International Valuation Guidance Note 3

Valuation of Plant and Equipment (Revised 2005)

1.0 Introduction

1.1 Plant and equipment collectively constitute a general class of tangible property assets. International Valuation Application 1 (IVA 1) deals with valuation requirements for financial reporting purposes. This Guidance Note provides additional information to assist in the application of the International Valuation Standards to plant and equipment assets.

1.2 Plant and equipment assets have particular characteristics that distinguish them from most types of real property and that influence both the approach to and reporting of their value. Plant and equipment are typically capable of being moved or relocated and often will depreciate at a significantly faster rate than real property. Frequently, the value will differ notably depending on whether an item of plant or equipment is valued in combination with other assets within an operational unit or whether it is valued as an individual item for exchange, and where it may be considered as either in-situ (in place) or for removal.

2.0 Scope

2.1 This Guidance Note focuses on the application of the approaches, principles and bases described in the Standards to the valuation of plant and equipment. The following Guidance Notes may also be relevant to the valuation of plant and equipment:

GN 4, Valuation of Intangible Assets
GN 5, Valuation of Personal Property
GN 6, Business Valuation
GN 7, Consideration of Hazardous and Toxic Substances in Valuation
GN 8, The Cost Approach for Financial Reporting—(DRC)

2.2 This Guidance Note applies to the valuation of the plant and equipment assets of both private-sector and public-sector entities.

3.0 Definitions

International Valuation Standards Definitions

3.1 *Plant and Equipment.* Tangible assets, other than *realty*, that:

(a) are held by an entity for use in the production or supply of goods or services, for rental by others, or for administrative purposes; and

(b) are expected to be used over a period of time.

The categories of plant and equipment are:

Plant. Assets that are inextricably combined with others and that may include specialised buildings, machinery, and equipment.

Machinery. Individual machines or a collection of machines. A machine is an apparatus used for a specific process in connection with the operation of the entity.

Equipment. Other assets that are used to assist the operation of the enterprise or entity.

3.2 *Market Value.* The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

International Financial Reporting Standards Definitions

3.3 *Property, Plant and Equipment.* Tangible items that:

a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
b) are expected to be used during more than one (accounting) period. (IAS 16, para. 6)

3.4 *Fair Value.* The amount for which an asset could be exchanged between knowledgeable willing parties in an arm's length transaction (IAS 16, para. 6).

3.5 *Finance lease.* A lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not be eventually transferred. (IAS 17, para. 4)

3.6 *Operating Lease.* A lease other than a finance lease. (IAS 17, para. 4)

4.0 Relationship to Accounting Standards

4.1 Under International Financial Reporting Standards (IFRSs), *Property Plant and Equipment* may be included on an entity's balance sheet at either cost less depreciation less impairment or at fair value at the date of revaluation less depreciation less impairment. (IAS 16, paras. 29, 30 and 31). The fair value of items of plant and equipment is usually their market value determined by appraisal (IAS 16, para. 32). Plant and equipment, together with other fixed assets, may be subject to other IFRSs, including IAS 2, Inventories; IAS 17, Leases; IAS 36, Impairment of Assets; IFRS 3, Business Combinations; and IFRS 5, Non-Current Assets Held for Sale and Discontinued Operations.

4.2 International Valuation Application (IVA) 1, Valuation for Financial Reporting, sets out the valuation and valuation reporting requirements under the various IFRSs referred to above.

4.3 The valuation approach and assumptions applicable to a valuation of plant and equipment for inclusion in a financial statement may be different from those appropriate for another purpose. A clear distinction should be made if values for different purposes are reported in the same document. Different valuation assumptions may be appropriate under different IFRSs and therefore it is important for the Valuer to be familiar with the basic requirements of the relevant standard, and to discuss the appropriate assumptions with the client before proceeding.

5.0 Guidance

5.1 Valuations of plant and equipment can be carried out using any of the following approaches:

5.1.1 the *sales comparison approach.*
5.1.2 the *cost approach (depreciated replacement cost)* (see GN 8); and
5.1.3 the *income capitalisation approach.*

5.2 For many purposes, including compliance with IFRSs, the most appropriate basis of value is *Market Value.* However, *Market Value* simply stipulates that an exchange is assumed to take place on an arm's-length basis between knowledgeable and willing parties; it is silent as to how the particular asset is to be presented for sale or any of the other specific circumstances that could have a fundamental effect on the valuation. When undertaking a valuation of plant and equipment, the Valuer must therefore establish and state the additional assumptions that are appropriate, having regard to the nature of the asset and the purpose of the valuation. These assumptions may include the state of the business in which the plant and equipment are currently utilised, or the extent to which individual items are aggregated with other assets. Examples of assumptions that may be appropriate in different circumstances, or for different valuation purposes include:

5.2.1 that the plant and equipment are valued as a whole, in-situ (in place) and as part of the business as a going concern;
5.2.2 that the plant and equipment are valued in-situ but on the assumption that the business is closed; or
5.2.3 that the plant and equipment are valued as individual items for removal from their current location.

