RED BOOK GLOBAL STANDARDS

RICS Valuation – Global Standards

Effective from 31 January 2022

Global

RICS VALUATION – GLOBAL STANDARDS

Global

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Preface

This updated global edition of the *RICS Valuation – Global Standards*, or the RICS 'Red Book Global Standards' as it has become widely known, reflects, among other things, the recent changes made and incorporated into the *International Valuation Standards* (IVS), as well as continuing progress in the development of international standards for ethics and for measurement. Other refinements include, but are not limited to:

- articulating in more detail the need for clear, unambiguous and documented terms of engagement when members apply any exceptions to VPS 1-5 under **PS 1 section 5**, *Exceptions*
- definitions and additional commentary on matters relating to sustainability/resilience and environmental, social and governance (ESG) in the Glossary, VPS 2, VPS 3, VPGA 2, *Secured lending* and VPGA 8, *Valuation of real property interests*
- improving and/or clarifying some of the existing Red Book Global Standards text in the light of feedback, experience and also evolving needs.

Red Book Global Standards reflects the growing importance of successfully combining professional, technical and performance standards in order to deliver high quality valuation advice that meets the expectations and requirements of clients; of governments, regulatory bodies and other standard-setters; and of the public.

Transparency, consistency and the avoidance of conflicts of interest have never been more important. Nor has technical expertise and practical ability ever been more in demand, including the experience and insight necessary to interpret and review market dynamics and trends, and – in relation to real estate assets – to recognise the growing relevance of *sustainability* factors as a market influence. RICS-qualified valuers are at the forefront of the valuation profession and the Red Book Global Standards is their definitive implementation guide.

Changes in this updated edition continue to focus on enhancing its clarity and ease of use, with improved cross-references to other source documents. As before, the *International Valuation Standards* are cross-referenced throughout and reproduced in full in Part 6.

All members providing a written valuation are required to comply with the standards set out in this updated edition – in other words, unless stated otherwise, they are **mandatory**. The valuation practice guidance – applications (VPGAs) also included in this edition focus in greater detail on the practical application of the standards in specific contexts, whether for a particular valuation purpose or in relation to a particular asset type – they are **advisory**. The status of the component elements of the Red Book Global Standards is explained in more detail in the Introduction that follows and in the second section of the Glossary.

Part 1: Introduction

Overall purpose

1 Consistency, objectivity and transparency are fundamental to building and sustaining public confidence and trust in *valuation*. In turn their achievement depends crucially on *valuation* providers possessing and deploying the appropriate skills, knowledge, experience and ethical behaviour, both to form sound judgments and to report opinions of value clearly and unambiguously to clients and other *valuation* users in accordance with globally recognised norms.

2 As the requirements of governments and regulators progressively increase and the expectations of valuation users continue to grow, global standards for *valuation* have continued to evolve and now take three different but closely interrelated forms:

a ***Professional*** standards – centred on ethics and conduct, underpinned by knowledge and competence.

b ***Technical*** standards – centred on common definitions and conventions, underpinned by consistent application through recognised approaches.

c ***Performance*** or ***delivery*** standards – centred on rigour in analysis and objectivity of judgment, backed by appropriate documentation and clarity when reporting.

3 With its focus on practical implementation, this updated edition of the *RICS Valuation – Global Standards*, commonly referred to as the RICS Red Book Global Standards, applies the latest international standards and supplements them with additional requirements and best practice guidance that, when combined, provide the highest levels of assurance to promote and maintain public trust in valuation professionalism and quality.

4 At its heart this volume adopts and applies the *International Valuation Standards* (IVS) published by the International Valuation Standards Council (IVSC). The IVS consist of mandatory requirements that *must* be followed in order to state that a *valuation* was performed in compliance with it. Some aspects of the standards do not direct or mandate any particular course of action, but provide fundamental principles and concepts that must be considered in undertaking a *valuation*.

5 These technical standards are delivered within a broader framework of RICS standards, or professional statements as they are individually termed, covering ethics, skills and conduct – including express requirements regarding the maintenance of confidentiality and the avoidance of conflicts of interest. This RICS framework also has regard to the International Ethics Standards. Finally, when undertaking work in connection with real estate, RICS *members* must also have regard to the International Property Measurement Standards (IPMS) wherever applicable, which also continue in development.

6 Compliance with professional, technical and performance standards is reinforced by a well-established system of regulation and, where necessary, enforcement; and by the progressive introduction of a system of practising RICS Valuer Registration. The whole ensures

the positioning of RICS *members* and regulated *firms* as the leading global providers of IVS-compliant *valuations*.

7 The aim is simply stated – it is to engender confidence, and to provide assurance to clients and recognised users alike, that a *valuation* provided by an RICS-qualified valuer anywhere in the world will be undertaken to the highest professional standards overall.

Coverage

From the valuation provider's perspective

8 For ***members***, these global standards set out procedural rules and guidance which:

a impose on individual valuers or firms registered for regulation by RICS certain mandatory obligations regarding competence, objectivity, transparency and performance

b establish a framework for uniformity and best practice in the execution and delivery of valuation assignments through adoption of the IVS

c expressly comply with **RICS Rules of Conduct**.

9 These global standards do not:

a instruct *members* on how to value in individual cases

b prescribe a particular format for reports: provided the mandatory requirements in these standards are met, reports should always be appropriate and proportionate to the task

c override standards specific to, and mandatory within, individual jurisdictions.

From the valuation user's perspective

10 For clients and other valuation users these global standards ensure that valuation assignments will be carried out in accordance with the *IVS*, and furthermore promote and maintain a high level of public trust by providing assurance of:

a consistency in approach, aiding understanding of the valuation process and hence of the value reported

b credible and consistent valuation opinions by suitably trained valuers with appropriate qualification and adequate experience for the task, including current knowledge and understanding of the relevant market

c independence, objectivity and transparency in the valuer's approach

d clarity regarding *terms of engagement* (scope of work), including matters to be addressed and disclosures to be made

e clarity regarding the *basis of value*, including any *assumptions* or material considerations to be taken into account

f clarity in reporting, including proper and adequate disclosure of relevant matters where *valuations* may be relied on by a third party.

Arrangement and status of RICS global material

11 The RICS global material in this edition has been grouped into three distinct sections (in Parts 3, 4 and 5), as explained in detail in paragraphs 12 to 17 below. The first two cover matters relevant to valuation assignments generally, the third covers matters relating to particular valuation applications. The intention is to make clear to *members* what is mandatory and what is advisory – thus collected together in the first two sections is the mandatory material and in the third the advisory material.

Professional standards – mandatory

12 Global professional and ethical standards as they expressly apply to valuers are denoted by the use of a **PS** reference number and are **mandatory** (unless otherwise stated) for all *members* providing written *valuations*. They define the parameters for compliance with the Red Book Global Standards, including adoption of the *International Valuation Standards*; set out the associated RICS regulatory requirements; and clarify the detailed application of the **RICS Rules of Conduct** when *members* are undertaking valuation work. They comprise:

PS 1 – Compliance with standards where a written *valuation* is provided

PS 2 – Ethics, competency, objectivity and disclosures.

Valuation technical and performance standards – mandatory

13 Global valuation technical and performance standards are denoted by the use of a **VPS** reference number and contain specific, **mandatory** (unless otherwise stated) requirements and related implementation guidance, directed to the provision of a *valuation* that is IVS-compliant. They comprise:

VPS 1 – Terms of engagement (scope of work)

VPS 2 – Inspections, investigations and records

VPS 3 – Valuation reports

VPS 4 – Bases of value, assumptions and special assumptions

VPS 5 – Valuation approaches and methods.

14 While VPS 1, 4 and 5 focus more on technical standards and VPS 2 and 3 focus more on performance and delivery standards, it would not be helpful to seek to categorise them further in any way. Instead their current order corresponds with that of the *International Valuation Standards*, which the VPSs adopt and apply.

RICS global valuation practice guidance – applications (VPGAs) – advisory

15 RICS valuation practice guidance – applications are denoted by the use of a **VPGA** reference number and provide further implementation guidance in the specific instances listed. Thus, among the topics covered, they include *valuations* for specific purposes (of which financial reporting and secured lending are among the most widely encountered), and *valuations* of certain specific asset types, where particular issues and/or practical considerations expressly need to be taken into account. These VPGAs embody 'best practice' – that is procedures that in the opinion of RICS meet a high standard of professional competence.

16 While not themselves mandatory, the VPGAs do include links and cross references to the material in the *International Valuation Standards* and to material in these global standards that is mandatory. This is intended to assist members in identifying material relevant to the particular valuation assignment they are undertaking.

17 The VPGAs comprise:

VPGA 1 – Valuation for inclusion in financial statements

VPGA 2 – Valuation of interests for secured lending

VPGA 3 – Valuation of businesses and business interests

VPGA 4 – Valuation of individual trade related properties

VPGA 5 – Valuation of plant and equipment

VPGA 6 – Valuation of intangible assets

VPGA 7 – Valuation of personal property, including arts and antiques

VPGA 8 – Valuation of real property interests

VPGA 9 – Identification of portfolios, collections and groups of properties

VPGA 10 – Matters that may give rise to material valuation uncertainty.

National or jurisdictional standards

18 RICS also publishes – separately from but supplementary to these global standards – a number of national supplements (commonly titled *Red Book Jurisdictional Applications*, *National Association Valuation Standards* or *Application of RICS Valuation: Professional Standards*) that address the application of these standards in individual jurisdictions and generally assist interpretation in local contexts. These can be accessed through **RICS' website**. While remaining consistent with the relevant international standards overall, they are designed to cover specific statutory or regulatory requirements in those jurisdictions. This approach is fully in accord with United Nations voluntary guidelines encouraging jurisdictions to enhance transparency and overall consistency in valuation. Compliance with local jurisdictional standards is covered in more detail in **PS 1** below.

19 National or jurisdictional standards and accompanying guidance are **available directly from RICS**.

Effective date, duration and amendments to RICS global material

Effective date

20 The RICS material included in this edition takes effect from 31 January 2022 and applies to all *valuations* where the *valuation date* is on or after that day. Any amendments issued to take effect after that date will be clearly labelled accordingly.

Currency of the text

21 The definitive RICS Red Book Global Standards text current at any given date is that on the **RICS website**. Any users of this publication should take care to ensure that they have had proper regard to any amendments subsequently issued.

Amendments and exposure drafts

22 The content of these standards is under regular review, and amendments and additions will be issued as and when required. *Members*' attention will be drawn to these changes using established RICS electronic communications channels. Such changes will be made to the web-based publication on rics.org at the time, but for the printed version they will be included only in subsequent editions.

23 Where amendments may have a substantial effect, for instance the rewriting of a valuation technical and performance standard **(VPS)** or valuation practice guidance application **(VPGA)**, they may be published as an exposure draft on the **RICS website**. An exposure draft will contain the text authorised for issue for public comment by the RICS Standards and Regulation Board, see the **RICS website.**

24 The purpose of an exposure draft is to enable *members* and others to comment on the proposed text, and possibly identify flaws, before its incorporation into the Red Book Global Standards. The text of an exposure draft will, after consideration of any comments made and final approval by the RICS Standards and Regulation Board, become mandatory on the effective date of the next Red Book Global Standards update following its publication. Again *members*' attention will expressly be drawn to such changes using established RICS electronic communication channels.

25 The RICS Global Standards and Regulation Board is pleased to receive suggestions for inclusion of additional material or requests for clarification of the text.

IVSC International Valuation Standards

Effective date, duration and amendments to the International Valuation Standards

26 The *International Valuation Standards* reproduced with kind permission from IVSC in full in Part 6 are those approved by the IVSC Standards Board with an effective date of 31 January 2022.

27 *Members* are reminded that IVSC reserves the right to make further amendments to IVS at any time. Any consequential amendments to Red Book Global Standards will be made as soon as possible and will be accessible on **RICS' website** (see under 'Currency of the text' and 'Amendments and exposure drafts' above).

28 The IVS are adopted and applied through these RICS global standards, being cross-referenced throughout Parts 3 to 5 for members' convenience.

Important note

It is the member's responsibility to be aware of changes since the date of publication of this edition to legislation or to its interpretation through case law – and also to be aware of amendments to the International Valuation Standards or to any other valuation standards relevant to the particular valuation assignment. Valuers should refer to the RICS website for any updates regarding RICS material, including changes consequent on amendments to the International Valuation Standards. More generally, members are reminded of their responsibility to undertake continuing professional development (CPD) to ensure that they continue to meet the broader requirements for knowledge, experience and competence expected and reflected in these global standards that follow.

Part 2: Glossary

RICS glossary of technical terms

This glossary defines terms used in these global standards that have a special or restricted meaning. Words or phrases not appearing in the glossary follow their common dictionary meaning. Where a term defined below is used in the remainder of this volume, it is identified in the text with *italic* font.

Members' attention is drawn to the fact that IVS (reproduced in Part 6 of this edition) includes a short, dedicated glossary with certain additional definitions specifically to assist with understanding and application of the IVS, including the convention used by IVSC to signal the status of individual IVS content, for example, whether it is mandatory, advisory, etc. These are not replicated here. The individual IVSC standards also contain definitions specific to the particular IVS, to which valuers should refer as appropriate.

RICS national or jurisdictional standards may have additional defined terms: these will be identified and defined in the context of the specific standard.

assumption	A supposition taken to be true. It involves facts, conditions or situations affecting the subject of, or approach to, a *valuation* that, by agreement, do not need to be verified by the valuer as part of the valuation process. Typically, an *assumption* is made where specific investigation by the valuer is not required in order to prove that something is true.
basis of value	A statement of the fundamental measurement *assumptions* of a *valuation*. In some jurisdictions, the basis of value is also known as the 'standard of value'.
cost approach	An approach that provides an indication of 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 construction.
date of the report	The date on which the valuer signs the report.
date of valuation	See *valuation date*.
departure	Special circumstances where the mandatory application of these global standards may be inappropriate or impractical. (See **PS 1 section 6**.)

depreciated replacement cost (DRC)	The current cost of replacing an asset with its modern equivalent asset less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.
equitable 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 (see IVS 104 paragraph 50.1).
external valuer	A valuer who, together with any associates, has no material links with the client, an agent acting on behalf of the client or the subject of the assignment.
Environmental, social and governance (ESG)	'The criteria that together establish the framework for assessing the impact of the sustainability and ethical practices of a company on its financial performance and operations. ESG comprises three pillars: environmental, social and governance, all of which collectively contribute to effective performance, with positive benefits for the wider markets, society and world as a whole.' **IVS 2020 Agenda Consultation** (p14). Although ESG principally refers to companies and investors, ESG-related factors are also used to describe the characteristics and, where relevant, operation of individual assets. It is used throughout these standards in this context.
fair value	'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 derives from International Financial Reporting Standards IFRS 13.)
financial statements	Written statements of the financial position of a person or a corporate entity, and formal financial records of prescribed content and form. These are published to provide information to a wide variety of unspecified *third party* users. *Financial statements* carry a measure of public accountability that is developed within a regulatory framework of accounting standards and the law.
firm	The *firm* or organisation for which the *member* works, or through which the *member* trades.
goodwill	Any future economic benefit arising from a business, an interest in a business, or from the use of a group of assets that is not separable.
income approach	An approach that provides an indication of value by converting future cash flows to a single current capital value.

inspection	A visit to a property or *inspection* of an asset, to examine it and obtain relevant information, in order to express a professional opinion of its value. However, physical examination of a non-real estate asset, for example, a work of art or an antique, would not be described as '*inspection*' as such.
intangible asset	A non-monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and/or economic benefits to its owner.
internal valuer	A valuer who is in the employ of either the enterprise that owns the assets, or the accounting firm responsible for preparing the enterprise's financial records and/or reports. An *internal valuer* is generally capable of meeting the requirements of independence and professional objectivity in accordance with **PS 2 section 3**, but may not always be able to satisfy additional criteria for independence specific to certain types of assignment, for example under **PS 2 paragraph 3.4**.
International Financial Reporting Standards (IFRS)	Standards set by the International Accounting Standards Board (IASB) with the objective of achieving uniformity in accounting principles. The standards are developed within a conceptual framework so that elements of *financial statements* are identified and treated in a manner that is universally applicable.
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, or worth	The value of an asset to the owner or a prospective owner for individual investment or operational objectives (see IVS 104 paragraph 60.1). (May also be known as *worth*.)
market approach	An approach that provides an indication of value by comparing the subject asset with identical or similar assets for which price information is available.
market rent (MR)	The estimated amount for which an interest in real property should be leased on the *valuation date* between a willing lessor and 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 (see IVS 104 paragraph 40.1).

market value (MV)	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 and where the parties had each acted knowledgeably, prudently and without compulsion (see IVS 104 paragraph 30.1).
marriage value	An additional element of value created by the combination of two or more assets or interests where the combined value is more than the sum of the separate values.
member	A Fellow, professional *member*, associate *member* or honorary *member* of the Royal Institution of Chartered Surveyors (RICS).
personal property	*Personal property* means assets (or liabilities) not permanently attached to land or buildings: • **including**, but not limited to, fine and decorative arts, antiques, paintings, gems and jewellery, collectables, fixtures and furnishings, and other general contents • **excluding** trade fixtures and fittings, *plant and equipment*, businesses or business interests, or *intangible assets*.
plant and equipment	*Plant and equipment* may be broadly divided into the following categories: • **plant**: assets that are combined with others and that may include items that form part of industrial infrastructure, utilities, building services installations, specialised buildings, and machinery and equipment forming a dedicated assemblage • **machinery**: individual, or a collection or a fleet or system of, configured machines/technology (including mobile assets such as vehicles, rail, shipping and aircraft) that may be employed, installed or remotely operated in connection with a user's industrial or commercial processes, trade or business sector (a machine is an apparatus used for a specific process) or • **equipment**: an all-encompassing term for other assets such as sundry machinery, tooling, fixtures, furniture and furnishings, trade fixtures and fittings, sundry equipment and technology and loose tools that are used to assist the operation of the enterprise or entity.
real estate	Land and all things that are a natural part of the land (e.g. trees, minerals) and things that have been attached to the land (e.g. buildings and site improvements) and all permanent building attachments (e.g. mechanical and electrical plant providing services to a building), that are both below and above the ground. (Note that a right of ownership, control, use or occupation of land and buildings is defined as a real property interest in IVS 400 at paragraph 20.2.)

registered for regulation/ registered by RICS	a) A *firm* that is registered for regulation by RICS under the RICS bye-laws. b) A *member* who is registered as a valuer under RICS Valuer Registration (VR).
special assumption	An *assumption* that either assumes facts that differ from the actual facts existing at the valuation date or that would not be made by a typical market participant in a transaction on the valuation date.
special purchaser	A particular buyer for whom a particular asset has a *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*.
specialised property	A property that is rarely, if ever, sold in the market, except by way of a sale of the business or entity of which it is part, due to the uniqueness arising from its specialised nature and design, its configuration, size, location or otherwise.
sustainability	*Sustainability* is, for the purpose of these standards, taken to mean the consideration of matters such as (but not restricted to) environment and climate change, health and wellbeing, and personal and corporate responsibility that can or do impact on the *valuation* of an asset. In broad terms it is a desire to carry out activities without depleting resources or having harmful impacts. There is as yet no universally recognised and globally adopted definition of 'sustainability'. Therefore, members should exercise caution over the use of the term without additional appropriate explanation. In some jurisdictions, the term 'resilience' is being adopted to replace the term 'sustainability' when related to property assets. Sustainability may also be a factor in environmental, social and governance (ESG) considerations.
terms of engagement	Written confirmation of the conditions that either the *member* proposes or that the *member* and client have agreed shall apply to the undertaking and reporting of the *valuation*. Referred to in IVS as scope of work – see IVS 101 paragraph 10.1.
third party	Any party, other than the client, who may have an interest in the *valuation* or its outcome.
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.

trading stock	Stock held for sale in the ordinary course of business, for example, in relation to property, land and buildings held for sale by builders and development companies.
valuation	An opinion of the value of an asset or liability on a stated basis, at a specified date. If supplied in written form, all valuation advice given by members is subject to at least some of the requirements of the Red Book Global Standards – there are no exemptions (**PS 1 paragraph 1.1**). Unless limitations are agreed in the *terms of engagement, a valuation* will be provided after an *inspection*, and any further investigations and enquiries that are appropriate, having regard to the nature of the asset and the purpose of the *valuation*.
valuation date	The date on which the opinion of value applies. The *valuation date* should also include the time at which it applies if the value of the type of asset can change materially in the course of a single day.
worth	See *investment value*.

Standards and guidance naming conventions explained

Description	Status	Inclusions	Comments
Standards	Mandatory	The *International Valuation Standards* (IVS) as issued by the International Valuation Standards Council (IVSC). RICS professional standards – denoted by the prefix PS. RICS valuation technical and performance standards – denoted by the prefix VPS.	The IVS are adopted and applied by RICS in Red Book Global Standards, being cross-referenced throughout.
Guidance	Advisory	RICS valuation practice guidance applications – denoted by the prefix VPGA.	VPGAs are advisory and not mandatory in content. However, they alert *members* (where appropriate) to relevant mandatory material contained elsewhere in Red Book Global Standards, including to the relevant IVS, by the inclusion of appropriate cross-references.

RICS also separately publishes guidance from time to time on other valuation topics in the form of guidance notes. Such material is advisory in nature. It is available on the **RICS website**.

Part 3: Professional standards

PS 1 Compliance with standards where a written valuation is provided

This mandatory standard:

- applies International Valuation Standard (IVS) 102 Section 10 General Principle (Compliance with IVS) and Section 40 Compliance with Other Standards
- recognises the International Ethics Standards and the International Property Measurement Standards
- specifies additional mandatory requirements for RICS *members*.

All *members*, whether practising individually or within an RICS-regulated or non-regulated *firm*, who provide a written *valuation* are required to comply with the international standards and RICS global standards set out below.

***Members* must also comply with the requirements of RICS Valuer Registration (VR).**

1 Mandatory application

1.1 All *members* and regulated *firms,* wherever practising, must comply with the professional, valuation technical and performance standards (designated by the prefixes **PS** and **VPS**) in Parts 3 and 4 of this global edition.

1.2 In accordance with RICS bye-law B5.2.1(b) Liability of Members and RICS bye-law B5.3.1 Liability of Firms, these global standards are therefore of mandatory application to any *member* of RICS or RICS-regulated *firm* involved in undertaking or supervising valuation services by the provision of written valuation advice. Together with the guidance relating to specific valuation practice guidance – applications (VPGAs) in Part 5 of this global edition, they are commonly referred to as the RICS 'Red Book Global Standards'.

1.3 The phrase 'undertaking or supervising valuation services' includes any person who is responsible for, or accepts responsibility for, analysing and communicating a written opinion of value. This may include individuals who produce but do not sign valuation reports within their organisation, and conversely individuals who sign by way of supervision or assurance but do not produce valuation reports within their organisation. 'Written' for this purpose means conveyed by paper, by any electronic or digital means or form of recorded media (for purely oral opinions of value see paragraph 1.6 below).

1.4 For the avoidance of doubt, the provision of an automated valuation model (AVM)-derived output or one based on a valuation modelling tool (see **VPS 5 paragraph 4**) is regarded as the provision of a written *valuation* for the purpose of these standards.

1.5 An estimated replacement cost figure for assets other than *personal property* that is provided either within a written report or separately, for the purpose of insurance, is not a 'written opinion of value' for the purpose of 'undertaking valuation services' as defined in paragraph 1.3 above.

1.6 For the avoidance of doubt, where – exceptionally – valuation advice is provided wholly orally, the principles set out in this volume should still be observed to the fullest extent possible. *Members* are reminded that the mere fact that advice is provided orally does not mean that it is therefore provided without liability – the valuer's responsibilities and obligations will always depend on the facts and circumstances of the individual case. In some jurisdictions, the provision of oral valuation advice is in any event subject to jurisdiction-specific standards requirements. Furthermore, in all jurisdictions valuers acting as expert witnesses should be alert to the fact that both oral and written advice will be subject to the same criteria – see for example the RICS UK practice statement and guidance note, **Surveyors acting as expert witnesses**, 4th edition (2014).

1.7 These global standards have been written as they apply to the individual *member*. Where it is necessary to consider their application to a *firm registered for regulation by RICS*, they are to be interpreted accordingly.

2 Compliance within firms

2.1 There is an individual responsibility on the part of all *members* to comply with these global standards whether they practise as individuals or within *firms*. In the latter case, how this responsibility is put into practice will depend, to a certain extent, on the nature of the *firm*:

- ***Firms* regulated by RICS**: The *firm* and all RICS *members* within the *firm* must ensure that all processes and *valuations* are fully compliant with the mandatory requirements in these global standards. This includes *valuations* that are not the responsibility of an RICS *member*.
- ***Firms* not regulated by RICS**: While such *firms* may have their own corporate processes over which RICS cannot exert control, individual *members* in these *firms* who are responsible for *valuations* must comply with the mandatory requirements in these global standards.

2.2 There may be circumstances where the *firm's* processes expressly prevent compliance with a particular aspect of these global standards. In such cases the *member* is entitled to depart from the specific standard, but must:

- be satisfied that the non-compliance does not lead to clients being misled or to unethical behaviour
- identify in the *terms of engagement* (see **VPS 1**) and the report (see **VPS 3**) the specific areas where compliance with any element of the standards has been precluded, together with the reason for this non-compliance and
- comply with all other aspects of these global standards.

2.3 Where the *member* contributes to a *valuation*, reference should also be made to **PS 2 section 2**.

3 Compliance with international standards

International Valuation Standards (IVS)

3.1 RICS recognises the International Valuation Standards Council (IVSC) as the setter of *International Valuation Standards* (IVS), which comprise internationally accepted valuation principles and definitions. These global standards adopt and apply the IVS, setting out specific requirements for, together with additional guidance on, their practical implementation. The IVS effective from 31 January 2020 are reproduced in full in Part 6 of these global standards.

3.2 Where there is an express requirement in relation to an individual valuation assignment that the *valuation* complies with IVS, and this needs to be made clear both in the *terms of engagement* and in the report, then the form of endorsement in **VPS 1 paragraph 3.2(n)** and **VPS 3 paragraph 2.2(k)** may be adopted. Otherwise, the general form of endorsement in **VPS 1** and **VPS 3** may be used, namely that the *valuation* will be/has been undertaken in accordance with RICS Red Book Global Standards (more formally, the *RICS Valuation – Global Standards*).

3.3 *Members* are reminded that where a statement is made that a *valuation* will be or has been undertaken in accordance with the IVS it is implicit that all relevant individual IVS standards are complied with. Where a departure from IVS is necessary, this should be clearly explained.

International Ethics Standards (IES)

3.4 RICS is a member of the international coalition of professional organisations established to develop and implement the first set of globally recognised ethics standards for property and related professional services. The global standards in this volume are consistent with the ethical principles published to date by the IES coalition, and also include additional and more detailed requirements that all *members* must observe.

International Property Measurement Standards (IPMS)

3.5 RICS is also a member of the international coalition of professional organisations established to develop and implement consistent and transparent property (i.e. *real estate*) measurement standards. Where *members* are undertaking valuation work relating to *real estate* assets or liabilities, they must have regard to the International Property Measurement Standards wherever applicable. The **RICS property measurement** professional statement contains more detail.

4 Compliance with jurisdictional or other valuation standards

4.1 It is recognised that a *member* may be requested to provide a report that complies with standards other than the standards set out in Red Book Global Standards. This will normally arise in relation to the particular requirements that apply within individual jurisdictions. It is perfectly proper for *members* to comply with such requirements, which may include a *basis of value* not listed in **VPS 4** below, provided it is absolutely clear which standards are being adopted.

4.2 In these cases a statement must be included in the *terms of engagement* and in the report that the named standards have been complied with. If the compliance is mandatory in the jurisdiction concerned, i.e. because of statutory, regulatory or other authoritative requirements,

then this does not preclude the *valuation* still being declared as performed in accordance with the Red Book Global and – if appropriate – with the IVS.

4.3 For a number of jurisdictions, RICS publishes national supplements to the Red Book Global Standards to assist *members* in the application of the valuation standards in a local context. Where appropriate, these supplements may be produced as joint publications with local valuation professional organisations (VPOs) or published separately but reflecting those VPOs' requirements where not at variance with RICS requirements.

4.4 Where the compliance with other valuation standards is voluntary, i.e. not falling within either **paragraph 4.2** above or this paragraph, this will involve a departure – see **section 6** below. Note that compliance with such standards cannot override the mandatory requirements of **PS 1** and **PS 2**, which *members* must at all times observe.

4.5 Where the *valuation* involves assets in two or more countries or states with different valuation standards, the *member* must agree with the client which standards will apply to the instruction.

4.6 Departures from the IVS to comply with legislative and regulatory requirements that are in conflict with the standards are allowed. In such circumstances, a valuer may still state that the valuation has been performed in accordance with the IVS.

5 VPS 1–5 exceptions

5.1 If supplied in written form, **all** valuation advice given by *members* is subject to at least some of the requirements of the Red Book Global Standards – there are **no exemptions (PS 1 paragraph 1.1**). Similarly, where valuation advice is given wholly orally, the principles set out in the Red Book Global Standards should still be observed to the fullest extent possible (**PS 1 paragraph 1.6**). Thus **PS 1** and **PS 2** are mandatory in **all** cases (see **Introduction paragraph 12** and **PS 1 paragraph 7.1**). In other words, they apply to all *members* whatever type of valuation activity they are engaged in.

5.2 However, given the sheer diversity of activity undertaken by *members*, and the diversity of jurisdictional contexts in which *valuations* and valuation advice are delivered, there is a need for differentiation between particular types of assignment where the mandatory application of **VPS 1–5** may be unsuitable or inappropriate. Even though not mandatory in such circumstances, the adoption of the relevant standards is nevertheless encouraged where not precluded by the specific requirement or context. These **exceptions** regarding **VPS 1–5** are set out at greater length below. However, it is not practical to set out every possible scenario – thus in cases of doubt, it is safer to regard **VPS 1–5** as mandatory.

5.3 Valuers should be aware that **exceptions** are not usually specific to individual cases but cover particular categories, phases or aspects of valuation activity (see **PS 1 paragraph 6.2**). In such cases *members* are reminded that they must not state that the *valuation* was performed in accordance with the IVS. (See the IVS Framework.)

5.4 The areas of exception in relation to **VPS 1–5** are where a *member* is:

- Providing an agency or brokerage service in respect of the acquisition or disposal of one or more assets – to which activity the RICS global practice statement and guidance note, *Real estate agency and brokerage guidance*, 3rd edition (2016) applies. This exception covers the

provision of advice in the expectation of, or in the course of, an agency instruction to acquire or dispose of an interest in an asset. It also covers advice on whether a given offer should be made or accepted. However, the exception does not cover a purchase report that includes a *valuation*.

- Acting or preparing to act as an expert witness – the reason for the exception is to recognise that a *member* acting as an expert witness must follow very precisely the specific rules and procedures laid down by the court, tribunal or other judicial body before which the *member* will, or may, be appearing. In addition, the *member* must meet and observe very high standards of impartiality and objectivity. Reference may usefully be made to the RICS UK practice statement and guidance note, *Surveyors acting as expert witnesses*, 4th edition (2014).
- Performing statutory functions – where the relevant statutory provisions will define the task and also frequently govern the manner in which it is to be carried out. The emphasis in this exception is on the word function, i.e. the performance of a statutory role or duty involving the exercise or enforcement of powers that are expressly defined or recognised in legislation, normally involving the formal appointment of an individual to that specific role. The mere fact that a *valuation* is being provided in accordance or compliance with, or consequence of, legislation is not the point. For example, the provision of a *valuation* for inclusion in a statutory return to a tax authority, which involves compliance with the law but not the exercise or enforcement of it, does not fall within this exception.
- Providing *valuations* to a client purely for internal purposes, without liability, and without communication to a *third party*. The internal purposes exception is designed to recognise that there are occasions where advice is sought from a valuer by a client – often by a regular portfolio valuation client – that will be without liability, and will not be released to *third parties* (for example, in connection with proposed asset management initiatives or proposed acquisitions). Where *members* undertake such work, it is vital that the *terms of engagement* and the written advice itself are quite explicit about the prohibition on disclosure to any other party and/or use for any other purpose and about the exclusion of liability. Such advice often does not attract an additional fee and this element of the valuation service may or may not be explicitly referred to in the *terms of engagement* for a regular portfolio *valuation*. The mere fact that the provider of the *valuation* is an *internal valuer* does not bring the valuation assignment within the exception – the focus here is on the 'internal only' purpose of the *valuation* and not the process or means of its delivery. It is therefore possible for an *external valuer* to provide an 'internal purposes' *valuation*, though where that is done, the need for the *terms of engagement* and written advice to be absolutely clear about non-disclosure to *third parties*, and about the exclusion of liability, becomes even more crucial.
- Providing valuation advice expressly in preparation for, or during the course of, negotiations or litigation, including where the valuer is acting as advocate.

  The negotiations exception covers valuation advice on the probable outcome of current or impending negotiations, or requests for figures to be quoted in connection with such negotiations. It therefore recognises that:

  - Although there may not yet be an unresolved dispute, the advice is being provided expressly in preparation for, or during the course of, negotiations that may lead either to agreement or to the creation of an unresolved dispute, triggering (where the context allows it) a formal process of resolution (for example, reference to the courts, to arbitration, etc.).

- The negotiation advice may, and often will, extend to advice on matters such as tactics and/or probable outcomes and/or options to achieve resolution without recourse either to litigation or to other formal procedures.

The litigation exception recognises that:

- There is a formal dispute in existence, however it arises, and the proceedings will therefore be subject to any relevant legislation, regulation, rules or court directions that may be in place or issued, which will always take precedence over the Red Book Global Standards.
- Advice given to a client may extend to various matters going beyond the provision of advice on value, for example advice on tactics and/or the probable outcome of litigation and/or options regarding settlement of the dispute or mitigation of costs.

5.5 The circumstances in which valuers are instructed to provide valuation reports and advice vary widely and may, in some cases, take several years to reach a conclusion. During this time, the instruction may be significantly amended – resulting in an instruction that began as an 'exception' ceasing to be so. Valuers should always focus on the actual task in hand at a specific point in the valuation process. If a valuer's role changes during this process, it is imperative that their actions are transparent, the application of Red Book Global Standards at any given point in time is fully documented and the client is made aware of any change to the valuer's role or undertaking.

5.6 Even though the content of VPS 1 may not be mandatory in 'exception' cases, it cannot be too strongly emphasised that terms of engagement are still required and that they must be clear, unambiguous and appropriately documented (PS 2 section 7 paragraphs 7.3 and 7.4). This is as much in the interests of the valuer as of the client, as it ensures that there is no ambiguity about what is being requested and what is being supplied.

5.7 Valuations are either compliant with Red Book Global Standards or not. Terms such as 'quasi–Red Book' or 'partial Red Book' – or even 'non-Red Book' – must not be used in terms of engagement or reporting. Any appropriate exceptions to VPS 1–5 should be explicitly stated and explained in the terms of engagement and valuation report.

6 Departures

6.1 No departure is permitted from **PS 1**, where a written *valuation* is provided, or **PS 2** in these global standards, which are mandatory in all circumstances.

6.2 If separately and independently from either the specific exceptions set out above or any assignment falling within the scope of **section 4** above, there are special circumstances where it is considered inappropriate to comply, in whole or in part, with **VPS 1 to VPS 5 inclusive**, then these must be confirmed and agreed with the client as a *departure* and a clear statement to that effect included in the *terms of engagement*, report, and any published reference to it.

6.3 For the avoidance of doubt:

- If the *valuation* falls to be provided in compliance with prescribed statutory or legal procedures or other authoritative requirements then provided those requirements are mandatory in the particular context or jurisdiction, compliance does not by itself constitute a *departure* – though the requirement to do so must be made clear.

- For most valuation purposes, one of the *bases of value* specified in **paragraph 2.2 of VPS 4** will be appropriate. Where another basis is used, this must be clearly defined and stated in the report. If adoption of that basis is mandatory in the particular context or jurisdiction, then adoption does not by itself constitute a *departure*, though the mandatory requirement to do so must be made clear. RICS does not encourage the voluntary use of a *basis of value* not specified in **VPS 4**, and will always regard such voluntary use as involving a *departure* from the Red Book Global Standards.

6.4 A *member* who makes a *departure* may be required to justify the reasons for this.

6.5 The circumstances in which a valuer can make a departure from the IVS are as described in Section 60 of the IVS Framework.

7 Regulation: monitoring compliance with these global standards

7.1 As a self-regulatory body, RICS has a responsibility to monitor and seek assurance of compliance by its *members* and regulated *firms* with these global standards. It has the right under its bye-laws to seek information from *members* or *firms*. The procedures under which such powers will be exercised in relation to *valuations* are set out on the **RICS website**.

7.2 *Members* must also comply with the **RICS Valuer Registration requirements** where applicable.

8 Application to members of other valuation professional organisations

8.1 These global standards may also be formally adopted by other valuation professional organisations (VPOs) subject to the prior approval and agreement of RICS.

8.2 Except where RICS has formally agreed to the use of the Red Book Global Standards by appropriately qualified members of another VPO, no valuer who is not a *member* of RICS may state that their *valuation* is or has been undertaken in full compliance with RICS Red Book Global Standards.

PS 2 Ethics, competency, objectivity and disclosures

This mandatory standard:

- applies the International Valuation Standards (IVS) Framework
- recognises the International Ethical Standards and the International Property Measurement Standards
- specifies additional mandatory requirements for RICS *members*.

As it is fundamental to the integrity of the valuation process, all *members* practising as valuers must have the appropriate experience, skill and judgment for the task in question and must always act in a professional and ethical manner free from any undue influence, bias or conflict of interest.

1 Professional and ethical standards

1.1 RICS *members* operate to the highest professional and ethical standards. Thus the criteria for RICS membership and for qualification and practice as a valuer, including the requirements of RICS Valuer Registration where applicable (see **PS 1 section 1**), meet or exceed the standards for the conduct and competency of professional valuers promoted by the IVSC.

1.2 These global standards are also fully consistent with the ethical principles published to date by the **International Ethical Standards Coalition**, of which RICS is a member.

1.3 As well as being required to conform to these high-level principles and requirements, all RICS *members* are subject to additional – and in many cases more stringent – requirements as set out below. Observance is monitored and enforced through RICS Regulation.

1.4 The requirements set out in these global standards are expressly focussed on *members* undertaking valuation work, i.e. opinions of value prepared by a *member* having the appropriate technical skills, experience and knowledge of the subject of *valuation*, the market and the purpose of the *valuation*.

1.5 *Members* must at all times act with integrity and avoid any actions or situations that are inconsistent with their professional obligations. They must bring the required levels of independence and objectivity to bear on individual assignments, applying professional scepticism to information and data where it is to be relied on as evidence. Professional scepticism is an attitude that includes a questioning mind, critically assessing evidence relied on in the valuation process and being alert to conditions that may cause information provided to be misleading. *Members* must not allow conflicts of interest to override their professional or business judgment and obligations, and must not divulge confidential information. All *members* are bound by the **RICS Rules of Conduct** and must comply with **Conflicts of interest**, RICS professional statement.

2 Member qualification

2.1 Members and firms *must* ensure that services are provided by competent individuals who have the necessary expertise. The test of whether an individual is appropriately qualified to accept responsibility for, or supervise the inputs into, a *valuation* involves satisfying the following criteria:

- appropriate academic/professional qualifications, demonstrating technical competence
- membership of a professional body, demonstrating a commitment to ethical standards
- sufficient current local, national and international (as appropriate) knowledge of the asset type and its particular market, and the skills and understanding necessary, to undertake the *valuation* competently
- compliance with any country or state legal regulations governing the right to practise *valuation* and
- where applicable, compliance with the RICS Valuer Registration (VR) requirements.

2.2 As *members* are active across a wide range of specialisms and markets, membership of (including the holding of a qualification from) RICS or registration as a valuer does not of itself imply that an individual necessarily has the practical experience of *valuation* in a particular sector or market: this must always be verified by appropriate confirmation.

2.3 In some jurisdictions, valuers are required to be certified or licensed to undertake certain *valuations*. In such cases **PS 1 section 4** will apply. In addition, either the client or RICS national requirements may stipulate more stringent requirements. In such cases a statement must be included in the *terms of engagement* and in the report that the named standards have been complied with – **PS 1 paragraph 4.2**.

2.4 If the *member* does not have the required level of expertise to deal with some aspect of the valuation assignment properly then he or she should decide what assistance is needed. With the express agreement of the client where appropriate, the *member* should then commission, assemble and interpret relevant information from other professionals, such as specialist valuers, environmental surveyors, accountants and lawyers.

2.5 The personal knowledge and skill requirements may be met in aggregate by more than one *member* within a *firm*, provided that each meets all the other requirements of this standard.

2.6 The client's approval must be obtained if the *member* proposes to employ another *firm* to provide some or all of the *valuations* that are the subject of the instruction (see also **VPS 3, paragraph 2.2(a)**).

2.7 Where more than one valuer has undertaken or contributed to the *valuation*, a list of those valuers must be retained with the working papers, together with a confirmation that each named valuer has complied with the requirements of **PS 1**.

2.8 A *member* responsible for supervision (see **PS 1 paragraph 1.3**) must be able to demonstrate:

- an appropriate level of supervision throughout all stages of the valuation instruction, suitably evidenced and capable of standing up to scrutiny and challenge at a later date, particularly where the valuation assignment involves remote locations and/or more than one jurisdiction

- an acceptance of responsibility and accountability for the valuation report and its content, and the ability to explain and defend it if challenged – it is essential that the process is not seen as one simply of approving automatically without proper consideration.

3 Independence, objectivity, confidentiality and the identification and management of conflicts of interest

3.1 Independence and objectivity are inextricably linked to the proper observance of the confidentiality of information and to the wider issue of the identification and management of conflicts of interest. *Members* must follow the mandatory requirements in **Conflicts of interest**, RICS professional statement, and have careful regard to the guidance that accompanies it. The text in the remainder of this section is specifically directed to valuation work and is supplementary.

3.2 Valuers are reminded of two fundamental requirements contained in **Conflicts of interest**:

a No *member* shall advise or represent a client where doing so would involve a conflict of interest or a significant risk of a conflict of interest, other than where all of those who are or may be affected have provided their prior informed consent. (The affected party can only give informed consent if the person explaining the position to them is entirely transparent, and also that the person explaining the position is sure that the party affected understands what they are doing – including the risks involved and any alternative options available – and is doing it willingly). Informed consent may be sought only where the *member* is satisfied that proceeding despite a conflict of interest is in the interests of all of those who are or may be affected.

b *Members* should keep records of the decisions made in relation to whether to accept (and where relevant, to continue) individual professional assignments, the obtaining of informed consent, and any measures taken to avoid conflicts of interest arising.

3.3 Bringing the required levels of independence and objectivity to bear on individual assignments, respecting and maintaining confidentiality, and identifying and managing potential or actual conflicts of interest are of crucial importance. Valuation work often has a particular complexity or sensitivity concerning such matters and it is a requirement that *members* act strictly in accordance with the following general standards and valuation-specific criteria.

3.4 For some purposes, statutes, regulations, rules of regulatory bodies or clients' special requirements (such as for secured lending *valuations* – see **VPGA 2**) may set out specific criteria that the *member* must meet (i.e. they are additional to the general requirements below) in order to achieve a defined state of independence. Frequently such additional criteria provide a definition of the acceptable level of independence and may use terms such as 'independent expert', 'expert valuer', 'independent valuer', 'standing independent valuer' or 'appropriate valuer'. It is important that the *member* confirms compliance with these criteria both when confirming acceptance of the instruction and in the report, so that the client and any *third party* relying on the report can be assured that the additional criteria have been satisfied.

3.5 Confidential information is defined in the RICS professional statement **Conflicts of interest** as 'confidential information, whether held or disseminated electronically, verbally or in

hard copy'. There is a general duty to treat information relating to a client as confidential where that information becomes known as a result of the professional relationship and is not in the public domain. Information gathered in the course of valuation work may be market sensitive and this duty is therefore of special importance.

3.6 In particular, great care must be exercised not to breach confidentiality when reporting to clients in compliance with **VPS 3 paragraph 2.2(h)** concerning reference to the 'key inputs used'. In accordance with the RICS professional statement **Conflicts of interest**, the duty of confidentiality will always take precedence over the duty of disclosure, subject to legal override.

3.7 The risk of disclosure of confidential information is also a material factor that the valuer should consider in identifying whether or not there is a potential conflict of interest, or in the terms of the RICS professional statement a 'Confidential Information Conflict' (definition 4.2(c)). It is sometimes necessary to disclose some details of the valuer's involvement in the subject of the *valuation*. If an adequate disclosure cannot be made without breaching the duty of confidentiality, then the instruction should be declined.

3.8 The duty of confidentiality is continuous and ongoing, and includes current, past and even potential clients.

3.9 While it is not possible to provide a definitive list of situations in a valuation context where a threat to a *member's* independence or objectivity may arise, the following should always be regarded as presenting a potential or actual threat and therefore requiring appropriate action as specified in the RICS professional statement:

- acting for the buyer and the seller of a property or asset in the same transaction
- acting for two or more parties competing for an opportunity
- valuing for a lender where advice is also being provided to the borrower or the broker
- valuing a property or asset previously valued for another client of the same valuer or firm
- undertaking a *valuation* for *third-party* consumption where the valuer's *firm* has other fee-earning relationships with the client and
- valuing both parties' interests in a leasehold transaction.

Members are also reminded that the interest of any *third parties* in the *valuation*, and the reliance they may place on it, will also be a relevant consideration.

3.10 A threat to the *member's* objectivity can arise where the outcome of a *valuation* is discussed before its completion with either the client or another party with an interest in the *valuation*. While such discussions are not improper, and indeed may be beneficial to both the *member* and the client, the *member* must be alert to the potential influence that such discussions may have on their fundamental duty to provide an objective opinion. Where such conversations take place, the *member* must make a written record of any meetings or discussions, and whenever the *member* decides to alter a provisional *valuation* as a result, the grounds for doing so must also be carefully noted.

3.11 The *member* may need to discuss various matters, such as the verification of facts and other relevant information (for example, confirming the outcome of rent reviews or clarifying the boundaries of a property), before forming a preliminary opinion of value. At any stage in the valuation process such discussions give the client an opportunity to understand the *member's*

viewpoint and evidence. It is expected that the client would disclose facts or information, including information about transactions in the property, asset or liability, relevant to the valuation task.

3.12 In providing a client with preliminary advice, or a draft report or *valuation* in advance of its completion, the *member* must state that:

- the opinion is provisional and subject to completion of the final report
- the advice is provided for the client's internal purposes only and
- any draft is on no account to be published or disclosed.
- If any matters of fundamental importance are not reflected, their omission must be declared.

3.13 Where discussions with a client occur after the provision of preliminary material or opinions, it is important that such discussions do not, and can be shown not to, lead to any perception that the *member's* opinion has been influenced by those discussions, other than to correct inaccuracies or incorporate any further information provided.

3.14 To demonstrate that the discussions have not compromised the *member's* independence the file notes of discussions with the client on draft reports or *valuations* should include:

- the information provided, or the suggestions made, in relation to the *valuation*
- how that information was used to consider a change in material matters or opinions and
- the reasons why the *valuation* has or has not been changed.

3.15 If requested, this record should be made available to auditors or any other party with a legitimate and material interest in the *valuation*.

4 Maintaining strict separation between advisers

4.1 RICS has strict guidelines on the minimum standards that must be adopted by organisations, once 'informed consent' has been obtained in accordance with the RICS professional statement **Conflicts of interest**, when separating the advisers acting for 'conflicting' clients. Any arrangement (colloquially known in some jurisdictions as a 'Chinese wall') that is established must be robust enough to offer no chance of information or data passing from one set of advisers to another. This is a very strict test; taking 'reasonable steps' to operate an effective separation is not sufficient.

4.2 Accordingly, any arrangement set up and agreed to by affected clients must be overseen by a 'compliance officer' as described below, and must satisfy all of the following requirements:

a the individual(s) acting for conflicting clients must be different – note that this extends to secretarial and other support staff

b such individuals or teams must be physically separated, at least to the extent of being in different parts of a building, if not in different buildings altogether

c any information or data, however held, must not be accessible to 'the other side' at any time and, if in a written form, must be kept secure in separate, locked accommodation to the satisfaction of the compliance officer, or another senior independent person, within the firm

d the compliance officer or other senior independent person:

i should oversee the setting up and maintenance of the arrangement while it is in operation, adopting appropriate measures and checks to ensure it is effective

ii must have no involvement in either of the instructions and

iii should be of sufficient status within the organisation to be able to operate without hindrance and

e there should be appropriate education and training within the *firm* on the principles and practices relating to the management of conflicts of interest.

4.3 Effective arrangements are unlikely to work without considerable planning, as their management needs to be an established part of a firm's culture. It will therefore be more difficult, and often impossible, for smaller firms or offices to operate them.

5 Disclosures where the public has an interest or upon which third parties may rely

5.1 Disclosure requirements

5.1.1 Certain types of *valuation* may be relied on by parties other than the client that either commissioned the report or to whom it is addressed. Examples of this type of *valuation* would include those for:

- a published financial statement
- a stock exchange, or similar body
- publication, prospectus or circular
- investment schemes (in the Americas, where applicable: investment programs), which may take a number of forms in individual jurisdictions
- takeovers or mergers.

Where the *valuation* is of an asset that has previously been valued by the valuer, or the valuer's *firm* for any purpose, the following disclosures must be made in the *terms of engagement*, in the report, and in any published reference to the *valuation*, as the case may be, as set out later below:

- the relationship with the client and previous involvement
- rotation policy
- time as signatory
- proportion of fees.

5.1.2 The disclosures required by this standard may be modified or extended by requirements that apply to a specific country or state), or that are incorporated into the relevant national standards (where **PS 1 section 4** applies).

5.1.3 For modified or extended requirements in relation to *valuation* for secured lending see **VPGA 2**.

5.2 Reliance by third parties

5.2.1 Where reliance may be placed on a *valuation* by a *third party* (as defined in the Glossary) who or which is identifiable from the outset, the disclosures in accordance with this section must be made promptly to that party before the *valuation* is undertaken. In addition to those disclosures there must also be disclosure of any circumstances where the valuer or the *firm* will gain from the appointment beyond a normal fee or commission. This gives *third parties* the opportunity to object to the appointment if they feel that the *member's* independence and objectivity may be compromised.

5.2.2 However, in many cases the *third parties* will be a class of individuals, for example, the shareholders of a company, where disclosure at the outset to all interested *third parties* would clearly be impractical. In such cases the earliest practical opportunity for disclosure will be in the report or any published reference to it. A greater onus thus lies on the *member* to consider, before accepting the instruction, whether those *third parties* relying on the *valuation* will accept that any involvement requiring disclosure does not unduly compromise the *member's* objectivity and independence. See **section 8** below for further detail about disclosures in relation to specific categories of *valuation*.

5.2.3 *Valuations* in the public domain, or which will be relied on by *third parties*, are frequently subject to statute or regulation. There are often specific stipulations that the *member* must meet in order to be deemed suitable to provide a truly objective and independent view. Where that is not the case, the onus is on the *member* to ensure that there is an awareness of potential conflicts and other threats to independence and objectivity.

5.3 The relationship with the client and previous involvement

5.3.1 Although the requirement for the *member* to act with independence, integrity and objectivity as described above is clear, it does not necessarily require disclosure of all the working relationships between the *member* and the client. The *member* should consider and follow the principles set out in the RICS professional statement **Conflicts of interest**. In cases of doubt it is recommended that a disclosure is made.

5.3.2 To expose any potential conflict of interest where the *member*, or the *member's firm*, has been involved with the purchase of one or more assets for the client within the period of 12 months preceding the date of instruction or date of agreement of the *terms of engagement* (whichever is earlier) or a specific longer period prescribed or adopted in a particular jurisdiction, the *member* must disclose in relation to those assets:

- receipt of an introductory fee or
- negotiation of that purchase on behalf of the client.

5.3.3 In considering the disclosures required by this professional statement, it is necessary to identify the 'client' and 'firm'.

5.3.4 There are many different relationships that may be considered to fall within the identification of the client and firm. To be consistent with the minimum *terms of engagement* (see **VPS 1**) and reporting (see **VPS 3**), the client is the entity that agrees the *terms of engagement* and to which the report is addressed. The firm is the entity that is identified in the confirmation of the *terms of engagement* and the report.

5.3.5 Closely connected companies within a group should properly be regarded as a single client or firm. However, due to the often complex nature of modern business it is frequently the case that the other entities have only a remote legal or commercial connection with the client for which the *member's firm* also acts. There may also be practical difficulties in identifying such relationships, for example, between the associates of the *member's firm* in other countries or states and the client. Sometimes it is the *member's* commercial relationship with a party other than the client that could create a perceived threat to independence.

5.3.6 The *member* is expected to make reasonable enquiries proportionate to the circumstances: it is not necessary to establish every potential relationship that there may be, provided the *member* adheres to the principles of this standard.

5.3.7 The following are examples of where the disclosure requirements will relate to and include parties other than the entity giving the valuation instruction:

- subsidiaries of an instructing holding company
- where instructions are from a subsidiary company, those other companies connected by the same holding company or
- a *third party* issuing valuation instructions as an agent for different legal entities, for example, the managers of a property fund.

5.3.8 Similar considerations apply in identifying the extent of the *member's firm* for disclosure purposes, where there may be separate legal entities in different locations and/or undertaking different types of work. It may not be relevant to include all organisations connected with the *firm* undertaking the *valuation* where the activities are remote or immaterial – for example, they do not involve the provision of asset valuation or similar advice. However, if there is a series of closely connected entities trading under a common style, the extent of the client's relationship with all those entities should be disclosed – for example, a *firm* where one arm is undertaking *valuations* and another undertaking all other property advice and management.

5.3.9 National or jurisdictional valuation standards or local regulations may extend this requirement by applying additional requirements.

5.4 Rotation policy

5.4.1 The obligation to disclose the *firm's* rotation policy will arise only where the *member* has provided a series of *valuations* over a period of time. Where it is a first or one-off instruction, it is not necessary to comment on any general rotation policy.

5.4.2 Where the *member* responsible for the *valuation* in accordance with this standard holds that responsibility for many years, familiarity with either the client or the asset valued could lead to the perception that the *member's* independence and objectivity has been compromised. This may be addressed by arranging for the rotation of the *member* who accepts responsibility for the *valuation*.

5.4.3 The method by which a *firm* arranges for any rotation of those responsible for *valuations* is for the *firm* to decide, after discussion with the client if appropriate. However, RICS recommends that the individual responsible for signing the report, no matter the standing of that *member* in the *firm*, has that responsibility for a limited number of years. The exact period will depend on:

- the frequency of valuation
- any control and review procedures in place such as 'valuation panels', which assist both the accuracy and objectivity of the valuation process and
- good business practice.

RICS considers it good practice, albeit not mandatory, to rotate valuers at intervals not exceeding seven years.

5.4.4 If a *firm* is of insufficient size to rotate the signatory, or to have in place 'valuation panels', other arrangements could be made to comply with the principles of this standard. For example, where the same valuation instruction is undertaken on a regular basis, an arrangement for the *valuation* to be periodically reviewed at intervals not greater than seven years by another *member* would assist in demonstrating that the *member* is taking steps to ensure that objectivity is maintained and thus may retain the confidence of those relying on the *valuation*.

5.5 Time as signatory

5.5.1 The purpose of this requirement is to provide any *third party* with information on the length of time that a *member* has continuously been the signatory to *valuations* for the same purpose. It also requires a similar disclosure as to the length of time the *member's firm* has been carrying out *valuations* of that asset for the same client, and the extent and duration of their relationship.

5.5.2 In relation to the *member*, the disclosure should relate to the continuous period of responsibility for the *valuation* up to the *date of the report*. It is possible that the *member* was the signatory to previous reports for the same purpose, but due to the *firm's* rotation policy (as set out earlier) there was a period of time when the *member* did not have that responsibility. There is no requirement to include that earlier period in the disclosure.

5.5.3 The *member* is not required to provide a comprehensive account of all work ever undertaken by the *member's firm* for the client. A simple, concise statement that discloses the nature of other work done and the duration of the relationship is all that is required.

5.5.4 If there is no relationship other than the valuation instruction in question, a statement to that effect should be made.

5.6 Previous involvement

5.6.1 The purpose of this requirement is to expose any potential conflict of interest where the *member*, or the *member's firm*, has valued the asset for the same purpose, or has been involved with the purchase of the same asset for the client either within the period of 12 months preceding the *valuation date* or within such other period and criteria as may be prescribed or adopted in a particular state or country.

5.6.2 Where the *valuation* is provided for inclusion in a published document in which the public has an interest, or upon which *third parties* may rely, the *member* should make the following disclosures:

a where a *valuation* is of an asset that has previously been valued by the *member* or the *member's firm*, for the same purpose:

- in the *terms of engagement*, a statement about the *firm's* policy on the rotation of the valuer responsible for the *valuation* and
- in the report, and published reference to it, a statement of the length of time the valuer has continuously been the signatory to *valuations* provided to the client for the same purpose as the report and, in addition, the length of time the valuer's *firm* has continuously been carrying out the valuation instruction for the client

b the extent and duration of the relationship of the valuer's *firm* with the client for any purpose

c where the report, and any published reference to it, includes one or more assets acquired by the client within the period applicable under **paragraph 5.6.1** immediately above, and the *member* or *member's firm*, has in relation to those assets:

- received an introductory fee or
- negotiated that purchase on behalf of the client

a statement should be made to such effect including, wherever relevant, endorsement of the report in accordance with **paragraph 5.7** immediately below.

5.6.3 National valuation standards or local regulations may extend this requirement by applying additional criteria.

5.6.4 For additional or modified requirements in relation to *valuation* for secured lending see **VPGA 2**.

5.7 Proportion of fees

5.7.1 A statement should be made that the proportion of the total fees payable by the client during the preceding year relative to the total fee income of the *member's firm* during the preceding year are minimal, significant or substantial.

5.7.2 A proportion of fees less than 5% may be considered to be 'minimal'. Between 5% and 25% may be considered to be significant, and above 25% is substantial.

5.7.3 National valuation standards or local regulations may extend this requirement by applying additional criteria.

5.8 Other disclosures

5.8.1 Care should be taken to make sure that, in addition to the various disclosures required under **VPS 1 to VPS 3**, all other disclosures required for a particular *valuation* or purpose are made. Disclosure requirements that may require more specific information related to the purpose of the *valuation* include:

- material involvement
- the status of the *member*
- specific requirements as to independence
- knowledge and skills of the *member*
- extent of investigations
- management of any conflicts of interest

- the valuation approach
- disclosures required by any regulatory body governing the purpose of the *valuation*.

6 Reviewing another valuer's valuation

6.1 A valuer may quite properly be requested to review all or part of a *valuation* prepared by another valuer in circumstances that include the following, though the list is not exhaustive:

- assisting the consideration of risk assessment
- providing comment on a published *valuation*, for instance in a takeover situation
- commenting on *valuations* produced for use in legal proceedings
- assisting an audit enquiry.

6.2 It is important to make a clear distinction between a critical review of a *valuation* and an audit of a *valuation* or an independent *valuation* of a property, asset or liability included in another valuer's report.

6.3 In carrying out any review the *member* is expected, by reference to the *valuation date* and to the facts and circumstances relevant to the asset at the time, to:

- form opinions as to whether the analysis in the work under review is appropriate
- consider whether the opinions and conclusions are credible and
- consider whether the report is appropriate and not misleading.

6.4 The review must be undertaken in the context of the requirements applicable to the work under review, and the *member* must develop and report opinions and conclusions together with the reasons for any disagreement.

6.5 A *member* must not undertake a critical review of a *valuation* prepared by another valuer that is intended for disclosure or publication, unless the *member* is in possession of all the facts and information upon which the first valuer relied.

7 Terms of engagement (scope of work)

7.1 Consistent with the various requirements set out above and to ensure that all relevant matters have been, or will be, adequately covered, it is fundamental that by the time any written *valuation* is concluded, but prior to the issue of the report, all the matters material to the report must have been fully brought to the client's attention and appropriately documented. This is to ensure that the report does not contain any revision of the initial *terms of engagement* of which the client is unaware.

7.2 *Members* should take care that they understand their clients' needs and requirements fully, and appreciate that there will be occasions when they may need to guide clients to choose the most appropriate advice for the given circumstances.

7.3 The standards for minimum *terms of engagement* are set out in **VPS 1**. Where **VPS 1** is not mandatory (for example, **PS 1 section 5**), appropriate *terms of engagement* should nevertheless be prepared to suit the specific case. It is acknowledged, given the sheer diversity of valuation activity undertaken by *members*, and the diversity of jurisdictional contexts in which *valuations* and valuation advice are delivered, that *terms of engagement* will be commensurate to the client's

needs – but in all cases *members* must ensure that all matters material to the report have been brought to the client's attention.

