

Staff Draft

Proposed Revised International Valuation Standards

Issued 14 February 2010

This is the near final version of the standards that will be considered by the IVSB at its meeting on 4 March. It has been prepared by IVSC staff to reflect tentative decisions made by the Board following the consultation process but is subject to final agreement and approval by the Board. The objective of the Board is to approve the document for publication on 4 March after agreeing any final amendments.

It is released for information purposes only, and should not be relied upon as representing the finally approved document, or giving any indication of the final decision of the Board in relation to any matter.

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International Valuation Standards

Introduction

The International Valuation Standards Board (IVSB) is the standard-setting body of the International Valuation Standards 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).

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.

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,
- (c) conducts outreach activities including round table discussions with invited constituents and targeted discussions with specific users or user groups.

The IVSB is subject to oversight by the Board of Trustees of the IVSC to ensure that it acts in the public interest.

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 processes and reporting disclosures for the major purposes for which valuations are required,

- (d) identify specific matters 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.

The material in these standards meets at least one of the above criteria.

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.

Assets and Liabilities

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.

Critical Review Recommendations

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, the former 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 in 2007 and comments invited on its recommendations. The IVSB has accepted most of 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.

Structure

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

IVS Definitions

This contains those words or phrases that have a specific meaning in the context of the standards and that appear in more than one standard. Definitions that are only used in a single standard are only defined in that standard.

IVS Framework

The IVS Framework contains generally accepted valuation concepts and principles upon which the International Valuation Standards are based and that are to be considered and applied when following the standards.

General Standards

The three General Standards have general application for all valuation purposes, subject only to variations or additional requirements specified in the Asset Standards or the Valuation Applications. The General Standards are IVS 101 *Scope of Work*, IVS 102 *Implementation* and IVS 103 *Reporting*.

Asset Standards

The Asset Standards consist of a standard and a commentary. The standard sets out requirements that either modify or are additional to those in the General Standards and examples of how the principles in the General Standards are applied to the particular asset class. The commentary provides additional background information that describes the characteristics of each asset type that influence value, and identifies the common valuation approaches and methods used for their valuations. There are Asset Standards for Businesses, Intangible Assets, and Tangible Assets including Real Property, Plant and Equipment and Financial Instruments.

Valuation Applications

Valuation Applications are produced for two of the most common purposes for which valuations are required, financial reporting and secured lending. Each Application contains a standard and guidance. The standard includes any additional requirements to those appearing in the General Standards, any amendments to the General Standards and illustrations of how the principles in the General Standards and Asset Standards apply when undertaking valuations for that purpose. The guidance section provides an indication of common requirements for each application and typical valuation procedures and assumptions to meet those requirements.

Effective Dates

The effective date for each standard is shown in the standard. All standards are subject to revision and review. Although for convenience, printed and bound copies of the standards approved at a given date are published at regular intervals, the definitive version of the standards is published on the IVSC web site www.ivsc.org.

Changes from Previous Editions

The implementation of most of the Critical Review Group's recommendations and of a far more rigorous and extensive due process than has previously been undertaken has led to this edition being radically different in layout from earlier editions, although all the important principles have been retained. Because of this it is impractical to list every change that has been made. Among the more significant changes are:

Eliminating repetition:

To make the standards more accessible there was a need to reduce the length and apparent complexity. Merging material that previously appeared in different parts of IVS 2007 revealed significant repetition of the same concepts, eg the discussions on *market value* appearing in both GAVP and IVS 1. This has been avoided in the new edition.

Eliminating Methodology:

Two Guidance Notes in IVS 2007 on the Cost Approach (GN8) and Discounted Cash Flow (GN9) are discussions on the use and application of specific valuation techniques that fall outside the criteria for inclusion in the standards. In the new standards approaches and methods are defined and explained at high level but no detail is provided on their application. In future IVSC will publish technical papers on methodology separately from the standards. The former GN8 and GN9 are being reviewed by the IVSC Professional Board and draft Technical Information Papers (TIPs) have been published on these topics. Further TIPs are planned and details of the IVSC's current work plan can be found at www.ivsc.org.

Eliminating the Code of Ethics

IVSC is a valuation standard setter. Ethical behaviour is a vital component of valuation practice but accrediting and regulating individual valuers is a matter for those adopting the standards. Valuer regulation also takes many forms in different sectors and states. Including a Code of Ethics in standards that are intended to be capable of mandatory application created an obstacle to their adoption because the code inevitably differed in detail from those used by others. The Code of Ethics that appeared in earlier editions has therefore been removed although the IVSC Professional Board has a project to develop a model Code of Ethics to act as a benchmark for other codes and to assist the development of the profession in emerging economies.

Glossary.

In the current edition of the IVS the Glossary accounts for over a quarter of the book. This included many terms that are not used in the standards and superfluous definitions where the IVS definition was no different to the common dictionary meaning of the word or words.

In the new edition there is no Glossary, only a short list of definitions used in the standards themselves to assist in their interpretation. This is limited to words and terms that are used with a particular meaning that is not necessarily clear from their everyday or common usage. A comprehensive Glossary of common valuation terms is under development by the Professional Board but will not form part of the standards.

Reducing Prescription

In previous standards there has been a tendency to make prescriptive requirements that were too detailed for practical application across a wide range of global valuation practice. The new standards focus on the required principles, illustrated as necessary with examples, in order to enable them to be applied as widely as possible.

Changes by Section

Although detailed text changes cannot be individually referenced, the more significant changes from IVS 2007 on a section by section basis are summarised below:

IVS 2007

Ninth Edition

Concepts Fundamental to Generally Accepted Valuation Principles (GAVP)

The generic valuation principles have been carried forward into the IVS Framework. Other material discussing market value and land and property has been merged into IVS 230 *Real Property Interests*.

Code of Conduct

Removed – see above.

Property Types

Not directly replicated. Some elements included in individual asset standards.

Introduction to IVS 1,2,3

Not directly replicated. Elements included in IVS Framework and IVS 103 *Reporting*.

IVS 1 Market Value and IVS 2 Other Bases of Value

Merged into IVS Framework.

IVS 3 Valuation Reporting

Principles carried forward into IVS 103 *Reporting*.

IVA 1 Valuations for Financial Reporting

Now included in IVS 300 *Valuations for Financial Reporting*. The material has been updated and a clear distinction is now made between the valuation standard and guidance on the valuations needed to meet specific accounting requirements.

IVA 2 Valuations for Secured Lending

Made specific to real property and carried forward to IVS 310 *Valuations of Property Interests for Secured Lending*. The distinction between the valuation standard and guidance has been made clear and there have been other minor changes.

IVS 2007

Ninth Edition

IVA 3 Valuation of Public Sector Assets for Financial Reporting

Now forms annexe to IVS 300 *Valuations for Financial Reporting*.

GN1 Real Property Valuation and GN2 Lease Interests

Elements carried forward and merged into IVS 230 *Real Property Interests*.

GN3 Valuation of Plant and Equipment

Updated and carried forward to IVS 220 *Plant and Equipment*.

GN4 Valuation of Intangible Assets.

This was replaced by a revised and extended GN4 published in February 2010. This contained comprehensive guidance on intangible assets. The new standard IVS 210 *Intangible Assets* is based on the revised GN4, but the more detailed guidance has been omitted. This is being incorporated into a separate Technical Information Paper.

GN5 Valuation of Personal Property

No equivalent in new standards. The definition of personal property in the previous standards was very broad and covered many asset classes that are now the subject of more specific standards.

GN6 Business Valuation

Updated standards for business valuation are in IVS 200 *Businesses and Business Interests*.

GN7 Consideration of Hazardous and Toxic Materials

This topic is just one of many that potentially affect an asset's value. No other topics have been highlighted in previous IVS. Not carried forward.

GN8 Cost Approach and GN9 Discounted Cash Flow

These are discussions on valuation methods and do not meet the criteria for inclusion in the standards. The IVSC is producing revised Technical Information Papers on these and other methods.

GN10 Valuation of Agricultural Property

Not being carried forward as the previous standard contained no procedures that differed from other real property types.

GN11 Reviewing Valuations

The scope of and the limitations on any valuation assignment are now covered generically in IVS 101 *Scope of Work*. Not carried forward.

GN12 Valuation of Trade Related Property

Updated and carried forward as IVS 232 *Trade Related Property*.

GN13 Mass Appraisal for Property Taxation

Not being carried forward as it contains no valuation procedures that differ from the General Standards.

IVS 2007

Ninth Edition

GN14 Valuations of Properties
in Extractive Industries

A comprehensive project on valuations in the Extractive Industries
is about to commence and will probably lead to a new standard and
or Technical Guidance. Not carried forward.

GN15 Valuation of Historic
Property

Carried forward as annexe to IVS 230 *Real Property Interests*.

DRAFT

DEFINITIONS

IVS DEFINITIONS

The definitions below are of words or phrases used in the IVS Framework, the General Standards or in more than one Asset Standard or Valuation Application that have a specific or limited meaning. These terms are italicised in the text.

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

Cost approach– the cost approach estimates value using 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.

Fair value – 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.

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

Goodwill - any future economic benefit arising from a business or from the use of an asset or a group of assets which is not separable from the business, the asset or group of assets.

Income approach – the *income approach* estimates value by converting future cash flows to a single current capital value.

Intangible asset - 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 – 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.

Investment value –the value of an asset to the owner or a prospective owner for individual investment or operational objectives.

Market Approach - the *market approach* estimates value by comparison between the subject asset and the prices of identical or similar assets.

DEFINITIONS

Market rent - 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 - 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 – land and all things that are a natural part of the land, eg, trees, minerals and things that have been attached to the land, eg, buildings and site improvements and 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 – an assumption that either assumes facts that differ from the actual facts existing at the date that the report is prepared or that would not be made by a typical market participant in a transaction on the *valuation date*.

Special purchaser - a particular buyer for whom a particular asset has *special value* because of advantages arising from its ownership that would not be available to other buyers in a market.

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

Synergistic value - 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 – 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.

FRAMEWORK

IVS Framework

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FRAMEWORK

The IVS Framework includes generally accepted valuation concepts, principles and definitions upon which the International Valuation Standards are based. This framework should be considered and applied when following the individual standards and valuation applications.

Valuation and Judgement

1. Applying the principles in these standards to specific situations will require the exercise of judgement. That judgement must be applied objectively and should not be used to overstate or understate the valuation result. Judgement shall be exercised having regard to the purpose of the valuation, the *basis of value* and any other assumptions applicable to the valuation.

Independence and Objectivity

2. The process of valuation requires the valuer to make impartial judgements as to the reliance 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 on the process.
3. Many states have laws or regulations that only allow certain persons to value particular classes of assets for various purposes. Additionally, 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 principles and definitions for the preparation and reporting of valuations. They do not include regulations on the relationship between those commissioning valuations and those undertaking them, as matters relating to the conduct and ethical behaviour of valuers is for professional bodies or other bodies that have a regulatory role over valuers.
4. While specific 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 necessary 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

5. 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.

