

Primer on International Valuation Standards – Part 3

In the first of the series of articles dealing with *International Valuation Standards (IVS)*, a brief summary of the content and makeup of the 2007 Edition was presented. The next article provided a brief comparison between *Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP)* and *IVS*, as each deals with market value basis for appraising. This latter article illustrated that the basic underlying principles, methodologies and techniques of market value appraising are very similar whether operating under *CUSPAP* or *IVS*.

IVS also deals with bases other than market value, and presents certain concepts that may be new to our members. But, before these new concepts are introduced, it is necessary to revisit the basic concepts fundamental to generally accepted valuation principles in that the terminology of some of these concepts in *IVS* varies from what AIC members may be familiar with. At the very least, the following summary of *IVS* information can serve as a refresher course.

IVS, as one would expect from the title, are indeed designed to be international. In authoring *IVS*, it was recognized by the International Valuation Standards Council (IVSC) that there is indeed common worldwide agreement regarding the fundamentals that underpin the valuation discipline.

IVS devotes an entire chapter to these concepts, noting that there may be local laws and economic conditions that may require special application, but, for the most part, the concepts are indeed international.

The chapter begins noting that value is created by real estate's utility, or capacity to satisfy the needs and wants of human societies. A brief discussion ensues on the legal concept

of property that deals with the various rights, interests and benefits related to ownership.

The concept of property, however, extends beyond the real estate. To distinguish between real estate, which is a physical entity, and its ownership, which is a legal concept, the ownership of real estate is called real property. The word property, however, may refer to real property, personal property, or other types of property such as businesses and financial interests, or a combination thereof. By dealing with these concepts, *IVS* can serve as a platform that can eventually broaden the scope of work available to our members.

Property types

IVS recognizes that real property has to be distinguished from other categories of property, namely personal property, businesses, and financial interests.

Real property

Real property includes all the interests, benefits, and rights inherent in the ownership of physical real estate.¹ The combination of all the rights associated with the ownership of real property is sometimes referred to as the bundle of rights and includes the right to use, occupy, enter, sell, lease, bequeath, or give away, or to choose to exercise any or none of the above.

As new financial accounting rules take effect, our members will need to know that real property, in the terminology of accounting, usually falls into the category of fixed, or long-term, assets. Sometimes, real property may be considered a current asset, e.g., where land or improved real estate is held in inventory for sale.

1. Personal property

Personal; property refers to ownership of an interest in items other than real estate. These items can be tangible, such as a chattel, or intangible, such as a debt or patent. Tangible personal property represents interests in items that are not permanently attached or affixed to real estate and are generally characterized by their moveability.²

2. Businesses

A business is any commercial, industrial, service or investment entity pursuing an economic activity. Business entities are constituted as legal entities, either unincorporated or incorporated.³ In dealing with business valuations, our members will need to be familiar with concepts such as joint ventures, partnerships, proprietorships, trust arrangements, multiple entities, etc. *IVS* briefly describes these concepts, but ultimately, one must become competent in undertaking such assignments. Business valuations are not currently covered under either *CUSPAP* or our current errors and omission insurance program.

3. Financial interests

Financial interests in property result from the legal division of ownership interests in business and real property (e.g., partnerships, syndications, corporations, co-tenancies, joint ventures), from the contractual grant of an optional right to buy or sell property (e.g., realty, stock, or other financial instruments) at a stated price within a specific period, or from the creation of investment instruments secured by pooled real estate assets.⁴

Much of the discussion of financial interests in *IVS* will be new to many of our members, and again, caution should be exercised if you are currently dealing with these matters in terms of both *CUSPAP* compliance and insurance coverage.

Concepts fundamental to Generally Accepted Valuation Principles (GAVP)

Both *CUSPAP* and *IVS* define real estate, real property and personal property in similar terms. However, *IVS* opens the door to accounting terminology and *International Financial Reporting Standards (IFRS)* by offering definitions and concepts revolving around assets, both current and non-current. Some of these concepts may not be familiar to our members, but will soon be part of their vocabulary once *IFRS* take effect in Canada.

Briefly summarized, current assets are assets not intended for use on a continuing basis in the activities of an entity. Examples include stocks, obligations owed to the entity, short-term investments and cash. Non-current assets can be tangible or intangible assets that fall into two broad categories. The first category includes property, plant and equipment which are assets intended for use on a continuing basis in the activities of an entity. This is the category of assets that appraisers and valuers deal with most often. The second category includes receivables, goodwill, patents, trademarks, etc. and intangibles such as marketing skill, credit ratings, patents, trademarks, etc.

Accounting terminology differs somewhat from terms more common to appraisers. For example, our members are principally involved with fixed assets. Technically it is the ownership of the asset, or the right of ownership, that is valued, rather than the tangible or intangible asset itself. This concept distinguishes the economic concept of valuing an asset objectively based upon its ability to be purchased and sold in a marketplace from some subjective concept such as assuming an intrinsic or other than market value basis.

Another term, depreciation, differs between what we as appraisers know and the accountants understand. Appraisers know depreciation refers to the adjustments made to the cost of reproducing or replacing the asset to reflect physical deterioration and functional and external

obsolescence. Accountants know depreciation as the charge made against income to reflect the systematic allocation of the depreciable amount of an asset over its useful life to the entity. It is specific to the particular entity and its utilization of the asset, and is not necessarily affected by the market.⁵

Price, cost, market, and value

As *IVS* notes, imprecision of language, particularly in an international community, can and does lead to misinterpretations and misunderstandings. This is particularly problematic where words commonly used in a language also have specific meanings within a given discipline.

As a refresher to our members, and briefly stated, price is a term used for the amount asked, offered, or paid for a good or service. Price is a fact. Cost is the price paid for goods or services. Value is an economic concept referring to the prices most likely to be concluded by the buyers and sellers of a good or service. Value is hypothetical. The market is the environment in which goods and services trade.

Other fundamental concepts covered by *IVS* deal with market value, highest and best use, and utility. The differences between these concepts and what we as appraisers know is relatively minor. Indeed, the *IVS* definition of market value appears in the Practice Notes in the 2008 edition of *CUSPAP*.⁶ The definitions of highest and best use are similar to both *IVS* and *CUSPAP* and the concept of utility is very familiar to appraisers.

Market value versus fair value

The expression market value and the term fair value as it commonly appears in accounting standards are generally compatible, if not in every instance exactly equivalent concepts. Fair value, an accounting concept, is defined in *International Financial Reporting Standards* and other accounting standards as the amount for which an asset could be exchanged, or a liability

settled, between knowledgeable, willing parties in an arm's length transaction. Fair value is generally used for reporting both market value and non-market values in financial statements. Where the market value of an asset can be established, this value will equate to fair value.

Summary

The estimation and reporting of property and asset values, and related guidance, are the scope of the *IVS* standards, applications and guidance notes. How the results of valuations are to be compiled, conveyed and incorporated with the findings of other professionals is of crucial importance to appraisers. Proper understanding of terminology is essential for both those who prepare the reports and those who read them.

International Valuation Standards (IVS) are intended to serve the common objectives of those who prepare property and asset valuations and those who must rely on their results.⁷

End notes

- 1 *The Appraisal of Real Estate – Second Canadian Edition*
- 2 *International Valuation Standards (IVS) – 8th Edition – Property Types*
- 3 IBID
- 4 IBID
- 5 *International Valuation Standards (IVS) – 8th Edition – Fundamental Concepts*
- 6 *CUSPAP – Effective 2008 – 12.16.3*
- 7 *International Valuation Standards (IVS) – 8th Edition – Fundamental Concepts*

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