

IVS 2 – Valuation Bases Other Than Market Value

Introduction	109
Scope	109
Definitions	110
Relationship to Accounting Standards	114
Statement of Standard	114
Discussion	116
Disclosure Requirements	118
Departure Provisions	119
Effective Date	119



International Valuation Standards Committee

Standard 2

International Valuation Standards

Valuation Bases Other Than Market Value

This Standard should be read in the context of the background material and implementation guidance contained in General Valuation Concepts and Principles.

1.0 Introduction

- 1.1 The objectives of International Valuation Standard 2 (IVS 2) are twofold: first, to identify and explain bases of value other than *Market Value* and to establish standards for their application; and second, to distinguish them from *Market Value*.
- 1.2 Although the majority of professional valuations, particularly asset valuations referred to in International Valuation Application 1 (IVA 1), Valuation for Financial Reporting, involve *Market Value*, there are circumstances that call for bases other than *Market Value*. It is essential that both the Valuer and users of valuations clearly understand the distinction between *Market Value* and *Non-Market Value* based valuations and the effects (if any) that differences between these concepts may have on the applicability of the valuation.
- 1.3 The International Valuation Standards Committee (IVSC) seeks to avoid incidences of international misunderstanding and/or misconceptions within States concerning the use and application of non-market bases of valuation. Valuers responsible for applying these Standards must assure that proper bases are selected, using all reasonable means to enhance the understanding of valuation users, avoiding circumstances that might mislead the public, and reporting objectively supported estimates.

2.0 Scope

- 2.1 This Standard presents and explains bases of valuation other than *Market Value*.

3.0 Definitions

- 3.1 *Value in Use*. The value a specific property has for a specific use to a specific user and is, therefore, non-market related. This value type focuses on the value that specific property contributes to the entity of which it is a part, without regard to the property's *highest and best use* or the monetary amount that might be realised upon its sale. The accounting definition of *Value in Use* is *the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life*. (See International Accounting Standards 36, para. 5 [IAS 36, para. 5].)
- 3.2 *Limited Market Property*. Property that, because of market conditions, unique features, or other factors, attracts relatively few potential buyers at a particular time. The central distinguishing characteristic of *limited market properties* is not that they are incapable of being sold in the (open) market, but that the sale of such properties commonly requires a longer marketing period than is common for more readily saleable properties.
- 3.3 *Specialised, Special Purpose, or Specially Designed Property*. Property, which is rarely, if ever, sold in the (open) market, except by way of sale of the business of which it is a part (called the *business in occupation*), due to its uniqueness arising from the specialised nature and design of the building(s), its configuration, size, location, or otherwise, e.g., an oil refinery. Although each of the valuation approaches may be applied to specialised properties, and all applicable methods should be considered, the *Depreciated Replacement Cost* (DRC) methodology is commonly used. (See General Valuation Concepts and Principles, para. 4.9 and 8.3, and IVS 2, para. 3.8.)
- 3.4 *Investment Value, or Worth*. The value of property to a particular investor, or a class of investors, for identified investment objectives. This subjective concept relates specific property to a specific investor, group of investors, or entity with identifiable investment objectives and/or criteria. The *investment value, or worth*, of a property asset may be higher or lower than the *Market Value* of the property asset. The term *investment value, or worth*, should not be confused with the *Market Value* of an investment property. However, *Market Value* may reflect a number of individual assessments of the *investment value, or*

worth, of the particular property asset. *Investment value*, or *worth* is associated with *Special Value*. (See para. 3.11, below.)

