THE HONG KONG INSTITUTE OF
SURVEYORS
香 港 測 量 師 學 會

HKIS VALUATION Standards 2020

TABLE OF CONTENTS

2 FOREWORD

4 ACKNOWLEDGEMENTS

8 PART A: INTRODUCTION

12 PART B: GLOSSARY OF TERMS USED IN THE STANDARDS

PART C: GENERAL VALUATION STANDARDS
20 VS 1 – Compliance with International Valuation Standards and HKIS Valuation Standards
25 VS 2 – Qualifications of a Valuer / Valuation Reviewer
27 VS 3 – Ethics, Professionalism and Conflict of Interests
38 VS 4 – Terms of Engagement
47 VS 5 – Bases of Value
58 VS 6 – Valuation Approaches and Methods
74 VS 7 – Valuation Processes and Records
77 VS 8 – Assumptions and Special Assumptions
81 VS 9 – Reporting
92 VS 10 – Real Property Interests
101 VS 11 – Development Property

Part D: GUIDANCE NOTE
110 VGN 1 – Business Interests and Business Enterprises
116 VGN 2 – Intangible Assets
128 VGN 3 – Valuation for Financial Statements and Accounts Reporting Purposes
131 VGN 4 – Valuations of Real Properties for Secured Lending

140 Part E: INTERNATIONAL VALUATION STANDARDS (IVS)

FOREWORD

On behalf of the Hong Kong Institute of Surveyors ("HKIS") , I am delighted to introduce the institute's latest *Valuation Standards* publication of 2020, which is the third edition since the first release in 2012.

At the *HKIS*, we understand that the valuation of assets plays a crucial role in the financial and real estate markets and the necessity for the institute's *Valuation Standards* to align with internationally-recognised ones. With the release of the new versions of the *International Valuation Standards ("IVS")* by the International Valuation Standards Council and the Royal Institution of Chartered Surveyors' publication of the *Red Book Global Standards*, the Valuation Standards Panel of *HKIS* led by Sr CK Lau, reviewed the *HKIS Valuation Standards 2017* to ensure that changes in international guidelines would be reflected in our institute's version.

Following an extensive consultation of stakeholders and collaboration by the panel, this new edition incorporates the latest changes in the *IVS*, and most importantly, maintains the principle of enhancing clarity and ease of use by incorporating the principles and concepts that promote consistency and transparency in the valuation practice, bolstering the confidence of public and private stakeholders, both locally and globally.

As the only professional surveying body statutorily incorporated in the Hong Kong Special Administrative Region, we will maintain our strive for excellence to ensure that our professionals deliver the highest level of professionalism. I am grateful to the Valuation Standards Panel for all their hard work and efforts in preparing this new edition for providing industry leading direction and guidance to members of the *HKIS* so that they can exercise their duties with the highest levels of professionalism, integrity, clarity, reliability and impartiality.

I hope that you will find the publication a useful and informative guide for conducting the valuation of assets in the financial and property markets.

Sr SHIU Wai Yee, Winnie
President
The Hong Kong Institute of Surveyors
July 2020

ACKNOWLEDGEMENTS

The first edition of the HKIS Valuation Standards ("Standards") was published in 2012 as a unified and concise set of valuation standards to replace the following:-

- *The HKIS Valuation Standards on Trade-related Business Assets and Business Enterprises*
- *The HKIS Valuation Standards on Property*
- *Guidance Note on Valuations of Properties for Mortgage Purpose*

The *Standards* were updated in 2017, and are well known among valuers, Lands Tribunal and courts. Today, the *Standards* are widely regarded as an authoritative reference source on best practices in the valuation profession.

The International Valuation Standards Council ("IVSC") has made a series of enhancements to the *International Valuation Standards* ("*IVS*"), and the latest version came into effect on 31 January 2020. To maintain the highest standards of valuation professionalism, it is incumbent on the HKIS General Practice Division ("GPD") Council to review and revise our valuation standards to ensure alignment with the *IVS*.

The *HKIS Valuation Standards 2020* was drafted and published by the Valuation Standards Panel of the HKIS GPD Council following extensive consultation under the leadership of Sr CK Lau. The panel consists of the 14 experienced valuation professionals listed below.

1. Sr CK LAU
2. Sr Karl LI
3. Sr Victor CHOW
4. Mr Alton WONG
5. Sr Dorothy CHOW
6. Sr Ken LAM
7. Sr Eddie KWOK
8. Sr Cyrus FONG
9. Sr Kenneth TONG
10. Sr KB WONG
11. Sr Gary MAN
12. Sr Yuki CHAN
13. Ms Joanne LAW
14. Ms Chelsea YIP

You will find in the *HKIS Valuation Standards 2020*, inter alia, the following key updates:

Part A Introduction:	- Description of the growing relevance of sustainability factors.
Part B Glossary:	- Definitions of "Intended Use", "Intended User", "Residual Method", "Valuation" and "Value (noun)".
VS 4 Terms of Engagement:	- Identification of the asset(s) being valued for non-financial liabilities.
VS 6 Valuation Approaches and Methods:	- Circumstances where valuation may be limited and restricted. - Type of cash flow and discount rate under Income Approach. - Addition of a new section on valuation model.
VS 9 Reporting:	- Requirement of appropriate extent of description of valuation approaches and methods in valuation reports.
VS 10 Real Property Interests:	- Assessment of the implications for value related to sustainability factors.
VS 11 Development Property:	- Addition of a new chapter on Development Property to include different valuation approaches and methods that may be applicable in the valuation of development properties, such as the Residual Method.
VGN 1 Business Interests and Business Enterprises:	- Addition of the phrase "and/or liabilities" following the word assets". - Valuation method on different capital structures.
VGN 3 Valuation for Financial Statements and Accounts Reporting Purposes:	- Addition of a new section on Development Property to require relevant accounting requirements for development properties to be determined before selecting an appropriate valuation method.
VGN 4 Valuations of Real Properties for Secured Lending:	- Requirement of a minimum of two appropriate methods in valuing development site for secured lending or other purposes for demonstrating the consideration of the risks involved.

HKIS is grateful to IVSC for consenting to the adoption of *IVS* in *the Standards*. Many thanks are also due to the Royal Institution of Chartered Surveyors ("RICS") for permitting reference to be made to the *RICS Valuation – Global Standards*.

Finally, on behalf of the GPD Council, I express my sincere appreciation to all our panel members who dedicated their time and expertise to this critical milestone towards elevating our practice standards to yet another level.

Sr CHAN Chi Hing, Alnwick
Chairman
General Practice Division
The Hong Kong Institute of Surveyors

July 2020

PART A:
INTRODUCTION

1. Background of the *HKIS Valuation Standards* *("the Standards")*

1.1 'The *HKIS Valuation Standards on Trade-related Business Assets and Business Enterprises*' was first published in 2004 (the *"HKIS BVS"*) to cater for the growing need of the general public for business *valuation reports* due to the prosperous development of the merger and acquisition activities in Hong Kong since late-1990s. The first issue of the *HKIS BVS*, which is a mandatory standard to our members, comprised 5 practice statements and 2 guidance notes.

1.2 *'The HKIS Valuation Standards on Properties'* was first published in 2005 (the *"HKIS PVS"*) to cater for the growing need of the general public for a professional real property *valuation* service due to the development of a more sophisticated real property market in both Hong Kong and neighbouring regions when entering the 21st century. The first issue of the *HKIS PVS*, which is a mandatory standard to our members, comprised 8 valuation standards and 1 guidance note. There exists a separate *Guidance Notes on Valuations of Properties for Mortgage Purpose*, Second Edition, 2005, which is referred to by the *HKIS PVS* VS8.

1.3 *'The HKIS Valuation Standards – 2012 Edition'* was first published to cater for the drastic changes over in the capital market and the financial reporting standards in Hong Kong and a greater demand for various types of *valuation* services on different types of *property*. *HKIS* GPD believed that a unified and concise set of valuation standards, which was mandatory in nature, should be issued to cope with the changes.

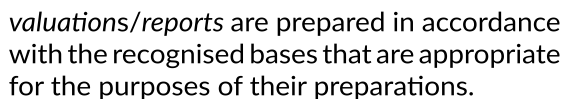
1.4 Since the 2012 Edition of the *Standards*, there have been significant developments in *International Valuation Standards ("IVS")* published by the International Valuation Standards Council ("IVSC"), of which the *HKIS* is a Valuation Organisation Member. As the *HKIS* is committed to achieving the objective of securing a set of common valuation standards acceptable worldwide, the *HKIS* would therefore, wherever possible, adopt the standards set by the IVSC in *the Standards*. In the light of such development, the Valuation Standards Panel of the *HKIS* General Practice Division ("GPD") Council has decided to conduct a comprehensive review of the *Standards* with a view to continuing to maintain the best professional standard in preparing *valuation reports*.

1.5 In preparing *the Standards*, the *HKIS* has taken into account opinions and advice given by members of the Securities and Futures Commission of Hong Kong ("SFC"), Hong Kong Institute of Certified Public Accountants and The Hong Kong Association of Banks wherever appropriate, and intends that *the Standards* shall be used by the *members* who deal with the *valuation* of *properties*.

1.6 The *HKIS* should endeavor to ensure that all information contained in *the Standards* is accurate, updated and complies with the laws, rules and regulations of Hong Kong. The *HKIS* reserves the rights to make any changes to *the Standards* from time to time as a result of any changes in law, rules and regulations, market practices, government policies, requirements of the Hong Kong Exchanges and Clearing Limited ("HKEx") or SFC and for any other reasons as the *HKIS* deems appropriate without further notice. The *HKIS* will publish an updated version of *the Standards* from time to time and *members* shall obtain an updated version of *the Standards* from the *HKIS* website at www.*HKIS*.org.hk. The *HKIS* accepts no responsibility and shall not be held responsible or liable for any losses or damages that *may* be suffered or incurred by any person or entity as a result of his or its relying on any information provided in *the Standards*. In the event that any *member* has queries or doubts arising out of or concerning the interpretation, application or implementation of *the Standards*, the *member should* write to the *HKIS*, in order to seek its view on such queries or doubts. *The Standards* shall be governed by and construed in accordance with the laws of Hong Kong. In the event that there is any inconsistency between the laws of Hong Kong and *the Standards*, the laws of Hong Kong shall prevail to the extent of such inconsistency.

2. Principal objectives of the *Standards*

2.1 The principal objectives of *the Standards* are to provide appropriate directions or guidance to *members* so that the *valuations*/*reports* prepared by them can achieve the highest standards of professionalism, integrity, clarity, reliability and impartiality, and that the



valuations/*reports* are prepared in accordance with the recognised bases that are appropriate for the purposes of their preparations.

2.2 *The Standards* define:

(a) Criteria used to establish whether a *member* is appropriately qualified to act as a *valuer* (as defined in *the Standards*) and the steps suggested to assist them in dealing with any actual or perceived threat against their acting independently and impartially in preparing a *valuation*/ *report*;

(b) Matters to be considered by a *member* when agreeing to the terms and conditions of an engagement for a *valuation*;

(c) *Bases of value*, *assumptions* and *material* considerations that *must* be taken into account when preparing a *valuation*/ *report*;

(d) Minimum contents required of a *report*; and

(e) Matters to be disclosed if the *valuations*/ *reports may* be relied upon by *third parties*.

2.3 *The 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 *the Standards* are met, *reports should* always be appropriate and proportionate to the task; and

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

2.4 It is emphasised that although *the Standards* sets out the minimum standards that the *members* shall comply with in *valuations*, it remains the responsibility of an individual *member* to exercise his reasonable and professional judgement in a *valuation*, including but not limited to incorporating all relevant information into the *valuation reports*.

2.5 *The Standards* adopts in full and applies the *International Valuation Standards ("IVS")* published by the International Valuation Standards Council ("IVSC"), included as part of *the Standards*.

2.6 The aim of *the Standards* is to engender confidence, and to provide assurance to *clients* and recognised users alike, that a *valuation* provided by a qualified *valuer* will be undertaken to the highest professional standards overall.

2.7 *The Standards* is required to be used and complied with by *members* who deal with a *valuation*. However, in the event that there is any conflict between *the Standards* and the standards of local practice overseas, *the Standards should* not be interpreted as imposing a lower standard than the standards adopted overseas and the *members* shall follow *the Standards* to the extent as much as is practicable.

2.8 It is the duty of all *members* carrying out *valuation* work to have knowledge of and be fully aware of the contents and requirements of *the Standards*, and to apply them.

3. Arrangement of *the Standards*

3.1 *The Standards* comprises General Valuation Standards (VS) and Valuation Guidance Note (VGN).

3.2 The General Valuation Standards (VS) are mandatory (unless otherwise stated) for all *members* providing *valuations* in writing. They define the parameters for compliance with the *Standards* and contain the specific requirements and related implementation guidance, directed to the provision of a *valuation* that is IVS- compliant.

3.3 The Valuation Guidance Notes (VGN) provide further implementation guidance in the specific instances listed. Thus, among the topics covered, they include *valuations* for specific purposes, and *valuations* of certain specific *asset* types, where particular issues and/or practical considerations expressly need to be taken into account. These VGNs embody 'best practice' – that is procedures that in the opinion of *HKIS* meet a high standard of professional competence. While not themselves mandatory, the VGNs do include links and cross references to the material in the VS that is mandatory. This is intended to assist *members* in identifying materials relevant to the particular *valuation* assignment they are undertaking.

3.4 *The Standards* contains a Glossary Section at Part B to enhance and maintain the professional standard of the *members* in preparing the *valuations*/*reports* in accordance with the requirements set out in *the Standards*.

4. Relationship to the financial reporting standards

4.1 The *Institute* considers that it is not appropriate to provide a direct link between *the Standards* and the financial reporting standards in Hong Kong. However, the *Institute* notes that in some instances *members* need to follow a set of procedures as required by the financial reporting standards to arrive at a value other than a *market value* to aid the auditors in the establishment or restatement of *financial statements*, such as 'value in use' or 'purchase price allocation in a business combination'. In this context, *members* need to disclose the set of procedures in the *report* and to follow *the Standards* whenever and wherever possible in preparing the *report*.

5. Effective date, amendments and additions

5.1 This *HKIS Valuation Standards 2020* comes into effect on 31 December 2020 to replace the previous *HKIS Valuation Standards 2012 Edition*. *The Standards* shall apply to all *valuations* where the *valuation date* is on or after that date. Early adoption of these standards, after final approval, is encouraged.

The contents of *the Standards* are under regular review and any amendments and additions will be issued by the *HKIS* from time to time as required. Whenever *the Standards* has been amended, the effective date of the amended *Standards* will be updated.

6. Sustainability

6.1 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. HKIS-qualified valuers are at the forefront of the valuation profession and the *HKIS Valuation Standards 2020* is their definitive implementation guide.

7. Other information

7.1 In *the Standards*: (a) references to the masculine include, where appropriate, the feminine; and (b) words in the singular number include the plural and vice versa; and (c) headings are inserted for convenient reference only and have no effect in limiting or extending the language of the provisions to which they refer.

7.2 *The Standards* has been approved and published by the *HKIS* General Council as the guidance notes under Bye-Law 6.1 of Part VI Professional Conduct of Bye-Laws of the HKIS.

7.3 The *IVS* are reproduced in full at the end of this *Standards*. They are adopted and applied through this *Standards*, with an effective date of 31 January 2020.

7.4 *Members* are reminded that IVSC reserves the rights to make further amendments to IVS at any time. Any consequential amendments to this *Standards*, if necessary in connection with any further amendments of IVS, will be made as soon as possible, but may not be reflected in hard copy versions of *the Standards*. *Members* are reminded to check, from time to time, for the most updated version of *the Standards* at the *HKIS* website www.*HKIS*.org.hk

7.5 If *members* or any other persons wish to comment or give their views on *the Standards*, they are welcomed to contact The Hong Kong Institute of Surveyors by writing to Room 1205, 12/F, Wing On Centre, 111 Connaught Road Central, Sheung Wan, Hong Kong or by e-mail to info@hkis.org.hk.

Published by The Hong Kong Institute of Surveyors
Room 1205, 12/F, Wing On Centre
111 Connaught Road Central
Sheung Wan, Hong Kong

Tel : 2526 3679
Facsimile : 2868 4612
E-mail : info@hkis.org.hk
Website : www.hkis.org.hk

© HKIS December 2020. Unless otherwise stated, copyright in all or any part of the Standards rests with the HKIS, and save with the prior written consent of the HKIS (which consent may be granted or rejected at the sole discretion of the HKIS), no part of the Standards shall be reproduced by any means, whether electronic, mechanical, photocopying or otherwise, now known or to be devised. All rights reserved.

PART B:
GLOSSARY OF TERMS USED IN THE STANDARDS

1. This glossary defines terms used in *the Standards* that have a special or restricted meaning. Where a term defined below is used in *the Standards*, it is identified in the text of *italic* font. Words or phrases not in this glossary or not in *italic* font follow their common dictionary meanings.

2. *HKIS* believes that *members* who prepare a *report* shall possess specialised skills, experiences, expertise and knowledge. Also, *members* shall communicate the procedures to value and conclusions, in a manner that is clear and not misleading, to their *clients*, unless otherwise instructed. As such, it is advisable for the valuation profession to use commonly used terms, which definitions have been established clearly and consistently and have been widely applied in the profession to enhance consistency and to develop better communications.

3. In order to enhance and maintain the professional standard, *HKIS* has adopted certain definitions published by various institutions, including but not limited to IVSC, in *the Standards*. *Members* are highly recommended to adopt such definitions in the *reports* whenever necessary.

4. If any *member* wishes to adopt any definition that is materially different from the definition set out in *the Standards*, the *member should* set out such definition and the authoritative source of such definition clearly in the *report* and, where possible, *terms of engagement* in order to avoid misunderstandings, confusion and potential disputes.

appraisal	See *valuation*.
asset	Items that might be subject to a *valuation* engagement. Unless otherwise specified in the standard, this term can be considered to mean *asset*, group of *assets*, liability, group of liabilities, or group of *assets* and liabilities.
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 *member* as part of the *valuation* process. Typically, *assumptions* are 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*.
client	The person, persons, or entity for whom the *valuation* is performed, that agrees the *terms of engagement* or to which the *report* is addressed. This *may* include external *clients* (i.e. when a *valuer* is engaged by a *third-party client*) as well as internal *clients* (i.e. *valuations* performed for an employer).
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 *the Standards may* be inappropriate or impractical.

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.
director(s)	The individual(s) responsible for the management of a company, *firm* or entity. This also includes, where the context so admits, the corresponding officers charged with similar duties (for example, trustees) of an undertaking, enterprise or other organisation, which does not have directors.
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.
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 Standard 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 financial reporting standards and the law.
firm	The firm or organisation for which the *member* works, or through which the *member* trades. Closely connected companies within a group should normally be regarded as a single firm unless: (i) The companies are separate legal entities (ii) There are no directors, partners or employees in common between the companies (iii) There is no direct or indirect fee sharing between the companies and (iv) There is no access to information or common internal data sharing arrangements relating to the area of conflict.
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*, e.g. a work of art or an antique, would not be described as 'inspection' as such.
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*.

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*.
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 production or supply of goods or services, or for administrative purposes, or (b) sale in the ordinary course of business.
(the) Institute/HKIS	The Hong Kong Institute of Surveyors incorporated under the Hong Kong Institute of Surveyors Ordinance (Chapter 1148 – Laws of Hong Kong).
investment value, or worth	The *value* of an *asset* to the owner or a prospective owner for individual investment or operational objectives.
jurisdiction	The legal and regulatory environment in which a *valuation* engagement is performed. This generally includes laws and regulations set by governments (e.g. country, state and municipal) and, depending on the purpose, rules set by certain regulators (e.g. banking authorities and securities regulators).
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.
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.
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*.
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*.
member	Any *member* under the membership of Honorary Grade, Professional and Technical Grade or any affiliate as referred to in the Constitution of the Hong Kong Institute of Surveyors from time to time.

method of valuation	A *method of valuation* is a procedure, or series of steps, to arrive at the value specified in the *basis of valuation*. Example of such methods include market comparison method, the investment method, the *residual method*, discounted cash flow method and the profits method.
must	The work "must" indicates an unconditional responsibility. The *valuer* must fulfill responsibilities of this type in all cases in which the circumstances consistent with the objectives of *the Standards*.
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.
report	Unless otherwise specified in *the Standards*, this term can be considered to mean "*valuation report*", "valuation review report" or both.
residual method	A method which bases on the completed gross development value and the deduction of development costs and the developer's return to arrive at the residual *value* of a development property.
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 Standards* 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.
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 judgements 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.
special assumption	An *assumption* that either assume 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. Examples include refineries, power stations, docks, specialised manufacturing facilities, public facilities, churches, museums, so on and so forth.
(the) Standards	The *HKIS Valuation Standards.*
sustainability	Sustainability is, for the purpose of this *Standards*, taken to mean the consideration of matters such as (but not restricted to) environment and climate change, health and well-being 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. [Note: There is, as yet, no universally recognised and globally adopted definition of 'sustainability', and therefore *members should* exercise caution over the use of the term without additional explanation.]
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.*
terms of engagement	Confirmation in writing 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*/valuation review.
third party	Any party, other than the *client*, who *may* have an interest in the *valuation* or its outcome.
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	A "valuation" refers to the act or process of determining an estimate of *value* of an *asset* or liability by applying VS. An opinion of the *value* of an *asset* or liability, at a specified date, given in writing. Unless limitations are agreed in the *terms of engagement*, this 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*. The wording "估價" and "估值" in Chinese bears the same meaning of *valuation* throughout this *Standards*.
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.
valuation method	See *method of valuation*.
valuation report	The means in writing of providing the *client* with the final conclusion of a *valuation* or *appraisal*.
valuation reviewer	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*.
value (noun)	The word "value" refers to the judgement of the *valuer* of the estimated amount consistent with one of the bases of *value* set out in **VS5 – Bases of Value**.
valuer	The *member* who is undertaking / undertook a *valuation*. *Unless* proven otherwise by evidence, the valuer of a *valuation* is identified as: (a) the *member* who appears as the signatory of the *report*; or (b) in case condition (a) above does not apply; the *member* who has the Vicarious Liability under the Rules of Conduct of *HKIS*. For the *valuer* who is qualified to undertake a *valuation*, see **VS2 – Qualifications of a Valuer**.
weight	The amount of reliance placed on a particular indication of *value* in reaching a conclusion of *value* (e.g. when a single method is used, it is afforded 100% weight).
weighting	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* without reasons, which is not acceptable.
worth	See *investment value*

PART C:
GENERAL VALUATION STANDARDS

VS 1

Compliance with *International Valuation Standards* and *HKIS Valuation Standards*

All *members*, whether practicing individually or working on behalf of his *firm*, who provide a *valuation* in writing are required to comply with the *International Valuation Standards* and *HKIS Valuation Standards*.