7.4 As disputes may arise many years after the completion of a *valuation*, it is essential that the agreement of the *terms of engagement* is contained in, or evidenced by, comprehensive documentation maintained in a recognised and acceptable business format.

8 Responsibility for the valuation

8.1 For the avoidance of doubt, once the various preliminary issues above have been adequately addressed, each assignment to which these global standards apply must be prepared by, or under the supervision of, an appropriately qualified, and named, valuer who accepts responsibility for it.

8.2 Where the *valuation* has been prepared with input from other *members* or valuers, or a separate valuation report on some specific aspect is incorporated, the resultant *valuation* remains the responsibility of the named valuer under **paragraph 7.1** above, but the others involved may be acknowledged ensuring that any statements expressly required under **VPS 3, paragraph 2.2(a)** are made.

8.3 RICS does not allow a *valuation* to be prepared by a '*firm*' (even though this is permitted by the IVS). However, the use of 'for and on behalf of' under the responsible valuer's signature is an acceptable substitution.

8.4 *Members* are discouraged from referring to any *valuation* or report as either 'formal' or 'informal', as these terms may give rise to misunderstanding, particularly regarding the extent of investigation and/or assumptions that the *member* may or may not have undertaken or made.

8.5 *Members* must exercise great caution before permitting *valuations* to be used for purposes other than those originally agreed. It is possible that a recipient or reader will not fully appreciate the restricted character of the *valuation* and of any qualifications in the report, and that it may be misquoted out of context. Furthermore a conflict of interest may potentially arise that would not have been relevant to the original assignment. It is essential therefore that the *terms of engagement* and the reporting appropriately address this risk. See also **section 4, Maintaining strict separation between advisers**, above.

Part 4: Valuation technical and performance standards

As explained in paragraphs 13 and 14 of the Introduction, the global technical and performance standards to be followed by *members* are set out in VPS 1–5 which follow. While VPS 1, 4 and 5 focus more on technical standards and VPS 2 and 3 focus more on performance and delivery standards, it would not be helpful to seek to categorise them further in any way. Instead their current order corresponds with that of the *International Valuation Standards*, which the VPSs adopt and apply. See the text box at the start of each VPS.

VPS 1 Terms of engagement (scope of work)

This mandatory standard:

- applies International Valuation Standard (IVS) 101 Scope of Work
- specifies additional mandatory requirements for RICS *members* designed to:
- enhance client understanding of the service to be provided, with clarity concerning the basis on which the fee will be calculated
- provide assurance that work undertaken by RICS *members* meets high professional standards backed by effective regulation
- address particular aspects of implementation that may arise in individual cases.

1 General principles

1.1 Normally the *terms of engagement* will be settled between the client and the valuer when instructions are first received and accepted (the initial confirmation of instructions). However, it is recognised that a valuation assignment may range from a single asset to a substantial portfolio, thus the extent to which all the minimum *terms of engagement* can be confirmed at the outset could also vary.

1.2 Valuers should take care to ensure that they understand their clients' needs and requirements fully, and appreciate that there will be occasions when they may need to guide clients to choose the most appropriate advice for the given circumstances.

1.3 In brief, the *terms of engagement* should convey a clear understanding of the valuation requirements and process and should be couched in terms that can be read and understood by someone with no prior knowledge of the subject asset, nor of the valuation process.

1.4 The format and detail of the proposed valuation report is a matter to be agreed between the valuer and the client and recorded in writing in the *terms of engagement*. It should always be proportionate to the task and – as for the *valuation* itself – be professionally adequate for the purpose. For clarity, the standards expressly to be met when issuing a valuation report are set out in **VPS 3**. These generally mirror the requirements set out here, but with some additional detail.

1.5 Whenever the valuer or client identifies that a *valuation* may need to reflect an actual or anticipated marketing constraint, details of that constraint must be agreed and set out in the *terms of engagement.* The term 'forced sale value' must not be used (see **VPS 4 section 10**).

1.6 By the time the *valuation* is concluded, but prior to the issue of the report, all relevant matters must have been fully brought to the client's attention and appropriately documented.

This is to ensure that the report does not contain any revision of the initial *terms of engagement* of which the client is unaware.

2 Terms of engagement format

2.1 *Firms* may have a standard form of *terms of engagement* or standing *terms of engagement* in place that may include several of the minimum terms required by this global standard. The valuer may need to amend such a form to refer to those matters that will be clarified at a later date.

2.2 Although the precise format of the *terms of engagement* may vary – for example, some 'in-house' *valuations* may have standing instructions or other internal policies or procedures – valuers must prepare written *terms of engagement* for all valuation work. The risks that can potentially arise if queries are subsequently raised and the parameters for the valuation assignment are insufficiently documented cannot be over-emphasised.

3 Terms of engagement (scope of work)

3.1 *Terms of engagement* must address the following matters.

a Identification and status of the valuer

b Identification of the client(s)

c Identification of any other intended users

d Identification of the asset(s) or liability(ies) being valued

e Valuation (financial) currency

f Purpose of the valuation

g Basis(es) of value adopted

h Valuation date

i Nature and extent of the valuer's work – including investigations – and any limitations thereon

j Nature and source(s) of information upon which the valuer will rely

k All assumptions and special assumptions to be made

l Format of the report

m Restrictions on use, distribution and publication of the report

n Confirmation that the valuation will be undertaken in accordance with the IVS

o The basis on which the fee will be calculated

p Where the firm is registered for regulation by RICS, reference to the firm's complaints handling procedure, with a copy available on request

q A statement that compliance with these standards may be subject to monitoring under RICS' conduct and disciplinary regulations

r A statement setting out any limitations on liability that have been agreed.

3.2 Each heading is considered in more detail below. The text in bold specifies the key principles. The accompanying text specifies how the principles are to be interpreted and implemented in individual cases.

a) Identification and status of the valuer

Include a statement confirming:

- **that the *valuation* will be the responsibility of a named individual valuer. RICS does not allow a *valuation* to be prepared by a '*firm*'**
- **that the valuer is in a position to provide an objective and unbiased *valuation***
- **whether or not the valuer has any material connection or involvement with the subject asset or the other parties to the valuation assignment. If there are any other factors that could limit the valuer's ability to provide an impartial and independent *valuation*, such factors must be disclosed**
- **that the valuer is competent to undertake the valuation assignment. If the valuer needs to seek material assistance from others in relation to any aspect of the assignment, the nature of such assistance and the extent of reliance must be clear, agreed and recorded.**

Implementation

1 The use of 'for and on behalf of' a firm is an acceptable substitution by an identified signatory when issuing a report. If the valuation has been undertaken by a member under the supervision of an appropriately qualified valuer, the valuer fulfilling the supervisory function must ensure, and be satisfied, that the work undertaken meets the same minimum standards as if he or she had been solely responsible for the task.

2 For some purposes the valuer may be required to state if he or she is acting as an internal or external valuer. Where the valuer is obliged to comply with additional requirements regarding independence, PS 2 section 3 will apply.

3 In considering the extent of any material involvement, whether past, current or possible future involvement, the valuer must state such involvement in the terms of engagement. Where there has not been any previous material involvement, a statement to that effect must be made in the terms of engagement and valuation report (see **VPS 3 paragraph 2.2(a)(4)**). More extensive guidance on independence and objectivity is given in **PS 2**.

4 With regard to the competence of the valuer, the statement may be limited to confirmation that the valuer has sufficient current local, national and international (as appropriate) knowledge of the particular market, and sufficiently developed skills and understanding to undertake the valuation competently. It is not necessary to provide any details. Where the provisos in **PS 2 section 3** apply, an appropriate disclosure is to be made.

b) Identification of the client(s)

Confirmation of those for whom the valuation assignment is being produced is important when determining the form and content of the report to ensure that it contains information relevant to their needs. Any restriction on those who may rely upon the valuation assignment must be agreed with the client and recorded.

Implementation

1 Requests for *valuations* will frequently be received from representatives of the client, in which event the valuer should ensure that the client is correctly identified. This is particularly relevant where:

- the request is made by the directors of a company, but the client is the company and the directors have a separate legal standing or
- the *valuation* is required for loan purposes and, although commissioned by the borrower or an entity acting for the lender (for example, a service management company), the report may be for the lender, its subsidiaries, or members of a syndicate, for example, so it is imperative to identify the true client or
- the *valuation* is required for estate management or estate-related revenue filings and, although commissioned by a financial adviser or an attorney, the report may be for the estate, the true client.

c) Identification of other intended users:

It is important to understand whether there are any other intended users of the valuation report, their identity, and their needs, in order to ensure that the report content and format meets those users' needs.

Implementation

1 The valuer must state whether or not any parties other than the client may rely upon the *valuation*.

2 In many cases, it will only be the valuer's client who is seeking reliance upon the *valuation*. Agreeing to extend reliance to *third parties* may significantly increase the risks to the valuer.

3 As a default position, valuers should confirm that they do not permit *third party* reliance on the valuation report in their *terms of engagement*. Any permitted reliance on the *valuation* by a *third party* should be carefully considered and the terms on which reliance is permitted should be documented. Particular care needs to be taken to ensure that the valuer does not unwittingly become exposed to the risk of *third parties* claiming that a duty of care has been extended to them, and that any relevant terms of business (such as limitations on liability) apply to *third parties* who are permitted to rely on a *valuation*. Valuers should consider taking legal advice in this regard.

4 Valuers should exercise care in considering whether assignment of the valuation engagement contract (as distinct from permitting *third parties* to rely upon it) is to be permitted, as doing so may expose valuers to additional risks. Valuers should ensure that the terms of their professional indemnity insurance provides the requisite cover where assignment is permitted.

d) Identification of the asset(s) or liability(ies) being valued:

The subject asset or liability in the valuation assignment must be clearly identified, taking care to distinguish between an asset or liability and an interest in or right to use that asset or liability as the case may be.

If the *valuation* is of an asset or liability that is used in conjunction with other assets or liabilities, it will be necessary to clarify whether those assets or liabilities are:

- **included in the valuation assignment**
- **excluded but assumed to be available or**
- **excluded and assumed not to be available.**

If the *valuation* is of a fractional interest held in an asset or liability, it will be necessary to clarify the relationship of the fractional interest being valued relative to all other fractional interests and the obligations of the fractional interest ownership, if any, to other fractional interest owners.

Particular regard must be had to the identification of portfolios, collections and groups of properties. It is essential to consider 'lotting' or 'grouping'; the identification of different property or asset categories; and any *assumptions* or *special assumptions* relating to the circumstances under which the properties, assets, liabilities or collections may be brought to the market.

Implementation

1 The legal interest in each asset or liability must be stated. Clarification is essential to distinguish between the characteristics of the asset in its entirety and the particular right or interest that is being valued.

2 When valuing an interest in real property that is subject to a tenancy, it may be necessary to identify any improvements undertaken by tenants and to clarify whether or not these improvements are to be disregarded on renewal, or review, of the lease, or even if they may give rise to a compensation claim by the tenant when vacating the property.

3 When valuing a fractional (percentage of the whole) ownership interest in a real property, the valuer also needs to identify the degree of control represented by the percentage interest being valued and any rights held by the other fractional interest ownerships that encumber the marketability of the interest being valued (such as a first right of purchase in the event the ownership being valued is to be sold).

4 Where there is doubt about what constitutes a single property or asset, the valuer must 'lot', or group, the properties for *valuation* in the manner most likely to be adopted in the case of an actual sale of the interest(s) being valued. However, the valuer must always discuss the options with the client and must confirm the approach adopted in the *terms of engagement* and subsequently in the valuation report.

5 For further guidance on portfolios, collections and groups of properties including the reporting format, see **VPGA 9**.

6 For non-financial liabilities, see IVS 220.

e) Valuation (financial) currency

The currency in which the *valuation* of the asset or liability is to be expressed must be established.

This requirement is particularly important for valuation assignments involving assets or liabilities in more than one jurisdiction and/or cash flows in multiple currencies.

Implementation

1 If a *valuation* has to be translated into a currency other than that of the country in which the asset is located, the basis of the exchange rate must be agreed.

f) Purpose of the valuation

The purpose for which the valuation assignment is being prepared must be clearly identified and stated as it is important that valuation advice is not used out of context or for purposes for which it is not intended.

The purpose of the *valuation* will also typically influence or determine the *basis(es) of value* to be used.

Where the purpose of valuation is a named exception (see PS 1 section 5), as a matter of good practice VPS 1-5 should be followed – where not precluded by the specific requirement or context.

Implementation

1 If the client declines to reveal the purpose of the *valuation*, valuers should be aware that it may be difficult to comply with all aspects of these global standards. If the valuer is willing to proceed with the *valuation*, the client must be advised in writing that this omission will be referred to in the report. In this case the report must not be published or disclosed to *third parties*.

2 If an unusually qualified *valuation* is to be provided, the *terms of engagement* must state that it is not to be used for any purpose other than that originally agreed with the client.

g) Basis(es) of value adopted:

The valuation basis must be appropriate for the purpose of the *valuation*. The source of the definition of any *basis of value* used must be cited or the basis explained. This requirement does not apply to a valuation review where no opinion of value is to be provided and the reviewer is not required to comment on the *basis of value* used.

Implementation

1 Where a valuation basis is expressly defined in these global standards (including IVS-defined bases), that definition must be reproduced in full. Where the definition is supplemented by a detailed conceptual framework or other explanatory material, it is not necessary to reproduce that framework or explanation. However, there is discretion to reproduce it should the valuer consider that it assists the client to understand more fully the reasoning behind the *basis of value* adopted.

2 For certain specific purposes, such as financial reporting under the International Financial Reporting Standards, or in consequence of individual jurisdictional requirements, the adoption of a specific *basis of value* may be stipulated. In all other cases the appropriate basis(es) is essentially a matter for the valuer's professional judgment.

3 It is recognised that for some purposes a projected value may be required in addition to a current *valuation*. Any such projection should comply with the applicable jurisdictional and/or national standards. See **VPS 4**.

h) Valuation date

The *valuation date* 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. Where appropriate, these dates should be clearly distinguished.

Implementation

1 The specific *valuation date* will need to be agreed with the client – an *assumption* that the *valuation date* is the date of the report is not acceptable.

2 Where, exceptionally, the advice being provided relates to a future date, see **VPS 3 paragraph 2.2(f)** and **VPS 4 section 11**, regarding the reporting requirements.

i) Nature and extent of the valuer's work – including investigations – and any limitations thereon

Any limitations or restrictions on the *inspection*, inquiry and/or analysis for the purpose of the valuation assignment must be identified and recorded in the *terms of engagement*.

If relevant information is not available because the conditions of the assignment restrict the investigation, then if the assignment is accepted, these restrictions and any necessary *assumptions* or *special assumptions* made as a result of the restriction must be identified and recorded in the *terms of engagement*.

Implementation

1 A client may require a restricted service; for example, a short timescale for reporting may make it impossible to establish facts that would normally be verified by *inspection*, or by making normal enquiries; or the request may be for a *valuation* based on the output of an automated valuation model (AVM). Note that the provision of an AVM-derived output would be regarded as the provision of a written *valuation* for the purpose of these standards (see **PS 1 paragraph 1.4**). Accordingly valuers should be alert to, and aware of, the implications of either accepting or manually modifying an AVM output. A restricted service will also include any limitations on *assumptions* made in accordance with **VPS 2.**

2 It is accepted that a client may sometimes require this level of service, but it is the duty of the valuer to discuss the requirements and needs of the client prior to reporting. Such instructions, when related to *real estate*, are often referred to as 'drive-by', 'desk-top' or 'pavement' *valuations*.

3 The valuer should consider if the restriction is reasonable, with regard to the purpose for which the *valuation* is required. The valuer may consider accepting the instruction subject to certain conditions, for example that the *valuation* is not to be published or disclosed to *third parties*.

4 If the valuer considers that it is not possible to provide a *valuation*, even on a restricted basis, the instruction should be declined.

5 The valuer must make it clear when confirming acceptance of such instructions that the nature of the restrictions and any resulting *assumptions*, and the impact on the accuracy of the *valuation*, will be referred to in the report. (See also **VPS 3**.)

6 **VPS 2** contains general requirements with regard to *inspections*.

j) Nature and source(s) of information upon which the valuer will rely

The nature and source of any relevant information that is to be relied upon and the extent of any verification to be undertaken during the valuation process must be identified, agreed and recorded.

For this purpose, 'information' is to be interpreted as including data and other such inputs.

Implementation

1 Where the client will provide information that is to be relied on, the valuer has a responsibility to state that information clearly in the *terms of engagement* and, where appropriate, its source. In each case the valuer must judge the extent to which the information to be provided is likely to be reliable, being mindful to recognise and not to exceed the limitations of their qualification and expertise in this respect.

2 The client may expect the valuer to express an opinion (and, in turn, the valuer may wish to express an opinion) on social, environmental and legal issues that affect the *valuation*. The valuer must therefore make clear in the report any information that must be verified by the client's or other interested parties' legal advisers before the *valuation* can be relied on or published.

k) All assumptions and special assumptions to be made

All *assumptions* and *special assumptions* that are to be made in the conduct and reporting of the valuation assignment must be identified and 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 or other advice provided.**
- **A *special assumption* is an *assumption* that either assumes facts that differ from the actual facts existing at the *valuation date* or that would not be made by a typical market participant in a transaction on the *valuation date*.**

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

Implementation

1 *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.

2 Further guidance on *assumptions* and *special assumptions*, including the case of projected values (i.e. future state of the asset or of any factors relevant to its *valuation*) can be found in **VPS 4**.

l) Format of the report

The valuer must establish the format of the report and how the *valuation* will be communicated.

Implementation

1 **VPS 3** sets out the mandatory reporting requirements. Where – exceptionally – it is agreed that any of the minimum reporting contents are to be excluded they may be treated as *departures*, provided they are agreed in the *terms of engagement,* are appropriately referred to in the valuation report, and do not result in a report that is misleading and/or professionally inadequate for its purpose.

2 A report prepared in accordance with this standard and with **VPS 3** must not itself be described as a certificate or statement, the use of such language implying either a guarantee or a level of certainty that is often inappropriate. However, a valuer may use the term 'certified', or similar words, within the body of a report where it is known that the *valuation* is to be submitted for a purpose that requires formal certification of a valuation opinion.

3 Valuers should be aware that the terms 'certificate of value', 'valuation certificate' and 'statement of value' have specific meanings in certain countries or states in designating statutory documents. One common factor is that these documents require a simple confirmation of price or value, without any requirement to understand the context, fundamental *assumptions* or analytical processes behind the figure provided. A valuer who has previously provided a *valuation* or advised on a transaction involving the asset may prepare such a document where the client is required to provide it by statute.

m) Restrictions on use, distribution and publication of the report

Where it is necessary or desirable to restrict the use of the valuation advice or those relying upon it, the restrictions must be clearly communicated.

Implementation

1 The valuer must state the permitted use, distribution and publication of the valuation report.

2 Restrictions are only effective if notified to the client in advance.

3 The valuer should keep in mind that any insurance that protects against claims for negligence under professional indemnity insurance (PII) policies may require the valuer to have particular qualifications, and to include certain limiting clauses in every report and *valuation*. If this is the case the relevant words should be repeated, unless the insurers agree to either

a modification or a complete waiver. If in doubt, valuers should refer to their insurance policy before accepting instructions.

4 Some *valuations* will be for purposes where the exclusion of *third party* liability is either forbidden by law or by an external regulator. In other cases, it will be a matter for clarification or agreement with the client, having regard also to the judgment of the valuer.

5 Particular care should be taken in relation to valuation assignments in connection with secured lending to address *third party* liability issues.

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

The valuer should provide:

> **confirmation that the *valuation* will be undertaken in accordance with the *International Valuation Standards* (IVS) and that the valuer will assess the appropriateness of all significant inputs**

or (depending on clients' particular requirements)

> **confirmation that the *valuation* will be undertaken in accordance with the *RICS Valuation – Global Standards*, which incorporate the IVS, and (where applicable) the relevant RICS national or jurisdictional supplement. Where appropriate, such confirmation may be abbreviated to refer simply to the RICS Red Book Global Standards.**

In both cases an accompanying note and explanation of any *departures* from the IVS or the RICS Red Book Global Standards must be included. Any such *departure* must be identified, together with justification for that *departure*. A *departure* would not be justified if it results in a *valuation* that is misleading.

Implementation

1 There is no material difference in outcome between the respective forms of endorsement above, which may be used according to the particular requirements of the valuation assignment. Some clients will expressly wish to have confirmation that the *valuation* has been undertaken in accordance with the IVS, and it is naturally in order for this to be given. In all other cases confirmation that the *valuation* has been undertaken in accordance with the RICS Red Book Global Standards carries with it the dual assurance of compliance with the IVS technical standards and with the RICS professional standards overall.

2 References to the RICS Red Book Global Standards without reference to the year of issue will be taken to mean the version of the RICS standards operative at the *valuation date*, provided that it is on or before the *date of the report*. Where a 'projected value' is to be provided (i.e. relating to a date after the *date of the report*) the *date of the report* will be the deciding factor as to the RICS Red Book Global Standards version that applies.

3 The statement of compliance should draw attention to any *departures* (see **PS 1 section 6**). Where a *departure* is made that is not mandatory, it will not be possible to confirm compliance with the IVS.

4 Where other valuation standards – specific to a particular jurisdiction – will be followed, this should be confirmed as part of agreeing the *terms of engagement*.

o) The basis on which the fee will be calculated

Implementation

1 The level of the fee is a matter to be settled with the client, unless there is a fee basis prescribed by an external body that binds both parties. RICS does not publish any scale of recommended fees.

p) Where the firm is registered for regulation by RICS, reference to the firm's complaints handling procedure, with a copy available on request

Implementation

1 This requirement is included to emphasise the need for firms *registered for regulation by RICS* to comply with the **RICS Rules of Conduct**.

q) A statement that compliance with these standards may be subject to monitoring under RICS' conduct and disciplinary regulations

Implementation

1 The purpose of this statement is to draw the attention of the client to the possibility that the *valuation* may be investigated for compliance with these standards.

2 Guidance on the operation of the monitoring regime, including matters relating to confidentiality, is available on the **RICS website**.

3 Clients should be aware that this statement cannot validly be made by any valuer who is not a *member* or practising within an RICS-regulated *firm* or covered by an arrangement under **PS 1 Section 8**.

r) A statement setting out any limitations on liability that have been agreed

Implementation

1 The issues of risk, liability and insurance are closely linked. Pending the issue of guidance of global application, *members* should check the latest RICS guidance applicable in their jurisdiction on the **RICS website**.

VPS 2 Inspections, investigations and records

This mandatory standard:

- applies International Valuation Standard (IVS) 102 Investigations and compliance
- specifies additional mandatory requirements for RICS *members* designed to enhance client understanding of the valuation process and report
- addresses particular aspects of implementation that may arise in individual cases.

1 Inspections and investigations

***Inspections* and investigations must always be carried out to the extent necessary to produce a *valuation* that is professionally adequate for its purpose. The valuer must take reasonable steps to verify the information relied on in the preparation of the *valuation* and, if not already agreed, clarify with the client any necessary *assumptions* that will be relied on.**

These general principles are supplemented by the following additional requirements embodied in **VPS 1** and **VPS 3**:

- **Any limitations or restrictions on the *inspection*, inquiry and analysis for the purpose of the valuation assignment must be identified and recorded in the *terms of engagement* (VPS 1 paragraph 3.2(i)) and also in the report (VPS 3 paragraph 2.2(h)).**
- **If the relevant information is not available because the conditions of the assignment restrict the investigation, then if the assignment is accepted, these restrictions and any necessary *assumptions* or *special assumptions* made as a result of the restriction must be identified and recorded in the *terms of engagement* (VPS 1 paragraph 3.2(i)) and in the report (VPS 3 paragraph 2.2(h)).**

Implementation

1.1 When settling the *terms of engagement* the valuer must agree the extent to which the subject asset is to be inspected and any investigation is to be made – see **VPS 1**.

1.2 When determining the extent of evidence necessary, professional judgement is required to ensure the information to be obtained is adequate for the purpose of the *valuation* and consistent with the *basis of value* adopted. In each case the valuer must judge the extent to which the information to be provided is likely to be reliable and be mindful to recognise and not to exceed the limitations of their qualification and expertise when making this judgment.

1.3 When a property or other physical asset is inspected or examined the degree of investigation that is appropriate will vary, depending on the nature of the asset and the purpose of the *valuation*. Except in the circumstances described in the section 'Revaluation without re-inspection' below, valuers are reminded that to dispense voluntarily with an *inspection* or

examination of physical assets may introduce an unacceptable degree of risk in the valuation advice to be provided – they must therefore carefully assess that risk before proceeding: see **VPS 1 paragraph 3.2(i)** regarding 'restricted services', including the use of automated valuation models.

1.4 Where measurement needs to be undertaken or checked *members* must have regard to the International Property Measurement Standards wherever applicable. The **RICS property measurement**, RICS professional statement contains more detail.

1.5 VPGA 8 provides detailed commentary on matters evident or to be considered during *inspection* of *real estate*, including those matters that fall within the general heading of '*sustainability* and ESG matters'. Such factors are commonly important in terms of market and societal perception and influence, and valuers should have proper regard to their relevance and significance in relation to individual valuation assignments.

1.6 Subject to **PS 2 paragraph 2.4** and **VPS 1 paragraph 3.2(j)**, the valuer must take reasonable steps to verify the information relied on in the preparation of the *valuation* and, if not already agreed, clarify with the client any necessary *assumptions* that will be made. While a client may request, or consent to, an *assumption* being relied on, nevertheless if – following an *inspection* or examination – the valuer considers that such an *assumption* is at variance with the observed facts, then its continued adoption could, providing that it is realistic, relevant and valid for the particular circumstances of the *valuation* become a *special assumption* (see **VPS 4 section 9**).

1.7 If relevant information is not available because the conditions of the instruction prevent *inspection*, or where it is agreed that *inspections* and investigations may be limited, then if the instruction is accepted, the *valuation* will be on the basis of restricted information and **VPS 1 paragraph 3.2(j)** will apply. Any restriction on *inspection* or examination or lack of relevant information should be set out in the *terms of engagement* and valuation report. If the valuer considers that it is not possible to provide a *valuation* even on a restricted basis, the instruction should be declined.

1.8 When a valuation assignment involves reliance on information supplied by a party other than the valuer, the valuer should consider whether the information is credible and may be relied on without adversely affecting the credibility of the valuation opinion. In that event, the assignment may proceed. Significant inputs provided to the valuer (for example, by management or owners) that materially affect the valuation outcome but about which the valuer considers some element of doubt arises will require assessment, investigation and/or corroboration, as the case may be. In cases where the credibility or reliability of information supplied cannot be supported, such information should not be used.

1.9 While the valuer should take reasonable care to verify any information provided or obtained, any limitations on this requirement must be clearly stated. (See **VPS 1**.) When preparing a *valuation* for *financial statements* the valuer should be prepared to discuss the appropriateness of any *assumptions* with the client's auditor, other professional adviser or regulator.

1.10 A valuer meeting the criteria in **PS 2 section 2**, will be familiar with, if not expert on, many of the matters affecting either the type of asset, including where applicable the locality. Where an issue, or potential issue, that could affect value is within the valuer's knowledge

or evident from an *inspection* or examination of the asset, including where applicable the immediate locality, or from routine enquiries, it should be drawn to the client's attention no later than when the report is issued, and ideally in advance of the report in cases where the impact is significant.

2 Revaluation without re-inspection of real property previously valued

Implementation

2.1 A revaluation without a re-*inspection* of an interest in real property previously valued by the valuer or *firm* must not be undertaken unless the valuer is satisfied that there have been no material changes to the physical attributes of the property, or the nature of its location, since the last assignment.

2.2 It is recognised that the client may need the *valuation* of its property updated at regular intervals and that re-*inspection* on every occasion may be unnecessary. Provided that the valuer has previously inspected the property, and the client has confirmed that no material changes to the physical attributes of the property and the area in which it is situated have occurred, a revaluation without re-*inspection* may be undertaken. The *terms of engagement* must state that this *assumption* has been made.

2.3 The valuer must obtain from the client information of current or anticipated changes in rental and other relevant income from investment properties and any material changes to the non-physical attributes of each property, such as other lease terms, planning consents, statutory notices and so on. The valuer must also consider any *sustainability* and ESG factors that could affect the *valuation*.

2.4 Where the client advises that there have been material changes, or if the valuer is otherwise aware or has good reason to believe that such changes have taken place, the valuer must inspect the property. In all other cases, the interval between *inspections* is a matter for the professional judgment of the valuer who will, among other considerations, have regard to its type and location.

2.5 If the valuer believes that it is inappropriate to undertake a revaluation without re-*inspection* because of material changes, the passage of time or other reasons, the valuer may nevertheless accept an instruction to proceed without *inspection* providing the client confirms in writing, prior to the delivery of the report, that it is required solely for internal management purposes, that no publication or disclosure will be made to *third parties* and that the client accepts responsibility for the associated risk. A statement declaring this position, and that the report must not be published, must be set out unequivocally in the report.

3 Valuation records

A proper record must be kept of *inspections* and investigations, and of other key inputs, in an appropriate business format.

Implementation

3.1 Details of the *inspection* and any investigations must be clearly and accurately recorded in a manner that is neither ambiguous nor misleading and does not create a false impression.

3.2 To maintain a proper audit trail and be in a position to respond effectively to a future enquiry, legible notes (which may include photographs or other images) of the findings and, particularly, the limits of *inspection* and the circumstances in which it was carried out must be made. The notes should also include a record of the key inputs and all calculations, investigations and analyses considered when arriving at the *valuation*.

3.3 Valuers should collect and record appropriate and sufficient sustainability and ESG data for the valuation.

3.4 All notes and records should be retained in an appropriate business format. The appropriate period for retention will depend on the purpose of the *valuation* and the circumstances of the case but must have regard to any relevant statutory, legal or regulatory requirements.

VPS 3 Valuation reports

This mandatory standard:

- applies International Valuation Standard (IVS) 103 Reporting
- specifies additional mandatory requirements for RICS *members* designed to enhance client understanding and use of reports
- addresses particular aspects of implementation that may arise in individual cases.

1 General principles

The report must:

- **clearly and accurately set out the conclusions of the *valuation* in a manner that is neither ambiguous nor misleading, and which does not create a false impression. If appropriate, the valuer should draw attention to, and comment on, any issues affecting the degree of certainty, or uncertainty, of the *valuation* under item (o) below.**
- **deal with all the matters agreed between the client and the valuer in the *terms of engagement* (scope of work) (see VPS 1).**

1.1 In brief, the valuation report should convey a clear understanding of the opinions being expressed by the valuer and should be couched in terms that can be read and understood by someone with no prior knowledge of the subject asset or liability.

1.2 The format and detail of the report is a matter to be agreed between the valuer and the client in the *terms of engagement*. It should always be proportionate to the task, and – as for the *valuation* itself – professionally adequate for the purpose. Where the report is to be provided on a form, or in a format, specified by the client that omits reference to one or more of the headings below, then either the initial service agreement or the *terms of engagement* – or an appropriate combination of the two – must clearly address these matters. Failure to do so would result in the *valuation* not being undertaken in accordance with these global standards. See also **VPS 1(l)** in this regard.

1.3 Where multiple reports are to be made to a single client over a period of time, with identical *terms of engagement*, it must be made clear to the client and to any others who may rely on the valuation advice provided, that the *terms of engagement* and form of report must always be read together.

1.4 A valuer may provide the client with preliminary valuation advice, or a draft report or draft *valuation*, in advance of the completion of the final report – see **PS 2 paragraphs 3.12–3.15**. However, it is essential that the preliminary or provisional status is made clear, pending issue of the formal and final report.

1.5 *Members* are reminded that any valuation advice provided, in whatever format, creates a potential liability to the client, or under certain circumstances, to one or more *third parties*. Great care should therefore be taken to identify and understand when and how such liabilities do, or may, arise, and their likely extent. See **paragraph 2.2(p)** below.

1.6 The terms 'certificate of value', 'valuation certificate', and 'statement of value' should not be used in connection with the provision of valuation advice. However a valuer may use the term 'certified', or similar words in the body of the report where it is known that the *valuation* is to be submitted for a purpose that requires formal certification of a valuation opinion. (See **VPS 1(l)**.)

2 Report content

2.1 Valuation reports must address the following matters, which reflect the requirements set out in **VPS 1** for the *terms of engagement* (scope of work). Although reports may often commence with identification of the asset (or liability) and confirmation of the purpose of the *valuation*, valuers are otherwise strongly advised where possible to consider and follow the headings set out below when reporting, to ensure that all relevant matters are covered.

a Identification and status of the valuer

b Identification of the client and any other intended users

c Purpose of the valuation

d Identification of the asset(s) or liability(ies) valued

e Basis(es) of value adopted

f Valuation date

g Extent of investigation

h Nature and source(s) of the information relied upon

i Assumptions and special assumptions

j Restrictions on use, distribution and publication of the report

k Confirmation that the valuation has been undertaken in accordance with the IVS

l Valuation approach and reasoning

m Amount of the valuation or valuations

n Date of the valuation report

o Commentary on any material uncertainty in relation to the valuation where it is essential to ensure clarity on the part of the valuation user

p A statement setting out any limitations on liability that have been agreed.

2.2 Each report heading is considered in more detail below. The text in bold specifies the key principles. The accompanying text that follows specifies how the principles are to be interpreted and implemented in individual cases.

a) Identification and status of the valuer

The valuer can be an individual or a member of a *firm*. The report must include:

- **the signature of the individual responsible for the valuation assignment**

- **a statement confirming that the valuer is in a position to provide an objective and unbiased *valuation* and is competent to undertake the valuation assignment.**

If the valuer has obtained material assistance from others in relation to any aspect of the assignment, the nature of such assistance and the extent of reliance must be referenced in the report.

Implementation

1 A *valuation* is the responsibility of an individual *member*. RICS does not allow a *valuation* to be prepared by a '*firm*' although the use of 'for and on behalf of' under the responsible valuer's signature is an acceptable substitution.

2 In all cases the signatory's professional designation (for example, MRICS) or other relevant professional qualification, must be made clear.

3 Where it is a specific requirement to do so, the valuer must state if he or she is acting as an *internal* or *external valuer* as defined in the **RICS glossary**. However, for certain purposes in individual jurisdictions other definitions of these terms may apply, which must be recognised in the *terms of engagement* (assuming the valuer meets the criteria specified in the definition) and made explicit in the report. Where other criteria concerning the status of a valuer have been adopted they must again be confirmed, together with a statement that the valuer meets them.

4 In considering the extent of any material previous involvement, whether past, current or possible future, the valuer must have regard to the requirements of **PS 2 section 8**. Any disclosures or statements made in accordance with **VPS 1 paragraph 3.2(a)(3)**, must be repeated in the valuation report. Where there has not been any previous material involvement, a statement to that effect must be made in the valuation report. See also **PS 2**, relating to the resolution of conflicts of interest.

5 A statement should be made that the valuer has sufficient current local, national and international (as appropriate) knowledge of the particular market, and the skills and understanding to undertake the *valuation* competently. Where more than one valuer within a *firm* has contributed, confirmation that **PS 2 paragraph 2.7** has been satisfied is needed, though it is not necessary to provide any details.

6 Where the valuer incorporates into the report a *valuation* prepared by another valuer or *firm* – whether in the capacity of a subcontractor or third party expert in one or more aspects – see **(j) subparagraphs 4–5** below.

7 In some countries or states the relevant valuation standards specific to that jurisdiction may require additional disclosures to be made with regard to the status of the valuer.

b) Identification of the client and any other intended users

The party commissioning the valuation assignment must be identified together with any other parties whom it is intended may rely on the results of the assignment (see also (j) Restrictions on use, distribution or publication of the report, below).

Implementation

1 The report must be addressed to the client or its representatives. The source of the instructions and the identity of the client must be stated, if different from the addressee. Other known users of the report are to be named.

2 For some purposes valuers may be unable to exclude liability to *third parties* (see **PS 2 section 5**). Any limitation on disclosure of a *valuation* based on restricted information or instruction should be included (see **VPS 1 paragraph 3.2(j)**).

c) Purpose of the valuation

The purpose of the valuation assignment must be clearly stated.

Implementation

1 The report must be unambiguous. Where the purpose of the *valuation* is not disclosed by the client, the valuer should seek clarification why this is so. The valuation report must include an appropriate statement to clarify the circumstances.

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

The asset or liability to which the valuation assignment relates must be clearly identified. 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 used in conjunction with other assets, it will be necessary to clarify whether those assets are:

- **included in the valuation assignment**
- **excluded but assumed to be available or**
- **excluded and assumed not to be available.**

If the *valuation* is of a fractional interest held in an asset or liability, the relationship of the fractional interest being valued relative to all other fractional interests and the obligations of the fractional interest ownership, if any, to other fractional interest owners, must be made clear.

Particular regard must be had to the identification of portfolios, collections and groups of properties. It is essential to consider 'lotting' or 'grouping'; the identification of different property or asset categories; and any *assumptions* or *special assumptions* relating to the circumstances under which the properties, assets, liabilities or collections may be brought to the market.

Implementation

1 The legal interest in each asset or liability should be stated. Clarification is essential to distinguish between the characteristics of the asset in its entirety and the particular right or interest that is being valued. Where the asset is a property, the extent to which vacant possession is, or may be available (if required), should also be noted.

2 Where the assets are located in more than one country or state, the report must list the assets within each country or state separately and should normally be arranged so that all the assets in one country or state are grouped together. The legal interest in each asset or liability should be stated.

3 Where the *terms of engagement* have required separate identification of assets or liabilities by their use, category or class, the report should be structured accordingly.

4 Where there is doubt about what constitutes a single property or asset, the valuer should generally 'lot', or group, the properties for *valuation* in the manner most likely to be adopted in the case of an actual sale of the interest(s) being valued. However, the valuer should discuss the options with the client and must confirm the approach adopted in both the *terms of engagement* and the report. For further guidance on portfolios, collections and groups of properties including the reporting format, see **VPGA 9**.

e) Basis(es) of value adopted

The *basis of value* must be appropriate for the purpose. The source of the definition of any *basis of value* used must be cited or the basis explained.

This requirement does not apply to a valuation review where no opinion of value is to be provided or no comment is required on the *basis of value* used.

Implementation

1 The *basis of value*, together with its definition (but not supporting conceptual framework or other explanatory material regarding that definition), must be stated in full in the report.

2 Unless agreed otherwise in the *terms of engagement* the valuer is not required to provide a *valuation* on an alternative *basis of value*. However, where the *basis of value* is not a market-based figure and the *valuation* is materially different from *market value*, an explanatory statement to that effect may be appropriate, where necessary to ensure that the user of the *valuation* is alerted to the possibility that, although relevant for the specified purpose, the *valuation* may not bear a relation to the price that could be obtained if the asset or liability were placed on the market for disposal.

3 Where, exceptionally, a *valuation* is provided relating to a future date this must be made explicit (see **paragraph (f)** below and **VPS 4 paragraph 2.5**). It should always be separately reported with confirmation that it complies as appropriate with any applicable jurisdictional and/or national standards. A projection may take one of a number of forms and does not normally constitute a distinct *basis of value* in itself. But, as it rests substantially on *special assumptions*, which may or may not be borne out by actual events, it is of a different character from advice relating to a current or past date and must not be represented as if it were on an equal footing. In particular it must never be described or represented simply as '*market value*'.

f) Valuation date

The *valuation date* 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 appropriate, these dates must be clearly distinguished in the report.

This requirement does not apply to a valuation review unless the reviewer is required to comment on the *valuation date* used in the *valuation* under review.

Implementation

1 The *valuation date* must be stated (see **VPS 1 paragraph 3.2(h)**).

2 If there has been a material change in market conditions, or in the circumstances of a property, asset or portfolio, between the *valuation date* (where this is earlier than the date of the report) and the date of report, the valuer should draw attention to this. It may also be prudent in appropriate instances for the valuer to draw the client's attention to the fact that values change over time and a *valuation* given on a particular date may not be valid on an earlier or later date.

3 Additional care is needed when providing a projection of value, in order to ensure that the client understands that the actual value at the future date, on whatever basis is adopted, may diverge from that being reported and almost certainly will if the then state of the asset or conditions of the market differ from the *special assumptions* statements made at the time of the projection. See also **paragraph (e)(3)** above.

g) Extent of investigation

The extent of the investigations undertaken, including the limitations on those investigations set out in the *terms of engagement* (scope of work), must be disclosed in the report.

Implementation

1 Where the asset is a real property interest, the report must record the date and extent of any *inspection*, including reference to any part of the property to which access was not possible (see **VPS 2**). Equivalent steps, appropriate to the class of asset concerned, should be taken in relation to tangible *personal property*.

2 The valuer must make it clear if the *valuation* has been made without an opportunity to carry out an adequate *inspection* (see **VPS 2 paragraphs 1.2 and 1.7**) or equivalent check.

3 In the case of a revaluation, the report should also refer to any agreement in respect of the requirement for, or frequency of, an *inspection* of the property (see **VPS 2**).

4 Where a substantial number of properties are being valued, a generalised statement of these aspects (i.e. regarding *inspection*) is acceptable, provided that it is not misleading.

5 Where the asset is not real or tangible *personal property*, particular care should be taken in the report to note the extent to which investigations were possible.

6 Where the *valuation* is undertaken on the basis of restricted information, or is a revaluation without an *inspection*, the report must include full particulars of the restriction (see also **VPS 1 paragraph 3.2(i)**).

h) Nature and source(s) of the information relied upon

The nature and source of any relevant information relied upon in the valuation process and the extent of any steps taken to verify that information must be disclosed.

To the extent that information provided by the commissioning party or another party has not been verified by the valuer, this should be clearly stated with reference, as appropriate, to any representation from that party.

For this purpose, 'information' is to be interpreted as including data and other such inputs.

Implementation

1 Where the client has provided information that is to be relied on, the valuer has a responsibility to state clearly that the information is covered by, or in, the *terms of engagement* (see **VPS 1**) and, where appropriate, to specify its source. In each case the valuer must judge the extent to which the information to be provided is likely to be reliable and whether any further, reasonable steps are required to verify it.

2 The valuer must make it clear if the *valuation* has been carried out without information that would normally be, or be made, available. The valuer must also indicate in the report if verification (where practicable) is needed of any information or *assumptions* on which the *valuation* is based, or if any information considered material has not been provided.

3 If any such information or *assumption* requiring verification is material to the amount of the *valuation*, the valuer must make clear that the *valuation* should not be relied on without that verification (see **VPS 1 paragraph 3.2(j)**). In the case of a revaluation, a statement of any material changes advised by the client or a stated *assumption* that there have been no material changes, should be included.

4 The client may expect the valuer to express an opinion, and in turn the valuer may wish to express an opinion, on legal issues that affect the *valuation*. In these circumstances the valuer must therefore make clear in the report any information that must be verified by the client's or other interested parties' legal advisers before the *valuation* can be relied on or published.

5 The report should state any additional information that has been available to, or established by, the valuer, and is believed to be crucial to the client's ability to understand and benefit from the *valuation*, with regard to the purpose for which it has been prepared.

i) Assumptions and special assumptions

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

Implementation

1 All *assumptions* and any *special assumptions* must be set out in the report in full, together with any reservations that may be required and a statement that they have been agreed with the client. Both the valuation conclusion and the executive summary (if provided) should explicitly set out all *special assumptions* that have been made to arrive at the reported figure. Where the *assumptions* vary in different countries or states the report must make this clear.

j) Restrictions on use, distribution and publication of the report

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

Implementation

1 The valuer must state the permitted use, distribution and publication of the *valuation*.

2 Where the purpose of the report requires a published reference to it, the valuer must provide a draft statement for inclusion in the publication. This should be provided as a separate document, which may be annexed to the report.

3 A report may be published in full, for instance in the annual accounts of a company, but it is more common for only a reference to be made to it. In this case it is essential that the valuer has a close involvement in the publication statement to ensure that all the references are accurate and that the reader is not misled. This is particularly important if the valuer is asked to take responsibility for any published statement or any part of a published statement.

4 If the whole report is not to be published, the draft statement should be prepared as a separate document and provided to the client at the same time as the report. The content of the statement may be governed by rules issued by local regulatory bodies, but it should contain the following minimum information:

- the name and qualification of the valuer, or the valuer's *firm*
- an indication of whether the valuer is an *internal* or *external valuer*, and where required, that the specific criteria relating to this status have been met
- the *valuation date* and *basis (or bases) of value*, together with any *special assumptions*
- comment on the extent to which the values were determined directly by reference to market evidence or were estimated using other valuation techniques
- confirmation that the *valuation* has been made in accordance with these standards, or the extent of and reason(s) for *departure* from them and
- a statement indicating any parts of the report prepared by another valuer or specialist.

5 For *valuations* in which the public has an interest or which may be relied on by parties other than the client commissioning the report or to which it is addressed, the valuer must make additional disclosures in the valuation report and any published reference to it. These are set out in **PS 2 section 5**.

6 'Publication' does not include making the report or the valuation figure available to a mortgage (lending) applicant or borrower.

7 The valuer should check the accuracy of any other relevant material referring to the properties or to the *valuation* that is to be published.

8 The valuer is also advised to read the whole document in which the report or reference is to be published to ensure that there is no misstatement of any other matter or opinion of which the valuer may have knowledge.

9 The valuer should insist that a copy of the final proof of the document or the reference is supplied before issue, and attach that proof to the letter of consent. Any pressure by other parties or persuasion to delegate power to sign should be resisted.

10 The valuer is permitted to exclude information of a commercially sensitive nature from a report that is published in full, subject to any legal requirements that may apply in a particular country or state.

11 An opinion may be expressed which, if included in a public document, might have some effect on a matter that is in dispute, under negotiation or subject to certain rights between the owner and a *third party* (for example, an opinion of the rental or capital value of a property with an imminent rent review). The report may also include information about a company's trading that would not usually be in the public domain. Such information is commercially sensitive and

the client must decide, subject to the approval of the auditors and any regulatory body, whether it should be included in the publication.

12 In the published reference the valuer must refer to the omission(s) and state that this has been done on the express instructions of the client and with the approval of the regulatory body and/or auditors. Without this note the valuer may be inadvertently placed in a situation where there is unjustifiable criticism.

13 Where the full report is not published, the publication statement must refer to any *special assumption* made and any additional *valuation* provided. Similarly, sufficient reference to any *departures* should be made in any published document.

14 In each case the onus is on the valuer to determine what constitutes a 'sufficient reference'. A reference would not be regarded as 'sufficient' if it failed to alert the reader to matters of fundamental importance as to the basis or amount of the *valuation*, or if there was any risk that the reader might be misled.

15 It is expected that a valuer would not normally consent to the publication of a projected value. Where, in exceptional cases, consent is given, great care should be taken to ensure that any associated provisos or disclaimers are accurately reproduced.

k) Confirmation that the valuation has been undertaken in accordance with the IVS

The valuer should provide:

> **confirmation that the *valuation* has been undertaken in accordance with the *International Valuation Standards* (IVS) and that all significant inputs have been assessed by the valuer and found to be appropriate for the valuation provided**

or (depending on clients' particular requirements)

> **confirmation that the *valuation* has been undertaken in accordance with the *RICS Valuation – Global Standards*, which incorporate the IVS, and (where applicable) the relevant RICS national or jurisdictional supplement. Where appropriate, such confirmation may be abbreviated to refer simply to the RICS Red Book Global Standards.**

In both cases an accompanying note and explanation of any *departures* from the IVS or the RICS Red Book Global Standards must be included. A *departure* would not be justified if it resulted in a *valuation* that is misleading.

Implementation

1 There is no material difference in outcome between the respective forms of endorsement above, which may be used according to the particular requirements of the valuation assignment. Some clients will expressly wish to have confirmation that the *valuation* has been undertaken in accordance with the IVS, and it is naturally in order for this to be given. In all other cases confirmation that the *valuation* has been undertaken in accordance with the RICS Red Book Global Standards carries with it the dual assurance of compliance with the IVS technical standards and with the RICS professional standards overall.

2 References to the RICS Red Book Global Standards without reference to the year of issue will be taken to mean the version of the RICS standards operative at the *valuation date*, provided that it is on or before the date of signature of the report.

3 The statement of compliance should draw attention to any *departures* (see **PS 1 section 6**). Where a *departure* is made that is not mandatory, it will not be possible to confirm compliance with the IVS.

4 Where valuation standards specific to a particular jurisdiction have been followed, a formal statement regarding compliance with those jurisdictional standards may be added.

5 Where the valuer incorporates into the report a *valuation* prepared by another valuer or *firm* – whether as a subcontractor or as a *third party* expert – it must be confirmed that such *valuations* have been prepared in accordance with these global standards, or other standards that may apply in the particular circumstances.

6 The valuer may be requested to incorporate a *valuation* commissioned directly by the client. In such cases the valuer must be satisfied that any such report has been prepared in accordance with these global standards.

l) Valuation approach and reasoning

To understand the valuation figure in context, the report must make reference to the approach or approaches adopted, the method(s) applied and key inputs used and the principal reasons for the conclusions reached.

Where the report is of the results of a valuation review it must state the reviewer's conclusions about the work under review, including supporting reasons.

This requirement does not apply if it has been specifically agreed and recorded in the *terms of engagement* (scope of work) that a report shall be provided without reasons or other supporting information.

Implementation

1 Where different valuation approaches and assumptions are required for different assets it is important that they are separately identified and reported.

2 For the distinction between approach and method see **VPS 5 paragraph 1**. The extent of description of these in individual assignments should be proportionate to the task, being focussed on assisting understanding by the client and other intended users. The supporting reasons, or rationale, for the conclusions reached should, where relevant, include an explanation of any deviation from common practice within the profession.

3 In the case of assets or liabilities that are interests in real estate, attention is drawn to **VPS 2 paragraph 1.5** and the fact that, wherever appropriate, the relevance and significance of sustainability and ESG matters should form an integral part of the valuation approach and reasoning supporting the reported figure.

m) Amount of the valuation or valuations

This must be expressed in the applicable currency.

This requirement does not apply to a valuation review if the valuer is not required to provide their own valuation opinion.

Implementation

1 In the main body of the report the opinion of value is required in words, as well as in figures.

2 Where the valuation instruction includes a number of assets falling into different use categories or geographic location, whether the *valuation* is reported asset by asset or otherwise will depend on the purpose for which the *valuation* is required, the circumstances and client preferences. Where a portfolio includes assets of differing tenures, the value of the tenure groups may be subtotalled, together with a statement of the overall value.

3 An entity will usually require asset or liability values to be expressed in the currency of the country in which it is based. For *financial statement* purposes, this is known as the 'reporting currency'. Irrespective of the location of the client, *valuations* must be made in the currency of the country in which the asset or liability is located.

4 Where the client requires the *valuation* to be translated into a different currency (for example, into the reporting currency), unless agreed otherwise the exchange rate to be adopted is the closing rate (also known as the 'spot rate') on the *valuation date*.

5 Where the valuation instruction requires the opinion of value to be reported in more than one currency (such as with cross-border portfolio *valuations*), the opinion of value must indicate the currencies adopted and the amount should be shown in words and figures in the main body of the report. In addition the exchange rate adopted should be as at the *valuation date* and this must be stated in the valuation report.

6 If the identification of individual assets and their values is consigned to a schedule(s) appended to the report, a summary of values must be included within the body of the report.

7 If there has been a material change in market conditions, or in the circumstances of an asset or portfolio, between the *valuation date* (where this is earlier than the *date of the report*) and the *date of the report*, the valuer should draw attention to this. It may also be prudent in appropriate instances for the valuer to draw the client's attention to the fact that values change over time and a *valuation* given on a particular date may not be valid on an earlier or later date.

8 'Negative values' and liabilities may arise and must always be stated separately. They should not be offset.

n) Date of the valuation report

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

o) Commentary on any material uncertainty in relation to the valuation where it is essential to ensure clarity on the part of the valuation user

Implementation

1 This requirement is mandatory only where the uncertainty is material. For this purpose, 'material' means where the degree of uncertainty in a *valuation* falls outside any parameters that might normally be expected and accepted.

2 All *valuations* are professional opinions on a stated *basis of value*, coupled with any appropriate *assumptions* or *special assumptions*, which must also be stated (see **VPS 4**) – a *valuation* is not a fact. Like all opinions, the degree of subjectivity involved will inevitably vary from case to case, as will the degree of 'certainty' – for example, the probability that the valuer's opinion of *market value* would exactly coincide with the price achieved were there an actual sale at the *valuation date*, even if all the circumstances envisaged by the *market value* definition and the valuation *assumptions* were identical to the circumstances of an actual sale. Most *valuations* will be subject to a degree of variation (that is, a difference in professional opinion), a principle well-recognised by the courts in a variety of jurisdictions.

3 Ensuring user understanding and confidence in *valuations* requires clarity and transparency, hence the general requirement under subsection (m) above for the report to make reference to the approach or approaches adopted, the key inputs used and the principal reasons for the conclusions reached, thereby enabling the user to understand the valuation figure in context. How much explanation and detail is necessary concerning the supporting evidence, the valuation approach and the particular market context is a matter of judgment in individual cases.

4 Normally, *valuations* will not require additional explanation or clarification beyond the general requirement referred to in paragraph 3 above. However, in some cases there may be a greater degree of uncertainty concerning the valuation figure reported than usual, and where that uncertainty is material – which should be expressly signalled in the report – further proportionate commentary must be added in order to ensure that the report does not create a false impression. Valuers should not treat such a statement expressing less confidence in a *valuation* than usual as an admission of weakness – it is not a reflection on their professional skill or judgment, but a matter entirely proper for disclosure. Indeed, if a failure to draw attention to material uncertainty gave a client the impression that greater weight could be attached to the opinion than was warranted, the report would be misleading.

5 For further guidance on material uncertainty see **VPGA 10**.

p) A statement setting out any limitations on liability that have been agreed

Implementation

1 The issues of risk, liability and insurance are closely linked. Pending the issue of guidance of global application, *members* should check the **latest RICS guidance** applicable in their jurisdiction.

VPS 4 Bases of value, assumptions and special assumptions

This mandatory standard:

- applies International Valuation Standard (IVS) IVS 104 Bases of Value
- specifies additional mandatory requirements for RICS *members*
- addresses particular aspects of implementation that may arise in individual cases.

1 Bases of value

The valuer must ensure that the *basis of value* adopted is appropriate for, and consistent with, the purpose of the *valuation*.

If one of the *bases of value* defined in these global standards (including IVS-defined bases) is used, then it should be applied in accordance with the relevant definition and guidance, including the adoption of any *assumptions* or *special assumptions* that are appropriate.

If a *basis of value* not defined in these global standards (including IVS-defined bases) is used, it must be clearly defined and stated in the report, which must also draw attention to the fact that it is a departure if use of the basis in the particular valuation assignment is voluntary and not mandatory.

A valuer can only depart from the IVS as described in section 60 of the IVS Framework.

2 General principles

2.1 A *basis of value* is a statement of the fundamental measurement *assumptions* of a *valuation*.

2.2 The following bases are defined in the *International Valuation Standards* (see IVS 104 paragraph 20.1(a)) and most are in common use, albeit that they may not be universally adopted in all markets:

- *market value* (see section 4 below)
- *market rent* (see section 5 below)
- *investment value* (or *worth*) (see section 6 below)
- *equitable value* (previously, IVS-defined fair value)
- synergistic value and
- liquidation value.

Particular care is necessary to ensure that, where used, synergistic value is fully understood by the client.

2.3 In addition, for the purposes of financial reporting, fair value (under International Financial Reporting Standards) is widely recognised (including by RICS) and used, albeit again not universally – see further detail in section 7 below.

2.4 For some valuation assignments, particularly in relation to specific jurisdictions within which there may be mandatory requirements, another *basis of value* may be specified (for example, in legislation) or appropriate (*members* should note that IVS 104 gives some illustrative examples at paragraph 20.1 (b)). Where this is so, the valuer must define clearly the basis adopted and, in any case where adoption of the basis is other than mandatory, explain in the report why use of a basis reproduced in these global standards (including any jurisdiction-specific supplement to these standards) is considered inappropriate (see **PS 1 section 4**).

2.5 As markets continue to develop and advance, and as clients' needs continue to grow in terms of sophistication, additional demands are being placed on valuers to provide advice involving some element of prediction or forecast. Great care is needed to ensure that such advice is not misunderstood or misrepresented, and that any sensitivity analysis is carefully presented so as not to undermine the *basis of value* adopted.

2.6 Valuers are cautioned that the use of an unrecognised or bespoke *basis of value* without good reason could result in breach of the requirement that the valuation report should not be ambiguous or misleading (see **VPS 3 section 1**).

2.7 Attention is drawn to the fact that IVS 104 includes material on 'premises of value' that is not reproduced here.

3 Bases of value

3.1 The valuer has responsibility for ensuring that the *basis of value* adopted is consistent with the purpose of the *valuation* and appropriate to the circumstances – this responsibility is subject to compliance with any mandatory requirements, such as those imposed by statute. It is important that the basis to be adopted is discussed and confirmed with the client at the outset in any case where the position is not straightforward.

3.2 It is important to note that *bases of value* are not necessarily mutually exclusive. For example, the *worth* of a property or asset to a specific party, or the *equitable value* of a property or asset in exchange between two specific parties, may match the *market value* even though different assessment criteria are used.

3.3 Because bases other than *market value* may produce a value that could not be obtained on an actual sale, whether or not in the general market, the valuer must clearly distinguish the *assumptions* or *special assumptions* that are different from, or additional to, those that would be appropriate in an estimate of *market value*. Typical examples of such *assumptions* and *special assumptions* are discussed under the appropriate heading below.

3.4 Valuers must ensure in all cases that the *basis of value* is reproduced or clearly identified in both the *terms of engagement* (scope of work) and the report.

3.5 A valuer may be legitimately instructed to provide valuation advice based on other criteria, and therefore other *bases of value* may be appropriate. In such cases the definition adopted must be set out in full and explained. Where such a basis differs significantly from *market value* it is recommended that a brief comment is made indicating the differences.

4 Market value

***Market value* is defined in IVS 104 paragraph 30.1 as:**

'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 and where the parties had each acted knowledgeably, prudently and without compulsion.'

4.1 *Market value* is a *basis of value* that is internationally recognised and has a long-established definition. It describes an exchange between parties that are unconnected and are operating freely in the marketplace and represents the figure that would appear in a hypothetical contract of sale, or equivalent legal document, at the *valuation date*, reflecting all those factors that would be taken into account in framing their bids by market participants at large and reflecting the highest and best use of the asset. The highest and best use of an asset is the use of an asset that maximises its productivity and that is possible, legally permissible and financially feasible – fuller treatment of this particular premise of value can be found at section 140 of IVS 104.

4.2 It ignores any price distortions caused by *special value* (an amount that reflects particular attributes of an asset that are only of value to a *special purchaser*) or *marriage value*. It represents the price that would most likely be achievable for an asset across a wide range of circumstances. *Market rent* (see below) applies similar criteria for estimating a recurring payment rather than a capital sum.

4.3 In applying *market value*, regard must also be had to the requirement that the valuation amount reflects the actual market state and circumstances as of the effective *valuation date.* The full conceptual framework for *market value* can be found at paragraph 30.2 of IVS 104.

4.4 Notwithstanding the disregard of *special value*, where the price offered by prospective buyers generally in the market would reflect an expectation of a change in the circumstances of the asset in the future, the impact of that expectation is reflected in *market value*. Examples of where the expectation of additional value being created or obtained in the future may have an impact on the *market value* include:

- the prospect of development where there is no current permission for that development and
- the prospect of *marriage value* arising from merger with another property or asset, or interests within the same property or asset, at a future date.

4.5 The impact on value arising by use of an *assumption* or *special assumption* should not be confused with the additional value that might be attributed to an asset by a *special purchaser.*

4.6 In some jurisdictions a *basis of value* described as 'highest and best use' is adopted and this may either be defined by statute or established by common practice in individual countries or states.

5 Market rent

***Market rent* is defined in IVS 104 paragraph 40.1 as:**

'the estimated amount for which an interest in real property should 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.'

5.1 *Market rent* will vary significantly according to the terms of the assumed lease contract. The appropriate lease terms will normally reflect current practice in the market in which the property is situated, although for certain purposes unusual terms may need to be stipulated. Matters such as the duration of the lease, the frequency of rent reviews and the responsibilities of the parties for maintenance and outgoings will all affect the *market rent*. In certain countries or states, statutory factors may either restrict the terms that may be agreed, or influence the impact of terms in the contract. These need to be taken into account where appropriate.