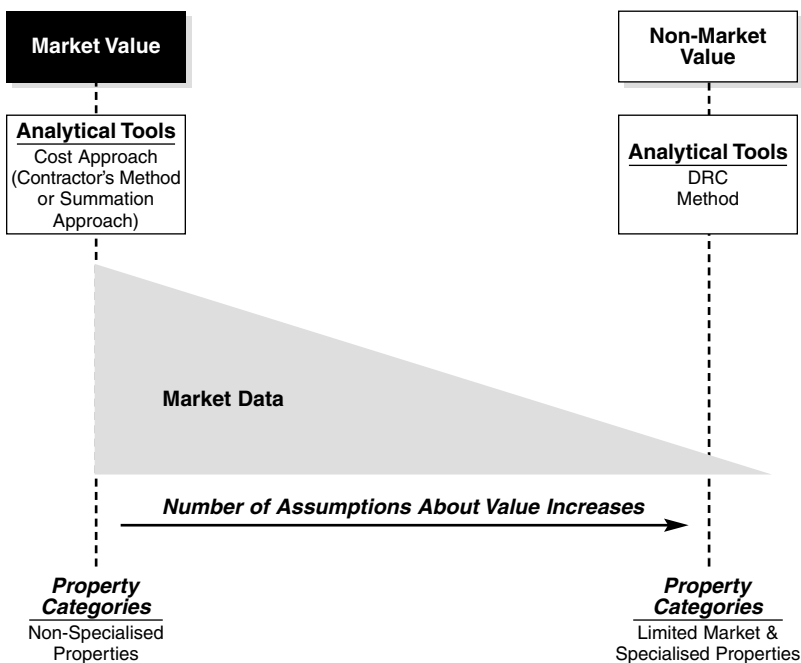
- 3.5 *Going Concern Value*. The value of a business as a whole. The concept involves valuation of a continuing enterprise from which allocations, or apportionments, of overall *going concern value* may be made to constituent parts as they contribute to the whole, but none of the components in themselves constitutes a basis for *Market Value*. Therefore, the concept of *Going Concern Value* can apply only to a property that is a constituent part of a business or entity.
- 3.6 *Insurable Value*. The value of property provided by definitions contained in an insurance contract or policy.
- 3.7 *Assessed, Rateable, or Taxable Value* is a value that is based on definitions contained within applicable laws relating to the assessment, rating, and/or taxation of property. Although some jurisdictions may cite *Market Value* as the assessment basis, methods used to estimate the value may produce results that differ from *Market Value* as defined in IVS 1. Therefore, *assessed, rateable, or taxable value* cannot be considered to comply with *Market Value* as defined in IVS 1 unless explicitly indicated to the contrary.
- 3.8 *Depreciated Replacement Cost (DRC)* is considered an acceptable method used in financial reporting to arrive at a surrogate for the *Market Value* of *specialised* and *limited market* properties, for which market evidence is unavailable. DRC is based on an estimate of the current *Market Value for the Existing Use* of the land, plus the current gross replacement (or reproduction) costs of the improvements, less allowances for physical deterioration and all relevant forms of obsolescence and optimisation.

Note: In order to remain consistent with IAS 16, modification of this definition is required. An exposure draft of the proposed new definition will be released as soon as possible.

The result combines market and non-market elements. An estimate derived from the DRC method is referred to as “valued by reference to DRC.” This result is subject to the adequate potential profitability or service potential of the enterprise from the use of the assets as a whole, an assumption that can be accepted or rebutted.

Depreciated Replacement Cost is one specific application of the *cost approach*. The *cost approach* may be applied in *Market Value* estimates, provided all elements of the approach are derived from (open) market evidence. These different cost applications must not be confused or misconstrued in making, presenting, or applying *Market Value*.

Continuum Between Market and Non-Market Values and Available Analytical Tools



3.9 *Salvage Value*. The value of a property, excluding land, as if disposed of for the materials it contains, rather than for continued use without special repairs or adaptation. It may be given as gross or net of disposal costs and, in the latter case, may equate to *net realisable value*. (See *net realisable value*, Addendum A to IVA 1, Valuation for Financial Reporting, para. A6.5.) In any event, components included or excluded should be identified.

- 3.10 *Liquidation or Forced Sale Value.* The amount that may reasonably be received from the sale of a property within a time frame too short to meet the marketing time frame required by the *Market Value* definition. In some States, *forced sale value* in particular may also involve an unwilling seller and a buyer or buyers who buy with knowledge of the disadvantage of the seller.
- 3.11 *Special Value.* A term relating to an extraordinary element of value over and above *Market Value*. *Special value* could arise, for example, by the physical, functional, or economic association of a property with some other property such as the adjoining property. It is an increment of value that could be applicable to a particular owner or user or prospective owner or user, of the property rather than to the market at large; that is, *special value* is applicable only to a purchaser with a special interest. *Marriage value*, the value increment resulting from the merger of two or more interests in a property, represents a specific example of *special value*. *Special value* could be associated with elements of *going concern value* and with *investment value*, or *worth*. The Valuer must ensure that the criteria used to value such properties are distinguished from those used to estimate *Market Value*, making clear any special assumptions made.
- 3.12 *Mortgage Lending Value.* The value of the property as determined by the Valuer making a prudent assessment of the future marketability of the property by taking into account long-term sustainable aspects of the property, the normal and local market conditions, and the current use and alternative appropriate uses of the property. Speculative elements may not be taken into account in the assessment of mortgage lending value. The mortgage lending value shall be documented in a transparent and clear manner.

The definition of *mortgage lending value* cited above is contained within European legislation (Directive 98/32/EC of the European Parliament and of the Council of 22 June 1998). *Mortgage lending value* is a *value-at-risk* concept used in a number of European countries for property lending purposes, based on the sustainable aspects of the property and restricting the assessment of property value to the permanent economic characteristics of the property and the revenue that any tenant could produce by proper management. This approach

International Valuation Standards, Sixth Edition

to valuation is an established tradition in several well-developed European markets.