1.1.0 Mandatory Application

1.1.1 All *members*, wherever practising, *must* comply with the general valuation standards (designated by prefixes **VS**) in Part C of *the Standards*. For practical convenience, the term "*members*" include both "member" and "affiliate" as defined in the Constitution of *HKIS* from time to time.

1.1.2 *The Standards* is of mandatory application to any *member* of *HKIS* involved in undertaking or supervising *valuation* services by the provision of *valuation* advice in writing.

1.1.3 The phrase 'undertaking or supervising *valuation* services' includes any person who is responsible for, or accepts responsibility for, analysing and communicating an opinion of *value* in writing. This may include individuals who produce but do not sign *valuation reports* within their organization, and conversely individuals who sign by way of supervision or assurance but do not produce *valuation reports* within their organisation.

1.1.4 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.

1.1.5 Except as otherwise stated, *valuations* of real property for secured lending *should* be prepared in accordance with **VGN 4 - Valuations of Real Properties for Secured Lending** published by the *HKIS* from time to time

1.2.0 Compliance with *International Valuation Standards*

1.2.1 *HKIS* recognises that *International Valuation Standards Council (IVSC)* as the setter of *International Valuation Standards (IVS)*, which comprise internationally accepted *valuation* principles and definitions. *The Standards* adopts and applies the *IVS*, setting out specific requirements for, together with additional guidance on their practical implementation. The *IVS* effective from 31 January 2020 are set out in full as Part E at the end of *the Standards*.

1.2.2 Where there is an express requirement in relation to an individual *valuation* assignment that the *valuation* complies with the *IVS*, and this needs to be made clear both in the *terms of engagement* and in the *report*, then the form of endorsement in **VS 4 Terms of Engagement paragraph 4.3.2(n)** and **VS 9 Reporting paragraph 9.2.3(k)** *may* be adopted. Or otherwise, the general form of endorsement that the *valuation* will be / has been undertaken in accordance with *the HKIS Valuation Standards may* be used.

1.2.3 *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.

1.3.0 Compliance with other valuation standards

1.3.1 It is recognised that a *member* may be requested to provide a *report* that complies with standards other than *the 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 **VS 5** below, provided it is absolutely clear which standards are being adopted.

1.3.2 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 Standards* and – if appropriate – with the *IVS*.

1.3.3 Where the compliance with other valuation standards is voluntary, i.e. not falling within paragraph 1.3.2 above, this will involve a *departure* – see section 1.5.0 below. Note that compliance with such standards cannot override the mandatory requirements of **VS 1, 2 and 3**, which *members must* at all times observe.

1.3.4 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.

1.4.0 VS 4 - 10 Exceptions

1.4.1 All *valuation* advice in writing given by *members* is subject to at least some of the requirements of *the Standards* - there are no exemptions. Similarly, where *valuation* advice is given wholly orally, the principles set out in the *Standards should* still be observed to the fullest extent possible. Thus **VS 1, 2 and 3** are mandatory in all cases. In other words, they apply to all *members* whatever type of *valuation* activity they are engaged in.

1.4.2 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 the **VS 4 – 10** may be unsuitable or inappropriate. Even though not mandatory in certain circumstances, the adoption of the relevant standards is nevertheless encouraged where not precluded by the specific requirement or context. These exceptions regarding **VS 4 – 10** 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 **VS 4 – 10** as mandatory.

1.4.3 *Valuers should* be aware that exceptions are not usually specific to individual cases but cover particular categories or aspects of *valuation* activity. In such cases *members* are reminded that they *must* not state that the *valuation* was performed in accordance with the *IVS*.

1.4.4 The areas of exception in relation to **VS 4 – 10** are where a *member* is:

1.4.4.1 Providing an agency or brokerage service in respect of the acquisition or disposal of one or more *assets*

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. It is recognized that any *member*, who may not be a Corporate Member from the General Practice Division, *may* provide agency or brokerage services to his *client*. It is perfectly proper for all *members* to provide their opinions on the *values* of subject *assets* in the course of agency services, **provided that the term "*valuation*" *must* not be used in any communications with the *client***. However, the exception does not cover a purchase report that includes a *valuation*.

1.4.4.2 Acting or preparing to act as an arbitrator, independent *valuer*, expert witness or mediator

When *members* act in a capacity ofarbitrators, independent *valuers*, expert witnesses and mediators for resolution of certain disputes such as rent review, exceptions of **VS 4 – 10** will apply since they *may* have to comply with certain statutory and/or other mandatory requirements imposed as a result of their appointment. However, when a *member* acts as an independent *valuer* or expert witness, the *member* shall, wherever practicable and with no conflict with their terms of appointment, follow the requirements set out in *the Standards*. The exception setting out in this paragraph does not apply in circumstances where the *value* is not yet in dispute, for example, when a *report* is required as part of the process of settling a different matter, such as a matrimonial

separation dispute.

In Hong Kong, *members* are reminded that they *must* follow the Code of Conduct for Expert Witnesses as set out in Appendix D of The Rules of The High Court (Chapter 4A – Laws of Hong Kong) when a *member* acts as an expert witness.

1.4.4.3 Performing statutory functions

This exception applies 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.

1.4.4.4 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 advice itself in writing 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 advice in writing to be absolutely clear about non-disclosure to *third parties*, and about the exclusion of liability, becomes even more crucial.

1.4.4.5 Providing *valuation* advice expressly in preparation for, or during the course of, negotiations or litigation, including where the *valuer* is acting as advocate.

The negotiation 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 the creation of an unresolved dispute, triggering (where the context allows it) a formal process of resolution (e.g. 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 Standards*.
- Advice given to a *client* may extend to various matter 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.

1.4.5 For all exceptions, the fact that **VS 4 – 10** are

not mandatory does not mean that they are simply to be ignored – as a matter of good practice they *should* be followed where not precluded by the specific requirement or context.

1.4.6 The exceptions shall not apply if a *client* specifically requires a *report* to be prepared in accordance with the requirements set out in *the Standards*. Further, even if a *report* is prepared under the condition that it shall comply with certain statutory or other mandatory requirements, *the Standards* will also apply, subject to such amendments as may be necessary to meet with those statutory or other mandatory requirements.

1.5.0 Departures

1.5.1 No *departure* is permitted from **VS 1**, where a *valuation* in writing is provided, or **VS 2 and 3** in *the Standards*, which are mandatory in all circumstances.

1.5.2 If separately and independently from either the specific exceptions set out above or any assignment falling within the scope of **section 1.3.0** above, there are special circumstances where it is considered inappropriate to comply, in whole or in part, with **VS 4 – 10**, 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.

1.5.3 A clear statement in writing ofany *departures*, if any, together with details of, and reasons for them, and the *client*'s agreement, *must* be given in the *terms of engagement* and the *report*.

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 **VS 5** 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. *HKIS* does not encourage the voluntary use of a *basis of value* not defined in **VS 5**, and will always regards such voluntary use as involving a *departure* from *the Standards*.

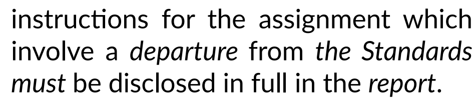
1.5.4 When statutory, legal, regulatory, or other authoritative requirements *must* be followed that differ from some of the requirements within *the Standards*, a *member* *must* follow the statutory, legal, regulatory, or other authoritative requirements. Such a *valuation* has still been performed in overall compliance with *the Standards*. (Also see **section 1.3.0** above)

1.5.5 The requirement to depart from *the Standards* pursuant to legislative, regulatory or other authoritative requirements takes precedence over all other requirements from *the Standards*.

1.5.6 Most other professional bodies, or *firms*' internal policies and procedures will impose additional requirements on the *member* rather than contradict to *the Standards*. Such requirements *may* be followed in addition to *the Standards* without being seen as *departures* or exceptions as long as all of the requirements in *the Standards* are fulfilled.

1.5.7 If a *member* is asked to perform an assignment that departs from *the Standards* or calls for something less than, or different from, the work normally performed in compliance with *the Standards*, the *member* *should* accept and perform such services only when the following conditions are satisfied:

- The *member* determines that the instructions will not mislead all the *intended users;*
- The *member* determines that the *valuation* is not so limited to the extent that the results are no longer reliable and credible for the intended purpose and use of the *valuation*; and
- The *member* advises the *client* that the



instructions for the assignment which involve a *departure* from *the Standards* *must* be disclosed in full in the *report*.

1.5.8 A *member* who makes a *departure* will be required to justify the reasons for this *departure* to the *HKIS* (or the disciplinary bodies of the *Institute* set up on its behalf or the GPD Council who has commenced investigation for such purpose) *should* the *departure* be called into question. If the *HKIS* is not satisfied with the reason(s) provided and/or the manner in which the *departure* is declared or made, it is entitled to take appropriate disciplinary actions under Rules of Conduct.

1.5.9 Each *valuation* to which *the Standards* applies *must* be prepared by, or under the supervision of, an appropriately qualified *valuer*, who is also a Corporate Member of the GPD Council of *HKIS*. Other than complying with the requirements set out in *the Standards*, in each and every case of preparing a *report*, it is the ultimate responsibility of the *member*, and not the *client* or other *intended users*, to determine whether any *departures* from *the Standards* are reasonable and justifiable.

1.6.0 Regulation: monitoring compliance with *the Standards*

1.6.1 As a self-regulatory body, *HKIS* has a responsibility to monitor and seek assurance of compliance by its *members* with *the Standards*. It has the right under its bye- laws to seek information from *members*. The procedures under which such powers will be exercised in relation to *valuations* are set out at www.*HKIS*.org.hk/en/*HKIS*_constitution. php.

VS 2

Qualifications of a *Valuer / Valuation Reviewer*

2.1.0 As it is fundamental to the integrity of the *valuation* process, all *members* practising as *valuers / valuation reviewers must* have the appropriate experiences, skills and judgements 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.

2.2.0 Testing on Qualification Requirement
The testing of whether a *member* is appropriately qualified to accept responsibility for, or supervise the input into a *valuation* / valuation review involves satisfying the following criteria:

- a Corporate Member from the General Practice Division of the *HKIS;*
- 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*/ valuation review competently;
- compliance with any country or state legal regulations governing the rights to undertake the *valuation*/valuation review; and
- compliance with the requirements on qualified valuer imposed by the General Practice Division of the *HKIS* from time to time.

2.2.1 A qualified *valuer must* be a Corporate Member from the General Practice Division of the *HKIS*, but the Professional Membership from the General Practice Division of the *HKIS* does not of itself imply that a Corporate Member has the practical experience of *valuation* in a particular sector or market: this *must* always be verified by appropriate confirmation.

2.2.2 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, accountants and lawyers.

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

2.3.0 In conducting real property *valuations* for incorporation or reference in prospectuses and circulars and *valuations* in connection with takeovers or mergers and acquisitions in Hong Kong, a qualified *valuer must* be on the *HKIS* List of the Property Valuers for such purposes as published by the *HKIS* from time to time.

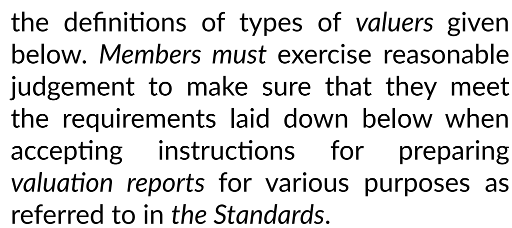
2.4.0 The *client*'s approval *must* be obtained if the *member* proposes another *firm* to provide some or all the *valuations* that are the subject of the instruction.

2.5.0 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 **VS 1**.

2.6.0 A *member* responsible for supervision (See **VS 1 paragraph 1.1.3**) *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.

2.7.0 The attention of *members* is drawn to



the definitions of types of *valuers* given below. *Members must* exercise reasonable judgement to make sure that they meet the requirements laid down below when accepting instructions for preparing *valuation reports* for various purposes as referred to in *the Standards*.

2.7.1 Internal Valuer

An 'Internal Valuer' is 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* and has no significant financial interest in the company or organisation that he works at. A significant financial interest refers to a person, his family members or associates entitling (individually or collectively) to exercise, or control the exercise of, 5% or more of the voting power at any general meeting of the *client*'s company or group.

2.7.2 External Valuer

An 'External Valuer' is 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.

2.7.3 Independent Valuer

An 'Independent Valuer' is an External Valuer and who can fulfill all the requirements set out in **section 3.2.0 of VS 3** of *the Standards*.

2.7.4 Joint Valuers

The term 'Joint Valuers' *should* only be used on those occasions where two (or more) *valuers* are jointly (and severally) appointed to provide a *valuation*. In such cases a single *valuation report may* be provided carrying the signatures of the Joint Valuers together with their names and addresses.

VS 3

Ethics, Professionalism and Conflict of Interests

As it is fundamental to the integrity of the *valuation* process, all *members* practising as *valuers must* always act in a professional and ethical manner from any undue influence, bias or conflict of interest.

3.1.0 Professional and ethical standards

3.1.1 *HKIS members* operate to the highest professional and ethical standards. Thus the criteria for *HKIS* membership and for qualification and practice as a *valuer* meet or exceed the standards for the conduct and competency of professional *valuers* promoted by the IVSC.

3.1.2 As well as being required to conform to these high-level principles and requirements, all *HKIS members* are subject to additional – and in many cases more stringent – requirements as set out below. Observance is monitored and enforced through *HKIS* Bye-laws and Rules of Conduct.

3.1.3 The requirements set out in this *Standards* are expressly focused 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*.

3.1.4 *Members must* at all times act with integrity and avoid any actions or situations that are inconsistent with their professional obligations. *Members must* not allow conflicts of interest to override their professional or business judgement and obligations, and *must* not divulge confidential information. All *members* are bound by the *HKIS* Rules of Conduct. More detail is available at www. *HKIS*.org.hk/en/ *HKIS*_rules.php.

3.2.0 Independence, objectivity, confidentiality and the identification and management of conflicts of interests

3.2.1 *Members must* use reasonable care and judgements to achieve and maintain independence and objectivity in a *valuation*. A *member must* not offer, solicit, or accept any gift, benefit, compensation, or consideration that reasonably could be expected to compromise their own or another's independence and objectivity.

3.2.2 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.

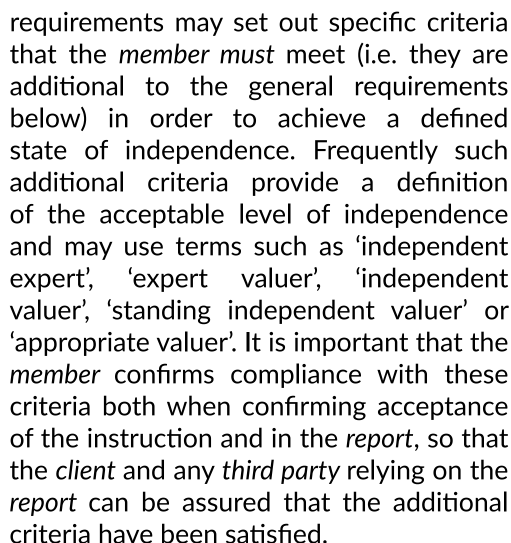
3.2.3 *Valuers should* recognise two fundamental requirements on conflicts of interest:

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 defined in **paragraph 3.2.8** below. (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 the 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.

3.2.4 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 valuation standards and valuation-specific criteria.

3.2.5 For some purposes, statutes, regulations, rules of regulatory bodies or *client's* special



requirements 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.

3.2.6 Three common types of conflict of interests which may arise in a *valuation* are identified as follows:

a) **Party Conflict** – a situation in which the duty of a *member* or his *firm* to act in the interests of a *client* or other party in a professional assignment conflicts with a duty owed to another *client* or party in relation to the same or a related professional assignment.
b) **Own Interest Conflict** – a situation in which the duty of a *member* or his *firm* to act in the interests of a *client* in a professional assignment conflicts with the interests of that same *member* or his *firm*.
c) **Confidential Information Conflict** – a conflict between the duty of a *member* to provide *material* information to one *client*, and the duty of that *member* or his *firm* to another *client* to keep that same information confidential.

The above is only three common types and it is not possible to set out every possible scenario. *Members* are reminded they have their absolute duty of care to identify and avoid any actual or potential conflicts of interests. *Members should* always consider whether the proposed course of action might:

- Reasonably be perceived to imply a lack of integrity;
- Cause embarrassment to the profession; or
- Mean that you are unable to advise and represent each *client* objectively and independently.

If there is a material risk of the proposed course of action having such an effect, the *member must* not proceed. A *member must* disclose to his *firm* on any actual or potential conflict of interests.

3.2.7 Where a conflict of interest or a significant risk of one exists, a *member should* only consider proceeding with the work (and seek Informed Consent defined in 3.2.8 below from all relevant affected party in order to proceed) if the *member* are reasonably satisfied that all of the relevant *clients*' (or other parties') interests will be served by the *member* or his *firm* doing the work (as opposed to another *firm* doing it). A *member should* not seek Informed Consent in order to proceed because his *firm*'s interest are served by doing so. Obtaining Informed Consent is a process that requires proper considerations, professional judgements, and careful executions with every affected party.

3.2.8 An Informed Consent means a consent given willingly by a party who may be affected by a conflict of interest, that party having demonstrated to the *member* that the party understands:

a) that there is a conflict of interest or a significant risk of a conflict of interest;
b) the facts known by the *member* or his *firm* that are material to the conflict of interest;
c) what that conflict of interest is or may be; and
d) that a conflict of interest may affect the ability of the *member* or his *firm* to advise or act fully in the interests of a *client*.

3.2.8.1 Giving Informed Consent is the way in which a party who might be affected adversely by a conflict of interests acknowledges the existence for that risk, but instructs the *member* to proceed despite that risk. The affected party can only give Informed Consent if the person explaining the position to them:

- is entirely transparent about any material factors; and
- 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.

3.2.8.2 The fact that the affected parties are willing to give Informed Consent does not mean that the *member* or his *firm* has to proceed. The *member* or his *firm must* still exercise professional judgement and decide whether it is the correct thing to do and be sure that they will not cause professional embarrassment to the *member*, his *firm* or the profession by proceeding where there is a conflict of interest.

3.2.8.3 In obtaining Informed Consent to a conflict of interest (or a significant risk of one) the *member should* consider and discuss with the affected parties:

i) all of the matters set out in the definition of Informed Consent; and
ii) what precautions *should* be taken in the conduct of the *valuation* to protect them.

3.2.8.4 In seeking to obtain Informed Consent, the effect is that the degree of sophistication and nature of the party concerned *must* be reflected in the information provided in order to be satisfied that the party has understood what they are doing and is giving Informed Consent willingly. A large corporate entity is likely to appreciate more readily the risks involved in giving Informed Consent, whereas a small business or individual person who rarely employs professionals may require greater detail to understand the position.

3.2.8.5 There may be reasons to believe that the party affected does not have sufficient understanding of the issues to make an informed decision on the implications of what is required. In such a case, the instruction *should* be declined, unless the prospective *client* has taken advice from an independent and suitably qualified professional (for example, a lawyer or an accountant) about the situation before instructing the *member* or his *firm* to proceed despite a conflict of interests.

3.2.8.6 A decision to proceed with a *valuation* by obtaining Informed Consent *should* be recorded in the *terms of engagement* and the *report*.

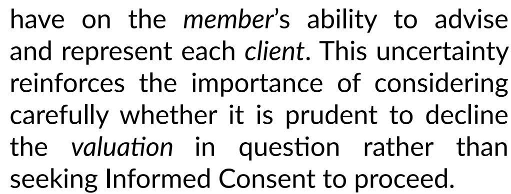
3.2.8.7 Communications with the affected parties from whom Informed Consent is obtained *should* also be auditable. This is because in the event of a complaint, an investigation, or a civil claim, the onus will be on the *member* or the *firm* to show that Informed Consent was obtained. If such communications are not made in writing, it *may* be difficult for Informed Consent to be proved, particularly after some time has passed, or if the account of those communications from the *member* or his *firm* is contested. Therefore if Informed Consent is obtained in a meeting or by telephone, communication in writing *should* be sent as soon as possible afterwards, noting the content and conclusion of the discussion. To avoid risk of criticism, this proof *should* not be that consent was obtained, but that Informed Consent was obtained, as defined above.

3.2.8.8 It is for the *member* or his *firm* to decide what type of document to use in each context in order to achieve Informed Consent as defined above. The explanation given about the conflict of interests (or significant risk of it) needs to be fair and accurate, and appropriate given the degree of sophistication of the person signing it, and the party signing it needs to do so freely, demonstrating an understanding of the situation.

3.2.8.9 To comply with the requirements for obtaining Informed Consent, the prospective *client must* be told, and understand, the nature of the competing interest. If it is not possible to achieve that without breaching a duty of confidentiality owed to another *client* or party, it will mean that the *member* or his *firm* cannot proceed with the new *valuation*.

3.2.8.10 Parties who may be affected by a conflict of interest include the instructing party and, if practical to obtain an Informed Consent, other third parties who may rely upon the *valuation*. In case it is not practical to obtain an Informed Consent from third parties who may rely upon the *valuation*, *members should* only consider proceeding with the work if satisfied that all the relevant parties' interests will be served as opposed to another firm doing it.

3.2.9 One of the greatest challenges in acting with a conflict of interest is predicting with certainty what the effect of the conflict of interest, even if managed carefully, might



have on the *member*'s ability to advise and represent each *client*. This uncertainty reinforces the importance of considering carefully whether it is prudent to decline the *valuation* in question rather than seeking Informed Consent to proceed.

3.2.10 Even where a conflict of interest (or a significant risk of a conflict of interests) does not exist at the outset of a *valuation*, it can arise during the lifetime of the *valuation*. This means that conflict of interest *must* be considered and applied – and appropriate records made – not only when new *valuations* are being considered, but also as the *valuations* progress.

3.2.11 A *member* or his *firm* who obtained the Informed Consent may still be required to justify to *HKIS* the reasons to proceed with the *valuation*.

3.2.12 Any information in a *valuation should* be taken as confidential, unless:

a) such information comes from a reliable source in the public domain;
b) such information has been publicized and such information was intended to be publicized by all the relevant affected parties; or
c) all the relevant affected parties have given their prior Informed Consents to the disclosure of such information.