5.2 *Market rent* will normally be used to indicate the amount for which a vacant property may be let, or for which a let property may re-let when the existing lease terminates. *Market rent* is not a suitable basis for settling the amount of rent payable under a rent review provision in a lease, where the definitions and *assumptions* specified in the lease have to be used.

5.3 Valuers must therefore take care to set out clearly the principal lease terms that are assumed when providing an opinion of *market rent*. If it is the market norm for lettings to include a payment or concession by one party to the other as an incentive to enter into a lease, and this is reflected in the general level of rents agreed, the *market rent* should also be expressed on this basis. The nature of the incentive assumed must be stated by the valuer, along with the assumed lease terms.

6 Investment value

***Investment value* (*worth*) is defined in IVS 104 paragraph 60.1 as:**

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

As the definition implies, and in contrast to *market value*, this *basis of value* does not envisage a hypothetical transaction but is a measure of the value of the benefits of ownership to the current owner or to a prospective owner, recognising that these may differ from those of a typical market participant. It is often used to measure performance of an asset against an owner's own investment criteria.

7 Fair value

7.1 ***Fair value* (the definition adopted by the International Accounting Standards Board (IASB) in IFRS 13) 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.'

7.2 The guidance in IFRS 13 includes an overview of the fair value measurement approach.

7.3 The objective of a *fair value* measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. It is thus sometimes described as a 'mark to market' approach. Indeed the references in IFRS 13 to market participants and a sale make it clear that for most practical purposes the concept of *fair value* is consistent with that of *market value*, and so there would ordinarily be no difference between them in terms of the valuation figure reported.

7.4 A *fair value* measurement requires an entity to determine all of the following:

- the particular asset or liability that is the subject of the measurement (consistently with its unit of account)
- for a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use)
- the principal (or most advantageous) market for the asset or liability
- the valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the *fair value* hierarchy within which the inputs are categorised.

7.5 Valuers undertaking *valuations* for inclusion in *financial statements* should familiarise themselves with the relevant requirements – see also **VPGA 1**.

8 Assumptions

An *assumption* is made where it is reasonable for the valuer to accept that something is true without the need for specific investigation or verification.

Any such *assumption* must be reasonable and relevant having regard to the purpose for which the *valuation* is required.

8.1 The full definition from the RICS glossary is as follows:

'A supposition taken to be true. It involves facts, conditions or situations affecting the subject of, or approach to, a *valuation* that, by agreement, do not need to be verified by the valuer as part of the valuation process. Typically, an *assumption* is made where specific investigation by the valuer is not required in order to prove that something is true.'

8.2 It will almost always be necessary to couple a *basis of value* with appropriate *assumptions* (or *special assumptions* – see **section 9** below) that describe the assumed status or condition of the property or asset at the *valuation date*.

8.3 An *assumption* is often linked to a limitation on the extent of the investigations or enquiries that could be undertaken by the valuer – see **VPS 2**. Therefore all *assumptions* that are likely to be included in the report must be agreed with the client and included in the *terms of engagement*. Where it is not possible to include *assumptions* in the *terms of engagement,* they should be agreed in writing with the client before the valuation report is issued.

8.4 If, after *inspection* or investigation, the valuer considers that an *assumption* agreed in advance with the client is likely to be inappropriate, or should become a *special assumption*, the

revised *assumptions* and approach must be discussed with the client prior to the conclusion of the valuation assignment and delivery of the report.

8.5 See also **VPGA 8** for practical application in relation to real property interests.

9 Special assumptions

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

Where *special assumptions* are necessary in order to provide the client with the *valuation* required, these must be expressly agreed and confirmed in writing to the client before the report is issued.

***Special assumptions* may only be made if they can reasonably be regarded as realistic, relevant and valid for the particular circumstances of the *valuation*.**

Implementation

9.1 The valuer may include in the report some comment or assessment of the likelihood of the *special assumption* being fulfilled. For example, a *special assumption* that permission had been granted to develop land may have to reflect the impact on value of any conditions that might be imposed.

9.2 A typical *special assumption* might be that a property or asset has been altered in some defined way, for example, 'the *market value* on the *special assumption* that the works had been completed'. In other words, it assumes facts that differ from those existing at the *valuation date*.

9.3 If a client requests a *valuation* on the basis of a *special assumption* that the valuer considers to be unrealistic, the instruction should be declined.

9.4 Circumstances where it may be appropriate to make *special assumptions* include, for example:

- a situation where a bid from a *special purchaser* has been made, or can be reasonably anticipated
- a situation where the interest being valued cannot be offered freely and openly in the market
- a past change in the physical aspects of the property or asset where the valuer has to assume those changes have not taken place
- an impending change in the physical aspects of the property, such as a new building to be constructed or an existing building to be refurbished or demolished
- an anticipated change in the mode of occupation or trade at the property
- the treatment of alterations and improvements carried out under the terms of a lease
- the property may be affected by environmental factors, including natural (such as flooding), non-natural (such as contamination) or existing use issues (such as a non-conforming user).

9.5 Some illustrations of *special assumptions* in relation to real property interests are that:

- planning (zoning) consent has been, or will be, granted for development (including a change of use) at the property
- a building or other proposed development has been completed in accordance with a defined plan and specification
- the property has been changed in a defined way (for example, removal of process equipment)
- the property is vacant when, in reality, at the *valuation date* it is occupied
- the property is let on defined terms when, in reality, at the *valuation date* it is vacant or
- the exchange takes place between parties where one or more has a special interest and that additional value, or *marriage value*, is created as a result of the merger of the interests.

9.6 Where a property has been damaged the *special assumptions* may include:

- treating the property as having been reinstated (reflecting any insurance claims)
- valuing as a cleared site with development permission assumed for the existing use
- refurbishment or redevelopment for a different use reflecting the prospects of obtaining the necessary development permissions.

9.7 The adoption of some of these *special assumptions* may qualify the application of *market value*. They are often particularly appropriate where the client is a lender and *special assumptions* are used to illustrate the potential effect of changed circumstances on the value of a property as a security.

9.8 Where *valuations* are prepared for *financial statements* the normal *basis of value* will exclude any additional value attributable to *special assumptions*. However, if (exceptionally) a *special assumption* is made, this must be referred to in any published reference. See **VPS 3 paragraph 2.2(i) and (l)**.

10 Valuations reflecting an actual or anticipated market constraint, and forced sales

Wherever the valuer, or client, identifies that a *valuation* may need to reflect an actual or anticipated marketing constraint, details of that constraint must be agreed and set out in the *terms of engagement*.

Implementation

10.1 The valuer may be instructed to undertake a *valuation* reflecting an actual or anticipated market constraint, which may take one of many different forms.

10.2 If a property or asset cannot be freely or adequately presented to the market, the price is likely to be adversely affected. Before accepting instructions to advise on the likely effect of a constraint, the valuer should ascertain whether this arises from an inherent feature of the asset, or of the interest being valued, or from the particular circumstances of the client, or some combination of all of these.

10.3 If an inherent constraint exists at the *valuation date*, it is normally possible to assess its impact on value. The constraint should be identified in the *terms of engagement*, and it should be made clear that the *valuation* will be provided on this basis. It may also be appropriate to

provide an alternative *valuation* on the *special assumption* that the constraint did not exist at the *valuation date* in order to demonstrate its impact.

10.4 Greater care is needed if an inherent constraint does not exist at the *valuation date*, but is a foreseeable consequence of a particular event or sequence of events. Alternatively, the client may request a *valuation* to be on the basis of a specified marketing restriction. In either case the *valuation* would be provided on the *special assumption* that the constraint had arisen at the *valuation date*. The precise nature of the constraint must be included in the *terms of engagement*. It may also be appropriate to provide a *valuation* without the *special assumption* in order to demonstrate the impact that the constraint would have if it arose.

10.5 A *special assumption* that simply refers to a time limit for disposal without stating the reasons for that limit would not be a reasonable *assumption* to make. Without a clear understanding of the reasons for the constraint, the valuer would be unable to determine the impact that it may have on marketability, sale negotiations and the price achievable, or to provide meaningful advice.

10.6 A marketing constraint should not be confused with a forced sale. A constraint may result in a forced sale, but it can also exist without compelling the owner to sell.

10.7 The term 'forced sale value' must not be used. A 'forced sale' is a description of the situation under which the exchange takes place, not a distinct *basis of value*. Forced sales arise where there is pressure on a particular vendor to sell at a specific time – for example, because of the need to raise money or to extinguish a liability by a given date. The fact that a sale is 'forced' means that the vendor is subject to external legal or personal commercial factors, and therefore the time constraint is not merely a preference of the vendor. The nature of these external factors and the consequences of failing to conclude a sale are just as important in determining the price that can be achieved within the length of time available.

10.8 While a valuer can assist a vendor in determining a price that should be accepted in forced sale circumstances, this is a commercial judgment. Any relationship between the price achievable by a forced sale and the *market value* is coincidental; it is not a *valuation* that can be determined in advance, but a figure that might be seen as a reflection of worth to that particular vendor at the particular point in time having regard to the specific context. As emphasised in paragraph 10.7 above, although advice may be given on the likely realisation in forced sale circumstances, the term is a description of the situation under which the sale takes place, and so it must not be described or used as a *basis of value*.

10.9 It is a common misconception that in a poor or falling market there are automatically few 'willing sellers' and that, as a consequence, most transactions in the market are the result of 'forced sales'. Accordingly, the valuer may be asked to provide forced sale advice on this basis. This argument has little merit because it suggests that the valuer should ignore the evidence of what is happening in the market. The commentary for *market value* in **VPS 4 section 4** makes it clear that a willing seller is motivated to sell at the best terms available in the market after proper marketing, whatever that price may be. The valuer should be careful not to accept instructions on the basis of a misconception and should explain to clients that, in the absence of a defined constraint affecting either the asset or the vendor, the appropriate basis is *market value.* In a depressed market, a significant proportion of sales may be made by vendors that are obliged to sell, such as administrators, liquidators and receivers. However, such vendors are normally under a duty to obtain the best price in the current circumstances and cannot impose

unreasonable marketing conditions or constraints of their own volition. These sales will normally comply with the definition of *market value*.

11 Assumptions and special assumptions related to projected values

Any *assumptions*, *special* or otherwise, relating to projected values must be agreed with the client prior to reporting an opinion of value.

The valuation report must make reference to the higher degree of uncertainty that is likely to be implicit with a projected value, where by definition, comparable evidence will not be available.

Implementation

11.1 By their nature, projected values rely wholly on *assumptions*, which may include some significant *special assumptions*. For example, the valuer may make various *assumptions* about the state of the market in the future – yields, rental growth, interest rates, etc. which must be supported by credible studies or economic outlook-based forecasts.

11.2 Great care is required to ensure that all *assumptions* made are:

- in accordance with any applicable national or jurisdictional standard
- realistic and credible
- clearly and comprehensively set out in the report.

11.3 When making *special assumptions*, great care must also be exercised concerning the reliability and precision of any methods, tools or data used for forecasting or extrapolation.

VPS 5 Valuation approaches and methods

This mandatory standard:

- applies International Valuation Standard (IVS) 105 Valuation Approaches and Methods
- addresses particular aspects of implementation that may arise in individual cases.

Valuers are responsible for adopting, and as necessary justifying, the valuation approach(es) and the valuation methods used to fulfil individual valuation assignments. These must always have regard to:

- **the nature of the asset (or liability)**
- **the purpose, intended use and context of the particular assignment and**
- **any statutory or other mandatory requirements applicable in the jurisdiction concerned.**

Valuers should also have regard to recognised best practice within the valuation discipline or specialist area in which they practise, although this should not constrain the proper exercise of their judgment in individual valuation assignments in order to arrive at an opinion of value that is professionally adequate for its purpose.

Unless expressly required by statute or by other mandatory requirements, no one valuation approach or single valuation method necessarily takes precedence over another. In some jurisdictions and/or for certain purposes more than one approach may be expected or required in order to arrive at a balanced judgment. In this regard, the valuer must always be prepared to explain the approach(es) and method(s) adopted.

Implementation

1 Although no formal, universally recognised definition of valuation approach exists, the term is generally used to mean the overall manner in which the valuation task is undertaken in order to determine the value of the particular asset or liability. The term valuation method is generally used to refer to the particular procedure, or technique, used to assess or calculate the result.

2 *Valuations* are required of different interests in different types of assets for a range of different purposes. Given this diversity, the approach to the estimation of value in one case may well be inappropriate in another, let alone the actual method(s) or technique(s) used. Using the working definition in paragraph 1 above, the overall valuation approach is usually classified into one of three main categories:

- The *market approach* is based on comparing the subject asset with identical or similar assets (or liabilities) for which price information is available, such as a comparison with market transactions in the same, or closely similar, type of asset (or liability) within an appropriate time horizon.

- The *income approach* is based on capitalisation or conversion of present and predicted income (cash flows), which may take a number of different forms, to produce a single current capital value. Among the forms taken, capitalisation of a conventional market-based income or discounting of a specific income projection can both be considered appropriate depending on the type of asset and whether such an approach would be adopted by market participants.
- The *cost approach* is based on the economic principle that a purchaser will pay no more for an asset than the cost to obtain one of equal utility whether by purchase or construction.

3 Underlying each valuation approach and valuation method is the need to make such comparisons as are practically possible, since this is the essential ingredient in arriving at a market view. It may well be possible to arrive at a valuation opinion by adopting more than one approach and one method or technique, unless statute or some other mandatory authority imposes a particular requirement. Great care must be exercised when relying on the *cost approach* as the primary or only approach, as the relationship between cost and value is rarely direct.

4 Valuation methods may include a range of analytical tools or techniques as well as different forms of modelling, many of which involve advanced numerical and statistical practices. In general, the more advanced the method, the greater the degree of vigilance needed to ensure there is no internal inconsistency, for example, in relation to the *assumptions* adopted.

5 Further detail on the application of approaches and methods may be found in the *International Valuation Standards* at IVS 105, including the responsibilities of valuers in relation to valuation modelling. It must be emphasised that the valuer is ultimately responsible for selection of the approach(es) and method(s) to be used in individual valuation assignments, unless statute or other mandatory authority imposes a particular requirement.

Part 5: Valuation applications

Introduction

This part of the Red Book Global Standards is concerned with the application and implementation of the global standards in specific contexts, whether for a particular purpose or in relation to a particular asset type.

The RICS valuation practice guidance – applications (VPGAs) that follow are intended to set out the key issues that need to be taken into account and also focus in greater detail on the practical application of the standards in specific contexts. While not themselves mandatory, the VPGAs do include links and cross-references to important material in the *International Valuation Standards* and elsewhere in these global standards which is mandatory. These links and cross references are intended to assist *members* in identifying material relevant to the particular valuation assignment they are undertaking.

Members are expressly reminded that the IVS include the following IVS Asset Standards, the full text of which is reproduced in Part 6 of these global standards:

- IVS 200 Businesses and Business Interests
- IVS 210 Intangible Assets
- IVS 220 Non-Financial Liabilities
- IVS 230 Inventory
- IVS 300 Plant and Equipment
- IVS 400 Real Property Interests
- IVS 410 Development Property
- IVS 500 Financial Instruments.

The full list of RICS VPGAs is as follows:

- VPGA 1 – Valuation for inclusion in financial statements
- VPGA 2 – Valuation of interests for secured lending
- VPGA 3 – Valuation of businesses and business interests
- VPGA 4 – Valuation of individual trade related properties
- VPGA 5 – Valuation of plant and equipment
- VPGA 6 – Valuation of intangible assets
- VPGA 7 – Valuation of personal property, including arts and antiques
- VPGA 8 – Valuation of real property interests
- VPGA 9 – Identification of portfolios, collections and groups of properties
- VPGA 10 – Matters that may give rise to material valuation uncertainty.

VPGA 1 Valuation for inclusion in financial statements

This guidance is advisory and not mandatory in content. Where appropriate, however, it alerts *members* to relevant mandatory material contained elsewhere in these global standards, including the *International Valuation Standards*, using cross-references in bold type. These cross-references are for the assistance of *members* and do not alter the status of the material that follows below. *Members* are reminded that:

- this guidance cannot cover every circumstance, and they must always have regard to the facts and circumstances of individual assignments when forming valuation judgements
- they should remain alert to the fact that individual jurisdictions may have specific requirements that are not covered by this guidance.

1 Scope

1.1 The guidance below provides additional commentary on the *valuation* of property, assets and liabilities for inclusion in *financial statements*.

1.2 *Valuations* for inclusion in *financial statements* require particular care as they must comply strictly with the applicable financial reporting standards adopted by the entity. Valuers are strongly advised to clarify at the outset which standards their clients have adopted along with referencing the full definition of the relevant corresponding basis of value in reporting.

1.3 Although the International Financial Reporting Standards (IFRS) are nowadays widely adopted, other financial reporting standards may still apply in individual jurisdictions.

1.4 In all cases, valuers are reminded that both IFRS and non-IFRS financial reporting standards continue to evolve – they should always refer to the standards current at the date to which the *financial statements* relate.

2 Valuations under International Financial Reporting Standards (IFRS)

2.1 Where the entity has adopted IFRS the *basis of value* will be *fair value* (see also **VPS 4 section 7**) and IFRS 13 Fair Value Measurement will apply. It is essential that the valuer is familiar with IFRS 13 requirements, especially the disclosure requirements. IFRS 13 may be obtained from **the IFRS website.**

2.2 In March 2021, the International Accounting Standards Board published the exposure draft **Disclosure Requirements in IFRS Standards—A Pilot Approach.** The exposure draft sets out a proposed new approach to developing and drafting disclosure requirements in IFRS standards, as well as new disclosure requirements for IFRS 13 Fair Value Measurement.

From the valuation community perspective, the most noteworthy potential change is the expectation or requirement that information will be provided to clients as a matter of course on what are described as 'reasonably possible alternative fair value measurements', to reflect any uncertainty that may exist regarding the significant inputs used to determine fair value.

2.3 IFRS 16 Leases, introduced in 2016, sets out the principles for the recognition, measurement, presentation and disclosure of leases. IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019, with earlier application permitted.

IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments.

3 Valuations of public sector assets under International Public Sector Accounting Standards (IPSAS)

3.1 Where public sector assets fall to be included in *financial statements* complying with IPSAS, care must be taken to refer to the version of the standards applicable at the financial reporting date, which can be accessed at **www.ifac.org/public-sector**

4 Other cases

4.1 Legislative, regulatory, accounting or jurisdictional requirements may require the modification of this application in some countries/states or under certain conditions.

5 Performance standards

5.1 Financial statements, whether drawn up under IFRS or otherwise, have to be prepared with appropriate rigour, and this applies equally to valuations of assets (or liabilities) in support of them. Subject to the particular statutory, regulatory or other authoritative requirements (see **PS 1 section 4**) applicable to the particular valuation assignment within the jurisdiction concerned, it is recommended that the following practices are observed (note that in some jurisdictions such practices may form part of a mandatory performance framework). Where such practices contain elements that are mandatory for RICS *members* and *firms*, the appropriate cross-references are included.

Professionalism and professional competence

5.2 The mandatory general requirements regarding ethical standards (**PS 2 section 1**), member qualification and professional competence (**PS 2 section 2**) apply with equal force here, as do the requirements to provide assurance concerning competence both when establishing the *terms of engagement* (**VPS 1 section 3**) and when reporting the valuation opinion (**VPS 3 section 2**).

5.3 Bringing professional scepticism to bear on the valuation assignment is also essential (see **PS 2 section 1 paragraph 1.5** and **VPS 2 section 1 paragraph 1.2**), it being particularly important in the context of *financial statements* to be able to demonstrate freedom from bias.

5.4 Where the *member* does not have the required level of expertise to deal with some aspects of the valuation assignment properly, then they may – with the client's approval wherever necessary or appropriate – draw on the expertise of others (see **PS 2 section 2 paragraphs 2.4 to 2.7**).

5.5 Where a sub-contractor is used to assist with the valuation assignment, the member or firm will need to be satisfied that the requirements of **PS 1** can be met (see **PS 2 section 2 paragraph 2.7**). It is important to document and make clear in the valuation report the level of responsibility being assumed by each party to the sub-contract.

5.6 To the extent that the *member* with overall responsibility for the valuation assignment cannot or does not assume responsibility for any specialist input, it is important that the sub-contractor's report (and any associated working papers supplied) is retained with the *member's* working papers, and that it can, as necessary, be demonstrated that the sub-contractor is content with the form in which its opinion or advice will be incorporated or reproduced in the *member's* report (see also **VPS 3 section 2 k) paragraph 5**).

Terms of engagement

5.7 It is especially important in the context of financial reporting that there are *terms of engagement* which are clear (**PS 2 section 7**), leaving no areas of doubt as to what the *member* undertakes to do, however comprehensive or otherwise the valuation assignment will be, including the manner in which the valuation opinion will be reproduced (see **VPS 3 section 2 j) paragraphs 2 to 14**). *Members* are reminded that any changes to the scope of work that are subsequently agreed or necessitated are to be brought to the client's attention and appropriately documented prior to the issue of the valuation report (see **VPS 1 section 1 paragraph 1.6**).

5.8 In addition to the comprehensive list of matters set out in **VPS 1**, it is important to ensure that the responsibilities of the client, insofar as they impact on the fulfilment of the valuation assignment and on the valuation opinion, are set out clearly – this will include, but is not necessarily confined to, specifying the nature of the information which the client agrees to supply. It is also expected that the *terms of engagement* are specific in relation to the timescale within which the report will be produced and issued.

5.9 It is the responsibility of the valuer to discuss and agree with their client and include within the terms of engagement, full details of the accounting standards to be adopted in the valuation, and to include the full definition of the basis of value, including reference of the basis of value definition (e.g. IFRS 13 or FRS 102, etc.), along with details of the accounting standard body or a local regulator whose definition has been applied.

Sources and verification of information

5.10 **VPS 1 section 3 j)** and **VPS 3 section 2 h)** address the nature and source of the information and data to be relied on.

5.11 Source documents may include information and data supplied by the entity and may extend to financial information from sources other than its audited financial statements. It may also include information prepared by third-party advisers or specialists retained by the entity. In all cases information provided by or through the reporting entity's management should be considered just as objectively as information from other sources, professional scepticism being

applied when forming a view on its credibility (see **VPS 2 section 1 paragraph 1.8**). See also **PS 2 section 3 paragraphs 3.11 to 3.15** if discussions about information are held with the client, or any other form of management interview is undertaken.

Documentation

5.12 Particular care is needed over the documentation, including both source and analysis documents and any other relevant papers or records – such as notes of inspections and investigations (**see VPS 2 section 3**) – used to derive and support a valuation opinion. This is because of the reliance to be placed by the reporting entity's management on the valuation opinion when producing the *financial statements* for which they are responsible, which must properly satisfy statutory, regulatory and auditing requirements. *Members'* attention is expressly drawn to **PS 2 section 5.1** where the public has an interest and **PS 2 section 5.2** (in particular **paragraph 5.2.2**) where third-party reliance may or does arise.

Reports

5.13 It is essential that valuation reports provided in support of *financial statements* should 'clearly and accurately set out the conclusions of the valuation in a manner that is neither ambiguous or misleading, and which does not create a false impression' – see **VPS 3**, which sets out a comprehensive list of mandatory requirements designed to fulfil this objective. The following paragraphs provide additional guidance on certain aspects in the specific context of *financial statements*.

5.14 The extent of description of the valuation approach(es) adopted and method(s) used should always be proportionate to the task (see **VPS 3 section l) paragraph 2**) as should the description of the reasoning, but in the particular context of valuation for financial reporting, the presumption is towards a fuller description in order to assist understanding by the client and other intended users. It helps ensure that management decisions concerning the coverage and content of the *financial statement* in relation to the assets (or liabilities) concerned are properly informed and that the entity's management can in turn report in a way that is neither ambiguous or misleading.

5.15 *Members* should be particularly alert in relation to information or data that appears to provide contrary evidence to the valuation opinion reached and should ensure that adequate explanation of how this was considered is included in the valuation report.

5.16 While **VPS 1** and **VPS 3** refer to *valuation date* and amount of the *valuation*, as those italicised terms are defined in the **RICS glossary**, *members* may find that clients refer to the 'measurement date' and 'measurement' amount, as used in accounting standards. As noted in IVS 104 Paragraph 10.1, *basis of value* may sometimes be termed 'standard of value' by clients.

5.17 If any subsequent events are referred to in the report (see **VPS 3 section 2 m) paragraph 7**), the relevant date should normally be provided.

5.18 It is the responsibility of the valuer to include within the valuation reporting, full details of the accounting standards to be adopted in the valuation, and to include the full definition of the basis of value including reference of the basis of value definition (e.g. IFRS 13 or FRS 102, etc.), along with details of the accounting standard body or a local regulator whose definition has been applied. Where appropriate, the valuer should also clearly state whether the basis of value

adopted is considered to be consistent with the basis of *market value* and identify if the specific application of the accounting basis of value definition leads to different values.

5.19 Valuers should be familiar with the measurement requirements of the relevant accounting standards to which they are applying their opinion of value. It is also important that the valuer clearly identifies within the valuation report, the client's classification of the asset(s) being valued along with reference to the corresponding accounting standard.

VPGA 2 Valuation of interests for secured lending

This guidance is advisory and not mandatory in content. Where appropriate, however, it alerts *members* to relevant mandatory material contained elsewhere in these global standards, including the *International Valuation Standards*, using cross-references in bold type. These cross-references are for the assistance of *members* and do not alter the status of the material that follows below. *Members* are reminded that:

- this guidance cannot cover every circumstance, and they must always have regard to the facts and circumstances of individual assignments when forming valuation judgments
- they should remain alert to the fact that individual jurisdictions may have specific requirements that are not covered by this guidance.

1 Scope

1.1 The guidance below provides additional commentary on the *valuation* of interests in real property and in other tangible assets for secured lending.

1.2 Mandatory requirements in these global standards are highlighted using cross-references in **bold type**. While the remaining material is advisory in most jurisdictions, valuers should always refer to the appropriate national supplement (see **PS 1 section 4**) for additional mandatory requirements.

2 Background

2.1 The most common examples of security in relation to real property interests where a valuer's advice is likely to be sought are:

a property that is, or will be, owner-occupied

b property that is, or will be, held as an investment

c property that is fully equipped as a trading entity and valued with regard to trading potential and

d property that is, or is intended to be, the subject of development or refurbishment.

Each of the above examples is discussed further in paragraph 6.2 of this VPGA.

2.2 This VPGA deals with the following matters that are specific to *valuations* for secured lending:

- taking instructions and disclosures
- independence, objectivity and conflicts of interest
- *basis of value* and *special assumptions* and

- reporting and disclosures.

2.3 In most jurisdictions there is a wide variety of assets offered as security and a range of lending products available, and so each case will require a slightly different approach. It is therefore open to the valuer and lender to agree variations, subject to **PS 1 section 4**. The overriding objective is that the valuer should understand the lender's needs and objectives, including the terms of the loan being contemplated, and the lender should understand the advice that is given. These principles apply to real property interests and to other tangible assets alike.

3 Independence, objectivity and conflicts of interest

3.1 *Members* are reminded that in accordance with **PS 2 section 3**, they must at all times act with integrity, independence and objectivity, and avoid conflicts of interest and any actions or situations that are inconsistent with their professional obligations. Additionally, *members* are reminded that they must also declare any potential conflicts of interest – personal or professional – to all relevant parties. It will be appreciated that these requirements are of special relevance and importance in the context of secured lending.

3.2 Where requested or required to do so, valuers who comply with the provisions for independence and objectivity under **PS 2 section 3** may confirm that they are acting as 'independent valuers', subject to compliance also with paragraph 3.3 below.

3.3 The lender may specify additional criteria for independence for a *valuation* for secured lending. There may also be specific criteria that apply in individual jurisdictions. In the absence of any specification, the additional criteria are deemed to include a stipulation that the valuer has had no previous, current or anticipated involvement with the borrower, or prospective borrower, the asset to be valued or any other party connected with a transaction for which the lending is required. 'Previous involvement' would normally be anything within the period of 24 months preceding the date of instruction or date of agreement of the *terms of engagement* (whichever is earlier), but a specific longer period may be prescribed or adopted in individual jurisdictions.

3.4 Any previous or current involvement with the borrower or the property or asset to be valued is to be disclosed to the lender prior to the acceptance of the instruction. Disclosure should also extend to any anticipated future involvement. (References to 'borrower' include a prospective borrower or any other party connected with the transaction for which the lending is required). Examples of such involvement that may result in a conflict of interest include situations where the valuer or *firm*:

- has a long-standing professional relationship with the borrower or the owner of the property or asset
- is introducing the transaction to the lender or the borrower, for which a fee is payable to the valuer or *firm*
- has a financial interest in the asset or in the borrower
- is acting for the owner of the property or asset in a related transaction
- is acting (or has acted) for the borrower on the purchase of the property or asset

- is retained to act in the disposal or letting of a completed development on the subject property or asset
- has recently acted in a market transaction involving the property or asset
- has provided fee earning professional advice on the property or asset to current or previous owners or their lenders and/or
- is providing development consultancy for the current or previous owners.

3.5 Valuers are reminded – consistently with paragraph 3.1 above – that they must consider whether any previous, current or anticipated involvement with either the property or asset or related parties is sufficient to create a conflict with the valuer's duty to be independent and objective. Matters such as the quantum of any financial interest in a connected party, the scope for the valuer or *firm* to benefit materially from a particular valuation outcome and the level of fees earned from any connected party as a proportion of total fee income may all be material.

3.6 If the valuer considers that any involvement creates an unavoidable conflict with their duty to the potential client, the instruction should be declined.

3.7 If the valuer and the client agree that any potential conflict can be avoided by introducing arrangements for managing the instruction, those arrangements are to be recorded in writing, included in the *terms of engagement* and referred to in the report.

3.8 Although a valuer may take into account the views of the prospective client in deciding whether a recent, current or anticipated involvement creates a conflict, it remains the valuer's professional responsibility to decide whether or not to accept the instruction having regard to the principles of the **RICS Rules of Conduct**. If the instruction is accepted where material involvement has been disclosed, the valuer may be required to justify this decision to RICS. If a satisfactory justification is not provided, RICS may take disciplinary measures.

3.9 *Members* should refer to the global RICS professional statement **Conflicts of interest** for additional information.

4 Taking instructions and disclosures

4.1 Valuers are reminded that the *terms of engagement* must incorporate the minimum requirements of **VPS 1 paragraph 3.1**. Where the lender has additional or alternative requirements, they will need to be confirmed and particular care is to be taken to agree and record any *special assumptions* that are to be made.

4.2 In some circumstances a *valuation* for secured lending may be commissioned by a party that is not the intended lender, for example, a prospective borrower or broker. If the party does not know, or is unwilling to disclose, the identity of the intended lender, it will need to be stated in the *terms of engagement* that the *valuation* may not be acceptable to a lender. This may be because some lenders do not accept that a *valuation* procured by a borrower or an agent is sufficiently independent, or because the particular lender has specific reporting requirements.

4.3 The valuer should enquire if there has been a recent transaction or a provisionally agreed price on any of the properties to be valued. If such information is revealed, further enquiries should be made, for example, the extent to which the property was marketed, the effect of any incentives, the price realised or agreed and whether it was the best price obtainable.

4.4 The valuer should request details of the terms of the lending facilities being contemplated by the lender.

4.5 Valuers are reminded that they must ensure that all the relevant disclosures required by the instructions, in compliance with **VPS 1 paragraph 3.1**, and having regard to the matters in section 6 below, are made.

5 Basis of value and special assumptions

5.1 *Market value* is the *basis of value* widely used for *valuations* or appraisals undertaken for secured lending. However, in some jurisdictions alternative bases may be recognised or expressly required, for example, as a result of statute or regulation, 'mortgage lending value' being one example. These alternative bases may, and often do, involve prescribed approaches or assumptions and may therefore result in a value for the purpose of secured lending that is quite markedly different from *market value* as defined in IVS 104 paragraph 30.1 and reproduced in **VPS 4**. Sometimes described as a 'mark to model' valuation approach to distinguish it from a 'mark to market' approach, the valuation output must only be used for the particular purpose for which it is provided. This is because often the basis or model used is, or forms part of, a risk assessment tool, the risk being viewed primarily from the lender's perspective across an extended period of time. While it is proper for valuers to provide advice using these alternative *bases of value*, what is essential is that the particular *basis of value* adopted is always made clear.

5.2 Any *special assumptions* (see **VPS 4 section 9**) made in arriving at the value reported are to be agreed in writing with the lender in advance and referred to in the report.

5.3 Circumstances that often arise in *valuations* for secured lending where *special assumptions* may be appropriate include, for example:

- planning consent has been granted for development at the property
- there has been a physical change to the property, such as new construction or refurbishment
- a new letting on given terms, or the settlement of a rent review at a specific rent, has been completed
- there is a *special purchaser*, which may include the borrower
- a constraint that could prevent the property being either brought or adequately exposed to the market is to be ignored
- a new economic or environmental designation has taken effect
- the property suffers from natural, non-natural or existing use environmental constraints
- any unusual volatility in the market as at the *valuation date* is to be discounted and
- any lease or leases between connected parties has been disregarded.

The above list is not exhaustive, and the appropriate *special assumptions* will depend on the circumstances under which the *valuation* is requested and the nature of the property to be valued.

5.4 Any *valuation* for secured lending purposes arrived at by making a *special assumption* must be accompanied by a comment on any material difference between the reported value with and without that *special assumption*.

6 Reporting and disclosures

6.1 In addition to the matters set out in **VPS 3 paragraph 2.2**, matters that will frequently require consideration and comment in a report prepared for secured lending include:

- disclosure of any involvements (see subsection 4 of this VPGA) identified in the original or subsequent amendment to the *terms of engagement*, or any arrangements agreed for avoiding a conflict of interest. If the valuer has had no involvement, a statement to that effect is to be made
- the valuation method adopted, supported (where appropriate or requested) with the calculation used (note that in some jurisdictions, the method or methodology itself will be prescribed in some degree)
- where a recent transaction on the property has occurred or a provisionally agreed price has been disclosed, the extent to which that information has been accepted as evidence of value. Where the enquiry does not reveal any information, the valuer will make a statement to that effect in the report, accompanied by a request that if such information comes to light before the loan is finalised, the matter must be referred back to the valuer for further consideration
- comment on the suitability of the property as security for mortgage purposes, bearing in mind the length and terms of the loan being contemplated. Where the terms are not known, the comment should be restricted to the general marketability of the property
- any circumstances of which the valuer is aware that could affect the price (these must also be drawn to the attention of the lender, and an indication of their effect must be provided)
- any other factor that potentially conflicts with the definition of the *basis of value* or its underlying *assumptions* must be noted and its effect explained
- potential and demand for alternative uses, or any foreseeable changes in the current mode or category of occupation
- the potential occupational demand for the property
- disrepair, or whether any deleterious or harmful materials have been noted
- comment on any environmental or economic designation
- comment on environmental issues, such as flood risk potential, historic contamination or non-conforming uses
- past, current and future trends, and any volatility in the local market and/or demand for the category of property
- the current marketability of the interest and whether it is likely to be sustainable over the life of the loan
- details of any significant comparable transactions relied upon and their relevance to the *valuation*
- any other matter revealed during normal enquiries that might have a material effect on the value currently reported and
- if the property is, or is intended to be, the subject of development or refurbishment for residential purposes, the impact of giving incentives to purchasers.

Sustainability and ESG factors (see **VPGA 8**) can be a significant market influence and valuations for secured lending should always have appropriate regard to their relevance to the particular assignment.

6.2 The following paragraphs indicate matters that it may be appropriate to include when valuing interests in different categories of real property, as listed in paragraph 2.1 of this VPGA.

a) Property that is, or will be, owner-occupied

Typical *special assumptions* that may arise when valuing this category of property include:

- planning consent has been, or will be, granted for development, including a change of use of the property
- a building or other proposed development has been completed in accordance with a defined plan and specification
- all necessary licences and consents are in place
- the property has been changed in a defined way (for example, removal of equipment or fixtures) and
- the property is vacant when, in reality, at the *valuation date* it is occupied.

b) Property that is, or will be, held as an investment

i Additional report contents should include:

- a summary of occupational leases, indicating whether the leases have been read or not, and the source of any information relied on
- a statement of, and commentary on, current rental income, and comparison with current market rental value. Where the property comprises a number of different units that can be let individually, separate information should be provided on each
- an *assumption* as to covenant strength where there is no information readily available, or comment on the market's view of the quality, suitability and strength of the tenant's covenant
- comment on maintainability of income over the life of the loan (and any risks to the maintainability of income), with particular reference to lease breaks or determinations and anticipated market trends – this may well need to be considered in a broader *sustainability* and ESG context, such as potential future cost liabilities related to meeting regulatory and investor requirements and
- comment on any potential for redevelopment or refurbishment at the end of the occupational lease(s).

ii Typical *special assumptions* that may arise in valuing this category of real property include whether:

- a different rent has been agreed or determined, e.g. after a rent review
- any existing leases have been determined, and the property is vacant and to let or
- a proposed lease on specified terms has been completed.

c) Property that is fully equipped as a trading entity and valued with regard to trading potential

i The closure of the business could have a significant impact on the *market value*. The valuer should therefore report on this impact, either individually or as a combination of one or more of the following *special assumptions*:

- the business has been closed and the property is vacant
- the trade inventory has been depleted or removed
- the licences, consents, certificates and/or permits have been lost or are in jeopardy and/or
- accounts and records of trade are not available to a prospective purchaser.

ii Typical *special assumptions* that may arise in valuing this category of real property include:

- *assumptions* made on the trading performance and
- projections of trading performance that materially differ from current market expectations.

d) Property that is, or is intended to be, the subject of development or refurbishment

i Additional report contents should include:

- comment on costs and contract procurement
- comment on the viability of the proposed project
- if the *valuation* is based on a residual method, an illustration of the sensitivity of the *valuation* to any *assumptions* made
- the implications on value of any cost overruns or contract delays and
- comment on the anticipated length of time the redevelopment or refurbishment will take, as this may affect the current value due to inconvenience and/or temporary lack of utility.

ii Typical *special assumptions* that may arise in valuing this category of property include whether:

- the works described had been completed in a good and workmanlike manner, in accordance with all appropriate statutory requirements
- the completed development had been let, or sold, on defined terms or
- a prior agreed sale or letting has failed to complete.

iii Where a *valuation* is required on the *special assumption* that the work had been completed as of a current *valuation date*, the value reported should be based on current market conditions. If a *valuation* is required on the *special assumption* that the work has been completed as of a future date and the *valuation date* is as of that future date, the valuer is reminded of the requirements for developing and reporting the opinion of value in accordance with **VPS 1 paragraph 3.2(k)** and **VPS 3 paragraph 2.2(i)**.

6.3 It is good practice to attach any instruction letter and the *terms of engagement* to the report and refer to these documents in the body of the report.

VPGA 3 Valuation of businesses and business interests

This guidance is advisory and not mandatory in content. Where appropriate, however, it alerts *members* to relevant mandatory material contained elsewhere in these global standards, including the *International Valuation Standards*, using cross-references in bold type. These cross-references are for the assistance of *members* and do not alter the status of the material that follows below. *Members* are reminded that:

- this guidance cannot cover every circumstance, and they must always have regard to the facts and circumstances of individual assignments when forming valuation judgments
- they should remain alert to the fact that individual jurisdictions may have specific requirements that are not covered by this guidance.

1 Scope

1.1 The guidance below provides additional commentary on the *valuation* of businesses and business interest and the practical application of **IVS 200 Businesses and Business Interests**. Any cross-references to mandatory requirements are highlighted in **bold type**.

2 Introduction

2.1 For the purposes of this application, a 'partial interest' means ownership of a right or rights that represent less than all of the rights in a tangible or *intangible asset*, such as the right to use but not sell an asset or property. 'Fractional interest' means ownership of a percentage of the right or rights in a tangible or *intangible asset* (whether such rights are in the entirety of the asset, or a partial interest in the asset) such as the ownership of an asset which is vested in more than one party.

2.2 IVS 200 defines a business as 'a commercial, industrial, service or investment activity'. This VPGA is concerned with the *valuation* of entire businesses – whether companies, sole traders or partnerships (including limited liability partnerships) – together with interests therein, such as company stocks and shares or partnership interests.

2.3 This VPGA does not deal with the *valuation* of *intangible assets* (for which see **VPGA 6**), *plant and equipment* (for which see **VPGA 5**), land, or other tangible assets that may sometimes constitute part of a business. However, a business valuer may often be required to rely on the *valuation* of such assets provided by other specialist valuers, for example, of real estate, and of mineral rights.

2.4 *Valuation* of financial interests, loan capital, debentures, options, warrants, convertibles and fixed interest securities may form part of a business valuation assignment.

2.5 To satisfy **PS 2 section 2**, it is important that the valuer is regularly involved in business *valuation*, as practical knowledge of the factors affecting investment in any particular property, asset, business or share, is essential.

3 Scope of work and terms of engagement

3.1 The valuation knowledge of clients will vary widely. Some will have a thorough understanding of business *valuation*, while others will be unfamiliar with the terms and concepts used by business valuers.

3.2 It is important that both the scope of the work to be undertaken and the *terms of engagement* are understood and agreed between the valuer and the client prior to commencement of the assignment. The asset or liability, or the specific interest in the asset or liability that is to be valued, or the right (or rights to) that are to be appraised should be recorded. Such record should specify:

- the legal structure of the business entity
- whether the asset to be valued is the interest in its entirety or a fractional interest
- if the asset to be valued is confined to, or excludes, certain assets or liabilities, and
- the class (or classes) of shares concerned.

3.3 Any *assumptions* that are made must be clearly stated in compliance with **VPS 4 sections 8 and 9**. For example, the valuer should state whether he or she assumes that the owners of shares or partial interests are intending to sell or retain such interests, or whether certain assets or liabilities owned by the business are to be disregarded.

3.4 There may be situations where the interest in the asset to be valued is shared with others, i.e. common use or shared ownership, and in such cases, it should be clearly specified.

3.5 Valuers may wish to develop standard letters of engagement that can be used for any type of valuation instruction. Where a *valuation* has to comply with the RICS Red Book Global Standards the valuer must produce *terms of engagement* that comply with the minimum terms set out in **PS 2 section 7** and **VPS 1**, adapted as necessary to refer to business *valuation*.

4 Businesses and business interests

4.1 A business *valuation* may either comprise the whole of the activity of an entity or a part of the activity. It is important to distinguish as necessary between the entirety value, the value of a partial interest (see paragraph 2.1 above), the values of specific assets or liabilities of the entity, and the intended use of the *valuation* (for example, for tax planning, or management's internal purposes), prior to commencing the *valuation*.

4.2 It is essential to be clear about the 'purpose' of the *valuation*, and its 'intended use'. Purpose may refer to the provision of an opinion in accordance with a specific *basis of value*, for example, *market value* or *fair value*. Intended use may refer to a type of transaction or activity, for example, financial reporting.

4.3 Where individual assets, divisions and liabilities are to be valued, and are capable of being independently transferred, they should, where possible, be valued at their respective *market values* rather than by apportionment of the entirety value of the business.

4.4 When valuing a business or interest in a business, the valuer should consider whether a higher value could be arrived at on a liquidation basis and, if so, consider the prospect of realising such value, having regard to the ownership interest.

4.5 Whatever the ownership interest – whether a proprietorship, a partnership, or in corporate form – the rights, privileges and conditions attaching to that interest have to be considered in the *valuation*. Ownership interests may be the entire business, or part or shares therein, and it may be important to distinguish between legal and beneficial ownership, rights and obligations inherent to the interest and those rights that may be contained in any agreement between current shareholders. Ownership rights will usually be set out in legally binding documents such as articles of association, articles of incorporation, business memoranda, bye-laws, partnership articles or other agreements, and shareholder agreements.

4.6 The documents referred to in paragraph 4.5 above may contain transfer restrictions and may state the *basis of value* that has to be used on a transfer of the business interest. It is important to distinguish between rights and obligations inherent in the interest to be valued. For example, the ownership documentation may require the *valuation* to be done on a pro-rata proportion of the entity value, regardless of size of interest. The valuer will then have to comply with such requirements and the rights attaching to any other class of interest. IVS 200 provides further commentary on ownership rights.

4.7 A non-controlling interest may have a lower value than a controlling one, although a majority interest does not necessarily control the entity. Voting control and other rights will be set out by the legal frameworks mentioned in paragraph 4.5 above and may give control or veto even to minority interests in certain circumstances. There are often different equity classes in a business, each with different rights.

4.8 The reason why the valuer has been instructed to perform a business *valuation* is important to understand, as the *valuation* may be required for a wide variety of purposes. Examples include financial reporting, taxation, public sector assignments, transactions and flotations, fairness opinions, banking arrangements, insolvency and administration, knowledge management, or portfolio review. The purpose will introduce various *bases of value*, some governed by statute and case law, and others by international and national standards of professional valuation practice.

4.9 *Bases of value* typically encountered for these *valuations* are *fair value*, fair market value, *market value*, open market value, *investment value*, owner value and net realisable value. It is important to check the precise terms of any *basis of value* that may be described, for example, in shareholders' agreements, legislation or regulations. Valuers should be mindful of the requirements of **PS 1 sections 3, 4 and 7**, relating to the use of a *basis of value* not recognised in the Red Book Global Standards.

4.10 Depending on the rules and practice followed in respect of the *basis of value*, *valuations* of the same asset may be different. For example, because of the rules concerning tax *valuations*, a tax authority might view a *valuation* differently to a litigant, merger partner or *special purchaser*.

4.11 While the valuer should consider future returns likely to be received from the business, as well as the often theoretical aspects of *valuation* (particularly fiscal factors), ultimately the business that is to be valued is the one that actually exists, or the one that could exist on a commercial basis as at the *valuation date*. The valuer therefore needs to account for the future expectations of operation of the business. These expectations may be based partly on actual historic performance and partly on a notional unachieved one. They will be those of the market participants as identified by the valuer, following appropriate research as to the business and outlook for the industry, and discussions with the operators of the business as to their expectations.

4.12 As the underlying concept revolves around the profits that the purchaser might expect to accrue from ownership, these are generally measured after deducting the commercial costs of managing the business entity. Therefore, where a business entity does not bear actual management costs, the valuer will need to consider the deduction of notional management costs at a market rate in arriving at profitability for business valuation purposes.

4.13 In many cases the valuer may need to apply more than one valuation method, particularly where there is insufficient information or evidence to enable the valuer to rely on just one. In such cases, the valuer may use additional methods, to arrive at the final *valuation* indicating why preference is given to any one or more methodologies. The valuer should consider all valuation approaches, giving reasons why any particular approach has not been completed.

5 Information

5.1 Business *valuation* often depends on information received from the proprietors and their advisers or representatives. The valuer should specify what reliance has been placed on what information, as well as stating the rationale for accepting and using, without verification, information provided by the client or that person's representative. Some information may have to be verified in whole or in part, and this will need to be stated in the valuation report. Although the value may largely depend on future expectations, the history may assist in determining what these expectations might reasonably be.

5.2 The valuer needs to be aware of any relevant economic developments, industry trends and the context in which the *valuation* is being prepared, for example, political outlook, government policies, inflation and interest rates, and market activity. Such factors may affect businesses in different sectors in distinct ways.

5.3 The interest being valued will reflect the financial standing of the business at the *valuation date*. The nature of the assets and liabilities needs to be understood, and the valuer is expected to consider which ones are employed for income generation, and which ones are redundant to such activities at the *valuation date*. The valuer should also take account of off-balance sheet assets or liabilities where necessary.

6 Valuation investigation

6.1 As a minimum requirement, valuers should not contemplate carrying out a *valuation* in the absence of a detailed knowledge and understanding of the history of, and activities associated with, the business and or asset(s). They will also need a comprehensive

understanding of, as appropriate, management structures and personnel, state of the subject industry, the general economic outlook and political factors. In addition, consideration must be given to such issues as the rights of minority shareholders. For these reasons, valuers should have appropriate competency in business *valuation*.

6.2 Typical information requirements to assist the valuer in understanding the subject company and/or asset(s) could include:

- most recent *financial statements*, and details of current and prior projections or forecasts
- description and history of the business or asset, including legal protections
- information about the business or asset and supporting intellectual property and intangibles (for example, marketing and technical know-how, research and development, documentation, design graphics and manuals, including any licences/approvals/consents/permits to trade, etc.)
- articles of association, company memorandum, shareholders' agreements, subscription agreements, other collateral agreements
- precise activities of the business, and its associated companies or subsidiaries
- class rights of all share and debenture classes (security over assets)
- previous valuation reports
- product(s) dealt in, supported or extended by the business and intangibles
- company's market(s) and competition, barriers to entry in such markets, business and marketing plans, due diligence
- strategic alliances and joint venture details
- whether contractual arrangements can be assigned or transferred in any *intangible asset* or royalty agreement
- major customers and suppliers
- objectives, developments or trends expected in the industry and how these are likely to affect the company or asset
- accounting policies
- strengths, weaknesses, opportunities and threats (SWOT) analysis
- key market factors (for example, monopoly or dominant market position, market share)
- major capital expenditure in prospect
- competitor positions
- seasonal or cyclical trends
- technological changes affecting the business or asset
- vulnerability of any source of raw materials or supplier arrangement
- whether there have been any recent acquisitions or mergers in the sector around the *valuation date*, and the criteria that were applied
- whether there have been any significant developments or changes to the business since the latest accounting date (for example, management information, budgets, forecasts)
- offers to acquire the business, or discussions with banks and other sponsors to go public

- management of research and development (for example, non-disclosure agreements, subcontractors, training and incentives)
- *valuations* of underlying assets.

6.3 Much of the information relied on will be derived from the client(s) and it may not be possible to verify it. In such cases, the valuation report should make this clear. It may, however, extend to information obtained from other specialist valuers or other comment or informed sources, as set out at paragraph 5.1 above, and it should be made clear if reliance has been placed on such information.

7 Valuation approaches and methodology

7.1 In broad terms, valuation theory recognises four distinct approaches in the *valuation* of shares and businesses. These are:

- the *market approach* (sometimes known as the direct market comparison approach)
- the *income approach*
- the *cost approach* and
- the asset-based approach.

7.2 While the *market* and *income approaches* can be used for the *valuation* of any business or business interest, the *cost approach* will not normally apply except where profits and cash flows cannot reliably be determined, for example, in start-up businesses and early stage companies.

7.3 An alternative that may be used for the *valuation* of businesses and interests in businesses is the asset-based approach, which is based on the underlying assets being revalued, if necessary. This would include, for example, property holding and investment companies, and investment businesses holding listed company shares.

7.4 Involvement of market participants, who are able to provide insights to transactions and market conditions that are critical to proper use of the data in analysis, is advisable wherever possible.

Market approach

7.5 The *market approach* measures the value of an asset by comparing recent sales or offerings of similar or substitute property and related market data to the business being valued.

7.6 The two primary *market approach* methods are the 'market multiple method' and the 'similar transactions method'. These are based on data derived from three principal sources:

- public stock markets
- the acquisition market where entire businesses are traded and
- prior transactions in the shares of the entity being valued, or offers for that subject business.

7.7 The market multiple method focuses on comparing the subject asset to guideline similar, publicly traded, companies and assets. In applying this method, valuation multiples are derived from historic and operating data of comparables. These are selected, where possible, from the same industry, or one affected by the same economic factors as that of the subject business, and are evaluated on both a qualitative and quantitative basis. The data is then adjusted having

regard to the strengths and weaknesses of the subject asset relative to the selected companies, and applied to the appropriate operating data of the subject asset to arrive at an indication of value. Appropriate adjustments (as supported by market-derived information presented in the report) to reflect different properties or characteristics, are usually made to the derived data. Examples of such matters are differences in perceived risk and future expectations, and differences in ownership interest, including level of control, marketability and size of holding.

7.8 The similar transactions method uses valuation multiples based on historical transactions that have occurred in the subject company's shares and/or asset's direct or related industries. These derived multiples are then adjusted and applied to the appropriate operating data of the subject asset to arrive at an indication of value.

7.9 In certain industries, businesses are bought and sold on the basis of established market practices or rules of thumb, often (though not exclusively) derived from multiples or percentages of turnover, and not linked to profitability. Where such rules of thumb exist, and there is evidence that buyers and sellers in the actual market rely on them, the business valuer may need to consider them. However, it would be sensible to cross check the results arising from such market practices against one or more other methods. Care should be taken that the 'established market practice' has not been superseded by changes in circumstances over time.

Income approach

7.10 The *income approach* has a number of variants, but essentially this approach is based on the income that an asset is likely to generate over its remaining useful life or a specified period. This estimation is determined by reference to both historic performance and forecasts. Where these are not available, the single period capitalisation method may be appropriate instead.

7.11 The single period capitalisation method commonly estimates the value by capitalising that income. A thorough understanding of accounting and economic profits, their historical record based usually on historic financial statements, and forecasting is necessary in each case. Normalised profits after tax are determined and, if necessary, adjusted to reflect differences between actual historic profits and cash flows and those that could be expected to be received by a purchaser of the business at the *valuation date*.

7.12 Further adjustments may include restating non-arm's length transactions and costs incurred with related parties to commercial terms, and reflecting the effect of non-recurring events whether of income or cost. Examples of this include one-off redundancies, exceptional profits or losses. Comparison of depreciation and inventory accounting should be on a like-for-like basis.

7.13 Profits are then capitalised by the price to earnings (P/E) ratio. A similar exercise can be carried out by applying a suitable capitalisation multiple to normalised profits before tax. A suitable capitalisation multiple will often be applied to earnings before interest and tax (EBIT), or earnings before interest, tax, depreciation and amortisation (EBITDA). Care must be taken in these cases to distinguish between:

- enterprise value (which also considers the debt of the business and any liquid assets owned by the entity that might mitigate the acquirer's purchase price) and
- equity value (i.e. the value of the shares).

7.14 Business value is often derived by capitalising profits or cash flows before costs of servicing debt, using a capitalisation or discount rate that is the weighted average cost of capital (WACC) of a comparable mix of debt and equity. The equity value is the enterprise value less the *market value* of the net debt, but can be established by measuring the equity cash flow itself.

7.15 Present value techniques measure the value of an asset by the present value of its future economic cash flow, which is cash that is generated over a period of time by an asset, group of assets, or business enterprise. These can include earnings, cost savings, tax deductions, and proceeds from its disposition. When applied to business *valuation*, value indications are developed by discounting expected cash flows, estimated, where appropriate, to include growth and price inflation, to their net present value at a rate of return. The rate of return incorporates the risk-free rate for the use of funds, the expected rate of inflation and risks associated with the particular investment and the market. The discount rate selected is generally based on rates of return available from alternative investments of similar type and quality as at the *valuation date*. Expressions such as 'rate of return' may mean different things to different individuals so valuers should consider defining what is meant by such terms.

7.16 The values of redundant or surplus assets, namely those owned but not used in the business operations, need to be taken into account in enterprise or equity values.

7.17 The *income approach*, as applied using the dividend *basis of value*, is common in company *valuation*, principally in relation to minority shareholdings. For business *valuations*, value indicators are developed by determining a share's future dividends and prospect of dividends, and a rate of return, using dividend discount and initial yield models.

Cost approach

7.18 The *cost approach* indicates the value of an asset by the cost to create or replace the asset with another similar one, on the premise that a purchaser would not pay more for an asset than the cost to obtain one of equal usefulness. This method is frequently used in valuing investment companies or capital intensive firms. However, it would normally not be used except when the other two approaches have been considered but deemed not applicable, and the report would contain an explanation as to why this was so.

7.19 When applied to business *valuation*, obsolescence, maintenance and the time value of money are considerations. If the asset being valued is less attractive than a modern equivalent, by reason of age or obsolescence, the valuer may need to adjust the cost of the perceived modern equivalent, thus arriving at the depreciated replacement cost.

Asset-based approach

7.20 The asset-based approach measures the value of a business and asset by reference to the value of individual assets and liabilities. This approach is commonly adopted in the area of property investment and share investment portfolio situations (investment trusts). This approach is not normally the preferred one for trading businesses, except where they are failing to achieve an adequate return on the tangible assets used in the business, or where a trading business also has substantial investment activity or surplus cash. The net asset value per share can be discounted or enhanced by the addition of a premium.

7.21 The valuation *assumptions* and inputs may be based either on actual data or on assumed information. The *market approach* is likely to be based on actual inputs, such as prices achieved

on sales of similar assets or businesses and actual income or profits generated. Assumed inputs might include cash flow forecasts or projections. For *valuations* adopting the cost approach, actual inputs might include the actual cost of an asset, whereas assumed inputs may have regard to an estimated cost of an asset and other factors, such as the perceived attitude to risk of other players in the market.

7.22 As a general rule, *valuation* by summation, sometimes known as *valuation* by assembly, should be avoided. Accordingly, when valuing the totality of various assets or component parts of an entity, the valuer must avoid arriving at the value of the whole merely by adding together the values indicated for the various separate assets or component parts.

8 Reports

8.1 Where the *valuation* has to comply with the RICS Red Book Global Standards, the valuer must produce a report that complies with the minimum terms set out in **VPS 3**. Generally the report has a brief introductory section or executive summary that defines the assignment, summarises the conclusion and sets the stage for the details of the report. The structure should move from the general to the specific, providing a logical flow of data and analysis within which all the necessary considerations can be incorporated, leading to the valuation conclusions.

8.2 Most reports will have the following major sections, although not necessarily in this order:

- introduction
- purpose and *basis of value*
- *assumptions* and *special assumptions*
- subject of *valuation*
- description and history of the business
- accounting and accounting polices
- *financial statement* analysis
- business and marketing plan analysis, and prospects
- search results for comparables and comparative transactions
- industry in which the business operates, economic environment, yields and risk assessment
- environmental constraints
- valuation methods and conclusion
- caveats, disclaimers and limitations.

8.3 Some reports will have a separate section containing a general discussion of valuation methodology, which will often follow the introduction. If national, regional and economic data are important to the company and asset, each may have its own section.

8.4 Where appropriate, factual information, or sources thereof, should be identified either in the body of the report or in the appendices. Where the opinion of an expert is required for litigation purposes, the report must adhere to the requirements imposed by the local jurisdiction and must therefore contain all relevant disclosures including the statement of the expert's qualifications and the statement of truth.

9 Confidentiality

9.1 Information in respect of many business assets will be confidential. Valuers should use their best endeavours to preserve such confidentiality, particularly in relation to information obtained in respect of comparable assets. Where required by the client, business valuers will comply with any requests to enter into non-disclosure or similar agreements.

VPGA 4 Valuation of individual trade related properties

This guidance is advisory and not mandatory in content. Where appropriate, however, it alerts *members* to relevant mandatory material contained elsewhere in these global standards, including the *International Valuation Standards*, using cross-references in bold type. These cross-references are for the assistance of *members* and do not alter the status of the material that follows below. *Members* are reminded that:

- this guidance cannot cover every circumstance, and they must always have regard to the facts and circumstances of individual assignments when forming valuation judgments
- they should remain alert to the fact that individual jurisdictions may have specific requirements that are not covered by this guidance.

1 Background

1.1 Certain trade related properties are valued using the profits method (also known as the *income approach*) of *valuation*. The guidance below sets out the principles of this method of valuation but does not concern itself with the detailed approach to a *valuation*, which may vary according to the property to be valued.

1.2 This VPGA relates only to the *valuation* of an individual property that is valued on the basis of trading potential.

1.3 Some properties are normally bought and sold on the basis of their trading potential. Examples include hotels, pubs and bars, restaurants, nightclubs, fuel stations, care homes, casinos, cinemas and theatres, and various other forms of leisure property. The essential characteristic of this type of property is that it has been designed or adapted for a specific use, and the resulting lack of flexibility usually means that the value of the property interest is intrinsically linked to the returns that an owner can generate from that use. The value therefore reflects the trading potential of the property. It can be contrasted with generic property that can be occupied by a range of different business types, such as standard office, industrial or retail property.

1.4 Other types of properties such as car parks, garden centres, caravan parks and crematoria, fulfil the requirements at 1.3 and are valued in some jurisdictions with reference to trading potential using a profits approach. This list is not intended to be exhaustive. A further subset of properties includes those where the adaptation in use or restraint on flexibility is less marked, but a valuation based on an income approach, including many aspects of this VPGA, may still be regarded as the best indicator of value. A non-exhaustive list of examples includes self-storage, flexible workspace and purpose-built investment student housing. The choice of method will be a matter for valuer judgement having regard to the specific type, form and use of the property and market circumstances prevailing, and evolving, at the time.

1.5 Valuers who prepare *valuations* of *trade related property* usually specialise in this particular market. Knowledge of the operational aspects of the property *valuation*, and of the industry as a whole, is fundamental to the understanding of market transactions and the analysis required.

