



INTERNATIONAL VALUATION STANDARDS COUNCIL

# IVS 300: PLANT AND EQUIPMENT

## EXPOSURE DRAFT

*Publication date: 2 June 2016*

Comments on this Exposure Draft are invited before 31 August 2016. All replies may be put on public record unless confidentiality is requested by the respondent. Comments may be sent as email attachments to:

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## **Introduction to Exposure Draft**

### **Why is the International Valuation Standards Board (IVSB) issuing IVS 300 Plant and Equipment?**

In October 2015 the IVSC published its *Purpose and Strategy Document* which stated that the priority of the IVSC is to expand the quality and depth of International Valuations Standards (IVS) and ensure they are fit for purpose and provide much needed clarity and market efficiency.

### **What are the Main Provisions?**

The main provisions of this chapter are:

- a) an overview of plant and equipment and the circumstances in which they are valued,
- b) a framework for the selection and application of approaches and methodologies for the valuation of plant and equipment, and
- c) a discussion of special topics related to the valuation of plant and equipment including financing arrangements and forced sale.

### **How do the Proposed Provisions Compare with IVS 2013?**

This chapter includes elements from IVS 2013 that were included in IVS 220 *Plant and Equipment*. Some of the concepts from IVS 2013 have been clarified and/or expanded upon in this Exposure Draft, but the majority of the content has remained the same. Sections have been added relating to selection and application of approaches and methodologies

## Questions for Respondents

The Board invites individuals and organisations to comment on all matters in this proposed update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

- (a) In IVS 2013, all substantive portions of IVS 220 *Plant and Equipment* were labelled as “commentary” (except for scope and effective date). This label seems to have created some confusion amongst stakeholders as to whether the standard was mandatory. The Board’s position is that all aspects of IVS 2017 should be mandatory and this Exposure Draft has removed the “commentary” label for clarity. Do you agree with the removal of the commentary label?
- (b) The Board believes that the standard presented in this Exposure Draft can be applied in the valuation of plant and equipment regardless of the purpose of the valuation (secured lending, sales of plant and equipment, taxation, litigation, insolvency proceedings and financial reporting etc.). Do you agree? If not, for what purpose(s) do you believe this standard cannot be applied? Why?
- (c) Are there any further topics that you feel the Board should add or remove from IVS 300 *Plant and Equipment*? If so, what are they and what is your rationale?

## IVS 300 Plant and Equipment

### 10. Introduction

- 10.1. The principles contained in the General Standards apply to valuations of plant and equipment. This standard only includes modifications, additional requirements or specific examples of how the General Standards apply for valuations to which this standard applies.

### 20. Overview

- 20.1. Items of plant and equipment (sometimes referred to as personal property) are tangible assets that are held by an entity for use in the production or supply of goods or services, for rental by others or for administrative purposes and that are expected to be used over a period of time. The right to use an item of plant and equipment (such as a right arising from a lease) would also follow the requirements of this chapter.

- 20.2. 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. When there is an intangible asset component valuer should also follow IVS 210 *Intangible Assets*.

- 20.3. A valuation of plant and equipment will normally require consideration of a range of factors relating to the asset itself, its environment and its economic potential. Examples of factors that may need to be considered under each of these headings include the following:

(a) Asset related:

1. the asset's technical specification,
2. the remaining physical life,
3. the asset's condition, including maintenance history,
4. if the asset is not valued in its current location, the costs of decommissioning and removal, and
5. any potential loss of a complementary asset, eg the operational life of a machine may be curtailed by the length of lease on the building in which it is located.

(b) Environment related:

1. the location in relation to source of raw material and market for product. The suitability of a location may also have a limited life, eg where raw materials are finite or where demand is transitory, and
2. the impact of any environmental or other legislation that either restricts utilisation or imposes additional operating or decommissioning costs.

(c) Economic related:

1. the actual or potential profitability of the asset based on comparison of running costs with earnings or potential earnings,
  2. the demand for the product from the plant and equipment with regard to both macro and micro economic factors that could impact on demand, and
  3. the potential for the asset to be put to a more valuable use than the current use.
- 20.4. To comply with the requirement to identify the asset or liability to be valued in IVS 101 *Scope of Work*, para 20.3 (d), consideration shall be given to the degree to which the item of plant and equipment is attached to or integrated with other assets. For example:
- (a) assets may be permanently attached to the land and could not be removed without substantial demolition of either the asset or any surrounding structure or building,
  - (b) an individual machine may be part of an integrated production line where its functionality is dependent upon other assets.