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.

3.2.13 In particular, great care *must* be exercised not to breach confidentiality when reporting to *clients* in regard to compliance with **VS 9** concerning reference to the 'key inputs used'. The duty of confidentiality will always take precedence over the duty of disclosure, subject to legal override.

3.2.14 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 the Confidential Information Conflict above. 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.

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

3.2.16 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 action as specified in paragraph 3.2.7 above:

- 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.

3.2.17 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 his or her fundamental duty to provide an objective opinion. Where such conversations take place, the *member must* make a record in writing 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.

3.2.18 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 or *asset*, relevant to the *valuation* task.

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

1) The opinion is provisional and subject to completion of the final *report*;
2) The advice is provided for *client's* internal purposes only; and
3) 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.

3.2.20 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 influence by those discussions, other than to correct inaccuracies or incorporate any further information provided.

3.2.21 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.

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

3.3.0 Maintaining strict separation between advisers

3.3.1 In case an Informed Consent has been obtained for 'Party Conflict' or 'Confidential Information Conflict', a *member* or his *firm must* make arrangements to separate the advisors of the *firm*. 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.

3.3.2 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 writing, *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.

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

3.3.3 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.

3.4.0 Professionalism

3.4.1 Competence

3.4.1.1 *Valuations must* be prepared by an individual or *firm* 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*.

3.4.1.2 If a *member* 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 *terms of engagement* and the *report*.

3.4.1.3 A *member must* have the technical skills, experience and knowledge to understand, interpret and utilize the work of any specialists.

3.4.1.4 Details of the qualification requirements of a *member* in preforming a *valuation* are discussed in **VS 2**.

3.4.2 Suitability

3.4.2.1 Consistent with the various requirements set out in the *Standards* and to ensure that all relevant matters have been, or will be, adequately covered, it is fundamental that by the time any *valuation* in writing is concluded, but prior to the issue of the *report*, all the matters *material* to the *report* 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.

3.4.2.2 *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.

3.4.2.3 The standards for minimum *terms of engagement* are set out in **VS 4**. Where **VS 4** is not mandatory, 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.

3.4.2.5 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 evidencedby, comprehensive documentation maintained in a recognised and acceptable business format.

3.4.2.6 If a *member* is asked to perform an assignment that departs from *the Standards* or calls for something less than, or different from, the work normally performed in compliance with *the Standards*, the *member should* accept and perform such services only when the following conditions are satisfied:

- The *member* determines that the instructions will not mislead all the *intended users;*
- The *member* determines that the *valuation* is not so limited to the extent that the results are no longer reliable and credible for the intended purpose and use of the *valuation*; and
- The *member* advises the *client* that the instructions for the assignment which involve a *departure* from *the Standards must* be disclosed in full in the *report*.

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

3.5.1 Disclosure requirements

3.5.1.1 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, 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.

3.5.2 Reliance by third parties

3.5.2.1 Where reliance may be placed on a *valuation* by a *third party* 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.

3.5.2.2 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 3.7.0** below for further detail about disclosures in relation to specific categories of *valuation*.

3.5.2.3 *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.

3.5.2.4 *Members* are reminded to notice the applicable law on the reliance of a *valuation* by *third parties* in different *jurisdiction*.

3.5.3 The relationship with the *client* and previous involvement

3.5.3.1 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*. In cases of doubt it is recommended that a disclosure is made.

3.5.3.2 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*.

3.5.3.3 In considering the disclosures required, it is necessary to identify the '*client*' and '*firm*'.

3.5.3.4 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 **VS 4**) and reporting (see **VS 9**), the *client* is the entity that agrees the *terms of engagement* or to which the *report* is addressed while the *firm* is the entity that is identified in the confirmation of the *terms of engagement* and the *report*.

3.5.3.5 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.

3.5.3.6 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 *the Standards*.

3.5.3.7 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 agent for different legal entities, for example, the managers of a property fund.

3.5.3.8 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. *Members* should note the definition of *firm* in Glossary of Terms Used in the Standards.

3.5.4 Rotation policy

3.5.4.1 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.

3.5.4.2 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*.

3.5.4.3 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, *HKIS* 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.
- *HKIS* considers it good practice, albeit not mandatory, to rotate *valuers* at intervals not exceeding seven years.

3.5.4.4 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*.

3.5.5 Time as signatory

3.5.5.1 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.

3.5.5.2 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.

3.5.5.3 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.

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

3.5.6 Previous involvement

3.5.6.1 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.

3.5.6.2 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 3.5.6.1** 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 3.5.7** immediately below.

3.5.7 Proportion of fees

3.5.7.1 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.

3.5.7.2 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.

3.5.8 Other disclosures

3.5.8.1 Care *should* be taken to make sure that, in addition to the various disclosures required under **VS 4 to VS 10**, 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*.

3.6.0 Reviewing another valuer's valuation

3.6.1 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.

3.6.2 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 or *asset* included in another *valuer*'s *report*.

3.6.3 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.

3.6.4 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.

3.6.5 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. This paragraph does not apply to any legal proceedings or any investigation carried out by *HKIS*, regulatory authorities or other affected parties.

3.7.0 Responsibility for the valuation

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

3.7.2 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 3.7.1** above, but the others involved *may* be acknowledged ensuring that any statements expressly required under **VS 9 - Reporting** are made.

3.7.3 *HKIS* 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.

3.7.4 *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.

3.7.5 *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.

VS 4
Terms of Engagement

4.1.0 General principles

4.1.1 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.

4.1.2 *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.

4.1.3 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.

4.1.4 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 **VS 9**. These generally mirror the requirements set out here, but with some additional detail.

4.1.5 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.

4.1.6 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.

4.2.0 Terms of engagement format

4.2.1 *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 *the Standards*. The *valuer may* need to amend such a form to refer to those matters that will be clarified at a later date.

4.2.2 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 *terms of engagement* in writing 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.

4.3.0 Terms of engagement (scope of work)

4.3.1 *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) 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* and/or *HKIS Valuation Standards*

o) The basis on which the fee will be calculated
p) A statement setting out any limiting conditions have been agreed.

4.3.2 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***. HKIS 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.

(i) 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.

(ii) 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, **VS 3 section 3.2.0** will apply.

(iii) 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 **VS 9 paragraph 9.2.3 (a)**). More extensive guidance on independence and objectivity is given in **VS 3 section 3.2.0**.

(iv) 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 **VS 3 section 3.2.0** 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.

(i) 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.

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

(ii) 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*.

(iii) 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.

(iv) *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)* being valued:

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

(i) The legal interest in each *asset 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.

(ii) 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 *real estate*.

(iii) 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).

(iv) 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*.

(v) For non-financial liabilities, see IVS 220.

e) Valuation (financial) currency

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

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

(i) 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.

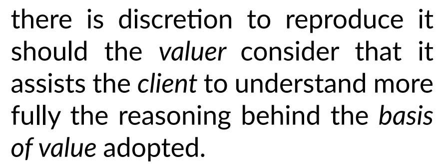
(i) If the *client* declines to reveal the purpose of the *valuation*, *valuers should* be aware that it *may* be difficult to comply with all aspects of *the Standards*. If the *valuer* is willing to proceed with the *valuation*, the *client must* be advised in writing that this omission will be referred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

(ii) 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.

(i) Where a valuation basis is expressly defined in *the 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.

(ii) 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.

(iii) 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 **VS 8 section 8.4.0**.

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.

(i) 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.

(ii) Where, exceptionally, the advice being provided relates to a future date, see **VS 8 section 8.4.0 and VS 9 paragraph 9.2.3(f)**, 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*.

(i) 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. A restricted service will also include any limitations on *assumptions* made in accordance with **VS 8**. 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*.

(ii) 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*.

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

(iv) 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 **VS 9**)

(v) **VS 7** 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.

(i) 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.

(ii) 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.

(i) *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.

(ii) 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 **VS 8**.

(iii) *HKIS* recognises the '*Value* for Sale under Repossession' (VSR) as a *valuation* under *special assumptions* on actual or potential marketing constraints, but not as a *basis of value.*

l) Format of the *report*

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

(i) **VS 9** 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.

(ii) A *report* prepared in accordance with this standard and with **VS 9** *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.

(iii) *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.

(iv) Where necessary for the purpose of brevity, *members* may provide a separate summary of *values*, provided that it is part of a *valuation report* prepared for the required same purpose and complying fully with *the Standards*, and clearly cross referenced and stated as such.

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.

(i) The *valuer must* state the permitted use, distribution and publication of the *valuation report*.

(ii) Restrictions are only effective if notified to the *client* in advance.

(iii) 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.

(iv) 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*.

(v) 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* and/or *HKIS Valuation Standards*

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 *HKIS Valuation Standards*, which incorporate the *IVS*.

In both cases an accompanying note and explanation of any *departures* from the *IVS* or *the 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.

(i) 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 *HKIS Valuation Standards* carries with it the dual assurance of compliance with the IVS technical standards and with the *HKIS Valuation Standards* overall.

(ii) References to the *HKIS Valuation Standards* without reference to the year of issue will be taken to mean the version of the *HKIS 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 version that applies.

(iii) The statement of compliance *should* draw attention to any *departures* (see **VS 1 section 1.5.0**). Where a *departure* is made that is not mandatory, it will not be possible to confirm compliance with the IVS.

(iv) Where other valuation standards – specific to a particular *jurisdiction* – will be followed, this *should* be confirmed as a part of agreement in the *terms of engagement*.

o) The basis on which the fee will be calculated

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. *HKIS* does not publish any scale of recommended fees.

p) A statement setting out any limiting conditions that have been agreed

The issues of risk, liability and insurance are closely linked. 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.

4.4.0 *Valuation* to reflect marketing constraints

4.4.1 Both the *client* and the *valuer* shall agree to the actual or anticipated marketing constraint as set out in the *terms of engagement* (see paragraph 4.4.2 (k) above).

4.4.2 The term 'forced sale *value*' *must* not be used as it is not a recognised *basis of value*; rather 'forced sale' is a description of the situation under which the transfer takes place.

4.4.3 The *Institute* recognises the '*Value* for Sale under Repossession' is a *valuation* to reflect marketing constraints but not a *basis of value*.

4.5.0 *Valuation* to be carried out with restricted information

Prior to the issue of a *report*, a *valuer* shall confirm in writing with the *client* the basis of restricted information, its nature and its possible implications upon the *valuation report*.

4.6.0 *Valuation* engagement to conduct a critical review of another *valuer's valuation*

4.6.1 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.

4.6.2 Subject to the following requirements, a *valuation reviewer may*, on the instruction of the *client*, conduct the critical review on the basis of agreed-upon procedures for the *client's* internal reference:-

(a) The *client* in the *terms of engagement* agrees that the nature and scope of the procedures are adequate for his purpose.
(b) The *valuation reviewer* in the *terms of engagement* and his valuation review report discloses the limitation he has in conducting his valuation review.
(c) The *valuation reviewer* in the *terms of engagement* and his valuation review report states that should additional documents and facts be available to him at a later date, he *may* reserves the right to amend his findings and conclusions in his valuation review report.
(d) The *valuation reviewer* in the *terms of engagement* and his valuation review report states that the valuation review report shall not be disclosed to a third party or published to the public.

4.6.3 This section does not apply to *reports* prepared for any legal proceedings where a *member* may be required to comment on a *report* prepared by a *valuer* representing or acting on behalf of the opposing party in legal proceedings.

4.6.4 This section does not apply to situations where the GPD Council commences an investigation to a *valuer*.

4.6.5 This section does not apply to situations where complaints from the public has been received by the *HKIS* or come to its attention, or the *HKIS* has, for some reasons, commenced a disciplinary investigation to determine whether a *valuation*/*report* prepared by a *member* complies with the requirements set out in *the Standards*.

4.7.0 Valuation engagement for finanncial and accounts reporting and *valuation* to be included or disclosed in the *financial statements*

4.7.1 *A valuer* is required to reach an agreement with the *client* in the *terms of engagement* on the working relationship with the *client*'s auditor. This *may* include such details as the way and the extent of releasing working papers and data to the *client*'s auditor, to avoid unnecessary disputes with the *client* and the *client*'s auditor thereafter.

4.7.2 It is a good practice to have a meeting with the *client* and their auditor to understand and to agree on the scope of work prior to proposing and entering an engagement with the *client*.

VS 5
Bases of Value

5.1.0 General principles

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

5.1.2 If one of the *bases of value* defined in *the 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* (see VS 8) that are appropriate.

5.1.3 If a *basis of value* not defined in *the 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. Where a *departure* is made that is not mandatory, compliance with *IVS* is not possible.

5.1.4 A *basis of value* is a statement of the fundamental measurement *assumptions* of a *valuation*. It describes the fundamental premises on which the reported *values* will be based. It is critical that the *basis 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*.

5.1.5 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 *the Standards* (including any *jurisdiction*-specific supplement to these standards) is considered inappropriate (see **VS 1 section 1.3.0**)..

5.1.6 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.

5.1.7 *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.

5.2.0 *Bases of Value*

5.2.1 The following bases are defined in the International Valuation Standards and International Financial Reporting 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:

a) IVS-defined *bases of value:*
   1. Market Value (section 5.3.0)
   2. *Market Rent* (section 5.4.0)
   3. Equitable Value (section 5.5.0)
   4. Investment Value/Worth (section 5.6.0)
   5. Synergistic Value (section 5.7.0)
   6. Liquidation Value (section 5.8.0) and

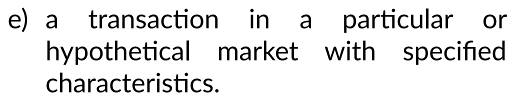
b) IFRS-defined *bases of value:*
   1. Fair Value (section 5.9.0)

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

5.2.2 While there are many different *bases of value* used in *valuations*, most have certain common elements: an assumed transaction, an assumed date of the transaction and the assumed parties to the transaction.

5.2.3 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.

5.2.4 The assumed date of a transaction will influence what information and data a *valuer* consider 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.

5.2.5 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 (e.g. duress), and/or
e) an assumed knowledge level.

5.2.6 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* and any *intended users*, if applicable, at the outset in any case where the position is not straightforward. However, regardless of instructions and input provided to the *valuer*, the *valuer should* not use a *basis of value* that is inappropriate for the intended purpose of the *valuation* (for example, if instructed to use a IVS-defined *basis of value* for financial reporting purposes under IFRS, compliance with *the Standards* may require the *valuer* to use a *basis of value* that is not defined or mentioned in *the Standards*).

5.2.7 *Valuers* are responsible for understanding the regulation, case law and other interpretive guidance related to all *bases of value* used.

5.2.8 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.

5.2.9 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 in **VS 8**.

5.2.10 *Valuers must* ensure in all cases that the *basis of value* is reproduced or clearly identified in both the *report* and, if possible, the *terms of engagement* (scope of work). If, after engagement, the *valuer* considers that a *basis of value* agreed in advance with the *client* is likely to be inappropriate, the revised *basis of value must* be discussed and agreed with the *client* and, as far as possible, the *intended users*, prior to the conclusion of the *valuation* assignment and delivery of the *report*.

5.2.11 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.

5.3.0 Market Value

5.3.1 *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.'

5.3.2 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.

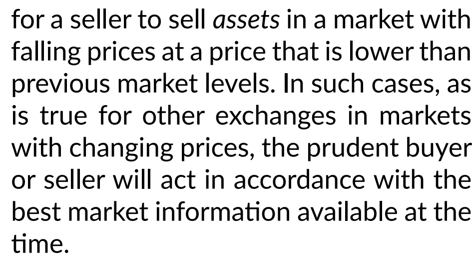
d) "Between a willing buyer" refers to one who is motivated, but not compelled to buy. This buyer is neither over eager nor determined to buy at any price. This buyer is also one who purchases in accordance with the realities of the current market and with current market expectations, rather than in 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, e.g. 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.

5.3.4 *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.

5.3.5 *Market value* is understood as the *value* of an *asset* or liability estimated without regard to costs of sale or purchase (or transaction) and without offset for any associated taxes or potential taxes. The definition, however, does not preclude the consideration of taxes and transaction costs in the calculations. *Valuers* always have to exercise reasonable judgements on the impact of relevant taxes and transaction costs in their *valuation* models.

5.3.6 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.

5.3.7 The *market value* of an *asset* will reflect its highest and best use (see section 5.12.0). 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.

5.3.8 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.

5.3.9 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*.

5.3.10 The *valuation* process requires *members* to conduct adequate and relevant research, to perform competent analyses, and to draw informed and supportable judgements. In this process, *valuers* do not accept data without questions but *should* consider pertinent market evidence, trends, comparable transactions, and other information. Where market data is limited, or essentially non- existent, the *valuer must* make proper disclosure of the situation and *must* state whether the estimate is in any way limited by the inadequacy of data.

5.3.11 *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 (*special value*). 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.

5.3.12 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.

5.3.13 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*.

5.3.14 As changing conditions are characteristics of markets, *valuers must* consider whether the available data reflects and meets the criteria for *market value*. However, if the interest being valued is incapable of being disposed of in the market, *market value may* not be an appropriate basis to use.

(a) Periods of rapid changes in market condition are typified by rapidly changing prices, a condition commonly referred to as disequilibrium. A period of disequilibrium *may* continue over a period of years and can constitute the current and expected future market condition. In other circumstances, rapid economic change may give rise to erratic market data. If some sales are out of line with the market, the *valuer* will generally give them less *weight*. It *may* still be possible for the *valuer* to judge from available data where the realistic level of the market is. Individual transaction prices may not be evidence of *market value*, but analysis of such market data *should* be taken into consideration in the valuation process.

(b) In poor or falling markets there may or may not be a large number of "willing sellers." Some, but not necessarily all, transactions may involve elements of financial (or other) duress or conditions that reduce or eliminate the practical willingness of certain owners to sell. *Valuers must* take into account, as far as possible, relevant factors in such market conditions and attach such *weight* to individual transactions that they believe proper to reflect the market. Liquidators and receivers are normally under a duty to obtain the best price in property disposals. Sales, however, may take place without proper marketing or a reasonable marketing period. *Valuers must* judge such transactions to determine the degree to which they meet the requirements of the *market value* definition and the *weight* that such data *should* be given.

5.3.15 When assessing the *market value* of a property, any encumbrances such as mortgage, debenture or other charges against it *should* be disregarded.

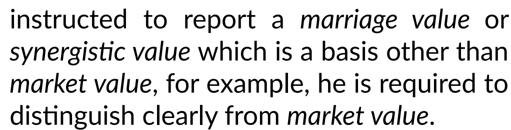
5.3.16 A *client* may wish to include the 'hope value' of a property in its *market value* and the 'hope value' refers to the situation that the market has an expectation that the circumstances affecting the property may have a positive change in the future. Examples of the 'hope value' include:

(a) The prospect of having re-development opportunity where in fact there is no current permission of re-development granted for that real property.

(b) The realisation of '*marriage value*' arising from merger with another real property or interests within the same real property.

(c) The prospect of positive cash flows of a business enterprise which though at present records a negative equity in the balance sheet.

However, the amount of hope value *must* be limited to the extent that it would be reflected in offers made by prospective purchasers in a general market under a rational environment which means with market-evidence. Should the *valuer* be



instructed to report a *marriage value* or *synergistic value* which is a basis other than *market value*, for example, he is required to distinguish clearly from *market value*.

5.3.18 *Valuers should* not mix up the concept of 'highest and best use' with 'hope value'. 'Hope value' not only includes a particular synergy in a purchase so long as it is reflected in the open market, but also the prospect of obtaining approval or lease modification as the case may be. The proposed use from which the 'hope value' is derived conforms with the 'highest and best use' in the sense that the proposed use is legally allowable when there is a reasonable prospect (as reflected in the market of at least 50% chance) that the regulation, zoning, deed restriction, etc. can be changed to permit the proposed use.

5.4.0 IVS-Defined *Basis of Value – Market Rent*

5.4.1 *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.'

5.4.2 *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*.

5.4.3 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.

5.4.4 The conceptual framework supporting the definition of *market value* shown above can be applied to assist in the interpretation of *market rent*.

5.4.5 *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.

5.4.6 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 may be 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.

5.4.7 In some circumstances the *market rent may* have to be assessed based on terms of an existing lease (e.g. for rental determination purposes where the lease terms are existing and therefore not to be assumed as part of a notional lease). The existing lease term or the reference to the existing lease term *must* be stated in the *report*.

5.4.8 If the lease term is not specified, the estimated amount excludes a rent inflated or deflated by special terms, considerations or concessions and 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.

5.4.9 *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.

5.4.10 *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* be considered to be expressed on this basis. The nature of the incentive assumed *must* be stated by the *valuer*, along with the assumed lease terms. In a rental determination where an existing lease is in place, *valuers may* have to determine and agree with the *client* and the *intended users* whether any incentives will be provided in the assumed lease term, and the estimated amount *may* have to be adjusted accordingly.

5.5.0 IVS-Defined *Basis of Value* – Equitable Value

5.5.1 *Equitable value* is defined in IVS 104 paragraph 50.1 as:

'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.'

5.5.2 *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.

5.5.3 *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.

5.5.4 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.

5.6.0 IVS-Defined *Basis of Value* – Investment Value/Worth

5.6.1 *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.'

5.6.2 *Investment value* is an entity-specific *basis of value* that measures the *value* of the benefits of ownership to the current owner or to a prospective owner, recognizing that these may differ from those of a typical market participant. 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.

5.6.3 In some instances, the owner of the *asset* may instruct the *valuer* to use a target rate of return to test or analyse the financial performance of the *asset* to the owner, and that target rate of return is not market- derived. Such instructions *should* be disclosed by the *valuer* in the *valuation report*.

5.7.0 IVS-Defined *Basis of Value* – Synergistic Value

5.7.1 *Synergistic Value* is is defined in IVS 104 paragraph 70.1 as:

'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*.'

5.6.2 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*."

5.8.0 IVS-Defined *Basis of Value* – Liquidation Value

5.8.1 Liquidation Value is defined in IVS 104 paragraph 60.1 as:

'the amount that would be realised when an *asset* or group of *assets* are sold on a piecemeal basis.'

5.8.2 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 5.14.0), or
b) a forced transaction with a shortened marketing period (see section 5.15.0).

5.8.3 A *valuer must* disclose which premise of *value* is assumed.

5.9.0 Fair Value (IFRS)

5.9.1 *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.'

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

5.9.3 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.

5.9.4 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.