1.6 Comparable information may be derived from a wide variety of sources, not just transactional evidence. Also, information may be drawn from different operational entities with regard to the component parts of the profits *valuation*. The valuer should emphasise within the report that the *valuation* is assessed having regard to trading potential and should refer to the actual profits achieved. If the trading potential and/or the actual profits vary, there could be a change in the reported value (see **VPS 3 paragraphs 2.2(h)(4) and 2.2(o)**).

1.7 This VPGA assumes that the current trade related use of the property will continue. However, where it is clear that the property may have an alternative use that may have a higher value, an appropriate comment should be made in the report. Where such an alternative use value is provided, it should be accompanied by a statement that the *valuation* takes no account of the costs of business closure, disruption or any other costs associated with realising this value.

2 Terms used in this VPGA

2.1 The terms used in this VPGA may have different meanings when used by other professional disciplines.

Adjusted net profit

2.2 This is the valuer's assessment of the actual net profit of a currently trading operational entity. It is the net profit that is shown from the accounts once adjustments for abnormal and non-recurring expenditure, finance costs and depreciation relating to the property itself, as well as rent where appropriate, have been made. It relates to the existing operational entity and gives the valuer guidance when assessing the fair maintainable operating profit (FMOP).

Earnings before interest, taxes, depreciation and amortisation (EBITDA)

2.3 This term relates to the actual operating entity and may be different from the valuer's estimated FMOP.

Fair maintainable operating profit (FMOP)

2.4 This is the level of profit, stated prior to depreciation and finance costs relating to the asset itself (and rent if leasehold), that the reasonably efficient operator (REO) would expect to derive from the fair maintainable turnover (FMT) based on an assessment of the market's perception of the potential earnings of the property. It should reflect all costs and outgoings of the REO, as well as an appropriate annual allowance for periodic expenditure, such as decoration, refurbishment and renewal of the trade inventory.

Fair maintainable turnover (FMT)

2.5 This is the level of trade that an REO would expect to achieve on the *assumption* that the property is properly equipped, repaired, maintained and decorated.

Market rent

2.6 This is the estimated amount for which an interest in real property should 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. Whenever *market rent* is provided the 'appropriate lease terms' that it reflects should also be stated.

Market value

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

Operational entity

2.8 An operational entity usually includes:

- the legal interest in the land and buildings
- the trade inventory, usually comprising all trade fixtures, fittings, furnishings and equipment and
- the market's perception of the trading potential, together with an assumed ability to obtain/ renew existing licences, consents, certificates and permits.

Consumables and stock in trade are normally excluded.

Personal goodwill (of the current operator)

2.9 This is the value of profit generated over and above market expectations that would be extinguished upon sale of the *trade related property*, together with financial factors related specifically to the current operator of the business, such as taxation, depreciation policy, borrowing costs and the capital invested in the business.

Reasonably efficient operator (REO)

2.10 This is a concept where the valuer assumes that the market participants are competent operators, acting in an efficient manner, of a business conducted on the premises. It involves estimating the trading potential rather than adopting the actual level of trade under the existing ownership, and it excludes personal goodwill.

Tenant's capital

2.11 This may include, for example, all consumables, purchase of the inventory, stock, and working capital.

Trade related property

2.12 This is any type of real property designed or adapted for a specific type of business where the property value reflects the trading potential for that business.

Trading potential

2.13 This is the future profit, in the context of a *valuation* of the property that an REO would expect to be able to realise from occupation of the property. This could be above or below the recent trading history of the property. It reflects a range of factors (such as the location, design and character, level of adaptation and trading history of the property within the market conditions prevailing) that are inherent to the property asset.

3 Profits method of valuation

3.1 The profits method of *valuation* involves the following steps:

Step 1: An assessment is made of the FMT that could be generated at the property by an REO.

Step 2: Where appropriate, an assessment is made of the potential gross profit, resulting from the FMT.

Step 3: An assessment is made of the FMOP. The costs and allowances to be shown in the assessment should reflect those to be expected of the REO – which will be the most likely purchaser or operator of the property if offered in the market.

Step 4:

- **a** To assess the *market value* of the property the FMOP is capitalised at an appropriate rate of return reflecting the risk and rewards of the property and its trading potential. Evidence of relevant comparable market transactions should be analysed and applied.
- **b** In assessing *market value* the valuer may decide that an incoming new operator would expect to improve the trading potential by undertaking alterations or improvements. This will be implicit within the valuer's estimate of FMT at step 1. In such instances, an appropriate allowance should be made from the figure resulting from step 4 to reflect the costs of completing the alterations or improvements and the delay in achieving FMT. Similarly, if the property is in need of repair and/or decoration to enable the REO to achieve the FMT, then an appropriate allowance should be made from the figure resulting from step 4(a) to reflect the cost of such repairs and decorations.
- **c** To assess the *market rent* for a new letting, the rent payable on a rent review or the reasonableness of the actual rent passing (particularly when preparing an investment *valuation*), an allowance should be made from the FMOP to reflect a return on the tenant's capital invested in the operational entity – for example, the cost of trade inventory, stock and working capital. The resultant sum is referred to as the divisible balance. This is apportioned between the landlord and tenant having regard to the respective risks and rewards, with the landlord's proportion representing the annual rent.

3.2 Certain extended or more detailed approaches to a profits method of *valuation* may be appropriate, particularly for some larger or more complex *trade related properties*. Consideration of discounted cash flow assessments and different income streams may be adopted. Such knowledge will aid in the analysis and review of historic and current trading performance, as well as with forecasts that may show increases or decreases on actual trade. This can assist in forming an opinion of the FMT and FMOP considered achievable by a likely purchaser or REO.

3.3 It is important that the valuer is regularly involved in the relevant market for the class of property, as practical knowledge of the factors affecting the particular market is required.

3.4 When preparing a *trade related property valuation* it is essential that the valuer reviews the cumulative result of the different steps of the valuation process. The *valuation* should be considered having regard to the valuer's general experience and knowledge of the market.

4 Valuation special assumptions

4.1 A *trade related property* will usually be valued to *market value* or *market rent*, but valuers are commonly asked for a *valuation* subject to *special assumptions*.

Typical special assumptions are:

- **a** on the basis that trade has ceased and no trading records are available to prospective purchasers or tenants
- **b** on the same basis as (a) but also assuming the trade inventory has been removed
- **c** as a fully equipped operational entity that has yet to trade (also known as 'day one' *valuation*) and
- **d** subject to stated trade projections, assuming they are proven. This is appropriate when considering development of the property.

5 Valuation approach for a fully equipped operational entity

5.1 The *valuation* of a *trade related property* as a fully equipped operational entity necessarily assumes that the transaction will be either the letting or the sale of the property, together with the trade inventory, licences, etc., required to continue trading.

5.2 However, care must be taken because this *assumption* does not necessarily mean that the entire trade inventory is to be included in the *valuation* of the property. For example, some equipment may be owned by *third parties* and therefore would not form part of the interest being valued. Any *assumption* made about the trade inventory included in the *valuation* should be clearly set out in the report.

5.3 There may be tangible assets that are essential to the running of the operational entity but are either owned separately from the land and buildings, or are subject to separate finance leases or charges. In such cases, an *assumption* may need to be made that the owners or beneficiaries of any charge would consent to the transfer of the assets as part of a sale of the operational entity. If it is not certain that such an *assumption* can be made, the valuer must consider carefully the potential impact on the *valuation* that the lack of availability of those assets would have to anyone purchasing or leasing the operational entity and comment accordingly in the report.

5.4 When *trade related properties* are sold or let as fully equipped operational entities, the purchaser or operator normally needs to renew licences or other statutory consents and take over the benefit of existing certificates and permits. If the valuer is making any different *assumption*, it should be clearly stated as a *special assumption*.

5.5 Where it is not possible to inspect the licences, consents, certificates and permits relating to the property, or other information cannot be verified, the *assumptions* made should be identified in the report, together with a recommendation that their existence should be verified by the client's legal advisers.

6 Assessing the trading potential

6.1 There is a distinction between the *market value* of a *trade related property* and the *investment value* – or its *worth* – to the particular operator. The operator will derive *worth* from the current and potential net profits from the operational entity operating in the chosen format. While the present operator may be one potential bidder in the market, the valuer will need to understand the requirements and achievable profits of other potential bidders, along with the dynamics of the open market, to come to an opinion of value for that particular property.

6.2 A *trade related property* is considered to be an individual trading entity and is typically valued on the *assumption* that there will be a continuation of trading.

6.3 When assessing future trading potential, the valuer should exclude any turnover and costs that are attributable solely to the personal circumstances, or skill, expertise, reputation and/or brand name of the existing operator. However, the valuer should reflect additional trading potential that might be realised by an REO taking over the property at the *valuation date*.

6.4 The actual trading performance should be compared with similar types of *trade related property* and styles of operation. To do so the valuer needs a proper understanding of the profit potential of those property types and how they compare with one another. A *trade related property* valuer should test, by reference to market transactions and similar *trade related properties*, whether the present trade represents the FMT in current market conditions. When available, the actual trading accounts of the subject property and similar properties may need adjusting to reflect the circumstances of the REO.

6.5 For many trading entities, the vehicle for a transfer of the business will be the sale of a freehold or leasehold interest in the property. Such transactional evidence can be used as comparable evidence in the *valuation* of *trade related properties*, so long as the valuer is in a position to exclude the value of the component parts of the transaction that are not relevant. Examples include stock, consumables, cash, liabilities and *intangible assets* (such as brand names or contracts, to the extent they would not be available to the REO).

6.6 Changes in competition can have a dramatic effect on profitability, and hence value. The valuer should be aware of the impact of current and expected future levels of competition. If a significant change from existing levels is anticipated, the valuer should clearly identify this in the report and comment on the general impact it might have on profitability and value.

6.7 Outside influences, such as the construction of a new road or changes in relevant legislation, can also affect the trading potential and hence the value of the *trade related property*.

6.8 Where it is intended to reflect purchaser's costs in the *valuation* (usually in the case of investment *valuations*), the normal *market approach* is to be adopted and an appropriate comment should be made in the report.

6.9 Where the property is trading and the trade is expected to continue, the *valuation* should be reported as follows:

> 'Market value *[or market rent]* as a fully equipped operational entity having regard to trading potential subject to any agreed or special assumptions … *[which must be clearly set out]*.'

7 Valuation approach for a non-trading property

7.1 The valuation process for a non-trading property is the same as outlined in section 5 above, but where the property is empty either through cessation of trade, or because it is a new property with no established trading history, different *assumptions* are to be made. For example, an empty property may have been stripped of all or much of its trade inventory or a new property may not have the trade inventory installed, but either could still be valued having regard to its trading potential.

7.2 The cessation of an operational entity and the removal of some or all the trade inventory are likely to have an effect on the value of the property. It would therefore be appropriate to express the value on both the basis of one or more *special assumptions*, and a basis reflecting the status quo. This is often a requirement when advising a lender on the value of *trade related property* for loan security purposes. For example, the differences could reflect the cost and time involved in purchasing and installing the trade inventory, obtaining new licences, appointing staff and achieving FMT.

7.3 Where the property is empty, the *valuation* should be reported as follows:

> 'Market value *[or market rent]* of the empty property having regard to trading potential subject to the following special assumptions … *[which must be clearly set out]*.'

8 Apportionment (referred to as Allocation of Value in IVS 104 Bases of Value)

8.1 The valuer may need, or may be requested, to provide an indicative apportionment of a *valuation* or a transaction price for:

- analysis as a comparable
- inclusion in *financial statements* to comply with the applicable accounting standards
- secured lending or
- tax purposes.

8.2 Any such apportionment of *market value* would usually relate to:

- the land and buildings reflecting the trading potential and
- the trade inventory.

8.3 When considering the apportionment of a transaction price, particularly where the sale is through share transfer in a limited company, the valuer should proceed with caution as the transaction may, in addition to that listed in paragraph 8.2, reflect the following:

- the *trading stock*, consumables and cash
- *intangible assets* and
- liabilities, such as salaries, taxes, debts, etc.

8.4 Apportionments for tax purposes have to be in accordance with specific legislation and are outside the scope of this VPGA.

9 Valuation for investment purposes

9.1 The basic approach to an investment *valuation* of *trade related property* is the same as for any other category of property. Where the investment is a portfolio or group of properties VPGA 9 will be relevant.

9.2 When valuing a *trade related property* investment, the valuer will need to carry out the assessment of the FMT and FMOP as set out in paragraph 3.1. It is also necessary to assess the *market rent* of the property so as to determine the security of the income stream and growth potential. The rent payable and the rent review will be determined by the terms of the subsisting or proposed lease.

9.3 The capitalisation rate adopted for investment *valuations* differs from that for vacant possession *valuations*. The investment rate of return will generally be determined by market transactions of similar *trade related property* investments. Clearly, due to the differing characteristics of *trade related property* and the wide variety of lease terms, careful analysis of comparable transactions is essential.

9.4 The valuer will include the landlord's fixtures and fittings with the land and buildings, but probably not the trade inventory, which is usually owned by the occupational tenant. However, the valuer should highlight the importance of the trade inventory to the trading potential and value of the property.

VPGA 5 Valuation of plant and equipment

This guidance is advisory and not mandatory in content. Where appropriate, however, it alerts *members* to relevant mandatory material contained elsewhere in these global standards, including the *International Valuation Standards*, using cross-references in bold type. These cross-references are for the assistance of *members* and do not alter the status of the material that follows below. *Members* are reminded that:

- this guidance cannot cover every circumstance, and they must always have regard to the facts and circumstances of individual assignments when forming valuation judgments
- they should remain alert to the fact that individual jurisdictions may have specific requirements that are not covered by this guidance.

1 Scope

1.1 The guidance below provides additional commentary on the *valuation* of *plant and equipment* and the practical application of **IVS 300 Plant and Equipment**. Any cross-references to mandatory requirements are highlighted in **bold type**.

2 Background

2.1 *Plant and equipment* forms a significant part of the global asset class known as tangible fixed assets, but with particular characteristics that distinguish them from most types of real property. This fact influences the approach to the classification, measurement and reporting of value in respect of *plant and equipment*. *Plant and equipment* may also be physically affixed to real property in whole or in part, and also capable of being moved or relocated. Some *plant and equipment* asset classes may also depreciate at a quicker or less linear rate than real property due to rapid technological change in particular market sectors. *Plant and equipment* is frequently valued as an operational unit in combination with other assets, and also in connection with a wider business *valuation* of a commercial entity. It follows that while the nature of *plant and equipment* assets varies from other asset classes, valuers have a duty to provide consistency in reporting across asset classes insofar as is possible. *Plant and equipment* may also be valued for leasing or collateral purposes, which require additional market value considerations, including the concept of asset sales in situ and for removal from their working place (in whole or in part).

2.2 *Plant and equipment* may be broadly divided into three categories:

- Plant:
  Assets that are combined with others and that may include items that form part of industrial infrastructure, utilities, building services installations, specialised buildings, and machinery and equipment forming a dedicated assemblage.

- Machinery:
  Individual, or a collection or a fleet or system of, configured machines/technology (including mobile assets such as vehicles, rail, shipping and aircraft) that may be employed, installed or remotely operated in connection with a user's industrial or commercial processes, trade or business sector (a machine is an apparatus used for a specific process).
- Equipment:
  An all-encompassing term for other assets such as sundry machinery, tooling, fixtures, furniture and furnishings, trade fixtures and fittings, sundry equipment and technology and loose tools that are used to assist the operation of the enterprise or entity.

2.3 The boundaries between these categories are not always easy to define, and the criteria used may vary according to the particular market sector the assets serve, the purpose of the *valuation* and relevant national and international accounting conventions. In particular the term '*personal property*' is used to describe *plant and equipment* (and other assets not forming part of real property) in certain jurisdictions, and the term is additionally used to describe arts and antiques in other jurisdictions.

2.4 The general principle is that assets installed primarily to provide services to the buildings or personnel should be valued as part of the property interest if they would normally be included in the sale of the property and or balance sheet classification. However, exceptions to this general principle will almost certainly occur where the *valuation* is required for inclusion in a balance sheet or for tax purposes. In these cases the client may require a separate *valuation* for certain items of building service plant or allied equipment.

2.5 In a *valuation* for *financial statements* the treatment of fixed assets in the accounts of the entity will normally provide some guidance regarding the particular items of *plant and equipment* that may be separately valued. However, in many cases, the valuer will need to clarify with the client and advisers the items that should be included in a *valuation* of the *plant and equipment*. Additional consideration may be required in respect of adjustments for issues such as market sector metrics, asset utilisation, income-based *valuations* and adjustments for obsolescence. Consultation in this regard is strongly encouraged at the time of engagement.

2.6 When different valuers are employed to carry out business, property and plant *valuations*, careful liaison will be needed to avoid either omissions or double counting. Similarly, careful liaison may be required by and with business valuers when *plant and equipment* is to be valued on an *income approach*, or as part of a wider commercial entity.

3 Plant and equipment usually included in valuations of the property interest

3.1 This will include:

- items associated with the provision of services (gas, electricity, water, drainage, fire protection and security) to the property
- equipment for space heating, hot water and air conditioning not integral to any process and
- structures and fixtures that are not an integral part of process equipment, for instance, chimneys, plant housings and railway tracks.

3.2 Occasionally, items normally valued with the land and buildings will be subject to a *third-party* interest, for example, a finance arrangement or finance lease (see section 5 below). The valuer should be particularly cautious in such cases and seek advice from the client and its advisers regarding the treatment of such assets, which may vary according to statute and jurisdiction. The *valuation* and report in such instances may require *special assumptions*, which should be agreed, in writing, at the time of engagement.

4 Plant and equipment separately valued

4.1 *Plant and equipment* valued separately from the property interest can be divided into broad categories of assets. 'Fixed assets' are often defined by the accounting standards applicable in the relevant country or state. The different categories may need to be identified and valued separately, depending on the purpose of the *valuation*.

4.2 Examples of 'fixed assets' include:

- process and production plant and machinery
- transport infrastructure
- exploration, mining and metals
- vehicle, rail, shipping and aviation
- computing, technology and office furniture classification
- mobile plant
- health, education and defence
- general manufacturing
- utilities.

4.3 Many borderline assets that may not qualify as fixed assets are valued by *plant and equipment* valuers, including:

- computer and technology software, licences and consents
- spare parts and consumables
- inventory (stock)
- product-dedicated items (for example, moulds, jigs and dies)
- work in progress.

4.4 Although *intangible assets* fall outside the definition of *plant and equipment*, the two asset classes often operate in concert, which may have an impact on their discrete and/or composite values. In such cases the valuer should establish appropriate *assumptions* in this regard (preferably at the engagement stage) and prior to reporting a *valuation*. Valuers should also be aware of the fact that the definition of *intangible assets* may vary relative to statute, local practices and accounting convention. Particular attention may be required when *plant and equipment* assets being valued form part of (or are connected with) intangibles, trading concerns, licences, software, consents, income streams, royalties and other intellectual property, when a combination of the *cost*, *income* and *market approaches* may be required.

5 Plant and equipment subject to finance, lease and collateral agreements

5.1 It is common for *plant and equipment* to be subject to lease or financing arrangements. Such asset backed or based arrangements vary from a simple hire/lease purchase agreement through to complex, cross-border financing agreements. Hence valuers will need to establish the reporting basis and any *special assumptions* at the time of engagement, or agree and document the *assumptions* as the engagement progresses. In particular, the lease/finance agreement terms, stakeholders and wider commercial circumstances will need to be taken into account and the valuer may need to liaise with other advisers in this regard.

5.2 National and International Financial Reporting Standards and lending regulators' rules regarding the treatment of leased/financed assets are subject to regular review and change. Valuers should clearly set out the basis and extent of their proposed work relative to such rules and standards, to ensure that the resulting valuation advice is appropriate to the particular reporting circumstances.

5.3 Some recent accounting changes require *plant and equipment* to be valued as a component of a wider financial instrument, including opinions regarding allocation of future residual values. Similarly, accounting provisions for future lending losses will require forward looking estimates of *plant and equipment market values* as a component of wider financial provisions. It follows that close liaison with clients, auditors and other valuation skill sets will be required, and at the very least, valuers should be explicit in preparing their *terms of engagement*.

6 Material considerations

6.1 When valuing *plant and equipment* on the basis of *market value*, **VPS 4 section 4** requires an indication of whether the *valuation* assumes that the assets will remain in their working place, or are valued for removal (as a whole or as individual items). Further *assumptions* may also be required, depending on the purpose of the *valuation*.

Examples include:

- how *plant and equipment* are to be offered for sale (for example, as a whole or as individual items)
- the assumed method of sale
- environmental issues and constraints
- any restriction on sale method (for example, lease conditions preclude sale by auction)
- whether the purchaser or vendor is to bear the costs of decommissioning or removal and
- whether allowance is made for any cost of reinstatement of the property following removal and, if so, who will bear the cost.

6.2 If a *valuation* is being undertaken with a view to disposing of *plant and equipment* separately from the property in which it is situated, there may be constraints on the time available for marketing and disposal – for example, if a lease on the property is due to expire, or determined by an earlier event (such as insolvency). If the valuer considers that this time limit is inadequate for proper marketing, as defined in the conceptual framework for *market value*, it may require the use of a *special assumption* in the reporting framework. However, the

valuer should always report the benchmark *market value* in the first instance, followed by the commercial advice regarding the likely sale price and wider circumstances. The valuer should not describe this as a 'forced sale' value (see **VPS 4 section 10, paragraphs 5 to 9**), unless such a term is required in accordance with the jurisdiction in which the valuer is reporting. While valuers will often be asked to prepare forced sale or liquidation (IVS-defined *basis of value* – IVS 104 paragraph 80.1) *valuations* these terms are subject to wide interpretation and will also vary by jurisdiction. Hence, adoption of *market value* based on regular market assumptions (which must be reasonable) should be the core approach, followed by agreed *special assumptions* and their related effect on value.

6.3 If, in the opinion of the valuer, no constraint exists at the *valuation date*, but a client requires advice on the impact that such a constraint on the marketing period may have, a *market value* can be provided subject to a *special assumption* in the report that clarifies the time limit assumed and the reasons for it, provided that the report also advises the unrestricted *market value* in the first instance. This is especially important in respect of asset-based lending, foreclosure or insolvency-related instructions.

6.4 Many of the *inspection* requirements set out in **VPS 2**, can be readily adapted to *plant and equipment* assets. In order to prepare a *valuation*, the valuer first needs to establish matters such as the type, specification, capacity and purpose of the items, then consider matters such as age, efficiency, condition, functional and economic obsolescence, and estimated total and remaining useful economic working life. When providing opinions of *market value* in situ, the valuer needs to be quite specific about the reasoning and methodology used, i.e. is the value based in whole or part on the subject *plant and equipment*'s future earnings potential? When providing opinions of *market value* whereby the *plant and equipment* are to remain at the property, the valuer needs to be quite specific about the reasoning and method(s) used. Is the *market value*, in these circumstances, based on a premium over the value of the same *plant and equipment* for removal, or an adjustment for economic obsolescence?

6.5 As when valuing other asset classes and taking into account the often very wide and complex range of *plant and equipment* (and the corresponding market sectors it serves), it will normally be impractical (and sometimes impossible) for the valuer to establish each and every material fact that could have an impact on the *valuation*. Therefore the extent of the valuer's investigations, and any *assumptions* reflected in the *valuation*, will have to be agreed with the client at the time of engagement (in so far as can be reasonably foreseen) and included in the later report. This is especially important when *market values* are being used in connection with secured lending or other financing or where there is a contemplated transaction involving the subject *plant and equipment*.

6.6 Similarly, there will be occasions when factors affecting other asset classes (such as land and buildings) will impact the *valuation* of *plant and equipment*. Examples include where the property is held on a short lease, if there are proposals for redevelopment or if there is contamination of the land and plant that would require plant to be decontaminated prior to removal.

7 Regulatory measures

7.1 Industrial activities are frequently subject to specific legislation and regulations. Non-compliance with these legal requirements may result in the suspension of the right to use the

plant and equipment in question. Many of these are specific to the plant and process being considered and wider national and local statute and regulations. While valuers are not expected to be regulatory experts, they should have an overall appreciation of regulatory matters surrounding the subject asset class, and should offer to discuss and agree how such matters may affect the *valuation*.

7.2 Where there is doubt about compliance with any regulations affecting the value of *plant and equipment*, the valuer should discuss the matter with the client and any related advisers and refer to the outcome in the report. This should be done either by agreeing to make *assumptions* in the report, or to compliance undertakings as advised by the client and any related advisers.

VPGA 6 Valuation of intangible assets

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- this guidance cannot cover every circumstance, and they must always have regard to the facts and circumstances of individual assignments when forming valuation judgments
- they should remain alert to the fact that individual jurisdictions may have specific requirements that are not covered by this guidance.

1 Scope

1.1 The guidance below provides additional commentary on the *valuation* of *intangible assets* and the practical application of **IVS 210 Intangible Assets**. Any mandatory requirements are highlighted in **bold type**.

It covers the *valuation* of *intangible assets* in respect of acquisitions, mergers and sale of businesses or parts of businesses and purchases and sales of *intangible assets*.

2 Introduction

2.1 An *intangible asset* is defined as a non-monetary asset that manifests itself by its economic properties. It does not have physical substance but grants rights and/or economic benefits to its owner. It is therefore an asset that is capable of being separated or divided from a business entity and sold, transferred, licensed, rented or exchanged individually or with a related asset, liability or contract. Non-identifiable *intangible assets* arising from contractual or legal rights that may or may not be separable from the entity, or other rights and obligations, are generally termed '*goodwill*'.

2.2 Identified *intangible assets* include:

- marketing related assets: typically associated with, and primarily used in, the marketing or promotion of a company's products or services (trademarks, brands, trade names, trade dress, internet domain names, newspaper mastheads, non-compete agreements)
- customer or supplier related assets: arise from relationships with, or knowledge of, customers and suppliers, and are used in the development, procurement, management and maintenance of a company's customers (customer lists, order or production backlog, customer contracts and related relationships, non-contractual customer relationships)
- artistic related assets: arise from artistic products or services that are protected by a contractual or legal right (copyright and design), and give rise to benefits including royalties

from artistic works (plays, operas, ballet, books, magazines, newspapers, musical works, pictures, photographs, videos, films, television programmes)

- technology related assets: these represent the value of technological innovation or advancements, and can arise from non-contractual rights to use technology, or be protected through legal or contractual rights (patented technology, computer software, unpatented technology, databases, trade secrets, in-process research and development, manufacturing processes and know-how).

2.3 *Intangible assets* may be either contractual or non-contractual. Contract-based assets represent the value of rights that arise from contractual arrangements (licensing, royalty, and standstill agreements; contracts for advertising, construction, management, service or supply lease agreements; construction permits; franchise agreements; operating and broadcasting rights; contractual use rights other than those expressly classified or properly regarded as tangible assets; servicing contracts; and employment contracts).

2.4 A major *intangible asset* is *goodwill*, which is defined as any future economic benefit arising from a business, an interest in a business or the use of a group of assets that is not separable. The benefits that may form part of *goodwill* include synergies that follow a business combination and are company specific. Examples of this include:

- economies of scale not otherwise reflected in the values of other assets
- growth opportunities, such as expansion into other markets and
- organisational capital, for instance the benefits obtained from an assembled network.

Goodwill is sometimes defined as the amount remaining after the value of all separable and identifiable assets have been deducted from the overall value of the business. This definition is commonly used for accounting purposes.

2.5 *Intangible assets* are differentiated from one another by characteristics such as ownership, function, market position and image. For example, ladies' fashion shoe brands may be characterised by use of particular colours and styles, as well as price. In addition, while *intangible assets* within the same class will inevitably have similar characteristics, there will also be aspects that differentiate them from other similar ones.

2.6 It is important that the valuer is regularly involved in *intangible asset valuation*, as practical knowledge of the factors affecting investing in any particular asset is essential (see **PS 2 section 2**).

3 Terms of engagement

3.1 The valuation knowledge of clients will vary widely. Some will have a thorough understanding of intangible property rights and *intangible asset valuation*, while others will be unfamiliar with the terms and concepts used by valuers of *intangible assets*.

3.2 It is imperative that the *terms of engagement* are understood and agreed between the valuer and the client prior to commencement of the assignment. Any supplementary or contributory assets should be identified and agreement reached on whether they are to be included or not. Contributory assets are those used in conjunction with the subject asset to generate cash flows. Where contributory assets are not to be valued, it is important to clarify whether the intention is therefore for the principal asset to be valued on a stand-alone basis.

3.3 There may be situations where the interest in the asset to be valued is shared with others, and in such cases, it should be clearly specified.

3.4 Valuers may wish to develop standard letters of engagement that can be used for any type of valuation instruction. Where a *valuation* has to comply with the RICS Red Book Global Standards, the valuer must produce *terms of engagement* that comply with the minimum terms set out in **PS 2 section 7** and **VPS 1**.

4 Valuation concepts

4.1 The reason why the valuer has been instructed to perform a *valuation* is important to understand, as the *intangible asset valuation* may be required for a wide variety of purposes. Examples include financial reporting, tax, public sector assignments, transactions and flotations, fairness opinions, banking arrangements, insolvency and administration, knowledge management, or portfolio review. The answer will introduce various concepts of value, some governed by statute and case law, and others by international and national standards of professional valuation practice.

4.2 Valuation bases typically encountered for these types of *valuations* (not all of which are recognised by the IVS or the Red Book Global Standards) are *fair value*, fair market value, *market value*, and open market value. Valuers should be mindful of the requirements of **PS 1 section 1**, where a written *valuation* is provided.

4.3 Depending on the rules and practice followed in respect of the concept, the valuation conclusion in respect of the same asset may be different. For example, because of the rules concerning tax *valuations*, a tax authority could view *valuation* differently to how a litigant, merger partner or *special purchaser* would.

4.4 Except in the case where there are strong indications to the contrary, the presumption is that of a 'going concern' and that the asset will continue to have a useful life for the foreseeable future. In some cases, this period will be based on what is specified either by law, or under the terms of any relevant agreements or protocols that govern the asset. However, for financial reporting purposes the value of an *intangible asset* that is to be disposed of, or abandoned, might have to be considered.

4.5 In many cases it may be necessary to apply more than one valuation method, particularly where there is insufficient information or evidence to enable the valuer to rely on just one. In such cases, the valuer may use additional methods to arrive at the final *valuation*, indicating why preference is given to any one or more methodologies. The valuer should consider all valuation approaches, giving reasons why any particular approach has not been completed.

5 Valuation due diligence

5.1 In line with **PS 2 section 2**, valuers should have appropriate competency in *intangible asset valuation*. As a minimum requirement, a valuer should not contemplate carrying out a *valuation* in the absence of a detailed knowledge and understanding of such issues as:

- the rights of the owners of the asset(s)
- the history of, and activities associated, with the asset(s)

- as appropriate, the state of the subject industry, the general economic outlook and political factors.

5.2 Typical information requirements to assist the valuer in understanding the subject asset(s) could include:

- most recent income statements associated with the subject asset, and details of current and prior projections or forecasts
- description and history of the subject asset, including legal protections and rights associated with it (the extent to which such legal rights have been assessed should be disclosed)
- information about the asset and supporting documentation (for example, registrations, territorial applications, marketing, technical research and development, documentation, design graphics and manuals)
- other collateral agreements
- details of the precise activities exploiting the *intangible asset*
- previous valuation reports
- product(s) dealt in, supported or extended by the business and intangibles
- whether anyone else is permitted to use the *intangible asset*(s), and whether there are plans to do so
- the company's market(s) and competition, barriers to entry in such markets, business and marketing plans, due diligence
- licensing, strategic alliances and joint venture detail
- whether contractual arrangements can be assigned or transferred in any *intangible asset* or royalty agreement
- major customers and suppliers
- objectives, developments or trends expected in the industry and how these are likely to affect the company or asset
- accounting policies
- strengths, weaknesses, opportunities and threats (SWOT) analysis
- key market factors (for example, monopoly or dominant market position, market share)
- major capital expenditure in prospect
- competitor positions
- seasonable or cyclical trends
- technological changes affecting the asset
- vulnerability of any source of raw materials or supplier arrangement
- whether there have been any recent acquisitions or mergers in this sector around the *valuation date*, and the criteria that were applied
- management of research and development (non-disclosure agreements, subcontractors, training and incentives)
- whether there is an intellectual property asset schedule setting out the extent of intellectual property right (IPR) ownership, and the interests of *third parties* (if any)

- examination of comparable licensing of similar assets.

5.3 The valuer should, as far as it is possible, verify facts and information used in arriving at the *valuation* and benchmark, where possible, inputs to the *valuation*.

5.4 Much of the information relied on by the valuer will be provided by the client(s), and it may not be possible to verify it. In such cases, the valuation report should make this clear.

6 Valuation approaches

6.1 In broad terms, valuation theory recognises three distinct approaches in *valuation*, including for intangibles. These are the *market approach* (sometimes known as the direct market comparison approach), the *income approach*, and the *cost approach*.

6.2 Each approach requires the valuer to adopt an estimate of the asset's remaining useful life. This could be a finite period set by the length of a contract or normal life expectancy in the sector, or it could be indefinite. A number of factors will have to be considered in determining life expectancy, including legal, technical, economic and functional aspects. The presumed life expectancy of an asset that has been licensed for a particular period may be shorter if a superior competitor product is likely to reach the market before the licence expiration. In such case, the valuer would need to take a view on this.

Market approach

6.3 The *market approach* measures the value of an asset by comparing recent sales or offerings of similar or substitute property and related market data. However, it is rarely possible to find such evidence relating to identical assets.

6.4 The two primary *market approach* methods are the 'market multiple method' and the 'similar transactions method'.

6.5 The market multiple method focuses on comparing the subject asset with guideline data such as industry royalty rates. In applying this method, matters such as royalty rates are evaluated and adjusted based on the strengths and weaknesses of the subject asset relative to similar assets. They are then applied to the appropriate operating data of the subject asset to arrive at an indication of value. Appropriate adjustments to reflect different properties or characteristics are usually made to the derived data.

6.6 The similar transactions method uses valuation data based on historical transactions that have occurred in the subject asset's direct or related industries. The derived data are then adjusted and applied to the appropriate operating data of the subject asset to arrive at an indication of value.

6.7 In certain industries, assets are bought and sold on the basis of established market practices or rules of thumb, often (though not exclusively) derived from data or percentages of turnover, and not directly linked to profit generation. Care should be taken that the 'established market practice' has not been superseded by changes in circumstances over time. Where such rules of thumb exist, they may need to be considered by the valuer.

Income approach

6.8 The *income approach* has a number of variants. When applied (using, for example, the discounted cash flow (DCF) method), it measures the value of an asset by the present value of its future economic benefits. These benefits can include earnings, cost savings, tax deductions, and proceeds from its disposal.

6.9 When applied to an *intangible asset valuation*, value indications are developed by discounting expected cash flows to their present value at a rate of return that incorporates the risk-free rate for the use of funds, the expected rate of inflation, and risks associated with the particular investment. The discount rate selected is generally based on rates of return available from alternative investments of similar type and quality as at the *valuation date*.

6.10 The *income approach* also embraces methods such as the relief-from-royalty method, defined in IVS 210 Intangible Assets as one that estimates 'the value of an *intangible asset* ... 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'.

6.11 There is also the 'multi period excess earnings' method. This is a method of estimating the economic benefits of an *intangible asset* over multiple time periods by identifying the cash flows associated with the use of the asset and deducting a periodic charge reflecting a fair return for the use of contributory assets.

6.12 The *income approach*, as applied using the capitalised earnings *basis of value*, is common in *intangible asset valuation*. A thorough understanding of accounting and economic profits, their historical record and forecasting is necessary in each case.

6.13 Appraisal of *intangible assets* and IPR includes techniques to identify the earnings specifically associated with the subject asset, such as gross profit differential, excess profits and relief from royalty. A thorough understanding of the historic and forecast earnings is necessary.

Cost approach

6.14 The *cost approach* indicates the value of an asset by the cost to create or replace it with another similar asset. When applied to *intangible asset valuation*, obsolescence, maintenance and the time value of money are considerations. When the *basis of value* in the *valuation* is *market value*, the indications of obsolescence must be supported by market data.

7 Present value techniques

7.1 Present value techniques (PVT) measure the value of an asset by the present value of its future economic cash flow, which is cash that is generated over a period of time by an asset, group of assets, or business enterprise.

7.2 Issues to consider in relation to this technique include:

- the number of years over which the cash flow is applied
- the capitalisation rate or discount rate applied at the end of the term
- the discount rate(s) adopted
- whether inflation is built into the cash flow

- what other variables need to be considered in respect of the cash flow in the future
- the trading profile of the asset
- initial and running yields, internal rate of return (IRR) and the terminal value.

7.3 Where a PVT approach is applied, it is important that market transactions (i.e. comparables) reflecting the same approach to *valuation* are taken into consideration. The details of market transactions may be more difficult to obtain where a PVT approach is adopted. However, such transactions will assist in assessing the discount rate to be adopted, the IRR sought and the general approach taken by the market.

7.4 If the *valuation* is for a specific *intangible asset*, before undertaking the detailed cash flow modelling, the valuer is required to quantify the remaining useful life and deterioration rate associated specifically with the use of the asset. Typically this remaining useful life analysis will quantify the shortest of the following:

- physical life (for example, of an underlying tangible asset)
- functional life (for example, of an underlying tangible asset)
- technological life
- economic life
- legal life.

7.5 PVT *valuation* will thus involve these key components: a financial forecast identifying specific intellectual capital and associated earnings, and the discount rate (cost of capital). Unsystematic and systematic risk will be considered, and the discount rate determination in its basic application will require identification and application of the cost of capital to known and projected cash flows.

7.6 Discounting appropriately at the weighted average cost of capital (WACC) will be adopted. The two basic elements of the cost of capital are the cost of debt and the cost of equity. To aid the calculation of an appropriate rate of return and discount rates, the valuer uses a number of different methodologies, including capital asset pricing model (CAPM), arbitrage pricing theory and hybrids, depending on the particular circumstances.

7.7 Valuers may be required to consider *intangible assets* in a licensing context, for example, the licensing in or out of technology or patents. Much of what has been covered in this VPGA is relevant in the calculation of an appropriate rate of return in royalty rate calculations. In practice the rate is estimated by reference to some or all of the following:

- existing licences for the intangibles (the comparables approach)
- industry norms for licences for similar assets (the *market approach*)
- allocation of economic benefits derived from the use of, for example, the patented invention (sometimes referred to as the available profits or analytical approach)
- licensing practice (rule of thumb approaches).

7.8 Licensing appraisal examines specifics such as:

- how other relevant licences were negotiated
- *intangible asset* and support
- length of the licence agreement

- exclusivity
- special terms for special deals
- geography
- sector in which the *intangible asset* is licensed
- any special relationships.

Even if previous licensing practice is comparable, it can only provide a benchmark. Intangibles, by their nature, are unique and may involve carrying out numerous required adjustments to make a fair comparison.

7.9 PVT models the approaches such as the relief-from-royalty method (see paragraph 6.10 above, under *Income approach*).

8 Reports

8.1 Where the *valuation* has to comply with the Red Book Global Standards, the valuer must produce a report that complies with the minimum terms set out in **VPS 3**. Generally the report has a brief introductory section or executive summary that defines the assignment, summarises the conclusion and sets the stage for the details of the report. The structure should move from the general to the specific, providing a logical flow of data and analysis within which all the necessary considerations can be incorporated, leading to the valuation conclusions.

8.2 Most situations will easily form into major sections as follows, although not necessarily in this order:

- introduction
- purpose and *basis of value*
- *assumptions* and *special assumptions*
- subject of *valuation*
- description and history of the asset(s), and the business entity in which it has (they have) been used
- accounting and accounting polices
- *financial statement* analysis, if appropriate
- business and marketing plan analysis, and prospects
- search results for comparative transactions
- industry in which the asset is used
- economic context and environment, yields and risk assessment
- valuation methods and conclusion
- caveats, disclaimer, and limitations.

8.3 Some reports will have a separate section containing a general discussion of valuation methodology, which will often follow the introduction. If national, regional and economic data are important to the company and asset, each may have its own section.

8.4 Where appropriate, factual information, or sources thereof, should be identified either in the body of the report or in the appendices. Where the report is that of an expert required

for litigation purposes, it must adhere to the requirements imposed by the local jurisdiction and must therefore contain all relevant disclosures including the statement of the expert's qualifications and the 'statement of truth'.

9 Confidentiality

9.1 Information in respect of many *intangible assets* will be confidential. Valuers should use their best endeavours to preserve such confidentiality, including information obtained in respect of comparable assets. Where required by the client, valuers of *intangible assets* will comply with any requests to enter into non-disclosure or similar agreements.

VPGA 7 Valuation of personal property, including arts and antiques

This guidance is advisory and not mandatory in content. Where appropriate, however, it alerts *members* to relevant mandatory material contained elsewhere in these global standards, including the *International Valuation Standards*, using cross-references in bold type. These cross-references are for the assistance of *members* and do not alter the status of the material that follows below. *Members* are reminded that:

- this guidance cannot cover every circumstance, and they must always have regard to the facts and circumstances of individual assignments when forming valuation judgements
- they should remain alert to the fact that individual jurisdictions may have specific requirements that are not covered by this guidance.

1 Introduction and scope

1.1 This guidance provides additional commentary on the application of the International Valuation Standards and **VPS 1–5** to '*personal property*', being those assets (or liabilities) specified in 1.2 below.

1.2 For the purpose of this VPGA, '*personal property*' means assets (or liabilities) not permanently attached to land or buildings:

- **including**, but not limited to, fine and decorative arts, antiques, paintings, gems and jewellery, collectables, fixtures and furnishings, and other general contents
- **excluding** trade fixtures and fittings, *plant and equipment*, businesses or business interests, or *intangible assets*.

Valuations of personal property may arise in many different contexts and for a variety of purposes which may include, but are not restricted to, the following:

- insurance coverage
- damage or loss due to fire, water or other reason
- taxation (charitable contribution, gift tax, estate tax, casualty loss)
- financial reporting
- business transactions
- litigation, including claims of fraud
- estate planning, equitable distribution, and probate
- pre-nuptial agreements
- dissolution of marriage

- dissolution of business
- advice on the acquisition or disposition of property for investment or personal consumption
- loan collateral
- bankruptcy
- inventory *valuation*.

1.3 This list is not definitive, as national or regional variations may exist. Statutory requirements within a given jurisdiction will take precedence. This may especially be the case where *valuations* are prepared for the assessment of tax liabilities, including probate or for accounting purposes.

1.4 It is essential to be clear about the purpose of the *valuation*, which will often dictate the particular *basis of value* to be used. See **VPS 1**.

2 Terms of engagement

2.1 To properly define the valuation assignment and, as well, the valuer's responsibilities, the valuer should identify the client and any others who might rely on the *valuation* (i.e. the intended users) to ensure that the *valuation* is both meaningful to them and not misleading.

2.2 The *terms of engagement*, including the minimum terms set out in **VPS 1**, will generally be agreed between the valuer and the client prior to the commencement of the valuation engagement. When it is necessary to commence work prior to the *terms of engagement* being fully documented, all matters concerning those terms must be brought to the client's attention and documented before the report is issued (see **VPS 1**).

2.3 When agreeing the *terms of engagement*, the valuer should advise the client of the possible effect on value of any other relevant matters (for example, the provenance of the object, or the impact of a group of objects being valued as a collection, rather than individually). Not to do so could be misleading, in breach of **VPS 3**.

3 Identifying the market

3.1 *Valuations* are based on an understanding of the market in which the *valuation* takes place. Valuers should assess the nature and state of the market that provides the context for their investigations and value conclusions. Considerations that the valuer should take into account include the level of activity, confidence and trends. Valuers should also consider the legal and regulatory position pertaining to the subject property and any proposals that could influence the behaviour of market participants.

3.2 *Personal property* valuers should recognise that there are different markets within which a particular asset may be traded and that each may generate its own sales data. In particular, an asset may have a different value at the wholesale level of trade, the retail level of trade, or when trading at auction. The valuer should identify and analyse the relevant market consistent with the asset being valued and the purpose of the *valuation* undertaken. It should be recognised that *valuations* undertaken for the purpose of advising on a sale between businesses that trade in a particular form of asset may differ from that between a business and an individual.

3.3 In identifying the market, *personal property* valuers should be aware that the method of sale could affect the resultant sale price. For example, online auctions and other forms of e-commerce have loosened many transactional constraints, expanding the pool of potential purchasers for some types of items. However, valuers should be aware that the quality of information and matters such as commissions and costs of sale associated with some online platforms, where these are not associated with offline sales, can render the sales data unreliable as a source of comparable evidence.

3.4 In *personal property*, groups of assets are often held as collections which, if divided, may be worth significantly more or less per item than when held collectively. The valuer will need to assess whether holding assets collectively has any impact on their *valuation*, and advise accordingly.

4 Inspection, research and analysis

4.1 Valuers of *personal property* should collect, verify and analyse pertinent sales data; analyse pertinent economic and market conditions; and consider any additional related information necessary to generate realistic value conclusions. **VPS 2** sets out the requirements for conducting investigations.

4.2 *Personal property* valuers should always be aware that the degree of reliability of previous sales data may be limited and should always assess the reliability of data used to support the analysis. They should document the sources of information used in the analysis. As noted in paragraph 3.3 above, valuers should take particular care when using information obtained from online platforms and internet sources.

4.3 Any limitations or conditions that impede the *inspection*, research, and/or analysis should be taken into account by the valuer. If there are such limitations the valuer may need to make *assumptions/special assumptions*. **VPS 4** sets out the requirements relating to *assumptions* and *special assumptions*. Any *assumptions* must be discussed and agreed with the client prior to the conclusion of the *valuation* and clearly documented in both the *terms of engagement* and the report.

4.4 The valuer should consider economic and market data, such as supply and demand in the marketplace and market movements. When there is a degree of uncertainty with respect to the information used, or the state of the market, the valuer should refer to **VPS 3**.

4.5 It is the responsibility of the valuer to ensure that they have undertaken an appropriate level of due diligence in relation to establishing the provenance of the item to be valued, as this may have a very significant impact on value. Establishing provenance, in addition to expert knowledge in the field, may involve archival research and/or forensic examination. Where provenance is in doubt, the valuer should consult with the client to establish the level of investigation that should be undertaken and any implication this may have in respect of fees or third-party work to be undertaken before a valuation can be provided.

4.6 When the valuer is required to consult with specialists/professionals the valuer should (to the extent necessary for the purpose of the *valuation*), ensure that the specialist or professional is appropriately qualified to provide advice and that the services are carried out competently.

5 Valuation

Valuation approaches and applications

5.1 The three approaches to arriving at *market value* (as defined at IVS 104 paragraph 30.1) for *personal property* are:

- the sales comparison approach
- the *cost approach* and
- the *income approach*.

5.1.1 The sales comparison approach

This provides an indication of value by comparing the subject asset to similar assets for which sales data are available. This approach is the most commonly used in the *valuation* of *personal property*. When applying this approach, the valuer should be careful in the analysis of the appropriate comparable sales data, in accordance with section 4 above. Where it is possible to assess the value by reference to comparables, it is normally the preferred approach.

5.1.2 The cost approach

This provides an indication of value based on the estimated current costs to reproduce or create a property of equal quality, utility, and marketability. This approach includes replacement with a copy or replacement produced by other means such as a facsimile. A copy is a generic term used when the original item is reproduced as near as possible to the original in terms of nature, quality, use and age of materials and production technique. Where the copy is produced by the original artist, it is termed a replica. A facsimile is an exact copy of the original item, created with materials of a closely similar nature, quality and age, using techniques or fabrication methods of the original period. All of these approaches (i.e. copy, replica or facsimile) are usually only adopted for insurance purposes where it is not practicable to establish a value using another method. When applying the cost approach, the valuer should analyse pertinent and appropriate cost data to estimate the cost of replacement. The valuer should be aware that the nature of reproduction (copy, replica or facsimile) will have a significant bearing on the resultant value and adjust their valuation accordingly.

5.1.3 The income approach

This provides an indication of value by calculating the anticipated monetary benefits (such as a stream of income) for the subject asset. When applying this approach, the valuer should analyse pertinent and appropriate data to reliably estimate the income in the relevant marketplace of the property. Valuers should base projections of anticipated monetary benefits on an analysis of past and current data, trends and competitive factors. Although instances do arise where assets are leased by the owner to another party, nevertheless in most cases artwork, antiques and personal property assets are not ‘income producing’ and so are unlikely to be valued using the investment method. However, in some cases, especially when they are placed within the context of an ‘income-producing asset’, such as an historic real estate, their presence may add to the value of the overall holding and should be considered.

5.1.4 In all approaches, the valuer should use prudent and well-informed judgement to synthesise the data collected and the analysis thereof into a logical value conclusion.

5.1.5 All valuation conclusions should be reasonably based and clearly supported by appropriate evidence including that relating to provenance. If more than one valuation approach has been used in the analysis, the valuer should include both and then reconcile the results.

5.1.6 RICS does not prescribe the method(s) that a valuer should use. However, the valuer should be prepared to justify the rationale for the approach and method adopted.

Other valuation considerations

5.2 In addition to the requirements of **VPS 3**, the valuer's research and analysis should consider:

- the extent of the information that should be communicated to the client and other intended users. The valuer should take account of the fact that the valuation knowledge of clients will vary and should communicate information that can be understood by all intended users of the report
- the interest to be valued (there may be situations in which the interest in *personal property* to be valued is shared with others, and in such cases, it should be clearly specified)
- the characteristics required to establish the identity of the property (including, but not limited to, artist or maker, material or medium, size, title, origin, style, age, provenance or history, condition, forensic examination, exhibition history, and citations in the literature)
- the *basis of value* to be adopted (for example, *market value*, replacement value, etc.) and the source of the definition for that value
- any special assignment conditions and/or regulatory/statutory requirements
- restrictions, encumbrances, leases, covenants, contracts, or any other such considerations that may affect the *valuation* or ownership of the *personal property* to be valued
- the degree to which third-party information can be verified and relied on
- the relationship of the object to any real property or *intangible assets* that may affect the *valuation* of the property
- the importance of individual assets in an instruction that includes multiple objects with a wide range of values
- analysis of prior sales of the property being valued, if relevant
- the degree to which the current market conditions and the economy affect the level of certainty of the valuation conclusion.

6 Reports

6.1 It is the responsibility of the valuer to ensure that the valuation report is clear and accurate, and that no element of it is ambiguous or misleading. It should be prepared with independence, integrity and objectivity (see **PS 2**).

6.2 The valuer should comply with the minimum requirements listed in **VPS 3**, and incorporate all the valuation considerations listed in paragraph 5.2 above (Other valuation considerations). Additionally, when the valuer has consulted a specialist or professional individual or firm in the process of preparing the *valuation*, the sources and credentials should in each instance be identified and the nature of the input acknowledged (see paragraph 4.6 above).

6.3 The level of detail provided in the valuation report should adequately address the needs of the client and the intended user(s), the nature of the property, and the intended use of the *valuation*. The terminology used in the report should be capable of being understood by all intended users.

6.4 The valuer should state any limitations or conditions regarding *inspection*, research or analysis and explain any effect on the valuer's conclusions.

6.5 The purpose of the *valuation* (for example, equitable distribution), the *basis of value* (for example, *market value*), and the market in which the (notional or actual) transaction is presumed to take place (for example, auction) should be set out clearly within the report.

6.6 The valuer should report, if necessary, that the conclusion complies with any special requirements of the client, regulatory rules or pertinent laws.

6.7 The valuer should summarise the research conducted and the data used in the analysis. The valuer should state the valuation approach(es) used (i.e. comparison, cost or income) as well as the rationale for choosing it (them). The valuer should also state why other approaches were considered but rejected. If multiple approaches were used in the analysis, these should be detailed in the report and a reconciliation of the results should be included.

6.8 When arriving at a *valuation* based on any *assumption* or *special assumptions* (such as when an aggregated value is being determined) – see **VPS 4 section 8 and section 9** – these should be specifically stated together with the effect on value, if any, of the *assumption(s)/special assumption(s)*. In particular, where the valuer has been unable to fully establish provenance with full certainty, this should be reported, together with any *assumptions* that have been made.

6.9 The valuer should comment on any issues affecting the certainty of the *valuation*. The extent of the commentary will vary, depending on the purpose of the *valuation* and the knowledge of the user.

6.10 Photographs should be appropriate and used as required by the assignment. If any alterations were made to the photographs, these should be noted.

VPGA 8 Valuation of real property interests

This guidance is advisory and not mandatory in content. Where appropriate, however, it alerts *members* to relevant mandatory material contained elsewhere in these global standards, including the *International Valuation Standards*, using cross-references in bold type. These cross-references are for the assistance of *members* and do not alter the status of the material that follows below. *Members* are reminded that:

- this guidance cannot cover every circumstance, and they must always have regard to the facts and circumstances of individual assignments when forming valuation judgments
- they should remain alert to the fact that individual jurisdictions may have specific requirements that are not covered by this guidance.

This guidance provides additional commentary on certain specific topics and issues that arise in relation to the *valuation* of *real estate*, and is supplemental to **IVS 400 Real Property Interests**, **IVS 410 Development Property** and **VPS 2**. It expressly covers *inspections* and investigations, and includes important material on *sustainability* and ESG issues, which can be a market influence in relation to *real estate*.

1 Inspection

1.1 This and the following section 2 relate to *inspections* and investigations involving *real estate*, more specifically where the asset to be valued is a right of ownership, control, use or occupation of land and buildings (see IVS 400 paragraph 20.2).

1.2 Many matters may or will have an impact on the market's perception of the value of the relevant interest, aspects of which may only become fully apparent during an *inspection* of the property. These can include:

a characteristics of the locality and surrounding area, and the availability of communications, services and facilities that affect value

b characteristics of the property and its use

i dimensions, areas and use(s) of constituent elements

ii age, construction and nature of buildings or structures

iii accessibility both for occupiers and for visitors

iv installations, amenities and services

v fixtures, fittings and improvements

vi *plant and equipment* that would normally form an integral part of the building (see also **VPGA 5**)

vii apparent state of repair and condition

viii hazardous materials kept on the property, such as (but not limited to) regulated items including chemicals, radioactive substances, explosive materials, asbestos, ozone depleting substances, oils, etc. or regulated activities being conducted such as waste management activity.

c characteristics of the site

i natural hazards such as ground instability, mining or mineral extraction, risk of flooding from all mechanisms, including pluvial and fluvial sources

ii non-natural hazards such as ground contamination where there are substances in, on or under the ground resulting from historic or current uses (see also (b) above)

d potential for development or redevelopment

i any physical restrictions on further development, if appropriate.

1.3 Other matters on which relevant information may be acquired during, or further enquiries made prompted by, an *inspection*, may include:

a improvements to leasehold properties: when valuing leases and reversions, where the property included in the original letting may subsequently have been altered or improved, care needs to be taken to ascertain what is to be valued as it may not exactly equate with what is seen and (as appropriate) measured on the ground. If the valuer is unable to inspect the lease, or due to the absence of documented licences the extent of alterations or improvements cannot be confirmed, the valuer should proceed on the basis of stated *assumptions*

b planning (zoning) controls: controls and the need for licences or permissions for increased or altered use, including development, will vary between countries or states and the extent of the particular enquiries that are appropriate and need to be made in individual cases will be informed by the valuer's knowledge of the relevant market, by the nature and extent of the property, and by the purpose of the *valuation*

c where relevant, information on any substantial outgoings and running costs, and the level of recovery from the occupier – energy efficiency and carbon emissions may be among a number of relevant factors when considering *sustainability* and ESG issues (see 2.6 below).

2 Investigations and assumptions

2.1 The following aspects are common to many *valuations* involving *real estate*, and often raise issues about the extent of investigation that is appropriate or about the nature of the *assumptions* that might validly be made. The guidance below cannot cover all circumstances – a valuer's knowledge, experience and judgment will always need to be brought to bear on individual assignments, and in some cases appropriate limitations will have been specified by, or discussed and agreed with, the client as part of the *terms of engagement*. Similarly, the relevance and appropriateness of *assumptions* can only be judged on a 'case by case' basis – what follows is not in any way prescriptive.

2.2 Title

The valuer must have information on the essential details of the interest being valued. This may take one of a number of forms, such as a synopsis obtained from the client or a third party; copies of the relevant documents; or a current detailed report on title by the client's lawyers – this list is not exhaustive.

The valuer must state what information has been relied on and – where appropriate – what *assumptions* have been made. For example, if a lease document were not available the valuer might need to make an *assumption* that the terms advised and stated were those in the actual lease. However, if an assurance of good title had been provided, the valuer might reasonably rely on the correctness of this information – but this would ultimately be a matter for lawyers, and where appropriate the valuer might specifically note that the position must be checked by the client's legal advisers. A valuer would not expect to take responsibility or liability for the true interpretation of the client's legal title in the property or asset.

2.3 Condition of buildings

Even if competent to do so, a valuer would not normally undertake a building survey to establish the details of any building defects or disrepair. However, it would also be wrong for the valuer to ignore obvious defects that would have an impact on the value, unless a *special assumption* to that effect has been agreed. The valuer should therefore clearly state that the *inspection* will not amount to a full building survey. In addition the limits that will apply to the valuer's responsibility to investigate and comment on the structure or any defects must be defined. It should also be stated – wherever appropriate – that an *assumption* will be made that the building(s) is(are) in good repair, except for any (minor) defects specifically noted.

2.4 Services

The presence and efficiency of building services and any associated *plant and equipment* will often have a significant impact on value: however, detailed investigation will normally be outside the scope of the *valuation*. The valuer will need to establish what sources of information are available, and the extent to which these can be relied on, in undertaking the *valuation*. It is usual to agree on an *assumption* that the services and any associated controls or software are in working order or free from defect.

2.5 Planning (zoning)

Where there is an element of doubt, the valuer may need to establish whether the property has the necessary statutory consents for the current buildings and use, or advise that verification should be sought, and whether there are any policies or proposals by statutory authorities that could impact the value positively or adversely. This information will often be readily available, but delays or expenses may be incurred in obtaining definitive information. The valuer should, among other things, state what investigations are proposed, or what *assumptions* will be made, where verification of the information is impractical within the context of the *valuation*.