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6. 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 101 *Scope of Work*).

Price, Cost and Value

7. Price is 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 may be different from the value which might be ascribed to the goods or services by others.
8. 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.
9. Value is not a fact but an estimate of either:
 - a) the most probable price to be paid for goods and services in an exchange or,
 - b) a measure of the economic benefits of owning those goods or services.

A value in exchange is a hypothetical price and the hypothesis on which the value is estimated is determined by the purpose of the valuation. A value to the owner is an estimate of the benefits that would accrue to a particular owner or beneficiary of the goods or services.
10. 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

11. 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.

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12. In order to estimate the most probable 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 *valuation 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.
13. 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.
14. 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 *valuation date* and to which most participants in that market, including the current owner, normally have access.
15. 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 the most probable 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.

FRAMEWORK

Market Activity

16. 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.
17. 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 may be 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 are likely to have in mind a price at which they would be prepared to enter the market.
18. Price information from an inactive market may still be evidence of *market value*. A period of falling prices is likely to see both decreased levels of activity and an increase in sales that can be termed forced (see paras 53 to 55 below). However, there are sellers in falling markets that are not acting under duress and to dismiss the evidence of prices realised by such sellers would be to ignore the realities of the market.

Market Participants

19. References in IVS to market participants are to the whole body of individuals, companies or other entities that are involved in actual transactions or who are contemplating entering into a transaction for a particular type of asset. The willingness to trade and any views attributed to market participants are typical of those of buyers and sellers, or prospective buyers and sellers, active in a market on the *valuation date*, not to those of any particular individual or entity.
20. In undertaking a market based valuation, matters that are specific to the current owner are not relevant because the willing seller is a hypothetical individual or 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 market participants generally.

Entity Specific Factors

21. The factors that are specific to a particular buyer or seller 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 market participants include the following:

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- (a) additional value derived from the 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.
22. 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. For example, an asset may not normally be transacted as a stand-alone item but as part of a group. Any synergies with related assets would transfer to market participants along with the transfer of the group and therefore are not entity specific.
23. 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) supporting investment decisions,
 - (b) reviewing the performance of an asset.

Aggregation

24. 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.
 - (e) interdependent land, buildings, plant and other equipment employed in a business enterprise.
25. 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 of assets that is to be valued or each of the assets individually. If the latter, it is also important to establish whether each asset is assumed to be valued:

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- (a) as an individual item but assuming that the other assets are available to a buyer or
- (b) as an individual item but assuming that the other assets are not available to a buyer.

Basis of Value

26. A *basis of value* is a statement of the fundamental measurement assumptions of a valuation.
27. 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 in specific circumstances.
28. A *basis of valuation* can fall into one of three principal categories:
- (a) The first is to estimate the most probable price that would be achieved in a hypothetical exchange in a free and open market. *Market value* as defined in these standards 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 these standards 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 these standards falls into this category.

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29. 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 of value* 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 (IFRS) and other accounting standards.

Market Value

30. *Market value* is the estimated amount for which an asset 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.
31. 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 the most probable price reasonably obtainable in the market on the *valuation date* in keeping with the *market value* definition. It is the best price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer. 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 *valuation date*.
 - c) "on the *valuation date*" requires that the *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.

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- 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*.

FRAMEWORK

- 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 *valuation date*. 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 *valuation date*, 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.
32. 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 paras 16 to 20 above).
33. 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.
34. The highest and best use of an asset valued on a stand-alone basis may be different from its *highest and best use* as part of a group, when its contribution to the overall value of the group must be considered.
35. 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.

FRAMEWORK

- (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

36. *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

37. *Investment value* is the value of an asset to the owner or a prospective owner for individual investment or operational objectives.
38. 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

39. *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.
40. The definition of fair value in IFRS is different from the above. The IVSB considers that the definitions of fair value in IFRS are generally consistent with *market value*. The definitions and application of fair value under IFRS are discussed in IVS 300 *Valuations for Financial Reporting*.
41. 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. It is commonly applied in judicial contexts. In contrast, *market value* requires any advantages that would not be available to market participants generally to be disregarded.

FRAMEWORK

42. *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.
43. 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

44. *Special value* is an amount that reflects particular attributes of an asset that are only of value to a *special purchaser*.
45. A *special purchaser* is a particular buyer for whom a particular asset has *special value* because of advantages arising from its ownership that would not be available to other buyers in the market.
46. *Special value* can arise where an asset has attributes that make it more attractive to a particular buyer than to other 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.
47. When *special value* is identified, it should be reported and clearly distinguished from *market value*.
48. *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. If the synergies are only available to one specific buyer then it is an example of *special value*.

Assumptions

49. In addition to stating the *basis of value*, it is often necessary to make an assumption or multiple assumptions to clarify either the state of the asset in the hypothetical exchange or the circumstances under which the asset is assumed to be exchanged. Such assumptions can have a significant impact on value.

FRAMEWORK

50. Examples of additional assumptions in common use include, without limitation:
- an assumption that a business is transferred as a complete operational entity,
 - an assumption that assets employed in a business are transferred without the business, either individually or as a group,
 - an assumption that an individually-valued asset is transferred together with other complementary assets (see paras 24 and 25 above),
 - an assumption that a holding of shares is transferred either as a block or individually,
 - an assumption that a property that is owner-occupied is vacant in the hypothetical transfer.
51. Where an assumption is made that assumes facts that differ from those existing at the date on which the report is prepared, it becomes a *special assumption* (see IVS 101 *Scope of Work*). *Special assumptions* are often used to illustrate the effect of possible changes on the value of an asset. They are designated as “special” so as to highlight to a valuation user that the valuation conclusion is contingent upon a change in the current circumstances or that it reflects a view that would not be taken by market participants generally on the *valuation date*.
52. Assumptions and *special assumptions* must be reasonable and relevant having regard to the purpose for which the valuation is required.

Forced Sales

53. The term “forced sale” is often used in circumstances where a seller is under compulsion to sell and that, as consequence, a proper marketing period is not possible. 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 may 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 *basis of value*.

FRAMEWORK

54. If an estimate of the price obtainable under forced sale circumstances 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*.
55. Sales in an inactive or falling market are not automatically “forced sales” simply because a seller might hope for a better price if conditions improved. Unless the seller is compelled to sell by a deadline that prevents proper marketing, the seller will be a willing seller within the definition of *market value* (see paras 18 and 31(d)) above).

Valuation Approaches

56. One or more valuation approaches may be used in order to arrive at the valuation defined by the appropriate *basis of value* (see paras 26 to 29 above). The three approaches described and defined in this Framework are the main approaches used in valuation. They all are based on the economic principles of price equilibrium, anticipation of benefits or substitution.

Market Approach

57. The *market approach* estimates value by comparison between the subject asset and the prices of identical or similar assets.
58. Under this approach the first step is to consider the prices for transactions of identical or similar assets that have occurred recently in the market. If few recent transactions have occurred, it may also be appropriate to consider the prices of identical or similar assets that are listed or offered for sale provided the relevance of this information is clearly established and critically analysed. It may be necessary to adjust the price information from other transactions to reflect any differences in the terms of the actual transaction and the *basis of value* and any assumptions to be adopted in the valuation being undertaken. There may also be differences in the legal, economic or physical characteristics of the assets in other transactions and the asset being valued.

Income Approach

59. The *income approach* estimates value by converting future cash flows to a single current capital value.

FRAMEWORK

60. This approach considers the income that an asset will generate over its useful life and estimates value through a capitalisation process. Capitalisation involves the conversion of income into a capital sum through the application of an appropriate discount rate. The income stream may be derived under a contract or contracts, or be non-contractual, eg, the anticipated profit generated from either the use of or holding of the asset.
61. Methods that fall under the *income approach* include:
- income capitalisation, where an all risks or overall capitalisation rate is applied to a representative single period income,
 - discounted cash flow where a discount rate is applied to a series of cash flows for future periods to discount them to a present value,
 - various option pricing models.
62. The *income approach* can be applied to liabilities by considering the cash flows required to service a liability until it is discharged.

Cost Approach

63. The *cost approach* estimates value using 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.
64. This approach is based on the economic principle that the price that a buyer in the market would pay for the asset being valued would, unless undue time, inconvenience, risk or other factors are involved, be not more than the cost to purchase or construct a modern equivalent asset. Often the asset being valued will be less attractive than the alternative that could be purchased or constructed because of age or obsolescence. Where this is the case, adjustments will need to be made to the cost of the alternative asset.

Methods of Application

65. Each of these principal valuation approaches includes different detailed methods of application. Various methods that are commonly used for different asset classes are discussed in the Asset Standards.

Valuation Inputs

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

FRAMEWORK

67. Examples of actual inputs include:

- prices achieved for identical or similar assets,
- actual cash flows generated by the asset,
- the actual cost of identical or similar assets.

68. Examples of assumed inputs include:

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

69. Greater reliance will normally be placed on actual inputs; however, where these are less relevant, eg, where the evidence of actual transactions is dated, historic cash flows are not indicative of future cash flows or the actual cost information is historic, assumed inputs will be more relevant.

70. The nature and source of the valuation inputs should reflect the *basis of value*, which in turn depends on the valuation purpose. For example, various approaches and methods may be used to estimate *market value* providing they use market derived data. The *market approach* will by definition use market derived inputs. To estimate *market value* the *income approach* should be applied using inputs and assumptions that would be adopted by market participants. To estimate *market value* using 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 the available data and the circumstances relating to the market for the asset being valued will determine which valuation methods are most relevant and appropriate, the outcome should be *market value* if each method is based on appropriately analysed market derived data.

71. Valuation approaches and methods are generally common to many types of valuation. However, valuation of different types of assets involves different sources of data that must 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.

GENERAL STANDARDS

IVS 101 Scope of Work

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General Principle

1. There are many different types and levels of valuation advice that may be provided. IVS are designed to apply to a wide spectrum of valuation assignments. A valuation must be appropriate for its intended purpose and it is also important that the recipient understands what is to be provided and any limitations on the use of the valuation. It is therefore important that a scope of work is prepared that sets out the agreed purpose of the valuation, the extent of investigation, procedures that will be adopted, assumptions that will be made and the limitations that will apply. The scope of work may be prepared at the outset or during the progress of the valuation assignment but before the valuation and report are finalised.

Requirements

2. A scope of work shall be prepared and confirmed in writing that addresses the matters set out below. For certain asset classes or applications there may be variations from this standard or additional matters to be included or considered in preparing the scope of work. These are found in the relevant Asset Standard or Valuation Application.