5.9.5 *Valuers* undertaking *valuations* for inclusion in *financial statements should* familiarise themselves with the relevant requirements.

5.10.0 Value for Sale Under Repossession (VSR)

5.10.1 Value for sale under repossession (the word repossession means the action of regaining possession especially the seizure of

collateral securing a loan that is in default) refers to the price that might reasonably be expected to realise within a defined period of time (the period shall be agreed upon between Lender and *valuer*) from the sale of a real property in the market under repossession by the lender or receiver, on an "as is" basis, taking into account the unique quality of the real property and the existence of any specific demand as well as factors which might adversely affect the marketability of the real property due to market perception of increased risk or stigma, justified or otherwise.

5.10.2 The underlying *basis of value* of VSR is *market value*, but subject to *special assumptions* on actual or hypothetical marketing constraints which cause the perception of increased risk of stigma. The marketing constraint *must* be agreed with the lender prior to reporting. An example of the marketing constraint includes the anticipated time frame for completion of a transaction which strikes a balance between the Lender's liquidity need and the reasonable care to the mortgagor, but which may be considered as inadequate for the real property to be presented in the market.

5.10.3 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.

5.10.4 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.

5.10.5 While a *valuer* can assist a lender in determining a price that should be accepted in marketing constraints, this is a commercial judgement of the lender whether a discounted price to the *market value* will be accepted. A *valuer should* make a qualification in the *report* on the reliance of VSR.

5.10.6 To provide an estimate of the VSR, the *valuer should*:

(1) agree with the *lender* or receiver on the details of the actual or anticipated marketing constraints that might have impact on the *market value* whilst taking into account the unique quality of the real property and the existence of any specific demand;
(2) ascertain whether the constraint 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;
(3) estimate the *market value* of the real property;
(4) analyse and apply adjustment(s) to the *market value* of the real property by taking into account the negative impacts and to arrive at the *value* for sale under repossession independently; and
(5) make a qualification in the *report* on the reliance of the VSR.

5.10.7 When value for sale under repossession is reported, it *should* always be clearly distinguished from *market value*. Should a *special assumption* be adopted in arriving at the *value* for sale under repossession, the *valuer* is required to comply with the requirement set out in *the Standards*.

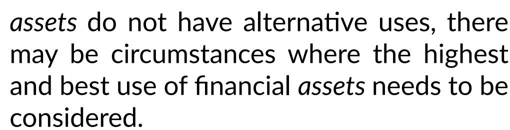
5.11.0 Premise of *Value*/Assumed Use

5.11.1 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.

5.12.0 Premise of *Value* – Highest and Best Use

5.12.1 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.

5.12.2 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*.

5.12.3 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.

5.12.4 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.

5.12.5 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*, e.g. town planning/zoning designations, need to be taken into account as well as the likelihood that these restrictions will change.
c) Therequirement that the use be financially feasible takes into account whether an alternative use that is physically possible and legally permissible will generate sufficient return to a typical market participant, after taking into account the costs of conversion to that use, over and above the return on the existing use.

5.13.0 Premise of *Value* – Current Use/Existing Use

5.13.1 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.

5.14.0 Premise of *Value* – Orderly Liquidation

5.14.1 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.

5.14.2 The reasonable period of time to find a purchaser (or purchasers) may vary by *asset* type and market conditions.

5.15.0 Premise of *Value* – Forced Sale

5.15.1 The term “forced sale” is often used in circumstances where a seller is under compulsionto 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*. (See **VS 8 Section 8.3.0**).

5.15.2 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.

5.16.0 Entity-Specific Factors

5.16.1 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.

5.16.2 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 standalone 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.

5.16.3 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 5.6.1 and 5.6.2), 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*.

5.17.0 Synergies

5.17.1 "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.

5.17.2 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 paragraphs 5.16.1 – 5.16.3).

5.17.3 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.

5.18.0 Transaction Costs

5.18.1 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 purchaser and without adjustment for any taxes payable by either party as a direct result of the transaction.

5.18.2 The definitions, however, does not preclude the consideration of taxes and transaction costs in the calculations. *Valuers* always have to exercise reasonable judgements on the impact of relevant taxes and transaction costs in their *valuation* models.

VS 6
Valuation Approaches and Methods

6.1.0 General Principles

6.1.1 *Valuers* are responsible for adopting, and as necessary justifying, the valuation approaches and the valuation methodologies 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.

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

6.1.3 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.

6.1.4 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.

6.1.5 *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 6.1.4 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* for which price information is available, such as a comparison with market transactions in the same, or closely similar, type of *asset* 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.

The three approaches are all based on the economic principles of price equilibrium, anticipation of benefits or substitution.

6.1.6 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.

6.1.7 *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.

6.1.8 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.

6.1.9 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).

6.1.10 *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*.

6.1.11 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. *Members may* use a method not defined or mentioned in *the Standards* or *IVS* but can still claim compliance with *the Standards*.

6.1.12 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 6.1.9 to determine whether one of the approaches/ methods provides a better or more reliable indication of *value*.

6.1.13 *Valuers should* maximize 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.

6.1.14 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.

6.1.15 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 compliant with the standards.

6.1.16 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*.

6.2.0 *Market Approach*

6.2.1 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.

6.2.2 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*.

6.2.3 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 (i.e., 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.

6.2.4 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 *marke approach* is not used, the use of market-based inputs *should* be maximised in the application of other approaches (e.g. market-based valuation metrics such as effective yields and rates of return).

6.2.5 When comparable market information does not relate to the exact or substantially the same *asset*, the *value 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.

6.2.6 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.

6.3.0 *Market Approach* Methods Comparable Transactions Method

6.3.1 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*.

6.3.2 When the comparable transactions considered involve the subject *asset*, this method is sometimes referred to as the prior transactions method.

6.3.3 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

6.3.4 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 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

6.3.5 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 (i.e. yield).

6.3.6 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 6.3.12(d)),
e) apply the adjusted valuation metrics to the subject *asset*, and
f) if multiple valuation metrics were used, reconcile the indications of *value.*

6.3.7 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.

6.3.8 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 (e.g. legal form of ownership, amount/percentage held).

6.3.9 Guideline publicly-traded comparable method

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*.

6.3.10 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.

6.3.11 The method *should* be used only when the subject *asset* is sufficiently similar to the publicly-traded comparables to allow for meaningful comparison.

6.3.12 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*.

6.3.13 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.

6.3.14 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 6.3.17),
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.

6.3.15 Other Market Approach Considerations

The following paragraphs address a non-exhaustive list of certain special considerations that *may* form part of a *market approach valuation*.

6.3.16 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.

6.3.17 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 (i.e. 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.

6.4.0 *Income Approach*

6.4.1 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*.

6.4.2 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.

6.4.3 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.

6.4.4 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.

6.4.5 Generally, investors can only expect to be compensated for systemic risk (also known as "market risk" or "undiversifiable risk).

6.5.0 *Income Approach* Methods

6.5.1 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

6.5.2 Under the DCF method the forecasted cash flow is discounted back to the *valuation date*, resulting in a present *value* of the *asset*.

6.5.3 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.

6.5.4 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 (i.e. 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

6.5.5 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: If a post-tax basis is used, 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 the same inflation rate and 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 its 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.

6.5.6 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.

6.5.7 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 6.5.7(a) can be applied.

Explicit Forecast Period

6.5.8 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.

6.5.9 *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*.

6.5.10 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).

6.5.11 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

6.5.12 Cash flow for the explicit forecast period is constructed using prospective financial information (PFI) (projected income/ inflows and expenditure/outflows).

6.5.13 As required by para 6.5.12, regardless of the source of the PFI (e.g. 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 of the valuation 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.

6.5.14 The cash flow is divided into suitable periodic intervals (e.g. 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.

6.5.15 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*.

6.5.16 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.

6.5.17 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.

6.5.18 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 *valuations*. 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.

6.5.19 *Valuers must* ensure that seasonality and cyclicality in the subject has been appropriately considered in the cash flow forecasts.

Terminal Value

6.5.20 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.

6.5.21 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 predetermined 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.

6.5.22 *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

6.5.23 The constant growth model assumes that the *asset* grows (or declines) at a constant rate into perpetuity.

***Market Approach*/Exit Value**

6.5.24 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.

6.5.25 Common ways to calculate the terminal value under this method include application of a market-evidence based capitalisation factor or a market multiple.

6.5.26 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 6.2.0 and 6.3.0). 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

6.5.27 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.

6.5.28 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

6.5.29 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*.

6.5.30 The discount rate *must* be consistent with the type of cash flow

6.5.31 *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.

6.5.32 *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

6.5.33 In developing a discount rate, a *valuer should* consider:

(a) the type of *asset* being valued. For example, discount rates used in *valuing* debt could 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 instrument 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.

6.5.34 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.

6.5.35 *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).

6.5.36 *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

6.5.37 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.

6.5.38 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.

6.5.39 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 *participants* would assess the discount rate for the *asset* on a standalone basis, or in the context of a broader portfolio and therefore consider the potential diversification of unsystematic risks.

6.5.40 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.

6.6.0 Cost Approach

6.6.1 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.

6.6.2 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.

6.6.3 Although the circumstances in paragraph 6.6.2 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*.

6.6.4 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.

6.7.0 Cost Approach Methods

6.7.1 Broadly, there are four cost approach methods:

a) replacement cost method: a method that indicates value by calculating the cost of a similar *asset* offering equivalent utility,

b) *depreciated replacement cost* ("DRC") is a method in the absence of sufficient market data to arrive at the *market value* of real property and plant and equipment by means of market-based evidence,

c) *reproduction cost* method: a method under the cost that indicates value by calculating the cost to recreating a replica of an *asset*, and

d) 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

6.7.2 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*.

6.7.3 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*.

6.7.4 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 depreciation related to physical, functional and external obsolescence associated with the subject *asset*, and

c) deduct total depreciation from the total costs to arrive at a value for the subject *asset*.

6.7.5 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.

Depreciated Replacement Cost

6.7.6 *Depreciated replacement cost* ("DRC") is an application (method) in the absence of sufficient market data to arrive at the *market value* of real property and plant and equipment by means of market-based evidence. The application of DRC method in real property *valuation* is based on an estimate of the *market value* of the land in its existing use, plus the current cost of replacement of the improvements less allowance for physical deterioration and all relevant forms of obsolescence and optimization.

(1) The application of the DRC method in real property *valuations* is based on an estimate of the *market value* of the land in its existing use, plus the current cost of replacement of the improvements less allowance for physical deterioration and all relevant forms of obsolescence and optimisation.

(2) When the *client* instructs the *valuer* to estimate the *market value* of the land on alternative use basis which is different from the existing use of the land, the *valuer should* take reasonable steps to verify the rationale and soundness of the instruction. Where the alternative use is not an *assumption* but a *special assumption*, VS 2.2 applies.

(3) When using the DRC method, the *valuer should* include a statement in the *report*

to justify his use of the DRC method and the efforts he made in considering the DRC method as the most appropriate approach to value.

(4) Should the subject real property comprise various buildings and structures of a complex or development, the *valuer* should include a statement in the *report* that the reported *market value* only applies to the whole of the complex or development as a unique interest, and no piecemeal transaction of the complex or development is assumed.

(5) The DRC method when used in the private sector *must* always be expressed by the *valuer* as subject to adequate potential profitability of the business (or to service potential of the entity from the use of *assets* as a whole) paying due regard to the total *assets* employed.

(6) The DRC method when used in the public sector *must* always be expressed by the *valuer* as subject to the prospect and viability of the continued operation and use instead of subject to adequate potential profitability of the business (or to service potential of the entity from the use of *assets* as a whole).

Reproduction Cost Method

6.7.7 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.

6.7.8 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

6.7.9 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.

6.7.10 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*.

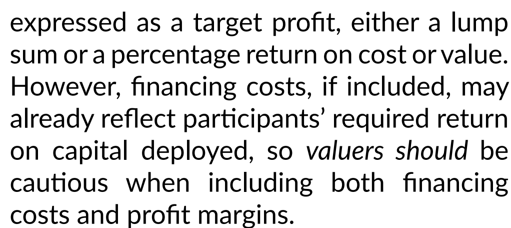
Cost Considerations

6.7.11 The *cost approach should* capture all of the costs that would be incurred by a typical participant.

6.7.12 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 (e.g. interest on debt financing), and
   8. profit margin/entrepreneurial profit to the creator of the *asset* (e.g. return to investors).

6.7.13 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.

6.7.14 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.

6.7.15 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.

6.8.0 Depreciation/ Obsolescence

6.8.1 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.

6.8.2 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.

6.8.3 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.

6.8.4 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.

6.8.5 Physical obsolescence can be measured in two different ways:

a) curable physical obsolescence, i.e. 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.

6.8.6 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*.

6.8.7 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:

6.8.8

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.

6.8.9 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*.

6.9.0 *Valuation* Model

6.9.1 A *valuation* model refers collectively to the quantitative methods, systems, techniques and qualitative judgements used to estimate and document *value*.

6.9.2 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.

6.9.3 Regardless of the nature of the *valuation* model, the *valuer* must ensure that the *valuation* complies with all requirements of the standards.

VS 7

Valuation Processes and Records

The process of a *valuation*, including *inspection*, investigation, analysis and computation, etc., *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 **VS 4** and **VS 9**:

- 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* and also in the *report*.

- 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* and in the *report*.

7.1.0 General Requirements

7.1.1 Sufficient evidence *must* be assembled by means, such as *inspection*, examination, inquiry, research, comparison, analysis and computation, etc., to ensure that the *valuation* is properly supported.

7.1.2 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 **VS 4 paragraph 4.3.2(i)**.

7.1.3 When determining the extent of evidence necessary, professional judgment is required to ensure the information to be obtained and the analysis to be carried out are 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.

7.1.4 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 of real property previously valued**' 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.

7.1.5 Where it is agreed that *inspections* and investigations may be limited, it is likely that the *valuation* will be on the basis of restricted information and **VS 4 section 4.5.0** will apply.

7.1.6 The *valuer*, having considered the knowledge, experience, reliability and ability of his staff member, could designate suitably trained staff member(s) under his supervision to conduct the *inspection* in order to comply with the mandatory *inspection* requirement under *the Standards*. However, the *valuer* shall still be liable for the accuracy of the entire contents of the *valuation report* and hence is fully accountable for the input of his designated staff member(s).

7.1.7 Subject to **VS 2 paragraph 2.2.2** and **VS 4 paragraph 4.3.2(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*.

7.1.8 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 **VS 4 paragraph 4.3.2 (j) and section 4.5.0** 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.

7.1.9 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* (e.g. 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.

7.1.10 While the *valuer should* take reasonable care to verify any information provided or obtained as well as to conduct analysis to such information, any limitations on this requirement *must* be clearly stated. When preparing a *valuation* for *financial statements* the *valuer should* be prepared to discuss the appropriateness of any *assumptions* that were made with the *client*'s auditor, other professional adviser or regulator.

7.1.11 A *valuer* meeting the criteria in **VS 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*.

7.2.0 Revaluation without re-inspection of real property previously valued

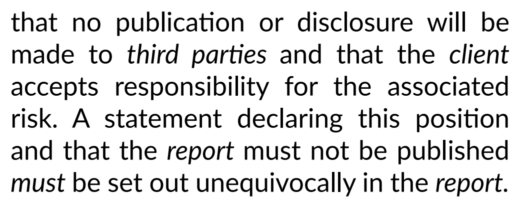
7.2.1 A revaluation without a re-inspection of an interest in real property previously valued by the *valuer* or his *firm must* not be undertaken unless the *valuer* is satisfied that there have been no *material* changes to the physical attributes of the property, or the nature of its location, since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

7.2.2 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.

7.2.3 The *valuer must* obtain from the *client* information of current or anticipated changes in rental 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 whether any *sustainability* factors that affect the *valuation* are likely to have altered.

7.2.4 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.

7.2.5 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*.

7.3.0 *Valuation* records

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

7.3.1 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.

7.3.2 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*.

7.3.3 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.

7.3.4 For all *reports* where the governing *jurisdiction* is Hong Kong law, such records *must* be held for at least six (6) years after completion of the engagement or two (2) years after the final disposition of any judicial proceeding in which a testimony was given.

7.3.5 The records *must* include:

a. the name of the *client* and the identity, by name or type, of any other *intended users;*
b. true copies of any written *reports*, documented on any forms of media;
c. summaries of any oral *reports* or testimony, or a transcript of testimony, the *valuer's* signed and dated certification; and,
d. all other data, information, and documentation, which are necessary to support the *valuer's* opinions and conclusions and to prove compliance with *the Standards*, or reference to the location(s) of such other documentation.

7.3.6 If a *valuer* is unable to retain a copy of the *report* and its working papers, whether by reason of an employer's internal rules or by change of employers, all reasonable steps *must* be taken by the *valuer* to ensure the availability of such data upon request. In this regard, the *valuer should* obtain written commitment from his employer that such data will be made available when required by regulatory authorities, including, but not limited to, the Committee of Investigation /Disciplinary Board of the Institute. If the employer refuses to provide such written commitment, the *valuer* shall keep a record of such refusal and provide it to the *HKIS*, upon receipt of request from the *HKIS*.

VS 8

Assumptions and Special Assumptions

8.1.0 Assumptions

8.1.1 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.

8.1.2 The full definition from the 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 *member* as part of the *valuation* process. Typically, *assumptions* are made where specific investigation by the *valuer* is not required in order to prove that something is true.'

8.1.3 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.

8.1.4 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 *valuation date*, and
b) assumed facts that differ from those existing at the *valuation date*.

The *assumptions* under category a) above is taken as General *Assumptions* which is covered in the paragraphs below and those under category b) is *special assumptions* which is covered in section 8.2.0.

8.1.5 General *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.

8.1.6 As a General *Assumption* is often linked to a limitation on the extent of the investigations or enquiries that could be undertaken by the *valuer*, all General *Assumptions* that are likely to be included in the *report* areat best practice to be agreed with the *client* and included in the *terms of engagement*. In any cases, the General *Assumptions should* be agreed in writing with the *client* before the *valuation report* is issued. *Client*'s confirmation on the contents of the draft *reports* containing all the General *Assumptions* will be taken as one form of agreement in writing.

8.1.7 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*.

8.2.0 Special Assumptions

8.2.1 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.*

8.2.2 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* and *intended users* before the *report* is issued.

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

8.2.4 *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* 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*.

8.2.5 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.

8.2.6 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*.

8.2.7 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.

8.2.8 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; and
- 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).

8.2.9 Some illustrations of *special assumptions* in relation to real property 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.

8.2.10 Where a *real estate* 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.

8.2.11 All the *special assumptions must* be expressly agreed and confirmed in writing to *the client* and the *intended users* before the *report* is issued. *Members must*, in writing, communicate with the *clients* and the *intended users*, as far as applicable, on any *special assumptions* and confirm with the *clients* and the *intended users* on their agreements on the *valuations* under such *special assumptions*. The confirmation *must*

be made expressly, and mere confirmation on the contents of the *report* may not be taken as sufficient.

8.2.12 All the *special assumptions must* be clearly written in the prominent positions in the *report*.

8.2.13 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.

8.2.14 Where *valuations* are prepared for *financial statements* or public announcements, 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.

8.3.0 Valuation reflecting an actual or anticipated market constraint, and forced sales

8.3.1 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*.

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

8.3.3 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.

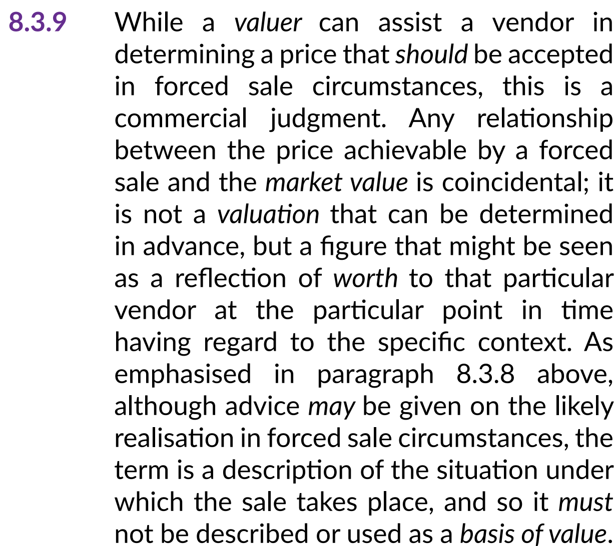
8.3.4 If an inherent constraint exists at the *valuation date*, it is normally possible to assess its impact on value. The constraint *should* be identified in the *terms of engagement*, and it *should* be made clear that the *valuation* will be provided on this basis. It *may* also be appropriate to provide an alternative *valuation* on the *special assumption* that the constraint did not exist at the *valuation date* in order to demonstrate its impact.

8.3.5 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.

8.3.6 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.

8.3.7 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.

8.3.8 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.



8.3.9 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 8.3.8 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*.

8.3.10 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 definition of *market value* 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*.

8.4.0 Assumptions and special assumptions related to projected *values*

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

8.4.2 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.

8.4.3 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.

8.4.4 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*.

8.4.5 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.

8.4.6 If a *client* requests a projected *values* on the basis of a cash flow projection that the *valuer* considers to be unrealistic, the instruction *should* be declined.

VS 9
Reporting

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 paragraph 9.2.2(o) below.
- deal with all the matters agreed between the *client* and the *valuer* in the *terms of engagement* (see VS 4 Terms of Engagement).

9.1.0 General Requirements

9.1.1 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* and *should* be couched in terms that can be read and understood by someone with no prior knowledge of the subject asset or liability.

9.1.2 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* **(VS8 Assumptions and Special Assumptions),** *significant* uncertainty or limiting conditions that directly affect the *valuation*.

9.1.3 This standard applies to all *valuation report* on the outcome of a valuation review which may range from comprehensive narrative *reports* to abbreviated summary *reports*.

9.1.4 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 this *Standards*.

9.1.5 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 **VS4 Terms of Engagement**).

9.1.6 Compliance with this standard does not require a particular form or format of *report* (please refer to section 9.2.0); 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.

9.1.7 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 sections 9.2.0 and 9.3.0, as applicable.

9.1.8 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.

9.1.9 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*. However, it is essential that the preliminary or provisional status is made clear, pending issue of the formal and final *report*.

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

1) The opinion is provisional and subject to completion of the final *report*;
2) The advice is provided for *client's* internal purposes only; and
3) 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.

9.1.11 *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 9.2.3 (p) below.

9.1.12 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.