2.6 Sustainability, and environmental, social and governance (ESG) matters

Potential or actual constraints on the enjoyment and use of property caused by sustainability and ESG factors may result from natural causes (such as flooding, severe storms and wildfires),

from non-natural causes (such as contamination) or sometimes from a combination of the two (such as subsidence resulting from the historic extraction of minerals). There may also be sustainability and ESG factors beyond the directly physical, such as carbon emissions. Despite the considerable diversity of circumstances, the key question is always the extent to which the factors identified affect value. Particular care should be taken when assessing or commenting on ESG factors, as valuers may not have the specialist knowledge and experience required. In appropriate cases, the valuer may recommend making further enquiries and/or obtaining further specialist or expert advice in respect of these matters. The following paragraphs consider the matter in more detail.

a) Natural environmental constraints

i Some property will be affected by environmental factors that are an inherent feature either of the property itself or of the surrounding area, and which have an impact on the value of the property interest. Examples include ground instability issues (such as swelling and shrinking clay, subsidence consequent on historic or current mineral extraction, etc.) and the risk of flooding from any mechanism. Resilience protection measures may alleviate the impact of the factor.

ii Although detailed commentary on both the risks and the effects may be outside the realm of the valuer's direct knowledge and expertise, the presence, or potential presence, of these factors is something that can often be established in the course of a valuation *inspection* through normal enquiries or by local knowledge. Use of the relevant Property Observation Checklist from appendices A to C of the RICS guidance note **Environmental risks and global real estate**, 1st edition (2018), may be of assistance when undertaking *inspections*. It is not just the risk of a particular event occurring that needs to be considered, but also the various consequences. For example, if the property has suffered a recent event such as flooding this may affect the availability of insurance cover, which, if material, should be reflected in the *valuation*.

iii The valuer should be careful to state the limits that will apply to the extent of the investigations and the *assumptions* that will be made in relation to environmental matters, and should state any sources of information relied upon.

b) Non-natural constraints (contamination and hazardous substances)

i A valuer may not be competent to advise on the nature or risks of contamination or hazardous substances, or on any costs involved with their removal. However, a valuer who has prior knowledge of the locality and experience of the type of property being valued can reasonably be expected to comment on the potential that may exist for contamination and the impact that this could have on value and marketability.

ii The nature and risks may of course be directly attributable to the use of the property itself. For example, a number of businesses depend on activities that involve the use of hazardous substances or operate waste management activities that may be regarded as a nuisance by *third parties*. Although detailed commentary on such effects may be outside the realm of the valuer's expertise, their presence, or potential presence, is something that can often be established in the course of a valuation *inspection* through normal enquiries or by local knowledge.

iii The valuer should state the limits on the investigations that will be undertaken and state any sources of information or *assumptions* that will be relied on. Any historic or existing use matters observed can again be recorded on the relevant Property Observation Checklist from appendices A to C of the RICS guidance note **Environmental risks and global real estate**, 1st edition (2018).

c) Sustainability and ESG – assessing the implications for value

i While not a term that has a universally recognised definition yet (see the **RICS glossary** in Part 2), in a valuation context *sustainability* encompasses a wide range of physical, social, environmental and economic factors that can affect value and of which valuers should be aware.

ii The range of issues includes, but is not limited to, key physical risks, such as flooding, heat, wildfires and severe storms, and transitional risks such as energy efficiency, carbon emissions and climate impact. The impact of these risks can be influenced by current and historic land use as well as matters of design, configuration, accessibility, legislation, management and fiscal considerations. Sustainability matters can impact occupier preferences and purchaser behaviour, and may also be a consideration for investors, secured lenders, insurers and public bodies.

iii The pace at which *sustainability* and ESG is feeding directly or indirectly into value has jurisdictional variations. In order to respond appropriately as markets change, valuers should continuously seek to enhance their knowledge. The role of valuers is to assess value in the light of evidence normally obtained through analysis of comparable transactions. While valuers should reflect markets, not lead them, they should be aware of *sustainability* features and the implications these could have on property values in the short, medium and longer term. The issues may extend to:

- sustainability and ESG matters (see above) including, where applicable, climate change and resilience to climate change
- configuration and design including use of materials and concepts increasingly associated with 'wellness'
- accessibility and adaptability, including access and use by those with disabilities
- carbon emissions, energy efficiency, building 'intelligence' and other 'costs in use'
- fiscal considerations.

iv Valuers should identify and collect sustainability and ESG-related data. Where available, this might include details of rating schemes related to the asset.

v Only where existing market evidence would support this, or where in the valuer's judgement market participants would expressly reflect such matters in their bids, should *sustainability* characteristics directly influence value(s) reported.

vi Valuers are often asked to provide additional comment and strategic advice. In these cases, the valuer should, subject to their competence and expertise, consult with the client on the use and applicability of *sustainability and ESG* metrics and benchmarks that are applicable in each case. For example, when preparing *valuations* on the basis of *investment value* or *worth*, *sustainability and ESG* factors that could influence investment decision-making may properly be incorporated, even though they are not directly evidenced through transactions. Such

valuations may also be the principal place to consider the ‘social’ and ‘governance’ aspects of ESG.

vii Where appropriate, in order to comply with best practice in reporting, valuers should:

- assess the extent to which the subject property currently meets the *sustainability* and ESG criteria typically expected within the context of its market standing and arrive at an informed view on the likelihood of these impacting on value, e.g. how a well-informed purchaser would take account of them in making a decision as to offer price
- provide a description of the s*ustainability*-related property characteristics and attributes that have been collected
- provide a statement of their opinion on the relationship between *sustainability* factors and the resultant *valuation*, including a comment on the current benefits/risks that are associated with these characteristics, or the lack of risks and
- provide an opinion on the potential impact of these benefits and/or risks to relative property values over time.

viii The latest edition of *Sustainability and ESG in commercial property valuation and strategic advice*, RICS guidance note provides guidance on the identification, assessment and impact of sustainability and ESG issues for commercial real estate valuations.

VPGA 9 Identification of portfolios, collections and groups of properties

This guidance is advisory and not mandatory in content. Where appropriate, however, it alerts *members* to relevant mandatory material contained elsewhere in these global standards, including the *International Valuation Standards*, using cross-references in bold type. These cross-references are for the assistance of *members* and do not alter the status of the material that follows below. *Members* are reminded that:

- this guidance cannot cover every circumstance, and they must always have regard to the facts and circumstances of individual assignments when forming valuation judgments
- they should remain alert to the fact that individual jurisdictions may have specific requirements that are not covered by this guidance.

1 Scope

1.1 This guidance provides additional commentary on the identification of portfolios, collections and groups of properties for reporting in accordance with **VPS 3**.

2 Examples where specific clarification of the lotting assumption needs to be made

2.1 Examples include:

a physically adjoining properties that have been acquired separately by the current owner (for example, where a developer has assembled a site with a view to future redevelopment, or where an investor is building a strategic stake in the locality)

b physically separate properties that are occupied by the same entity and where there is a functional dependence between the properties (for example, a car park that is separate from, but exclusively used by, the occupier of a building)

c where ownership of a number of separate properties or assets would be of particular advantage to a single owner or occupier because of economies that may result from either increased market share or savings in administration or distribution, as with a block of flats or hotels, and

d where each individual property is an essential component of an operation covering a large geographical area (for example, as part of a national or regional utility network, such as telecommunication masts).

3 Purpose of the valuation and identification of the lots within the portfolio

3.1 The purpose of the *valuation* may dictate the approach taken. For example, there may be a requirement for the value of the assets to be reported individually. The extent of what comprises an individual property or other asset will need to be clarified with the client.

3.2 Requests to value properties on an *assumption* that lots them in an artificial manner should normally be declined. However in certain circumstances, unusual lotting may be dealt with using a *special assumption* (see **VPS 4 section 9**).

3.3 Once the valuer has identified the lots within a portfolio that are to be valued separately, consideration needs to be given to any particular *assumptions* or *special assumptions* that may be necessary. These need to be recorded in the *terms of engagement* (see **VPS 1**) and in the report (see **VPS 3**). Examples of situations where different *assumptions* can have a material effect on the *valuation* of a portfolio are discussed in the following paragraphs.

3.4 If a whole portfolio, or a substantial number of properties within it, were to be placed on the market at the same time, it could effectively flood the market, leading to a reduction in values. Conversely, the opportunity to purchase a particular group of properties might produce a premium. In other words, the value of the whole could exceed the sum of the individual parts, and vice versa.

3.5 If valuing for a purpose that assumes that the portfolio will continue to remain in the existing ownership or occupation, for example, for inclusion in *financial statements*, it would be inappropriate to make any reduction or allowance in the *valuation* to reflect the possible effect of flooding the market. A statement to this effect should be made in the report.

3.6 If the same portfolio were to be valued as security for secured lending, the possible adverse effect on individual properties if the whole portfolio were placed on the market at the same time should not be ignored. In such case it would normally be appropriate to state that the *assumption* has been made that the properties would be marketed in an orderly way and would not all be placed on the market at the same time. However, if circumstances existed that such an *assumption* would not be made by the market, for example, if it were known that the current owner was in financial difficulty, this would become a *special assumption* and its effect on the *valuation* should be clearly stated (see **VPS 4 section 9**).

3.7 Likewise, where the valuer ascribes a single value to a group of separate properties, any *assumptions* necessary to support that approach should be stated. If the valuer considers that the treatment of the portfolio on this basis is not one that the market would necessarily make, such an *assumption* would become a *special assumption* (see **VPS 4 section 9**).

3.8 In any case where the total value of the properties within a portfolio would differ significantly depending on whether they were disposed of individually, in groups or as a single lot, this should be stated clearly in the report. The lotting *assumptions* made should also be included in any published reference.

3.9 Where a portfolio or group of properties or assets has been valued on the *assumption* that it would be sold as a single entity, the reported *market value* will relate to the whole of the group. Any breakdown of the *market value* of the individual properties or assets should

be clearly expressed as such, with a statement that this apportionment does not necessarily equate to the *market value* of the interest in any individual property or asset.

3.10 Conversely, if the total of the *market values* for each individual property or asset in a portfolio as an aggregated figure is provided, care should be taken not to present this as the *market value* of the entire portfolio.

VPGA 10 Matters that may give rise to material valuation uncertainty

This guidance is advisory and not mandatory in content. Where appropriate, however, it alerts *members* to relevant mandatory material contained elsewhere in these global standards, including the *International Valuation Standards*, using cross-references in bold type. These cross-references are for the assistance of *members* and do not alter the status of the material that follows below. *Members* are reminded that:

- this guidance cannot cover every circumstance, and they must always have regard to the facts and circumstances of individual assignments when forming valuation judgments
- they should remain alert to the fact that individual jurisdictions may have specific requirements that are not covered by this guidance.

1 Scope

1.1 This guidance provides additional commentary on matters that may give rise to material valuation uncertainty in accordance with **VPS 3 paragraph 2.1(o)**.

2 Examples

2.1 It is not possible to provide an exhaustive list of circumstances in which material uncertainty may arise – however, the examples in 2.2, 2.3 and 2.4 represent the three most common circumstances.

2.2 The asset or liability itself may have very particular characteristics that make it difficult for the valuer to form an opinion of the likely value, regardless of the approach or method used. For example, it may be a very unusual, or even unique, type. Similarly, the quantification of how purchasers would reflect a potential significant change, such as a potential planning permission, may be highly dependent on the *special assumptions* made.

2.3 Where the information available to the valuer is limited or restricted, either by the client or the circumstances of the *valuation*, and the matter cannot be sufficiently addressed by adopting one or more reasonable *assumptions*, less certainty can be attached to the *valuation* than would otherwise be the case.

2.4 Markets can be disrupted by relatively unique factors. Such disruption can arise due to unforeseen financial, macro-economic, legal, political or even natural events. If the *valuation date* coincides with, or is in the immediate aftermath of, such an event there may be a reduced level of certainty that can be attached to a *valuation*, due to inconsistent, or an absence of, empirical data, or to the valuer being faced with an unprecedented set of circumstances on which to base a judgment. In such situations demands placed on valuers can be unusually testing. Although

valuers should still be able to make a judgment, it is important that the context of that judgment is clearly expressed.

3 Reporting

3.1 The overriding requirement is that a valuation report must not be misleading or create a false impression. The valuer should expressly draw attention to, and comment on, any issues resulting in material uncertainty in the *valuation* as at the specified *valuation date*. Such comment should not be about the general risk of future market movements or the inherent risk involved in forecasting future cash flows – both of which can and should be considered and reflected as part of the valuation process (for example, the *valuation* of an investment property that is subject to a very uncertain future cash flow could nevertheless be underpinned by a depth of consistent comparable transaction information) – but should be related to the risk surrounding the *valuation* of that asset.

3.2 Where material uncertainty exists, it will normally be expressed in qualitative terms, indicating the valuer's confidence in the valuation opinion offered by use of a suitable form of words. Indeed this may be the only realistic way in which to do so, given that the very conditions that create valuation uncertainty will frequently mean there is an absence of empirical data to inform or support a quantitative estimate.

3.3 In most cases it is either inappropriate or impractical to reflect material uncertainty in the valuation figure quantitatively, and indeed any attempt to do so might well seem contradictory. If a mathematical measure of uncertainty is included in any report, it is **essential** that the method or model used is adequately explained, with any limitations appropriately highlighted. In some limited circumstances a sensitivity analysis may be judged appropriate in order to illustrate the effect that clearly stated changes to specified variables could have on the reported *valuation*, which should be accompanied by suitable explanatory comment. It will be appreciated that the inherent risk with quantification of any sort is that it might convey an impression of precision that could be misleading.

3.4 In other cases, where the valuer can reasonably foresee that different values may arise under different but well-defined circumstances, an alternative approach would be for the valuer to enter into a dialogue with the client to consider alternative *valuations* using *special assumptions* that reflect those different circumstances. However, *special assumptions* may only be used if they can be regarded as realistic, relevant and valid in connection with the circumstances of the *valuation*. Where different values arise under different circumstances, they can be reported separately on the stated *special assumptions*.

3.5 It would not normally be acceptable for a valuation report to have a standard caveat to deal with material valuation uncertainty. The degree to which an opinion is uncertain will normally be unique to the specific *valuation*, and the use of standard clauses can devalue or bring into question the authority of the advice given. The task is to produce authoritative and considered professional advice within the report. Issues that affect the degree of certainty should be reported in this context.

3.6 Unless specifically requested, the expression of values within a stated range is not good practice and would not normally be regarded as an acceptable form of disclosure. In most cases the valuer has to provide a single figure in order to comply with the client's requirements and

terms of engagement. Similarly, the use of qualifying words such as 'in the region of' would not normally be appropriate or adequate to convey material uncertainty without further explicit comment, and is again actively discouraged. Where different values may arise under different circumstances it is preferable to provide them on stated *special assumptions* (see paragraph 3.4 above).

3.7 Attention is drawn to the fact that financial reporting standards may, and often do, have specific disclosure requirements in relation to valuation uncertainty, though that particular term may not be expressly used. Compliance with those requirements is **mandatory** in cases to which they apply.

Part 6: International Valuation Standards

The *International Valuation Standards* (IVS) are reproduced in full in this Part, with kind permission from IVSC. Effective from 31 January 2022, they are adopted and applied through these RICS Red Book Global Standards, being cross-referenced throughout Parts 3 to 5.

Members are reminded that IVSC reserves the right to make further amendments to IVS at any time. Any consequential amendments to Red Book Global Standards will be made in accordance with the arrangements described in paragraph 27 of Part 1: Introduction.

Summary of main changes to IVS 2020 – effective from 31 January 2022

Core Principles – A list of 'core principles' for standard setting and valuation has been added to the Introduction.

Glossary – The Glossary has been extended.

Framework – Two clauses have been added to explain what is meant by compliance with the standards and when a departure may be made. Other changes indicate that an individual or group of individuals responsible for preparing a valuation must be appropriately qualified, competent and unbiased, and act ethically.

IVS 101 Scope of Work – Valuers preparing valuations for their own employers are now referred to as 'employed valuers'. Valuers preparing valuations for a third-party client are called 'engaged valuers'.

IVS 104 Bases of Value – A section on 'allocation of value' has been added.

IVS 105 Valuation Approaches and Methods – Wording has been reinstated to clarify that market, income and cost approaches are not exclusive and may be used in any combination.

IVS 200 Businesses and Business Interests – The Introduction has been amended to better describe the scope of the standard.

IVS 230 Inventory – This is a new standard and addresses the valuation of goods that will be used in future production, work in progress and goods awaiting sale. It excludes real estate and buildings under construction.

IVS 400 Real Property Interests – The Introduction has been amended to provide additional clarification of what this standard covers, including the valuation of agricultural land and unregistered land.

International Valuation Standards (IVS)

Effective 31 January 2022

International Valuation Standards Council

International Valuation Standards

Effective 31 January 2022

International Valuation Standards Council

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Introduction

The International Valuation Standards Council (IVSC) is an independent, not-for-profit organisation committed to advancing quality in the valuation profession. Our primary objective is to build confidence and public trust in valuation by producing standards and securing their universal adoption and implementation for the valuation of assets across the world. We believe that International Valuation Standards (IVS) are a fundamental part of the financial system, along with high levels of professionalism in applying them.

Valuations are widely used and relied upon in financial and other markets, whether for inclusion in financial statements, for regulatory compliance or to support secured lending and transactional activity. The International Valuation Standards (IVS) are standards for undertaking valuation assignments using generally recognised concepts and principles that promote transparency and consistency in valuation practice. The IVSC also promotes leading practice approaches for the conduct and competency of professional valuers.

The IVSC Standards Board is the body responsible for setting the IVS. The Board has autonomy in the development of its agenda and approval of its publications. In developing the IVS, the Board:

- follows established due process in the development of any new standard, including consultation with stakeholders (valuers, users of valuation services, regulators, valuation professional organisations, etc) and public exposure of all new standards or material alterations to existing standards,
- liaises with other bodies that have a standard-setting function in the financial markets,
- conducts outreach activities including round-table discussions with invited constituents and targeted discussions with specific users or user groups.

The objective of the IVS is to increase the confidence and trust of users of valuation services by establishing transparent and consistent valuation practices. A standard will do one or more of the following:

- identify or develop globally accepted principles and definitions,
- identify and promulgate considerations for the undertaking of valuation assignments and the reporting of valuations,
- identify specific matters that require consideration and methods commonly used for valuing different types of assets or liabilities.

The IVS consist of mandatory requirements that must be followed in order to state that a valuation was performed in compliance with the IVS. Certain aspects of the standards do not direct or mandate any particular course of action, but provide fundamental principles and concepts that must be considered in undertaking a valuation.

The IVSC Standards Boards have taken into account the following core principles when drafting the International Valuation Standards.

Core Principles of Valuation Standard Setting

1. Purpose (Objective)

The purpose of valuation standards is to promote and maintain a high level of public trust in valuation practice by establishing appropriate requirements for valuers.

2. Valuation Standards

Valuation Standards should be principle based and adequately address the development of a credible opinion of value and the communication of that opinion to the intended user(s).

3. Development and Revisions of Standards

Standards are to be created and revised, when necessary, by way of a transparent process after appropriate exposure.

4. Jurisdiction

Departures from the standards to comply with legislative and regulatory requirements that are in conflict with the standards are allowed.

Core Principles of Valuation

1. Ethics

Valuers must follow the ethical principles of integrity, objectivity, impartiality, confidentiality, competence and professionalism to promote and preserve the public trust.

2. Competency

At the time the valuation is submitted, valuers must have the technical skills and knowledge required to appropriately complete the valuation assignment.

3. Compliance

Valuers must disclose or report the published valuation standards used for the assignment and comply with those standards.

4. Basis (ie, Type or Standard) of Value

Valuers must select the basis (or bases) of value appropriate for the assignment and follow all applicable requirements. The basis of value (or bases) must be either defined or cited.

5. Date of Value (ie, Effective Date/Date of Valuation)

Valuers must disclose or report the date of value that is the basis of their analyses, opinions or conclusions. Valuers must also state the date they disclose or report their valuation.

6. Assumptions and Conditions

Valuers must disclose significant assumptions and conditions specific to the assignment that may affect the assignment result.

7. Intended Use

Valuers must disclose or report a clear and accurate description of the intended use of the valuation.

8. Intended User(s)

Valuers must disclose or report a clear and accurate description of the intended user(s) of the valuation.

9. Scope of Work

Valuers must determine, perform, and disclose or report a scope of work that is appropriate for the assignment that will result in a credible valuation.

10. Identification of Subject of Valuation

Valuers must clearly identify what is being valued.

11. Data

Valuers must use appropriate information and data inputs in a clear and transparent manner so as to provide a credible valuation.

12. Valuation Methodology

Valuers must properly use the appropriate valuation methodology(ies) to develop a credible valuation.

13. Communication of Valuation

Valuers must clearly communicate the analyses, opinions and conclusions of the valuation to the intended user(s).

14. Record Keeping

Valuers must keep a copy of the valuation and a record of the valuation work performed for an appropriate period after completion of the assignment.

The IVS are arranged as follows:

The IVS Framework

This serves as a preamble to the IVS. The IVS Framework consists of general principles for valuers following the IVS regarding objectivity, judgement, competence and acceptable departures from the IVS.

IVS General Standards

These set forth requirements for the conduct of all valuation assignments including establishing the terms of a valuation engagement, bases of value, valuation approaches and methods, and reporting. They are designed to be applicable to valuations of all types of assets and for any valuation purpose.

IVS Asset Standards

The Asset Standards include requirements related to specific types of assets. These requirements must be followed in conjunction with the General Standards when performing a valuation of a specific asset type. The Asset Standards include certain background information on the characteristics of each asset type that

influence value and additional asset-specific requirements on common valuation approaches and methods used.

What is the Effective Date?

This version of International Valuation Standards is published on 31 July 2021, with an effective date of **31 January 2022**. The IVSC permits early adoption from the date of publication.

Future Changes to these Standards

The IVSC Standards Board intends to continuously review the IVS and update or clarify the standards as needed to meet stakeholder and market needs. The Board has continuing projects that may result in additional standards being introduced or amendments being made to the standards in this publication at any time. News on current projects and any impending or approved changes can be found on the IVSC website at www.ivsc.org.

An FAQ document in relation to International Valuation Standards is available at www.ivsc.org.

Glossary

10. Overview of Glossary

10.1. This glossary defines certain terms used in the International Valuation Standards.

10.2. This glossary is only applicable to the International Valuation Standards and does not attempt to define basic valuation, accounting or finance terms, as valuers are assumed to have an understanding of such terms (see definition of "valuer").

20. Defined Terms

20.1. Asset or Assets

To assist in the readability of the standards and to avoid repetition, the words "asset" and "assets" refer generally to items that might be subject to a valuation engagement. Unless otherwise specified in the standard, these terms can be considered to mean "asset, group of assets, liability, group of liabilities, or group of assets and liabilities".

20.2. Basis (bases) of Value

The fundamental premises on which the reported values are or will be based (see IVS 105 *Valuation Approaches and Methods*, para 10.1) (in some jurisdictions also known as standard of value).

20.3. Client

The word "client" refers to the person, persons, or entity for whom the valuation is performed. This may include external clients (ie, when a valuer is engaged by a third-party client) as well as internal clients (ie, valuations performed for an employer).

20.4. Cost(s) (noun)

The consideration or expenditure required to acquire or create an asset.

20.5. Discount Rate(s)

A rate of return used to convert a monetary sum, payable or receivable in the future, into a present value.

20.6. Equitable Value

This 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.

20.7. Fair Market Value

1. The Organisation for Economic Co-operation and Development (OECD) defines "fair market value" as the price a willing buyer would pay a willing seller in a transaction on the open market.

2. For United States tax purposes, Regulation §20.2031-1 states: "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts"[1].

20.8. Fair Value (International Financial Reporting Standards)

IFRS 13 defines "fair value" as 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.

20.9. Intended Use

The use(s) of a valuer's reported valuation or valuation review results, as identified by the valuer based on communication with the client.

20.10. Intended User

The client and any other party as identified, by name or type, as users of the valuation or valuation review report by the valuer based on communication with the client.

20.11. Investment Value

The value of an asset to the owner or a prospective owner given individual investment or operational objectives (may also be known as worth).

20.12. Jurisdiction

The word "jurisdiction" refers to the legal and regulatory environment in which a valuation engagement is performed. This generally includes laws and regulations set by governments (eg, country, state and municipal) and, depending on the purpose, rules set by certain regulators (eg, banking authorities and securities regulators).

20.13. Liquidation Value

The amount that would be realised when an asset or group of assets are sold on a piecemeal basis. Liquidation value should take into account the costs of getting the assets into saleable condition as well as those of the disposal activity. Liquidation value can be determined under two different premises of value (see IVS 104 *Bases of Value*, section 80):

(a) an orderly transaction with a typical marketing period; or

(b) a forced transaction with a shortened marketing period.

[1] United States Internal Revenue Service

20.14. 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 and where the parties had each acted knowledgeably, prudently and without compulsion.

20.15. May

The word *"may"* describes actions and procedures that valuers have a responsibility to consider. Matters described in this fashion require the valuer's attention and understanding. How and whether the valuer implements these matters in the valuation engagement will depend on the exercise of professional judgement in the circumstances consistent with the objectives of the standards.

20.16. Must

The word *"must"* indicates an unconditional responsibility. The valuer must fulfill responsibilities of this type in all cases in which the circumstances exist to which the requirement applies.

20.17. Participant

The word "participant" refers to the relevant participants pursuant to the basis (or bases) of value used in a valuation engagement (see IVS 104 *Bases of Value*). Different bases of value require valuers to consider different perspectives, such as those of "market participants" (eg, market value, IFRS fair value) or a particular owner or prospective buyer (eg, investment value).

20.18. Price (noun)

The monetary or other consideration asked, offered or paid for an asset, which may be different from the value.

20.19. Purpose

The word "purpose" refers to the reason(s) a valuation is performed. Common purposes include (but are not limited to) financial reporting, tax reporting, litigation support, transaction support, and to support secured lending decisions.

20.20. Should

The word "should" indicates responsibilities that are presumptively mandatory. The valuer must comply with requirements of this type unless the valuer demonstrates that alternative actions which were followed under the circumstances were sufficient to achieve the objectives of the standards.

In the rare circumstances in which the valuer believes the objectives of the standard can be met by alternative means, the valuer must document why the indicated action was not deemed to be necessary and/or appropriate.

If a standard provides that the valuer "should" consider an action or procedure, consideration of the action or procedure is presumptively mandatory, while the action or procedure is not.

20.21. Significant and/or Material

Assessing significance and materiality require professional judgement. However, that judgement should be made in the following context:

- Aspects of a valuation (including inputs, assumptions, special assumptions, and methods and approaches applied) are considered to be significant/material if their application and/or impact on the valuation could reasonably be expected to influence the economic or other decisions of users of the valuation; and judgments about materiality are made in light of the overall valuation engagement and are affected by the size or nature of the subject asset.
- As used in these standards, "material/materiality" refers to materiality to the valuation engagement, which may be different from materiality considerations for other purposes, such as financial statements and their audits.

20.22. Subject or Subject Asset

These terms refer to the asset(s) valued in a particular valuation engagement.

20.23. Synergistic Value

The result of a combination of two or more assets or interests where the combined value is more than the sum of the separate values. If the synergies are only available to one specific buyer, then synergistic value will differ from market value, as the synergistic value will reflect particular attributes of an asset that are only of value to a specific purchaser. The added value above the aggregate of the respective interests is often referred to as marriage value.

20.24. Valuation

The act or process of determining an opinion or conclusion of value of an asset on a stated basis of value at a specified date in compliance with IVS.

20.25. Valuation Approach

In general, a way of estimating value that employs one or more specific valuation methods (see IVS 105 *Valuation Approaches and Methods*).

20.26. Valuation Method

Within valuation approaches, a specific way to estimate a value.

20.27. Valuation Purpose or Purpose of Valuation

See "Purpose".

20.28. Valuation Reviewer

A "valuation reviewer" is a professional valuer engaged to review the work of another valuer. As part of a valuation review, that professional may perform certain valuation procedures and/or provide an opinion of value.

20.29. Value (noun)

The opinion resulting from a valuation process that is compliant with IVS. It is an estimate of either the most probable monetary consideration for an interest in an asset or the economic benefits of holding an interest in an asset on a stated basis of value.

20.30. Valuer

A “valuer” is an individual, group of individuals or individual within an entity, regardless of whether employed (internal) or engaged (contracted/external), possessing the necessary qualifications, ability and experience to execute a valuation in an objective, unbiased, ethical and competent manner. In some jurisdictions, licensing is required before one can act as a valuer.

20.31. Weight

The word “weight” refers to the amount of reliance placed on a particular indication of value in reaching a conclusion of value (eg, when a single method is used, it is afforded 100% weight).

20.32. Weighting

The word “weighting” refers to the process of analysing and reconciling differing indications of values, typically from different methods and/or approaches. This process does not include the averaging of valuations, which is not acceptable.

20.33. Worth

See investment value.

IVS Framework

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10. Compliance with Standards

10.1. When a statement is made that a *valuation* will be, or has been, undertaken in accordance with the IVS, it is implicit that the *valuation* has been prepared in compliance with all relevant standards issued by the IVSC.

10.2. In order for a *valuation* to be compliant with IVS the *valuer must* comply with all the requirements contained within IVS.

10.3. A *valuer* can only depart from International Valuation Standards (IVS) as described in section 60 of this *Framework*.

20. Assets and Liabilities

20.1. The standards can be applied to the *valuation* of both *assets* and liabilities and present and future claims on *assets* and liabilities. To assist the readability of these standards, the words *asset* or *assets* have been defined to include liability or liabilities and groups of *assets*, liabilities, or *assets* and liabilities, except where it is expressly stated otherwise, or is clear from the context that liabilities are excluded.

30. Valuer

30.1. *Valuer* has been defined as “an individual, group of individuals, or individual within an entity, regardless of whether employed (internal) or engaged (contracted/external), possessing the necessary qualifications, ability and experience to undertake a *valuation* in an objective, unbiased, ethical and competent manner. In some *jurisdictions*, licensing is required before one can act as a *valuer*. Because a *valuation reviewer must* also be a *valuer*, to assist with the legibility of these standards, the term *valuer* includes *valuation reviewers* except where it is expressly stated otherwise, or is clear from the context that *valuation reviewers* are excluded.

40. Objectivity

40.1. The process of *valuation* requires the *valuer* to make impartial judgements as to the reliability of inputs and assumptions. For a *valuation* to be credible, it is important that those judgements are made in a way that promotes transparency and minimises the influence of any subjective factors on the process. Judgement used in a *valuation must* be applied objectively to avoid biased analyses, opinions and conclusions.

40.2. It is a fundamental expectation that, when applying these standards, appropriate controls and procedures are in place to ensure the necessary degree of objectivity in the valuation process so that the results are free from bias. The IVSC *Code of Ethical Principles for Professional Valuers* provides an example of an appropriate framework for professional conduct.

50. Competence

50.1. *Valuations must* be prepared by an individual, group of individuals or individual within an entity, regardless of whether employed (internal) or engaged (contracted/external), possessing the necessary qualifications, ability and experience to execute a *valuation* in an objective, unbiased, ethical and competent manner and having the appropriate technical skills, experience and knowledge of the subject of the *valuation*, the market(s) in which it trades and the *purpose* of the *valuation*.

50.2. If a *valuer* does not possess all of the necessary technical skills, experience and knowledge to perform all aspects of a *valuation*, 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*) and the report (see IVS 103 *Reporting*).

50.3. The *valuer must* have the technical skills, experience and knowledge to understand, interpret and utilise the work of any specialists.

60. Departures

60.1. A "*departure*" is a circumstance where specific legislative, regulatory or other authoritative requirements *must* be followed that differ from some of the requirements within IVS. Departures are mandatory in that a *valuer must* comply with legislative, regulatory and other authoritative requirements appropriate to the *purpose* and *jurisdiction* of the *valuation* to be in compliance with IVS. A *valuer* may still state that the *valuation* was performed in accordance with IVS when there are departures in these circumstances.

60.2. The requirement to depart from IVS pursuant to legislative, regulatory or other authoritative requirements takes precedence over all other IVS requirements.

60.3. As required by IVS 101 *Scope of Work*, para 20.3 (n) and IVS 103 *Reporting*, para 10.2 the nature of any departures *must* be identified (for example, identifying that the *valuation* was performed in accordance with IVS and local tax regulations). If there are any departures that *significantly* affect the nature of the procedures performed, inputs and assumptions used, and/or valuation conclusion(s), a *valuer must* also disclose the specific legislative, regulatory or other authoritative requirements and the *significant* ways in

which they differ from the requirements of IVS (for example, identifying that the relevant *jurisdiction* requires the use of only a market approach in a circumstance where IVS would indicate that the income approach *should* be used).

60.4. Departure deviations from IVS that are not the result of legislative, regulatory or other authoritative requirements are not permitted in *valuations* performed in accordance with IVS.

General Standards

IVS 101 Scope of Work

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10. Introduction

10.1. A scope of work (sometimes referred to as terms of engagement) describes the fundamental terms of a *valuation*, such as the *asset(s)* being valued, the *purpose* of the *valuation* and the responsibilities of parties involved in the *valuation*.

10.2. This standard is intended to apply to a wide spectrum of valuation assignments, including:

(a) *valuation*s performed by *valuers* for their own employers (employed),

(b) *valuation*s performed by *valuers* for *clients* other than their employers (engaged), and

(c) valuation reviews where the *valuation reviewer may* not be required to provide their own opinion of *value*.

20. General Requirements

20.1. All valuation advice and the work undertaken in its preparation *must* be appropriate for the intended *purpose*.

20.2. A *valuer must* ensure that the intended recipient(s) of the valuation advice understand(s) what is to be provided and any limitations on its use before it is finalised and reported.

20.3. A *valuer must* communicate the scope of work to its *client* prior to completion of the assignment, including the following:

(a) Identity of the *valuer*: The *valuer* may be an individual, group of individuals or a firm. If the *valuer* has any material connection or involvement with the subject *asset* or the other parties to the valuation assignment, or if there are any other factors that could limit the *valuer's* ability to provide an unbiased and objective *valuation*, such factors

must be disclosed at the outset. If such disclosure does not take place, the valuation assignment is not in compliance with IVS. If the *valuer* needs to seek *material* assistance from others in relation to any aspect of the assignment, the nature of such assistance and the extent of reliance *must* be made clear.

(b) Identity of the *client(s)* (if any): Confirmation of those for whom the valuation assignment is being produced is important when determining the form and content of the report to ensure that it contains information relevant to their needs.

(c) Identity of other *intended users* (if any): It is important to understand whether there are any other *intended users* of the valuation report, their identity and their needs, to ensure that the report content and format meets those users' needs.

(d) *Asset(s)* being valued: The subject asset in the valuation assignment *must* be clearly identified.

(e) The valuation currency: The currency for the *valuation* and the final valuation report or conclusion *must* be established. For example, a *valuation* might be prepared in euros or US dollars. This requirement is particularly important for valuation assignments involving *assets* in multiple countries and/or cash flows in multiple currencies.

(f) *Purpose* of the *valuation:* The *purpose* for which the valuation assignment is being prepared *must* be clearly identified as it is important that valuation advice is not used out of context or for *purposes* for which it is not intended. The *purpose* of the *valuation* will also typically influence or determine the *basis/bases of value* to be used.

(g) *Basis/bases of value* used: As required by IVS 104 *Bases of Value*, the valuation basis *must* be appropriate for the *purpose* of the *valuation*. The source of the definition of any *basis of value* used *must* be cited or the basis explained. This requirement is not applicable to a valuation review where no opinion of *value* is to be provided and the reviewer is not required to comment on the *basis of value* used.

(h) Valuation date: The valuation date *must* be stated. If the valuation date is different from the date on which the valuation report is issued or the date on which investigations are to be undertaken or completed then where appropriate, these dates *should* be clearly distinguished.

(i) The nature and extent of the *valuer's* work and any limitations thereon: Any limitations or restrictions on the inspection, enquiry and/or analysis in the valuation assignment *must* be identified (see IVS *Framework*, paras 60.1-60.4) If relevant information is not available because the conditions of the assignment restrict the investigation, these restrictions and any necessary assumptions or special assumptions (see IVS 104 *Bases of Value*, paras 200.1-200.5) made as a result of the restriction *must* be identified.

(j) The nature and sources of information upon which the *valuer* relies: The nature and source of any relevant information that is to be relied upon and the extent of any verification to be undertaken during the valuation process *must* be identified.

(k) *Significant* assumptions and/or special assumptions: All *significant* assumptions and special assumptions that are to be made in the conduct and reporting of the valuation assignment *must* be identified.

(l) The type of report being prepared: The format of the report, that is, how the *valuation* will be communicated, *must* be described.

(m) Restrictions on use, distribution and publication of the report: Where it is necessary or desirable to restrict the use of the *valuation* or those relying on it, the *intended users* and restrictions *must* be clearly communicated.

(n) That the *valuation* will be prepared in compliance with IVS and that the *valuer* will assess the appropriateness of all *significant* inputs: The nature of any departures *must* be explained, for example, identifying that the *valuation* was performed in accordance with IVS and local tax regulations. See *IVS Framework* paras 60.1-60.4 relating to departures.

20.4. Wherever possible, the scope of work *should* be established and agreed between parties to a valuation assignment prior to the *valuer* beginning work. However, in certain circumstances, the scope of a valuation engagement *may* not be clear at the start of that engagement. In such cases, as the scope becomes clear, *valuers must* communicate and agree the scope of work to their *client*.

20.5. A written scope of work *may* not be necessary. However, since *valuers* are responsible for communicating the scope of work to their *client*, a written scope of work *should* be prepared.

20.6. Some aspects of the scope of work *may* be addressed in documents such as standing engagement instructions, master services agreements or a company's internal policies and procedures.

30. Changes to Scope of Work

30.1. Some of the items in para 20.3 *may* not be determinable until the valuation assignment is in progress, or changes to the scope *may* become necessary during the course of the assignment due to additional information becoming available or matters emerging that require further investigation. As such, whilst the scope of work *may* be established at the outset, it *may* also be established over time throughout the course of the assignment.

30.2. In valuation assignments where the scope of work changes over time, the items in para 20.3 and any changes made over time *must* be communicated to the *client* before the assignment is completed and the valuation report is issued.

IVS 102 Investigations and Compliance

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10. General Principle

10.1. To be compliant with IVS, valuation assignments, including valuation reviews, *must* be conducted in accordance with all of the principles set out in IVS that are appropriate for the *purpose* and the terms and conditions set out in the scope of work.

20. Investigations

20.1. Investigations made during the course of a valuation assignment *must* be appropriate for the *purpose* of the valuation assignment and the *basis(es) of value*. References to a *valuation* or valuation assignment in this standard include a valuation review.

20.2. Sufficient evidence *must* 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 judgement is required to ensure the information to be obtained is adequate for the *purpose* of the *valuation*.

20.3. Limits *may* be agreed on the extent of the *valuer's* investigations. Any such limits *must* be noted in the scope of work. However, IVS 105 *Valuation Approaches and Methods*, para 10.7 requires *valuers* to perform sufficient analysis to evaluate all inputs and assumptions and their appropriateness for the valuation *purpose*. If limitations on investigations are so substantial that the *valuer* cannot sufficiently evaluate the inputs and assumptions, the valuation engagement *must* not state that it has been performed in compliance with IVS.

20.4. When a valuation assignment involves reliance on information supplied by a party other than the *valuer*, consideration *should* be given as to whether the information is credible or that the information may otherwise by relied upon without adversely affecting the credibility of the valuation opinion. *Significant* inputs provided to the *valuer* (eg, by management/owners) *should* be considered, investigated and/or corroborated. In cases where credibility or reliability of information supplied cannot be supported, consideration *should* be given as to whether or how such information is used.

20.5. In considering the credibility and reliability of information provided, *valuers should* consider matters such as:

(a) the *purpose* of the *valuation*,

(b) the *significance* of the information to the valuation conclusion,

(c) the expertise of the source in relation to the subject matter, and

(d) whether the source is independent of either the subject asset and/or the recipient of the *valuation* (see IVS 101 *Scope of Work*, paras 20.3 (a)).

20.6. 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 part of the valuation assignment's scope of work that *must* be communicated to all parties to the valuation assignment (see IVS 101 *Scope of Work*).

20.7. 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, or limitations on investigations are so substantial that the *value*r cannot sufficiently evaluate the inputs and assumptions, the valuation assignment will not comply with IVS.

30. Valuation Record

30.1. A record *must* be kept of the work performed during the valuation process and the basis for the work on which the conclusions were reached for a reasonable period after completion of the assignment, having regard to any relevant statutory, legal or regulatory requirements. Subject to any such requirements, this record *should* include the key inputs, all calculations, investigations and analyses relevant to the final conclusion, and a copy of any draft or final report(s) provided to the *client*.

40. Compliance with Other Standards

40.1. As noted in the IVS *Framework*, when statutory, legal, regulatory or other authoritative requirements *must* be followed that differ from some of the requirements within IVS, a *valuer must* follow the statutory, legal, regulatory or other authoritative requirements (called a "*departure*"). Such a *valuation* has still been performed in overall compliance with IVS.

40.2. Most other sets of requirements, such as those written by Valuation Professional Organisations, other professional bodies, or firms' internal policies and procedures, will not contradict IVS and, instead, typically impose additional requirements on *valuers*. Such standards *may* be followed in addition to IVS without being seen as *departures* as long as all of the requirements in IVS are fulfilled.

IVS 103 Reporting

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10. Introduction

10.1. It is essential that the valuation report communicates the information necessary for proper understanding of the *valuation* or valuation review. A report *must* provide the *intended users* with a clear understanding of the *valuation*.

10.2. To provide useful information, the report *must* set out a clear and accurate description of the scope of the assignment, its *purpose* and *intended use* (including any limitations on that use) and disclosure of any assumptions, special assumptions (IVS 104 *Bases of Value*, para 200.4), *significant* uncertainty or limiting conditions that directly affect the *valuation*.

10.3. This standard applies to all valuation reports or reports on the outcome of a valuation review which *may* range from comprehensive narrative reports to abbreviated summary reports.

10.4. For certain asset classes there *may* be variations from these standards or additional requirements to be reported upon. These are found in the relevant IVS Asset Standards.

20. General Requirements

20.1. 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 *should* be agreed with all parties as part of establishing a scope of work (see IVS 101 *Scope of Work*).

20.2. Compliance with this standard does not require a particular form or format of report; however, the report *must* be sufficient to communicate to the *intended users* the scope of the valuation assignment, the work performed and the conclusions reached.

20.3. The report *should* also be sufficient for an appropriately experienced valuation professional with no prior involvement with the valuation engagement to review the report and understand the items in paras 30.1 and 40.1, as applicable.

30. Valuation Reports

30.1. Where the report is the result of an assignment involving the *valuation* of an *asset* or *assets*, the report *must* convey the following, at a minimum:

(a) the scope of the work performed, including the elements noted in para 20.3 of IVS 101 *Scope of Work*, to the extent that each is applicable to the assignment,

(b) *intended use*,

(c) *intended users*,

(d) the *purpose*,

(e) the approach or approaches adopted,

(f) the method or methods applied,

(g) the key inputs used,

(h) the assumptions made,

(i) the conclusion(s) of *value* and principal reasons for any conclusions reached, and

(j) the date of the report (which *may* differ from the valuation date).

30.2. Some of the above requirements *may* be explicitly included in a report or incorporated into a report through reference to other documents (engagement letters, scope of work documents, internal policies and procedures, etc).

40. Valuation Review Reports

40.1. Where the report is the result of a valuation review, the report *must* convey the following, at a minimum:

(a) the scope of the review performed, including the elements noted in para 20.3 of IVS 101 *Scope of Work* to the extent each is applicable to the assignment,

(b) the valuation report being reviewed and the inputs and assumptions upon which that *valuation* was based,

(c) the reviewer's conclusions about the work under review, including supporting reasons, and

(d) the date of the report (which *may* differ from the valuation date).

40.2. Some of the above requirements *may* be explicitly included in a report or incorporated into a report through reference to other documents (eg, engagement letters, scope of work documents, internal policies and procedures, etc).

IVS 104 Bases of Value

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Compliance with this mandatory standard requires a *valuer* to select the appropriate *basis (or bases) of value* and follow all applicable requirements associated with that *basis of value*, whether those requirements are included as part of this standard (for IVS-defined *bases of value*) or not (for non-IVS-defined *bases of value*).

10. Introduction

10.1. *Bases of value* (sometimes called standards of *value*) describe the fundamental premises on which the reported *values* will be based. It is critical that the *basis (or bases) of value* be appropriate to the terms and *purpose* of the valuation assignment, as a *basis of value may* influence or dictate a *valuer's* selection of methods, inputs and assumptions, and the ultimate opinion of *value*.

10.2. A *valuer may* be required to use *bases of value* that are defined by statute, regulation, private contract or other document. Such bases have to be interpreted and applied accordingly.

10.3. While there are many different *bases of value* used in *valuation*s, most have certain common elements: an assumed transaction, an assumed date of the transaction and the assumed parties to the transaction.

10.4. Depending on the *basis of value*, the assumed transaction could take a number of forms:

(a) a hypothetical transaction,

(b) an actual transaction,

(c) a purchase (or entry) transaction,

(d) a sale (or exit) transaction, and/or

(e) a transaction in a particular or hypothetical market with specified characteristics.

10.5. The assumed date of a transaction will influence what information and data a *valuer* considers in a *valuation*. Most *bases of value* prohibit the consideration of information or market sentiment that would not be known or knowable with reasonable due diligence on the measurement/valuation date by *participants*.

10.6. Most *bases of value* reflect assumptions concerning the parties to a transaction and provide a certain level of description of the parties. In respect to these parties, they could include one or more actual or assumed characteristics, such as:

(a) hypothetical,

(b) known or specific parties,

(c) members of an identified/described group of potential parties,

(d) whether the parties are subject to particular conditions or motivations at the assumed date (eg, duress), and/or

(e) an assumed knowledge level.

20. Bases of Value

20.1. In addition to the IVS-defined *bases of value* listed below, the IVS have also provided a non-exhaustive list of other non-IVS-defined *bases of value* prescribed by individual *jurisdictional* law or those recognised and adopted by international agreement:

(a) IVS-defined *bases of value*:

1. *Market value* (section 30),
2. Market rent (section 40),
3. *Equitable value* (section 50),
4. *Investment value/worth* (section 60),

5. *Synergistic value* (section 70), and
6. *Liquidation value* (section 80).

(b) Other *bases of value* (non-exhaustive list):

1. *Fair value* (International Financial Reporting Standards) (section 90),
2. *Fair market value* (Organisation for Economic Co-operation and Development) (section 100),
3. *Fair market value* (United States Internal Revenue Service) (section 110), and
4. *Fair value* (Legal/Statutory) (section 120):

   a. the Model Business Corporation Act, and

   b. Canadian case law (Manning v Harris Steel Group Inc).

20.2. *Valuers must* choose the relevant *basis (or bases) of value* according to the terms and *purpose* of the valuation assignment. The *valuer's* choice of a *basis (or bases) of value should* consider instructions and input received from the *client* and/or its representatives. However, regardless of instructions and input provided to the *valuer*, the *valuer should* not use a *basis (or bases) of value* that is inappropriate for the intended *purpose* of the *valuation* (for example, if instructed to *value* for financial reporting *purposes* under IFRS, compliance with IVS *may* require the *valuer* to use a *basis of value* that is not defined or mentioned in the IVS).

20.3. In accordance with IVS 101 *Scope of Work*, the *basis of value must* be appropriate for the *purpose* and the source of the definition of any *basis of value* used *must* be cited or the basis explained.

20.4. *Valuers* are responsible for understanding the regulation, case law and other interpretive guidance related to all *bases of value* used.

20.5. The *bases of value* illustrated in sections 90-120 of this standard are defined by organisations other than the IVSC and the onus is on the *valuer* to ensure they are using the relevant definition.

30. IVS-Defined Basis of Value – Market Value

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

30.2. The definition of *market value must* 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 *value* available only to a specific owner or purchaser.

(b) "An *asset* or liability *should* exchange" refers to the fact that the *value* of an *asset* or liability is an estimated amount rather than a predetermined amount or actual sale price. It is the *price* in a transaction that meets all the elements of the *market value* definition at the valuation date.

(c) "On the valuation date" requires that the *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 market state and circumstances as at the valuation date, not those at any other date.

(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. The *market value* transaction is presumed to be between unrelated parties, each acting independently.

(g) "After proper marketing" means that the *asset* has been exposed to the market in the most appropriate manner to effect its disposal at the best price reasonably obtainable in accordance with the *market value* definition. The method of sale is deemed to be that most appropriate to obtain the best *price* in the market to which the seller has access. The length of exposure time is not a fixed period but will vary according to the type of *asset* and market conditions. The only criterion is that there *must* have been sufficient time to allow the *asset* to be brought to the attention of an adequate number of market *participants*. The exposure period occurs prior to the valuation date.

(h) "Where 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 use that knowledge prudently to seek the *price* that is most favourable for their respective positions in the transaction.

Prudence is assessed by referring to the state of the market at the valuation date, not with the 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.

30.3. 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 presumed exposed for sale is the one in which the *asset* notionally being exchanged is normally exchanged.

30.4. The *market value* of an *asset* will reflect its highest and best use (see paras 140.1-140.5). The highest and best use is the use of an *asset* that maximises its potential 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.

30.5. The nature and source of the valuation inputs *must* be consistent with the *basis of value*, which in turn *must* have regard to the valuation *purpose*. For example, various approaches and methods *may* be used to arrive at an opinion of *value* providing they use market-derived data. The market approach will, by definition, use market-derived inputs. To indicate *market value*, the income approach *should* be applied, using inputs and assumptions that would be adopted by *participants*. To indicate *market value* using the cost approach, the *cost* of an *asset* of equal utility and the appropriate depreciation *should* be determined by analysis of market-based costs and depreciation.

30.6. The data available and the circumstances relating to the market for the *asset* being valued *must* determine which valuation method or methods are most relevant and appropriate. If based on appropriately analysed market-derived data, each approach or method used *should* provide an indication of *market value*.

30.7. *Market value* does not reflect attributes of an *asset* that are of *value* to a specific owner or purchaser that are not available to other buyers in the market. Such advantages *may* relate to the physical, geographic, economic or legal characteristics of an *asset*. *Market value* requires the disregard of any such element of *value* because, at any given date, it is only assumed that there is a willing buyer, not a particular willing buyer.

40. IVS-Defined Basis of Value – Market Rent

40.1. Market rent is the estimated amount for which an interest in real property *should* 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.

40.2. Market rent *may* be used as a *basis of value* when valuing a lease or an interest created by a lease. In such cases, it is necessary to consider the contract rent and, where it is different, the market rent.

40.3. The conceptual framework supporting the definition of *market value* shown above 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*. An indication of market rent *should* only be provided in conjunction with an indication of the principal lease terms that have been assumed.

40.4. 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.

40.5. In some circumstances the market rent *may* have to be assessed based on terms of an existing lease (eg, for rental determination *purposes* where the lease terms are existing and therefore not to be assumed as part of a notional lease).

40.6. In calculating market rent, the *valuer must* consider the following:

(a) in regard to a market rent subject to a lease, the terms and conditions of that lease are the appropriate lease terms unless those terms and conditions are illegal or contrary to overarching legislation, and

(b) in regard to a market rent that is not subject to a lease, the assumed terms and conditions are the terms of a notional lease that would typically be agreed in a market for the type of property on the valuation date between market *participants*.

50. IVS-Defined Basis of Value – Equitable Value

50.1. *Equitable 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.

50.2. *Equitable value* requires the assessment of the *price* that is fair between two specific, identified parties considering the respective advantages or disadvantages that each will gain from the transaction. In contrast, *market value* requires any advantages or disadvantages that would not be available to, or incurred by, market *participants* generally to be disregarded.

50.3. *Equitable 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 *equitable value*

will involve taking into account matters that have to be disregarded in the assessment of *market value*, such as certain elements of *synergistic value* arising because of the combination of the interests.

50.4. Examples of the use of *equitable value* include:

(a) determination of a *price* that is equitable for a shareholding in a non-quoted business, where the holdings of two specific parties *may* mean that the *price* that is equitable between them is different from the *price* that might be obtainable in the market, and

(b) determination of a *price* that would be equitable between a lessor and a lessee for either the permanent transfer of the leased *asset* or the cancellation of the lease liability.

60. IVS-Defined Basis of Value – Investment Value/Worth

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

60.2. *Investment value* 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 involve a presumed 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.

70. IVS-Defined Basis of Value – Synergistic Value

70.1. *Synergistic value* is the result of a combination of two or more *assets* or interests where the combined *value* is more than the sum of the separate *values*. If the synergies are only available to one specific buyer then *synergistic value* will differ from *market value*, as the *synergistic value* will reflect particular attributes of an *asset* that are only of *value* to a specific purchaser. The added *value* above the aggregate of the respective interests is often referred to as “marriage value.”

80. IVS-Defined Basis of Value – Liquidation Value

80.1. *Liquidation value* is the amount that would be realised when an *asset* or group of *assets* are sold on a piecemeal basis. *Liquidation value should* take into account the *costs* of getting the *assets* into saleable condition as well as those of the disposal activity. *Liquidation value* can be determined under two different premises of *value*:

(a) an orderly transaction with a typical marketing period (see section 160), or

(b) a forced transaction with a shortened marketing period (see section 170).

80.2. A *valuer must* disclose which premise of *value* is assumed.

90. Other Basis of Value – Fair Value (International Financial Reporting Standards)

90.1. IFRS 13 defines *fair value* as 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.

90.2. For financial reporting *purposes*, over 130 countries require or permit the use of International Accounting Standards published by the International Accounting Standards Board. In addition, the Financial Accounting Standards Board in the United States uses the same definition of *fair value* in Topic 820.

100. Other Basis of Value – Fair Market Value (Organisation for Economic Co-operation and Development (OECD))

100.1. The OECD defines *fair market value* as the *price* a willing buyer would pay a willing seller in a transaction on the open market.

100.2. OECD guidance is used in many engagements for international tax *purposes*.

110. Other Basis of Value – Fair Market Value (United States Internal Revenue Service)

110.1. For United States tax *purposes*, Regulation §20.2031-1 states: “The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.”

120. Other Basis of Value – Fair Value (Legal/Statutory) in different jurisdictions

120.1. Many national, state and local agencies use *fair value* as a *basis of value* in a legal context. The definitions can vary *significantly* and *may* be the result of legislative action or those established by courts in prior cases.

120.2. Examples of US and Canadian definitions of *fair value* are as follows:

(a) The Model Business Corporation Act (MBCA) is a model set of law prepared by the Committee on Corporate Laws of the Section of Business Law of the American Bar Association and is followed by 24 States in the United States. The definition of *fair value* from the MBCA is the *value* of the corporation’s shares determined:

(1) immediately before the effectuation of the corporate action to which the shareholder objects,

(2) using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal, and

(3) without discounting for lack of marketability or minority status except, if appropriate, for amendments to the articles pursuant to section 13.02(a)(5).

(b) In 1986, the Supreme Court of British Columbia in Canada issued a ruling in *Manning v Harris Steel Group Inc*. that stated: “Thus, a ‘fair’ value is one which is just and equitable. That terminology contains within itself the concept of adequate compensation (indemnity), consistent with the requirements of justice and equity.”

130. Premise of Value/Assumed Use

130.1. A premise of value or assumed use describes the circumstances of how an *asset* or liability is used. Different *bases of value may* require a particular

premise of value or allow the consideration of multiple premises of value. Some common premises of value are:

(a) highest and best use,

(b) current use/existing use,

(c) orderly liquidation, and

(d) forced sale.

140. Premise of Value – Highest and Best Use

140.1. Highest and best use is the use, from a *participant* perspective, that would produce the highest *value* for an *asset*. Although the concept is most frequently applied to non-financial *assets* as many financial *assets* do not have alternative uses, there *may* be circumstances where the highest and best use of financial *assets* needs to be considered.

140.2. The highest and best use *must* be physically possible (where applicable), financially feasible, legally allowed and result in the highest *value*. If different from the current use, the *costs* to convert an *asset* to its highest and best use would impact the *value*.

140.3. The highest and best use for an *asset may* be its current or existing use when it is being used optimally. However, highest and best use *may* differ from current use or even be an orderly liquidation.

140.4. 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 of *assets*, when its contribution to the overall *value* of the group *must* be considered.

140.5. The determination of the highest and best use involves consideration of the following:

(a) To establish whether a use is physically possible, regard will be had to what would be considered reasonable by *participants*.

(b) To reflect the requirement to be legally permissible, any legal restrictions on the use of the *asset*, eg, town planning/zoning designations, need to be taken into account as well as the likelihood that these restrictions will change.

(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 *participant*, after taking into account the *costs* of conversion to that use, over and above the return on the existing use.

150. Premise of Value – Current Use/Existing Use

150.1. Current use/existing use is the current way an *asset*, liability, or group of *assets* and/or liabilities is used. The current use *may* be, but is not necessarily, also the highest and best use.

160. Premise of Value – Orderly Liquidation

160.1. An orderly liquidation describes the *value* of a group of *assets* that could be realised in a liquidation sale, given a reasonable period of time to find

a purchaser (or purchasers), with the seller being compelled to sell on an as-is, where-is basis.

160.2. The reasonable period of time to find a purchaser (or purchasers) *may* vary by *asset* type and market conditions.

170. Premise of Value – Forced Sale

170.1. The term "forced sale" is often used in circumstances where a seller is under compulsion to sell and that, as a consequence, a proper marketing period is not possible and buyers *may* not be able to undertake adequate due diligence. 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. A "forced sale" is a description of the situation under which the exchange takes place, not a distinct *basis of value*.

170.2. If an indication 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.

170.3. A forced sale typically reflects the most probable price that a specified property is likely to bring under all of the following conditions:

(a) consummation of a sale within a short time period,

(b) the *asset* is subjected to market conditions prevailing as of the date of valuation or assumed timescale within which the transaction is to be completed,

(c) both the buyer and the seller are acting prudently and knowledgeably,

(d) the seller is under compulsion to sell,

(e) the buyer is typically motivated,

(f) both parties are acting in what they consider their best interests,

(g) a normal marketing effort is not possible due to the brief exposure time, and

(h) payment will be made in cash.

170.4. 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 30.1-30.7).

170.5. While confirmed "forced sale" transactions would generally be excluded from consideration in a *valuation* where the *basis of value* is *market value*, it

can be difficult to verify that an arm's length transaction in a market was a forced sale.

180. Entity-Specific Factors

180.1. For most *bases of value*, the factors that are specific to a particular buyer or seller and not available to *participants* generally are excluded from the inputs used in a market-based valuation. Examples of entity-specific factors that *may* not be available to *participants* include:

(a) additional *value* or reduction in *value* derived from the creation of a portfolio of similar *assets*,

(b) unique synergies between the *asset* and other *assets* owned by the entity,

(c) legal rights or restrictions applicable only to the entity,

(d) tax benefits or tax burdens unique to the entity, and

(e) an ability to exploit an *asset* that is unique to that entity.

180.2. 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 of *assets*. Any synergies with related *assets* would transfer to *participants* along with the transfer of the group and therefore are not entity specific.

180.3. If the objective of the *basis of value* used in a *valuation* is to determine the *value* to a specific owner (such as *investment value/worth* discussed in paras 60.1 and 60.2), 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, and

(b) reviewing the performance of an *asset*.

190. Synergies

190.1. "Synergies" refer to the benefits associated with combining *assets*. When synergies are present, the *value* of a group of *assets* and liabilities is greater than the sum of the *values* of the individual *assets* and liabilities on a stand-alone basis. Synergies typically relate to a reduction in *costs*, and/or an increase in revenue, and/or a reduction in risk.

190.2. Whether synergies *should* be considered in a *valuation* depends on the *basis of value*. For most *bases of value*, only those synergies available to other *participants* generally will be considered (see discussion of Entity-Specific Factors in paras 180.1-180.3).

190.3. An assessment of whether synergies are available to other *participants may* be based on the amount of the synergies rather than a specific way to achieve that synergy.

200. Assumptions and Special Assumptions

200.1. 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*.

200.2. These types of assumptions generally fall into one of two categories:

(a) assumed facts that are consistent with, or could be consistent with, those existing at the date of valuation, and

(b) assumed facts that differ from those existing at the date of valuation.

200.3. Assumptions related to facts that are consistent with, or could be consistent with, those existing at the date of valuation *may* be the result of a limitation on the extent of the investigations or enquiries undertaken by the *valuer*. Examples of such assumptions include, without limitation:

(a) an assumption that a business is transferred as a complete operational entity,

(b) an assumption that *assets* employed in a business are transferred without the business, either individually or as a group,

(c) an assumption that an individually valued *asset* is transferred together with other complementary *assets*, and

(d) an assumption that a holding of shares is transferred either as a block or individually.

200.4. Where assumed facts differ from those existing at the date of valuation, it is referred to as a “special assumption”. 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 *participants* generally on the valuation date. Examples of such assumptions include, without limitation:

(a) an assumption that a property is freehold with vacant possession,

(b) an assumption that a proposed building had actually been completed on the valuation date,

(c) an assumption that a specific contract was in existence on the valuation date which had not actually been completed, and

(d) an assumption that a financial instrument is valued using a yield curve that is different from that which would be used by a *participant*.

200.5. All assumptions and special assumptions *must* be reasonable under the circumstances, be supported by evidence, and be relevant having regard to the *purpose* for which the *valuation* is required.

210. Transaction Costs

210.1. Most *bases of value* represent the estimated exchange price 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.

220. Allocation of Value

220.1. Allocation of value is the separate apportionment of *value* of an *asset(s)* on an individual or component basis.

220.2. When apportioning *value*, the allocation method must be consistent with the overall valuation premise/basis and the *valuer must*:

(a) follow any applicable legal or regulatory requirements,

(b) set out a clear and accurate description of the *purpose* and *intended use* of the allocation,

(c) consider the facts and circumstances, such as the relevant characteristic(s) of the items(s) being apportioned,

(d) adopt appropriate methodology(ies) in the circumstances.

IVS 105 Valuation Approaches and Methods

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10. Introduction

10.1. Consideration *must* be given to the relevant and appropriate valuation approaches. One or more valuation *approaches may* be used in order to arrive at the *value* in accordance with the *basis of value*. The three approaches described and defined below are the main approaches used in *valuation*. They are all based on the economic principles of price equilibrium, anticipation of benefits or substitution.

The principal valuation approaches are:

(a) market approach,

(b) income approach, and

(c) cost approach.

10.2. Each of these valuation approaches includes different, detailed methods of application.

10.3. The goal in selecting valuation approaches and methods for an *asset* is to find the most appropriate method under the particular circumstances. No one method is suitable in every possible situation. The selection process *should* consider, at a minimum:

(a) the appropriate *basis(es) of value* and premise(s) of value, determined by the terms and *purpose* of the valuation assignment,

(b) the respective strengths and weaknesses of the possible valuation approaches and methods,

(c) the appropriateness of each method in view of the nature of the *asset*, and the approaches or methods used by *participants* in the relevant market, and

(d) the availability of reliable information needed to apply the method(s).