For assets in the public sector, the assumption equivalent to a business continuing as a going concern is that the public sector assets will continue to be used for the provision of the relevant public good or service.

5.3 The list of assumptions above is not comprehensive. Because of the diverse nature and transportability of much plant and equipment, *Market Value* will need appropriate qualifying assumptions to describe the state and circumstances in which the asset is offered to the market. These assumptions should be discussed with the client and must be included in the report. Frequently, it may be appropriate to report on more than one set of assumptions, e.g., in order to illustrate the effect of business closure or cessation of operations on the *Market Value* of plant and equipment assets, where closure or cessation is not yet definite.

5.4 Other factors that can affect the *Market Value* of plant and equipment include:

5.4.1 the costs of installation and commissioning where plant and equipment are valued in situ;

5.4.2 where they are valued for removal, any allowance made for the costs of decommissioning, removal, and possible reinstatement following removal, and which party is to bear those costs. In some cases, these costs can be substantial and therefore the Valuer should reach an agreement with the client as to how they should be reflected and which specific assumption(s) are to be made.

5.5 Factors such as finite sources of raw materials, the limited life of the buildings or limited tenure of the land and buildings housing the plant, and statutory restrictions or environmental legislation can also have a significant impact on the value of plant and equipment. These factors will need to be taken into account by the Valuer and any necessary assumptions will have to be made.

5.6 Some plant and equipment connected with the supply or provision of services to a building will normally be included in any exchange of the real estate interest. Examples include plant for the supply of electricity, gas, heating, cooling or ventilation and equipment such as elevators. Although the value of these items would normally be reflected in the value of the real estate interest, for certain purposes, such as depreciation accounting, it may be necessary to value these items separately. Where this is the case, the Valuer should make it clear that the separate valuation and treatment of these items will affect the value of the real estate interest. When different Valuers are employed to carry out valuations of real estate assets and plant and equipment assets at the same location, careful liaison is necessary to avoid either omissions or double counting.

5.7 Intangible assets fall outside the definition of plant and equipment. However, intangible assets may have an impact on the value of plant and equipment; for example the value of patterns and dies is often inextricably linked to associated intellectual property rights. In such cases the Valuer should establish what assumptions are appropriate as to the availability of those intangible assets before reporting a valuation. Operating software, technical data, production records and patents are examples of intangible assets that can have an impact on the value of plant and equipment, depending on whether or not they are included in the transfer.

5.8 An item of plant and equipment may be subject to a financing arrangement, such as a finance lease. Accordingly, the asset cannot be sold without the lender or lessor being paid any balance outstanding under the arrangement. This payment may or may not exceed the unencumbered value of the item. Items of plant and equipment subject to such arrangements should be separately identified from assets that are unencumbered, and their value separately reported. Items which are subject to operating leases or are otherwise the property of third parties are normally excluded as the benefits of ownership are not transferred to the lessee. Guidance on Finance and Operating Leases is included in Addendum 1 to IVA 1.

5.9 *Market Value* does not imply any particular method of sale, as for example, by private treaty, tender, auction, etc. The conceptual framework in IVS 1 makes it clear that *Market Value* assumes a sale after proper marketing in the most appropriate manner. It is implicit in this definition that the method of sale will be the one that will achieve the highest price for the asset or the defined group of assets in a given set of circumstances. A willing and knowledgeable seller would not voluntarily choose a method of sale that did not maximize the price. However, if the exchange is to take place under circumstances that prevented the seller from choosing the optimal method of disposal, the anticipated realization will not be the *Market Value* unless the constraint on the seller was one common to all sales in that particular market at that time. A constraint specific to a particular seller or asset, coupled with a requirement to sell subject to that constraint, may result in a forced sale situation.

5.10 Plant and equipment assets are more likely to be subject to forced sale circumstances than real estate interests. For example, assets sometimes have to be disposed of in a time frame that precludes proper marketing because the current owner of the assets has to vacate or surrender the land and buildings where they are located. If such a scenario has actually arisen, or is reasonably foreseeable, it may be appropriate for the Valuer to provide advice on the price that could be anticipated or that should be accepted, although before doing so the Valuer will need to establish the exact nature of the constraint on the vendor and understand the consequences for the vendor of failing to dispose of the assets within the stipulated time limit. For example, the assets may be subject to forfeit or the owner may be subject to a specific financial penalty. It may also be necessary to consider any alternatives to sale, for example, the practicality and cost of removing the items to another location for disposal. Without knowledge of the actual or anticipated circumstances, the Valuer cannot give meaningful advice since the exchange may fall outside the definition of *Market Value.* Assumptions regarding the realisation of a transfer under forced sale circumstances must be carefully considered and clearly stipulated.

6.0 Effective Date

6.1 This Guidance Note is effective from 1 January 2006 although earlier adoption is encouraged.