(a) Identification and status of the valuer

A statement confirming:

- i) The identity of the valuer. The valuer may be an individual or firm;
- ii) That the valuer is in a position to provide an objective and independent valuation;
- iii) Whether the valuer has any material connection or involvement with the subject of the valuation or the party commissioning the valuation.
- iv) That the valuer is competent to undertake the valuation. If the valuer needs to seek assistance from others in relation to any aspect of the assignment, the nature of such assistance and the extent of reliance shall be agreed and recorded.

GENERAL STANDARDS

(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 agreed and recorded.

(c) Purpose of the valuation

The purpose for which the valuation is being prepared shall be clearly stated, eg, the valuation is required for loan security, to support a share transfer or to support an issue of shares. The purpose of the valuation will determine the *basis of value*.

It is important that valuations are not used out of context or for purposes for which they are not intended.

(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 an asset that is utilised in conjunction with other assets, it will be necessary to clarify whether those assets are included in the valuation, excluded but assumed to be available or excluded and assumed not to be available (see *IVS Framework* paras 24 and 25).

(e) Basis of value

The valuation basis must be appropriate for the purpose. The source of the definition of any *basis of value* used shall be cited or the basis explained. The valuation bases recognised by IVS are defined and discussed in the *IVS Framework*, but other bases may be used. It may also be necessary to clarify 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 on which the valuation report is to be issued or the date on which investigations are to be undertaken or completed.

GENERAL STANDARDS

(g) Extent of investigation

Any limitations or restrictions on the inspection, inquiry and analysis for the purpose of the valuation shall be set out in the scope of work.

If relevant information is not available because the conditions of the assignment restrict the investigation, if the assignment is accepted, then these restrictions and any necessary assumptions or *special assumptions* shall be recorded in the scope of work.

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

The nature and source of any relevant information that is to be relied upon without specific verification during the valuation process shall be agreed and recorded.

(i) Assumptions and special assumptions

All assumptions and any *special assumptions* that are to be made in the conduct and reporting of the valuation shall be recorded.

Assumptions are matters that are reasonable to accept as fact in the context of the valuation assignment 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 date that the report is prepared 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. Examples of *special assumptions* include:

- that a proposed building had actually been completed on the *valuation date*;
- that a specific contract was in existence on the *valuation date* which had not actually been completed;
- That a financial instrument is valued using a yield curve that is different from that which would be used by a market participant.

Only assumptions and *special assumptions* that are reasonable and relevant having regard to the purpose for which the valuation is required shall be made.

GENERAL STANDARDS

(j) Restrictions on use, distribution or publication

Where it is necessary or desirable to restrict the use of the valuation or those relying upon it, this shall be recorded. If matters are identified that are likely to cause the valuation to be qualified, this shall also be recorded.

(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 shall 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 format of the report to be provided shall be agreed and recorded. Reference shall be made to any of the report contents specified in IVS 103 *Reporting* that are to be excluded.

Changes to Scope of Work

3. Some of the above matters may not be capable of determination until the assignment is in progress, or changes to the scope may become necessary during the course of the assignment, eg, additional information may become available or a matter emerge that requires further investigation. 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 assignment providing all matters are recorded before the assignment is completed and the valuation report is issued.
4. The effective date of this standard is #### 2011, although earlier adoption is encouraged.

GENERAL STANDARDS

IVS 102 Implementation

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General Principle

1. Valuation assignments shall be conducted in accordance with the principles set out in this standard and the terms and conditions set out in the scope of work.

Investigations

2. Investigations made during the course of a valuation assignment must be adequate having regard to the purpose for which the valuation is required and the *basis of value* to be reported.
3. Sufficient evidence shall be assembled by means such 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.
4. The purpose of the valuation, the *basis of value*, the extent and limits on the investigations and any sources of information that may be relied upon are recorded in the scope of work, see IVS 101 *Scope of Work*. If during the course of an assignment it becomes clear that the investigations included in the scope of work will not result in a credible valuation or information to be provided by third parties is either unavailable or inadequate, an appropriate revision to the scope of work shall be made.

GENERAL STANDARDS

Valuation Approaches

5. Consideration shall be given as to the relevant and appropriate valuation approaches. The principal valuation approaches are described in the IVS Framework and methods that are commonly used to apply these approaches to different asset types are discussed in the commentaries to the Asset Standards.
6. The most appropriate valuation approach or method will depend upon consideration of the following:
 - the adopted *basis of value*, determined by the purpose of the valuation;
 - the availability of valuation inputs and data;
 - the approaches or methods used by participants in the relevant market.
7. More than one valuation approach or method is often considered to arrive at an indication of value, especially where there are insufficient factual or observable inputs for a single method to produce a reliable conclusion. Where more than one approach and method is used, the resulting indications of value should be analysed and reconciled to reach a valuation conclusion.

Valuation Record

8. A record shall be kept of the work done during the valuation process. This shall include the valuation approaches and methods used, all calculations, the key inputs, investigations, analyses, all assumptions and any *special assumptions* made in arriving at the valuation conclusion.
9. The effective date of this standard is #### 2011, although earlier adoption is encouraged.

GENERAL STANDARDS

IVS 103 Reporting

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General Principle

1. The final step in the valuation process is 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. For certain asset classes or applications there may be variations from this standard or additional requirements to be reported upon. These are found in the relevant Asset or Valuation Application.

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. The format of the report and any exclusion from the content requirements of this standard should have been agreed and recorded in the scope of work.

GENERAL STANDARDS

5. All valuation reports shall contain the information listed below. Items (a) to (k) in this list relate to matters that should be recorded in the scope of work (see IVS 101 *Scope of Work*). It is recommended that the scope of work be referenced in the report.

(a) Identification and status of the valuer

The valuer can be an individual or a firm. A statement confirming that the valuer is in a position to provide an objective and independent valuation and is competent to undertake the valuation shall be included.

The report shall include the signature of the firm or valuer responsible for the preparing the valuation report.

If the valuer has obtained assistance from others in relation to any aspect of the assignment, the nature of such assistance and the extent of reliance shall be disclosed 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) 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 an asset that is utilised in conjunction with other assets, it will be necessary to clarify whether those assets are included in the valuation, excluded but assumed to be available or excluded and assumed not to be available (see IVS Framework paras 24 and 25).

(e) Basis of value

This shall be appropriate for the purpose. The source of the definition of any *basis of value* used shall be cited or the basis explained. The valuation bases recognised by IVS are defined and discussed in the IVS *Framework*.

GENERAL STANDARDS

(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 on which the valuation report is issued or the date on which investigations are to be undertaken or completed. Where relevant, these dates shall be clearly distinguished in the report.

(g) Extent of investigation

The extent of the investigations undertaken, including the limitations on those investigations set out in the scope of work, shall be disclosed in the report.

(h) Nature and source of the information relied upon

The nature and source of any relevant information relied upon in the valuation process without specific verification by the valuer shall be disclosed.

(i) Assumptions and special assumptions

All assumptions and any *special assumptions* made shall be clearly stated.

(j) Restrictions on use, distribution or publication

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

(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 the IVS. Any such departure shall be identified, together with justification for that departure. A departure would not be justified if it results in a valuation that is misleading.

GENERAL STANDARDS

(l) Valuation approach and reasoning

To understand the valuation figure in context, the report shall make reference to the approach or approaches adopted, the key inputs used and the principal 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 valuation report shall be provided without reasons or other supporting information.

(m) Amount of the valuation or valuations

This shall be expressed as in the applicable currency

(n) Date of the valuation report

The date on which the report is issued shall be included. This may be different from the *valuation date* (see (e) above).

Post Valuation Date Events

6. If there has been a material change in either the subject of the valuation, its environment or the market conditions between the *valuation date* and the date of the report this shall be disclosed. This is not required if the purpose of the valuation requires the provision of a retrospective valuation at a historic date.
7. The effective date of this standard is #### 2011, although earlier adoption is encouraged.

ASSET STANDARDS

IVS 200 Businesses and Business Interests

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STANDARD

1. The principles contained in the General Standards apply to valuations of businesses and business interests. This standard only includes modifications, additional requirements or specific examples of how the General Standards apply for valuations to which this standard applies.

Scope of Work (IVS 101)

2. To comply with the requirement to identify the asset or liability to be valued in IVS 101 2(d), the specific interest in the business to be valued shall be recorded. This will include items such as specifying the legal structure of the business, whether it is a whole or partial interest, whether it is confined to or excludes certain assets or liabilities and the class or classes of shares involved.

ASSET STANDARDS

3. Typical assumptions or *special assumptions* that may need to be stated to comply with IVS 101 2(i) when valuing a business or business interest include:
- In the case of a partial interest, an assumption clarifying whether the owner or owners of the remaining interest(s) are either intending to sell or retain their holdings.
 - In the case of a valuation of only certain assets within a business, assumptions to clarify the availability of any complementary assets required to generate cash flows.
 - Whether certain assets or liabilities owned by the business are to be disregarded.

Implementation (IVS 102)

4. There are no additional requirements for businesses and business interests

Valuation Reporting (IVS 103)

5. There are no additional requirements for businesses and business interests other than inclusion of appropriate references to matters addressed in the scope of work in accordance with paras 2 and 3 above.

Effective Date

6. The effective date of this standard is #### 2011, although earlier adoption is encouraged.

ASSET STANDARDS

COMMENTARY

C1. In the context of this commentary, the following definitions apply.

- (a) Enterprise value – the total value of the equity in a business plus the value of its interest bearing debt and other liabilities, less any cash held.
- (b) Equity value – the value of a business to all of its shareholders.

Businesses

C2. 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.

C3. Valuations of businesses are required for different purposes including acquisitions, mergers and sales of businesses, taxation, litigation and insolvency proceedings, and financial reporting.

C4. 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

C5. The rights, privileges or conditions that attach to the ownership interest, whether held in proprietorship, corporate or partnership form, require consideration in the valuation process. Ownership rights are usually defined within a jurisdiction by legal documents such as articles of association, clauses in the memorandum of the business, articles of incorporation, bylaws, partnership agreements and shareholder agreements. Ownership interests may be of part, or share, of a business or of the entire business. In some situations it may also be necessary to distinguish between legal and beneficial ownership. Care should be taken to distinguish between rights and obligations inherent to the interest and those that may be contained in an agreement between current shareholders.

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- C6. 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 should be valued as a pro rata fraction of the entire issued share capital regardless of whether it is a controlling or 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.
- C7. A non controlling interest will normally have a lower value than a controlling interest. A majority interest is not necessarily a controlling interest. The voting and other rights attaching to the interest will be determined by the legal framework under which the entity is established. There are often different classes of equity in business, each having different rights. Where this is the case it is therefore possible that a minority interest may still have control or an effective veto over certain actions.