10.4. *Valuers* are not required to use more than one method for the *valuation* of an *asset*, particularly when the *valuer* has a high degree of confidence in the accuracy and reliability of a single method, given the facts and

circumstances of the valuation engagement. However, *valuers should* consider the use of multiple approaches and methods and more than one valuation approach or method *should* be considered and *may* be used to arrive at an indication of *value*, particularly when 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, or even multiple methods within a single approach, the conclusion of *value* based on those multiple approaches and/or methods *should* be reasonable and the process of analysing and reconciling the differing *values* into a single conclusion, without averaging, *should* be described by the *valuer* in the report.

10.5. While this standard includes discussion of certain methods within the cost, market and income approaches, it does not provide a comprehensive list of all possible methods that *may* be appropriate. It is the *valuer's* responsibility to choose the appropriate method(s) for each valuation engagement. Compliance with IVS *may* require the *valuer* to use a method not defined or mentioned in the IVS.

10.6. When different approaches and/or methods result in widely divergent indications of *value*, a *valuer should* perform procedures to understand why the *value* indications differ, as it is generally not appropriate to simply *weight* two or more divergent indications of *value*. In such cases, *valuers should* reconsider the guidance in para 10.3 to determine whether one of the approaches/methods provides a better or more reliable indication of *value*.

10.7. *Valuers should* maximise the use of relevant observable market information in all three approaches. Regardless of the source of the inputs and assumptions used in a *valuation*, a *valuer must* perform appropriate analysis to evaluate those inputs and assumptions and their appropriateness for the valuation *purpose*.

10.8. Although no one approach or method is applicable in all circumstances, price information from an active market is generally considered to be the strongest evidence of *value*. Some *bases of value may* prohibit a *valuer* from making subjective adjustments to price information from an active market. Price information from an inactive market *may* still be good evidence of *value*, but subjective adjustments *may* be needed.

10.9 In certain circumstances, the *valuer* and the *client may* agree on the valuation approaches, methods and procedures the *valuer* will use or the extent of procedures the *valuer* will perform. Depending on the limitations placed on the *valuer* and procedures performed, such circumstances *may* result in a *valuation* that is not IVS compliant.

10.10. A *valuation may* be limited or restricted where the *valuer* is not able to employ the valuation approaches, methods and procedures that a reasonable and informed third party would perform, and it is reasonable to expect that the effect of the limitation or restriction on the estimate of *value* could be *material*.

20. Market Approach

20.1. The market approach provides an indication of *value* by comparing the *asset* with identical or comparable (that is similar) *assets* for which price information is available.

20.2. The market approach *should* be applied and afforded *significant weight* under the following circumstances:

(a) the subject *asset* has recently been sold in a transaction appropriate for consideration under the *basis of value*,

(b) the subject *asset* or substantially similar *assets* are actively publicly traded, and/or

(c) there are frequent and/or recent observable transactions in substantially similar *assets*.

20.3. Although the above circumstances would indicate that the market approach *should* be applied and afforded *significant weight*, when the above criteria are not met, the following are additional circumstances where the market approach *may* be applied and afforded *significant weight*. When using the market approach under the following circumstances, a *valuer should* consider whether any other approaches can be applied and *weighted* to corroborate the *value* indication from the market approach:

(a) Transactions involving the subject *asset* or substantially similar *assets* are not recent enough considering the levels of volatility and activity in the market.

(b) The *asset* or substantially similar *assets* are publicly traded, but not actively.

(c) Information on market transactions is available, but the comparable *assets* have *significant* differences to the subject *asset*, potentially requiring subjective adjustments.

(d) Information on recent transactions is not reliable (ie, hearsay, missing information, synergistic purchaser, not arm's-length, distressed sale, etc).

(e) The critical element affecting the *value* of the *asset* is the *price* it would achieve in the market rather than the *cost* of reproduction or its income-producing ability.

20.4. The heterogeneous nature of many *assets* means that it is often not possible to find market evidence of transactions involving identical or similar *assets*. Even in circumstances where the market approach is not used, the use of market-based inputs *should* be maximised in the application of other approaches (eg, market-based valuation metrics such as effective yields and rates of return).

20.5. When comparable market information does not relate to the exact or substantially the same *asset*, the *valuer must* perform a comparative analysis of qualitative and quantitative similarities and differences between the comparable *assets* and the subject *asset*. It will often be necessary to make adjustments based on this comparative analysis. Those adjustments *must* be reasonable and *valuers must* document the reasons for the adjustments and how they were quantified.

20.6. The market approach often uses market multiples derived from a set of comparables, each with different multiples. The selection of the appropriate multiple within the range requires judgement, considering qualitative and quantitative factors.

30. Market Approach Methods

Comparable Transactions Method

30.1. The comparable transactions method, also known as the guideline transactions method, utilises information on transactions involving *assets* that are the same or similar to the subject *asset* to arrive at an indication of *value*.

30.2. When the comparable transactions considered involve the subject *asset*, this method is sometimes referred to as the prior transactions method.

30.3. If few recent transactions have occurred, the *valuer may* consider the *prices* of identical or similar *assets* that are listed or offered for sale, provided the relevance of this information is clearly established, critically analysed and documented. This is sometimes referred to as the comparable listings method and *should* not be used as the sole indication of *value* but can be appropriate for consideration together with other methods. When considering listings or offers to buy or sell, the *weight* afforded to the listings/offer price *should* consider the level of commitment inherent in the *price* and how long the listing/offer has been on the market. For example, an offer that represents a binding commitment to purchase or sell an *asset* at a given price *may* be given more *weight* than a quoted price without such a binding commitment.

30.4. The comparable transaction method can use a variety of different comparable evidence, also known as units of comparison, which form the basis of the comparison. For example, a few of the many common units of comparison used for real property interests include price per square foot (or per square metre), rent per square foot (or per square metre) and capitalisation rates. A few of the many common units of comparison used in business valuation include EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation) multiples, earnings multiples, revenue multiples and book value multiples. A few of the many common units of comparison used in financial instrument valuation include metrics such as yields and interest rate spreads. The units of comparison used by *participants* can differ between *asset* classes and across industries and geographies.

30.5. A subset of the comparable transactions method is matrix pricing, which is principally used to value some types of financial instruments, such as debt securities, without relying exclusively on quoted prices for the specific securities, but rather relying on the securities' relationship to other benchmark quoted securities and their attributes (ie, yield).

30.6. The key steps in the comparable transactions method are:

(a) identify the units of comparison that are used by *participants* in the relevant market,

(b) identify the relevant comparable transactions and calculate the key valuation metrics for those transactions,

(c) perform a consistent comparative analysis of qualitative and quantitative similarities and differences between the comparable *assets* and the subject *asset*,

(d) make necessary adjustments, if any, to the valuation metrics to reflect differences between the subject *asset* and the comparable *assets* (see para 30.12(d)),

(e) apply the adjusted valuation metrics to the subject *asset*, and

(f) if multiple valuation metrics were used, reconcile the indications of *value*.

30.7. A *valuer should* choose comparable transactions within the following context:

(a) evidence of several transactions is generally preferable to a single transaction or event,

(b) evidence from transactions of very similar *assets* (ideally identical) provides a better indication of *value* than *assets* where the transaction prices require *significant* adjustments,

(c) transactions that happen closer to the valuation date are more representative of the market at that date than older/dated transactions, particularly in volatile markets,

(d) for most *bases of value*, the transactions *should* be "arm's length" between unrelated parties,

(e) sufficient information on the transaction *should* be available to allow the *valuer* to develop a reasonable understanding of the comparable *asset* and assess the valuation metrics/comparable evidence,

(f) information on the comparable transactions *should* be from a reliable and trusted source, and

(g) actual transactions provide better valuation evidence than intended transactions.

30.8. A *valuer should* analyse and make adjustments for any material differences between the comparable transactions and the subject *asset*. Examples of common differences that could warrant adjustments *may* include, but are not limited to:

(a) material characteristics (age, size, specifications, etc),

(b) relevant restrictions on either the subject *asset* or the comparable *assets*,

(c) geographical location (location of the *asset* and/or location of where the *asset* is likely to be transacted/used) and the related economic and regulatory environments,

(d) profitability or profit-making capability of the *assets*,

(e) historical and expected growth,

(f) yields/coupon rates,

(g) types of collateral,

(h) unusual terms in the comparable transactions,

(i) differences related to marketability and control characteristics of the comparable and the subject *asset*, and

(j) ownership characteristics (eg, legal form of ownership, amount percentage held).

Guideline publicly-traded comparable method

30.9. The guideline publicly-traded method utilises information on publicly-traded comparables that are the same or similar to the subject *asset* to arrive at an indication of *value*.

30.10. This method is similar to the comparable transactions method. However, there are several differences due to the comparables being publicly traded, as follows:

(a) the valuation metrics/comparable evidence are available as of the valuation date,

(b) detailed information on the comparables are readily available in public filings, and

(c) the information contained in public filings is prepared under well-understood accounting standards.

30.11. The method *should* be used only when the subject *asset* is sufficiently similar to the publicly-traded comparables to allow for meaningful comparison.

30.12. The key steps in the guideline publicly-traded comparable method are to:

(a) identify the valuation metrics/comparable evidence that are used by *participants* in the relevant market,

(b) identify the relevant guideline publicly-traded comparables and calculate the key valuation metrics for those transactions,

(c) perform a consistent comparative analysis of qualitative and quantitative similarities and differences between the publicly-traded comparables and the subject *asset*,

(d) make necessary adjustments, if any, to the valuation metrics to reflect differences between the subject *asset* and the publicly-traded comparables,

(e) apply the adjusted valuation metrics to the subject *asset*, and

(f) if multiple valuation metrics were used, *weight* the indications of *value*.

30.13. A *valuer should* choose publicly-traded comparables within the following context:

(a) consideration of multiple publicly-traded comparables is preferred to the use of a single comparable,

(b) evidence from similar publicly-traded comparables (for example, with similar market segment, geographic area, size in revenue and/or *assets*, growth rates, profit margins, leverage, liquidity and diversification)

provides a better indication of *value* than comparables that require *significant* adjustments, and

(c) securities that are actively traded provide more meaningful evidence than thinly-traded securities.

30.14. A *valuer should* analyse and make adjustments for any material differences between the guideline publicly-traded comparables and the subject *asset*. Examples of common differences that could warrant adjustments *may* include, but are not limited to:

(a) material characteristics (age, size, specifications, etc),

(b) relevant discounts and premiums (see para 30.17),

(c) relevant restrictions on either the subject *asset* or the comparable *assets*,

(d) geographical location of the underlying company and the related economic and regulatory environments,

(e) profitability or profit-making capability of the *assets*,

(f) historical and expected growth,

(g) differences related to marketability and control characteristics of the comparable and the subject *asset*, and

(h) type of ownership.

Other Market Approach Considerations

30.15. The following paragraphs address a non-exhaustive list of certain special considerations that *may* form part of a market approach valuation.

30.16. Anecdotal or "rule-of-thumb" valuation benchmarks are sometimes considered to be a market approach. However, value indications derived from the use of such rules *should* not be given substantial *weight* unless it can be shown that buyers and sellers place *significant* reliance on them.

30.17. In the market approach, the fundamental basis for making adjustments is to adjust for differences between the subject *asset* and the guideline transactions or publicly-traded securities. Some of the most common adjustments made in the market approach are known as discounts and premiums.

(a) Discounts for Lack of Marketability (DLOM) *should* be applied when the comparables are deemed to have superior marketability to the subject *asset*. A DLOM reflects the concept that when comparing otherwise identical *assets*, a readily marketable *asset* would have a higher *value* than an *asset* with a long marketing period or restrictions on the ability to sell the *asset*. For example, publicly-traded securities can be bought and sold nearly instantaneously while shares in a private company *may* require a *significant* amount of time to identify potential buyers and complete a transaction. Many *bases of value* allow the consideration of restrictions on marketability that are inherent in the

subject *asset* but prohibit consideration of marketability restrictions that are specific to a particular owner. DLOMs *may* be quantified using any reasonable method, but are typically calculated using option pricing models, studies that compare the *value* of publicly-traded shares and restricted shares in the same company, or studies that compare the *value* of shares in a company before and after an initial public offering.

(b) Control Premiums (sometimes referred to as *Market Participant Acquisition Premiums* or *MPAPs*) and Discounts for Lack of Control (DLOC) are applied to reflect differences between the comparables and the subject *asset* with regard to the ability to make decisions and the changes that can be made as a result of exercising control. All else being equal, *participants* would generally prefer to have control over a subject *asset* than not. However, *participants*' willingness to pay a Control Premium or DLOC will generally be a factor of whether the ability to exercise control enhances the economic benefits available to the owner of the subject *asset*. Control Premiums and DLOCs *may* be quantified using any reasonable method, but are typically calculated based on either an analysis of the specific cash flow enhancements or reductions in risk associated with control or by comparing observed prices paid for controlling interests in publicly-traded securities to the publicly-traded price before such a transaction is announced. Examples of circumstances where Control Premiums and DLOC *should* be considered include where:

1. shares of public companies generally do not have the ability to make decisions related to the operations of the company (they lack control). As such, when applying the guideline public comparable method to value a subject *asset* that reflects a controlling interest, a control premium *may* be appropriate, or

2. the guideline transactions in the guideline transaction method often reflect transactions of controlling interests. When using that method to value a subject *asset* that reflects a minority interest, a DLOC *may* be appropriate.

(c) Blockage discounts are sometimes applied when the subject *asset* represents a large block of shares in a publicly-traded security such that an owner would not be able to quickly sell the block in the public market without negatively influencing the publicly-traded price. Blockage discounts *may* be quantified using any reasonable method but typically a model is used that considers the length of time over which a *participant* could sell the subject shares without negatively impacting the publicly-traded price (ie, selling a relatively small portion of the security's typical daily trading volume each day). Under certain *bases of value*, particularly *fair value* for financial reporting *purposes*, blockage discounts are prohibited.

40. Income Approach

40.1. The income approach provides an indication of *value* by converting future cash flow to a single current value. Under the income approach, the *value* of an *asset* is determined by reference to the *value* of income, cash flow or cost savings generated by the *asset*.

40.2. The income approach *should* be applied and afforded *significant weight* under the following circumstances:

(a) the income-producing ability of the *asset* is the critical element affecting *value* from a *participant* perspective, and/or

(b) reasonable projections of the amount and timing of future income are available for the subject *asset*, but there are few, if any, relevant market comparables.

40.3. Although the above circumstances would indicate that the income approach *should* be applied and afforded *significant weight*, the following are additional circumstances where the income approach *may* be applied and afforded *significant weight*. When using the income approach under the following circumstances, a *valuer should* consider whether any other approaches can be applied and *weighted* to corroborate the value indication from the income approach:

(a) the income-producing ability of the subject *asset* is only one of several factors affecting *value* from a *participant* perspective,

(b) there is *significant* uncertainty regarding the amount and timing of future income-related to the subject *asset*,

(c) there is a lack of access to information related to the subject *asset* (for example, a minority owner *may* have access to historical financial statements but not forecasts/budgets), and/or

(d) the subject *asset* has not yet begun generating income, but is projected to do so.

40.4. A fundamental basis for the income approach is that investors expect to receive a return on their investments and that such a return *should* reflect the perceived level of risk in the investment.

40.5. Generally, investors can only expect to be compensated for systematic risk (also known as “market risk” or “undiversifiable risk”).

50. Income Approach Methods

50.1. Although there are many ways to implement the income approach, methods under the income approach are effectively based on discounting future amounts of cash flow to present value. They are variations of the Discounted Cash Flow (DCF) method and the concepts below apply in part or in full to all income approach methods.

Discounted Cash Flow (DCF) Method

50.2. Under the DCF method the forecasted cash flow is discounted back to the valuation date, resulting in a present value of the *asset*.

50.3. In some circumstances for long-lived or indefinite-lived *assets*, DCF *may* include a terminal value which represents the *value* of the *asset* at the end of the explicit projection period. In other circumstances, the *value* of an *asset may* be calculated solely using a terminal value with no explicit projection period. This is sometimes referred to as an income capitalisation method.

50.4. The key steps in the DCF method are:

(a) choose the most appropriate type of cash flow for the nature of the subject *asset* and the assignment (ie, pre-tax or post-tax, total cash flows or cash flows to equity, real or nominal, etc),

(b) determine the most appropriate explicit period, if any, over which the cash flow will be forecast,

(c) prepare cash flow forecasts for that period,

(d) determine whether a terminal value is appropriate for the subject *asset* at the end of the explicit forecast period (if any) and then determine the appropriate terminal value for the nature of the *asset*,

(e) determine the appropriate *discount rate*, and

(f) apply the *discount rate* to the forecasted future cash flow, including the terminal value, if any.

Type of Cash Flow

50.5. When selecting the appropriate type of cash flow for the nature of *asset* or assignment, *valuers must* consider the factors below. In addition, the *discount rate* and other inputs *must* be consistent with the type of cash flow chosen.

(a) Cash flow to whole *asset* or partial interest: Typically cash flow to the whole *asset* is used. However, occasionally other levels of income *may* be used as well, such as cash flow to equity (after payment of interest and principle on debt) or dividends (only the cash flow distributed to equity owners). Cash flow to the whole *asset* is most commonly used because an *asset should* theoretically have a single *value* that is independent of how it is financed or whether income is paid as dividends or reinvested.

(b) The cash flow can be pre-tax or post-tax: The tax rate applied *should* be consistent with the *basis of value* and in many instances would be a *participant* tax rate rather than an owner-specific one.

(c) Nominal versus real: Real cash flow does not consider inflation whereas nominal cash flows include expectations regarding inflation. If expected cash flow incorporates an expected inflation rate, the *discount rate* has to include an adjustment for inflation as well.

(d) Currency: The choice of currency used *may* have an impact on assumptions related to inflation and risk. This is particularly true in emerging markets or in currencies with high inflation rates. The currency in which the forecast is prepared and related risks are separate and distinct from risks associated with the country(ies) in which the *asset* resides or operates.

(e) The type of cash flow contained in the forecast: For example, a cash flow forecast *may* represent expected cash flows, ie, probability-*weighted* scenarios), most likely cash flows, contractual cash flows, etc

50.6. The type of cash flow chosen *should* be in accordance with *participant's* viewpoints. For example, cash flows and *discount rates* for real property

are customarily developed on a pre-tax basis while cash flows and *discount rates* for businesses are normally developed on a post-tax basis. Adjusting between pre-tax and post-tax rates can be complex and prone to error and *should* be approached with caution.

50.7. When a *valuation* is being developed in a currency ("the valuation currency") that differs from the currency used in the cash flow projections ("the functional currency"), a *valuer should* use one of the following two currency translation methods:

(a) Discount the cash flows in the functional currency using a *discount rate* appropriate for that functional currency. Convert the present value of the cash flows to the valuation currency at the spot rate on the valuation date.

(b) Use a currency exchange forward curve to translate the functional currency projections into valuation currency projections and discount the projections using a *discount rate* appropriate for the valuation currency. When a reliable currency exchange forward curve is not available (for example, due to lack of liquidity in the relevant currency exchange markets), it *may* not be possible to use this method and only the method described in para 50.7(a) can be applied.

Explicit Forecast Period

50.8. The selection criteria will depend upon the *purpose of the valuation*, the nature of the *asset*, the information available and the required *bases of value*. For an *asset* with a short life, it is more likely to be both possible and relevant to project cash flow over its entire life.

50.9. *Valuers should* consider the following factors when selecting the explicit forecast period:

(a) the life of the *asset*,

(b) a reasonable period for which reliable data is available on which to base the projections,

(c) the minimum explicit forecast period which *should* be sufficient for an *asset* to achieve a stabilised level of growth and profits, after which a terminal value can be used,

(d) in the *valuation* of cyclical *assets*, the explicit forecast period *should* generally include an entire cycle, when possible, and

(e) for finite-lived *assets* such as most financial instruments, the cash flows will typically be forecast over the full life of the *asset*.

50.10. In some instances, particularly when the *asset* is operating at a stabilised level of growth and profits at the valuation date, it *may* not be necessary to consider an explicit forecast period and a terminal value *may* form the only basis for value (sometimes referred to as an income capitalisation method).

50.11. The intended holding period for one investor *should* not be the only consideration in selecting an explicit forecast period and *should* not impact the *value* of an *asset*. However, the period over which an *asset* is intended to be held *may* be considered in determining the explicit forecast period if the objective of the *valuation* is to determine its *investment value*.

Cash Flow Forecasts

50.12. Cash flow for the explicit forecast period is constructed using prospective financial information (PFI) (projected income/inflows and expenditure/outflows).

50.13. As required by para 50.12, regardless of the source of the PFI (eg, management forecast), a *valuer must* perform analysis to evaluate the PFI, the assumptions underlying the PFI and their appropriateness for the valuation *purpose*. The suitability of the PFI and the underlying assumptions will depend upon the *purpose* and the required *bases of value*. For example, cash flow used to determine *market value should* reflect PFI that would be anticipated by *participants*; in contrast, *investment value* can be measured using cash flow that is based on the reasonable forecasts from the perspective of a particular investor.

50.14. The cash flow is divided into suitable periodic intervals (eg, weekly, monthly, quarterly or annually) with the choice of interval depending upon the nature of the *asset*, the pattern of the cash flow, the data available, and the length of the forecast period.

50.15. The projected cash flow *should* capture the amount and timing of all future cash inflows and outflows associated with the subject *asset* from the perspective appropriate to the *basis of value*.

50.16. Typically, the projected cash flow will reflect one of the following:

(a) contractual or promised cash flow,

(b) the single most likely set of cash flow,

(c) the probability-*weighted* expected cash flow, or

(d) multiple scenarios of possible future cash flow.

50.17. Different types of cash flow often reflect different levels of risk and *may* require different *discount rates*. For example, probability-*weighted* expected cash flows incorporate expectations regarding all possible outcomes and are not dependent on any particular conditions or events (note that when a probability-*weighted* expected cash flow is used, it is not always necessary for *valuers* to take into account distributions of all possible cash flows using complex models and techniques. Rather, *valuers may* develop a limited number of discrete scenarios and probabilities that capture the array of possible cash flows). A single most likely set of cash flows *may* be conditional on certain future events and therefore could reflect different risks and warrant a different *discount rate*.

50.18. While *valuers* often receive PFI that reflects accounting income and expenses, it is generally preferable to use cash flow that would be anticipated by *participants* as the basis for *valuation*s. For example, accounting non-cash expenses, such as depreciation and amortisation, *should* be added back, and expected cash outflows relating to capital expenditures or to changes in working capital *should* be deducted in calculating cash flow.

50.19. *Valuers must* ensure that seasonality and cyclicality in the subject has been appropriately considered in the cash flow forecasts.

Terminal Value

50.20. Where the *asset* is expected to continue beyond the explicit forecast period, *valuers must* estimate the *value* of the *asset* at the end of that period. The terminal value is then discounted back to the valuation date, normally using the same *discount rate* as applied to the forecast cash flow.

50.21. The terminal value *should* consider:

(a) whether the *asset* is deteriorating/finite-lived in nature or indefinite-lived, as this will influence the method used to calculate a terminal value,

(b) whether there is future growth potential for the *asset* beyond the explicit forecast period,

(c) whether there is a pre-determined fixed capital amount expected to be received at the end of the explicit forecast period,

(d) the expected risk level of the *asset* at the time the terminal value is calculated,

(e) for cyclical *assets*, the terminal value *should* consider the cyclical nature of the *asset* and *should* not be performed in a way that assumes "peak" or "trough" levels of cash flows in perpetuity, and

(f) the tax attributes inherent in the *asset* at the end of the explicit forecast period (if any) and whether those tax attributes would be expected to continue into perpetuity.

50.22. *Valuers may* apply any reasonable method for calculating a terminal value. While there are many different approaches to calculating a terminal value, the three most commonly used methods for calculating a terminal value are:

(a) Gordon growth model/constant growth model (appropriate only for indefinite-lived *assets*),

(b) market approach/exit value (appropriate for both deteriorating/finite-lived *assets* and indefinite-lived *assets*), and

(c) salvage value/disposal cost (appropriate only for deteriorating/ finite-lived *assets*).

Gordon Growth Model/Constant Growth Model

50.23. The constant growth model assumes that the *asset* grows (or declines) at a constant rate into perpetuity.

Market Approach/Exit Value

50.24. The market approach/exit value method can be performed in a number of ways, but the ultimate goal is to calculate the *value* of the *asset* at the end of the explicit cash flow forecast.

50.25. Common ways to calculate the terminal value under this method include application of a market-evidence based capitalisation factor or a market multiple.

50.26. When a market approach/exit value is used, *valuers should* comply with the requirements in the market approach and market approach methods section of this standard (sections 20 and 30). However, *valuers should* also consider the expected market conditions at the end of the explicit forecast period and make adjustments accordingly.

Salvage Value/Disposal Cost

50.27. The terminal value of some *assets may* have little or no relationship to the preceding cash flow. Examples of such *assets* include wasting *assets* such as a mine or an oil well.

50.28. In such cases, the terminal value is typically calculated as the salvage value of the *asset*, less *costs* to dispose of the *asset*. In circumstances where the *costs* exceed the salvage value, the terminal value is negative and referred to as a disposal cost or an *asset* retirement obligation.

Discount Rate

50.29. The rate at which the forecast cash flow is discounted *should* reflect not only the time value of money, but also the risks associated with the type of cash flow and the future operations of the *asset*.

50.30. The *discount rate must* be consistent with the type of cash flow.

50.31. *Valuers may* use any reasonable method for developing an appropriate *discount rate*. While there are many methods for developing a *discount rate* or determining the reasonableness of a *discount rate*, a non-exhaustive list of common methods includes:

(a) a capital *asset* pricing model (CAPM),

(b) a *weighted* average cost of capital (WACC),

(c) observed or inferred rates/yields,

(d) a build-up method.

50.32. *Valuers should* consider corroborative analyses when assessing the appropriateness of a *discount rate*. A non-exhaustive list of common analyses *should* include:

(a) an internal rate of return (IRR),

(b) a *weighted* average return on *assets* (WARA),

(c) *value* indications from other approaches, such as market approach, or comparing implied multiples from the income approach with guideline company market multiples or transaction multiples.

50.33. In developing a *discount rate*, a *valuer should* consider:

(a) the type of *asset* being valued. For example, *discount rates* used in valuing debt would be different to those used when valuing real property or a business,

(b) the rates implicit in comparable transactions in the market,

(c) the geographic location of the *asset* and/or the location of the markets in which it would trade,

(d) the life/term and/or maturity of the *asset* and the consistency of inputs. For example, the maturity of the risk-free rate applied will depend on the circumstances, but a common approach is to match the maturity of the risk-free rate to the time horizon of the cash flows being considered,

(e) the *bases of value* being applied,

(f) the currency denomination of the projected cash flows.

50.34. In developing a *discount rate*, the *valuer must*:

(a) document the method used for developing the *discount rate* and support its use,

(b) provide evidence for the derivation of the *discount rate*, including the identification of the significant inputs and support for their derivation or source.

50.35. *Valuers must* consider the *purpose* for which the forecast was prepared and whether the forecast assumptions are consistent with the *basis of value* being applied. If the forecast assumptions are not consistent with the *basis of value*, it could be necessary to adjust the forecast or *discount rate* (see para 50.38).

50.36. *Valuers must* consider the risk of achieving the forecast cash flow of the *asset* when developing the *discount rate*. Specifically, the *valuer must* evaluate whether the risk underlying the forecast cash flow assumptions are captured in the *discount rate*.

50.37. While there are many ways to assess the risk of achieving the forecast cash flow, a non-exhaustive list of common procedures includes:

(a) Identify the key components of the forecast cash flow and compare the forecast cash flow key components to:

- Historical operating and financial performance of the *asset*,
- Historical and expected performance of comparable *assets*,
- Historical and expected performance for the industry, and
- Expected near-term and long-term growth rates of the country or region in which the *asset* primarily operates,

(b) Confirm whether the forecast cash flow represents expected cash flows (ie, probability-*weighted* scenarios), as opposed to most likely cash flows (ie, most probable scenario), of the *asset*, or some other type of cash flow,

(c) If utilising expected cash flows, consider the relative dispersion of potential outcomes used to derive the expected cash flows (eg, higher dispersion *may* indicate a need for an adjustment to the *discount rate*),

(d) Compare prior forecasts of the *asset* to actual results to assess the accuracy and reliability of managements' estimates,

(e) Consider qualitative factors, and

(f) Consider the value indications such as those resulting from the market approach.

50.38. If the *valuer* determines that certain risks included in the forecast cash flow for the *asset* have not been captured in the *discount rate*, the *valuer must* 1) adjust the forecast, or 2) adjust the *discount rate* to account for those risks not already captured.

(a) When adjusting the cash flow forecast, the *valuer should* provide the rationale for why the adjustments were necessary, undertake quantitative procedures to support the adjustments, and document the nature and amount of the adjustments,

(b) When adjusting the *discount rate*, the *valuer should* document why it was not appropriate or possible to adjust the cash flow forecast, provide the rationale for why such risks are not otherwise captured in the *discount rate*, undertake quantitative and qualitative procedures to support the adjustments, and document the nature and amount of the adjustment. The use of quantitative procedures does not necessarily entail quantitative derivation of the adjustment to the *discount rate*. A *valuer* need not conduct an exhaustive quantitative process but *should* take into account all the information that is reasonably available.

50.39. In developing a *discount rate*, it *may* be appropriate to consider the impact the *asset*'s unit of account has on unsystematic risks and the derivation of the overall *discount rate*. For example, the *valuer should* consider whether market *participant*s would assess the *discount rate* for the *asset* on a standalone basis, or whether market *participant*s would assess the *asset* in the context of a broader portfolio and therefore consider the potential diversification of unsystematic risks.

50.40. A *valuer should* consider the impact of intercompany arrangements and transfer pricing on the *discount rate*. For example, it is not uncommon for intercompany arrangements to specify fixed or guaranteed returns for some businesses or entities within a larger enterprise, which would lower the risk of the entity forecasted cash flows and reduce the appropriate *discount rate*. However other businesses or entities within the enterprise are deemed to be residual earners in which both excess return and risk are allocated, thereby increasing the risk of the entity forecasted cash flows and the appropriate *discount rate*.

60. Cost Approach

60.1. The cost approach provides an indication of *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, unless undue time, inconvenience, risk or other factors are involved. The approach provides an indication of *value* by calculating the current replacement or reproduction cost of an *asset* and making deductions for physical deterioration and all other relevant forms of obsolescence.

60.2. The cost approach *should* be applied and afforded *significant weight* under the following circumstances:

(a) *participants* would be able to recreate an *asset* with substantially the same utility as the subject *asset*, without regulatory or legal restrictions, and the *asset* could be recreated quickly enough that a

participant would not be willing to pay a *significant* premium for the ability to use the subject *asset* immediately,

(b) the *asset* is not directly income-generating and the unique nature of the *asset* makes using an income approach or market approach unfeasible, and/or

(c) the *basis of value* being used is fundamentally based on replacement cost, such as replacement value.

60.3. Although the circumstances in para 60.2 would indicate that the cost approach *should* be applied and afforded *significant weight*, the following are additional circumstances where the cost approach *may* be applied and afforded *significant weight*. When using the cost approach under the following circumstances, a *valuer should* consider whether any other approaches can be applied and *weighted* to corroborate the value indication from the cost approach:

(a) *participants* might consider recreating an *asset* of similar utility, but there are potential legal or regulatory hurdles or *significant* time involved in recreating the *asset*,

(b) when the cost approach is being used as a reasonableness check to other approaches (for example, using the cost approach to confirm whether a business valued as a going-concern might be more valuable on a liquidation basis), and/or

(c) the *asset* was recently created, such that there is a high degree of reliability in the assumptions used in the cost approach.

60.4. The *value* of a partially completed *asset* will generally reflect the *costs* incurred to date in the creation of the *asset* (and whether those *costs* contributed to *value*) and the expectations of *participants* regarding the *value* of the property when complete, but consider the *costs* and time required to complete the *asset* and appropriate adjustments for profit and risk.

70. Cost Approach Methods

70.1. Broadly, there are three cost approach methods:

(a) replacement cost method: a method that indicates *value* by calculating the *cost* of a similar *asset* offering equivalent utility,

(b) reproduction cost method: a method under the *cost* that indicates *value* by calculating the *cost* to recreating a replica of an *asset*, and

(c) summation method: a method that calculates the *value* of an *asset* by the addition of the separate *values* of its component parts.

Replacement Cost Method

70.2. Generally, replacement cost is the *cost* that is relevant to determining the *price* that a *participant* would pay as it is based on replicating the utility of the *asset*, not the exact physical properties of the *asset*.

70.3. Usually replacement cost is adjusted for physical deterioration and all relevant forms of obsolescence. After such adjustments, this can be referred to as depreciated replacement cost.

70.4. The key steps in the replacement cost method are:

(a) calculate all of the *costs* that would be incurred by a typical *participant* seeking to create or obtain an *asset* providing equivalent utility,

(b) determine whether there is any deprecation related to physical, functional and external obsolescence associated with the subject *asset*, and

(c) deduct total deprecation from the total *costs* to arrive at a *value* for the subject *asset*.

70.5. The replacement cost is generally that of a modern equivalent *asset*, which is one that provides similar function and equivalent utility to the *asset* being valued, but which is of a current design and constructed or made using current cost-effective materials and techniques.

Reproduction Cost Method

70.6. Reproduction cost is appropriate in circumstances such as the following:

(a) the *cost* of a modern equivalent *asset* is greater than the *cost* of recreating a replica of the subject *asset*, or

(b) the utility offered by the subject *asset* could only be provided by a replica rather than a modern equivalent.

70.7. The key steps in the reproduction cost method are:

(a) calculate all of the *costs* that would be incurred by a typical *participant* seeking to create an exact replica of the subject *asset*,

(b) determine whether there is any deprecation related to physical, functional and external obsolescence associated with the subject *asset*, and

(c) deduct total deprecation from the total *costs* to arrive at a *value* for the subject *asset*.

Summation Method

70.8. The summation method, also referred to as the underlying *asset* method, is typically used for investment companies or other types of *assets* or entities for which *value* is primarily a factor of the *values* of their holdings.

70.9. The key steps in the summation method are:

(a) value each of the component *assets* that are part of the subject *asset* using the appropriate valuation approaches and methods, and

(b) add the *value* of the component *assets* together to reach the *value* of the subject *asset*.

Cost Considerations

70.10. The cost approach *should* capture all of the *costs* that would be incurred by a typical *participant*.

70.11. The cost elements *may* differ depending on the type of the *asset* and *should* include the direct and indirect costs that would be required to replace/

recreate the *asset* as of the valuation date. Some common items to consider include:

(a) direct costs:

1. materials, and
2. labour.

(b) indirect costs:

1. transport costs,
2. installation costs,
3. professional fees (design, permit, architectural, legal, etc),
4. other fees (commissions, etc),
5. overheads,
6. taxes,
7. finance costs (eg, interest on debt financing), and
8. profit margin/entrepreneurial profit to the creator of the *asset* (eg, return to investors).

70.12. An *asset* acquired from a third party would presumably reflect their *costs* associated with creating the *asset* as well as some form of profit margin to provide a return on their investment. As such, under *bases of value* that assume a hypothetical transaction, it *may* be appropriate to include an assumed profit margin on certain *costs* which can be expressed as a target profit, either a lump sum or a percentage return on *cost* or *value*. However, financing costs, if included, *may* already reflect *participants*' required return on capital deployed, so *valuers should* be cautious when including both financing costs and profit margins.

70.13. When *costs* are derived from actual, quoted or estimated prices by third party suppliers or contractors, these *costs* will already include a third parties' desired level of profit.

70.14. The actual *costs* incurred in creating the subject *asset* (or a comparable reference *asset*) *may* be available and provide a relevant indicator of the *cost* of the *asset*. However, adjustments *may* need to be made to reflect the following:

(a) cost fluctuations between the date on which this *cost* was incurred and the valuation date, and

(b) any atypical or exceptional *costs*, or savings, that are reflected in the cost data but that would not arise in creating an equivalent.

80. Depreciation/Obsolescence

80.1. In the context of the cost approach, "depreciation" refers to adjustments made to the estimated *cost* of creating an *asset* of equal utility to reflect the impact on *value* of any obsolescence affecting the subject *asset*. This meaning is different from the use of the word in financial reporting or tax law where it generally refers to a method for systematically expensing capital expenditure over time.

80.2. Depreciation adjustments are normally considered for the following types of obsolescence, which *may* be further divided into subcategories when making adjustments:

(a) Physical obsolescence: Any loss of utility due to the physical deterioration of the *asset* or its components resulting from its age and usage.

(b) Functional obsolescence: Any loss of utility resulting from inefficiencies in the subject *asset* compared to its replacement such as its design, specification or technology being outdated.

(c) External or economic obsolescence: Any loss of utility caused by economic or locational factors external to the *asset*. This type of obsolescence can be temporary or permanent.

80.3. Depreciation/obsolescence *should* consider the physical and economic lives of the *asset*:

(a) The physical life is how long the *asset* could be used before it would be worn out or beyond economic repair, assuming routine maintenance but disregarding any potential for refurbishment or reconstruction.

(b) The economic life is how long it is anticipated that the *asset* could generate financial returns or provide a non-financial benefit in its current use. It will be influenced by the degree of functional or economic obsolescence to which the *asset* is exposed.

80.4. Except for some types of economic or external obsolescence, most types of obsolescence are measured by making comparisons between the subject *asset* and the hypothetical *asset* on which the estimated replacement or reproduction cost is based. However, when market evidence of the effect of obsolescence on *value* is available, that evidence *should* be considered.

80.5. Physical obsolescence can be measured in two different ways:

(a) curable physical obsolescence, ie, the *cost* to fix/cure the obsolescence, or

(b) incurable physical obsolescence which considers the *asset*'s age, expected total and remaining life where the adjustment for physical obsolescence is equivalent to the proportion of the expected total life consumed. Total expected life *may* be expressed in any reasonable way, including expected life in years, mileage, units produced, etc

80.6. There are two forms of functional obsolescence:

(a) excess capital cost, which can be caused by changes in design, materials of construction, technology or manufacturing techniques resulting in the availability of modern equivalent *assets* with lower capital costs than the subject *asset*, and

(b) excess operating cost, which can be caused by improvements in design or excess capacity resulting in the availability of modern equivalent *assets* with lower operating costs than the subject *asset*.

80.7. Economic obsolescence *may* arise when external factors affect an individual *asset* or all the *assets* employed in a business and *should* be deducted after physical deterioration and functional obsolescence. For real estate, examples of economic obsolescence include:

(a) adverse changes to demand for the products or services produced by the *asset*,

(b) oversupply in the market for the *asset*,

(c) a disruption or loss of a supply of labour or raw material, or

(d) the *asset* being used by a business that cannot afford to pay a market rent for the *assets* and still generate a market rate of return.

80.8. Cash or cash equivalents do not suffer obsolescence and are not adjusted. Marketable *assets* are not adjusted below their *market value* determined using the market approach.

90. Valuation Model

90.1. A valuation model refers collectively to the quantitative methods, systems, techniques and qualitative judgements used to estimate and document *value*.

90.2. When using or creating a valuation model, the *valuer* must:

(a) Keep appropriate records to support the selection or creation of the model,

(b) Understand and ensure the output of the valuation model, the significant assumptions and limiting conditions are consistent with the basis and scope of the *valuation*, and

(c) Consider the key risks associated with the assumptions made in the valuation model.

90.3. Regardless of the nature of the valuation model, to be IVS compliant, the *valuer* must ensure that the *valuation* complies with all other requirements contained within IVS.

Asset Standards

IVS 200 Businesses and Business Interests

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10. Overview

10.1. The principles contained in the General Standards apply to *valuation*s of businesses and business interests. This standard contains additional requirements that apply to *valuation*s of businesses and business interests.

20. Introduction

20.1. The definition of what constitutes a business *may* differ depending on the *purpose* of a *valuation*, but generally involves an organisation or integrated collection of *assets* engaged in commercial, industrial, service or investment activity. Generally, a business would include more than one *asset* (or a single *asset* in which the *value* is dependent on employing additional *assets*) working together to generate economic activity that differs from the outputs that would be generated by the individual *assets* on their own.

20.2. Individual intangible assets, or a group of intangible assets might not constitute a business but would nonetheless be within the scope of this standard if such *assets* generate economic activity that differs from the outputs that would be generated by the individual assets on their own. If the *assets* do not meet these criteria, a *valuer* should defer to IVS 210 *Intangible Assets* and IVS 220 *Non-Financial Liabilities*.

20.3. The commercial, industrial, service or investment activity of the business may result in greater economic activity (ie, *value*), than those *assets* would generate separately. The excess value is often referred to as going concern value or goodwill. This excess value may constitute a separate *asset* under certain *bases of value* in certain situations. The absence of excess value does not automatically mean that the *asset* or group of *assets* does not constitute a business. In addition, economically, substantially all of the *value* of *assets* within a business may reside in a single *asset*.

20.4. Businesses can take many legal forms, such as corporations, partnerships, joint ventures and sole proprietorships. However, businesses could take other forms such as a division, branch, line of business, segment, cash generating unit, and asset group that can consist of parts of one or more legal entities.

20.5. Interests in a business (eg, securities) can also take many forms. To determine the value of a business interest, a *valuer* should first determine the *value* of the underlying business by applying these standards. In such instances, business interests should be within the scope of this standard but depending on the nature of the interest certain other standards may be applicable.

20.6. *Valuers* must establish whether the *valuation* is of the entire entity, shares or a shareholding in the entity (whether a controlling or non-controlling interest), or a specific business activity of the entity. The type of *value* being provided must be appropriate to the *purpose* of the *valuation* and communicated as part of the scope of the engagement (see IVS 101 *Scope of Work*). It is especially critical to clearly define the business or business interest being valued as, even when a *valuation* is performed on an entire entity, there may be different levels at which that *value* could be expressed. For example:

(a) Enterprise value: Often described as the total value of the equity in a business plus the *value* of its debt or debt-related liabilities, minus any cash or cash equivalents available to meet those liabilities.

(b) Total invested capital value: The total amount of money currently invested in a business, regardless of the source, often reflected as the *value* of total assets less current liabilities and cash.

(c) Operating value: The total value of the operations of the business, excluding the value of any non-operating assets and liabilities.

(d) Equity value: The *value* of a business to all of its equity shareholders.

20.7. *Valuations* of businesses are required for different purposes including acquisitions, mergers and sales of businesses, taxation, litigation, insolvency proceedings and financial reporting. Business valuations may also be needed as an input or step in other *valuations* such as the *valuation* of stock options, particular class(es) of stock, or debt.

30. Bases of Value

30.1. In accordance with IVS 104 *Bases of Value*, a *valuer must* select the appropriate *basis(es) of value* when valuing a business or business interest.

30.2. Often, business valuations are performed using *bases of value* defined by entities/organisations other than the IVSC (some examples of which are

mentioned in IVS 104 *Bases of Value*) and it is the *valuer's* responsibility to understand and follow the regulation, case law and/or other interpretive guidance related to those *bases of value* as of the valuation date.

40. Valuation Approaches and Methods

40.1. The three principal valuation approaches described in IVS 105 *Valuation Approaches and Methods may* be applied to the *valuation* of businesses and business interests.

40.2. When selecting an approach and method, in addition to the requirements of this standard, a *valuer must* follow the requirements of IVS 105 *Valuation Approaches and Methods*, including para 10.3.

50. Market Approach

50.1. The market approach is frequently applied in the *valuation* of businesses and business interests as these *assets* often meet the criteria in IVS 105 *Valuation Approaches and Methods*, para 20.2 or 20.3. When valuing businesses and business interests under the Market Approach, *valuers should* follow the requirements of IVS 105 *Valuation Approaches and Methods*, sections 20 and 30.

50.2. The three most common sources of data used to value businesses and business interests using the market approach are:

(a) public stock markets in which ownership interests of similar businesses are traded,

(b) the acquisition market in which entire businesses or controlling interests in businesses are bought and sold, and

(c) prior transactions in shares or offers for the ownership of the subject business.

50.3. There *must* 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 that *should* be considered in assessing whether a reasonable basis for comparison exists include:

(a) similarity to the subject business in terms of qualitative and quantitative business characteristics,

(b) amount and verifiability of data on the similar business, and

(c) whether the *price* of the similar business represents an arm's length and orderly transaction.

50.4. When applying a market multiple, adjustments such as those in para 60.8 *may* be appropriate to both the subject company and the comparable companies.

50.5. *Valuers should* follow the requirements of IVS 105 *Valuation Approaches and Methods*, paras 30.7-30.8 when selecting and adjusting comparable transactions.

50.6. *Valuers should* follow the requirements of IVS 105 *Valuation Approaches and Methods*, paras 30.13-30.14 when selecting and adjusting comparable public company information.

60. Income Approach

60.1. The income approach is frequently applied in the *valuation* of businesses and business interests as these *assets* often meet the criteria in IVS 105 *Valuation Approaches and Methods*, paras 40.2 or 40.3.

60.2. When the income approach is applied, *valuers should* follow the requirements of IVS 105 *Valuation Approaches and Methods*, sections 40 and 50.

60.3. Income and cash flow related to a business or business interest can be measured in a variety of ways and *may* be on a pre-tax or post-tax basis. The capitalisation or *discount rate* applied *must* be consistent with the type of income or cash flow used.

60.4. The type of income or cash flow used *should* be consistent with the type of interest being valued. For example:

(a) enterprise value is typically derived using cash flows before debt servicing costs and an appropriate *discount rate* applicable to enterprise-level cash flows, such as a *weighted*-average cost of capital, and

(b) equity value *may* be derived using cash flows to equity, that is, after debt servicing costs and an appropriate *discount rate* applicable to equity-level cash flows, such as a *cost* of equity.

60.5. 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 *participants* for similar investments and the risk inherent in the anticipated benefit stream are considered (see IVS 105 *Valuation Approaches and Methods*, paras 50.29-50.31).

60.6. In methods that employ discounting, expected growth *may* be explicitly considered in the forecasted income or cash flow. In capitalisation methods, expected growth is normally reflected in the capitalisation rate. If a forecasted cash flow is expressed in nominal terms, a *discount rate* that takes into account the expectation of future price changes due to inflation or deflation *should* be used. If a forecasted cash flow is expressed in real terms, a *discount rate* that takes no account of expected price changes due to inflation or deflation *should* be used.

60.7. 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.

60.8. 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) adjusting revenues and expenses to levels that are reasonably representative of expected continuing operations,

(b) presenting financial data of the subject business and comparison businesses on a consistent basis,

(c) adjusting non-arm's length transactions (such as contracts with customers or suppliers) to market rates,

(d) adjusting the *cost* of labour or of items leased or otherwise contracted from related parties to reflect market prices or rates,

(e) reflecting 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, and

(f) adjusting the inventory accounting to compare with similar businesses, whose accounts *may* be kept on a different basis from the subject business, or to more accurately reflect economic reality.

60.9. When using an income approach it *may* also be necessary to make adjustments to the *valuation* to reflect matters that are not captured in either the cash flow forecasts or the *discount rate* adopted. Examples *may* include adjustments for the marketability of the interest being valued or whether the interest being valued is a controlling or non-controlling interest in the business. However, *valuers should* ensure that adjustments to the *valuation* do not reflect factors that were already reflected in the cash flows or *discount rate*. For example, whether the interest being valued is a controlling or non-controlling interest is often already reflected in the forecasted cash flows.

60.10. While many businesses *may* be valued using a single cash flow scenario, *valuers may* also apply multi-scenario or simulation models, particularly when there is *significant* uncertainty as to the amount and/or timing of future cash flows.

70. Cost Approach

70.1. The cost approach cannot normally be applied in the *valuation* of businesses and business interests as these *assets* seldom meet the criteria in IVS 105 *Valuation Approaches and Methods*, paras 70.2 or 70.3. However, the cost approach is sometimes applied in the *valuation* of businesses, particularly when:

(a) the business is an early stage or start-up business where profits and/or cash flow cannot be reliably determined and comparisons with other businesses under the market approach is impractical or unreliable,

(b) the business is an investment or holding business, in which case the summation method is as described in IVS 105 *Valuation Approaches and Methods*, paras 70.8-70.9, and/or

(c) the business does not represent a going concern and/or the *value* of its *assets* in a liquidation *may* exceed the business' *value* as a going concern.

70.2. In the circumstances where a business or business interest is valued using a cost approach, *valuers should* follow the requirements of IVS 105 *Valuation Approaches and Methods*, sections 70 and 80.

80. Special Considerations for Businesses and Business Interests

80.1. The following sections address a non-exhaustive list of topics relevant to the *valuation* of businesses and business interests:

(a) Ownership Rights (section 90).

(b) Business Information (section 100).

(c) Economic and Industry Considerations (section 110).

(d) Operating and Non-Operating Assets (section 120).

(e) Capital Structure Considerations (section 130).

90. Ownership Rights

90.1. 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 (collectively "corporate documents"). In some situations, it *may* also be necessary to distinguish between legal and beneficial ownership.

90.2. Corporate documents *may* contain restrictions on the transfer of the interest or other provisions relevant to *value*. For example, corporate 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 non-controlling interest. In each case, the rights of the interest being valued and the rights attaching to any other class of interest need to be considered at the outset.

90.3. Care *should* be taken to distinguish between rights and obligations inherent to the interest and those that *may* be applicable only to a particular shareholder (ie, those contained in an agreement between current shareholders which *may* not apply to a potential buyer of the ownership interest). Depending on the *basis(es) of value* used, the *valuer may* be required to consider only the rights and obligations inherent to the subject interest or both those rights and considerations inherent to the subject interest and those that apply to a particular owner.

90.4. All the rights and preferences associated with a subject business or business interest *should* be considered in a *valuation*, including:

(a) if there are multiple classes of stock, the *valuation should* consider the rights of each different class, including, but not limited to:

1. liquidation preferences,

2. voting rights,

3. redemption, conversion and participation provisions, and

4. put and/or call rights.

(b) When a controlling interest in a business *may* have a higher *value* than a non-controlling interest. Control premiums or discounts for lack of control *may* be appropriate depending on the valuation method(s) applied (see IVS 105 *Valuation Approaches and Methods*, para 30.17.(b)). In respect of actual premiums paid in completed transactions, the *valuer should* consider whether the synergies and other factors that caused the acquirer to pay those premiums are applicable to the subject *asset* to a comparable degree.

100. Business Information

100.1. The *valuation* of a business entity or interest frequently requires reliance upon information received from management, representatives of the management or other experts. As required by IVS 105 *Valuation Approaches and Methods*, para 10.7, a *valuer must* assess the reasonableness of information received from management, representatives of management or other experts and evaluate whether it is appropriate to rely on that information for the valuation *purpose*. For example, prospective financial information provided by management *may* reflect owner-specific synergies that *may* not be appropriate when using a *basis of value* that requires a *participant* perspective.

100.2. 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. *Valuers should* therefore consider the business' historical financial statements as part of a valuation engagement. To the extent the future performance of the business is expected to deviate *significantly* from historical experience, a *valuer must* understand why historical performance is not representative of the future expectations of the business.

110. Economic and Industry Considerations

110.1. Awareness of relevant economic developments and specific industry trends is essential for all *valuation*s. Matters such as political outlook, government policy, exchange rates, inflation, interest rates and market activity *may* affect *assets* in different locations and/or sectors of the economy quite differently. These factors can be particularly important in the *valuation* of businesses and business interests, as businesses *may* have complex structures involving multiple locations and types of operations. For example, a business *may* be impacted by economic and industry factors specific related to:

(a) the registered location of the business headquarters and legal form of the business,

(b) the nature of the business operations and where each aspect of the business is conducted (ie, manufacturing *may* be done in a different location to where research and development is conducted),

(c) where the business sells its goods and/or services,

(d) the currency(ies) the business uses,

(e) where the suppliers of the business are located, and

(f) what tax and legal *jurisdictions* the business is subject to.

120. Operating and Non-Operating Assets

120.1. 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 operations of the business and which ones are redundant or "excess" to the business at the valuation date.

120.2. Most valuation methods do not capture the *value* of *assets* that are not required for the operation of the business. For example, a business valued using a multiple of EBITDA would only capture the *value* the *assets* utilised in generating that level of EBITDA. If the business had non-operating *assets* or liabilities such as an idle manufacturing plant, the *value* of that non-operating plant would not be captured in the *value*. Depending on the level of *value* appropriate for the valuation engagement (see para 20.3), the *value* of non-operating *assets may* need to be separately determined and added to the operating value of the business.

120.3. Businesses *may* have unrecorded *assets* and/or liabilities that are not reflected on the balance sheet. Such *assets* could include intangible *assets*, machinery and equipment that is fully depreciated and legal liabilities/lawsuits.

120.4. When separately considering non-operating *assets* and liabilities, a *valuer should* ensure that the income and expenses associated with non-operating *assets* are excluded from the cash flow measurements and projections used in the *valuation*. For example, if a business has a *significant* liability associated with an underfunded pension and that liability is valued separately, the cash flows used in the *valuation* of the business *should* exclude any "catch-up" payments related to that liability.

120.5. If the *valuation* considers information from publicly-traded businesses, the publicly-traded stock prices implicitly include the *value* of non-operating *assets*, if any. As such, *valuers must* consider adjusting information from publicly-traded businesses to exclude the *value*, income and expenses associated with non-operating *assets*.

130. Capital Structure Considerations

130.1. Businesses are often financed through a combination of debt and equity. However, in many cases, *valuers* could be asked to value only equity, particular class of equity, or some other form of ownership interest. While equity or a particular class of equity can occasionally be valued directly, more often the enterprise value of the business is determined and then that *value* is allocated between the various classes of debt and equity.

130.2. While there are many ownership interests in an *asset* which a *valuer* could be asked to value, a non-exhaustive list of such interests includes:

(a) bonds,

(b) convertible debt,

(c) partnership interest,

(d) minority interest,

(e) common equity,

(f) preferred equity,

(g) options,

(h) warrants.

130.3. When a *valuer* is asked to value only equity, or determine how the business value as a whole is distributed among the various debt and equity classes, a *valuer must* determine and consider the different rights and preferences associated with each class of debt and equity. Rights and preferences can broadly be categorised as economic rights or control rights.

A non-exhaustive list of such rights and preferences *may* include:

(a) dividend or preferred dividend rights,

(b) liquidation preferences,

(c) voting rights,

(d) redemption rights,

(e) conversion rights,

(f) participation rights,

(g) anti-dilution rights

(h) registration rights, and

(i) put and/or call rights.

130.4. For simple capital structures that include only common stock and simple debt structures (such as bonds, loans and overdrafts), it *may* be possible to estimate the *value* of all of the common stock within the enterprise by directly estimating the *value* of debt, subtracting that *value* from the enterprise value, then allocating the residual equity value pro rata to all of the common stock. This method is not appropriate for all companies with simple capital structures, for example it *may* not be appropriate for distressed or highly leveraged companies.

130.5. For complex capital structures, being those that include a form of equity other than just common stock, *valuers may* use any reasonable method to determine the *value* of equity or a particular class of equity. In such cases, typically the enterprise value of the business is determined and then that *value* is allocated between the various classes of debt and equity. Three methods that *valuers* could utilise in such instances are discussed in this section, including:

(a) current value method (CVM);

(b) option pricing method (OPM); and

(c) probability-*weighted* expected return method (PWERM).

130.6. While the CVM is not forward looking, both the OPM and PWERM estimate *values* assuming various future outcomes. The PWERM relies on discrete assumptions for future events and the OPM estimates the future distribution of outcomes using a lognormal distribution around the current value.

130.7. A *valuer should* consider any potential differences between a “pre-money” and “post-money” valuation, particularly for early stage companies with complex capital structures. For example, an infusion of cash (ie, “post-money valuation”) for such companies *may* impact the overall risk profile of the enterprise as well as the relative value allocation between share classes.

130.8. A *valuer should* consider recent transactions in the subject equity or a particular class of equity, and ensure the assumptions used in the subject *valuation* are updated as necessary to reflect changes in the investment structure and changes in market conditions.

Current Value Method (CVM)

130.9. The current value method (CVM) allocates the enterprise value to the various debt and equity securities assuming an immediate sale of the enterprise. Under the CVM, the obligations to debt holders, or debt equivalent securities, is first deducted from the enterprise value to calculate residual equity value (*valuers should* consider if the enterprise value includes or excludes cash, and the resulting use of gross or net debt for allocation *purpose*s). Next, *value* is allocated to the various series of preferred stock based on the series’ liquidation preferences or conversion values, whichever would be greater. Finally, any residual value is allocated to any common equity, options, and warrants.

130.10. A limitation of the CVM is that it is not forward looking and fails to consider the option-like payoffs of many share classes.

130.11. The CVM *should* only be used when 1) a liquidity event of the enterprise is imminent, 2) when an enterprise is at such an early stage of its development that no significant common equity value above the liquidation preference on any preferred equity has been created, 3) no material progress has been made on the company’s business plan, or 4) no reasonable basis exists for estimating the amount and timing of any such *value* above the liquidation preference that might be created in the future.

130.12. *Valuers should* not assume that the *value* of debt, or debt-like securities, and its book value are equal without rationale for the determination.

Option Pricing Method (OPM)

130.13. The OPM values the different share classes by treating each share class as an option on the cash flows from the enterprise. The OPM is often applied to capital structures in which the payout to different share classes changes at different levels of total equity value, for instance, where there are convertible preferred shares, management incentive units, options, or other classes of shares that have certain liquidation preferences. The OPM *may* be performed on the enterprise value, thereby including any debt in the OPM, or on an equity basis after separate consideration of the debt.

130.14. The OPM considers the various terms of the stockholder agreements that would affect the distributions to each class of equity upon a liquidity event, including the level of seniority among the securities, dividend policy, conversion ratios, and cash allocations.

130.15. The starting point for the OPM is the *value* of total equity for the *asset*. The OPM is then applied to allocate the total equity value among equity securities.

130.16. The OPM (or a related hybrid method) is suited to circumstances where specific future liquidity events are difficult to forecast or the company is in an early stage of development.

130.17 The OPM most frequently relies on the Black–Scholes option pricing model to determine the *value* associated with distributions above certain value thresholds.

130.18. When applying the OPM, a non-exhaustive list of the steps *valuers should* perform includes:

(a) Determine the total equity value of the *asset*,

(b) Identify the liquidation preferences, preferred dividend accruals, conversion prices, and other features attached to the relevant securities that influences the cash distribution,

(c) Determine the different total equity value points (breakpoints) in which the liquidation preferences and conversion prices become effective,

(d) Determine the inputs to the Black–Scholes model:

1) determine a reasonable time horizon for the OPM,

2) select a risk-free rate corresponding to the time horizon,

3) determine the appropriate volatility factor for the equity of the *asset*, and,

4) determine the expected dividend yield.

(e) Calculate a *value* for the various call options and determine the *value* allocated to each interval between the breakpoints,

(f) Determine the relative allocation to each class of shares in each interval between the calculated breakpoints,

(g) Allocate the *value* between the breakpoints (calculated as the call options) among the share classes based on the allocation determined in step (f) and the *value* determined in step (e),

(h) Consider additional adjustments to the share classes as necessary, consistent with the *basis of value*. For example, it *may* be appropriate to apply discounts or premiums.

130.19. When determining the appropriate volatility assumption *valuers should* consider:

1) the development stage of the *asset* and the relative impact to the volatility when compared to that observed by the comparable companies, and,

2) the relative financial leverage of the *asset*.

130.20. In addition to the method as discussed above, the OPM can be used to back solve for the *value* of total equity value when there is a known price for an individual security. The inputs to a back solve analysis are the same as above. *Valuers* will then solve for the *price* of the known security by changing the *value* of total equity. The back solve method will also provide a *value* for all other equity securities.

Probability-Weighted Expected Return Method (PWERM)

130.21. Under a PWERM, the *value* of the various equity securities are estimated based upon an analysis of future *values* for the *asset*, assuming various future outcomes. Share value is based upon the probability-*weighted* present value of expected future investment returns, considering each of the possible future outcomes available to the *asset*, as well as the rights and preferences of the share classes.

130.22. Typically, the PWERM is used when the company is close to exit and does not plan on raising additional capital.

130.23. When applying the PWERM, a non-exhaustive list of the steps *valuers should* perform includes:

(a) Determine the possible future outcomes available to the *asset*,

(b) Estimate the future value of the *asset* under each outcome,

(c) Allocate the estimated future value of the *asset* to each class of debt and equity under each possible outcome,

(d) Discount the expected value allocated to each class of debt and equity to present value using a risk-adjusted *discount rate*,

(e) *Weight* each possible outcome by its respective probability to estimate the expected future probability-*weighted* cash flows to each class of debt and equity,

(f) Consider additional adjustments to the share classes as necessary, consistent with the *basis of value*. For example, it *may* be appropriate to apply discounts or premiums.