9.1.13 Where necessary for the purpose of brevity, *members* may provide a separate summary of *values*, provided that it is part of a *valuation report* prepared for the required same purpose and complying fully with *the Standards*, and clearly cross referenced and stated as such.

9.1.14 In some instances, the *client may* request the *valuer* to prepare a *report* in a language other than English. Due care *must* be taken to ensure that the requirements set out in *the Standards* have been fully complied with and reflected in such a *report* and that the approved text of *the Standards* is correctly interpreted.

9.2.0 Valuation Reports

9.2.1 Where the *report* is the result of an assignment involving the *valuation* of an *asset*, the *report must* convey the following, at a minimum:

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)* 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) All *assumptions* and *special assumptions*
j) Restrictions on use, distribution and publication of the *report*
k) Confirmation that the assignment has been undertaken in accordance with the *IVS* and/or *HKIS Valuation Standards*
l) Valuation approach and reasoning
m) Amount of the *valuation* or *valuations*
n) *Date of the 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 on whether or not any limiting conditions have been agreed.

9.2.2 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.).

9.2.3 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*.

i. A *valuation* is the responsibility of an individual *member*. *HKIS* 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.

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

iii. 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 **VS 2**. 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.

iv. In considering the extent of any material previous involvement, whether past, current or possible future, the *valuer must* have regard to the requirements of **VS 3 Section 3.5.0**. Any disclosures or statements made in accordance with **VS4 paragraph 4.3.2 (a) (iii)**, *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*.

v. 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 **VS 2** has been satisfied is needed, though it is not necessary to provide any details.

vi. 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 iv–v below.

vii. 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).

i. 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.

ii. For some purposes *valuers may* be unable to exclude liability to third parties (see **VS 3 Ethics, Professionalism and Conflict of Interests section 3.5.0**). Any limitation on disclosure of a *valuation* based on restricted information or instruction *should* be included (see **VS 4 Terms of Engagement** 4.3.2(j)).

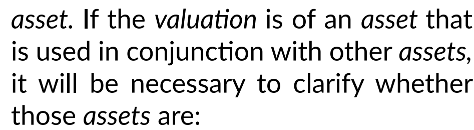
c) Purpose of the *valuation*

The purpose of the valuation assignment *must* be clearly stated.

i. 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)* valued

The *asset* or liability to which the *valuation* assignment relates *must* **b**e 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.

i. 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 real property, the extent to which vacant possession is, or may be available (if required), *should* also be noted.
ii. 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.
iii. Where the *terms of engagement* have required separate identification of *assets* by their use, category or class, the *report should* be structured accordingly.
iv. 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*.

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.

i. 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*.
ii. 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.
iii. Where, exceptionally, a *valuation* is provided relating to a future date this *must* be made explicit (see paragraph (f) below). 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.

i. The *valuation date must* be stated (see **VS 4 Terms of Engagement** 4.3.2(h)).
ii. 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.
iii. 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)(iii) 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*.

i. 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. Equivalent steps, appropriate to the class of *asset* concerned, *should* be taken in relation to tangible personal property.
ii. The *valuer must* make it clear if the *valuation* has been made without an opportunity to carry out an adequate *inspection* (see **VS 7 paragraphs 7.1.3 and 7.1.8**) or equivalent check.
iii. 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 **VS 7**).
iv. Where a substantial number of properties are being valued, a generalized statement of these aspects (i.e. regarding *inspection*) is acceptable, provided that it is not misleading.
v. 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.
vi. 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 **VS 4 paragraph 4.3.2(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.

i. 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* 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.
ii. 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.
iii. 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 **VS 4 paragraph 4.3.2(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.
iv. 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.
v. 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) All *assumptions* and *special assumptions*

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

i. 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.

i. The *valuer must* state the permitted use, distribution and publication of the *valuation*.
ii. 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 *may* be provided as a separate document annexed to the *report* or a part of the *report*, where the rules or regulations under different *jurisdiction* may require to do so.
iii. 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, unless the *valuer* is not provided with or is barred from amendments on the reference of such publication

statement. This is particularly important if the *valuer* is asked to take responsibility for any published statement or any part of a published statement.

iv. If the whole *report* is not to be published, it is common for the *valuer* to prepare a statement or summary as a separate document and to provide to the *client* at the same time as the *report*. The content of the statement or summary may be governed by rules issued by local regulatory bodies, *valuers must* check and ensure his *report* containing all the minimum contents as required under the prevailing rules of the regulatory bodies. In case the contents in the statement or summary are not specified, the statement or summary *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.

v. 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 **VS 3 section 3.5.0**.

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

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

viii. 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.

ix. 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.

x. 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.

xi. 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.

xii. 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.

xiii. 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.

xiv. 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.

xv. 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 assignment has been undertaken in accordance with the *IVS* and /or *HKIS Valuation Standards*

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 *HKIS Valuation Standards*, which incorporate the *IVS*, and (where applicable) the relevant *HKIS* or jurisdictional supplement.

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

i. 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 *HKIS Valuation Standards* carries with it the dual assurance of compliance with the IVS technical standards and with the *HKIS Valuation Standards* overall.

ii. References to the *HKIS Valuation Standards* without reference to the year of issue will be taken to mean the version of the *HKIS standards* operative at the *valuation date*, provided that it is on or before the date of signature of the *report*.

iii. The statement of compliance *should* draw attention to any *departures* (see **VS 1 section 1.5.0**). Where a *departure* is made that is not mandatory, it will not be possible to confirm compliance with the *IVS*.

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

v. 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 *the Standards*, or other standards that may apply in the particular circumstances.

vi. 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 *the 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 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.

i. Where different valuation approaches and *assumptions* are required for different *assets* it is important that they are separately identified and reported.
ii. For the distinction between approach and method see **VS 6.1.4.** The extent of description of these in individual assignments should be proportionate to the task, being focused 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.

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 his or her own valuation opinion.

i. In the main body of the *report* the opinion of *value* is required in words, as well as in figures.
ii. 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.
iii. 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.
iv. 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*.
v. 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*.
vi. 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*.
vii. 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.
viii. 'Negative *values*' and liabilities may arise and *must* always be stated separately. They *should* not be offset. **It is not correct in such cases to report a 'nil' figure of *value*.**

n) Date of the *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

i. 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.
ii. 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 **VS 8**) – 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*.
iii. Ensuring user understanding and confidence in *valuations* requires clarity and transparency, hence the general requirement under subsection (l) 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.
iv. Normally, *valuations* will not require additional explanation or clarification beyond the general requirement referred to in paragraph iii. 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* 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.

p) A statement on whether or not any limiting conditions have been agreed.

The statement on whether or not any limiting conditions, such as limitations on liability, etc., *must* be included.

9.3.0 Valuation Review Reports

9.3.1 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 **VS4 Terms of Engagement** 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*).

9.3.2 Some of the above requirements may be explicitly included in a *report* or incorporated into a *report* through reference to other

documents (e.g. engagement letters, scope of work documents, internal policies and procedures, etc.).

VS 10
Real property

10.1.0 Overview

10.1.1 This *Standard* contains additional requirements for *valuations* of real property.

10.2.0 Introduction

10.2.1 Property interests are normally defined by state or the law of individual *jurisdictions* and are often regulated by national or local legislation. Before undertaking a *valuation* of a real property, a *valuer must* understand the relevant legal framework that affects the interest being valued.

10.2.2 A real property is a right of ownership, control, use or occupation of land and buildings. 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, e.g. 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, e.g. a right to pass over land or to use it only for a specified activity.

10.2.3 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, *valuer should* also follow **VGN 2 Intangible Assets.**

10.2.4 Although different words and terms are used to describe these types of real property 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.

10.2.5 To comply with the requirement to identify the *asset* to be valued in **VS 4** the following matters *must* be included:

(a) a description of the real property to be valued, and
(b) identification of any superior or subordinate interests that affect the interest to be valued.

10.2.6 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 **VS4**, the following matters *must* be considered:

(a) the evidence required to verify the real property and any relevant related interests,
(b) the extent of any *inspection*,
(c) responsibility for information on the site area and any 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 and foundation conditions,
(g) responsibility for the identification of actual or potential environmental risks,
(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.

10.2.7 Typical examples of *special assumptions* that *may* need to be agreed and confirmed

in order to comply with **VS4** include:

(a) that a defined physical change had occurred, e.g. 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, e.g. 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.

10.2.8 *Valuations* of real property are often required for different purposes including secured lending, sales, taxation, litigation, compensation, insolvency proceedings and financial reporting.

10.3.0 *Bases of Value*

10.3.1 In accordance with **VS 5**, a *valuer must* select the appropriate *basis(es) of value* when valuing real property.

10.3.2 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 **VS5 paragraph 5.3.6**). This assessment is particularly important to real property which can be changed from one use to another or that have development potential.

10.3.3 There are certain types of *real properties* that have been designed to be sold in an open market as fully operational business units for a strictly limited use and at prices based upon trading potential. Examples of these are hotels, bars, restaurants, movie theatres or cinemas, gasoline or petrol stations. The prices of these real properties will include trade fixtures, fittings, furniture, furnishings and equipment. A *valuer* will need to collect additional information apart from *market value*, clarifying whether the *valuation* assumes that the real property is to be sold as a fully-equipped real property, part of a going concern trading entity, or on some other *assumptions*.

10.4.0 Valuation Approaches and Methods

10.4.1 The three valuation approaches described in the **VS6 – Valuation Approaches and Methods** can all be applicable for the *valuation* of a real property.

10.4.2 When selecting an approach and method, in addition to the requirements of this standard, a *valuer must* follow the requirements of **VS6 – Valuation Approaches and Methods**.

10.5.0 *Market Approach*

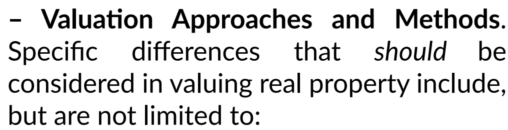
10.5.1 Property interests are generally heterogeneous (i.e. with different characteristics). Even if the land and buildings have identical physical characteristics to others being exchanged in the market, the location will be different. Notwithstanding these dissimilarities, the *market approach* is commonly applied for the *valuation* of real property.

10.5.2 In order to compare the subject of the *valuation* with the price of other real property, *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, e.g. crop yields.

10.5.3 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.

10.5.4 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 **VS6**



– **Valuation Approaches and Methods**. Specific differences that *should* be considered in valuing real property 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*.

10.6.0 *Income Approach*

10.6.1 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 10.9.1 – 10.9.3); 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.

10.6.2 For some real property, 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".

10.6.3 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 may* also comply as appropriate with the requirements of **VGN 1 – Business Interests and Businesses Enterprises** and, where applicable, **VGN 2 – Intangible Assets.**

10.6.4 For real property, 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.

10.6.5 Further information on the derivation of discount rates is included in **VS 6**. The development of a yield or discount rate will be influenced by the objective of the *valuation*. For example:

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 i f 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 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 **VS 6**.

10.6.6 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.

10.7.0 Cost Approach

10.7.1 In applying the *cost approach*, *valuers must* follow the guidance contained in **VS 6**.

10.7.2 This approach is generally applied to the *valuation* of real property through the depreciated replacement cost method.

10.7.3 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.

10.7.4 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.

10.7.5 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*.

10.7.6 The cost of the modern equivalent *must* then, as appropriate, be subject to adjustment for physical, functional, technological and economic obsolescence (see **VS 6**). 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.

10.8.0 Special Considerations for Real property

10.8.1 The following sections address a non-exhaustive list of topics relevant to the *valuation* of real property.

(a) Hierarchy of Interests (section 10.9.0).
(b) Rent (section 10.10.0).

10.9.0 Hierarchy of Interests

10.9.1 The different types of real property 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.

10.9.2 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, e.g. 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) Aright 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.

10.9.3 When valuing a real property 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.

10.10.0 Rent

10.10.1 *Market rent* is addressed as a *basis of value* in **VS 5**.

10.10.2 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*.

10.10.3 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.

10.11.0 Inspection

10.11.1 *Valuers must* carry out *inspections* and investigations into the real property to the extent necessary to produce a *valuation report* which is professionally adequate for its purpose.

10.11.2 *Inspection* is mandatory save for a *valuation* for secured lending instructed by the lenders otherwise. The *valuer should* state the extent and date of the *inspection* in his *report*.

10.11.3 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
   (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, including any physical restrictions on further development, if appropriate.

10.11.4 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 may be one of a number of factors relevant when considering *sustainability* issues.

10.11.5 In a *valuation* for secured lending and where the lender has instructed the *valuer* not to carry out any *inspection* (internal or external or both), the *valuer must* consider the risk before proceeding. In case any *valuation* without *inspection* is taken, the *valuer should* state such instruction in the *report* and a caveat or *assumption* is required to reflect the absence of *inspection.*

10.11.6 If any *valuation* without adequate *inspection* may undermine the reliability of such *valuation*, such instruction *must* not be taken.

10.11.7 The primary reason for *inspection* of a *real estate* is to enable the *valuer* to have a better understanding of the real property and its characteristics that are relevant to its value. The *valuer should* agree with the *client* on the extent and depth of the *inspection* and investigation and identify the minimum level of *inspection* and investigation procedures to be conducted prior to commencing the engagement, and document such agreed scope of *inspection* and investigation in his *report*.

10.11.8 For the avoidance of doubt, the *inspection* required in *the Standards* is not the equivalent of an *inspection* to be conducted by a professional (for instance, Building Surveyor, Structural Engineer or Electrical Engineer) other than a General Practice Surveyor to the subject property. In other words, the *inspection* required under this Standard is not a building survey or the like.

10.11.9 The *inspection* of comparables is also expected under normal circumstances where and when possible.

10.11.10 The *valuer*, having considered the knowledge, experience, reliability and ability of his staff member, could designate suitably trained staff member(s) under his supervision to conduct the *inspection* in order to comply with the mandatory *inspection* requirement under *the Standards*. However, the *valuer* signing off the *valuation report* shall still be liable for the accuracy of the entire content of the *valuation report* and hence is fully accountable for the input of his designated staff member.

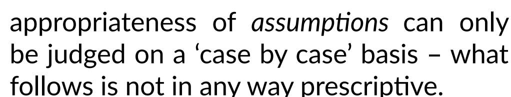
10.11.11 Where the *valuer* does not inspect the real property directly, the *valuation report must* disclose the fact that the *inspection* was undertaken by the designated staff member under the supervision of the *valuer*. The identity and qualifications of the staff member assigned to undertake the *inspection must* be disclosed in the *report*.

10.11.12 Where measurement needs to be undertaken or checked, *members must* have regard to the Code of Measuring Practice wherever applicable.

10.11.13 Should the *valuer*, at the time of his *inspection*, suspect that there may have a possible alterations or additions or improvements made in the *real estate* being inspected and such alterations or additions or improvements do not appear on any approved building plan, he has a duty to disclose the same in his *report* and to advise the *client* to consult a professional, such as building surveyor or a *firm* of professional building surveyors in Hong Kong or other professional in other *jurisdictions*, in respect of these potential unauthorized building works. And that, the *valuer should* make a highlight in his *report* on the extent of such unauthorized building works may affect his reported value.

10.12.0 Investigation and assumptions

10.12.1 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.

10.12.2 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*.

10.12.3 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.

10.12.4 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.

10.12.5 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*.

10.12.7 Environmental matters

Potential or actual constraints on the enjoyment and use of property caused by environmental factors may result from natural causes (suchas flooding), from non-natural causes (such as contamination) or sometimes from a combination of the two (such as subsidence resulting from historic minerals extraction). 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 environmental factors, as *valuers may* not have the specialist knowledge and experience that is often required. In appropriate cases the *valuer may* recommend the making of further enquiries and/or the obtaining of further specialist or expert advice in respect of environmental 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.

(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. 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* will not normally be competent to advise on the nature or risks of contamination or hazardous substances, or on any costs involved with their removal, except in the more straightforward cases. 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 will normally 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.

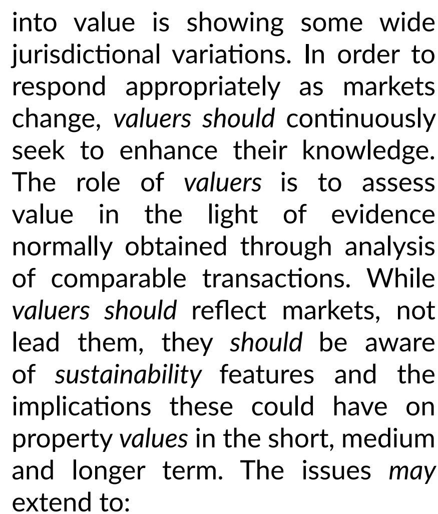
(iii) The *valuer should* state the limits on the investigations that will be undertaken and state any sources of information or *assumptions* that will be relied on.

c) *Sustainability* – assessing the implications for value

(i) While not a term that yet has a universally recognised definition, 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 environmental risks, such as flooding, energy efficiency and climate, current and historical land use as well as matters of design, configuration, accessibility, legislation, management and fiscal considerations. As commercial markets in particular become more sensitised to *sustainability* matters, so they may begin to complement traditional value drivers, both in terms of occupier preferences and in terms of purchaser behaviour.

(iii) The pace at which *sustainability* is feeding directly or indirectly



into value is showing some wide 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:

- environmental matters (see above) including, where applicable, 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
- energy efficiency,
  building 'intelligence' and other 'costs in use'
- fiscal considerations.

(iv) Notwithstanding its current bearing on value, within the context of their instructions *valuers* are actively encouraged to identify and collect *sustainability* related data, as and when it becomes available, for future comparability.

(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 it *may* be appropriate to consult with the *client* as to the use and applicability of *sustainability* metrics and benchmarks that are applicable in each case. For example, when preparing *valuations* on the basis of *Investment value* or *worth*, *sustainability* factors that could influence investment decision- making *may* properly be incorporated, even though they are not directly evidenced through transactions.

(vii) Where appropriate, in order to comply with best practice in reporting, *valuers* are recommended to:

- assess the extent to which the subject property currently meets *sustainability* criteria typically expected within the context of its market standing and arrive at an informed view on the likelihood of these impacting on value, i.e. how a well-informed purchaser would take account of them in making a decision as to offer price
- provide a description of the *sustainability*-related property characteristics and attributes that have been collected, which *may*, where appropriate, include items not directly reflected in the final advice as to value
- 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 *sustainability* 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.

VS 11
Development Property

11.1.0 Overview

11.1.1 The principles contained in **VS 6 to VS 10** apply to *valuations* of development properties. This *Standard* only includes modifications, additional requirements or specific examples of how the General Valuation Standards is applicable to *valuations* to which this standard applies. Valuations of development properties must also follow **VS 10 Real Property Interests**.

11.1.2 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 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.

11.1.3 *Valuations* of development properties *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 or not 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.

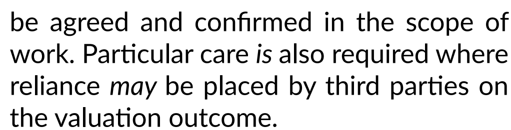
11.1.4 The residual *value* or land *value* of a development property can be very sensitive to changes in assumptions or projections concerning the income or revenue to be derived from the completed project or any of the development costs that will be incurred. This remains the case regardless of the method or methods used or however diligently the various inputs are researched in relation to the valuation date.

11.1.5 Sensitivity also applies to the impact of *significant* changes in either the costs of the project or the *value* on completion of the current *value*. 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.

11.2.0 *Bases of Value*

11.2.1 In accordance with **VS5 Bases of Value**, a *valuer must* select the appropriate *basis(es) of value* when valuing development properties.

11.2.2 The *valuation* of development properties often includes a *significant* number of assumptions and special assumptions regarding the condition or status of the project when completed. For example, special assumptions *may* be made assuming that the development has been completed or the property is fully leased. As required by **VS8 Assumptions and Special Assumptions**, *significant* assumptions and special assumptions used in a *valuation must* be communicated to all parties engaged in the valuation and *must*



be agreed and confirmed in the scope of work. Particular care *is* also required where reliance *may* be placed by third parties on the valuation outcome.

11.2.3 Very often, 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 ground conditions which have not been investigated. If this is the case, it *may* be appropriate to make assumptions of no abnormality of ground conditions were found that would result in *significant*ly increase in costs. If this was an assumption that a *participant* would not make, it would need to be presented as a special assumption.

11.2.4 In situations where there was 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 for completion of 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 is required to reflect the current *value* of the alternative project and the costs and risks associated with completion of that project.

11.2.5 For cases where development properties are closely tied to a particular use or business/trading activity or a special assumption is made assuming that the completed property will trade at specified and sustainable levels, the *valuer* must, as appropriate, also comply with the requirements of **VGN 1 Business and Business Interests** and, where applicable, **VGN 2 Intangible Assets.**

11.3.0 Valuation Approaches and Methods

11.3.1 All of the three principal valuation approaches described in **VS6 Valuation Approaches and Methods** *may* be applicable to the *valuation* of a real property interest. There are two main approaches in relation to the *valuation* of the development property. They are:

(a) the *market approach* (see section 11.4.0), and

(b) the *residual method* which is a hybrid of the *market approach*, the *income approach* and the cost approach (see sections 11.4.0-11.6.0). It 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 11.8.0).

11.3.2 In selecting an approach and method, in addition to the requirements of this standard, a *valuer must* follow the requirements of **VS6 Valuation Approaches and Methods.**

11.3.3 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. It *should* always be the most appropriate to those circumstances. Therefore, the exercise of judgement in the selection of the most suitable approach is crucial.

11.4.0 *Market Approach*

11.4.1 Some types of development properties are sufficiently homogenous and frequently transacted in market. For these development properties, there are sufficient data from recent sales for use as direct comparison when a *valuation* is required.

11.4.2 In most markets, there are limitations in adopting the *market approach* for larger or more complex development properties, or smaller properties where the proposed improvements are heterogeneous. This is because due to the number and extent of the variables between different properties, direct comparisons of all variables are inapplicable though correctly adjusted market evidence (See **VS6 Valuation Approaches and Methods**, section 6.2.5) *may* be used as the basis for a number of variables within the *valuation*.

11.4.3 For development properties where work on the improvements have commenced but are not yet completed, the application of the *market approach* is even more problematic. Such properties are rarely transferred between *participants* in their partially-completed state, with the exception of the situations of either part of a transfer of the owning entity or where the seller is either insolvent or facing insolvency and therefore is unable to complete the project. Even in the unlikely event that there is evidence of a transfer of another partially-completed development property close to the *valuation* date, the degree of work which has been completed would almost certainly differ, even if the properties were otherwise similar.