- 3.13 Other expressions of value more specific to plant and equipment, and/or special situations, are defined in Guidance Note 3 (GN 3), Valuation of Plant and Equipment.

4.0 Relationship to Accounting Standards

- 4.1 Valuation for financial reporting, which is the focus of International Valuation Application 1, should be read in conjunction with this standard.

4.1.1 IVA 1, Valuation for Financial Reporting, provides guidance to Valuers, Accountants, and the Public regarding valuation standards affecting accountancy. The *Fair Value* of fixed assets is usually their *Market Value*. (See IVS General Valuation Concepts and Principles, para. 8.1.)

4.1.2 When there is no evidence of *Market Value* because of the specialised nature of the fixed assets and because they are rarely sold except as part of a continuing business, they are valued at their *Depreciated Replacement Cost* (IAS 16).

- 4.2 There are numerous examples of terms used interchangeably by Valuers and Accountants. Some lead to misunderstandings and possible Standards abuses. IVS 1 defines *Market Value* and discusses criteria for establishing *Market Value*. Other important terms are defined in IVS 1 and 2 and contribute to the more specific requirements discussed in IVA 1, Valuation for Financial Reporting.

5.0 Statement of Standard

To perform valuations that comply with these Standards and Generally Accepted Valuation Principles (GAVP), it is mandatory that Valuers adhere to all sections of the IVS Code of Conduct pertaining to Ethics, Competence, Disclosure, and Reporting (sections 4, 5, 6, and 7).

- 5.1 **In performing and reporting a *Non-Market Value* estimate, the Valuer shall**

- 5.1.1 **completely and understandably set forth the valuation in a manner that will not be misleading;**
- 5.1.2 **ensure that the estimate of value is based on data and circumstances appropriate to the assignment;**
- 5.1.3 **ensure that the estimate of value is undertaken using appropriate methods and techniques;**
- 5.1.4 **provide sufficient information to permit those who read and rely on the report to fully understand its data, reasoning, analyses, and conclusions; and**
- 5.1.5 **comply with the requirements of International Valuation Standard 3 in reporting the valuation. Accordingly, the Valuer shall**
 - 5.1.5.1 **define the value being estimated and state the purpose and intended use of the valuation, the effective date of valuation, and the date of the report;**
 - 5.1.5.1.1 **distinguish that the valuation reported is not a *Market Value* estimate if the estimate is made on a basis other than *Market Value*;**
 - 5.1.5.2 **clearly identify and describe the property and property rights or interests being valued;**
 - 5.1.5.3 **describe the scope/extent of the work undertaken and the extent to which the property was inspected;**
 - 5.1.5.4 **state any assumptions and limiting conditions upon which the valuation is based;**
 - 5.1.5.5 **fully and completely explain the valuation bases/approaches applied and the reasons for their applications and conclusions; and**

5.1.5.6 include a signed Compliance Statement (Certification of Value) attesting to the Valuer's objectivity, professional contributions, non-bias, non-contingency of professional fees or other compensation, as well as Standards' applicability, and other disclosures.

5.2 Although the concept, use, and application of non-market bases of value may be appropriate under certain circumstances, the Valuer shall ensure that if such value is to be found and reported, it will not reasonably be construed as a representation of *Market Value*.

6.0 Discussion

6.1 *Value in use* (see para. 3.1) is a *Non-Market Value* measured from the perspective of a particular user. Value in use is sometimes referred to as 'value to a particular user or owner'. *Value in exchange* (see IVS 1, para. 1.2 et seq.) is the value recognised by a market in which exchange of asset ownership hypothetically, or notionally, takes place. The IVSC definition of *Market Value* appropriate for financial reporting is based on the principle of *value in exchange*, not *value in use*.

6.2 The expressions *value in use* and *value in exchange* can lead to misunderstanding without explanation. They should be avoided when confusion might result.

6.3 Properties may be valued on bases other than *Market Value* or may exchange hands at prices that do not reflect *Market Value* as defined. Such alternative bases may either be reflections of the economic utility or functions of a property other than its marketability, or of unusual and non-market conditions. Examples include *value in use*; *investment value*, or *worth*; *going concern value*; *insurable value*; *assessed, or rateable, value*; *special value*; *liquidation, or forced sale, value*; and *salvage value*. (See 3.0 et seq. above.)

6.4 *Going concern value* expresses the value ascribed to an established business, not to any of its constituent parts. The value allocated, or apportioned, to individual assets making up a part of the going concern is based on their contribution to the whole, commonly referred to as their *value in use* when related to a specific business and its owner. It is not market related. (See para. 3.5, above.)