130.24. *Valuers should* reconcile the probability-weighted present values of the future exit values to the overall *asset* value to make sure that the overall *valuation* of the enterprise is reasonable.

130.25. *Valuers* can combine elements of the OPM with the PWERM to create a hybrid methodology by using the OPM to estimate the allocation of *value* within one or more of the probability-*weighted* scenarios.

IVS 210 Intangible Assets

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10. Overview

10.1. The principles contained in the General Standards apply to *valuation*s of intangible assets and *valuations* with an intangible assets component. This standard contains additional requirements that apply to *valuations* of intangible assets.

20. Introduction

20.1. An intangible *asset* is a non-monetary *asset* that manifests itself by its economic properties. It does not have physical substance but grants rights and/or economic benefits to its owner.

20.2. 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.

20.3. There are many types of intangible assets, but they are often considered to fall into one or more of the following categories (or goodwill):

(a) Marketing-related: Marketing-related intangible assets are used primarily in the marketing or promotion of products or services. Examples include trademarks, trade names, unique trade design and internet domain names.

(b) Customer-related: Customer-related intangible assets include customer lists, backlog, customer contracts, and contractual and non-contractual customer relationships.

(c) Artistic-related: Artistic-related intangible assets arise from the right to benefits from artistic works such as plays, books, films and music, and from non-contractual copyright protection.

(d) Contract-related: Contract-related intangible assets represent the *value* of rights that arise from contractual agreements. Examples include licensing and royalty agreements, service or supply contracts, lease

agreements, permits, broadcast rights, servicing contracts, employment contracts and non-competition agreements and natural resource rights.

(e) Technology-based: Technology-related intangible assets arise from contractual or non-contractual rights to use patented technology, unpatented technology, databases, formulae, designs, software, processes or recipes.

20.4. 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*. In addition, certain intangible assets, such as brands, *may* represent a combination of categories in para 20.3.

20.5. Particularly in valuing an intangible *asset*, *valuers must* understand specifically what needs to be valued and the *purpose* of the *valuation*. For example, customer data (names, addresses, etc) typically has a very different value from customer contracts (those contracts in place on the valuation date) and customer relationships (the *value* of the ongoing customer relationship including existing and future contracts). What intangible assets need to be valued and how those intangible assets are defined *may* differ depending on the *purpose* of the *valuation*, and the differences in how intangible assets are defined can lead to *significant* differences in *value*.

20.6. Generally, goodwill is any future economic benefit arising from a business, an interest in a business or from the use of a group of *assets* which has not been separately recognised in another *asset*. The *value* of goodwill is typically measured as 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. It is often represented as the excess of the price paid in a real or hypothetical acquisition of a company over the *value* of the company's other identified *assets* and liabilities. For some *purposes*, goodwill *may* need to be further divided into transferable goodwill (that which can be transferred to third parties) and non-transferable or "personal" goodwill.

20.7. As the amount of goodwill is dependent on which other tangible and intangible assets are recognised, its *value* can be different when calculated for different *purposes*. For example, in a business combination accounted for under IFRS or US GAAP, an intangible *asset* is only recognised to the extent that it:

(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.

20.8. While the aspects of goodwill can vary depending on the *purpose* of the *valuation*, goodwill frequently includes elements such as:

(a) company-specific synergies arising from a combination of two or more businesses (eg, reductions in operating costs, economies of scale or product mix dynamics),

(b) opportunities to expand the business into new and different markets,

(c) the benefit of an assembled workforce (but generally not any intellectual property developed by members of that workforce),

(d) the benefit to be derived from future *assets*, such as new customers and future technologies, and

(e) assemblage and going concern value.

20.9. *Valuers may* perform direct *valuation*s of intangible assets where the *value* of the intangible assets is the *purpose* of the analysis or one part of the analysis. However, when *valuing* businesses, business interests, real property, and machinery and equipment, *valuers should* consider whether there are intangible assets associated with those *assets* and whether those directly or indirectly impact the *asset* being valued. For example, when *valuing* a hotel based on an income approach, the contribution to *value* of the hotel's brand *may* already be reflected in the profit generated by the hotel.

20.10. Intangible *asset* valuations are performed for a variety of *purposes*. It is the *valuer's* responsibility to understand the *purpose* of a *valuation* and whether intangible assets *should* be valued, whether separately or grouped with other *assets*. A non-exhaustive list of examples of circumstances that commonly include an intangible *asset* valuation component is provided below:

(a) For financial reporting *purposes*, *valuations* of intangible assets are often required in connection with accounting for business combinations, *asset* acquisitions and sales, and impairment analysis.

(b) For tax reporting *purposes*, intangible *asset* valuations are frequently needed for transfer pricing analyses, estate and gift tax planning and reporting, and ad valorem taxation analyses.

(c) Intangible assets *may* be the subject of litigation, requiring valuation analysis in circumstances such as shareholder disputes, damage calculations and marital dissolutions (divorce).

(d) Other statutory or legal events *may* require the *valuation* of intangible *assets* such as compulsory purchases/eminent domain proceedings.

(e) *Valuers* are often asked to value intangible assets as part of general consulting, collateral lending and transactional support engagements.

30. Bases of Value

30.1. In accordance with IVS 104 *Bases of Value*, a *valuer must* select the appropriate *basis(es) of value* when valuing intangible assets.

30.2. Often, intangible asset valuations are performed using *bases of value* defined by entities/organisations other than the IVSC (some examples of which are mentioned in IVS 104 *Bases of Value*) and the *valuer must*

understand and follow the regulation, case law, and other interpretive guidance related to those *bases of value* as of the valuation date.

40. Valuation Approaches and Methods

40.1. The three valuation approaches described in IVS 105 *Valuation Approaches* can all be applied to the *valuation* of intangible assets.

40.2. When selecting an approach and method, in addition to the requirements of this standard, a *valuer must* follow the requirements of IVS 105 *Valuation Approaches*, including para 10.3.

50. Market Approach

50.1. Under the market approach, the *value* of an intangible *asset* is determined by reference to market activity (for example, transactions involving identical or similar *assets*).

50.2. Transactions involving intangible assets frequently also include other *assets*, such as a business combination that includes intangible assets.

50.3. *Valuers must* comply with paras 20.2 and 20.3 of IVS 105 when determining whether to apply the market approach to the *valuation* of intangible assets. In addition, *valuers should* only apply the market approach to value intangible assets if both of the following criteria are met:

(a) information is available on arm's length transactions involving identical or similar intangible assets on or near the valuation date, and

(b) sufficient information is available to allow the *valuer* to adjust for all *significant* differences between the subject intangible *asset* and those involved in the transactions.

50.4. The heterogeneous nature of intangible assets and the fact that intangible assets seldom transact separately from other *assets* means that it is rarely possible to find market evidence of transactions involving identical *assets*. If there is market evidence at all, it is usually in respect of *assets* that are similar, but not identical.

50.5. Where evidence of either *prices* or valuation multiples is available, *valuers should* make adjustments to these to reflect differences between the subject *asset* and those involved in the transactions. 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. However, the need for *significant* qualitative adjustments *may* indicate that another approach would be more appropriate for the *valuation*.

50.6. Consistent with the above, examples of intangible assets for which the market approach is sometimes used include:

(a) broadcast spectrum,

(b) internet domain names, and

(c) taxi medallions.

50.7. The guideline transactions method is generally the only market approach method that can be applied to intangible assets.

50.8. In rare circumstances, a security sufficiently similar to a subject intangible *asset may* be publicly traded, allowing the use of the guideline public company method. One example of such securities is contingent value rights (CVRs) that are tied to the performance of a particular product or technology.

60. Income Approach

60.1. 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 attributable to the intangible *asset* over its economic life.

60.2. *Valuers must* comply with paras 40.2 and 40.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the income approach to the *valuation* of intangible assets.

60.3. Income related to intangible assets is frequently included in the price paid for goods or a service. It *may* be challenging to separate the income related to the intangible *asset* from income related to other tangible and intangible assets. Many of the income approach methods are designed to separate the economic benefits associated with a subject intangible *asset*.

60.4. The income approach is the most common method applied to the *valuation* of intangible assets and is frequently used to value intangible assets including the following:

(a) technology,

(b) customer-related intangibles (eg, backlog, contracts, relationships),

(c) tradenames/trademarks/brands,

(d) operating licenses (eg, franchise agreements, gaming licenses, broadcast spectrum), and

(e) non-competition agreements.

Income Approach Methods

60.5. There are many income approach methods. The following methods are discussed in this standard in more detail:

(a) excess earnings method,

(b) relief-from-royalty method,

(c) premium profit method or with-and-without method,

(d) greenfield method, and

(e) distributor method.

Excess Earnings Method

60.6. The excess earnings method estimates the *value* of an intangible *asset* as the present value of the cash flows attributable to the subject intangible

asset after excluding the proportion of the cash flows that are attributable to other *assets* required to generate the cash flows ("contributory *assets*"). It is often used for *valuation*s where there is a requirement for the acquirer to allocate the overall price paid for a business between tangible *assets*, identifiable intangible assets and goodwill.

60.7. Contributory *assets* are *assets* that are used in conjunction with the subject intangible *asset* in the realisation of prospective cash flows associated with the subject intangible *asset*. *Assets* that do not contribute to the prospective cash flows associated with the subject intangible *asset* are not contributory *assets*.

60.8. The excess earnings method can be applied using several periods of forecasted cash flows ("multi-period excess earnings method" or "MPEEM"), a single period of forecasted cash flows ("single-period excess earnings method") or by capitalising a single period of forecasted cash flows ("capitalised excess earnings method" or the "formula method").

60.9. The capitalised excess earnings method or formula method is generally only appropriate if the intangible *asset* is operating in a steady state with stable growth/decay rates, constant profit margins and consistent contributory *asset* levels/charges.

60.10. As most intangible assets have economic lives exceeding one period, frequently follow non-linear growth/decay patterns and *may* require different levels of contributory *assets* over time, the MPEEM is the most commonly used excess earnings method as it offers the most flexibility and allows *valuers* to explicitly forecast changes in such inputs.

60.11. Whether applied in a single-period, multi-period or capitalised manner, the key steps in applying an excess earnings method are to:

(a) forecast the amount and timing of future revenues driven by the subject intangible *asset* and related contributory *assets*,

(b) forecast the amount and timing of expenses that are required to generate the revenue from the subject intangible *asset* and related contributory *assets*,

(c) adjust the expenses to exclude those related to creation of new intangible assets that are not required to generate the forecasted revenue and expenses. Profit margins in the excess earnings method *may* be higher than profit margins for the overall business because the excess earnings method excludes investment in certain new intangible *assets*. For example:

1. research and development expenditures related to development of new technology would not be required when *valuing* only existing technology, and

2. marketing expenses related to obtaining new customers would not be required when valuing existing customer-related intangible assets.

(d) identify the contributory *assets* that are needed to achieve the forecasted revenue and expenses. Contributory *assets* often include working capital, fixed *assets*, assembled workforce and identified intangible *assets* other than the subject intangible *asset*,

(e) determine the appropriate rate of return on each contributory *asset* based on an assessment of the risk associated with that *asset*. For example, low-risk *assets* like working capital will typically have a relatively lower required return. Contributory intangible assets and highly specialised machinery and equipment often require relatively higher rates of return,

(f) in each forecast period, deduct the required returns on contributory *assets* from the forecast profit to arrive at the excess earnings attributable to only the subject intangible *asset*,

(g) determine the appropriate *discount rate* for the subject intangible *asset* and present value or capitalise the excess earnings, and

(h) if appropriate for the *purpose* of the *valuation* (see paras 110.1-110.4), calculate and add the tax amortisation benefit (TAB) for the subject intangible *asset*.

60.12. Contributory asset charges (CACs) *should* be made for all the current and future tangible, intangible and financial *assets* that contribute to the generation of the cash flow, and if an *asset* for which a CAC is required is involved in more than one line of business, its CAC *should* be allocated to the different lines of business involved.

60.13. The determination of whether a CAC for elements of goodwill is appropriate *should* be based on an assessment of the relevant facts and circumstances of the situation, and the *valuer should* not mechanically apply CACs or alternative adjustments for elements of goodwill if the circumstances do not warrant such a charge. Assembled workforce, as it is quantifiable, is typically the only element of goodwill for which a CAC *should* be taken. Accordingly, *valuers must* ensure they have a strong basis for applying CACs for any elements of goodwill other than assembled workforce.

60.14. CACs are generally computed on an after-tax basis as a fair return on the *value* of the contributory *asset*, and in some cases a return of the contributory *asset* is also deducted. The appropriate return on a contributory *asset* is the investment return a typical *participant* would require on the *asset*. The return of a contributory *asset* is a recovery of the initial investment in the *asset*. There *should* be no difference in *value* regardless of whether CACs are computed on a pre-tax or after-tax basis.

60.15. If the contributory *asset* is not wasting in nature, like working capital, only a fair return on the *asset* is required.

60.16. For contributory intangible assets that were valued under a relief-from-royalty method, the CAC *should* be equal to the royalty (generally adjusted to an after-tax royalty rate).

60.17. The excess earnings method *should* be applied only to a single intangible *asset* for any given stream of revenue and income (generally the primary or most important intangible *asset*). For example, in valuing the intangible assets of a company utilising both technology and a tradename in delivering a product or service (ie, the revenue associated with the technology and the tradename is the same), the excess earnings method *should* only be used to value one of the intangible assets and an alternative method *should* be used

for the other *asset*. However, if the company had multiple product lines, each using a different technology and each generating distinct revenue and profit, the excess earnings method *may* be applied in the *valuation* of the multiple different technologies.

Relief-from-Royalty Method

60.18. 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. Conceptually, the method *may* also be viewed as a discounted cash flow method applied to the cash flow that the owner of the intangible *asset* could receive through licensing the intangible *asset* to third parties.

60.19. The key steps in applying a relief-from-royalty method are to:

(a) develop projections associated with the intangible *asset* being valued for the life of the subject intangible asset. The most common metric projected is revenue, as most royalties are paid as a percentage of revenue. However, other metrics such as a per-unit royalty *may* be appropriate in certain *valuation*s,

(b) develop a royalty rate for the subject intangible asset. Two methods can be used to derive a hypothetical royalty rate. The first is based on market royalty rates for comparable or similar transactions. A prerequisite for this method is the existence of comparable intangible assets that are licensed at arm's length on a regular basis. The second method is based on a split of profits 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,

(c) apply the selected royalty rate to the projections to calculate the royalty payments avoided by owning the intangible asset,

(d) estimate any additional expenses for which a licensee of the subject *asset* would be responsible. This can include upfront payments required by some licensors. A royalty rate *should* be analysed to determine whether it assumes expenses (such as maintenance, marketing and advertising) are the responsibility of the licensor or the licensee. A royalty rate that is "gross" would consider all responsibilities and expenses associated with ownership of a licensed *asset* to reside with the licensor, while a royalty that is "net" would consider some or all responsibilities and expenses associated with the licensed *asset* to reside with the licensee. Depending on whether the royalty is "gross" or "net", the *valuation should* exclude or include, respectively, a deduction for expenses such as maintenance, marketing or advertising expenses related to the hypothetically licensed asset,

(e) if the hypothetical *costs* and royalty payments would be tax deductible, it *may* be appropriate to apply the appropriate tax rate to determine the after-tax savings associated with ownership of the intangible *asset*. However, for certain *purposes* (such as transfer pricing), the effects of taxes are generally not considered in the *valuation* and this step *should* be skipped,

(f) determine the appropriate *discount rate* for the subject intangible *asset* and present value or capitalise the savings associated with ownership of the intangible asset, and

(g) if appropriate for the *purpose* of the *valuation* (see paras 110.1-110.4), calculate and add the TAB for the subject intangible asset.

60.20. Whether a royalty rate is based on market transactions or a profit split method (or both), its selection *should* consider the characteristics of the subject intangible asset and the environment in which it is utilised. The consideration of those characteristics form the basis for selection of a royalty rate within a range of observed transactions and/or the range of profit available to the subject intangible asset in a profit split. Factors that *should* be considered include the following:

(a) Competitive environment: The size of the market for the intangible *asset*, the availability of realistic alternatives, the number of competitors, barriers to entry and presence (or absence) of switching *costs*.

(b) Importance of the subject intangible to the owner: Whether the subject *asset* is a key factor of differentiation from competitors, the importance it plays in the owner's marketing strategy, its relative importance compared with other tangible and intangible assets, and the amount the owner spends on creation, upkeep and improvement of the subject *asset*.

(c) Life cycle of the subject intangible: The expected economic life of the subject *asset* and any risks of the subject intangible becoming obsolete.

60.21. When selecting a royalty rate, a *valuer should* also consider the following:

(a) When entering a licence arrangement, the royalty rate *participants* would be willing to pay depends on their profit levels and the relative contribution of the licensed intangible asset to that profit. For example, a manufacturer of consumer products would not license a tradename at a royalty rate that leads to the manufacturer realising a lower profit selling branded products compared with selling generic products.

(b) When considering observed royalty transactions, a *valuer should* understand the specific rights transferred to the licensee and any limitations. For example, royalty agreements *may* include *significant* restrictions on the use of a licensed intangible asset such as a restriction to a particular geographic area or for a product. In addition, the *valuer should* understand how the payments under the licensing agreement are structured, including whether there are upfront payments, milestone payments, puts/calls to acquire the licensed property outright, etc.

With-and-Without Method

60.22. The with-and-without method indicates the *value* of an intangible asset by comparing two scenarios: one in which the business uses the subject intangible asset and one in which the business does not use the subject intangible asset (but all other factors are kept constant).

60.23. The comparison of the two scenarios can be done in two ways:

(a) calculating the *value* of the business under each scenario with the

difference in the business values being the *value* of the subject intangible asset, and

(b) calculating, for each future period, the difference between the profits in the two scenarios. The present value of those amounts is then used to reach the *value* of the subject intangible asset.

60.24. In theory, either method *should* reach a similar *value* for the intangible *asset* provided the *valuer* considers not only the impact on the entity's profit, but additional factors such as differences between the two scenarios in working capital needs and capital expenditures.

60.25. The with-and-without method is frequently used in the *valuation* of non-competition agreements but *may* be appropriate in the *valuation* of other intangible assets in certain circumstances.

60.26. The key steps in applying the with-and-without method are to:

(a) prepare projections of revenue, expenses, capital expenditures and working capital needs for the business assuming the use of all of the *assets* of the business including the subject intangible asset. These are the cash flows in the "with" scenario,

(b) use an appropriate *discount rate* to present value the future cash flows in the "with" scenario, and/or calculate the *value* of the business in the "with" scenario,

(c) prepare projections of revenue, expenses, capital expenditures and working capital needs for the business assuming the use of all of the *assets* of the business except the subject intangible asset. These are the cash flows in the "without" scenario,

(d) use an appropriate *discount rate* for the business, present value the future cash flows in the "with" scenario and/or calculate the *value* of the business in the "with" scenario,

(e) deduct the present value of cash flows or the *value* of the business in the "without" scenario from the present value of cash flows or *value* of the business in the "with" scenario, and

(f) if appropriate for the *purpose* of the *valuation* (see paras 110.1-110.4), calculate and add the TAB for the subject intangible asset.

60.27. As an additional step, the difference between the two scenarios *may* need to be probability-*weighted*. For example, when *valuing* a non-competition agreement, the individual or business subject to the agreement *may* choose not to compete, even if the agreement were not in place.

60.28. The differences in *value* between the two scenarios *should* be reflected solely in the cash flow projections rather than by using different *discount rates* in the two scenarios.

Greenfield Method

60.29. Under the greenfield method, the *value* of the subject intangible is determined using cash flow projections that assume the only *asset* of the business at the valuation date is the subject intangible. All other tangible and intangible assets *must* be bought, built or rented.

60.30. The greenfield method is conceptually similar to the excess earnings method. However, instead of subtracting contributory *asset* charges from the cash flow to reflect the contribution of contributory *assets*, the greenfield method assumes that the owner of the subject *asset* would have to build, buy or rent the contributory *assets*. When building or buying the contributory *assets*, the *cost* of a replacement *asset* of equivalent utility is used rather than a reproduction cost.

60.31. The greenfield method is often used to estimate the *value* of ”enabling” intangible assets such as franchise agreements and broadcast spectrum.

60.32. The key steps in applying the greenfield method are to:

(a) prepare projections of revenue, expenses, capital expenditures and working capital needs for the business assuming the subject intangible *asset* is the only *asset* owned by the subject business at the valuation date, including the time period needed to “ramp up” to stabilised levels,

(b) estimate the timing and amount of expenditures related to the acquisition, creation or rental of all other *assets* needed to operate the subject business,

(c) using an appropriate *discount rate* for the business, present value the future cash flows to determine the *value* of the subject business with only the subject intangible in place, and

(d) if appropriate for the *purpose* of the *valuation* (see paras 110.1-110.4), calculate and add the TAB for the subject intangible *asset*.

Distributor Method

60.33. The distributor method, sometimes referred to as the disaggregated method, is a variation of the multi-period excess earnings method sometimes used to value customer-related intangible assets. The underlying theory of the distributor method is that businesses that are comprised of various functions are expected to generate profits associated with each function. As distributors generally only perform functions related to distribution of products to customers rather than development of intellectual property or manufacturing, information on profit margins earned by distributors is used to estimate the excess earnings attributable to customer-related intangible assets.

60.34. The distributor method is appropriate to value customer-related intangible assets when another intangible *asset* (for example, technology or a brand) is deemed to be the primary or most *significant* intangible *asset* and is valued under a multi-period excess earnings method.

60.35. The key steps in applying the distributor method are to:

(a) prepare projections of revenue associated with existing customer relationships. This *should* reflect expected growth in revenue from existing customers as well as the effects of customer attrition,

(b) identify comparable distributors that have customer relationships similar to the subject business and calculate the profit margins achieved by those distributors,

(c) apply the distributor profit margin to the projected revenue,

(d) identify the contributory *assets* related to performing a distribution function that are needed to achieve the forecast revenue and expenses. Generally distributor contributory *assets* include working capital, fixed *assets* and workforce. However, distributors seldom require other *assets* such as trademarks or technology. The level of required contributory *assets should* also be consistent with *participants* performing only a distribution function,

(e) determine the appropriate rate of return on each contributory *asset* based on an assessment of the risk associated with that *asset*,

(f) in each forecast period, deduct the required returns on contributory *assets* from the forecast distributor profit to arrive at the excess earnings attributable to only the subject intangible *asset*,

(g) determine the appropriate *discount rate* for the subject intangible *asset* and present value the excess earnings, and

(h) if appropriate for the *purpose* of the *valuation* (see paras 110.1-110.4), calculate and add the TAB for the subject intangible *asset*.

70. Cost Approach

70.1. Under the cost approach, the *value* of an intangible *asset* is determined based on the replacement cost of a similar *asset* or an *asset* providing similar service potential or utility.

70.2. *Valuers must* comply with paras 60.2 and 60.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the cost approach to the *valuation* of intangible assets.

70.3. Consistent with these criteria, the cost approach is commonly used for intangible assets such as the following:

(a) acquired third-party software,

(b) internally-developed and internally-used, non-marketable software, and

(c) assembled workforce.

70.4. The cost approach *may* be used when no other approach is able to be applied; however, a *valuer should* attempt to identify an alternative method before applying the cost approach in situations where the subject *asset* does not meet the criteria in paras 60.2 and 60.3 of IVS 105 *Valuation Approaches and Methods*.

70.5. There are broadly two main methods that fall under the cost approach: replacement cost and reproduction cost. However, many intangible assets do not have physical form that can be reproduced and *assets* such as software, which can be reproduced, generally derive *value* from their function/utility rather than their exact lines of code. As such, the replacement cost is most commonly applied to the *valuation* of intangible assets.

70.6. The replacement cost method assumes that a *participant* would pay no more for the *asset* than the *cost* that would be incurred to replace the *asset* with a substitute of comparable utility or functionality.

70.7. *Valuers should* consider the following when applying the replacement cost method:

(a) the direct and indirect costs of replacing the utility of the *asset*, including labour, materials and overhead,

(b) whether the subject intangible *asset* is subject to obsolescence. While intangible assets do not become functionally or physically obsolete, they can be subject to economic obsolescence,

(c) whether it is appropriate to include a profit mark-up on the included *costs*. An *asset* acquired from a third party would presumably reflect their *costs* associated with creating the *asset* as well as some form of profit to provide a return on investment. As such, under *bases of value* (see IVS 104 *Bases of Value*) that assume a hypothetical transaction, it *may* be appropriate to include an assumed profit mark-up on *costs*. As noted in IVS 105 *Valuation Approaches and Methods*, *costs* developed based on estimates from third parties would be presumed to already reflect a profit mark-up, and

(d) opportunity costs *may* also be included, which reflect *costs* associated with not having the subject intangible asset in place for some period of time during its creation.

80. Special Considerations for Intangible Assets

80.1. The following sections address a non-exhaustive list of topics relevant to the *valuation* of intangible assets.

(a) *Discount Rates*/Rates of Return for Intangible Assets (section 90).

(b) Intangible Asset Economic Lives (section 100).

(c) Tax Amortisation Benefit (section 110).

90. Discount Rates/Rates of Return for Intangible Assets

90.1. Selecting *discount rates* for intangible assets can be challenging as observable market evidence of *discount rates* for intangible assets is rare. The selection of a *discount rate* for an intangible *asset* generally requires *significant* professional judgment.

90.2. In selecting a *discount rate* for an intangible *asset*, *valuers should* perform an assessment of the risks associated with the subject intangible *asset* and consider observable *discount rate* benchmarks.

90.3. When assessing the risks associated with an intangible *asset*, a *valuer should* consider factors including the following:

(a) intangible assets often have higher risk than tangible *assets*,

(b) if an intangible *asset* is highly specialised to its current use, it *may* have higher risk than *assets* with multiple potential uses,

(c) single intangible assets *may* have more risk than groups of *assets* (or businesses),

(d) intangible assets used in risky (sometimes referred to as non-routine) functions *may* have higher risk than intangible assets used in more low-risk or routine activities. For example, intangible assets used in research and development activities *may* be higher risk than those used in delivering existing products or services,

(e) the life of the *asset*. Similar to other investments, intangible assets with longer lives are often considered to have higher risk, all else being equal,

(f) intangible assets with more readily estimable cash flow streams, such as backlog, *may* have lower risk than similar intangible assets with less estimable cash flows, such as customer relationships.

90.4. Discount rate benchmarks are rates that are observable based on market evidence or observed transactions. The following are some of the benchmark rates that a *valuer should* consider:

(a) risk-free rates with similar maturities to the life of the subject intangible *asset*,

(b) *cost* of debt or borrowing rates with maturities similar to the life of the subject intangible *asset*,

(c) *cost* of equity or equity rates or return for *participants* for the subject intangible *asset*,

(d) *weighted* average cost of capital (WACC) of *participants* for the subject intangible *asset* or of the company owning/using the subject intangible *asset*,

(e) in contexts involving a recent business acquisition including the subject intangible *asset*, the Internal Rate of Return (IRR) for the transaction *should* be considered, and

(f) in contexts involving a *valuation* of all *assets* of a business, the *valuer should* perform a *weighted* average return on *assets* (WARA) analysis to confirm reasonableness of selected *discount rates*.

100. Intangible Asset Economic Lives

100.1. An important consideration in the *valuation* of an intangible *asset*, particularly under the income approach, is the economic life of the *asset*. This *may* be a finite period limited by legal, technological, functional or economic factors; other *assets may* have an indefinite life. The economic life of an intangible *asset* is a different concept than the remaining useful life for accounting or tax *purposes*.

100.2. Legal, technological, functional and economic factors *must* be considered individually and together in making an assessment of the economic life. For example, a pharmaceutical technology protected by a patent *may* have a remaining legal life of five years before expiry of the patent, but a competitor drug with improved efficacy *may* be expected to reach the market in three years. This might cause the economic life of the patent to be assessed as only three years. In contrast, the expected economic life of the technology could extend beyond the life of the patent if the knowhow associated with the technology would have *value* in production of a generic drug beyond the expiration of the patent.

100.3. In estimating the economic life of an intangible asset, a *valuer should* also consider the pattern of use or replacement. Certain intangible assets *may* be abruptly replaced when a new, better or cheaper alternative becomes available, while others *may* be replaced slowly over time, such as when a software developer releases a new version of software every year but only replaces a portion of the existing code with each new release.

100.4. For customer-related intangibles, attrition is a key factor in estimating an economic life as well as the cash flows used to value the customer-related intangibles. Attrition applied in the *valuation* of intangible assets is a quantification of expectations regarding future losses of customers. While it is a forward-looking estimate, attrition is often based on historical observations of attrition.

100.5. There are a number of ways to measure and apply historical attrition:

(a) a constant rate of loss (as a percentage of prior year balance) over the life of the customer relationships *may* be assumed if customer loss does not appear to be dependent on age of the customer relationship,

(b) a variable rate of loss *may* be used over the life of the customer relationships if customer loss is dependent on age of the customer relationship. In such circumstances, generally younger/new customers are lost at a higher rate than older, more established customer relationships,

(c) attrition *may* be measured based on either revenue or number of customers/customer count as appropriate, based on the characteristics of the customer group,

(d) customers *may* need to be segregated into different groups. For example, a company that sells products to distributors and retailers *may* experience different attrition rates for each group. Customers *may* also be segregated based on other factors such as geography, size of customer and type of product or service purchased, and

(e) the period used to measure attrition *may* vary depending on circumstances. For example, for a business with monthly subscribers, one month without revenue from a particular customer would indicate a loss of that customer. In contrast, for larger industrial products, a customer might not be considered "lost" unless there have been no sales to that customer for a year or more.

100.6. The application of any attrition factor *should* be consistent with the way attrition was measured. Correct application of attrition factor in first projection year (and therefore all subsequent years) *must* be consistent with form of measurement.

(a) If attrition is measured based on the number of customers at the beginning-of-period versus end-of-period (typically a year), the attrition factor *should* be applied using a "mid-period" convention for the first projection year (as it is usually assumed that customers were lost throughout the year). For example, if attrition is measured by looking at the number of customers at the beginning of the year (100) versus the number remaining at the end of the year (90), on average the company had 95 customers during that year, assuming they were lost evenly

throughout the year. Although the attrition rate could be described as 10%, only half of that *should* be applied in the first year.

(b) If attrition is measured by analysing year-over-year revenue or customer count, the resulting attrition factor *should* generally be applied without a mid-period adjustment. For example, if attrition is measured by looking at the number of customers that generated revenue in Year 1 (100) versus the number of those same customers that had revenue in Year 2 (90), application would be different even though the attrition rate could again be described as 10%.

100.7. Revenue-based attrition *may* include growth in revenue from existing customers unless adjustments are made. It is generally a best practice to make adjustments to separate growth and attrition in measurement and application.

100.8. It is a best practice for *valuers* to input historical revenue into the model being used and check how closely it predicts actual revenue from existing customers in subsequent years. If attrition has been measured and applied appropriately, the model *should* be reasonably accurate. For example, if estimates of future attrition were developed based on historical attrition observed from 20X0 through 20X5, a *valuer should* input the 20X0 customer revenue into the model and check whether it accurately predicts the revenue achieved from existing customers in 20X1, 20X2, etc

110. Tax Amortisation Benefit (TAB)

110.1. In many tax *jurisdictions*, intangible assets can be amortised for tax *purposes*, reducing a taxpayer's tax burden and effectively increasing cash flows. Depending on the *purpose* of a *valuation* and the valuation *method* used, it *may* be appropriate to include the *value* of TAB in the *value* of the intangible.

110.2. If the market or cost approach is used to value an intangible *asset*, the price paid to create or purchase the *asset* would already reflect the ability to amortise the *asset*. However, in the income approach, a TAB needs to be explicitly calculated and included, if appropriate.

110.3. For some valuation *purposes*, such as financial reporting, the appropriate *basis of value* assumes a hypothetical sale of the subject intangible *asset*. Generally, for those *purposes*, a TAB *should* be included when the income approach is used because a typical *participant* would be able to amortise an intangible *asset* acquired in such a hypothetical transaction. For other valuation *purposes*, the assumed transaction might be of a business or group of *assets*. For those *bases of value*, it *may* be appropriate to include a TAB only if the transaction would result in a step-up in basis for the intangible assets.

110.4. There is some diversity in practice related to the appropriate *discount rate* to be used in calculating a TAB. *Valuers may* use either of the following:

(a) a *discount rate* appropriate for a business utilising the subject *asset*, such as a *weighted* average cost of capital. Proponents of this view believe that, since amortisation can be used to offset the taxes on any income produced by the business, a *discount rate* appropriate for the business as a whole *should* be used, or

(b) a *discount rate* appropriate for the subject *asset* (ie, the one used in the *valuation* of the *asset*). Proponents of this view believe that the *valuation should* not assume the owner of the subject *asset* has operations and income separate from the subject *asset* and that the *discount rate* used in the TAB calculation *should* be the same as that used in the *valuation* of the subject *asset*.

IVS 220 Non-Financial Liabilities

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10. Overview

10.1. The principles contained in the General Standards apply to *valuation*s of non-financial liabilities and *valuation*s with a non-financial liability component. This standard contains additional requirements that apply to *valuations* of non-financial liabilities.

10.2. With regard to the determination of *discount rates* and risk margins, in circumstances in which IVS 105 *Valuation Approaches and Methods* (see paras 50.29-50.31) conflicts with IVS 220 *Non-Financial Liabilities, valuers must* apply the principles in sections 90 and 100 of this Standard in *valuation*s of non-financial liabilities.

20. Introduction

20.1. For *purpose*s of IVS 220 *Non-Financial Liabilities*, non-financial liabilities are defined as those liabilities requiring a non-cash performance obligation to provide goods or services.

20.2. A non-exhaustive list of liabilities that *may* in part or in full require a non-cash fulfilment and be subject to IVS 220 *Non-Financial Liabilities* includes: deferred revenue or contract liabilities, warranties, environmental liabilities, *asset* retirement obligations, certain contingent consideration obligations, loyalty programmes, power purchase agreements, certain litigation reserves and contingencies, and certain indemnifications and guarantees.

20.3. Although certain contingent consideration liabilities *may* require a non-cash performance obligation, such liabilities are not included in the scope of *IVS 220 Non-Financial Liabilities.*

20.4. The party assuming a non-financial liability typically requires a profit margin on the fulfilment effort to compensate for the effort incurred and risk borne for the delivery of goods or services.

20.5. For financial liabilities, cash fulfilment is typically the only performance obligation and no additional compensation is needed for the fulfilment effort. Given that cash fulfilment is the only performance obligation for financial liabilities, asset-liability symmetry most often enables *valuers* to assess the subject liability using an asset framework.

20.6. Asset-liability symmetry typically does not exist for non-financial liabilities due to the performance obligation to provide goods and services to satisfy the liability and additional compensation for such effort. As such, non-financial liabilities will most often be valued using a liability framework.

20.7. In instances in which a corresponding *asset* is recognised by the counterparty, the *valuer must* assess if the *values* would reflect *asset*-liability symmetry under circumstances consistent with the *basis of value*. Certain *bases of value* issued by entities/organisations other than the IVSC require the specific consideration and reconciliation to a corresponding *asset* under certain circumstances. The *valuer must* understand and follow the regulation, case law, and other interpretive guidance related to those *bases of value* as of the valuation date (see IVS 200 *Businesses and Business Interests*, para 30.2). Instances in which the *valuer should* reconcile to a corresponding asset value will be rare, reasons include:

(a) Non-financial liabilities often do not have a recorded corresponding *asset* recognised by the counterparty (eg, environmental liability), or can only be transferred in conjunction with another *asset* (eg, an automobile and related warranty are only transferred together).

(b) The corresponding *asset* of a non-financial liability *may* be held by numerous parties for which it is impractical to identify and reconcile the asset values.

(c) The market for the non-financial *asset* and liability is often highly illiquid, thus resulting in asymmetric information, high bid ask spreads, and asset-liability asymmetry.

20.8. *Participant*s that most often transact in the subject non-financial liability *may* not be the comparable companies and competitors of the entity holding the subject non-financial liability. Examples include insurance companies, third party warranty issuers, and more. *The valuer should* consider if a market, or *participants*, exist outside the immediate industry in which the entity holding the subject non-financial liability operates.

20.9. Non-financial liability valuations are performed for a variety of *purpose*s. It is the *valuer's* responsibility to understand the *purpose* of a *valuation* and whether the non-financial liabilities *should* be valued, whether separately or grouped with other *assets*. A non-exhaustive list of examples of circumstances that commonly include a non-financial liability valuation component is provided below:

(a) For financial reporting *purpose*s, *valuations* of non-financial liabilities are often required in connection with accounting for business combinations, *asset* acquisitions and sales, and impairment analysis.

(b) For tax reporting *purpose*s, non-financial liability valuations are often needed for transfer pricing analyses, estate and gift tax planning and reporting, and ad valorem taxation analyses.

(c) Non-financial liabilities *may* be the subject of litigation, requiring *valuation* analysis in certain circumstances.

(d) *Valuers* are sometimes asked to value non-financial liabilities as part of general consulting, collateral lending and transactional support engagements.

30. Bases of Value

30.1. In accordance with IVS 104 *Bases of Value*, a *valuer must* select the appropriate *basis(es) of value* when valuing non-financial liabilities.

30.2. Often, non-financial liability valuations are performed using *bases of value* defined by entities/organisations other than the IVSC (some examples of which are mentioned in IVS 104 *Bases of Value*) and the *valuer must* understand and follow the regulation, case law, and other interpretive guidance related to those *bases of value* as of the valuation date (see IVS 200 *Businesses and Business Interests*, para 30.2).

40. Valuation Approaches and Methods

40.1. Elements of the three valuation approaches described in IVS 105 *Valuation Approaches* (market, income and cost approach) can all be applied to the *valuation* of non-financial liabilities. The methods described below *may* exhibit elements of more than one approach. If it is necessary for the *valuer* to classify a method under one of the three approaches, the *valuer should* use judgement in making the determination and not necessarily rely on the classification below.

40.2. When selecting an approach and method, in addition to the requirements of this standard, a *valuer must* follow the requirements of IVS 105 *Valuation Approaches*, including para 10.3.

50. Market Approach

50.1. Under the market approach, the *value* of a non-financial liability is determined by reference to market activity (for example, transactions involving identical or similar non-financial liabilities).

50.2. Transactions involving non-financial liabilities frequently also include other *assets*, such as a business combinations that include tangible and intangible *assets*.

50.3. Transactions involving standalone non-financial liabilities are infrequent as compared with transactions for businesses and *assets*.

50.4. While standalone transactions of non-financial liabilities are infrequent, *valuers should* consider relevant market-based indications of *value*. Although such market-based indications *may* not provide sufficient information with which to apply the market approach, the use of market-based inputs *should* be maximised in the application of other approaches.

50.5. A non-exhaustive list of such market indications of *value* includes:

(a) Pricing from third parties to provide identical or similar products as the subject non-financial liability (eg, deferred revenue),

(b) Pricing for warranty policies issued by third parties for identical or similar obligations,

(c) The prescribed monetary conversion amount as published by *participant*s for certain loyalty reward obligations,

(d) The traded price for contingent value rights (CVRs) with similarities to the subject non-financial liability (eg, contingent consideration),

(e) Observed rates of return for investment funds that invest in non-financial liabilities (eg, litigation finance).

50.6. *Valuers must* comply with paras 20.2 and 20.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the market approach to the *valuation* of non-financial liabilities.

50.7. The diverse nature of many non-financial liabilities and the fact that non-financial liabilities seldom transact separately from other *assets* means that it is rarely possible to find market evidence of transactions involving similar non-financial liabilities.

50.8. Where evidence of market prices is available, *valuers should* consider adjustments to these to reflect differences between the subject non-financial liability and those involved in the transactions. These adjustments are necessary to reflect the differentiating characteristics of the subject non-financial liability and those involved in the transactions. Such adjustments *may* only be determinable at a qualitative, rather than quantitative, level. However, the need for *significant* qualitative adjustments could indicate that another approach would be more appropriate for the *valuation*.

50.9. In certain instances a *valuer may* rely on market prices or evidence for an *asset* corresponding to the subject non-financial liability. In such instances, the *valuer should* consider an entity's ability to transfer the subject non-financial liability, whether the *asset* and related price of the *asset* reflect those same restrictions, and whether adjustments to reflect the restrictions *should* be included. The *valuer should* take care to determine if the transfer restrictions are characteristics of the subject non-financial liability (for example, an illiquid market) or restrictions that are characteristics of the entity (for example, financial distress).

50.10. The comparable transaction method, also known as the guideline transactions method, is generally the only market approach method that can be applied to value non-financial liabilities.

50.11. In rare circumstances, a security sufficiently similar to a subject non-financial liability could be publicly traded, allowing the use of the guideline public company method. One example of such securities is contingent value rights that are tied to the performance of a particular product or technology.

Market Approach Methods

50.12. A method to value non-financial liabilities under the Market Approach is often referred to as the Top-Down Method.

Top-Down Method

50.13. Under the Top-Down Method, valuing non-financial liabilities is based on the premise that reliable market-based indications of pricing are available for the performance obligation.

50.14. A *participant* fulfilling the obligation to deliver the product or services associated with the non-financial liability could theoretically price the liability by deducting *costs* already incurred toward the fulfilment obligation, plus a mark-up on those *costs*, from the market price of services.

50.15. When market information is used to determine the *value* of the subject non-financial liability, discounting is typically not necessary because the effects of discounting are incorporated into observed market prices.

50.16. The key steps in applying a Top-Down Method are to:

(a) Determine the market price of the non-cash fulfilment.

(b) Determine the *costs* already incurred and *asset*s utilised by the transferor. The nature of such *costs* will differ depending on the subject non-financial liability. For example, for deferred revenue the *costs* will primarily consist of sales and marketing costs that have already been incurred in generating the non-financial liability.

(c) Determine a reasonable profit margin on the *costs* already incurred.

(d) Subtract *costs* incurred and profit from the market price.

60. Income Approach

60.1. Under the income approach, the *value* of a non-financial liability is often determined by reference to the present value of the *costs* to fulfil the obligation plus a profit margin that would be required to assume the liability.

60.2. *Valuers must* comply with paras 40.2 and 40.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the income approach to the *valuation* of non-financial liabilities.

Income Approach Methods

60.3. The primary method to value non-financial liabilities under the Income Approach is often referred to as the Bottom-Up Method.

Bottom-Up Method

60.4. Under the Bottom-Up Method, the non-financial liability is measured as the *costs* (which *may* or *may* not include certain overhead items) required to fulfil the performance obligation, plus a reasonable mark-up on those *costs*, discounted to present value.

60.5. The key steps in applying a Bottom-Up Method are to:

(a) Determine the *costs* required to fulfil the performance obligation. Such *costs* will include the direct costs to fulfil the performance obligation, but *may* also include indirect costs such as charges for the use of contributory *asset*s. Fulfilment costs represent those *costs* that are related to fulfilling the performance obligation that generates the non-financial liability. *Costs* incurred as part of the selling activities before the acquisition date *should* be excluded from the fulfilment effort.

1. Contributory asset charges *should* be included in the fulfilment costs when such *assets* would be required to fulfil the obligation and the related cost is not otherwise captured in the income statement.

2. In limited instances, in addition to direct and indirect costs, it *may* be appropriate to include opportunity costs. For example, in the licensing of symbolic intellectual property, the direct and indirect costs of fulfilment *may* be nominal. However, if the obligation reduces the ability to monetise the underlying *asset* (in an exclusive licensing arrangement for example), then the *valuer should* consider how *participants* would account for the potential opportunity costs associated with the non-financial liability.

(b) Determine a reasonable mark-up on the fulfilment effort. In most cases it *may* be appropriate to include an assumed profit margin on certain *costs* which can be expressed as a target profit, either a lump sum or a percentage return on *cost* or *value*. An initial starting point *may* be to utilise the operating profit of the entity holding the subject non-financial liability. However, this methodology assumes the profit margin would be proportional to the *costs* incurred. In many circumstances there is rationale to assume profit margins which are not proportional to *costs*. In such cases the risks assumed, *value* added, or intangibles contributed to the fulfilment effort are not the same as those contributed pre-measurement date. When *costs* are derived from actual, quoted or estimated prices by third party suppliers or contractors, these *costs* will already include a third party's desired level of profit.

(c) Determine timing of fulfilment and discount to present value. The *discount rate should* account for the time value of money and non-performance risk. Typically it is preferable to reflect the impact of uncertainty such as changes in anticipated fulfilment costs and fulfilment margin through the cash flows, rather than in the *discount rate*.

(d) When fulfilment *costs* are derived through a percent of revenue, *valuers should* consider whether the fulfilment *costs* already implicitly include the impact of discounting. For example, prepayment for services *may* result in a discount as one would expect to pay less for the same service as compared with paying throughout the contract term. As a result, the derived costs *may* also contain an implicit discount and further discounting *may* not be necessary.

70. Cost Approach

70.1. The cost approach has limited application for non-financial liabilities as *participants* typically expect a return on the fulfilment effort.

70.2. *Valuers must* comply with paras 60.2 and 60.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the cost approach to the *valuation* of non-financial liabilities.

80. Special Considerations for Non-Financial Liabilities

80.1. The following sections address a non-exhaustive list of topics relevant to the *valuation* of non-financial liabilities.

(a) *Discount Rates* for Non-Financial Liabilities (section 90)

(b) Estimating Cash Flows and Risk Margins (section 100)

(c) Restrictions on Transfer (section 110)

(d) Taxes (section 120)

90. Discount Rates for Non-Financial Liabilities

90.1. A fundamental basis for the income approach is that investors expect to receive a return on their investments and that such a return *should* reflect the perceived level of risk in the investment.

90.2. The *discount rate should* account for the time value of money and non-performance risk. Non-performance risk is typically a function of counterparty risk (ie, credit risk of the entity obligated to fulfil the liability) (see para 60.5c of this Standard).

90.3. Certain *bases of value* issued by entities/organisations other than the IVSC *may* require the *discount rate* to specifically account for liability specific risks. The *valuer must* understand and follow the regulation, case law, and other interpretive guidance related to those *bases of value* as of the valuation date (see IVS 200 *Businesses and Business Interests*, para 30.2).

90.4. *Valuers should* consider the term of the subject non-financial liability when determining the appropriate inputs for the time value of money and non-performance risk.

90.5. In certain circumstances, the *valuer may* explicitly adjust the cash flows for non-performance risk.

90.6. What a *participant* would have to pay to borrow the funds necessary to satisfy the obligation *may* provide insights to help quantify the non-performance risk.

90.7. Given the long-term nature of certain non-financial liabilities, the *valuer must* consider if inflation has been incorporated into the estimated cash flows, and *must* ensure that the *discount rate* and cash flow estimates are prepared on a consistent basis.

100. Estimating Cash Flows and Risk Margins

100.1. The principles contained in IVS 105 *Valuation Approaches and Methods may* not apply to *valuations* of non-financial liabilities and *valuations* with a non-financial liability component (see IVS 105 *Valuation Approaches and Methods*, paras 50.12-50.19). *Valuers must* apply the principles in sections 90 and 100 of this Standard in *valuations* of non-financial liabilities.

100.2. Non-financial liability cash flow forecasts often involve the explicit modelling of multiple scenarios of possible future cash flow to derive a probability-*weight*ed expected cash flow forecast. This method is often referred to as the Scenario-Based Method (SBM). The SBM also includes certain simulation techniques such as the Monte Carlo simulation. The SBM is commonly used when future payments are not contractually defined but rather vary depending upon future events. When the non-financial liability cash flows are a function of systematic risk factors, the *value*r *should* consider the appropriateness of the SBM, and *may* need to utilise other methods such as option pricing models (OPMs).

100.3. Considerations in estimating cash flows include developing and incorporating explicit assumptions, to the extent possible. A non-exhaustive list of such assumptions *may* include:

(a) The *costs* that a third party would incur in performing the tasks necessary to fulfil the obligation,

(b) Other amounts that a third party would include in determining the *price* of the transfer, including, for example, inflation, overhead, equipment charges, profit margin, and advances in technology,

(c) The extent to which the amount of a third party's *costs* or the timing of its *costs* would vary under different future scenarios and the relative probabilities of those scenarios, and,

(d) The *price* that a third party would demand and could expect to receive for bearing the uncertainties and unforeseeable circumstances inherent in the obligation.

100.4. While expected cash flows (ie, the probability-*weighted* average of possible future cash flows) incorporate the variable expected outcomes of the *asset's* cash flows, they do not account for the compensation that *participants* demand for bearing the uncertainty of the cash flows. For non-financial liabilities, forecast risk *may* include uncertainty such as changes in anticipated fulfilment costs and fulfilment margin. The compensation for bearing such risk *should* be incorporated into the expected payoff through a cash flow risk margin or the *discount rate*.

100.5. Given the inverse relationship between the *discount rate* and *value*, the *discount rate should* be decreased to reflect the impact of forecast risk (ie, the compensation for bearing risk due to uncertainty about the amount and timing of cash flows).

100.6. While possible to account for forecast risk by reducing the *discount rate*, given its limited practical application, the *valuer must* explain the rationale for reducing the *discount rate* rather than incorporating a risk margin, or specifically note the regulation, case law, or other interpretive guidance that requires the accounting for forecast risk of non-financial liabilities through the *discount rate* rather than a risk margin (see IVS 200 *Businesses and Business Interests*, para 30.2).

100.7. In developing a risk margin, a *valuer must*:

(a) document the method used for developing the risk margin, including support for its use, and,

(b) provide evidence for the derivation of the risk margin, including the identification of the significant inputs and support for their derivation or source.

100.8. In developing a cash flow risk margin, a *valuer must* consider:

(a) the life/term and/or maturity of the *asset* and the consistency of inputs,

(b) the geographic location of the *asset* and/or the location of the markets in which it would trade,

(c) the currency denomination of the projected cash flows, and

(d) the type of cash flow contained in the forecast, for example, a cash flow forecast *may* represent expected cash flows (ie, probability-*weighted* scenarios), most likely cash flows, contractual cash flows, etc

100.9. In developing a cash flow risk margin, a *valuer should* consider:

(a) the less certainty there is in the anticipated fulfilment costs and fulfilment margin, the higher the risk margin *should* be,

(b) given the finite term of most non-financial liabilities, as opposed to indefinite for many business and asset valuations, to the extent that emerging experience reduces uncertainty, risk margins *should* decrease, and vice versa,

(c) the expected distribution of outcomes, and the potential for certain non-financial liabilities to have high 'tail risk' or severity. Non-financial liabilities with wide distributions and high severity *should* have higher risk margins,

(d) the respective rights and preferences of the non-financial liability, and/or related *asset*, in the event of a liquidation and its relative position within the liquidation waterfall.

100.10. The cash flow risk margin *should* be the compensation that would be required for a party to be indifferent between fulfilling a liability that has a range of possible outcomes, and one that will generate fixed cash outflows.

100.11. A *value*r need not conduct an exhaustive quantitative process, but *should* take into account all the information that is reasonably available.

110. Restrictions on Transfer

110.1. Non-financial liabilities often have restrictions on the ability to transfer. Such restrictions can be either contractual in nature, or a function of an illiquid market for the subject non-financial liability.

110.2. When relying on market evidence, a *valuer should* consider an entity's ability to transfer such non-financial liabilities and whether adjustments to reflect the restrictions *should* be included. The *valuer may* need to determine if the transfer restrictions are characteristics of the non-financial liability or restrictions that are characteristics of an entity, as certain *basis of value may* specify one or the other be considered (see IVS 220 *Non-Financial Liabilities*, para 50.9).

110.3. When relying on an income approach in which the non-financial liability value is estimated through a fulfilment approach, the *valuer should* determine if an investor would require an additional risk margin to account for the limitations on transfer.

120. Taxes

120.1. *Valuers should* use pre-tax cash flows and a pre-tax *discount rate* for the *valuation* of non-financial liabilities.

120.2. In certain circumstances, it *may* be appropriate to perform the analysis with after tax cash flows and *discount rates*. In such instances, the *valuer must* explain the rationale for use of after tax inputs, or specifically note the regulation, case law, or other interpretive guidance that requires the use of after tax inputs (see IVS 200 *Businesses and Business Interests*, para 30.2).

120.3. If after tax inputs are used, it *may* be appropriate to include the tax benefit created by the projected cash outflow associated with the non-financial liability.

IVS 230 Inventory

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10. Overview

10.1. The principles contained in the General Standards apply to *valuations* of inventory and *valuations* with an inventory component. This standard contains additional requirements for *valuations* of inventory.

20. Introduction

20.1. Inventory broadly includes goods which will be used in future production processes (ie, raw materials, parts, supplies), goods used in the production process (ie, work-in-process), and goods awaiting sale (ie, finished goods).

20.2. This standard focuses on *valuation* of inventory of physical goods that are not real property, as the numerous and varied aspects of real property inventory were not considered or contemplated in the preparation of this standard. The *valuation* of real property is covered in IVS 400 *Real Property Interests*.

20.3. While the book value of inventory only includes historical costs, the profits earned in the production process, which reflect returns on the *assets* utilised in manufacturing (including working capital, property, plant, and equipment, and intangible assets), are not capitalised into book value. As a result, the *market value* of inventory typically differs from, and is usually higher than, the book value of inventory.

20.4. As inventory is seldom transacted at an interim stage (eg, work-in-process) or *may* not be frequently sold to a third party to conduct the selling effort (eg, finished goods sold via distributor networks), the valuation techniques and considerations for inventory frequently vary from those of other *assets*.

20.5. Inventory valuations are performed for a variety of *purposes*. It is the *valuer's* responsibility to understand the *purpose* of a *valuation* and whether the inventory *should* be valued, whether separately or grouped with other

assets. A non-exhaustive list of examples of circumstances that commonly include an inventory valuation component is provided below:

(a) For financial reporting *purposes*, *valuations* of inventory are often required in connection with accounting for business combinations, asset acquisitions and sales, and impairment analysis.

(b) For tax reporting *purposes*, inventory valuations are frequently needed for transfer pricing analyses, estate and gift tax planning and reporting, and ad valorem taxation analyses.

(c) Inventory valuation *may* be the subject of litigation, requiring valuation analysis in certain circumstances.

(d) *Valuers* are sometimes asked to value inventory as part of general consulting, collateral lending, transactional support engagements and insolvency.

30. Bases of Value

30.1. In accordance with IVS 104 *Bases of Value*, a *valuer must* select the appropriate *basis(es) of value* when valuing inventory.

30.2. Often, inventory valuations are performed using *bases of value* defined by entities/organisations other than the IVSC (some examples of which are mentioned in IVS 104 *Bases of Value*) and the *valuer must* understand and follow the regulation, case law, and other interpretive guidance related to those *bases of value* as of the valuation date.

40. Valuation Approaches and Methods

40.1. The three valuation approaches described in IVS 105 *Valuation Approaches* can all be applied to the *valuation* of inventory. The methods described below simultaneously exhibit elements of the cost approach, market approach, and income approach. If necessary for the *valuer* to classify a method under one of the three approaches, the *valuer should* use judgement in making the determination and not necessarily rely on the classification below.

40.2. When selecting an approach and method, in addition to the requirements of this standard, a *valuer must* follow the requirements of IVS 105 *Valuation Approaches*, including para 10.3.

50. Market Approach

50.1. The market approach, ie, reference to market activity involving identical or similar goods, has only narrow direct application for the *valuation* of inventory. Such applications typically include 1) inventory of commoditised products, or 2) inventory in which a market exists for the inventory at an interim stage in the production process. For non-commodity traded products or products that a market exists at an interim production stage, such selling prices *must* be adjusted downward to account for the disposal effort and related profit.

50.2. While the market approach is not directly applicable in most instances, *valuers should* consider market-based indications to determine the selling price as an input for other methods.

50.3. Other observable markets *may* provide insights on the returns attributable to the manufacturing and disposition of *assets* that can also be leveraged for inputs into other methods. Such returns are typically considered to exclude returns attributable to intellectual property. For example:

(a) Distributor profit margins represent a meaningful market proxy for returns on the disposition process, if an appropriate base of comparable companies is identified.

(b) Contract manufacturers, to the extent available, *may* provide a proxy for margins earned through the manufacturing process.

50.4. *Valuers must* comply with paras 20.2 and 20.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the market approach to the *valuation* of inventory. In addition, *valuers should* only apply the market approach to value inventory if both of the following criteria are met:

(a) information is available on arm's length transactions involving identical or similar inventory on or near the valuation date, and

(b) sufficient information is available to allow the *valuer* to adjust for all *significant* differences between the *subject* inventory and those involved in the transactions.

50.5. Where evidence of market prices is available, *valuers should* make adjustments to these to reflect differences between the *subject* inventory and those involved in the transactions. These adjustments are necessary to reflect the differentiating characteristics of the *subject* inventory and those involved in the transactions. Such adjustments may only be determinable at a qualitative, rather than quantitative, level. However, the need for *significant* qualitative adjustments *may* indicate that another approach would be more appropriate for the *valuation* (see IVS 105 *Valuation Approaches and Methods*, paras 10.1-10.10).

60. Income Approach

60.1. The *valuation* of inventory using the income approach requires the allocation of profit (value) contributed pre-valuation date versus the profit (value) contributed post-valuation date.

60.2. *Valuers must* comply with paras 40.2 and 40.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the income approach to the *valuation* of inventory.

Top-Down Method

60.3. The top-down method is a residual method that begins with the estimated selling price and deducts remaining *costs* and estimated profit.

60.4. The top-down method attempts to bifurcate the efforts, and related value, that were completed before the measurement date versus those efforts that are to be completed after the measurement date.

60.5. The key steps in applying the top-down method are to:

(a) Estimate the selling price. The *valuer should* rely on direct observations of selling prices when the information is available. However, such data is

often not available and the selling price is often estimated by applying an appropriate gross profit margin to the net book value of finished goods at the product level or aggregate level. Typically, the projected gross profit margin in the period the inventory will be sold is used.

(b) Estimate the *costs* to complete (for work-in-process only). Completion costs *should* include all of the expenditures directly or indirectly remaining to be incurred post-valuation date in bringing the work in progress inventory to its finished condition. *Costs* to complete *should* be adjusted to remove expenses benefitting future periods.

(c) Subtract the *costs* of disposal. *Costs* of disposal represent *costs* that would be incurred post-valuation date in order to deliver the finished goods to the end customer. *Costs* of disposal *should* be adjusted to remove expenses benefitting future periods. Disposal costs generally include selling and marketing expenses while procurement and manufacturing expenses have typically already been incurred for finished goods inventory. In order to properly determine *costs* of disposal, each expense in the inventory cycle (including indirect overhead) *should* be categorised as having been incurred and, therefore, contributed to the *value* of the finished goods inventory or remaining to be incurred during the disposal process.

(d) Subtract the profit allowance on the completion effort (for work-in-process only) and the disposal process. An initial starting point *may* be to utilise the operating profit of the company. However, this methodology assumes the profit margin would be proportional to the *costs* incurred. In most circumstances there is rationale to assume profit margins which are not proportional to *costs* (see section 90).

(e) Consider any necessary holding costs. Holding costs *may* need to be estimated in order to account for the opportunity cost associated with the time required to sell the inventory. Additionally, the *valuer should* consider the risk born during the holding period when determining the required rate of return. Risks *may* be a function of the length of inventory life cycle and the contractual arrangements with end customers (eg, manufacturer bears the risk of fluctuation in *costs* of completion and disposal). Holding costs *may* be immaterial if the inventory turnover is high and/or the borrowing rate is low.

60.6. When determining the *cost* to complete, *costs* of disposal and profit allowance, the *valuer should* identify and exclude any expenses that are intended to provide future economic benefit and are not necessary to generate the current period revenue. Examples of future-benefit expenses *may* include research and development (R&D) related to new product development; marketing for a new product; recruiting to increase the size of the workforce; expansion into a new territory; depreciation of an R&D facility dedicated to future research; or restructuring costs.

60.7. Internally developed intangible assets *should* either be modelled as 1) a *cost* as if they were hypothetically licensed, and therefore included in either the *cost* of production or disposal, or 2) considered as part of a functional apportionment when determining the appropriate profit allowance.

60.8. When utilising the top-down method, *valuers should* consider whether sufficient data are available to appropriately apply the key steps. If sufficient

data is not available, it *may* be appropriate to apply other methods or techniques.

60.9. The *valuer may* use the bottom-up method (see para 60.10) to corroborate the *value* derived from the top-down method (see paras 60.3 to 60.9).

