two parties that are incapable of assignment to a third party. This range of instrument types means that consideration of the liquidity of an instrument or the current level of market activity is important in determining the most appropriate valuation approach.
14. Liquidity and market activity can be distinguished. The liquidity of an asset is a measure of how easily and quickly it can be transferred in return for cash or a cash equivalent. Market activity is a measure of the volume of trading at any given time, and is a relative rather than an absolute measure, see IVS 101 *General Concepts and Principles*. By way of example, a painting by a famous Renaissance artist will always be readily saleable, ie, it has high liquidity; however, there are few such paintings in existence and the frequency of sales is low, which means that the market cannot be described as active.
15. Although separate concepts, illiquidity or low levels of market activity pose valuation challenges through a lack of relevant market data, ie, data that is either current at the date of valuation or that relates to a sufficiently similar asset to be reliable. The lower the liquidity or market activity, the greater the reliance that will be needed on valuation approaches that use techniques to adjust or weight the inputs based on the evidence of other transactions to reflect either market changes or differing characteristics of the asset.

Scope of Work

16. The minimum requirements in IVS 104 *Scope of Work* are applicable to valuations of financial instruments. Although there is a greater incidence of valuations being undertaken internally rather than by external valuers, it is still a fundamental to good governance practice that the scope and objectives of the valuation process are recorded.

17. In addition to the matters listed in IVS 104 *Scope of Work*, reference should also be made to any procedures that will be undertaken in order to comply with the entity's valuation control and governance procedures, see paragraphs 29 to 33.

Valuation Inputs

18. Except for liquid instruments that are traded on public exchanges, where current prices are both observable and accessible, valuation inputs or sources of data may come from different sources. Commonly used input sources are dealer quotations and consensus pricing services.
19. Where dealer quotations are used, dealer's bids for a particular instrument are taken into account rather than actual prices. Although not as reliable as the evidence of a contemporary and relevant trade, where such information is not available, dealer quotations can provide the next best evidence of how market participants would price the asset. However, problems associated with dealer quotations that can affect their reliability as a valuation input include:
- Dealers will normally only be willing to make markets and provide "genuine" bids in respect of more popular instruments and may not extend coverage to less liquid issues. Because liquidity often reduces with time, quotations may be harder to find for older instruments.
 - A dealer's prime interest is in dealing, not supporting valuation, and they have little incentive to research a quotation provided for a valuation as thoroughly as they would for an actual buy or sell enquiry. This impacts on the quality of the information.
 - There is an inherent conflict of interest where the dealers are the counter party to an instrument. Dealers also have an obvious incentive to keep buyer clients happy.
20. Consensus pricing services operate by collecting price information about an instrument from several participating subscribers. They reflect a pool of quotations from different sources, with or without statistical adjustment to reflect standard deviations or the distribution of the quotations.
21. Consensus pricing services overcome the conflict of interest problem associated with single dealer. However, the coverage of such services is at least as limited as that for single dealer quotations. As with any data set used as a valuation input, understanding the sources and how these are statistically adjusted by the provider is essential to understanding the weight that should be given to it in the valuation process.

Valuation Approaches

22. Many types of instruments, particularly those that are traded on exchanges, are routinely valued using computer based automated valuation models that use algorithms to analyse market transactions and produce valuations on the required asset. These models are often linked to proprietary trading platforms. It is beyond the scope of these standards to examine such models in detail, although as with other semi or non-automated valuation models or approaches, these standards set a context for their use and the reporting of the results.
23. Whether automated or manual, the various valuation methods used in financial markets are mostly based on variations of either the *direct market comparison approach* or the *income approach* described in IVS 102 *Valuation Approaches*. This standard describes the commonly used methods and matters that need to be considered or the inputs needed when applying these methods.
24. It is important when using a particular valuation method or model to ensure that it is calibrated with observable market information on a regular basis. This ensures that the model reflects current market conditions and identifies any potential deficiencies. As market conditions change, it might become necessary either to change the model(s) used or to make additional adjustments to the valuations. Those adjustments should be made to ensure that the result most closely results in the required valuation objective.

Direct Market Comparison Approach

25. A trade price obtained on a recognised exchange platform on or very close to the time or date of valuation is normally the best indication of the value of a holding of the identical instrument. As indicated in paragraph 5, there will often be no need for any adjustment to the price and little valuation technique required.
26. There may be situations where information from a particular trade is not directly relevant to the valuation objective and caution should be exercised. Examples of where some adjustment or weighting of the evidence of traded prices may be required are:
 - whether the instrument being valued has different characteristics to the ones for which prices are available,
 - differences in the size or volume of the reported trade to the holding being valued,
 - whether the trade was between willing parties acting independently,
 - the timing of the trade, which may be accentuated by the closure of exchanges.