In such cases it will be necessary to clearly define what is to be included or excluded from the valuation. Any necessary assumptions or special assumptions relating to the availability of any complementary assets shall also be stated, see also para 20.3 below.

- 20.5. Plant and equipment connected with the supply or provision of services to a building are often integrated within the building and once installed are not separable from it. These items will normally form part of the real property interest. Examples include plant with the primary function of supplying electricity, gas, heating, cooling or ventilation to a building and equipment such as elevators. If the purpose of the valuation requires these items to be valued separately the scope of work shall include a statement to the effect that the value of these items would normally be included in the real property interest and may not be separately realisable. When different valuation assignments 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.
- 20.6. Because of the diverse nature and transportability of many items of plant and equipment, additional assumptions will normally be required to describe the state and circumstances in which the assets are valued. In order to comply with IVS 101 *Scope of Work*, para 20.3 (k) these must be considered and included in the scope of work. Examples of assumptions that may be appropriate in different circumstances include:
- (a) that the plant and equipment assets are valued as a whole, in place and as part of the business, considered as a going concern,
  - (b) that the plant and equipment assets are valued as a whole, in place but on the assumption that the business is closed, and
  - (c) that the plant and equipment assets are valued as individual items for removal from their current location.
- 20.7. In some 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.

- 20.8. In addition to the minimum requirements in IVS 103 *Reporting*, a valuation report on plant and equipment shall include appropriate references to matters addressed in the scope of work in accordance with paras 20.1 to 20.3 above. The report shall also include comment on the effect on the reported value of any associated tangible or intangible assets excluded from the valuation, eg operating software for a machine or a continued right to occupy the land on which the item is situated.
- 20.9. Valuations of plant and equipment are often required for different purposes including secured lending, sales of real property, taxation, litigation, insolvency proceedings and financial reporting.

### **30. Basis of Value**

- 30.1. In accordance with IVS 104 *Bases of Value*, a valuer must select the appropriate basis(es) of value when valuing plant and equipment.
- 30.2. Using the appropriate basis(es) of value and associated premise of value (see IVS 104 *Bases of Value*, sections 140–180) is particularly crucial in the valuation of plant and equipment because differences in value can be pronounced depending on whether an item of plant and equipment is valued under an “in use” premise, orderly liquidation, or forced liquidation. The value of highly specialised equipment is particularly sensitive to different premises of value.
- 30.3. An example of forced liquidation conditions is where the assets have to be removed from a property in a timeframe 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 within the available time limit.

### **40. Valuation Approaches**

- 40.1. The three principal valuation approaches described in the IVS can all be applied to the valuation of plant and equipment assets.

### **50. Market Approach**

- 50.1. For classes of plant and equipment that are homogenous, eg motor vehicles and certain types of office equipment or industrial machinery, the market approach is commonly used as there is sufficient data of recent sales of similar assets. However, many types of plant and equipment are specialised and direct sales evidence for such items will not be available, necessitating the use of either the income approach or the cost approach.

### **60. Income Approach**

- 60.1. The income approach to the valuation of plant and equipment can be used where specific cash flows can be identified for the asset or a group of complementary assets, eg where a group of assets forming a process plant is operating to produce a marketable product. However, some of the cash flows may be attributable to intangible assets and difficult to separate from the cash flow contribution of the plant and equipment. Use of the income approach is not normally practical for many individual items of plant or equipment.
- 60.2. When an income approach is used to value plant and equipment, the valuation must consider the cash flows expected to be generated over the life of the asset(s) as well as the value of the asset at the end of its life. The value of the asset at the end of its life might

be an asset (sometimes called salvage value) or a liability (sometimes called an asset retirement obligation or ARO).