Bottom-Up Method

60.10. The key steps in applying the bottom-up method are to:

(a) Determine the book value of the *subject* inventory. The book value *may* need to be adjusted for multiple considerations (see para 70.4 and section 110).

(b) Add any *cost* of buying and holding already incurred.

(c) Add any *cost* toward completion already incurred. Such *costs* typically include procurement and manufacturing expenses

(d) Add profit on total *costs* already incurred. An initial starting point *may* be to utilise the operating profit of the company. However, this methodology assumes the profit margin would be proportional to the *costs* incurred. In most circumstances there is rationale to assume profit margins which are not proportional to *costs* (see section 90).

60.11. When determining the *costs* already incurred, *valuers should* consider internally developed intangible assets that have contributed toward the completion effort.

70. Cost Approach

70.1. The primary method to value inventory is the replacement cost method. Raw materials inventory is typically valued using the current replacement cost method.

70.2. *Valuers must* comply with paras 60.2 and 60.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the cost approach to the *valuation* of inventory.

Current Replacement Cost Method

70.3. The current replacement cost method (CRCM) *may* provide a good indication of *market value* if inventory is readily replaceable in a wholesale or retail business (eg, raw materials inventory).

70.4. The *market value* of raw materials and other inventory *may* be similar to the net book value as of the valuation date but certain adjustments *should* be considered.

(a) The book value *may* need to be adjusted to FIFO basis.

(b) If raw material prices fluctuate and/or the inventory turnover is slow the book value *may* need to be adjusted for changes in market prices.

(c) The book value of raw materials *may* also be decreased to account for obsolete and defective goods.

(d) The book value *may* also need to be decreased for shrinkage, which is the difference between inventory listed in the accounting records and the actual inventory due to theft, damage, miscounting, incorrect units of measure, evaporation, etc.

(e) The book value *may* need to be increased for any *costs* incurred in connection with raw material preparation (eg, purchasing, storage and handling).

80. Special Considerations for Inventory

80.1. The following sections address a non-exhaustive list of topics relevant to the *valuation* of inventory.

(a) Identification of value-added processes and returns on intangible assets (section 90).

(b) Relationship to other acquired assets (section 100).

(c) Obsolete inventory – reserves (section 110).

(d) Unit of account (section 120)

90. Identification of Value-Added Processes and Returns on Intangible Assets

90.1. The *valuation* of inventory involves an allocation of profit between the profit earned pre-measurement date and the profit earned post-measurement date. In practice, profit earned *may* not be proportional to expenses. In most cases the risks assumed, value added, or intangibles contributed to the inventory pre-measurement date are not the same as those contributed post-measurement date.

90.2. *Valuers* typically *should* not simply allocate profit in proportion to disposition and manufacturing costs. This assumption can misallocate profit, as it presupposes that a company's production process earns profit on a pro-rata basis based on *costs* incurred. For manufacturers, this method is inappropriate if the *costs* of materials represent an initial outflow without significant efforts. Such an assumption also fails to recognise the contribution of internally-generated intangible assets with minimal associated costs.

90.3. *Valuers should* distinguish between value-added costs and those that are not value-added. The materials portion of COGS may not be a value-added cost because it does not contribute any of the profit to the inventory.

90.4. For a company that owns internally developed intangible assets that contribute to an increase in the level of profitability, the return on and of those intangible assets would be included in the total profit margin of the business. However, whether intangible assets are owned or licensed, the *market value* of the inventory *should* be the same.

90.5. The *valuer should* determine the extent to which the technology, trademarks, and customer relationships support the manufacturing and distribution processes and whether the returns are applicable to the entire base of revenue. If the intangible asset has been utilised to create the inventory (eg, a manufacturing process intangible), then the *value* of the inventory would

be increased. Conversely, if the intangible asset is expected to be utilised in the future, at the time of disposal, the *value* of the inventory would be decreased.

90.6. For marketing intangibles, the determination of whether the intangible is an attribute of the inventory *may* be difficult. To assist with the determination, the *valuer may* consider how the inventory would be marketed by a market *participant* to its customers – pull vs push model. A push model requires significant disposal efforts for inventory and is less reliant on marketing intangibles, while a pull model depends on strong brand development and recognition to pull customers to the product.

90.7. A non-exhaustive list of other considerations for evaluating when intangible assets are contributed *may* include the amount of marketing spend, whether products are sold through a distributor, level of attrition for customer relationships, and any legal rights associated with the intangible assets.

90.8. In some cases, the intangible asset may consist of several elements that contribute to various aspects of the value creation, such as a pharmaceutical product intangible asset that is comprised of technology and tradename. This requires an assessment of how the overall profit related to each element of the intangible asset *should* be apportioned to manufacturing the inventory versus in the disposal effort.

90.9. Similarly, although a single intangible asset may only contribute to either the manufacturing or disposal effort, it is possible for a portion of the intangible to be contributed pre-measurement date and a portion contributed post-measurement date. For example, when assessing the contribution of symbolic IP for finished goods, although the product bears the respective branding associated with the symbolic IP, the related right to sell the branded product *may* not be conveyed with the transfer of inventory. As such, it *may* be appropriate to consider such rights in the *costs* of disposal.

100. Relationship to Other Acquired Assets

100.1. The *valuer should* maintain consistency, as appropriate, between assumptions used in the inventory valuation relative to *valuation* of other *assets* or liabilities.

110. Obsolete Inventory Reserves

110.1. The *valuer should* account for obsolete inventory reserve balances. The inventory reserve balances *should* be applied to the inventory in which the reserve applies, rather than netted against the entire inventory balance.

110.2. Typically, the obsolete inventory adjusted for the inventory reserve would not be valued as it has been adjusted to net realisable value. However, the *valuer may* need to consider further write-downs if *market value* is lower than net realisable value.

120. Unit of Account

120.1. For *purposes* of inventory valuation, it is often appropriate to assume inventory is one homogenous set of *assets*. However, it is possible for the profit margins, risk, and intangible asset contributions to vary by product or product group.

120.2. If the profit margins, risk, and intangible asset contributions vary by product or product group, and the relative mix of inventory being valued does not match the assumed sales mix used to develop the assumptions for the *valuation*, the *valuer should* assess the different groups of inventory separately.

IVS 300 Plant and Equipment

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10. Overview

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

20. Introduction

20.1. Items of plant and equipment (which *may* sometimes be categorised as a type of personal property) are tangible *assets* that are usually held by an entity for use in the manufacturing/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.

20.2. For lease of machinery and equipment, the right to use an item of machinery and equipment (such as a right arising from a lease) would also follow the guidance of this standard. It *must* also be noted that the "right to use" an *asset* could have a different life span than the service life (that takes into consideration of both preventive and predictive maintenance) of the underlying machinery and equipment itself and, in such circumstances, the service life span *must* be stated.

20.3. *Assets* for which the highest and best use is "in use" as part of a group of *assets must* be valued using consistent assumptions. Unless the *assets* belonging to the sub-systems *may* reasonably be separated independently from its main system, then the sub-systems *may* be valued separately, having consistent assumptions within the sub-systems. This will also cascade down to sub-sub-systems and so on.

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

of the inclusion of intangible *assets* and their impact on the *valuation* of the plant and equipment *assets*. When there is an intangible *asset* component, the *valuer should* also follow IVS 210 *Intangible Assets*.

20.5. A *valuation* of plant and equipment will normally require consideration of a range of factors relating to the *asset* itself, its environment and physical, functional and economic potential. Therefore, all plant and equipment *valuers should* normally inspect the subject *assets* to ascertain the condition of the plant and also to determine if the information provided to them is usable and related to the subject *assets* being valued. Examples of factors that *may* need to be considered under each of these headings include the following:

(a) Asset-related:

1. the *asset's* technical specification,

2. the remaining useful, economic or effective life, considering both preventive and predictive maintenance,

3. the *asset's* condition, including maintenance history,

4. any functional, physical and technological obsolescence,

5. if the *asset* is not valued in its current location, the *costs* of decommissioning and removal, and any *costs* associated with the *asset's* existing in-place location, such as installation and re-commissioning of *assets* to its optimum status,

6. for machinery and equipment that are used for rental *purposes*, the lease renewal options and other end-of-lease possibilities,

7. 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,

8. additional *costs* associated with additional equipment, transport, installation and commissioning, etc, and

9. in cases where the historical costs are not available for the machinery and equipment that *may* reside within a plant during a construction, the *valuer may* take references from the Engineering, Procurement, Construction ("EPC") contract.

(b) Environment-related:

1. the location in relation to the source of raw material and market for the product. The suitability of a location *may* also have a limited life, eg, where raw materials are finite or where demand is transitory,

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

3. radioactive substances that *may* be in certain machinery and equipment have a severe impact if not used or disposed of appropriately. This will have a major impact on expense consideration and the environment,

4. toxic wastes which *may* be chemical in the form of a solid, liquid or gaseous state *must* be professionally stored or disposed of. This is critical for all industrial manufacturing, and

5. licences to operate certain machines in certain countries *may* be restricted.

(c) Economic-related:

1. the actual or potential profitability of the *asset* based on comparison of operating costs with earnings or potential earnings (see IVS 200 *Business and Business Interests*),

2. the demand for the product manufactured by the plant with regard to both macro- and micro-economic factors could impact on demand, and

3. the potential for the *asset* to be put to a more valuable use than the current use (ie, highest and best use).

20.6. *Valuations* of plant and equipment *should* reflect the impact of all forms of obsolescence on *value*.

20.7. To comply with the requirement to identify the *asset* or liability to be valued in IVS 101 *Scope of Work*, para 20.3.(d) to the extent it impacts on *value*, consideration *must* be given to the degree to which the *asset* is attached to, or integrated with, other *assets*. For example:

(a) *assets may* be permanently attached to the land and could not be removed without substantial demolition of either the *asset* or any surrounding structure or building,

(b) an individual machine *may* be part of an integrated production line where its functionality is dependent upon other *assets*,

(c) an *asset may* be considered to be classified as a component of the real property (eg, a Heating, Ventilation and Air Conditioning System (HVAC)).

In such cases, it will be necessary to clearly define what is to be included or excluded from the *valuation*. Any special assumptions relating to the availability of any complementary *assets must* also be stated (see also para 20.8).

20.8. 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 and equipment 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 *must* include a statement to the effect that the *value* of these items would normally be included in the real property interest and *may* not be separately realisable. When different valuation assignments are undertaken to carry out *valuations* of the real property interest and plant and equipment *assets* at the same location, care is necessary to avoid either omissions or double counting.

20.9. Because of the diverse nature and transportability of many items of plant and equipment, additional assumptions will normally be required to describe the situation and circumstances in which the *assets* are valued. In order to comply with IVS 101 *Scope of Work*, para 20.3.(k) these *must* be considered and included in the scope of work. Examples of assumptions that *may* be appropriate in different circumstances include:

(a) that the plant and equipment *assets* are valued as a whole, in place and as part of an operating business,

(b) that the plant and equipment *assets* are valued as a whole, in place but on the assumption that the business is not yet in production,

(c) that the plant and equipment *assets* are valued as a whole, in place but on the assumption that the business is closed,

(d) that the plant and equipment *assets* are valued as a whole, in place but on the assumption that it is a forced sale (See IVS 104 *Bases of Value*),

(e) that the plant and equipment *assets* are valued as individual items for removal from their current location.

20.10. In some circumstances, it *may* be appropriate to report on more than one set of assumptions, eg, in order to illustrate the effect of business closure or cessation of operations on the *value* of plant and equipment.

20.11. In addition to the minimum requirements in IVS 103 *Reporting*, a valuation report on plant and equipment *must* include appropriate references to matters addressed in the scope of work. The report *must* also include comment on the effect on the reported value of any associated tangible or intangible *assets* excluded from the actual or assumed transaction scenario, eg, operating software for a machine or a continued right to occupy the land on which the item is situated.

20.12. *Valuation*s of plant and equipment are often required for different *purposes* including financial reporting, leasing, secured lending, disposal, taxation, litigation and insolvency proceedings.

30. Bases of Value

30.1. In accordance with IVS 104 *Bases of Value*, a *valuer must* select the appropriate *basis(es) of value* when valuing plant and equipment.

30.2. Using the appropriate *basis(es) of value* and associated premise of value (see IVS 104 *Bases of Value*, sections 140-170) is particularly crucial in the *valuation* of plant and equipment because differences in *value* can be pronounced, depending on whether an item of plant and equipment is valued under an “in use” premise, orderly liquidation or forced liquidation (see IVS 104 *Bases of Value*, para 80.1). The *value* of most plant and equipment is particularly sensitive to different premises of value.

30.3. An example of forced liquidation conditions is where the *assets* have to be removed from a property in a timeframe that precludes proper marketing because a lease of the property is being terminated. The impact of such circumstances on *value* needs careful consideration. In order to advise on the *value* likely to be realised, it will be necessary to consider any alternatives to a sale from the current location, such as the practicality

and *cost* of removing the items to another location for disposal within the available time limit and any diminution in *value* due to moving the item from its working location.

40. Valuation Approaches and Methods

40.1. The three principal valuation approaches described in the IVS *may* all be applied to the *valuation* of plant and equipment *assets* depending on the nature of the *assets*, the information available, and the facts and circumstances surrounding the *valuation*.

50. Market Approach

50.1. For classes of plant and equipment that are homogenous, eg, motor vehicles and certain types of office equipment or industrial machinery, the market approach is commonly used as there *may* be sufficient data of recent sales of similar *assets*. However, many types of plant and equipment are specialised and where direct sales evidence for such items will not be available, care *must* be exercised in offering an opinion of value when available market data is poor or non-existent. In such circumstances it *may* be appropriate to adopt either the income approach or the cost approach to the *valuation*.

60. Income Approach

60.1. The income approach to the *valuation* of plant and equipment can be used where specific cash flows can be identified for the *asset* or a group of complementary *assets*, eg, where a group of *assets* forming a process plant is operating to produce a marketable product. However, some of the cash flows *may* be attributable to intangible *assets* and difficult to separate from the cash flow contribution of the plant and equipment. Use of the income approach is not normally practical for many individual items of plant or equipment; however, it can be utilised in assessing the existence and quantum of economic obsolescence for an *asset* or *asset* group.

60.2. When an income approach is used to value plant and equipment, the *valuation must* consider the cash flows expected to be generated over the life of the *asset(s)* as well as the *value* of the *asset* at the end of its life. Care *must* be exercised when plant and equipment is valued on an income approach to ensure that elements of *value* relating to intangible *assets*, goodwill and other contributory *assets* is excluded (see IVS 210 *Intangible Assets*).

70. Cost Approach

70.1. The cost approach is commonly adopted for plant and equipment, particularly in the case of individual *assets* that are specialised or special-use facilities. The first step is to estimate the *cost* to a market *participant* of replacing the subject *asset* by reference to the lower of either reproduction or replacement cost. 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*. After concluding on a replacement cost, the *value should* be adjusted to reflect the impact on *value* of physical, functional, technological and economic obsolescence on *value*. In any event, adjustments made to any particular replacement cost *should* be designed to produce the same *cost* as the modern equivalent *asset* from an output and utility point of view.

70.2. An entity's actual *costs* incurred in the acquisition or construction of an *asset may* be appropriate for use as the replacement cost of an *asset* under certain circumstances. However, prior to using such historical cost information, the *valuer should* consider the following:

(a) Timing of the historical expenditures: An entity's actual *costs may* not be relevant, or *may* need to be adjusted for inflation/indexation to an equivalent as of the valuation date, if they were not incurred recently due to changes in market prices, inflation/deflation or other factors.

(b) The *basis of value*: Care *must* be taken when adopting a particular market *participant's* own costings or profit margins, as they *may* not represent what typical market *participants* might have paid. The *valuer must* also consider the possibility that the entity's *costs* incurred *may* not be historical in nature due to prior purchase accounting or the purchase of used plant and equipment *assets*. In any case, historical costs *must* be trended using appropriate indices.

(c) Specific costs included: A *valuer must* consider all significant costs that have been included and whether those costs contribute to the *value* of the *asset* and for some *bases of value*, some amount of profit margin on *costs* incurred *may* be appropriate.

(d) Non-market components: Any *costs*, discounts or rebates that would not be incurred by, or available to, typical market *participants should* be excluded.

70.3. Having established the replacement cost, deductions *must* be made to reflect the physical, functional, technological and economic obsolescence as applicable (see IVS 105 *Valuation Approaches and Methods*, section 80).

Cost-to-Capacity Method

70.4. Under the cost-to-capacity method, the replacement cost of an *asset* with an actual or required capacity can be determined by reference to the *cost* of a similar *asset* with a different capacity.

70.5. The cost-to-capacity method is generally used in one of two ways:

(a) to estimate the replacement cost for an *asset* or *assets* with one capacity where the replacement costs of an *asset* or *assets* with a different capacity are known (such as when the capacity of two subject *assets* could be replaced by a single *asset* with a known *cost*), or

(b) to estimate the replacement cost for a modern equivalent *asset* with capacity that matches foreseeable demand where the subject *asset* has excess capacity (as a means of measuring the penalty for the lack of utility to be applied as part of an economic obsolescence adjustment).

70.6. This method *may* only be used as a check method unless there is an existence of an exact comparison plant of the same designed capacity that resides within the same geographical area.

70.7. It is noted that the relationship between *cost* and capacity is often not linear, so some form of exponential adjustment *may* also be required.

80. Special Considerations for Plant and Equipment

80.1. The following section Financing Arrangements addresses a non-exhaustive list of topics relevant to the *valuation* of plant and equipment.

90. Financing Arrangements

90.1. Generally, the *value* of an *asset* is independent of how it is financed. However, in some circumstances the way items of plant and equipment are financed and the stability of that financing *may* need to be considered in *valuation*.

90.2. An item of plant and equipment *may* be subject to a leasing or financing arrangement. Accordingly, the *asset* cannot be sold without the lender or lessor being paid any balance outstanding under the financing arrangement. This payment *may* or *may* not exceed the unencumbered value of the item to the extent unusual/excessive for the industry. Depending upon the *purpose* of the *valuation*, it *may* be appropriate to identify any encumbered *assets* and to report their *values* separately from the unencumbered *assets*.

90.3. Items of plant and equipment that are subject to operating leases are the property of third parties and are therefore not included in a *valuation* of the *assets* of the lessee, subject to the lease meeting certain conditions. However, such *assets may* need to be recorded as their presence *may* impact on the *value* of owned *assets* used in association. In any event, prior to undertaking a *valuation*, the *valuer should* establish (in conjunction with *Client* and/or advisors) whether *assets* are subject to operating lease, finance lease or loan, or other secured lending. The conclusion on this regard and wider *purpose* of the *valuation* will then dictate the appropriate basis and valuation methodology.

IVS 400 Real Property Interests

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10. Overview

10.1. The principles contained in the General Standards apply to *valuation*s of real property interests. This standard contains additional requirements for *valuations* of real property interests.

20. Introduction

20.1. Property interests are normally defined by state or the law of individual *jurisdictions* and are often regulated by national or local legislation. In some instances, legitimate individual, communal/community and/or collective rights over land and buildings are held in an informal, traditional, undocumented and unregistered manner. Before undertaking a *valuation* of a real property interest, a *valuer must* understand the relevant legal framework that affects the interest being valued.

20.2. A real property interest is a right of ownership, control, use or occupation of land and buildings. A real property interest includes informal tenure rights for communal/community and or collective or tribal land and urban/rural informal settlements or transition economies, which can take the form of possession, occupation and rights to use.

There are three main 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 or other legally enforceable constraints,

(b) a subordinate interest that normally 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, and/or

(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.

20.3. Intangible *assets* fall outside the classification of real property *assets*. However, an intangible *asset may* be associated with, and have a material impact on, the *value* of real property *assets*. It is therefore essential to be clear in the scope of work precisely what the valuation assignment is to include or exclude. For example, the *valuation* of a hotel can be inextricably linked to the hotel brand. In such cases, the valuation process will involve consideration of the inclusion of intangible *assets* and their impact on the *valuation* of the real property and plant and equipment *assets*. When there is an intangible *asset* component, the *valuer should* also follow IVS 210 *Intangible Assets*.

20.4. Although different words and terms are used to describe these types of real property interest in different *jurisdictions*, 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. 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 legal interest rather than to the physical land and buildings.

20.5. To comply with the requirement to identify the *asset* to be valued in IVS 101 *Scope of Work*, para 20.3.(d) the following matters *must* be included:

(a) a description of the real property interest to be valued, and

(b) identification of any superior or subordinate interests that affect the interest to be valued.

20.6. 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 *Scope of Work*, para 20.3.(j) and IVS 102 *Investigations and Compliance*, the following matters *should* be considered:

(a) the evidence, if available, required to verify the real property interest and any relevant related interests,

(b) the extent of any inspection,

(c) responsibility for information on the site area, site characteristics and building floor areas,

(d) responsibility for confirming the specification and condition of any building,

(e) the extent of investigation into the nature, specification and adequacy of services,

(f) the existence of any information on ground conditions and soil conditions,

(g) responsibility for the identification of actual or potential environmental factors,

(h) legal permissions or restrictions on the use of the property and any buildings, as well as any expected or potential changes to legal permissions and restrictions.

20.7. Typical examples of special assumptions that *may* need to be agreed and confirmed in order to comply with IVS 101 *Scope of Work*, para 20.3.(k) include:

(a) that a defined physical change had occurred, eg, a proposed building is valued as if complete at the valuation date,

(b) 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,

(c) that the interest is being valued without taking into account other existing interests, and

(d) that the property is free from contamination or other environmental risks.

20.8. *Valuation*s of real property interests are often required for different *purposes* including secured lending, sales and purchases, taxation, litigation, compensation, insolvency proceedings and financial reporting.

30. Bases of Value

30.1. In accordance with IVS 104 *Bases of Value*, a *valuer must* select the appropriate *basis(es) of value* when valuing real property interests.

30.2. Under most *bases of value*, a *valuer must* consider the highest and best use of the real property, which *may* differ from its current use (see IVS 104 *Bases of Value*, para 30.3). This assessment is particularly important to real property interests which can be changed from one use to another or that have development potential.

40. Valuation Approaches and Methods

40.1. The three valuation approaches described in the IVS 105 *Valuation Approaches and Methods* can all be applicable for the *valuation* of a real property interest.

40.2. When selecting an approach and method, in addition to the requirements of this standard, a *valuer must* follow the requirements of IVS 105 *Valuation Approaches and Methods*, including para 10.3 and 10.4.

50. Market Approach

50.1. Property interests are generally heterogeneous (ie, with different characteristics). Even if the land and buildings 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.

50.2. In order to compare the subject of the *valuation* with the *price* of other real property interests, *valuers should* adopt generally accepted and appropriate units of comparison that are considered by *participants*, dependent upon the type of *asset* being valued. Units of comparison that are commonly used include:

(a) price per square metre (or per square foot) of a building or per hectare for land,

(b) price per room, and

(c) price per unit of output, eg, crop yields.

50.3. 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.

50.4. 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 in accordance with IVS 105 *Valuation Approaches and Methods*, para 30.8. Specific differences that *should* be considered in *valuing* real property interests include, but are not limited to:

(a) the type of interest providing the price evidence and the type of interest being valued,

(b) the respective locations,

(c) the respective quality of the land or the age and specification of the buildings,

(d) the permitted use or zoning at each property,

(e) the circumstances under which the *price* was determined and the *basis of value* required,

(f) the effective date of the price evidence and the valuation date, and

(g) market conditions at the time of the relevant transactions and how they differ from conditions at the valuation date.

60. Income Approach

60.1. Various methods are used to indicate *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 income 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 (see paras 90.1-90.3); 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.

60.2. For some real property interests, the income-generating ability of the property is closely tied to a particular use or business/trading activity (for example, hotels, golf courses, etc). Where a building is suitable for only a particular type of trading activity, the income is often related to the actual or potential cash flows that would accrue to the owner of that building from the trading activity. The use of a property's trading potential to indicate its *value* is often referred to as the "profits method".

60.3. When the income used in the income approach represents cash flow from a business/trading activity (rather than cash flow related to rent, maintenance and other real property-specific costs), the *valuer should* also comply as appropriate with the requirements of IVS 200 *Business and Business Interests* and, where applicable, IVS 210 *Intangible Assets*.

60.4. For real property interests, various forms of discounted cash flow models *may* be used. These vary in detail but share the basic characteristic that the cash flow for a defined future period is adjusted to a present value using a *discount rate*. The sum of the present day values for the individual periods represents an estimate of the capital value. The *discount rate* in a discounted cash flow model will be based on the time cost of money and the risks and rewards of the income stream in question.

60.5. Further information on the derivation of *discount rates* is included in IVS 105 *Valuation Approaches and Methods*, paras 50.29-50.31. The development of a yield or *discount rate should* be influenced by the objective of the *valuation*. For example:

(a) if the objective of the *valuation* 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 rate of return or their weighted average cost of capital, and

(b) if the objective of the *valuation* is to establish the *market value*, the *discount rate may* be derived from observation of the returns implicit in the price paid for real property interests traded in the market between *participants* or from hypothetical *participants*' required rates or return. When a *discount rate* is based on an analysis of market transactions, *valuers should* also follow the guidance contained in IVS 105 *Valuation Approaches and Methods*, paras 30.7 and 30.8.

60.6. An appropriate *discount rate may* also be built up from a typical "risk-free" return adjusted for the additional risks and opportunities specific to the particular real property interest.

70. Cost Approach

70.1. In applying the cost approach, *valuers must* follow the guidance contained in IVS 105 *Valuation Approaches and Methods*, paras 70.1-70.14.

70.2. This approach is generally applied to the *valuation* of real property interests through the depreciated replacement cost method.

70.3. It *may* be used as the primary approach 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.

70.4. In some cases, even when evidence of market transaction prices or an identifiable income stream is available, the cost approach *may* be used as a secondary or corroborating approach.

70.5. 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 valuation date. An exception is where an equivalent property would need to be a replica of the subject property in order to provide a *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 *must* reflect all incidental costs, as appropriate, such as the *value* of the land, infrastructure, design fees, finance costs and developer profit that would be incurred by a *participant* in creating an equivalent *asset*.

70.6. The *cost* of the modern equivalent *must* then, as appropriate, be subject to adjustment for physical, functional, technological and economic obsolescence (see IVS 105 *Valuation Approaches and Methods*, section 80). The objective of an adjustment for obsolescence is to estimate how much less valuable the subject property might, or 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.

80. Special Considerations for Real Property Interests

80.1. The following sections address a non-exhaustive list of topics relevant to the *valuation* of real property interests.

(a) Hierarchy of Interests (section 90).

(b) Rent (section 100).

90. Hierarchy of Interests

90.1. The different types of real property interests are not mutually exclusive. For example, 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, or coterminous with, the head lease out of which it is created.

90.2. These property interests will have their own characteristics, as illustrated in the following examples:

(a) 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 restrictions imposed by statute.

(b) 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 lessee, 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.

(c) A right of use *may* be held in perpetuity or *may* be for a defined period. The right *may* be dependent on the holder making payments or complying with certain other conditions.

90.3. 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 various different interests in the same property will frequently differ from the *value* of the unencumbered superior interest.

100. Rent

100.1. Market rent is addressed as a *basis of value* in IVS 104 *Bases of Value*.

100.2. When valuing either a superior interest that is subject to a lease or an interest created by a lease, *valuers must* consider the contract rent and, in cases where it is different, the market rent.

100.3. 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.

IVS 410 Development Property

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10. Overview

10.1. The principles contained in the General Standards IVS 101 to IVS 105 apply to *valuations* of development property. This standard only includes modifications, additional requirements or specific examples of how the General Standards apply for *valuations* to which this standard applies. *Valuation*s of development property *must* also follow IVS 400 *Real Property Interests*.

20. Introduction

20.1. In the context of this standard, development properties are defined as interests where redevelopment is required to achieve the highest and best use, or where improvements are either being contemplated or are in progress at the valuation date and include:

(a) the construction of buildings,

(b) previously undeveloped land which is being provided with infrastructure,

(c) the redevelopment of previously developed land,

(d) the improvement or alteration of existing buildings or structures,

(e) land allocated for development in a statutory plan, and

(f) land allocated for a higher *value* uses or higher density in a statutory plan.

20.2. *Valuations* of development property *may* be required for different *purposes*. It is the *valuer's* responsibility to understand the *purpose* of a *valuation*. A non-exhaustive list of examples of circumstances that *may* require a development valuation is provided below:

(a) when establishing whether proposed projects are financially feasible,

(b) as part of general consulting and transactional support engagements for acquisition and loan security,

(c) for tax reporting *purposes*, development valuations are frequently needed for ad valorem taxation analyses,

(d) for litigation requiring valuation analysis in circumstances such as shareholder disputes and damage calculations,

(e) for financial reporting *purposes*, *valuation* of a development property is often required in connection with accounting for business combinations, *asset* acquisitions and sales, and impairment analysis, and

(f) for other statutory or legal events that *may* require the *valuation* of development property such as compulsory purchases.

20.3. When *valuing* development property, *valuers must* follow the applicable standard for that type of *asset* or liability (for example, IVS 400 *Real Property Interests*).

20.4. The residual value or land value of a development property can be very sensitive to changes in assumptions or projections concerning the income or revenue to be derived from the completed project or any of the development costs that will be incurred. This remains the case regardless of the method or methods used or however diligently the various inputs are researched in relation to the valuation date.

20.5. This sensitivity also applies to the impact of *significant* changes in either the *costs* of the project or the *value* on completion. If the *valuation* is required for a *purpose* where *significant* changes in *value* over the duration of a construction project *may* be of concern to the user (eg, where the *valuation* is for loan security or to establish a project's viability), the *valuer must* highlight the potentially disproportionate effect of possible changes in either the construction costs or end value on the profitability of the project and the *value* of the partially completed property. A sensitivity analysis *may* be useful for this *purpose* provided it is accompanied by a suitable explanation.

30. Bases of Value

30.1. In accordance with IVS 104 *Bases of Value*, a *valuer must* select the appropriate *basis(es) of value* when *valuing* development property.

30.2. The *valuation* of development property often includes a *significant* number of assumptions and special assumptions regarding the condition or status of the project when complete. For example, special assumptions *may* be made that the development has been completed or that the property is fully leased. As required by IVS 101 *Scope of Work*, *significant* assumptions and special assumptions used in a *valuation must* be communicated to all parties to the valuation engagement and *must* be agreed and confirmed in the scope of work. Particular care *may* also be required where reliance *may* be placed by third parties on the valuation outcome.

30.3. Frequently it will be either impracticable or impossible to verify every feature of a development property which could have an impact on potential future development, such as where ground conditions have yet to be investigated. When this is the case, it *may* be appropriate to make assumptions (eg, that

there are no abnormal ground conditions that would result in significantly increased *costs*). If this was an assumption that a *participant* would not make, it would need to be presented as a special assumption.

30.4. In situations where there has been a change in the market since a project was originally conceived, a 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 development property under construction would need to reflect the current value of the alternative project and the *costs* and risks associated with completing that project.

30.5. For some development properties, the property is closely tied to a particular use or business/trading activity or a special assumption is made that the completed property will trade at specified and sustainable levels. In such cases, the *valuer must*, as appropriate, also comply with the requirements of IVS 200 *Business and Business Interests* and, where applicable, IVS 210 *Intangible Assets*.

40. Valuation Approaches and Methods

40.1. The three principal valuation approaches described in IVS 105 *Valuation Approaches and Methods may* all be applicable for the *valuation* of a real property interest. There are two main approaches in relation to the *valuation* of the development property. These are:

(a) the market approach (see section 50), and

(b) the residual method, which is a hybrid of the market approach, the income approach and the cost approach (see sections 40-70). This is based on the completed “gross development value” and the deduction of development costs and the developer’s return to arrive at the residual value of the development property (see section 90).

40.2. When selecting an approach and method, in addition to the requirements of this standard, a *valuer must* follow the requirements of IVS 105 *Valuation Approaches and Methods*, including para 10.3.

40.3. The valuation approach to be used will depend on the required *basis of value* as well as specific facts and circumstances, eg, the level of recent transactions, the stage of development of the project and movements in property markets since the project started, and *should* always be that which is most appropriate to those circumstances. Therefore, the exercise of judgement in the selection of the most suitable approach is critical.

50. Market Approach

50.1. Some types of development property can be sufficiently homogenous and frequently exchanged in a market for there to be sufficient data from recent sales to use as a direct comparison where a *valuation* is required.

50.2. In most markets, the market approach *may* have limitations for larger or more complex development property, or smaller properties where the proposed improvements are heterogeneous. This is because the number and extent of the variables between different properties make direct

comparisons of all variables inapplicable though correctly adjusted market evidence (See IVS 105 *Valuation Approaches and Methods*, section 20.5) *may* be used as the basis for a number of variables within the *valuation*.

50.3. For development property where work on the improvements has commenced but is incomplete, the application of the market approach is even more problematic. Such properties are rarely transferred between *participants* in their 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 development 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.

50.4. The market approach *may* also be appropriate for establishing the *value* of a completed property as one of the inputs required under the residual method, which is explained more fully in the section on the residual method (section 90).

60. Income Approach

60.1. Establishing the residual value of a development property *may* involve the use of a cash flow model in some markets.

60.2. The income approach *may* also be appropriate for establishing the *value* of a completed property as one of the inputs required under the residual method, which is explained more fully in the section on the residual method (see section 90).

70. Cost Approach

70.1. Establishing the development costs is a key component of the residual approach (see para 90.5).

70.2. The cost approach *may* also exclusively be used as a means of indicating the *value* of development property such as a proposed development of a building or other structure for which there is no active market on completion.

70.3. The cost approach is based on the economic principle that a buyer will pay no more for an *asset* than the amount to create an *asset* of equal utility. To apply this principle to development property, the *valuer must* consider the *cost* that a prospective buyer would incur in acquiring a similar *asset* with the potential to earn a similar profit from development as could be obtained from development of the subject property. However, unless there are unusual circumstances affecting the subject development property, the process of analysing a proposed development and determining the anticipated costs for a hypothetical alternative would effectively replicate either the market approach or the residual method as described above, which can be applied directly to the subject property.

70.4. Another difficulty in applying the cost approach to development property is in determining the profit level, which is its “utility” to a prospective buyer. Although a developer *may* have a target profit at the commencement of a project, the actual profit is normally determined by the *value* of the property at completion. Moreover, as the property approaches completion, some of

the risks associated with development are likely to reduce, which *may* impact on the required return of a buyer. Unless a fixed price has been agreed, profit is not determined by the *costs* incurred in acquiring the land and undertaking the improvements.

80. Special Considerations for a Development Property

80.1. The following sections address a non-exhaustive list of topics relevant to the *valuation* of development property:

(a) Residual Method (section 90).

(b) Existing *Asset* (section 100).

(c) Special Considerations for Financial Reporting (section 110).

(d) Special Considerations for Secured Lending (section 120).

90. Residual Method

90.1. The residual method is so called because it indicates the residual amount after deducting all known or anticipated *costs* required to complete the development from the anticipated value of the project when completed after consideration of the risks associated with completion of the project. This is known as the residual value.

90.2. The residual value can be highly sensitive to relatively small changes in the forecast cash flows and the practitioner *should* provide separate sensitivity analyses for each *significant* factor.

90.3. Caution is required in the use of this method because of the sensitivity of the result to changes in many of the inputs, which *may* not be precisely known on the valuation date, and therefore have to be estimated with the use of assumptions.

90.4. The models used to apply the residual method vary considerably in complexity and sophistication, with the more complex models allowing for greater granularity of inputs, multiple development phases and sophisticated analytical tools. The most suitable model will depend on the size, duration and complexity of the proposed development.

90.5. In applying the residual method, a *valuer should* consider and evaluate the reasonableness and reliability of the following:

(a) the source of information on any proposed building or structure, eg, any plans and specification that are to be relied on in the *valuation*, and

(b) any source of information on the construction and other *costs* that will be incurred in completing the project and which will be used in the *valuation*.

90.6. The following basic elements require consideration in any application of the method to estimate the *market value* of development property and if another basis is required, alternative inputs *may* be required.

(a) Completed property value,

(b) Construction costs,

(c) Consultants fees,

(d) Marketing costs,

(e) Timetable,

(f) Finance costs,

(g) Development profit,

(h) *Discount rate*.

Value of Completed Property

90.7. The first step requires an estimate of the *value* of the relevant interest in the real property following notional completion of the development project, which *should* be developed in accordance with IVS 105 *Valuation Methods and Approaches*.

90.8. Regardless of the methods adopted under either the market or income approach, the *valuer must* adopt one of the two basic underlying assumptions:

(a) the estimated *market value* on completion is based on *values* that are current on the valuation date on the special assumption the project had already been completed in accordance with the defined plans and specification, or

(b) the estimated value on completion is based on the special assumption that the project is completed in accordance with the defined plans and specification on the anticipated date of completion.

90.9. Market practice and availability of relevant data *should* determine which of these assumptions is more appropriate. However, it is important that there is clarity as to whether current or projected values are being used.

90.10. If estimated gross development value is used, it *should* be made clear that these are based on special assumptions that a *participant* would make based on information available on the valuation date.

90.11. It is also important that care is taken to ensure that consistent assumptions are used throughout the residual value calculation, ie, if current values are used then the *costs should* also be current and *discount rates* derived from analysis of current prices.

90.12. If there is a pre-sale or pre-lease agreement in place that is conditional on the project, or a relevant part, being completed, this will be reflected in the *valuation* of the completed property. Care *should* be taken to establish whether the *price* in a pre-sale agreement or the rent and other terms in a pre-lease agreement reflect those that would be agreed between *participants* on the valuation date.

90.13. If the terms are not reflective of the market, adjustments *may* need to be made to the *valuation*.

90.14. It would also be appropriate to establish if these agreements would be assignable to a purchaser of the relevant interest in the development property prior to the completion of the project.

Construction Costs

90.15. The *costs* of all work required at the valuation date to complete the project to the defined specification need to be identified. Where no work has started, this will include any preparatory work required prior to the main building contract, such as the *costs* of obtaining statutory permissions, demolition or off-site enabling work.

90.16. Where work has commenced, or is about to commence, there will normally be a contract or contracts in place that can provide the independent confirmation of *cost*. However, if there are no contracts in place, or if the actual contract costs are not typical of those that would be agreed in the market on the valuation date, then it *may* be necessary to estimate these *costs* reflecting the reasonable expectation of *participants* on the valuation date of the probable *costs*.

90.17. The benefit of any work carried out prior to the valuation date will be reflected in the *value*, but will not determine that *value*. Similarly, previous payments under the actual building contract for work completed prior to the valuation date are not relevant to current value.

90.18. In contrast, if payments under a building contract are geared to the work completed, the sums remaining to be paid for work not yet undertaken at the valuation date *may* be the best evidence of the construction *costs* required to complete the work.

90.19. However, contractual costs *may* include special requirements of a specific end user and therefore *may* not reflect the general requirements of *participants*.

90.20. Moreover, 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.

90.21. When valuing a partly completed development property, it is not appropriate to rely solely on projected costs and income contained in any project plan or feasibility study produced at the commencement of the project.

90.22. Once the project has commenced, this is not a reliable tool for measuring *value* as the inputs will be historic. Likewise, an approach based on estimating the percentage of the project that has been completed prior to the valuation date is unlikely to be relevant in determining the current *market value*.

Consultants’ Fees

90.23. These include legal and professional costs that would be reasonably incurred by a *participant* at various stages through the completion of the project.

Marketing Costs

90.24. If there is no identified buyer or lessee for the completed project, it will normally be appropriate to allow for the *costs* associated with appropriate marketing, and for any leasing commissions and consultants’ fees incurred for marketing not included under para 90.23.

Timetable

90.25. The duration of the project from the valuation date to the expected date of physical completion of the project needs to be considered, together with the phasing of all cash outflows for construction costs, consultants' fees, etc

90.26. If there is no sale agreement in place for the relevant interest in the development property following practical completion, an estimate *should* be made of the marketing period that might typically be required following completion of construction until a sale is achieved.

90.27. If the property is to be held for investment after completion and if there are no pre-leasing agreements, the time required to reach stabilised occupancy needs to be considered (ie, the period required to reach a realistic long-term occupancy level). For a project where there will be individual letting units, the stabilised occupancy levels *may* be less than 100 percent if market experience indicates that a number of units *may* be expected to always be vacant, and allowance *should* be considered for *costs* incurred by the owner during this period such as additional marketing costs, incentives, maintenance and/or unrecoverable service charges.

Finance Costs

90.28. These represent the *cost* of finance for the project from the valuation date through to the completion of the project, including any period required after physical completion to either sell the interest or achieve stabilised occupancy. As a lender *may* perceive the risks during construction to differ substantially from the risks following completion of construction, the finance cost during each period *may* also need to be considered separately. Even if an entity is intending to self-fund the project, an allowance *should* be made for interest at a rate which would be obtainable by a *participant* for borrowing to fund the completion of the project on the valuation date.

Development Profit

90.29. Allowance *should* be made for development profit, or the return that would be required by a buyer of the development property in the market place for taking on the risks associated with completion of the project on the valuation date. This will include the risks involved in achieving the anticipated income or capital value following physical completion of the project.

90.30. This target profit can be expressed as a lump sum, a percentage return on the *costs* incurred or a percentage of the anticipated value of the project on completion or a rate of return. Market practice for the type of property in question will normally indicate the most appropriate option. The amount of profit that would be required will reflect the level of risk that would be perceived by a prospective buyer on the valuation date and will vary according to factors such as:

(a) the stage which the project has reached on the valuation date. A project which is nearing completion will normally be viewed as being less risky than one at an early stage, with the exception of situations where a party to the development is insolvent,

(b) whether a buyer or lessee has been secured for the completed project, and

(c) the size and anticipated remaining duration of the project. The longer the project, the greater the risk caused by exposure to fluctuations in future *costs* and receipts and changing economic conditions generally.

90.31. The following are examples of factors that *may* typically need to be considered in an assessment of the relative risks associated with the completion of a development project:

(a) unforeseen complications that increase construction costs,

(b) potential for contract delays caused by adverse weather or other matters outside of developer's control,

(c) delays in obtaining statutory consents,

(d) supplier failures,

(e) entitlement risk and changes in entitlements over the development period,

(f) regulatory changes, and

(g) delays in finding a buyer or lessee for the completed project.

90.32. Whilst all of the above factors will impact the perceived risk of a project and the profit that a buyer or the development property would require, care *must* be taken to avoid double counting, either where contingencies are already reflected in the residual valuation model or risks in the *discount rate* used to bring future cash flows to present value.

90.33. The risk of the estimated value of the completed development project changing due to changed market conditions over the duration of the project will normally be reflected in the *discount rate* or capitalisation rate used to value the completed project.

90.34. The profit anticipated by the owner of an interest in development property at the commencement of a development project will vary according 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.

Discount Rate

90.35. In order to arrive at an indication of the *value* of the development property on the valuation date, the residual method requires the application of a *discount rate* to all future cash flows in order to arrive at a net present value. This *discount rate may* be derived using a variety of methods (see IVS 105 *Valuation Approaches and Methods*, paras 50.30-50.39.

90.36. If the cash flows are based on *values* and *costs* that are current on the valuation date, the risk of these changing between the valuation date and the anticipated completion date *should* be considered and reflected in the *discount rate* used to determine the present value. If the cash flows are based on prospective values and *costs*, the risk of those projections proving to be inaccurate *should* be considered and reflected in the *discount rate*.

100. Existing Asset

100.1. In the *valuation* of development property, it is necessary to establish the suitability of the real property in question for the proposed development. Some matters *may* be within the *valuer's* knowledge and experience but some *may* require information or reports from other specialists. Matters that typically need to be considered for specific investigation when undertaking a *valuation* of a development property before a project commences include:

(a) whether or not there is a market for the proposed development,

(b) is the proposed development the highest and best use of the property in the current market,

(c) whether there are other non-financial obligations that need to be considered (political or social criteria),

(d) legal permissions or zoning, including any conditions or constraints on permitted development,

(e) limitations, encumbrances or conditions imposed on the relevant interest by private contract,

(f) rights of access to public highways or other public areas,

(g) geotechnical conditions, including potential for contamination or other environmental risks,

(h) the availability of, and requirements to, provide or improve necessary services, eg, water, drainage and power,

(i) the need for any off-site infrastructure improvements and the rights required to undertake this work,

(j) any archaeological constraints or the need for archaeological investigations,

(k) sustainability and any *client* requirements in relation to green buildings,

(l) economic conditions and trends and their potential impact on *costs* and receipts during the development period,

(m) current and projected supply and demand for the proposed future uses,

(n) the availability and *cost* of funding,

(o) the expected time required to deal with preparatory matters prior to starting work, for the completion of the work and, if appropriate, to rent or sell the completed property, and

(p) any other risks associated with the proposed development.

100.2. Where a project is in progress, additional enquires or investigations will typically be needed into the contracts in place for the design of the project, for its construction and for supervision of the construction.

110. Special Considerations for Financial Reporting

110.1. The accounting treatment of development property can vary depending on how it is classified by the reporting entity (eg, whether it is being held for sale, for owner occupation or as investment property). This *may* affect the valuation requirements and therefore the classification and the relevant accounting requirements need to be determined before selecting an appropriate valuation method.

110.2. Financial statements are normally produced on the assumption that the entity is a going concern. It is therefore normally appropriate to assume that any contracts (eg, for the construction of a development property or for its sale or leasing 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.

120. Special Considerations for Secured Lending

120.1. The appropriate *basis of value* for secured lending is normally *market value*. However, in considering the *value* of a development property, regard *should* be given to the probability that any contracts in place, eg, for construction or for the sale or leasing of the completed project *may*, become void or voidable in the event of one of the parties being the subject of formal insolvency proceedings. Further regard *should* be given to any contractual obligations that *may* have a material impact on *market value*. Therefore, it *may* be appropriate to highlight the risk to a lender caused by a prospective buyer of the property not having the benefit of existing building contracts and/or pre-leases, and pre-sales and any associated warrantees and guarantees in the event of a default by the borrower.

120.2. To demonstrate an appreciation of the risks involved in valuing development property for secured lending or other *purpose*s, the *valuer should* apply a minimum of two appropriate and recognised methods to valuing development property for each valuation project, as this is an area where there is often “insufficient factual or observable inputs for a single method to produce a reliable conclusion” (see IVS 105 *Valuation Approaches and Methods*, para 10.4).

120.3. The *valuer must* be able to justify the selection of the valuation approach(es) reported and *should* provide an “As Is” (existing stage of development) and an “As Proposed” (completed development) value for the development property and record the process undertaken and a rationale for the reported value (see IVS 103 *Reporting*, paras 30.1-30.2).

IVS 500 Financial Instruments

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10. Overview

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

20. Introduction

20.1. A financial instrument is a contract that creates rights or obligations between specified parties to receive or pay cash or other financial consideration. Such instruments include but are not limited to, derivatives or other contingent instruments, hybrid instruments, fixed income, structured products and equity instruments. A financial instrument can also be created through the combination of other financial instruments in a portfolio to achieve a specific net financial outcome.

20.2. *Valuation*s of financial instruments conducted under IVS 500 *Financial Instruments* can be performed for many different *purposes* including, but not limited to:

(a) acquisitions, mergers and sales of businesses or parts of businesses,

(b) purchase and sale,

(c) financial reporting,

(d) legal or regulatory requirements (subject to any specific requirements set by the relevant authority),

(e) internal risk and compliance procedures,

(f) tax, and

(g) litigation.

20.3. A thorough understanding of the instrument being valued is required to identify and evaluate the relevant market information available for identical or comparable instruments. Such information includes *prices* from recent transactions in the same or a similar instrument, quotes from brokers or pricing services, credit ratings, yields, volatility, indices or any other inputs relevant to the valuation process.

20.4. When *valuation*s are being undertaken by the holding entity that are intended for use by external investors, regulatory authorities or other entities, to comply with the requirement to confirm the identity and status of the *valuer* in IVS 101 *Scope of Work*, para 20.3.(a), reference *must* be made to the control environment in place, as required by IVS 105 *Valuation Approaches and Methods* and IVS 500 *Financial Instruments* paras 120.1-120.3 regarding control environment.

20.5. To comply with the requirement to identify the *asset* or liability to be valued as in IVS 101 *Scope of Work*, para 20.3.(d), the following matters *must* be addressed:

(a) the class or classes of instrument to be valued,

(b) whether the *valuation* is to be of individual instruments or a portfolio, and

(c) the unit of account.

20.6. IVS 102 *Investigations and Compliance*, paras 20.2-20.4 provide that the investigations required to support the *valuation must* be adequate having regard to the *purpose* of the assignment. To support these investigations, sufficient evidence supplied by the *valuer* and/or a credible and reliable third party *must* be assembled. To comply with these requirements, the following are to be considered:

(a) All market data used or considered as an input into the valuation process *must* be understood and, as necessary, validated.

(b) Any model used to estimate the *value* of a financial instrument shall be selected to appropriately capture the contractual terms and economics of the financial instrument.

(c) Where observable prices of, or market inputs from, similar financial instruments are available, those imputed inputs from comparable price(s) and/or observable inputs *should* be adjusted to reflect the contractual and economic terms of the financial instrument being valued.

(d) Where possible, multiple valuation approaches are preferred. If differences in *value* occur between the valuation approaches, the *valuer must* explain and document the differences in *value*.

20.7. To comply with the requirement to disclose the valuation approach(es) and reasoning in IVS 103 *Reporting*, para 20.1, consideration *must* be given to the appropriate degree of reporting detail. The requirement to disclose this information in the valuation report will differ for different categories of financial instruments. 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 liability, or that obscures the

primary factors influencing *value*, *must* be avoided. In determining the level of disclosure that is appropriate, regard *must* be had to the following:

(a) 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.

(b) Uncertainty: The *value* of the instrument *may* be subject to *significant* 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.

(c) Complexity: The greater the complexity of the instrument, the greater the appropriate level of detail to ensure that the assumptions and inputs affecting *value* are identified and explained.

(d) 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.

(e) Underlying instruments: If the cash flows of a financial instrument are generated from or secured by identifiable underlying *assets* or liabilities, the relevant factors that influence the underlying value *must* be provided in order to help users understand how the underlying value impacts the estimated value of the financial instrument.

30. Bases of Value

30.1. In accordance with IVS 104 *Bases of Value*, a *valuer must* select the appropriate *basis(es) of value* when valuing financial instruments.

30.2. Often, financial instrument valuations are performed using *bases of value* defined by entities/organisations other than the IVSC (some examples of which are mentioned in IVS 104 *Bases of Value*) and it is the *valuer's* responsibility to understand and follow the regulation, case law, tax law and other interpretive guidance related to those *bases of value* as of the valuation date.

40. Valuation Approaches and Methods

40.1. When selecting an approach and method, in addition to the requirements of this chapter, a *valuer must* follow the requirements of IVS 105 *Valuation Approaches and Methods*.

40.2. The three valuation approaches described in IVS 105 *Valuation Approaches and Methods may* be applied to the *valuation* of financial instruments.

40.3. The various valuation methods used in financial markets are based on variations of the market approach, the income approach or the cost approach as described in the IVS 105 *Valuation Approaches and Methods*. This standard describes the commonly used methods and matters that need to be considered or the inputs needed when applying these methods.

40.4. When using a particular valuation method or model, it is important to ensure that it is calibrated with observable market information, where available, on a regular basis to ensure that the model reflects current market conditions. As market conditions change, it *may* become necessary to change to a more suitable model(s) or to modify the existing model and recalibrate and/or make additional adjustments to the valuation inputs. Those adjustments *should* be made to ensure consistency with the required valuation basis, which in turn is determined by the *purpose* for which the *valuation* is required; see the IVS *Framework*.

50. Market Approach

50.1. A *price* obtained from trading on a liquid exchange 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 transactions, the evidence of quoted or consensus prices, or private transactions *may* also be relevant.

50.2. It *may* be necessary to make adjustments to the price information if the observed instrument is dissimilar to that being valued or if the information is not recent enough to be relevant. For example, if an observable price is available for similar instruments with one or more different characteristics to the instrument being valued, then the implied inputs from the comparable observable price are to be adjusted to reflect the specific terms of the financial instrument being valued.

50.3. When relying on a *price* from a pricing service, the *valuer must* understand how the *price* was derived.

60. Income Approach

60.1. The *value* of financial instruments *may* be determined using a discounted cash flow method. The terms of an instrument determine, or allow estimation of, the undiscounted cash flows. The terms of a financial instrument typically set out:

(a) the timing of the cash flows, ie, when the entity expects to realise the cash flows related to the instrument,

(b) the calculation of the cash flows, eg, for a debt instrument, the interest rate that applies, or for a derivative instrument, how the cash flows are calculated in relation to the underlying instrument or index (or indices),

(c) the timing and conditions for any options in the contract, eg, put or call, prepayment, extension or conversion options, and

(d) 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.

60.2. 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 value of money and potential additional risks from, but not limited to the following:

(a) the terms and conditions of the instrument, eg, subordination,

(b) the credit risk, ie, uncertainty about the ability of the counterparty to make payments when due,

(c) the liquidity and marketability of the instrument,

(d) the risk of changes to the regulatory or legal environment, and

(e) the tax status of the instrument.

60.3. Where future cash flows are not based on fixed contracted amounts, estimates of the expected cash flows will need to be made in order to determine the necessary inputs. The determination of the *discount rate must* reflect the risks of, and be consistent with, the cash flows. For example, if the expected cash flows are measured net of credit losses then the *discount rate must* be reduced by the credit risk component. 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 *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 *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.

70. Cost Approach

70.1. In applying the cost approach, *valuers must* follow the guidance contained in IVS 105 *Valuation Approaches and Methods*, paras 70.1-70.14.

80. Special Considerations for Financial Instruments

80.1. The following sections address a non-exhaustive list of topics relevant to the *valuation* of financial instruments:

(a) Valuation Inputs (section 90).

(b) Credit Risk (section 100).

(c) Liquidity and Market Activity (section 110).

(d) Control Environment (section 120).

90. Valuation Inputs

90.1. As per IVS 105 *Valuation Approaches and Methods*, para 10.7, any data set used as a valuation input, understanding the sources and how inputs are adjusted by the provider, if any, is essential to understanding the reliance that *should* be given to the use of the valuation input.

90.2. Valuation inputs *may* come from a variety of sources. Commonly used valuation input sources are broker quotations, consensus pricing services, the *prices* of comparable instruments from third parties and market data pricing services. Implied inputs can often be derived from such observable prices such as volatility and yields.

90.3. When assessing the validity of broker quotations, as evidence of how

participants would price an *asset*, the *valuer should* consider the following:

(a) Brokers generally make markets and provide bids in respect of more popular instruments and *may* not extend coverage to less liquid instruments. Because liquidity often reduces with time, quotations *may* be harder to find for older instruments.

(b) A broker is concerned with trading, not supporting *valuation*, and they have little incentive to research an indicative quotation as thoroughly as they would an executable quotation. A *valuer* is required to understand whether the broker quote is a binding, executable quote or a non-binding, theoretical quote. In the case of a non-binding quote, the *valuer* is required to gather additional information to understand if the quote *should* be adjusted or omitted from the *valuation*.

(c) There is an inherent conflict of interest where the broker is the counterparty to an instrument.

(d) Brokers have an incentive to encourage trading.

90.4. Consensus pricing services operate by collecting price or valuation input information about an instrument from several participating subscribers. They reflect a pool of quotations from different sources, sometimes with adjustment to compensate for any sampling bias. This overcomes the conflict of interest problems associated with single brokers. However, as with a broker quotation, it *may* not be possible to find a suitable input for all instruments in all markets. Additionally, despite its name, a consensus price *may* not necessarily constitute a true market "consensus", but rather is more of a statistical estimate of recent market transactions or quoted prices. Therefore, the *valuer* needs to understand how the consensus pricing was estimated and if such estimates are reasonable, given the instrument being valued. Information and inputs relevant to the *valuation* of an illiquid instrument can often be gleaned through comparable transactions (see section 110 for further details).

100. Credit Risk Adjustments

100.1. Understanding the credit risk is often an important aspect of valuing a financial instrument and most importantly the issuer. Some of the common factors that need to be considered in establishing and measuring credit risk include the following:

(a) Own credit and counterparty risk: Assessing the financial strength of the issuer or any credit support providers will involve consideration of not only historical and projected financial performance of the relevant entity or entities but also consideration of performance and prospects for the industry sector in which the business operates. In addition to issuer credit, the *valuer must* also consider the credit exposure of any counterparties to the *asset* or liability being valued. In the case of a clearing house settlement process, many *jurisdictions* now require certain derivatives to be transacted through a central counterparty which can mitigate risk, however residual counterparty risk needs to be considered.

(b) The *valuer* also needs to be able to differentiate between the credit risk of the instrument and the credit risk of the issuer and/or counterparty. Generally, the credit risk of the issuer or counterparty does not consider specific collateral related to the instrument.

(c) 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.

(d) Leverage: The amount of debt used to fund the *assets* from which an instrument's return is derived can affect the volatility of returns to the issuer and credit risk.

(e) Netting agreements: Where derivative instruments are held between counterparties, 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.

(f) 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. Credit exposure 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 any other guarantees or insurance contracts the entity has written. If the provider of a guarantee has also guaranteed other correlated debt securities, the risk of its non-performance will likely increase.

100.2. For parties for which limited information is available, if secondary trading in a financial instrument exists, there *may* be sufficient market data to provide evidence of the appropriate risk adjustment. If not, it might be necessary to look to credit indices, information available for entities with similar risk characteristics, or estimate a credit rating for the party using its own financial information. The varying sensitivities of different liabilities to credit risk, such as collateral and/or maturity differences, *should* be taken into account in evaluating which source of credit data provides the most relevant information. The risk adjustment or credit spread applied is based on the amount a *participant* would require for the particular instrument being valued.

100.3. The own credit risk associated with a liability is important to its *value* as the credit risk of the issuer is relevant to the *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, 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 and can only settle the liability with the counterparty.

100.4. Collateral: The *assets* to which the holder of an instrument has recourse in the event of default need to be considered. In particular, the *valuer* needs to be understand whether recourse is to all the *assets* of the issuer or only to specified *asset(s)*. The greater the *value* and liquidity of the *asset(s)* to which an entity has recourse in the event of default, the lower the overall risk of the instrument due to increased recovery. In order not to double count, the *valuer* also needs to consider if the collateral is already accounted for in another area of the balance sheet.

100.5. When adjusting for own credit risk of the instrument, 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 exposure. If liabilities are subject to a frequent collateralisation process, there might not be a material own credit risk adjustment because the counterparty is mostly protected from loss in the event of default.

110. Liquidity and Market Activity

110.1. The liquidity of financial instruments range from those that are standardised and regularly transacted in high volumes to those that are agreed between counterparties that are incapable of assignment to a third party. This range 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.

110.2. Liquidity and market activity are distinct. 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. Low market activity for an instrument does not necessarily imply the instrument is illiquid.

110.3. Although separate concepts, illiquidity or low levels of market activity pose similar 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 comparable transactions to reflect either market changes or differing characteristics of the *asset*.

120. Valuation Control and Objectivity

120.1. 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. Where an external *valuer* is placing reliance upon an internally performed valuation, the external *valuer must* consider the adequacy and independence of the valuation control environment.

120.2. In comparison with other *asset* classes, financial instruments are more commonly valued internally by the same entity that creates and trades them. Internal valuations bring into question the independence of the *valuer* and hence this creates risk to the perceived objectivity of *valuation*s.

Please reference 40.1 and 40.2 of the IVS *Framework* regarding *valuation* performed by internal *valuers* and the need for procedures to be in place to ensure the objectivity of the *valuation* and steps that *should* be taken to ensure that an adequate control environment exists to minimise threats to the independence of the *valuation*. Many entities which deal with the *valuation* of financial instruments are registered and regulated by statutory financial regulators. Most financial regulators require banks or other regulated entities that deal with financial instruments to have independent price verification procedures. These operate separately from trading desks to produce *valuation*s required for financial reporting or the calculation of regulatory capital guidance on the specific valuation controls required by different regulatory regimes. This is outside the scope of this standard. However, as a general principle, *valuation*s produced by one department of an entity that are to be included in financial statements or otherwise relied on by third parties *should* be subject to scrutiny and approval by an independent department of the entity. Ultimate authority for such *valuation*s *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*.

120.3. When accessing your valuation controls, the following include items you *should* consider in the valuation process:

(a) 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,

(b) systems for regulatory compliance if applicable,

(c) a protocol for the frequency and methods for calibration and testing of valuation models,

(d) criteria for verification of certain *valuations* by different internal or external experts,

(e) periodic independent validation of the valuation model(s),

(f) identifying thresholds or events that trigger more thorough investigation or secondary approval requirements, and

(g) identifying procedures for establishing *significant* inputs that are not directly observable in the market, eg, by establishing pricing or audit committees.

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