Business Information

- C8. The valuation of a business entity or interest frequently requires reliance upon information received from management, representatives of the management or other experts. Significant care should be taken to specify what information can be relied upon and which has to be verified, and the extent of verification required, during the valuation process when settling the scope of work, see IVS *Scope of Work* para 101 2(g).
- C9. Although the value on a given date reflects the anticipated benefits of future ownership, the history of a business is useful in that it may give guidance as to the expectations for the future.
- C10. 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.
- C11. 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 required for use in the income producing process and which ones are redundant to the business at the *valuation date*.
- C12. Businesses may have unrecorded assets or liabilities 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 identifiable intangible assets have been taken into account. The valuation of intangible assets is addressed in IVS 210 *Intangible Assets*.

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Valuation Approaches

- C13. The market and the income approaches described in the IVS Framework 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 and adequate market information is available on the entity's assets.
- C14. 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". This is not a valuation approach in its own right as the values of the individual assets and liabilities are derived using one or more of the principal valuation approaches described in the IVS Framework before being aggregated.

Market Approach

- C15. The *market approach* compares the subject business to similar businesses, business ownership interests and securities that have been exchanged in the market and any relevant transactions of shares in the same business. Prior transactions or offers for any component of the business may be also indicative of value.
- C16. The three most common sources of data used in the *market 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 shares or offers for the ownership of the subject business.
- C17. There needs to be a reasonable basis for comparison with and reliance upon similar businesses in the *market 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.
- C18. A comparative analysis of qualitative and quantitative similarities and differences between similar businesses and the subject business should be made.

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- C19. 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 ratio appropriate for the subject business. Examples include adjustments for 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 the degree of control, marketability, or the size of the holding.
- C20. Anecdotal valuation “rules” such as price to earnings ratios are frequently used by market commentators as a short cut *market approach*. However, value indications derived from the use of such rules should not be given substantial weight, ie, importance, unless it can be shown that buyers and sellers place significant reliance on them. Even where this is the case, a cross check should be undertaken using at least one other method.
- C21. 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 also used as a reasonableness check on the business valuation conclusion derived under an another approach.

Income Approach

- C22. Various methods are used to estimate value under the *income approach*. These methods include the capitalised cash flow or earnings method and the discounted cash flow method.
- C23. Income and cash flow can be measured under a variety of definitions. The income or cash flow measured can be pre tax or post-tax, although the latter is more usual. The capitalisation or discount rate applied must be consistent with the definition of income or cash flow used.
- C24. 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 market participants for similar investments and the risk inherent in the anticipated benefit stream are considered.

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- C25. In 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 which include an inflation component should be used. When the forecasted income or cash flow is expressed in real terms, ie, level prices, real rates which do not include an inflation component should be used.
- C26. 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 *market value* of the interest bearing debt is deducted from the enterprise value to determine the overall equity value. Alternatively, the equity value may be determined by measuring the equity cash flow directly. Redundant, ie non-operating, assets need to be appropriately taken into account when calculating enterprise or equity value.
- C27. 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 may help provide the necessary information to assess the risks inherent in the business operations in the context of the industry and the prospects for future performance
- C28. Adjustments may be appropriate to reflect differences between the actual historic cash flows and those that would be experienced by a buyer of the business interest on the *valuation date*. Examples include:::
- (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 comparison businesses on a consistent basis,
 - (c) to adjust non-arm's length transactions to commercial rates,
 - (d) to adjust the cost of labour or of items leased or otherwise contracted from related parties to reflect market prices or rates,
 - (e) to reflect the impact of non-recurring events from historic revenue and expense items. Examples of non-recurring events include losses caused by strikes, new plant start-up and weather phenomena. However, the forecast cash flows should reflect any non-recurring revenues or expenses that can be reasonably anticipated and past occurrences may be indicative of similar events in the future.
 - (f) to adjust the reported depreciation and tax basis to an estimate that compares to depreciation used in similar businesses,

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- (g) 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.

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IVS 210 Intangible Assets

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STANDARD

1. The principles contained in the General Standards apply to valuations of intangible assets. This standard only includes modifications, additional requirements or specific examples of how the General Standards apply for valuations to which this standard applies.

Scope of Work (IVS 101)

2. To comply with the requirement in IVS 101 2(d) to identify the asset or liability to be valued, the *intangible asset* shall be clearly defined by reference to its type and the legal right or interest in that asset. The main types of *intangible asset* and their typical characteristics are discussed in paras C1 – C14 of the commentary to this standard.

ASSET STANDARDS

3. The scope of work should identify any contributory assets and confirm whether or not these are to be included in the valuation. A contributory asset is one that is used in conjunction with the subject asset to generate the cash flows associated with the subject asset. If contributory assets are to be excluded, it will be necessary to clarify whether the subject *intangible asset* is to be valued on the assumption that the contributory assets are available to a buyer or on the assumption that they are not, ie, the subject asset is valued on a stand-alone basis.
4. Common examples of assumptions or *special assumptions* that arise when valuing *intangible assets* and that are required to be referred to by IVS 101 2(i) 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.

Implementation (IVS 102)

5. There are no additional requirements for *intangible assets*.

Reporting (IVS 103)

6. There are no additional requirements for *intangible assets* other than inclusion of appropriate references to matters addressed in the scope of work in accordance with paras 2 to 4 above.

Effective Date

7. The effective date of this standard is #### 2011, although earlier adoption is encouraged.

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COMMENTARY

Principal Types of Intangible Assets

- C1. 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.
- C2. 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.
- C3. 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.
- C4. Any unidentifiable *intangible asset* associated with a business or group of assets is generally termed *goodwill*.
- C5. The principal classes of identifiable *intangible assets* are as follows:
- marketing related,
 - customer or supplier related,
 - technology related,
 - artistic related.
- C6. Identifiable *intangible assets* may be contractual or non-contractual. Within each class, assets may be either contractual or non-contractual.
- C7. 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:

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- 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,
 - 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.
- C8. Technology related *intangible assets* arise from contractual or non-contractual rights to use patented technology, unpatented technology, databases, formulae, designs, software, processes or recipes.
- C9. 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.
- Goodwill**
- C10. *Goodwill* is any future economic benefit arising from a business or from the use of an asset or a group of assets which is not separable from the business, the asset or group of assets. It should be noted that different definitions of *goodwill* apply under specific financial reporting or tax regimes; these may need to be reflected where valuations are being undertaken for these purposes.
- C11. 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 not reflected in the value of other assets
 - growth opportunities, eg, expansion into different markets,
 - organisational capital, eg, the benefits accruing from an assembled network.

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- C12. 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.

Characteristics of Intangible Assets

- C13. 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.
- C14. 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 the type of *intangible asset*.

Valuation Approaches

- C15. The three principal valuation approaches described in IVS *Framework* can all be applied to the valuation of *intangible assets*.
- C16. Because of the heterogeneous nature of many *intangible assets*, there is often a greater need to consider the use of multiple approaches and methods to derive value than for other asset classes.
- C17. 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.

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Market Approach

- C18. Under the *market approach*, the value of an *intangible asset* is determined by reference to market activity, eg, transaction bids or offers involving identical or similar assets.
- C19. 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. As an alternative, or in addition to, comparison with the prices in any relevant transactions involving identical or similar assets through analysis of sale transactions may provide evidence of valuation multiples, eg, it may be possible to determine a typical price to earnings ratio or rate of return for a class of similar *intangible assets*.
- C20. Where evidence of either prices or valuation multiples is available, it will often be necessary to make adjustments to these to reflect differences between the subject asset and those involved in the transactions.
- C21. These adjustments are 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

- C22. 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*. 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.
- C23. Each of these methods involve the converting of forecast cash flows to an indication of value using either discounted cash flow techniques or, in simple cases, the application of a capitalisation multiple to a representative single period cash flow.

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Relief-from-Royalty Method

- C24. 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*.
- C25. 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 rate to convert the projected hypothetical royalty payments to a present value.
- C26. Royalty rates can often vary significantly in the market for apparently similar assets. It is therefore prudent 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

- C27. 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*. It is often used when market based royalty rates are not available or are unreliable.
- C28. 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.

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- C29. 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

- C30. 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 contributory assets. The excess earnings method is typically used in the valuation of customer contracts, customer relationships and in process research and development projects.
- C31. 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.
- C32. The excess earnings method involves allocating the expected cash flows to the smallest business or group of assets of the entity that includes all the income derivable from the subject asset.
- C33. From this forecast of cash flows, a deduction is made in respect of the share of the cash flows attributable to contributory tangible, intangible and financial assets. This is done by calculating an appropriate charge or economic rent for the contributory assets and deducting this from the cash flows. To arrive at a reliable valuation of the subject asset, it may also be appropriate to make an additional deduction to reflect any additional value attributable to the fact that all the assets are utilised together as a going concern. This “going concern” benefit would include:
- any positive impact on the cash flows of matters such as having an assembled work force that would not be available to a buyer of the individual asset,
 - any costs that would be incurred by a buyer of the subject asset that are not reflected in the cash flows of the going concern, eg, start up marketing costs and reduced cash flows while the product is being brought to market.

Tax Amortisation Benefit

- C34. In many tax regimes, the amortisation of an *intangible asset* can be treated as an expense in calculating taxable income. This “tax amortisation benefit” can have a positive impact on the value of the asset. When an *income approach* is used, it will be necessary to consider the impact of any available tax benefit to buyers and make an appropriate adjustment to the cash flows.

ASSET STANDARDS

Cost Approach

- C35. 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 either a similar asset or one providing similar service potential or utility is estimated.
- C36. Examples of *intangible assets* for which the *cost approach* may be 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.
- C37. The inputs that are considered when applying the *cost approach* include the following:
- the cost of developing or purchasing an identical asset,
 - the cost of developing or purchasing an asset offering the same utility or service potential,
 - any adjustments required to the cost of developing or purchasing to reflect the specific characteristics of the subject asset, such as economic or functional obsolescence.

Multiple Approaches

- C38. Because of the heterogeneous nature of many intangible assets there is often a greater need to consider the use of multiple methods and approaches to derive value than for other asset classes.

ASSET STANDARDS

IVS 220 Plant and Equipment

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STANDARD

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.

Scope of Work (IVS 101)

2. To comply with the requirement to identify the asset or liability to be valued in IVS 101 para 2(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:
 - 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;
 - 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 4 below.

ASSET STANDARDS

3. 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.
4. 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 2(i) these must be considered and included in the scope of work. 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.

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.

Implementation (IVS 102)

5. There are no additional requirements for plant and equipment.

Reporting (IVS 103)

6. 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 2 to 4 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.

Effective Date

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

ASSET STANDARDS

COMMENTARY

Plant and Equipment

C1. Items of plant and equipment 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 following assets are not classed as plant and equipment

- real property
- mineral or natural resources
- raw materials and consumables
- stock and inventory
- consumables
- agricultural assets (eg plants, livestock etc.)
- personal property such as artworks, jewellery and collectibles

C2. 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:

Asset related:

- the assets technical specification,
- the remaining physical life,
- the assets condition, including maintenance history,
- if the asset is not valued in its current location, the costs of decommissioning and removal,
- 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.

