

International Valuation Guidance Note No. 3

Valuation of Plant and Equipment

1.0 Introduction

- 1.1 The objective of this Guidance Note (GN) is to provide clarification and guidance to Valuers in preparing valuations of *Plant and Equipment*. As defined below, plant and equipment collectively constitute a general class of property other than realty, classified for accounting purposes as tangible assets. International Valuation Application 1 (IVA 1) deals with valuation requirements for financial reporting purposes. This GN is intended to clarify and extend that discussion to tangible assets other than realty, and to distinguish valuations for financial reporting from other valuation bases that may be applied in non-financial reporting situations.
- 1.2 Plant and equipment may be valued for a variety of reasons. When valued for financial reporting purposes, plant and equipment are valued in the same manner as other assets, applying *Market Value* and *depreciated replacement cost* (DRC) concepts in accordance with IVA 1. When the purpose of the valuation is other than financial reporting, plant and equipment are valued by applying an appropriate valuation basis and by clearly distinguishing the results from *Market Value* if a *Non-Market Value* basis is applied.
- 1.3 Plant and equipment combine to constitute a wide variety of situations requiring skillful assessment of the utility of the property valued and careful consideration of such property's physical, functional, and economic characteristics. As tangible personal property, plant and equipment may be sold in conjunction with a variety of other tangible and intangible assets, grouped and sold separately, or divided into separate components and then sold. Available valuation methods include:
 - 1.3.1 *sales comparison approach*.
 - 1.3.2 *cost approach (depreciated replacement cost application)*, and

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1.3.3 *income capitalisation approach.*

- 1.4 IVSC seeks to avoid incidences of international misunderstanding and/or misconceptions within States concerning the valuation of Plant and Equipment. Valuers applying IVSC Standards and this Guidance are responsible for selecting proper valuation methods, enhancing the understanding of valuation users, avoiding circumstances that might mislead the public, and reporting objectively supported valuations.

2.0 Scope

- 2.1 This GN covers definitions, principles, and important considerations in valuation and related reporting for plant and equipment.
- 2.2 This GN is to be applied with particular reference to International Valuation Standards 1 and 2 (IVS 1 and 2) and IVA 1. Most notably these Standards and Guidance distinguish between valuations undertaken on the basis of *Market Value*, valuations performed on a basis other than *Market Value*, and between valuations for financial reporting purposes and valuations for other purposes.

3.0 Definitions

- 3.1 *Plant and Equipment.* Tangible assets other than realty intended to generate income for their owner. Relevant definitions appear below.
- 3.1.1 *Plant.* The assemblage of assets that may include specialised non-permanent buildings, machinery, and equipment.
- 3.1.2 *Machinery.* Individual machines or collections of machines. A machine is an apparatus using or applying mechanical power, having several parts each with a definite function, and together performing certain kinds of work.
- 3.1.3 *Equipment.* Ancillary assets that are used to assist the function of the enterprise/entity.
- 3.2 *Market Value* is defined in IVS 1:

Market Value is the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a will-

ing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

- 3.3 *Value in Use* is defined in IVS 2. It may be the valuation basis for plant and equipment when assets are to be valued as part of a going concern under the *going concern premise*. The value of assets to a going concern may differ considerably from the *Market Value* of the assets. Such valuations do not derive *Market Value* and should be carefully distinguished and explained by the Valuer.
- 3.4 IVA 1 covers the *Market Value* basis as applied to financial reporting.
- 3.5 Other *Non-Market Value* definitions that may be applied in various types of plant and equipment valuations include the following:
- 3.5.1 *Liquidation, or Forced Sale, Value* is defined in IVS 2. Either term refers to the amount which may reasonably be received from the sale of a property within a time frame too short to meet the marketing time frame of the *Market Value* definition. In some States, liquidation, or forced sale, *value* may also involve an unwilling seller and a buyer or buyers who buy with knowledge of the disadvantage of the seller. These values do not consider *make-ready costs*, the costs required to make the assets productive, since the income stream associated with the assets does not support such costs. Distinctions may be made as to the time over which the sale is to occur and as to its location.
- 3.5.2 *Salvage Value* is defined in IVS 2. It is the value of an asset, 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/disposition costs. In the latter case it may equate to *net realisable value*. It is assumed that certain components of the asset are capable of reuse. Salvage value may also be referred to as *scrap value*.
- 3.5.3 *Insurance Replacement Cost, or Insurable Value*. The depreciated replacement cost new as defined in the insurance policy less the depreciated replacement cost new of the items specifically excluded in the policy, if any.

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- 3.5.4 *Auction Realisable Value.* The estimated amount that one would expect to achieve at a properly promoted, conducted, and attended auction sale. It normally assumes that the sale is held on the site and substantially all of the assets in the inventory listing are offered for sale at one time.
- 3.5.5 *Reinstatement Value.* The cost necessary to replace, repair, or rebuild the insured property to a condition substantially the same as, but not better or more extensive than, its condition when new.
- 3.5.6 *Indemnity Value.* The cost necessary to replace, repair, or rebuild the insured property to a condition substantially the same as, but not better or more extensive than, its condition at the time that the damage occurred, taking into consideration age, condition, and remaining useful life.