11.4.4 The *market approach may* also be appropriate for establishing the *value* of a completed property which is one of the inputs required under the *residual method* to be explained more fully in the section on the *residual method* (section 11.8.0).

11.5.0 *Income Approach*

11.5.1 Establishing the residual *value* of a development property *may* involve the use of a cash flow model in some markets.

11.5.2 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 11.8.0).

11.6.0 *Cost Approach*

11.6.1 Establishing the development costs is a key component of the *residual method* (see section 11.8.5).

11.6.2 The *cost approach may* also exclusively be used as a means of indicating the *value* of development properties such as a proposed development of a building or other structure for which there is no active market on completion.

11.6.3 The *cost approach* is based on the economic principle that a buyer will pay no more for an *asset* than the amount required 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.

11.6.4 Another difficulty in applying the cost approach to a development property is 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. Furthermore, as the property approaches completion, some of the risks associated with the development are likely to reduce, which *may have* 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.

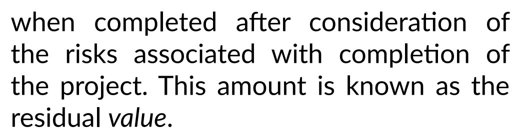
11.7.0 Special Considerations for a Development Property

11.7.1 The following sections are topics relevant to the *valuation* of development property, which are non-exhaustive:

(a) *Residual Method* (section 11.8.0).
(b) Existing Asset (section 11.17.0).
(c) Special Considerations for Financial Reporting (section 11.18.0).
(d) Special Considerations for Secured Lending (section 11.19.0).

11.8.0 *Residual Method*

11.8.1 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 amount is known as the residual *value*.

11.8.2 The residual *value* can be highly sensitive to relatively small changes in forecast cash flows and the practitioner *should* provide separate sensitivity analyses for each *significant* factor.

11.8.3 Caution is required in the use of this method because the result is sensitive to changes in many of the inputs which *may* not be precisely known on the valuation date, and therefore assumptions have to be used in the estimation.

11.8.4 The models used in 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.

11.8.5 In applying the *residual method*, a *valuer should* consider and evaluate the reasonableness and reliability of the following:

(a) the source of information of any proposed building or structure, eg any plans and specification which are to be relied on in the *valuation*, and

(b) any source of information of the construction and other costs which will be incurred in completing the project and which will be used in the *valuation*.

11.8.6 The following basic elements are required to be considered in application of the method to estimate the *market value* of development property. 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.

11.9.0 Value of Completed Property

11.9.1. The first step involves estimation 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 **VS6 Valuation Approaches and Methods.**

11.9.2. Regardless of the methods adopted, be it 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 and the special assumption that the project has 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.

11.9.3 The appropriateness of using which assumptions should be determined by market practice and availability of relevant data. However, it should be clearly stated out whether current or projected *values* are being used.

11.9.4 If estimated gross development value is used, it *should* be made clear that it is based on special assumptions that a *participant* would make, basing on information available on the valuation date.

11.9.5 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, the costs used *should* also be current and discount rates should be derived from analysis of current prices.

11.9.6 If a pre-sale or pre-lease agreement is 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 exercised 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.

11.9.7 If the terms are not reflective of the market, adjustments *may* need to be made to the *valuation*.

11.9.8 It would also be appropriate to establish if the agreement would be assignable to a purchaser of the relevant interest in the development property prior to the completion of the project.

11.10.0 Construction Costs

11.10.1 The costs of all work required for the completion of the project to the defined specification at the valuation date 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.

11.10.2 If work has commenced, or is about to commence, a contract or contracts will normally be in place which can provide the independent confirmation of cost. However, if no contracts are in place, or if the actual contract costs are not typical of those that would be agreed in the market on the valuation date, it *may* be necessary to estimate these costs reflecting the reasonable expectation of *participants* on the valuation date of the probable costs.

11.10.3 The benefit of any work carried out prior to the *valuation* date will be reflected in the *value* but will not determine the *value*. Similarly, previous payments under the actual building contract for work completed prior to the valuation date are not relevant to the current *value.*

11.10.4 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.

11.10.5 However, contractual costs *may* include special requirements of a specific end user and therefore *may* not reflect the general requirements of *participants*.

11.10.6 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.

11.10.7 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.

11.10.8 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*.

11.11.0 Consultants' Fees

11.11.1 Consultants' fees include legal and professional costs that would be reasonably incurred by a *participant* at various stages through the completion of the project.

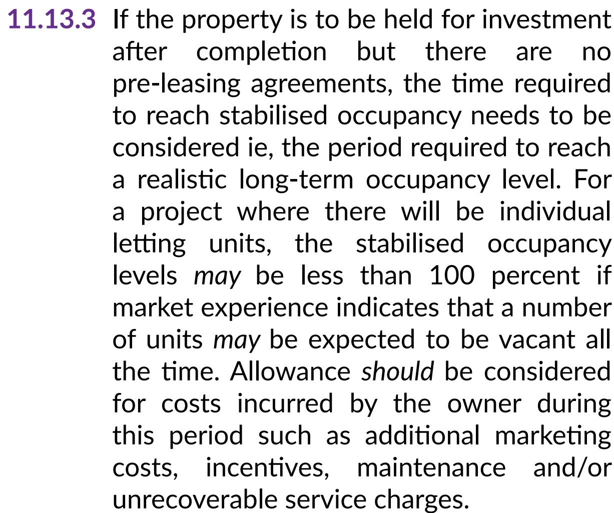
11.12.0 Marketing Costs

11.12.1 If there is no identified buyer or lessee for the completed project, it will normally be appropriate to allow for costs associated with appropriate marketing, and for any leasing commissions and consultants' fees incurred for marketing not included under para 11.11.1.

11.13.0 Timetable

11.13.1 The duration of the project from the valuation date to the expected date of physical completion of the project together with the phasing of all cash outflows for construction costs, consultants' fees, etc. need to be considered.

11.13.2 If no sale agreement is 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 from the completion of construction to the completion of sale.



11.13.3 If the property is to be held for investment after completion but 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 be vacant all the time. 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.

11.14.0 Finance Costs

11.14.1 These represent the cost of finance for the project from the valuation date to the completion of the project, including any period required after physical completion to either sale of the interest or achieving 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.

11.15.0 Development Profit

11.15.1 Allowance *should* be made for development profit, or 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 risks involved in achieving the anticipated income or capital *value* following physical completion of the project.

11.15.2 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. The most appropriate option for the type of property in question will normally be indicated by market practice. The amount of profit 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 in which the project has reached on the valuation date. A project which is approaching completion will normally be less risky than the one at an early stage, with the exception of situations where a party to the development is insolvent,

(b) whether or not a buyer or lessee has been secured for the completed project, and

(c) the size and anticipated remaining duration of the project. In general, the longer the project lasts, the greater is the risk due to fluctuations in future costs and receipts and changing economic conditions.

11.15.3 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 out of the developer's control,

(c) delay 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.

11.15.4 Whilst all of the above factors will have impact on 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 in which contingencies have already been reflected in the residual valuation model or have also been included in risks in the discount rate used to bring future cash flows to present *value*.

11.15.5 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.

11.15.6 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.

11.16.0 Discount Rate

11.16.1 When adopting the *residual method* to arrive at an indication of the *value* of the development property at the valuation date, a discount rate is required to be applied to all future cash flows to achieve the net present *value*. The discount rate may be derived using a variety of methods. (see **VS6 Valuation Approaches and Methods**).

11.16.2 If 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 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.

11.17.0 Existing *Asset*

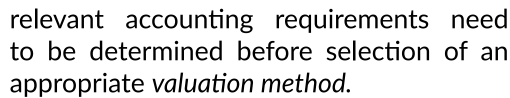
11.17.1 In the *valuation* of a development property, it is necessary to establish the suitability of the real property in question for the proposed development. Some matters *may* be within the *valuer's* knowledge and experience but some *may* require information or reports from other specialists. 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 or not 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.

11.17.2 Where a project is in progress, additional enquires or investigations into the contracts in place for the design of the project will typically be needed for its construction and for supervision of the construction.

11.18.0 Special Considerations for Financial Reporting

11.18.1 The accounting treatment of a development property can vary depending on how it is classified by the reporting entity eg, whether it is 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 selection of an appropriate *valuation method*.

11.18.2 Financial statements are normally produced on the *assumption* that the entity is an on-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 be passed to the buyer in the hypothetical exchange, even if the contracts *may* not be assignable in an actual exchange, with the exception that there was evidence of an abnormal risk of default by a contracted party on the valuation date.

11.19.0 Special Considerations for Secured Lending

11.19.1 The appropriate basis of valuation for secured lending is normally *market value*. However, in considering the *value* of a development property, regard *should* be given to the probability of any contracts in place eg, contracts 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. Any contractual obligations which *may* have a material impact on *market value* should also be considered. Therefore, it may be appropriate to highlight to a lender that, in the event of a default by the borrower, there is a risk that they may have to engage other building contractors and there may be complications arising from pre-leases, pre-sales and any associated warrantees and guarantees.

11.19.2 To demonstrate an appreciation of the risks involved in valuing development property for secured lending or other *purposes*, the *valuer should* apply a minimum of two appropriate methods to value development property for each valuation project, as usually there are "insufficient factual or observable inputs for a single method to produce a reliable conclusion" (see **VS6 Valuation Approaches and Methods,** para 6.1.10).

11.19.3 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 **VS9 Reporting,** paras 9.2.1 & 9.2.2).

PART D:
GUIDANCE NOTE

VGN 1

Business Interests and Business Enterprises

1.0 This guidance note contains additional requirements that apply to *valuations* of businesses and business interests.

2.0 Introduction

2.1 The definition of what constitutes a business may differ depending on the purpose of a *valuation*. However, generally a business conducts a commercial, industrial, service or investment activity. Businesses can take many forms, such as corporations, partnerships, joint ventures and sole proprietorships. The *value* of a business may differ from the sum of the *values* of the individual *assets or liabilities* that make up that business. When a business value is greater than the sum of the recorded and unrecorded net tangible and identifiable intangible *assets* of the business, the excess value is often referred to as going concern value or goodwill.

2.2 When valuing individual *assets or liabilities* owned by a business, *valuers should* follow the applicable standard for that type of *asset* or liability (**VGN2 Intangible Assets, VS10 Real property**, etc.).

2.3 *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. 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.

2.4 *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.

3.0 ***Bases of Value***

3.1 In accordance with **VS 5**, a *valuer must* select the appropriate *basis(es) of value* when valuing a business or business interest.

3.2 Often, business valuations are performed using *bases of value* defined by entities/organisations other than the *HKIS* (some examples of which are mentioned in **VS 5**) 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*.

4.0 Valuation Approaches and Methods

4.1 The three principal valuation approaches described in **VS 6** *may* be applied to the *valuation* of businesses and business interests.

4.2 When selecting an approach and method, in addition to the requirements of this guidance note, a *valuer must* follow the requirements of **VS 6**, including paragraph 6.4.3.

5.0 ***Market Approach***

5.1 The *market approach* is frequently applied in the *valuation* of businesses and business interests as these *assets* often meet the

criteria in **VS 6 paragraph 6.2.2 or 6.2.3**. When valuing businesses and business interests under the *market approach*, *valuers should* follow the requirements of **VS 6**.

5.2 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.

5.3 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.

5.4 When applying a market multiple, adjustments such as those in paragraph 6.8 below *may* be appropriate to both the subject company and the comparable companies.

5.5 When selecting and adjusting comparable transactions, 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.

5.6 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).

5.7 When selecting and adjusting comparable public company information, a *valuer should* choose 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.

5.8 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 **VS 6 paragraph 6.3.17**),
(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.

6.0 *Income Approach*

6.1 The *income approach* is frequently applied in the *valuation* of businesses and business interests as these *assets* often meet the criteria in **VS 6 paragraph 6.4.2 or 6.4.3**.

6.2 When the *income approach* is applied, *valuers should* follow the requirements of **VS 6 sections 6.4.0 and 6.5.0**.

6.3 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.

6.4 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.

6.5 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 **VS 6 paragraphs 6.5.29-6.5.31**).

6.6 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.

6.7 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.

6.8 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.

6.9 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.

6.10 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.

7.0 Cost Approach

7.1 The *cost approach* cannot normally be applied in the *valuation* of businesses and business interests as these *assets* seldom meet the criteria in **VS 6 paragraphs 6.6.2 or 6.6.3**. 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 **VS 6 paragraphs 6.7.9 and 6.7.10**, 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.

7.2 In the circumstances where a business or business interest is valued using a *cost approach*, *valuers should* follow the requirements of **VS 6 sections 6.7.0 and 6.8.0**.

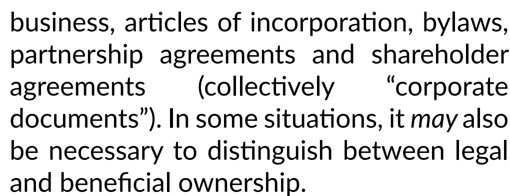
8.0 Special Considerations for Businesses and Business Interests

8.1 The following sections address a non-exhaustive list of topics relevant to the *valuation* of businesses and business interests:

(a) Ownership Rights.
(b) Business Information.
(c) Economic and Industry Considerations.
(d) Operating and Non-Operating *Assets*.
(e) Capital Structure Considerations.

9.0 Ownership Rights

9.1 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.

9.2 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.

9.3 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 (i.e., 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.

9.4 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 **VS 6 paragraph 6.3.17 (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.

10.0 Business Information

10.1 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 **VS 6**, 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.

10.2 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.

11.0 Economic and Industry Considerations

11.1 Awareness of relevant economic developments and specific industry trends is essential for all *valuations*. 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 (i.e., 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.

12.0 Operating and Non-Operating *Assets*

12.1 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*.

12.2 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* utilized 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 paragraph 2.3 above), the *value* of non-operating *assets may* need to be separately determined and added to the operating value of the business.

12.3 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.

12.4 When separately considering non-operating *assets and liabilties*, 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.

12.5 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*.

13.0 Capital Structure Considerations

13.1 Businesses are often financed through a combination of debt and equity. However, in many cases, *valuers could* be asked to value only equity or a 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. For details, see IVS 200.

VGN 2
Intangible Assets

1.0 This guidance note contains additional requirements that apply to *valuations* of intangible *assets*.

2.0 Introduction

2.1 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.

2.2 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.

2.3 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.

2.4 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 paragraph 2.3.

2.5 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.

2.6 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.

2.7 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, i.e., 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.

2.8 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.

2.9 *Valuers may* perform direct *valuations* 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.

2.10 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.

3.0 *Bases of Value*

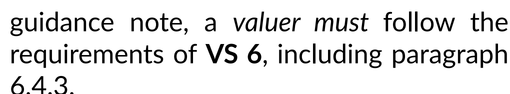
3.1 In accordance with **VS 5**, a *valuer must* select the appropriate *basis(es) of value* when valuing intangible *assets*.

3.2 Often, intangible *asset valuations* are performed using *bases of value* defined by entities/organisations other than the HKIS (some examples of which are mentioned in **VS 5**) 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*.

4.0 Valuation Approaches and Methods

4.1 The three valuation approaches described in **VS 6** can all be applied to the *valuation* of intangible *assets*.

4.2 When selecting an approach and method, in addition to the requirements of this



guidance note, a *valuer must* follow the requirements of **VS 6**, including paragraph 6.4.3.

5.0 *Market Approach*

5.1 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*).

5.2 Transactions involving intangible *assets* frequently also include other *assets*, such as a business combination that includes intangible *assets*.

5.3 *Valuers must* comply with **VS 6 paragraphs 6.2.2 and 6.2.3** 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.

5.4 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.

5.5 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*.

5.6 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.

5.7 The guideline transactions method is generally the only *market approach* method that can be applied to intangible *assets*.

5.8 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.

6.0 *Income Approach*

6.1 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.

6.2 *Valuers must* comply with **VS 6 paragraphs 6.4.2 and 6.4.3** when determining whether to apply the *income approach* to the valuation of intangible *assets*.

6.3 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*.

6.4 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.

6.5 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

6.6 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 *valuations* 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.

6.7 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*.

6.8 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").

6.9 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.

6.10 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.

6.11 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 paragraphs 11.1-11.4 below), calculate and add the tax amortisation benefit (TAB) for the subject intangible *asset*.

6.13 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.

6.14 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.

6.15 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.

6.16 If the contributory *asset* is not wasting in nature, like working capital, only a fair return on the *asset* is required.

6.17 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).

6.18 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 (i.e., 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

6.19 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.

6.20 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 *valuations*,

(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 paragraphs 16.1-16.4), calculate and add the TAB for the subject intangible *asset*.

6.21 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.

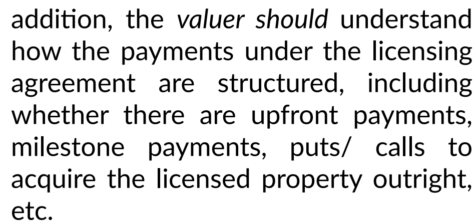
(b) Importance of the subject intangible to the owner: Whether the subject *asset* is a key factor of differentiation from competitors, the importance it plays in the owner's marketing strategy, its relative importance compared with other tangible and intangible *assets*, and the amount the owner spends 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.

6.22 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, royaltyagreements *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

6.23 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).

6.24 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*.

6.25 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.

6.26 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.

6.27 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 paragraphs 11.1-11.4), calculate and add the TAB for the subject intangible *asset*.

6.28 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.

6.29 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

6.30 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.

6.31 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.

6.32 The greenfield method is often used to estimate the *value* of "enabling" intangible *assets* such as franchise agreements and broadcast spectrum.

6.33 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 paragraphs 16.1-16.4 below), calculate and add the TAB for the subject intangible *asset*.

Distributor Method

6.34 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*.

6.35 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.

6.36 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 paragraphs 16.1-16.4 below), calculate and add the TAB for the subject intangible *asset*.

7.0 Cost Approach

7.1 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.

7.2 *Valuers must* comply with **VS 6 paragraphs 6.6.2 and 6.6.3** when determining whether to apply the *cost approach* to the *valuation* of intangible *assets*.

7.3 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.

7.4 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 **VS 6 paragraphs 6.6.2 and 6.6.3**.

7.5 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*.

7.6 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.

7.7 *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 **VS 5**) that assume a hypothetical transaction, it *may* be appropriate to include an assumed profit mark-up on costs. As noted in **VS 6**, 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.

8.0 Special Considerations for Intangible *Assets*

8.1 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 1.9.0).
(b) Intangible *Asset* Economic Lives (section 1.10.0).
(c) Tax Amortisation Benefit (section 1.11.0).

9.0 Discount Rates/Rates of Return for Intangible Assets

9.1 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.

9.2 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.

9.3 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.

9.4 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.

10.0 Intangible Asset Economic Lives

10.1 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.

10.2 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 know how associated with the technology would have value in production of a generic drug beyond the expiration of the patent.

10.3 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.

10.4 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.

10.5 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.

10.6 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%.

10.7 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.

10.8 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.

11.0 Tax Amortisation Benefit (TAB)

11.1 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.

11.2 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.

11.3 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*.

11.4 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* (i.e., 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*.

VGN 3

Valuation for Financial Statements and Accounts Reporting Purposes

1. General Requirements

1.1 This VGN provides additional guidance 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.

1.3 Although the International Financial Reporting Standards (IFRS) are nowadays widely adopted, other financial reporting standards may still apply in individual *jurisdictions*. *Valuer should* agree with the *client* and the auditor on the use of appropriate *basis of value* in the *terms of engagement* and disclose the same in his *report*.

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.

1.5 The definition of *fair value* is denoted in **VS 5 Section 5.9.0**.

1.6 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.

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

1.8 While different professions have different interpretations for the term "Plant and Equipment", the *Institute* has adopted the interpretation set out in the *IVS*, that is, "Items of plant and equipment are tangible *assets* that are held by an entity for use in the production or supply of goods and services, for rental by others or for administrative purpose and that are expected to be used over a period of time".

1.10 It is a general practice to have the *valuation date* being set as of the ending *date of the reporting* period of the *financial statements* (or referred to as the 'cut-off date'). There are cases that the *valuation date may* be set at a date earlier than the ending ding period of the *financial statements*, such as the transaction date. *Valuers* are required to discuss with the *clients* and the auditors of the *clients* to confirm the *valuation date* prior to taking up the engagement.

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.

3. *Valuations* under Hong Kong Financial Reporting Standards (HKFRS)

3.1 The *Institute* notices that in some instances *valuers* need to follow a set of procedures as required by the HKFRS or to arrive at a value other than a *market value* for aiding the accountant in the establishment or restatement of *financial statements*, such as 'fair value less costs to sell', 'value in use' or 'purchase price allocation in a business combination'. In this context, *members* need to disclose the set of procedures in the *report* and to follow *the Standards* whenever and wherever possible in preparing the *report*.

3.2 *Members* are encouraged to obtain copies of relevant HKFRS from the HKICPA in order to have a better understanding before performing *valuation* engagements for *financial statements* and accounts reporting purposes

4. Notional Apportionment of Land and Building Elements

4.1 In the circumstances that a *valuer*, at the instruction from the *client*, is required under any financial reporting standards to notionally break down the *value* conclusion of a real property into land and building elements. The apportionment *may* be done by using one of following methods:

(a) By deducting from the *valuation* of the whole real property, the *value* of the land for its existing use as of the *valuation date*. In many instances there will be ample evidence of land *values* upon which a notional apportionment can be made. However, where there is little or no evidence of the land *values*, greater reliance will have to be placed on method (b) below.

(b) By making an assessment of the net replacement cost of the improvements as of the *valuation date* and deducting this from the *valuation* of the whole real property. The figure for the improvements will be derived from gross replacement cost which will then be reduced to the written-down value or net replacement cost as set out below, in order to reflect the current value of the real property to the business.

The *valuer should* consult the *clients* and/or auditors acting for the *clients* as to the basis of calculating the depreciable amount of the improvements, in order to maintain consistency of practice in the future.

4.2 *Valuer should* make a qualification in the *report* that the apportioned *values should* not be used other than financial reporting purpose.

5. Development Property

5.1 The accounting treatment of development property can vary depending on how it is classified by the reporting entity (e.g. 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.