- 6.5 It would only be coincidental if a property's *value in use* were equal to its *Market Value*. A property's *value in use* would tend to be higher than *Market Value* if the operating entity were capable of employing it in a more useful and profitable manner than a typical producer of the same product or service. On the other hand, *value in use* could be lower than *Market Value* under conditions where the entity was not employing an asset to its maximum capacity and efficiency. *Value in Use* could also be higher than *Market Value* if the entity possessed special production rights, extraordinary contracts, unique patents and licenses, certain expertise, special goodwill, and other intangible assets, which would not be transferable to another owner.
- 6.6 *Special value* may accrue to a property by reason of a unique location, a temporary situation under exceptional market conditions, or a premium payable by a purchaser having a special interest. (See para. 3.11, above.) *Marriage value*, the value increment resulting from the merger of two or more interests in a property, represents a specific example of *special value*. Such elements of *special value* may be reported separately from *Market Value* as defined in these Standards. *Special value* should not be incorporated into a statement of *Market Value* because such a procedure would be misleading and, by default, would signify that such incremental element of value is not special.
- 6.7 A forced sale involves a price which arises from disposition under extraordinary or atypical circumstances, usually reflecting an inadequate marketing period without reasonable exposure, and sometimes reflecting the condition of an unwilling seller and/or disposal under compulsion or duress. For these reasons, the price associated with a forced, or distress(ed), sale, called *forced sale value* (see para. 3.10, above), is not *Market Value*. The price paid in a forced, or distress(ed), sale is a matter of fact. It is generally not easy for a Valuer to predict because of the nature and extent of subjective and conjectural assumptions that must be made in formulating such an opinion. A *forced sale value* or price may also be known as a *liquidation price*.
- 6.8 *Salvage value* (see para. 3.9) is ordinarily used to express the current price expected for property, other than land, that has reached the end of its useful life expectancy in terms of its original purpose and function. At that point the asset is valued for disposal as salvage rather than for its originally intended purpose. In this context, *salvage value* is also

International Valuation Standards, Sixth Edition

known in accountancy terminology as the net realisable amount for an asset with no further use to an entity. (See para. 3.9, above.)

6.8.1 *Salvage value* does not imply that a property has no further useful life or utility. Property sold for salvage could be rebuilt, converted to a similar or different use, or may provide spare parts for other properties that are still serviceable. At the other extreme, *salvage value* may represent *scrap value*, or the *value for recycling*.

7.0 Disclosure Requirements

- 7.1 Valuation Reports must not be misleading. Particular reporting standards may vary among States, but it is the responsibility of the Valuer to incorporate at least those items listed in para. 5.1 above. For *Non-Market Value* based valuations, it is required in accordance with the Code of Conduct that the purpose and intended use of the valuations be clearly reported, and that full disclosure be made of the basis for the valuation estimate, its applicability, and its limitations.
- 7.2 Each Valuation Report prepared on a basis other than *Market Value* shall contain a Statement of Contingent and Limiting Conditions or similar disclosure. Notwithstanding this provision, the Valuer shall not use the Statement of Contingent and Limiting Conditions to justify unreasonable departure from these Standards.
- 7.3 In performing a valuation on a basis other than *Market Value*, the Valuer shall not make assumptions that are unreasonable in the light of facts ascertainable at the effective date of valuation. All assumptions shall be disclosed in all reports.
- 7.4 Each Valuation Report prepared on a basis other than *Market Value* shall contain a signed Valuer's Certification of Value/Compliance Statement, or a certificate attesting to the Valuer's compliance with the guidelines outlined in the IVSC Code of Conduct, section 7.1, and IVS 1, para. 5.1.8. In particular, distinction should be drawn between *Market Value* and any other defined value that is analysed.
- 7.5 If a valuation by an Internal Valuer is made, i.e., one who is in the employ of either the entity that owns the assets or the accounting

firm responsible for preparing the entity's financial records and/or reports, there shall be a specific disclosure in the Valuation Report or Valuation Certificate of the existence and nature of any such relationships.

7.6 Other reporting shall be consistent with these Standards.

8.0 Departure Provisions

8.1 In following this Standard any departures must be in accordance with directions provided in IVS 3, Valuation Reporting.

8.2 If a Valuer is asked to perform an assignment that departs from these Standards, the Valuer shall accept and perform such services only if the Valuer

8.2.1 determines that the assignment will not tend to mislead the client, users of the report or services, or the public;

8.2.2 advises the client that the assignment involves a special assumption or departure from the Standards which must be disclosed in full in any report and/or third party representations made by the Valuer as a result of the assignment; and

8.2.3 requires as a condition of the Valuer's engagement that any special assumption or departure be disclosed in any published document in which reference is made to the Valuer's opinion.

9.0 Effective Date

9.1 This International Valuation Standard became effective 1 July 2000.