4.0 Relationship to Accounting Standards

- 4.1 Plant and equipment are tangible assets that, when present, will be reflected in valuations for financial reporting. Like other tangible assets, plant and equipment are valued at *Market Value*. When applicable, a *depreciated replacement cost* (DRC) basis is applied. (See IVA 1.)
- 4.2 If another valuation basis is reported, as in insurance, liquidation, or other special applications, the report will define any relevant bases of value applied and distinguish them from *Market Value*.
- 4.3 International Accounting Standard 16 (IAS 16), para. 31, provides specific direction as to the application of DRC to plant and equipment:

The fair value of items of plant and equipment is usually their market value determined by appraisal. When there is no evidence of market value because of the specialised nature of the plant and equipment and because these items are rarely sold, except as part of a continuing business, they are valued at their depreciated replacement cost.

- 4.4 *Depreciated replacement cost* (DRC) is typically applied in the absence of comparable sales data. An estimate derived from DRC is referred to as “valued by reference to DRC”. This result is subject to the adequate potential profitability or service potential of the entity from the use of assets as a whole, an assumption that can be accepted or rebutted. If the directors of the entity believe that the potential profitability of the business is insufficient to carry the DRC estimate, they may adopt a lower figure in their accounts, effectively converting the DRC estimate into *value in use*. It is incumbent upon the Valuer, however, to state whether the valuation arrived at by DRC was subject to the directors’ test of potential profitability.

5.0 Guidance

- 5.1 **Plant and equipment valuation situations are varied, and circumstances may even require the estimation of more than one type of value in a single assignment. Accordingly, plant and equipment will be valued on a basis that is appropriate for the circumstances, and that basis will be appropriately defined in the Valuation Report.**
- 5.2 **For financial reporting purposes, items comprising plant and equipment must be separated into operational, surplus, and investment property categories in accordance with IVA 1. Although this process can be extensive and is frequently complicated when there are large inventories of items to be valued, proper and detailed identification and classification of assets constituting plant and equipment are fundamental requisites for a valuation to be performed. Client instructions regarding these classifications should be obtained at the beginning of a valuation assignment.**
- 5.3 **If a Valuer accepts an assignment in which no specific instructions were given as to the value definition to be used, the Valuer shall independently carry out the necessary investigation and research to properly identify the relevant value definition.**
- 5.4 **Valuers shall make clear, unambiguous, and unequivocal disclosures in communicating plant and equipment valuations as out-**

lined in IVS 1, 2, and 3, and IVA 1. The requirements for valuation reports are addressed in the IVS Code of Conduct, and IVS 3, Valuation Reporting.

- 5.5 **To assure client and Valuation Report user understanding and to avoid potential abuses, Valuers shall take reasonable steps to assure that performance of the assignment will not lead to a conclusion that is misleading or inappropriate for the circumstances.**
- 5.6 **While undertaking a plant and equipment valuation, Valuers shall be aware of, understand, and correctly apply those valuation methods and techniques that are necessary to produce a valuation that is not misleading.**
- 5.7 **Although the concept, use, and application of non-market bases of value may be appropriate under certain circumstances, the Valuer is responsible to ensure that if such value is to be found and reported, it will not reasonably be construed as a representation of *Market Value*.**
- 5.8 **Valuations will clearly state whether plant and equipment assets have been valued in situ or ex situ (on site or off site).**
- 5.9 **The *Market Value* of plant and equipment rests upon the belief that a prudent purchaser would pay no more for an asset or a group of assets than the cost of acquiring (an) equally desirable substitute(s) in the market. In the valuation of plant and equipment, the cost of the substitute(s) often includes costs to make the asset(s) productive. These costs are sometimes called *make-ready costs*. Often included in these costs are necessary, associated expenses such as engineering, transportation, installation, attachment to utilities, and start-up.**
- 5.10 **Plant and equipment includes installations and support facilities for processes or manufacturing which are designed to perform a specific predetermined function. These include all non-realty devices in fixed or movable form deployed in the processing, manufacturing, or assembling of products from the stage of raw materials to finished goods. Separately reported items such as materials inventories, finished products, patents, and the like are not included. Thus, it is essential to the Valuation Process that all items to be valued are**

neither omitted nor accounted for twice in the valuation and related reporting.

5.11 **Plant and equipment may broadly be divided into four categories:**

5.11.1 **Machinery and equipment that may have been installed wholly in connection with the occupier's industrial or commercial processes,**

5.11.2 **Equipment that includes furniture and furnishings, tenants' fixtures and fittings, vehicles, stock, moulds, and loose tools, among others,**

5.11.3 **Factory and industrial buildings that are highly integrated with the enclosed process or equipment they support and structures of a specialised nature, and**

5.11.4 **Building services that are normally included in valuations of land and buildings.** Building services that are included within plant and equipment may include electricity, gas, water, space heating, hot water, air conditioning and ventilation, fire and security, drainage, and elevators/lifts and gantries, among others when they are provided as part of the industrial processes carried on by the occupier.

5.12 For valuations that deal with liquidation, or forced sale, value, the time frame for required sale is normally specified by the client, and may range from a relatively long period (still less than the period required for *Market Value*) to a shorter, urgent period. In some instances, the sale may be by auction. In others, a sale may be through solicitation or by a combination with other assets for package sale. **The manner of offering, time frame involved, and location of the assets at the time of sale are matters for proper disclosure in the Valuation Report.**

6.0 **Effective Date**

6.1 This International Valuation Guidance Note became effective 1 July 1997.