Environment related:

- 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,
- the impact of any environmental or other legislation that either restricts utilisation or imposes additional operating or decommissioning costs.

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Economic related

- the actual or potential profitability of the asset based on comparison of running costs with earnings or potential earnings,.
- the demand for the product from the plant and equipment with regard to both macro and micro economic factors that could impact on demand,
- the potential for the asset to be put to a more valuable use than the current use.

Intangible Assets

- C3. *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

- C4. 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.
- C5. 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.

ASSET STANDARDS

Forced Sale

- C6. Plant and equipment assets can be particularly susceptible to forced sale conditions, see the IVS Framework paras 53-55 . 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 within the available time limit.

Valuation Approaches

- C7. The three principal valuation approaches described the IVS Framework can all be applied to the valuation of plant and equipment assets.
- C8. 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*
- C9. 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 product¹. Even then it is important to understand that some of the cash flows may be attributable to *intangible assets*. For these reasons use of the *income approach* will not be practical for many individual items of plant or equipment.

¹ More detailed guidance is contained in the Exposure Draft TIP 1 *Discounted Cash Flow - Real Property and Business Valuations* published Jan 2011

ASSET STANDARDS

- C10. 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 cost² 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.
- C11. Having established the replacement cost deductions are then 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.

² More detailed guidance is contained in the Exposure Draft TIP 2 *Depreciated Replacement Cost* published February 2011.

ASSET STANDARDS

IVS 230 Real Property Interests

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STANDARD

1. The principles contained in the General Standards apply to valuations of *real property* interests. This standard only includes modifications, additional requirements or specific examples of how the General Standards apply for valuations to which this standard applies.

Scope of Work (IVS 101)

2. To comply with the requirement to identify the asset to be valued in IVS 101 2 (d) the following matters shall be included:
 - a description of the *real property* interest to be valued,
 - identification of any superior or subordinate interests that affect the interest to be valued.

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3. To comply with the requirements to state the extent of the investigation and the nature and source of the information to be relied upon in IVS 101 (g) and (h) respectively the following matters shall be considered:
 - the evidence required to verify the *real property* interest and any relevant related interests,
 - the extent of any inspection,
 - responsibility for information on the site area and any building floor areas,
 - responsibility for confirming the specification and condition of any building,
 - the extent of investigation into the nature, specification and adequacy of services,
 - the existence of any information on ground and foundation conditions,
 - responsibility for the identification of actual or potential environmental risks.

4. Typical examples of *special assumptions* that may need to be agreed and confirmed in order to comply with IVS 101 (i) 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*.

Implementation (IVS 102)

5. There are no additional requirements for *real property* interests.

Valuation Reporting (IVS 103)

6. No additional requirements for *real property* interests other than inclusion of appropriate references to matters addressed in the scope of work in accordance with paras 2 to 4 above.

Effective Date

7. The effective date of this standard is ## ## 2011, although earlier adoption is encouraged.

ASSET STANDARDS

COMMENTARY

Types of Real Property Interest

- C1. A *real property* interest is a right of ownership, control, use or occupation of land and buildings. There are three basic types of interest:
- (a) 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 subject only to any subordinate interests and any statutory constraints.
 - (b) A subordinate interest that gives the holder rights of exclusive possession and control of a defined area of land or buildings for a defined period, eg 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.
- C2. Interests in *real property* may be held jointly, where a number of parties have the right to the share the whole interest, or severally, where each party has a defined proportion of the whole interest.
- C3. Although different words and terms are used to describe these types of *real property* interest in different states, the 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 land and buildings. The value, therefore, attaches to the property interest rather than to the physical land and buildings.

The Hierarchy of Interests

- C4. The different types of *real property* interest are not mutually exclusive. A superior interest may be subject to one or more subordinate interests. The owner of the absolute interest may grant a lease interest in respect of part or all of his interest. Lease interests granted directly by the owner of the absolute interest are “head lease” interests. Unless prohibited by the terms of the lease contract, the holder of a head lease interest can grant a lease of part or all of that interest to a third party, which is known as a sub-lease interest. A sub-lease interest will always be shorter than the head lease out of which it is created, even if only by one day.

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- C5. These property interests will have their own characteristics, as illustrated in the following examples:
- Although an absolute 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.
 - A lease 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 on any transfer of the interest to a third party.
 - 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.
- C6. When valuing a *real 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 property. The sum of the individual values of different interests in the same property will frequently differ from the value of the unencumbered freehold interest.
- C7. Property interests are normally defined by state law and often regulated by national or local legislation. Before undertaking a valuation of a *real property* interest, an understanding of the relevant legal framework that affects the interest being valued is essential.

Rent

- C8. 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.
- C9. *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.

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- C10. The commentary given for the similar definition of *market value* in the IVS Framework 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.
- C11. 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.

Valuation Approaches

- C12. The three principal valuation approaches described in the IVS Framework can all be applicable for the valuation of a *real property* interest.

Market Approach

- C13. 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. Notwithstanding these dissimilarities, the *market approach* is commonly applied for the valuation of *real property* interests.
- C14. In order to compare the subject of the valuation with the price of other *real 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. To the extent possible any unit of comparison used should be one commonly used by participants in the relevant market.

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C15. The reliance that can be applied to any comparable price data in the valuation process is determined by comparing various characteristics of the property and transaction from which the data was derived with the property being valued.

Differences between the following should be considered:

- the interest providing the price evidence and the interest being valued,
- the respective locations,
- the respective quality of the land or the age and specification of the 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

C16. 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 (or rent saved) based on what it would cost the owner to lease equivalent space. Where a building is suitable for only a particular type of trading activity, that income may be related to the actual or potential cash flows that would accrue to the owner of that building, from the trading activity, see IVS 232 *Trade Related Property*. This latter example is often referred to as the “profits method”.

C17. 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, often known as the capitalisation rate. This figure represents the return, or “yield”, that an investor, or the notional return in the case of an owner occupier, would expect to reflect 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 to an extent greater than that generally expected in the market or where a more sophisticated analysis of risk is required.

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- C18. 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.
- C19. 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 *real property* interests traded in the market between market participants.
- C20. The appropriate discount rate should be determined from analysis of the rates implicit in transactions in the market. 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 *real property* interest.
- C21. 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 projections have been made to reflect anticipated future inflation or deflation. ¹

Cost Approach

- C22. This approach is generally applied to the valuation of *real property* interests through the depreciated replacement cost method.² It is normally used 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. It is principally used for the valuation of specialised property, which is 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.
- C23. The first step requires a replacement cost to be calculated. This is normally the cost of replacing the property with a modern equivalent at the relevant

¹ More detailed guidance is contained in the Exposure Draft TIP1 The Discounted Cash Flow Method published in January 2011

² More detailed guidance is contained in the Exposure Draft TIP 2 *Depreciated Replacement Cost* published February 2011.

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valuation date. An exception is where an equivalent property would need to be a replica of the subject property in order to provide a market participant with the same utility, in which case the replacement cost would be that of reproducing or replicating the subject building rather than replacing it with a modern equivalent. The replacement cost needs to reflect all incidental costs such as the cost of the land, infrastructure, design fees and finance costs that would be incurred by a market participant in creating an equivalent asset.

- C24. The cost of the land should reflect the cost of acquiring land suitable for the development of a modern equivalent facility. If physical or demographic changes to the locality of the subject property since its construction mean that a market participant would no longer buy land in the same location for that purpose because its value had been enhanced by potential for more valuable uses then the cost should be based on the cost of acquiring a site in a location that a market participant would consider as a suitable alternative. However, separate consideration of the value of the subject land may be necessary, see para C26 below.
- C25. The cost of the modern equivalent is then subject to adjustment for obsolescence. The objective of the adjustment for obsolescence is to estimate how much less valuable the subject property would be to a potential buyer than the modern equivalent. Obsolescence considers the physical condition, functionality and economic utility of the subject property compared to the modern equivalent.
- C26. In some cases the value of the interest in the land for an alternative use less demolition and remediation costs may be more than the depreciated replacement cost. In such cases, the *cost approach* may produce a value that is inappropriate or misleading for the intended purpose of valuation and other valuation approaches may be considered more appropriate.

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IVS 230 Real Property Interests

ANNEXE - HISTORIC PROPERTY

- A1. This Annexe gives additional guidance on matters that require consideration when valuations are undertaken of interests in historic *real property*.
- A2. 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,
 - a frequent obligation in some jurisdictions that it be accessible to the public.
- A3. 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

- A4. 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.
- A5. 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;

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

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- (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.

- A6. 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.

Features of Historic Property Affecting Valuations

- A7. 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.
- A8. 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,

² World Heritage Convention, Article I, UNESCO, 1972

³ World Heritage Convention, Article II, UNESCO, 1972

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- conservation easements that limit the future use of a property so as to protect open space, natural features or wildlife habitat.

- A9. 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.
- A10. 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.
- A11. In some cases 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.

Valuation Approaches

- A12. The three principal valuation approaches described in the IVS Framework can all be applied to the valuation of a historic property.

Market Approach

- A13. In applying the *market 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:

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- 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

- A14. Historic property fully utilised for commercial purposes may be valued by means of the *income approach*. Where the distinctive physical features of a 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 features of the property. Where work is required, allowances should be made for the time and cost involved in obtaining any necessary statutory consent.

Cost Approach

- A15. 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 a new building with a similarly distinctive and high specification.
- A16. 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.
- A17. 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.

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IVS 232 Trade Related Property

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STANDARD

1. The principles contained in the General Standards and in *IVS 230 Real Property Interests* apply to valuations of *trade related property*. This standard only includes modifications, additional requirements or specific examples of how the General Standards apply for valuations to which this standard applies.

Scope of Work (IVS 101)

2. To comply with the requirement to identify the asset or liability to be valued in IVS 101 2(d) it shall be stated whether tangible assets other than the *real property* interest that form part of the operational unit, eg, furniture, equipment, 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.
3. To comply with the requirement to state the extent of the investigation and, the nature and source of the information to be relied upon in IVS 101 2(g) and IVS 101 2(h) respectively the sources of information on current and historic levels of trade and other financial or prospective financial information shall be confirmed.

ASSET STANDARDS

4. To comply with the requirement in IVS 101 2(i) any assumptions or *special assumptions* all assumptions required to describe the property's trading state or trading potential shall be stated. Examples of *special assumptions* used when valuing this type of property 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* may be made that a defined level of trading performance had been reached on the *valuation date*;
 - 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 have expired or are in jeopardy.

Implementation (IVS 102)

5. To comply with IVS 102 5 consideration shall be given to whether an alternative use of the property may represent the highest and best use. This may indicate that an alternative valuation approach is required.