Discounted Cash Flow Method

27. The value of a financial instrument may be determined using a discounted cash flow method. The cash flows may be fixed for the life of the instrument or variable. The terms of an instrument determine, or allow estimation of, the undiscounted cash flows. The terms of a financial instrument typically set out:
- the timing of the cash flows, ie, when the entity expects to realise the cash flows related to the instrument,
 - the calculation of the cash flows, eg, for a debt instrument, the interest rate that applies, ie, the coupon, or for a derivative instrument, how the cash flows are calculated in relation to the underlying instrument or index (or indices),
 - the timing and conditions for any options in the contract, eg, put or call, prepayment, extension or conversion options,
 - protection of the rights of the parties to the instrument, eg, terms relating to credit risk in debt instruments or the priority over or subordination to other instruments held.
28. In establishing the appropriate discount rate, it is necessary to assess the return that would be required on the instrument to compensate for the risks related to:
- the timing of the cash flows for the instrument,
 - the credit risk, ie, uncertainty about the ability of the counter party to make payments when due,
 - currency risks,
 - the liquidity of the instrument.
29. Where future cash flows are not based on fixed contracted amounts, estimates of the probable income will need to be made in order to provide the necessary inputs. The determination of the discount rate will also require assumptions about the risks. Depending upon the purpose of the valuation, these assumptions will need to reflect either those that would be made by market participants, or be based on the holder's current expectations or targets. For example, if the purpose of the valuation is to determine *market value*, or fair value as defined in IFRS, the assumptions should reflect those of market participants. If the purpose is to measure performance of an asset against management determined benchmarks, eg, a target internal rate of return, then alternative assumptions may be appropriate.

Risk Replication Method

30. This method deconstructs an instrument into components or risk factors in order to replicate the value statically or dynamically. Although the theoretical purpose of the model is to find the price at which the position can be offset, in practice, the model defines a dynamic risk management strategy whose aim is to capture most of the value of the initial contract. Offsetting a position involves either selling the instruments, unwinding an existing contract or entering into a transaction that would cancel most of the risk of the initial position. It is often used to value derivatives that are difficult to transfer to a third party but may be unwound and are in most cases offset by opposite contracts. The risk replication method does not estimate a price that would be obtainable on sale on the *valuation date* but provides a value that will be realised over time through the risk management strategy.

Control Environment

31. Compared with other asset classes, the volume of financial instruments in circulation is vast but the number of active market participants relatively few. The nature and volume of instruments and their frequency of valuation means that valuation is often undertaken using computer based models linked to trading platforms. As a consequence of these factors, many instruments are routinely valued by the holding entity, even where the valuation is to be relied upon by external parties, eg, investors or regulatory authorities. The incidence of valuation by independent third party experts is less common than for other asset classes.
32. Valuation by the holding entity creates a significant risk to the perceived objectivity of valuations. Where valuations are for external consumption, steps should be taken to ensure that an adequate control environment exists to minimise threats to the independence of the valuation.
33. The control environment consists of the internal governance and control procedures that are in place with the objective of increasing the confidence of those who may rely on the valuation in the valuation process and conclusion.
34. As a general principle, valuations produced by an entity's "front office" brokerage and market making activities that are to be included in financial statements or otherwise relied on by third parties should be subject to "back office" scrutiny and approval. Ultimate authority for such valuations should be separate from, and fully independent of, the risk taking functions. The practical means of achieving a separation of the function will vary according to the nature of the entity, the type of instrument being valued and the materiality of the value of the particular class of instrument to the overall objective. The appropriate protocols and controls should be determined by careful consideration of the threats to objectivity that would be perceived by a third party relying on the valuation.

35. Examples of typical components of the control environment include:
- establishing a governance group responsible for valuation policies and procedures and for oversight of the entity's valuation process, including some members external to the entity,
 - a protocol for the frequency and methods for calibration and testing of valuation models,
 - criteria for verification of certain valuations by different internal or external experts,
 - identifying thresholds or events that trigger more thorough investigation or secondary approval requirements,
 - identifying procedures for establishing significant inputs that are not directly observable in the market, eg, by establishing pricing or audit committees.