6. Events after the reporting period

6.1 *The valuer should refer to material events after the reporting period in the financial statements of which he becomes aware and which would likely affect his valuation in the report, and, at the advice sought from the client and its auditors to distinguish those events between adjusting or non-adjusting events in the report.*

6.2 In referring to those *material* events in the *report*, the *Valuer* is required to discuss and obtain consent from the *directors* of the *client* to disclose such events in the *report*. The *valuer* is also required, at the advice from the *directors* of the *client* to distinguish between commercially confidential events or non-commercially confidential events, in particular when the *material* events are price sensitive to a public company.

6.3 HKAS 10 "Events after the Reporting Period" refers to events which occur between the end of the reporting period and the date on which the *financial statements* are approved by the *directors* of the *clients* and imposes upon the *directors* certain obligations regarding the disclosure of the events. Such events *may* be classified as "adjusting events" or "non-adjusting events". *Valuers* are advised to refer to the HKAS 10 for the examples of different events.

7. Connected Leasing Arrangement

Any real property occupied by a company under an inter-company leasing arrangement within a group account should be valued as owner-occupied real property.

8. Relationship with Auditor

8.1 According to various standards on auditing, the auditor has a responsibility, when using the work performed by an auditor's expert (individual or organisation), to obtain sufficient appropriate audit evidence that such work is adequate for the purposes of the audit. The *Institute* noted that the term "Expert" is defined by the Hong Kong Standard on Auditing 620 "Using the Work of an Auditor's Expert" as "an individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence". An auditor's expert may be either an auditor's internal expert or an auditor's external expert. The *HKIS* considers that a *member* who is a qualified *valuer* as defined in *the Standards* in performing *valuations* for *financial statements* and accounts reporting are an auditor's expert.

8.2 The auditor in performing his evaluation on whether the work of an auditor's expert is appropriate for the auditor's purposes, will consider the relevance and reasonableness of:

- the source data used;
- the *assumptions* and methods used; and
- the result of the auditor's expert work in the light of the results of other audit evidence.

8.3 In the course of the auditor's due diligence to the work with the auditor's expert, the auditor will follow the relevant standard on auditing by making inquiries regarding any procedures undertaken by the auditor's expert and reviewing or testing the data used by the auditor's expert. In some circumstances, even working papers are required to be submitted to the auditor for his review or testing.

8.4 The *valuer* is reminded that prior to submitting his working papers or data to the auditor, careful thought is required on the following:

- the scope of work as agreed in the *terms of engagement* with the *client*;
- the nature of the working papers and data, such as intellectual property rights; and,
- any consent, either expressly or implicitly, from the *client* for release of such works.

Under normal circumstances, the *report should* provide reasoning to all *intended users* on how the *value* conclusion is arrived. *Valuers* are presumed to have the responsibilities to assist all the *intended users* to understand the *valuation* and communications with the auditors on the key inputs are part of this responsibilities, provided that the requests from the auditor are not unreasonable.

8.5 The *valuer* is reminded to reach an agreement with the *client* in the *terms of engagement* on the working relationship with the *client*'s auditor. This could include the way and the extent of releasing working papers and data to the *client*'s auditor, to avoid unnecessary disputes with the *client* and the *client*'s auditor thereafter and any potential litigation in the future.

8.6 It is a good practice to have a meeting with the *client* and their auditor to understand and to agree on the scope of work prior to proposing and signing off the *terms of engagement* to the *client*.

VGN 4

Valuations of Real Properties for Secured Lending

The objective of this guidance notes on Valuations of Real Properties for Secured Lending is to provide guidance to *valuers* upon preparation of *valuation reports* of real properties on behalf of banks or lending institutions or lenders for secured lending.

1. The Qualified Valuer's Roles

1.1 The roles of the qualified *valuer* are:

1.1.1 to advise the bank or lending institution or lender (hereinafter collectively referred to as "the Lender") as to the *market value* of the real property(ies) at the *valuation date*; and

1.1.2 to advise the Lender as to the nature of the real property (see Section 5 below) and any factors likely to materially affect its *market value*.

1.2 It would be usual for the *valuer* to be asked to express an opinion as to the suitability of the real property as security for a loan. It is, however, a matter for the Lender to assess the risk involved and express their assessment in fixing the terms of the loan, such as the percentage of *value* to be advanced, and provision for repayment of the capital and the interest rate. The *valuer should* refer in his *report* where one is to be provided, to all matters which are within his knowledge and which may assist the Lender in his assessment of the risk. The *valuer should* not make a recommendation as to the amount or percentage of mortgage advance or as to the length of the loan term. Nor is it the *valuer's* responsibility to give advice as to the suitability of the real property 'for second mortgage purposes'.

1.3 When a real property is valued as security for a loan, by way of mortgage, debenture or otherwise, the *valuation* shall normally be on the basis of *market value*.

1.4 It is not normally appropriate to value a real property to be used as security for a loan on a basis other than *market value*. Where the Lender requires the *valuer* to advise on the *values* of certain real properties, either in addition to or in place of *market value*, e.g. *valuation* of flats subject to the restrictions upon assignment under Home Ownership Scheme or Sandwich Class Housing Scheme, 'surrender value' of industrial properties located in Industrial Estates in Hong Kong subject to restrictions on assignment and underletting, Hong Kong residence for Hong Kong People, etc., the *valuer should* state clearly the *basis of value* adopted in the *report*.

2. Taking Instruction

2.1 It is recognized as a common practice that the Lender may have a master service agreement with the *firm* of the *valuers* on the overall *valuation* services for secured lending, while the formal engagement will be contained in further correspondences in any appropriate business form. A *valuer should* ensure that the formal engagement instruction and the master service agreement together contains all the minimum contents as stipulated in **VS 4** of the *Standards*.

2.2 In case the *valuation* is not covered in any master service agreement, the *valuer must* make sure the *terms of engagement* in compliance with *the Standards*.

2.3 In some circumstances, a *valuation* may be commissioned by a party that is not the intended Lender, for example, a prospective borrower or an agent. If the party does not know, or is unwilling to disclose, the identity of the intended Lender, it *must* 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 that particular Lender has specific reporting requirements.

2.4 It is common practice for the *valuer* to provide a preliminary indication of *value* to the Lender before formal instruction. For the guidance on providing preliminary indication of *value*, see Appendix to this guidance note.

3. The Valuation Process

3.1 Inspection Arrangement

Inspections must always be carried out to the extent necessary to produce a *valuation* that is professionally adequate for its purpose, unless expressly agreed with the Lender. A visual and physical *inspection* shall be undertaken to the exterior and interior of the *real estate* as long as the same is accessible to the *valuer* (or designated qualified staff) without undue difficulty. With regard to the scope of *inspection* to be performed by the *valuer*, it is a best practice for the *valuer* to agree with the Lender prior to commencement of his *valuation* and to document such agreement in the *terms of engagement*. While the scope of the *inspection* is to be agreed between the *valuer* and the Lender, the *valuer* is required to observe the **VS 7** of *the Standards* and in no way should it give rise to a result that would mislead the Lender who reads the *report*. To avoid doubt, *inspection* required under *the Standards* is not in any form of a building survey to the subject *real estate*.

3.2 *Valuation* without Inspection

Where the Lender has instructed the *valuer* not to carry out any *inspection* (internal or external or both), the *valuer must* consider the risk before proceeding. If any *valuation* without *inspection* may undermine the reliability of such *valuation*, such instruction *must* not be taken. In case any *valuation* without *inspection* is taken, the *valuer should* state such instruction in the *report* and a caveat or *assumption* is required to reflect the absence of *inspection*.

3.3 Cases not Appropriate without Inspection

The *valuer should* alert the Lender and advise an internal *inspection* to be carried out when the characteristics of *real estate* are not typical in the market. Examples include, but not limited to, tenement buildings, properties subject to Building Order(s) being registered by the government, domestic buildings or non-typical developments over 30 years in age, properties with flat roof, roof and/or appurtenant open space, villas, village-type houses, all non- domestic properties, etc. If the Lender is not able to arrange an internal *inspection*, an external *inspection should* still be carried out.

3.4 Revaluation without re-inspection of real property previously valued

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

3.5 The *valuer should* ensure the entire *valuation* process in compliance with **VS 7** of *the Standards*.

4. The Report

4.1 Subject to the matters referred to in Sections 1 and 3 above, the *report should* be confined strictly to answering questions raised by the Lender.

4.2 If it is suspected that there exists hidden defects that could have *material* effect on the *value* of the real property, the *valuer should* so advise and recommend to the Lender that a more extensive investigation should be carried out. It *may* be appropriate in exceptional circumstances to defer making a *valuation* until the results of such further investigations are made known to the *valuer*.

4.3 If it is not possible to carry out *inspection* on any substantial part of the *real estate*, this *should* be stated in the *report*.

4.4 If there is obvious evidence of any serious disrepair, potential hazard or any other matters which may materially affect the *value* of the real property, this *should* be stated in the *report*.

4.5 Where the *valuer* relies on information provided by others, this *should* be indicated in the *report*, so *should* the source of that information. With regard to the verification work to be conducted by the *valuer*, it is a good practice for the *valuer* to agree with the Lender prior to commencement of his *valuation* and to document such agreement in the *terms of engagement*. While the scope of the verification work is to be agreed

between the *valuer* and the Lender, the *valuer* is required to observe the **VS 7** of *the Standards* and in no way should it give rise to a result that would mislead the Lender who reads the *report*.

4.6 The Lender *should* be informed of the existence of any apparent and *significant* additions, alterations and extensions so as to alert the Lender's legal adviser for any enquiries to be made. In particular, the Lender's attention *should* be drawn to any unauthorised structure or addition or alteration made in the subject *real estate* or any other apparent unauthorised structures which are or could be subject to action under Section 24 of the Buildings Ordinance (Chapter 123 – Laws of Hong Kong) or under applicable regulations in other *jurisdictions*.

4.7 The *valuer should* consider the subject real property in accordance with its original approved state and disregard any premium attached to the unauthorised additions and/or alterations. Unless otherwise agreed between the *valuer* and the Lender and with assistance from a registered contractor in the government, the *valuer* would not consider any costs required to restore the real property to its original approved state if requested by the government authorities. The *valuer should* state such *assumptions* in the *report*. If as instructed by the Lender to make any *assumptions* which are different from the above, the *valuer must* state such *assumptions* in the *report*.

4.8 If there are any additional requirements from a Lender in conducting *valuations*, subject to the agreement made between the Lender and *valuer* beforehand, extra information or findings can be included in the *report*.

4.9 The format and extent of the detail of the *report* are a matter of the *valuer*'s discretion except where the *report* is to be provided on a form supplied by the *client*. The presentation of the *valuation report should* take into account the need for any special format and *should* contain the following minimum required information:

(a) the status of the valuer and where appropriate and applicable, the disclosure of any material involvement, previously or current;
(b) the identification of the client and any other intended users;
(c) the purpose of the valuation;
(d) the identification of the asset(s) being valued;
(e) the *basis or bases of value;*
(f) the valuation date;
(g) the extent of the Valuer's inspections and investigations;
(h) the nature and source of information to be relied on by the valuer;
(i) any assumptions, special assumptions, reservations, any special instructions or departures;
(j) any restrictions on use, distribution and publication;
(k) confirmation that the assignment has been undertakne in accordance with the *IVS* and/or *HKIS Valuation Standards;*
(l) the valuation method adopted and the key inputs, subject to the instructions of the Lender;
(m) the opinions of *value* in figures and words;
(n) the date of the 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; and
(p) any limits or exclusion of liability to parties other than the client

5. The Valuation

5.1 Unless the facts clearly shown to the contrary or subject to paragraphs 4.6 and 4.7 above, the *valuer should* state the following *assumptions* in the *report* and will be under no duty to verify these *assumptions*:

5.1.1 that all necessary statutory approvals for the subject *real estate* or the building of which the subject *real estate* forms part of the use have been obtained;

5.1.2 that no deleterious or hazardous materials or techniques have been used in the construction of the subject *real estate*;

5.1.3 that the subject real property is not subject to any unusual or especially onerous restrictions, encumbrances or outgoings and that good title can be shown;

5.1.4 that those parts of the subject *real estate* which could not be inspected would not reveal *material* defects or cause the *valuer* to alter his *valuation*;

5.1.5 that the subject *real estate* is connected to main services and sewers which are available on normal terms;

5.1.6 that in the case of a *real estate* which is under construction, the *real estate* will be satisfactorily completed to the standard in due course and details as described in the latest development schedules as contained in the sales brochure;

5.1.7 that in *valuation* of a strata-titled real property, unless instructed by the Lender or otherwise aware of to the contrary, the cost of repairs and maintenance to the building of which the subject *real estate* forms part of the use are shared among all owners of the building, and that there are no onerous liabilities outstanding.

5.2 Suggested factors to be taken into account in the *valuation* are:

5.2.1 the tenure of the real property - If the real property is subject to tenancy(ies), details including lease period(s), rental amount(s), option to renew and other relevant conditions *should* be included;

5.2.2 the age, type, accommodation, location, amenities, fixtures and features of the *real estate* and other *significant* environmental factors within the locality;

5.2.3 the general state of repair, the construction and apparent major defects; and

5.2.4 the overall quality of management of the building of which the *real estate* forms part of.

5.3 In assessment of the *market values* of strata-titled units, unless otherwise instructed, any redevelopment potential attached to the site is to be excluded. The *valuer* would also not to include any element of *value* attributable to furnishings and removable fittings of any description when arriving at an opinion of *value*. Portable and temporary structures are also to be excluded.

5.4 Valuation for secured lending is normally based on *market value*. However, in considering the *value* of a development site, regard should be given to the risks of any contracts that are in place, e.g., for construction or for the sale or leasing of the completed project may, become void or voidable.

5.4.1 To demonstrate the consideration of the risks involved in valuing development site for secured lending or other purposes, the *valuer* should apply a minimum of two appropriate methods to valuing development site for each *valuation* project.

5.4.2 The *valuer* should be able to justify the selection of the valuation approaches reported and should provide an “As Is” (existing stage of development) and an “As Proposed” (assuming completed development) value for the development site and record the process undertaken and a rationale for the reported value.

5.5 ‘*Market value*’ shall be adopted in accordance with *the Standards*.

5.6 The *valuation* shall be made on the *assumption* that the owner sells the subject real property on the market without the benefit or burden of cash rebate, unusual payment terms, special incentive or any similar arrangement which could affect the *value* of the subject real property.

5.7 Value for sale under repossession (VSR)

Value for sale under repossession (the word repossession means the action of regaining possession especially the seizure of collateral securing a loan that is in default) refers to the price that might reasonably be expected to realise within a defined period of time (the period shall be agreed upon between Lender and *valuer*) from the sale of a real property in the market under repossession by the Lender or receiver, on an “as is” basis, taking into account the unique quality of the real property and the existence of any specific demand as well as factors which might adversely affect the marketability of the real property due to market perception of increased risk or stigma, justified or otherwise.

The underlying *basis of value* of VSR is *market value*, but subject to *special*

assumptions on actual or hypothetical marketing constraints which cause the perception of increased risk of stigma. The marketing constraint *must* be agreed with the Lender prior to reporting. An example of the marketing constraint includes the anticipated time frame for completion of a transaction which strikes a balance between the Lender's liquidity need and the reasonable care to the mortgagor, but which *may* be considered as inadequate for the real property to be presented in the market.

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.

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.

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. Unless in certain extreme cases the facts show otherwise, it *may* be remote and inappropriate to foresee a bank will be 'forced' to sell a real property under repossession.

While a *valuer* can assist a Lender in determining a price that *should* be accepted in marketing constraints, this is a commercial judgement of the Lender whether a discounted price to the *market value* will be accepted. A *valuer should* make a qualification in the *report* on the reliance of VSR.

To provide an estimate of the VSR, the *valuer should*:

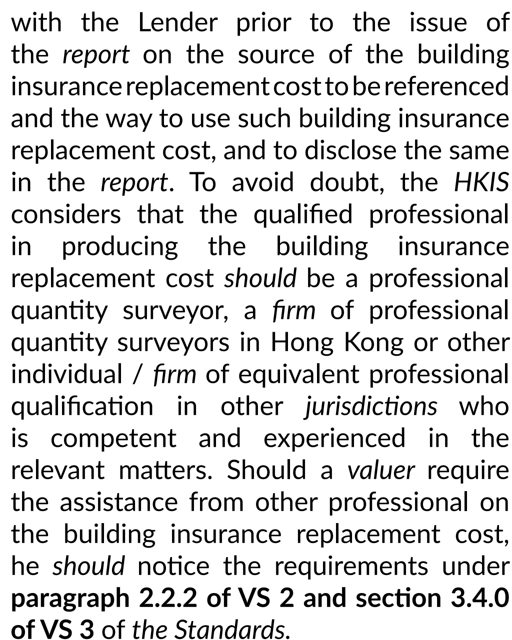
(1) agree with the *Lender* or receiver on the details of the actual or anticipated marketing constraints that might have impact on the *market value* whilst taking into account the unique quality of the real property and the existence of any specific demand;
(2) ascertain whether the constraint arises 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;
(3) estimate the *market value* of the real property;
(4) analyse and apply adjustment(s) to the *market value* of the real property by taking into account the negative impacts and to arrive at the *value* for sale under repossession independently; and
(5) make a qualification in the *report* on the reliance of the VSR.

6. Building Insurance Replacement Cost

In some cases, *valuers* are required to give the building insurance replacement cost of the subject *real estate* in the *reports* for the Lenders' reference.

The building insurance replacement cost is defined as the estimated cost of erecting the same *real estate* or a modern substitute *real estate* having the same area as the existing one at the relevant date, which includes fees, finance costs and other associated expenses directly related to the construction of the *real estate*. Coverage for loss of rent and other disturbances will not be included unless specifically requested by the Lender.

In producing the building insurance replacement cost in the *report*, should the *valuer* consider himself not a qualified professional to give an accurate building insurance replacement cost of the subject *real estate*, he *should* reach an agreement



with the Lender prior to the issue of the *report* on the source of the building insurance replacement cost to be referenced and the way to use such building insurance replacement cost, and to disclose the same in the *report*. To avoid doubt, the *HKIS* considers that the qualified professional in producing the building insurance replacement cost *should* be a professional quantity surveyor, a *firm* of professional quantity surveyors in Hong Kong or other individual / *firm* of equivalent professional qualification in other *jurisdictions* who is competent and experienced in the relevant matters. Should a *valuer* require the assistance from other professional on the building insurance replacement cost, he *should* notice the requirements under **paragraph 2.2.2 of VS 2 and section 3.4.0 of VS 3** of *the Standards*.

7. The Valuer's Record

7.1 The *valuer should* keep a record of the source of information quoted in the *report* and to make and retain legible notes as to his findings and, particularly, the limits of *inspection* and the circumstances under which it was carried out.

7.2 The *valuer should* also keep a record of the comparable transactions and/or *valuations* to which he has had regard in arriving at his *valuation*.

8. Independence, Objectivity and Conflicts of Interest

8.1 *Valuers 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. *Members must* also declare any potential conflicts of interest – personal or professional – to all relevant parties.

8.2 The Lender may specify additional criteria for independence for a *valuation* for secured lending. In the absence of specification, the additional criteria shall be 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*.

8.3 Any previous or current involvement with the borrower or the real property or *asset* to be valued *must* 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 his *firm*:

- has a long-standing professional relationship with the borrower or the owner of the real property or *asset*
- is introducing the transaction to the Lender or the borrower, for which a fee is payable to the *valuer* or his *firm*
- has a financial interest in the *asset* or in the borrower
- is acting for the owner of the real property or *asset* in a related transaction
- is acting (or has acted) for the borrower on the purchase of the real property or *asset*
- is retained to act in the disposal or letting of a completed development on the subject real property or *asset*
- has recently acted in a market transaction involving the real property or *asset*
- has provided fee earning professional advice on the real property or *asset* to current or previous owners or their lenders and/or
- is providing development consultancy for the current or previous owners.

8.4 The *valuer must* consider whether any previous, current or anticipated involvement with either the real 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 his *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*.

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

8.6 If the *client* considers that any disclosed involvement does create a conflict, the *valuer should* decline the instruction. If the *valuer* and the *client* agree that any potential conflict can be avoided by introducing arrangements for managing the instruction, those arrangements *must* be recorded in writing, included in the *terms of engagement*, if any, and referred to in the *report*.

8.7 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 Codes of Conduct and **VS 3** of *the Standards*. If the instruction is accepted where *material* involvement has been disclosed, the *valuer may* be required to justify this decision to *HKIS*. If a satisfactory justification is not provided, *HKIS* may take disciplinary measures.

9. Compliance with the Guidance Notes

All *valuations* for secured lending *should* be made in accordance with this guidance notes. In cases of any *departure* from this guidance notes, the *valuer must* note the disclosure requirements as denoted in **Sections 1.3.0 and 1.5.0 of VS 1** of *the Standards* and *should* notify the Lender, or be notified by the Lender, in writing. Such *departure should* be clearly stated in the *valuation report*, and, if possible, in the *terms of engagement*.

Valuers are reminded to observe their duty of care to the Lenders in performing their *valuations*, and the extent of liability of their *valuation reports* to the Lenders.

It have long been a common practice for the Lenders to request a preliminary indication of *value* of the intended subject of *valuation* before formal engagement. In the past, it was called “verbal valuation” which was conducted wholly orally to provide a preliminary indication on the *value* of an *asset*, but as time evolves, Lenders nowadays may request for a record in writing. A *member should* alert the Lender that the preliminary indication is a preliminary advice (see **paragraph 3.2.19 of VS 3**) only and *must* state that:

1. The opinion is provisional and subject to completion of the final *report*;
2. The advice is provided for the Lender’s internal purposes only; and
3. Any draft is on no account to be published or disclosed.

HKIS would recommend to use the term “Preliminary Indication of Value” or in short “Preliminary Indication” or in Chinese “初步參考值” for avoidance of doubt.

Appendix to VGN 4:

Guidance on Providing Preliminary Indication of Value

It is recognized that the preliminary indication is not necessarily conducted by a qualified *valuer* and it is perfectly proper for a *valuer* to designate suitably trained staff under his supervision to provide a preliminary indication. As a best practice, a *valuer should* consider the knowledge, experience, reliability and ability of his staff in any such designation.

For avoidance of doubt, no matter whether a preliminary indication is provided orally or in writing, the principles set out in *the Standards should* still be observed to the fullest extent possible. *Members* are reminded that the mere fact that *HKIS* considers a preliminary indication as preliminary advice does not mean that the preliminary indication is therefore provided without liability – the *valuer*'s responsibilities and obligations will always depend on the facts and circumstances of the individual case.