Reporting (IVS 103)

6. There are no additional requirements for *trade related property* other than inclusion of appropriate references to matters addressed in the scope of work in accordance with paras 2 to 4 above.

Effective Date

7. The effective date of this standard is ## ## 2011, although earlier adoption is encouraged.

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COMMENTARY

Trade Related Property

- C1. 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 of the property interest therefore reflects the trading potential of the property. It can be contrasted with generic *real property* that can be occupied by a wide range of different business types, such as standard office, industrial or retail. Another feature is that the ownership of the *real property* interest often transfers as part of the sale of the business in occupation, referred to in this standard as the “operational unit”.
- C2. The value of such *real property* reflects the trading potential, which may differ from 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 suitably experienced and knowledgeable market participant.
- C3. Where a *trade related property* is currently trading, the value of the operational unit may include various components including:
- the property interest,
 - furniture and equipment,
 - operating licences and permits,
 - *goodwill*.

If the valuation required is of the entire operational unit, reference should be made to IVS 200 *Businesses and Business Interests*.

Valuation Approaches

- C4. The *market approach* and the *income approach* described in the IVS Framework can be applied to the valuation of a *trade related property*. The *cost approach* is not normally applicable.

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Market Approach

- C5. If using the *market approach*, reference should be made to the matters discussed in IVS 230 *Real 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. While analysis on a unit basis, eg, per bed space or per room, may assist it is essential that due consideration is given to the range and impact of different factors affecting trading potential. The *market approach* may therefore be a less reliable indicator of value than the *income approach* but can be a useful cross check on the *income approach*.

Income Approach

- C6. The profits method is an application of the *income approach* that is commonly used in the valuation of *trade related property*. The profits method estimates the net operating profit, ie earnings before interest, tax, depreciation and amortisation (EBITDA) that could be maintained by a reasonably efficient operator. The EBITDA is then capitalised at an appropriate rate of return reflecting the potential risks and rewards of the property by analysis of comparable transactions. Where the valuation is required to estimate a *market rent* for the property, a further adjustment will be required to the EBITDA to allow for a reasonable return to the operator on its investment in the business.
- C7. 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 for atypical revenues and costs to arrive at a fair maintainable trade. Examples of adjustments include:
- additional revenue or costs 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.

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- C8. In the case of a vacant property, or a new *trade related property* that is planned or under construction, the trading potential will 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*.
- C9. 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.

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IVS 233 Investment Property under Construction

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STANDARD

1. The principles contained in the General Standards and in IVS 230 *Real Property Interests* apply to valuations of *investment property* under construction. This standard only includes modifications, additional requirements or specific examples of how the General Standards apply for valuations to which this standard applies.

Scope of Work

2. To comply with the requirements to state the extent of investigations and nature and source of the information to be relied upon in IVS 101 2(g) and 2(h) respectively the following matters shall be commented upon:
 - the source of information on the proposed building, eg identifying the plans and specification which will be used to estimate the value of the completed project,
 - the source of information on the construction and other costs required to complete the project.

ASSET STANDARDS

3. Typical examples of assumptions or *special assumptions* that may need to be agreed and confirmed in order to comply with IVS 101 2(i) include:
- that the building will be completed in accordance with the identified plans and specification,
 - that any preconditions required for agreed leases of the completed building would be met or complied with.

Implementation (IVS 102)

4. There are no additional requirements for *investment property* under construction.

Valuation Reporting (IVS 103)

5. In addition to the requirements of IVS 103 *Valuation Reporting* and IVS 230 *Real Property Interests* a valuation report on *investment property* under construction shall include appropriate references to matters addressed in the scope of work in accordance with paras 2 and 3 above. The report shall also include comment on such of the following matters 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 estimated cost to complete and the source of that estimate,
- identification of and, where possible, quantification of the remaining risks associated with the project, distinguishing between the risks in respect of generating rental income and construction risks,
- a description of how the risks have been reflected in the valuation,
- 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.

Effective Date

6. The effective date of this standard is ### ## 2011, although earlier adoption is encouraged.

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Commentary

Investment Property

- C1. *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.
- C2. The owner may hold a superior or subordinate interest in *investment property*. For the descriptions of the types of property interest and the principles to be applied in valuing them, see *IVS 230 Real Property Interests*. This standard is concerned with the situation where an *investment property* is in the course of construction on the *valuation date*.
- C3. 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.

Valuation Approaches

- C4. This standard provides principles that should be observed in estimating the *market value* of *investment property* under construction. *Market value* is discussed in detail in the IVS Framework 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 *valuation date*.
- C5. 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.

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- C6. 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.
- C7. 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*.
- C8. 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*.
- C9. 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.
- C10. 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.

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Valuation Inputs

- C11. 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 above. 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 costs 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 costs during this period could include fees, marketing, incentives, maintenance and unrecoverable service charges. 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.

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- (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 *valuation date* should be ignored.
- (f) Buyers Profit and Risk
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 *valuation date*. The buyer's return can be expressed as a target profit, either a lump sum or a percentage return on cost or value.
- 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.

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Alternatively, if a discounted cash flow method is used to produce the valuation, the discount rate 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.

(g) 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 for Financial Reporting

- C12. Financial statements are normally produced on the assumption that the entity is a going concern, see IVS 300 *Valuations for Financial Reporting*, para 4. 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 an abnormal risk of default by a contracted party on the *valuation date*.

Special Considerations for Secured Lending Valuations

- C13. As indicated in IVS 310 *Valuations of Property Interests for Secured Lending*, the appropriate *basis of valuation* for secured lending is *market value*. However, in considering the value of any property that is under construction as security, regard should be had to the fact many contracts either become void or voidable in the event of one of the parties becoming subject to formal insolvency proceedings. Therefore, it may not be appropriate to make an assumption that a buyer of the partially completed project would have the benefit of existing building contracts and any associated warranties and guarantees. Similarly with an agreement to lease, care should be taken in assuming that the benefit of any agreement entered into by the borrower acting as lessor would be transferable to a buyer.

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IVS 250 Financial Instruments

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STANDARD

1. The principles contained in the General Standards apply to valuations of financial instruments. This standard only includes modifications, additional requirements or specific examples of how the General Standards apply for valuations to which this standard applies.

Scope of Work (IVS 101)

2. To comply with the requirement to confirm the identity and status of the valuer in IVS 101 2(a) where valuations are being undertaken by the holding entity that are intended for use by external investors, regulatory authorities or other entities reference shall be made to the control environment in place, see Commentary paras c31- C35 below.

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3. To comply with the requirement to identify the asset or liability to be valued as in IVS101 2 (d) the following matters shall be addressed:
 - the class or classes of instrument to be valued
 - whether the valuation is to be of individual instruments, a portfolio of identical instruments or a whole portfolio of assets.

Implementation (IVS 102)

4. There are no additional requirements for financial instruments.

Reporting (IVS 103)

5. To comply with the requirement to disclose the valuation approach and reasoning in IVS 103 5(I), consideration shall be given to the appropriate degree and granularity of disclosure. This will differ for different categories of financial instrument. 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. Information that adds little to a users' understanding as to the nature of the asset or that obscures the primary factors influencing value shall be avoided. In determining the level of disclosure that is appropriate, regard shall be had to the following:
 - **Materiality;**

The value of an instrument or class of instruments in relation to the total value of the holding entity's assets and liabilities or the portfolio that is valued.
 - **Uncertainty;**

The value of the instrument may be subject to material uncertainty on the *valuation date* due to the nature of the instrument, the model or inputs used or to market abnormalities. Disclosure of the cause and nature of any material uncertainty should be made.
 - **Complexity;**

For complex instruments a more detailed description of the nature of the instrument and the factors influencing value is normally appropriate.
 - **Comparability;**

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.

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- Underlying Assets;

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.

6. 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 hierarchy of valuation inputs, see IVS 300 *Valuations for Financial Reporting*.

Effective Date

7. This effective date of this standard is ### 2011, although earlier adoption is encouraged.

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COMMENTARY

Introduction

- C1. A financial instrument is a contract that creates rights or obligations between specified parties to receive or pay cash or other financial consideration, or an equity instrument. 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.
- C2. 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.
- C3. 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.
- C4. 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 prices from recent transactions in the same or a similar instrument, quotes from dealer 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

- C5. 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.

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- C6. 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.
- C7. 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 varies significantly. Some common or “vanilla” swaps are traded daily in large volumes whereas for some bespoke swaps, there is often 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.
- C8. 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

- C9. Understanding the credit risk is an important aspect of valuing any debt instrument. Some of the common factors that need to be considered in establishing and measuring credit risk include:
- **Counterparty Risk:**

The financial strength of the issuer or any credit support providers will involve consideration of not only the trading history and profitability of the relevant entity but also consideration of performance and prospects for the industry sector generally.
 - **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.
 - **Leverage:**

The amount of debt used to fund the assets from which an instrument’s return is derived affects the volatility of returns to the issuer and can affect credit risk..

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- 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.
 - 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.
- C10. 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.

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Own Credit Risk

- C11. Because the credit risk associated with a liability is important to its value, it might appear to follow that when valuing the interest of the issuer of a liability, the credit risk of the issuer is relevant to its value in any transfer of that liability. Where it is necessary to assume a transfer of the liability regardless of any actual constraints on the ability of the counterparties to do so, eg in order to comply with financial reporting requirements, 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 or by reference to the value of the corresponding asset. However, in many cases the issuer of a liability will not have the ability to transfer it but can only settle the liability with the counter party.
- C12. 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

- C13. 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.
- C14. 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 the IVS Framework.

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- C15. 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 *valuation date* 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.

Valuation Inputs

- C16. Except for liquid instruments that are traded on public exchanges, where current prices are both observable and accessible to all market participants, valuation inputs or sources of data may come from different sources. Commonly used input sources are broker dealer quotations and consensus pricing services.
- C17. Although not as reliable as the evidence of a contemporary and relevant trade, where such information is not available, broker dealer quotations can provide the next best evidence of how market participants would price the asset. However, problems associated with broker dealer quotations that can affect their reliability as a valuation input include:
- broker dealers will normally only be willing to make markets and provide 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 can impact on the quality of the information,
 - there is an inherent conflict of interest where the broker dealers are the counter party to an instrument,
 - broker dealers have an incentive to weight advice to buyer clients in a way that favourably reflects the holding.
- C18. 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.

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- C19. Consensus pricing services overcome the conflict of interest problem associated with single broker dealer. However, the coverage of such services is at least as limited as that for single broker 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 reliance that should be given to it in the valuation process.

Valuation Approaches

- C20. 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.
- C21. Whether automated or manual, the various valuation methods used in financial markets are mostly based on variations of either the *market approach*, the *income approach* or the *cost approach* described in the IVS Framework. This standard describes the commonly used methods and matters that need to be considered or the inputs needed when applying these methods.
- C22. 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.