## 70. Cost Approach

- 70.1. The cost approach is commonly adopted for plant and equipment particularly in the case of individual assets that are specialised. This is done by calculating the depreciated replacement cost of the asset. The cost to a market participant of replacing the subject asset is estimated. The replacement cost is the cost of obtaining an alternative asset of equivalent utility; this can either be a modern equivalent providing the same functionality or the cost of reproducing an exact replica of the subject asset. The latter is only appropriate where the cost of a replica would be less than the cost of a modern equivalent or where the utility offered by the subject asset could only be provided by a replica rather than a modern equivalent.
- 70.2. An entity's actual costs incurred in the construction/creation of an asset may be appropriate for use as the replacement cost of an asset under certain circumstances. However, prior to using such historical cost information, the valuer should consider the following.
- (a) Timing of the historical expenditures: An entity's actual costs may not be relevant as of the valuation date if they were not incurred recently due to changes in market prices, inflation/deflation, or other factors.
  - (b) The basis of value: Particularly for bases of value that assume a transaction between market participants, an entity's own costs incurred may not be an appropriate measure of value. For example, an asset that is only or primarily useful to a particular entity may have very little value to market participants. In addition, for some bases of value, some amount of profit margin on costs incurred may be appropriate.
  - (c) Specific costs included: A valuer must understand all of the costs that have been included and whether those costs contribute to the value of the asset.
- 70.3. Having established the replacement cost, deductions must be made to reflect the physical, functional and economic obsolescence of the subject asset when compared to the alternative asset that could be acquired at the replacement cost (see IVS 105 *Valuation Approaches and Methods*, section 90).
- 70.4. One way to quantify functional and economic obsolescence is to use the cost-to-capacity method depending on the cause of the obsolescence.

### *Cost-to-Capacity Method*

- 70.5. Under the cost-to-capacity method the replacement cost of an asset with an actual or required capacity can be determined by reference to the cost of a similar asset with a different capacity.
- 70.6. The cost-to-capacity method is generally used in one of two ways:
- (a) estimate the replacement cost for an asset with one capacity where the replacement costs of an asset or assets with a different capacity are known, or
  - (b) estimate the replacement cost for a modern equivalent asset with capacity that matches foreseeable demand where the subject asset has

excess capacity (as a means of measuring the penalty for the lack of utility to be applied as part of an economic obsolescence adjustment).

#### **80. Special Considerations for Plant and Equipment**

- 80.1. Section 90 Financing Arrangements addresses a non-exhaustive list of topics relevant to the valuation of plant and equipment.

#### **90. Financing Arrangements**

- 90.1. Generally, the value of an asset is independent of how it is financed. However, in some circumstances the way items of plant and equipment are financed and the stability of that financing may need to be considered in valuation.
- 90.2. An item of plant and equipment may be subject to a financing arrangement. 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. Depending upon the purpose of the valuation it may be appropriate to identify any encumbered assets and to report their values separately from the unencumbered assets.
- 90.3. 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.

## **IVS 300 Plant and Equipment: Basis for Conclusions**

*The basis for conclusions do not form part of IVS 2017 and will not be included in the finalised document, but have been drafted to provide the reader with the rationale behind certain changes made within this Exposure Draft. The Board feels that the inclusion of this section is a necessary part of the consultative process and is in line with the recommendation contained within the IVS Purpose and Strategy Document requirement that “standards need sufficient consultation” and that the IVSC should be “operating in an open and transparent way”.*

In October 2015 IVSC published their *Purpose and Strategy Document* which stated that the priority of the IVSC is to expand the quality and depth of IVS and ensure they are fit for purpose and provide much needed clarity and market efficiency.

The Board has changed the numbering of many of the asset standards to allow for more flexibility in future standard-setting activities. As a result, this chapter, which was IVS 220 in IVS 2013 has been re-numbered to IVS 300. Furthermore, the numbering within the chapter has been revised so that there is more consistency in the format of standards between the various asset standards. The new format for the various asset standards will be as follows:

- Section 10: Overview
- Section 20: Introduction
- Section 30: Bases of Value
- Section 40: Valuation Approaches and Methods
- Section 50: Market Approach
- Section 60: Income Approach
- Section 70: Cost Approach
- Section 80 (and thereafter): Special Considerations

Discussions with stakeholders indicated that there was a significant amount of confusion related to what content represented mandatory standards versus what content represented non-mandatory commentary. The Board notes that in IVS 220 (like many other IVS 2013 standards), all substantive portions of the standard were labelled as “commentary” with the exception of the scope and effective date sections. This Exposure Draft has eliminated the “commentary” label to make it clear that the contents are mandatory for compliance with IVS.

The Board believes that one of the primary purposes of standards is to reduce diversity in practice. The IVSC performed outreach to stakeholders and identified several areas of diversity in practice related to the valuation of real property interests. As a result of that outreach, this Exposure Draft includes new requirements related to:

- an overview of plant and equipment and the circumstances in which they are valued, and
- the selection of valuation approaches and methodologies.