PART E:
International Valuation Standards (IVS)

International Valuation Standards (IVS)

Effective 31 January 2020

International Valuation Standards Council

International Valuation Standards

Effective 31 January 2020

International Valuation Standards Council

Copyright © 2019 International Valuation Standards Council.

All rights reserved.

No part of this publication may be translated, reprinted or reproduced or utilised in any form either in whole or in part or by any electronic, mechanical or other means, now known or hereafter invented, including photocopying and recording, or in any information storage and retrieval system, without permission in writing from the International Valuation Standards Council.

Please address publication and copyright matters to:
International Valuation Standards Council, 4 Lombard St, LONDON, EC3V 9AA, UK
United Kingdom Email: contact@ivsc.org www.ivsc.org

ISBN: 978-0-9931513-3-3-0

The International Valuation Standards Council, the authors and the publishers do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

Typeset and printed by Page Bros, Norwich

Contents

Introduction 1

Glossary 3

IVS Framework 6

General Standards

IVS 101 Scope of Work 9

IVS 102 Investigations and Compliance 12

IVS 103 Reporting 14

IVS 104 Bases of Value 16

IVS 105 Valuation Approaches and Methods 29

Asset Standards

IVS 200 Business and Business Interests 51

IVS 210 Intangible Assets 63

IVS 220 Non-Financial Liabilities 80

IVS 300 Plant and Equipment 90

IVS 400 Real Property Interests 97

IVS 410 Development Property 104

IVS 500 Financial Instruments 115

Index 124

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.

*Valuation*s 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 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 *valuation*s 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 2019, with an effective date of **31 January 2020**. 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. 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, *valuation*s performed for an employer).

20.3. *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*.

20.4. 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*.

20.5. 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).

20.6. May

The word *“may”* describes actions and procedures that *value*rs 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.

20.7. 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.

20.8. 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).

20.9. Purpose

The word "*purpose*" refers to the reason(s) a *valuation* is performed. Common *purpose*s include (but are not limited to) financial reporting, tax reporting, litigation support, transaction support, and to support secured lending decisions.

20.10. 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.

20.11. 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/materia*l 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.

20.12. Subject or Subject Asset

These terms refer to the *asset(s)* valued in a particular *valuation* engagement.

20.14. Valuation

A "*valuation*" refers to the act or process of determining an estimate of *value* of an *asset* or liability by applying IVS.

20.13. Valuation Purpose or Purpose of Valuation

See "*Purpose*".

20.15. 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*.

20.16. Value (n)

The word *"value"* refers to the judgement of the *value*r of the estimated amount consistent with one of the bases of value set out in IVS 104 *Bases of Value*.

20.17. Valuer

A "*valuer*" is an individual, group of individuals or a firm who possesses the necessary qualifications, ability and experience to execute a *valuation* in an objective, unbiased and competent manner. In some *jurisdictions*, licensing is required before one can act as a *valuer*.

20.18. 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*).

20.19. 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 *valuation*s, which is not acceptable.

IVS Framework

Contents | **Paragraphs**

Contents	Paragraphs
Compliance with Standards	10
Assets and Liabilities	20
Valuer	30
Objectivity	40
Competence	50
Departures	60

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.

20. Assets and Liabilities

20.1. The standards can be applied to the *valuation* of both *assets* and liabilities. To assist the legibility 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 a firm possessing the necessary qualifications, ability and experience to undertake a *valuation* in an objective, unbiased 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. *Valuation*s *must* be prepared by an individual or firm 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

Contents | **Paragraphs**

Contents	Paragraphs
Introduction	10
General Requirements	20
Changes to Scope of Work	30

10. Introduction

10.1. A scope of work (sometimes referred to as terms of engagement) describes the fundamental terms of a valuation engagement, 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 ("in-house *valuations*"),

(b) *valuation*s performed by *valuers* for *clients* other than their employers ("third-party *valuations*"), and

(c) valuation reviews where the 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

Contents	**Paragraphs**
General Principle	10
Investigations	20
Valuation Record	30
Compliance with Other Standards	40

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

Contents | **Paragraphs**

Contents	Paragraphs
Introduction	10
General Requirements	20
Valuation Reports	30
Valuation Review Reports	40

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) the *intended use*,

(c) the approach or approaches adopted,

(d) the method or methods applied,

(e) the key inputs used,

(f) the assumptions made,

(g) the conclusion(s) of *value* and principal reasons for any conclusions reached, and

(h) 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

Contents	Paragraphs
Introduction	10
Bases of Value	20
IVS-Defined Basis of Value – Market Value	30
IVS-Defined Basis of Value – Market Rent	40
IVS-Defined Basis of Value – Equitable Value	50
IVS-Defined Basis of Value – Investment Value/Worth	60
IVS-Defined Basis of Value – Synergistic Value	70
IVS-Defined Basis of Value – Liquidation Value	80
Other Basis of Value – Fair Value (International Financial Reporting Standards)	90
Other Basis of Value – Fair Market Value (Organisation for Economic Co-operation and Development (OECD))	100
Other Basis of Value – Fair Market Value (United States Internal Revenue Service)	110
Other Basis of Value – Fair Value (Legal/Statutory) in different jurisdictions	120
Premise of Value/Assumed Use	130
Premise of Value – Highest and Best Use	140
Premise of Value – Current Use/Existing Use	150
Premise of Value – Orderly Liquidation	160
Premise of Value – Forced Sale	170
Entity-Specific Factors	180
Synergies	190
Assumptions and Special Assumptions	200
Transaction Costs	210

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.

IVS 105 Valuation Approaches and Methods

Contents **Paragraphs**

Contents	Paragraphs
Introduction	10
Market Approach	20
Market Approach Methods	30
Income Approach	40
Income Approach Methods	50
Cost Approach	60
Cost Approach Methods	70
Depreciation/Obsolescence	80
Valuation Model	90

10. Introduction

10.1. Consideration *must* be given to the relevant and appropriate *valuation* approaches. 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 of the valuation* 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:

(b) 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

Contents

Contents	Paragraphs
Overview	10
Introduction	20
Bases of Value	30
Valuation Approaches and Methods	40
Market Approach	50
Income Approach	60
Cost Approach	70
Special Considerations for Businesses and Business Interests	80
Ownership Rights	90
Business Information	100
Economic and Industry Considerations	110
Operating and Non-Operating Assets	120
Capital Structure Considerations	130

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*. However, generally a business conducts a commercial, industrial, service or investment activity. Businesses can take many forms, such as corporations, partnerships, joint ventures and sole proprietorships. The *value* of a business *may* differ from the sum of the *values* of the individual *assets* or liabilities that make up that business. When a business value is greater than the sum of the recorded and unrecorded net tangible and identifiable intangible *assets* of the business, the excess value is often referred to as going concern *value* or goodwill.

20.2. When *valuing* individual *assets* or liabilities owned by a business, *valuers should* follow the applicable standard for that type of *asset* or liability (IVS 210 *Intangible Assets*, IVS 400 *Real Property Interests*, etc).

20.3. *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.

20.4. *Valuation*s of businesses are required for different *purposes* including acquisitions, mergers and sales of businesses, taxation, litigation, insolvency proceedings and financial reporting. Business *valuation*s *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

Contents **Paragraphs**

Contents	Paragraphs
Overview	10
Introduction	20
Bases of Value	30
Valuation Approaches and Methods	40
Market Approach	50
Income Approach	60
Cost Approach	70
Special Considerations for Intangible Assets	80
Discount Rates/Rates of Return for Intangible Assets	90
Intangible Asset Economic Lives	100
Tax Amortisation Benefit (TAB)	110

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 *asset*s.

(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

Contents **Paragraphs**

Contents	Paragraphs
Overview	10
Introduction	20
Bases of Value	30
Valuation Approaches and Methods	40
Market Approach	50
Income Approach	60
Cost Approach	70
Special Considerations for Non-Financial	80
Discount rates for Non-Financial Labilities	90
Estimating Cash Flows and Risk Margins	100
Restrictions on transfers	110
Taxes	120

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 *participants* 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 300 Plant and Equipment

Contents **Paragraphs**

Contents	Paragraphs
Overview	10
Introduction	20
Bases of Value	30
Valuation Approaches and Methods	40
Market Approach	50
Income Approach	60
Cost Approach	70
Special Considerations for Plant and Equipment	80
Financing Arrangements	90

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 income or cost approach 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

Contents | **Paragraphs**

Contents	Paragraphs
Overview	10
Introduction	20
Bases of Value	30
Valuation Approaches and Methods	40
Market Approach	50
Income Approach	60
Cost Approach	70
Special Considerations for Real Property Interests	80
Hierarchy of Interests	90
Rent	100

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. 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. 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 *must* be considered:

(a) the evidence 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 and any 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 and foundation conditions,

(g) responsibility for the identification of actual or potential environmental risks,

(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

Contents | **Paragraphs**

Contents	Paragraphs
Overview	10
Introduction	20
Bases of Value	30
Valuation Approaches and Methods	40
Market Approach	50
Income Approach	60
Cost Approach	70
Special Considerations for a Development Property	80
Residual Method	90
Existing Asset	100
Special Considerations for Financial Reporting	110
Special Considerations for Secured Lending	120

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 *significant*ly 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 valuation 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

Contents	Paragraphs
Overview	10
Introduction	20
Bases of Value	30
Valuation Approaches and Methods	40
Market Approach	50
Income Approach	60
Cost Approach	70
Special Considerations for Financial Instruments	80
Valuation Inputs	90
Credit Risk Adjustments	100
Liquidity and Market Activity	110
Valuation Control and Objectivity	120

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.

Index

A

adjustments
- cost approach 46–49
- credit risk 120–122
- for depreciation/obsolescence 47–49, 101
- income approach 44, 54–55, 68–69
- market approach 31, 33–34, 35–36, 66, 118

asset standards *see* IVS Asset Standards

asset-liability symmetry 81

assets and liabilities 3, 6, 26
- contributory assets 68, 69
- existing asset 113–114
- intangible *see* Intangible Assets (IVS 210)
- lease liabilities 21–22, 90, 96, 102–103
- non-financial *see* Non-Financial Liabilities (IVS 220)
- operating and non-operating 57–58
- subject asset 5
- valuation reports 15
- wasting assets 42

assumed use 24–26

assumptions 10, 11, 27–28
- bases of value 17
- development property 109
- plant and equipment 93
- *see also* special assumptions

attrition 77–78

B

bases of value 10
- business and business interests 52
- development property 105–106
- financial instruments 117
- intangible assets 65–66
- non-financial liabilities 82
- plant and equipment 93–94
- real property interests 99

Bases of Value (IVS 104) 16–28
- assumptions and special assumptions 27–28
- entity-specific factors 26
- fair market value 23
- fair value 23–24
- IVS defined 17–22
  - equitable value 21–22
  - investment value/worth 22
  - liquidation value 22
  - market rent 21, 102
  - market value 18–20

synergistic value 22
premise of value 24–26
current use/existing use 25
forced sale 25–26
highest and best use 24
orderly liquidation 25
synergies 26–27
transaction cost 28
blockage discounts 36
bottom-up method 84–85
broker quotations 119–120
Business and Business Interests (IVS 200) 51–62
special considerations 55–62
business information 56–57
capital structure 58–62
economic and industry 57
operating and non-operating assets 57–58
ownership rights 56
rights and interests 58–59
valuation approaches and methods 52–55
business information 56–57

C

capital structure considerations 58–62
capitalisation rate 54
cash flow 37–44, 86–88, 118–119
types of 38–39
changes to the scope of work 11
client 3, 10
collateral 122
comparable listings method 32
comparable transactions method 32–34, 83
competence 7
completed property value 109–110
compliance with standards 4, 6, 14, 16
financial instruments 116–117
intangible assets 65–66, 67, 74
Investigations and Compliance (IVS 102) 12–13, 98, 116
non-financial liabilities 82, 83, 84, 85
plant and equipment 91–94
real property interests 98, 100, 106
consensus pricing services 120
constant growth model 41
construction costs 110
consultants' fees 110
contract rent 21, 102–103
contributory asset charge (CAC) 69
contributory assets 68, 69
control environment 122–123
control premiums 36, 56
cost approach 44–49
adjustments 46–49

business and business interests 55
development property 107–108
financial instruments 119
intangible assets 74–75
non-financial liabilities 85
plant and equipment 94–96
real property interests 101
cost approach methods 45–46
cost-to-capacity method 95–96
replacement cost 45–46
reproduction cost 46
summation method 46
cost-to-capacity method 95–96
counterparty risk 120
credit risk adjustments 120–122
currency 10, 38–39
current use 25
current value method (CVM) 59, 60

D

default protection 121
departure 7, 11, 13
depreciation 47–49
development profit 111–112
Development Property (IVS 410) 104–114
assumptions and special assumptions 105–106
special considerations 108–114
completed property value 109–110
construction costs 110
consultants' fees 110
development profit 111–112
discount rate 112–113
existing asset 113–114
finance costs 111
for financial reporting 114
marketing costs 111
for secured lending 114
timetable 111
valuation approaches and methods 106–113
residual method 108–113
disaggregated method 73–74
discount rates 38–39, 40, 42–44
business and business interests 54
derivation of 101, 118–119
development property 112–113
financial instruments 118–119
intangible assets 75–76, 79
non-financial liabilities 86
real property interests 100–101
discounted cash flow (DCF) 37–44, 118–119
discounts for lack of control (DLOC) 36
discounts for lack of marketability (DLOM) 35–36

Index

disposal cost 42
distributor method 73–74

E

economic and industry considerations 57
economic life of an intangible asset 76–78
enterprise value 52, 54
entity-specific factors 26
equitable value 21–22
equity value 52, 54, 59–62
excess earnings method 68–70
existing asset 113–114
existing use 25
exit value 41–42
explicit forecast period 39

F

fair market value (OECD) 23
fair market value (USIRS) 23
fair value (IFRS) 23
fair value (legal/statutory) 23–24
finance costs 111
Financial Instruments (IVS 500) 115–123
- special considerations 119–123
  - control environment 122–123
  - credit risk 120–122
  - liquidity and market activity 122
  - valuation inputs 119–120
- valuation approaches and methods 117–119

financial reporting 23, 114, 121
financing arrangements 96
forced sale 25–26
forecast cash flow 40, 43–44

G

general standards *see* IVS General Standards
glossary 3–5
goodwill 64–65, 69
Gordon growth model 41
greenfield method 73
guideline publicly-traded comparable method 34–35
guideline transactions method 32–34, 83

H

hierarchy of interests 102
highest and best use 20, 24

I

income approach 36–44
- adjustments 54–55, 68–69
- business and business interests 53–55

development property 107
financial instruments 118–119
intangible assets 67–74
non-financial liabilities 84–85
plant and equipment 94
real property interests 100–101
income approach methods 37–44
bottom-up method 84–85
discounted cash flow (DCF) 37–44, 118–119
distributor method 73–74
excess earnings method 68–70
greenfield method 73
relief-from-royalty method 70–71
with-and-without method 72–73
information provided 12–13
Intangible Assets (IVS 210) 63–79
business and business interests 51–52
plant and equipment 90–91
real property interests 97–98
special considerations 75–79
discount rate/rate of return 75–76, 79
economic life 76–78
tax amortisation benefit (TAB) 78–79
valuation approaches and methods 66–75
intended use 3, 14
intended user 3, 10, 11, 14
intercompany arrangements 44
International Valuation Standards Board 1, 2
International Valuation Standards Council (IVSC) 1
Investigations and Compliance (IVS 102) 12–13, 98, 116
investment property 100, 111
investment value 22
IVS Asset Standards 2
Business and Business Interests (IVS 200) 51–62
Development Property (IVS 410) 104–114
Financial Instruments (IVS 500) 115–123
Intangible Assets (IVS 210) 63–79
Non-Financial Liabilities (IVS 220) 80–89
Plant and Equipment (IVS 300) 90–96
Real Property Interests (IVS 400) 97–103
IVS Definitions 3–5, 17–22
IVS Framework 2, 6–7
IVS General Standards 2
Bases of Value (IVS 104) 16–28
Investigations and Compliance (IVS 102) 12–13
Reporting (IVS 103) 14–15
Scope of Work (IVS 101) 9–11
Valuation Approaches and Methods (IVS 105) 29–49

J

jurisdiction 3

L

land *see* Development Property (IVS 410); Real Property Interests (IVS 400)
lease liabilities 21–22, 102–103
    plant and equipment 90, 96
leverage 121
liabilities *see* assets and liabilities
liquidation value 22
liquidity 122

M

market activity 122
market approach 30–36, 41–42
    adjustments 31, 33–34, 35–36, 66, 118
    business and business interests 52–53
    development property 106–107
    financial instruments 118
    intangible assets 66–67
    non-financial liabilities 82–84
    plant and equipment 94
    real property interests 99–100
market approach methods 32–36
    comparable transactions method 32–34, 83
    guideline publicly-traded comparable method 34–35
    top-down method 84
Market Participant Acquisition Premiums (MPAPs) 36
market rent 21, 102
market value 18–20
    development property 109, 114
marketing costs 111
marriage value 22
material/materiality 4–5
matrix pricing 32
may 4
multiple approaches 29–30
must 4

N

netting agreements 121
Non-Financial Liabilities (IVS 220) 80–89
    bases of value 82
    special considerations 86–89
        discount rates 86
        estimating cash flows and risk margins 86–88
        restrictions on transfer 88
        taxes 89
    valuation approaches and methods 83–85

O

objectivity 9–10, 122–123
    IVS Framework 6–7
obsolescence 47–49
    intangible assets 75

plant and equipment 92, 94, 95
real property interests 101
operating and non-operating assets 57–58
operating value 52
option pricing method (OPM) 59, 60–62
orderly liquidation 25
ownership interests 58–59
ownership rights 56

P

participant 4, 81
Plant and Equipment (IVS 300) 90–96
financing arrangements 96
special considerations 96
valuation approaches and methods 94–96
premise of value 24–26
prior transactions method 32
probability-weighted expected return method (PWERM) 59, 62
property interests *see* Development Property (IVS 410); Real Property Interests (IVS 400)
prospective financial information (PFI) 40
publicly-traded comparables 34–35
purpose of valuation 4, 10, 14
business and business interests 52
development property 104–105
financial instruments 115
intangible assets 64–65
non-financial liabilities 81–82
plant and equipment 92, 93
real property interests 99

R

Real Property Interests (IVS 400) 97–103
special considerations 102–103
hierarchy of interests 102
rent 102–103
valuation approaches and methods 99–101
relief-from-royalty method 70–71
rent 21, 102–103
replacement cost method 45–46
intangible assets 75
plant and equipment 94–96
real property interests 101
Reporting (IVS 103) 14–15
financial instruments 116–117
plant and equipment 93
reproduction cost method 46
residual method 108–113
restrictions on transfer 88
risk assessment 69, 75–76
credit risk adjustments 120–122
development property 111–112, 114
discounted cash flow method 40, 42, 43–44
risk margins 86–88

Index

royalty rate 70–71

S

salvage value 42
scenario-based method (SBM) 86–87
Scope of Work (IVS 101) 9–11
    business and business interests 52
    development property 105–106
    financial instruments 116
    plant and equipment 92–93
    real property interests 98–99
secured lending 114
sensitivity analysis 105
should 4
significant and/or material 4–5
special assumptions 10, 11
    Bases of Value (IVS 104) 25, 27–28
    development property 105–106, 109
    real property interests 98–99
    Reporting (IVS 103) 14
special considerations
    business and business interests 55–62
    development property 108–114
    financial instruments 119–123
    for financial reporting 114
    intangible assets 75–79
    non-financial liabilities 86–89
    plant and equipment 96
    real property interests 102–103
    for secured lending 114
standards of value *see* Bases of Value (IVS 104)
subject or subject asset 5
subordination 121
summation method 46
synergies 26–27
synergistic value 22

T

tax amortisation benefit (TAB) 78–79
taxes 89
terminal value 41–42
timetable 111
top-down method 84
total invested capital value 52
transaction cost 28
transactions 17, 19–20, 22, 31–34
    non-financial liabilities 82–83
transfer restrictions 88

U

units of comparison 32, 99

V

valuation 5
  general requirements 9–11
  multiple approaches 29–30
valuation approaches
  business and business interests 52–55
  development property 106–113
  financial instruments 117–119
  intangible assets 66–75
  non-financial liabilities 83–85
  plant and equipment 94–96
  real property interests 99–101
Valuation Approaches and Methods (IVS 105) 29–49
  cost approach 44–49
    cost considerations 46–49
    depreciation/obsolescence 47–49
    methods 45–46
  income approach 36–44
    methods 37–44
  market approach 30–36
    methods 32–36
    other considerations 35–36
  valuation model 49
valuation control 122–123
valuation date 10, 19–20
valuation inputs 119–120
valuation model 49
valuation purpose *see* purpose of valuation
valuation record 13
valuation report *see* Reporting (IVS 103)
valuation review reports 15
valuation reviewer 5, 6
value 5
  see also bases of value; Bases of Value (IVS 104)
valuer 3, 4, 5
  objectivity 6–7, 9–10

W

wasting assets 42
weight 5
weighting 5
with-and-without method 72–73
worth 22

International Valuation Standards

International Valuation Standards Council,
4 Lombard Street, London EC3V 9AA,
United Kingdom

Email: contact@ivsc.org Web: www.ivsc.org

International Valuation Standards Council

總辦事處 Head Office

香港上環干諾道中 111 號永安中心 12 樓 1205 室
Room 1205, 12/F, Wing On Centre,
111 Connaught Road Central, Sheung Wan, Hong Kong
Telephone: (852) 2526 3679 • Facsimile: (852) 2865 4612
Email: info@hkis.org.hk • Website: www.hkis.org.hk

北京辦事處 Beijing Office

中國北京市海淀區高樑橋斜街 59 號院 1 號樓
中坤大廈 6 層 616 室（郵編：100044)
Room 616, 6/F, Zhongkun Plaza, No.59 Gaoliangqiaoxiejie
No.1 Yard, Haidian District, Beijing, China, 100044
Telephone: 86(10) 8219 1069 • Facsimile: 86 (10) 8219 1050
Email: info-bjo@hkis.org.hk • Website: www.hkis.org.hk

ADDENDUM TO HKIS VALUATION STANDARDS 2020

This amendment hereby modifies and supplements the *HKIS VALUATION STANDARDS 2020.*

Page	Paragraph	Amendment
Part A P.11	5.1 line 3	*HKIS Valuation Standards 2012 Edition* changed to *HKIS Valuation Standards 2017 Edition*.