Market Approach

- C23. A price obtained from trading on a recognised exchange platform on or very close to the time or date of valuation is normally the best indication of the *market value* of a holding of the identical instrument. In cases where there have not been recent relevant trades, the evidence of quoted or offered prices may also be relevant.
- C24. Although there will be no need for adjustment of the price information if the instrument is identical, the information recent enough to be relevant and the holding similar, some adjustments may be necessary where this is not the

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case. Examples of where adjustment or weighting of the evidence of traded prices may be required are:

- where the instrument being valued has different characteristics to the ones for which prices are available,
- where there are differences in the size or volume of the reported trade to the holding being valued,
- where the trade was between willing parties acting independently,
- the timing of the trade, which may be accentuated by the closure of exchanges.

C25. A further factor that can create a difference between an exchange traded price and the instruments to be valued can arise where transfer of the holding results in either the creation of a controlling interest or prospect of a change of control.

Income Approach

C26. 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.

C27. In establishing the appropriate discount rate, it is necessary to assess the return that would be required on the instrument to compensate for the time cost of money and risks related to:

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- the credit risk, ie, uncertainty about the ability of the counter party to make payments when due,
 - the liquidity of the instrument,
 - the risk of changes to the regulatory or legal environment.
- C28. 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. The discount rate also needs to be consistent with the cash flows, eg if the cash flows are gross of tax then the discount rate should be derived from other gross of tax instruments.
- C29. Depending upon the purpose of the valuation, the inputs and assumptions made into the cash flow model will need to reflect either those that would be made by market participants, or those that would 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.

Cost Approach

- C30. The substitution principle inherent in the *cost approach* is applied to the valuation of financial instruments through the use of the replication method. This method provides an indication of the current value of an instrument or portfolio by reproducing or "replicating" its risks and cash flows in a hypothetical, or synthetic, alternative. This alternative is based on a combination of securities and/or simple derivatives in order to estimate the cost of offsetting, or hedging, the position at a point in time. Portfolio replication is often used to simplify the analytical procedures applied to value a portfolio of complex liabilities (e.g. expected insurance claims or structured products) by substituting a replicating portfolio of assets that are easier to value and therefore more efficiently risk managed on a daily basis. It is also used as the basis for dynamic hedging of non-linear portfolios, eg options or swaptions, using linear hedging instruments such as securities and swaps.

Control Environment

- C31. 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

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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.

- C32. 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.
- C33. 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.
- C34. 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.
- C35. 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 APPLICATIONS

IVS 300 Valuation for Financial Reporting

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VALUATION APPLICATIONS

INTRODUCTION

Valuations are required for different accounting purposes in the preparation of the financial reports or statements of companies and other entities. Examples of different accounting purposes include measurement of the value of an asset or liability for inclusion on the balance sheet, allocation of the purchase price of an acquired business, impairment testing, lease classification and valuation inputs to the calculation of depreciation charges in the profit and loss account.

The Guidance section of this Application makes references to various requirements under the International Financial Reporting Standards (IFRS). Although the IFRS are the most widely adopted *Financial Reporting Standards* globally, national standards are also extensively used. Although it is impractical to make reference to national accounting standards in an international guidance document, many are similar to or converging with IFRS. The guidance given may therefore be relevant for valuations for use in Financial Reporting Standards other than IFRS.

DEFINITIONS

In this Application the following definitions apply:

Financial Reporting Standards: any recognised or adopted standards for the preparation of periodic statements of an entity's financial position. These may also be referred to as accounting standards.

International Financial Reporting Standards (IFRSs): standards and interpretations adopted by the International Accounting Standards Board (IASB). They comprise:

- (a) International Financial Reporting Standards;
- (b) International Accounting Standards; and
- (c) Interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

Unit of Account: the level at which an asset to be valued is aggregated or disaggregated with other assets

VALUATION APPLICATIONS

STANDARD

1. Valuations undertaken for inclusion in a financial statement shall be provided to meet the requirements of the *Financial Reporting Standards* that are applicable. The principles contained in the General Standards (IVS 101 102 and 103) also apply except as specifically modified by a requirement of the relevant accounting standard or by this standard.

Scope of Work (IVS 101)

2. To comply with the requirement to confirm the purpose of the valuation in IVS 101 2(c) the scope of work shall include identification of the applicable Financial Reporting Standards including the specific accounting purpose for which the valuation is required. The accounting purpose is the use for which the valuation is required in the financial statements, eg measuring the carrying amount, undertaking an allocation of the purchase price following a business combination, impairment testing, lease classification or for calculating the depreciation charge for an asset.
3. In addition to the requirement to identify the asset to be valued in IVS 101 2(d) the scope of work shall include confirmation of how that asset is used or classified by the reporting entity. The required accounting treatment for identical or similar assets or liabilities can differ according to how they are used by an entity. For example:
 - the treatment of *real property* 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.

Where an asset is utilised in conjunction with other separately identifiable assets the unit of account shall be identified. The relevant Financial Reporting Standard may stipulate how the unit of account, or degree of aggregation, is to be determined for different asset types or for different accounting purposes.

To comply with IVS 101 2(e) the specific *basis of value* shall be clearly identified. Examples of bases required in accounting standards include fair value, net realizable value, recoverable amount, fair value less costs to sell, and value in use. The definition will be provided in the relevant accounting standard.

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4. To comply with IVS 101 2 (i) any assumptions to be made shall be stated. The appropriate assumptions will vary depending on how an asset is held or classified. Most Financial Reporting Standards provide 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. Except in the case of financial instruments it is therefore normally appropriate to 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 liquidate the entity, to dispose of a particular asset or that option of retirement and disposal of the asset has to be considered.
5. If the highest value of a stand-alone asset to a market participant would be as part of a group of complementary assets, an assumption shall be made that the asset would be transferred as part of that group.
6. 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*.
7. In considering any restrictions referred to under IVS 101 2(j) consideration shall be given to:
 - a. The extent and form of any references to the valuation that may appear in the published financial statements.
 - b. The extent of the valuers' duty to respond to any questions on the valuation raised by the entity's auditor.

Appropriate references to these matters shall be included in the scope of work.

Implementation (IVS 102)

8. There are no additional requirements when undertaking valuations for financial reporting.

Reporting (IVS 103)

9. In addition to the minimum requirements in IVS 103 *Reporting*, a valuation report for use in a financial statement shall include appropriate references to matters addressed in the scope of work in accordance with paras 2 to 7 above. The report shall also include comment on such of the following as is relevant:
 - (a) In addition to disclosure of the valuation approach(s) used the material inputs and the reasoning of the valuation.

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- (b) Regard shall also be had to any specific disclosures that the entity may be required to make in order to comply with the relevant Financial Reporting Standard. Some illustrations of valuation disclosures currently required by IFRS are provided below, but this is not intended to be comprehensive and reference must be made to the relevant Financial Reporting Standard in every case:¹

IFRS 7 Financial Instruments: Disclosures

- (a) The level in the defined fair value hierarchy in which the measurement is categorised.
- (b) For assets within the defined Level 3 an illustration of changing one or more of the inputs to reasonably possible alternative assumptions.

IAS 16 Property Plant and Equipment :

- (a) Whether an independent valuer was involved.
- (b) The methods and significant assumptions applied.
- (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 :

- (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.

10. Where the effect on value of any assumption made is material, the effect of that assumption shall be disclosed in the report.

¹ When IFRS 13 becomes effective it will alter many of the disclosure requirements in IFRS, including some of those referred to in this standard.

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11. If an entity is using an asset, other than a financial instrument, in a way that differs from its highest and best use the value of the asset assuming continuation of the current use and the *market value* having regard to the highest and best use shall be reported.
12. 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*.
13. To comply with the requirement to state restrictions on use, distribution or publication in IVS 103 5(j) the report shall include reference to any conditions on how it may be reproduced or referred to in the published financial statements of the entity.

Effective Date

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

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IVS 300 Valuation for Financial Reporting

APPLICATION GUIDANCE

This section provides background information on common valuation requirements under IFRS. IFRS are published by the International Accounting Standards Board (IASB). The IFRS collectively comprise individually numbered standards and interpretations. 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 January 2011. IFRSs and their interpretation change over time. Accordingly references in this document are liable to become out of date. 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.ifrs.org.

This guidance is produced to assist valuation professionals and users understand certain valuation requirements under IFRS. Although the guidance is intended to reflect generally accepted valuation practice at the date of publication it does not impose any mandatory requirements. References to accounting requirements are subject to the provisions of IFRS and in the event of a conflict between this guidance and IFRS, IFRS prevails. Although similar requirements may exist in other Financial Reporting Standards, IVSC makes no assertion as to the relevance of this guidance to such standards.

Fair Value

- G1. Fair value is either the required measurement basis or a permitted option for many types of asset or liability under IFRS. IFRS 13 *Fair Value Measurement* contains the following definition:

“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.”

This definition replaces earlier definitions appearing in various IFRSs. It should also be noted that this definition differs from that appearing in the IVS Framework and that is commonly used for purposes other than financial reporting.

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- G2. This definition and the associated commentary in IFRS 13 clearly indicate that fair value under IFRS is a different concept to *fair value* as defined and discussed in the IVS Framework. The commentary in IFRS 13 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 is consistent with the concept of *market value* as defined and discussed in the IVS Framework. For most practical purposes, therefore, *market value* under IVS will meet the fair value measurement requirement under IFRS.

Aggregation

- G3. 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. IFRS 13 requires 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 MS 101 *Scope of Work* and IVS 103 *Valuation Reporting*.

Valuation Inputs and Fair Value Hierarchy

- G4. IFRS 13 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)”.

This hierarchy also appears in IFRS 7, *Financial Instruments: Disclosures*

- G5. IFRS 13 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. It is therefore appropriate for a valuation report provided for use in financial statements prepared under IFRS to include sufficient information on the valuation inputs used to enable the reporting entity to correctly classify assets within this hierarchy.

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Liabilities

- G6. IFRS 13 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.
- G7. There are special provisions in IFRS 13 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.

Depreciation

- G8. IAS 16 includes a requirement for an entity to account for the depreciation of property, plant and equipment. Depreciation in the context of financial reporting is a charge made against income in the financial statements to reflect the consumption of an asset 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.
- G9. 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. 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.
- G10. 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.

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- 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.

G11. 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.

Depreciation: Land and Buildings

- G12. IAS 16 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. This is normally done by establishing the *market value* of the land at the date of the relevant financial statement and then deducting this from the carrying amount for the property interest, ie, the land and buildings combined, in order to establish the element of the overall property value that can be attributed to the buildings. This is a notional value as it would not be capable of being realised as buildings usually cannot be sold without the land on which they sit.
- G13. Having established the 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. Under IAS 16 the useful life is specific to the entity. 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.
- G14. 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 may 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.