Valuation Reporting

36. A valuation report on financial instruments shall contain the minimum requirements set out in IVS 105 *Valuation Reporting*.
37. With regard to the requirements to (d) identify the asset or liability being valued and to disclose the (l) valuation approach and reasoning used, consideration should be given to the degree and granularity of disclosure that is appropriate. This will differ for different categories of instrument. Although sufficient information should be provided to allow users to understand the nature of each class of instrument valued and the primary factors influencing the values, excessive disclosure may be superfluous or confusing if the important matters for users are not clearly highlighted.
38. The appropriate level of detail provided should be determined by consideration of those instruments that are likely to be of most interest to users. For example, if the market for a particular type of instrument has become extremely volatile and there have been large increases in bid-offer spreads, or if there has been a significant decrease in liquidity, then the level of risk associated with the instrument and the difficulty in valuing the instrument are likely to have increased. Providing more detailed or enhanced disclosures about this type of instrument will be helpful to users.
39. The instruments that are of particular interest to users may differ with the passage of time. The usefulness of the valuation report, or any other reference to the valuation, is enhanced if it reflects the information demands of users as market conditions change, although to be meaningful the information presented should allow comparison with previous periods.

40. Factors to consider in identifying the instruments for which more detailed disclosure is appropriate include:
- materiality,
The value of the instrument or class of instruments in relation to the total value of the holding entity's assets and liabilities will determine the amount of disclosure required.
 - uncertainty and subjectivity,
The value of the instrument could fall within a range depending on the inputs or the model used, and the choice of inputs and models might involve significant judgement. Disclosure of the judgements made helps users understand the significance of those judgements.
 - complexity,
The more complex an instrument, the more likely that it is difficult to value. Consequently, more detailed disclosure helps users understand the fair value measurement.
 - volatility.
Instruments that are subject to large movements in value or in bid-offer spreads will be of particular interest to users. The volatility might indicate a disturbance in the market that should be specifically commented upon.
41. If the cash flows of an instrument are generated from or secured by specific underlying assets, information about matters affecting the current value of those assets will help users to understand the reported value of the instrument.
42. When financial instruments are valued for inclusion in a financial report prepared under IFRS, IFRS 7 requires specific disclosures depending upon where the instrument is classified within the valuation hierarchy, see IVS 201.01 *Fair Value under International Financial Reporting Standards*.
- Effective Date**
43. This standard is effective from ## ## 2011, although earlier adoption is encouraged.

Glossary of Terms for the International Valuation Standards

This glossary contains definitions of words or terms that are used in more than one standard, and that have a specific or restricted meaning in these standards. Words and terms defined in this glossary appear in italics in text of the standards. Words or terms that are only used in one standard are defined within that standard.

Basis of value – is a statement of the fundamental measurement assumptions of a valuation.

Cost approach – is an approach to estimating value based on the economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility, whether by purchase or by construction.

Depreciated replacement cost – is the current cost of replacing an asset with its modern equivalent asset less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.

Direct market comparison approach – is an approach to estimating value using comparison of the subject asset with the price, or a proxy for price, of other similar assets or liabilities.

Fair value – is the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that properly reflects the respective interests of those parties.

Finance lease - a lease that transfers substantially all the risks and rewards incidental to ownership of an asset.

Goodwill - is any future economic benefit arising from a business or a group of assets which is not separable from the business or group of assets in its entirety.

Income approach – is an approach to estimating value by applying an appropriate yield, or discount rate, to a projected income stream to arrive at a capital value.

Intangible asset - is a non-monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and economic benefits to its owner.

Investment property – is property that is land or a building, or part of a building, or both, held by the owner to earn rentals or for capital appreciation, or both, rather than for:

- (c) use in the production or supply of goods or services or for administrative purposes,
or
- (d) sale in the ordinary course of business.

Investment value – is the value of an asset to the owner or a prospective owner.

Market rent - is the estimated amount for which a property would be leased on the *valuation date* between a willing lessor and a willing lessee on appropriate lease terms in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

Market value - is the estimated amount for which an asset or liability should exchange on the *valuation date* between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

Real estate – is land and all things that are a natural part of the land, eg, trees and minerals, things that have been attached to the land, eg, buildings and site improvements, all permanent building attachments, eg, mechanical and electrical plant providing services to a building, that are both below and above the ground.

Real property – all rights, interests and benefits related to the ownership of *real estate*.

Special assumption – is an assumption that either assumes facts that differ from the actual facts existing at the *valuation date* or that would not be made by a typical market participant in a transaction on the *valuation date*.

Special purchaser - is a particular buyer, or a restricted class of buyers, for whom a particular asset has *special value* because of advantages arising from its ownership that would not be available to general purchasers in the market.

Special value - is an amount that reflects particular attributes of an asset or liability that are only of value to a *special purchaser*.

Specialised property - a property that is rarely if ever sold in the market, except by way of sale of the business or entity of which it is part, due to uniqueness arising from its specialised nature and design, its configuration, size, location or otherwise

Synergistic value - is an additional element of value created by the combination of two or more interests where the value of the combined interest is worth more than the sum of the original interests.

Trade related property – A *trade related property* is any type of *real property* designed for a specific type of business where the property value reflects the trading potential for that business.

Valuation date – is the date on which the estimate of value applies.