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Depreciation: Plant and Equipment

- G15. 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.

Depreciation: Componentisation

- G16. 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.
- G17. 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.

Leases

- G18. Under IAS 17, leases are classified for inclusion in financial statements as either operating leases or finance leases. Valuations may be required to determine how a lease is classified, and if classified as a *finance lease*, to determine the carrying amount of the asset and liability. 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*.

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- G19. For leases of property (*real estate*) 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 G32 to G34. IAS 17 does not apply to biological assets as defined in IAS 41.

Lease Classification

- G20. 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 a 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.
- G21. The following examples are listed in IAS 17 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*.

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- G22. IAS 17 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.
- G23. Lease classification is made at the inception of the lease. 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 a valuation 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

- G24. Where a lease is of land and a building or buildings together, IAS 17, 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.
- G25. For most property leases the interest in the leased 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 return the buildings back to the lessor in good repair. These are normally 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. Consequently, many leases of land and buildings are readily identifiable as operating leases.
- G26. Finance leases of land and buildings will generally arise 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.

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- G27. Where a lease is of a plot 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 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.
- G28. 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*.

Leased Investment Property

- G29. Under IAS 17, 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.
- G30. *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 and therefore not included on the balance sheet. However, in recognition of the fact that many substantial investment properties are held on this basis, IAS 40 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.
- G31. Although the foregoing provisions mean that questions of classification and allocation do not generally arise in relation to *investment property*, a potential anomaly remains. The value of the investor's interest in an *investment property* held under a lease reflects the difference between the payments under the superior lease and the receipts or potential receipts under the sub lease or leases, see IVS 320 *Real Property Interests*. However, IAS 17, 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.

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- G32. In order to comply with this requirement, IAS 40 provides that where a valuation of an *investment property* held under a lease 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 should 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 Lease Asset or Liability

- G33. 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. IFRS 13 *Fair Value Measurement*, does not apply to leases.
- G34. 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 interest created by the lease (see *IAS 320 Real Property Interests*), as the latter reflects the lease liability as well as the value of the asset.
- G35. 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.
- G36. IAS 17 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.
- G37. The depreciation requirements in IAS 16 also apply to leased assets and, therefore, paras G8 to G17 may also be relevant.

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Purchase Price Allocation

- G38. Following a business combination, ie the acquisition of a controlling interest in one or more other businesses, IFRS 3 requires the acquirer to account for the transaction by recognising the acquiree's assets and liabilities at fair value. Under IFRS 3 goodwill is the difference between the acquisition price paid in the transfer of the business and the total fair value of the acquiree's identifiable assets and liabilities.
- G39. A business's tangible assets are generally separately identifiable and can be reliably valued. The IVS Asset Standards include commentaries giving guidance on common classes of asset. Challenges can arise with identifying separate *intangible assets* that can be distinguished from goodwill. IFRS 3 requires an asset to be recognised separately if its value can be measured reliably. IVS 210 *Intangible Assets*, includes guidance on the identification and valuation of *intangible assets*.
- G40. IFRS 3 contains exceptions to the above for the recognition and/or measurement of some identifiable assets and liabilities. Particular requirements apply to contingent liabilities, income taxes, employee benefits, indemnification assets, reacquired rights, share-based payment awards and assets held for sale.

Impairment Testing

- G41. Impairment arises where the carrying amount of an asset exceeds the amount that can be recovered from either its continued use and/or the sale of the asset. Under IAS 36 - *Impairment of Assets*, an entity is required to review certain categories of asset at each balance sheet date to determine 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. Certain assets (goodwill and intangibles with an indefinite life or not yet available for use) would be tested for impairment on an annual basis.
- G42. 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".

Impairment Testing - Recoverable Amount

- G43. 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.

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Impairment Testing - Value in Use

- G44. Value in use is defined in IAS 36 as 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.
- G45. 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.
- G46. 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.
- G47. 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.
- G48. 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.
- G49. IAS 36, sets out detailed considerations for assessing value in use.

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Impairment Testing - Fair Value less Costs to Sell

- G50. 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 disposal². 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 the IVS Framework.
- G51. 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.

² Will be altered when IFRS13 becomes effective

IVS 300 Valuations for Financial Reporting

Annexe - Property, Plant and Equipment in the Public Sector

International Public Sector Accounting Standards

- A1. 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). The references to IPSAS standards are to those in issue as at January 2011. IPSAS and their interpretation change over time. Accordingly, references in this document are liable to become out of date. 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.
- A2. IPSAS contain similar principles to IFRS but related to the public sector environment. This includes a requirement for certain assets and liabilities to be measured at fair value. As in the case of IFRS, the IVSB considers that fair value in this context is met by applying *market value* as defined in the IVS Framework. 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 annexe identifies specific provisions within IPSAS that affect the application of fair value to such assets.

Types of Public Sector Property Plant and Equipment Assets

- A3. 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.
- A4. 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:

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- 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

- A5. 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 paras 45 – 47 stipulate the following:

“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.”

“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.”

“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 unit approaches...”

- A6. Although there is no IPSAS equivalent of IFRS 13 *Fair Value Measurement*, 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

- A7. 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:

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“...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”.

- A8. Because of the lack of evidence of comparable market transactions for many public sector assets, the *market 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 the IVS Framework. IPSAS 21, referred to below, contains some guidance on these methods.

Impairment

- A9. IPSAS 21 Impairment of Non-Cash-Generating Assets, contains similar provisions to IAS 36, see IVS 300. 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,
“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.”

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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.

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,
"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 – IPSAS 21 para 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."

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- A10. 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.

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IVS 310 - Valuations of Real Property Interests for Secured Lending

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INTRODUCTION

Loans from banks and other financial institutions are often secured by the collateral of the borrower's *real 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.

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STANDARD

1. The principles contained in the General Standards and in IVS 230 *Real Property Interests* apply to valuations for secured lending unless these are modified by this standard. This standard includes only any modifications, additional requirements or specific examples of how the General Standards apply.

Scope of Work (IVS 101)

2. To comply with the requirement to confirm the identity and status of in IVS 101 2(a), the scope of work shall additionally include a disclosure 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 doubt 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.
3. To comply with the requirement to identify the assets to be valued in IVS 101 2(d), the *real property* interest to be used as the collateral for securing the loans or other financing arrangements shall be clearly identified, together with party in whom the interest is currently vested.
4. The *basis of value* to be specified in accordance with IVS 101 2(e) will normally be *market value*. Some lenders request valuations on the assumption of a forced sale or impose a time limit for the hypothetical disposal of the property. 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.
5. 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. To comply with the requirement to state any assumption in IVS 101 2(i) any *special assumptions* that are necessary shall be included in the scope of work: Examples of *special assumptions* that are commonly made in secured lending valuation include:
 - that a proposed building had been completed at the *valuation date*;
 - that a proposed lease of the property had been completed at the *valuation date*;
 - that a specified occupancy level had been reached by the *valuation date*.

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- that the seller had imposed a time limit for disposal that was inadequate for proper marketing.

Implementation (IVS 102)

6. There are no additional requirements when undertaking valuations for secured lending.

Reporting (IVS 103)

7. In addition to those matters required by in IVS 103 *Reporting*, a valuation report for secured lending shall include appropriate references to matters addressed in the scope of work in accordance with paras 2 to 5 above. The report shall also include comment on factors that are relevant to a lenders assessment of the performance of security over the life of the proposed loan. Examples of these factors include:

- current activity and trends in the relevant market,
- historic, current and anticipated future demand for the type property and location,
- any potential, and likely demand for, alternative uses that exist or can be anticipated at the *valuation date*,
- the impact of any events foreseeable at the *valuation date* on the probable future value of the security during the loan period. An example would be a tenant exercising an option to break a lease.
- where the *market value* is provided subject to a *special assumption*, the report shall 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*.

8. 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 shall comment on the reasons for this difference.

Effective Date

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

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IVS 310 Valuation of Real Property for Secured Lending

APPLICATION GUIDANCE

The Property Interest

- G1. The existence or creation of other interests will impact on the value of the *real property* interest offered as security. It is therefore important that all interests in the subject property are identified, together with the parties in whom those interests are vested. Where detailed information on title has not been provided or is unavailable, the assumptions that have been made concerning the *real property* interest should be clearly stated. It is also good practice to recommend that these matters be verified before any loan is finalised.
- G2. 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.

Incentives

- G3. 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 as the incentives may not be available to the lender in the event that it had to rely on the security.

Valuation Approaches

- G4. All valuation approaches used for developing and supporting an estimate of *market value* are based on market observations. Although the three approaches identified in the IVS Framework can be used to provide an indication of *market value* for secured lending, if the property is so specialised that there is insufficient evidence to use either the *market approach* or *income approach*, 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.

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Property Types

- G5. Different types of property have different characteristics as security. It is important that the valuation of the relevant interest addresses these in order to properly provide the lender with adequate information on the suitability of the property as security and to help the lender identify any risk factors associated with the property over the duration of the loan.

Investment Property

- G6. *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.
- G7. Consideration should be given to the expected demand for and marketability of the property over the life of the loan and appropriate advice on current market conditions provided in the report. This advice should not involve predicting future events or values but should reflect current market expectations of the future performance of the investment based on current trends. However, if such information suggests a significant risk to future rent payments, the impact of this risk on the valuation should be considered and commented upon in the report.

G8.

- G9. It is normally outside the scope of the valuation assignment to advise on the ability of a tenant to meet future rent payments and other lease obligations beyond reflecting the information available on the tenant that would be in the public domain and therefore be available to all market participants.
- G10. 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

- G11. 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.

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Specialised Property

- G12. 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 *special 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.
- G13. 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

- G14. 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 IVS232 *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 a potential alternative use may represent the *market value*.

Development Property

- G15. 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.
- G16. The approach to the valuation of development properties will depend on the state of development of the property at the *valuation date* 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, and the need to reflect any intended phasing of the development project,

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- (b) determining the effect of additional development requirements on costs and revenues, using present value discounting where appropriate,
 - (c) identifying, anticipated market trends over the period of the development,
 - (d) identifying the risks associated with the development,
 - (e) considering any special relationships between the parties involved in the development.
- G17. If the completed development will consist of multiple individual units the valuation method adopted should reflect the anticipated timing of both the completion of the construction of each unit and a realistic estimate of the rate at which individual sales will take place. When reporting, a clear distinction should be made between the value of the completed development to a single buyer who would assume the cost and risk of onward sales of the individual units in return for a profit margin, and the sum of the individual anticipated prices for each individual unit.
- G18. For further guidance on the value of a development property where construction has yet to commence or where construction in progress see the Commentary to IVS 233 *Investment Property under Construction*.

Wasting Assets

- G19. 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.