

# Primer on International Valuation Standards – Part 4

In previous articles dealing with International Valuation Standards (IVS), a brief summary of the content and makeup of the 2007 Edition was presented (Part 1). 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 (Part 2). The third installment provided a refresher course on generally accepted valuation principles (GAVP) and identified the various property types covered in IVS. (Part 3). This article will briefly summarize **IVS 1 – Market Value Basis of Valuation and IVS 2 – Basis Other Than Market Value.**

## IVS 1 – MARKET VALUE BASIS OF VALUATION

The introduction of this section of IVS provides the following definition of market value as being “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.”<sup>1</sup>

This very definition appears in *Canadian Uniform Standards of Appraisal Practice (CUSPAP)* in the Practice Notes at 12.16.3. However, IVS goes on to discuss in detail various words or phrases contained within this definition. Such as ‘the estimated amount. . .’, ‘a property should exchange. . .’, ‘on the date of valuation. . .’, ‘a willing buyer. . .’, etc. This discussion clarifies these important concepts that form part of the definition. For example, the ‘willing buyer’ is referred to as one who is motivated, but not compelled to buy; one that is not over-eager nor determined to buy at any price; one who purchases in accordance with the realities on

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. While this explanation may be obvious to a professional appraiser, similar discussions appear throughout IVS and provide an excellent resource that can assist our members in understanding various valuation concepts. These discussions also contain verbiage an appraiser can use to assist the reader of a report in understanding these same concepts.

The *Statement of Standard* provides rules that an appraiser must adhere to when performing a market value appraisal. As previously pointed out, these rules are not unfamiliar. *CUSPAP Appraisal Standard Rules* and *IVS-1* basically mirror each other. Indeed, in the *IVS-1 Statement of Standard*, it appears that the only major difference from *CUSPAP* is the certification statement. In *IVS* ‘certification’ is referred to as ‘compliance.’ In order to adhere to *IVS-1* when performing an appraisal for financial accounting purposes, an appraiser must include a certification statement, which includes the following:

*“My analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the Canadian Uniform Standards of Professional Appraisal Practice and the International Valuation Standards;”*

## IVS 2 – BASIS OTHER THAN MARKET VALUE

The objective of *IVS-2* is to identify, explain and distinguish bases of valuation other than market value and establish standards for their application. Alternative valuation basis may be appropriate in specific circumstances and *IVS-2* provides the distinctions between market value

and these various other valuation bases which generally require different assumptions, which, if not clearly identified, may result in a misinterpretation of the valuation.

These other valuation bases fall into three principle categories.

The first category reflects the benefits that an entity enjoys from ownership of an asset. The value is specific to that entity. Although, under some circumstances, it may be the same as the amount that could be realized from the sale of the asset, this value essentially reflects the benefits received by holding the asset, and, therefore, does not necessarily involve a hypothetical exchange. Investment value falls under this category. Differences between the value of an asset to a particular entity and the market value provide the motivation for buyers or sellers to enter the marketplace.

The second category represents the price that would be reasonably agreed between two specific parties for the exchange of an asset. Although the parties may be unconnected and have negotiated at arm’s length, the asset is not necessarily exposed in the wider market and the price agreed may be one that reflects the specific advantages (or disadvantages) of ownership to the parties involved rather than the market at large. This category includes fair value, special value and synergistic value.

The third category is value determined in accordance with a definition set out in a statute or a contract.<sup>2</sup> It is worthwhile to expand on these concepts in order to be able to distinguish them from market value.

**Fair value:** The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s-length transaction.

For most purposes, valuations under *Interna-*

tional Financial Reporting Standards (IFRS) require the use of fair value. This is a specific application of fair value that may require more restrictive assumptions than are required in general use.

A common application of *Fair Value* is for assessing the price that is fair for the shareholder in a business, where particular synergies between two specific parties may mean that the price that is fair between them is different from the price that might be obtainable in the wider market.

**Investment value:** The value of a property to a particular investor, or class of investors, for identified investment or operational objectives. This subjective concept relates a specific property to a specific investor, group of investors, or entity with identifiable investment objectives and/or criteria.

**Special purchaser:** A purchaser to whom a particular asset has *Special Value* because of advantages arising from its ownership that would not be available to general purchasers in the market.

**Special value:** An amount above the *Market Value* that reflects particular attributes of an asset that are only of value to a *Special Purchaser*. Such *attributes* can include the physical, geographical, economic or legal characteristics of an asset. *Market Value* requires the disregard of any element of *Special Value* because at any given date it is only assumed that there is a willing buyer, not a particular willing buyer.

**Synergistic value:** An additional element of value created by the combination of two or more interests where the value of the combined interest is worth more than the sum of the original interests.<sup>3</sup>

**Going concern:** This describes a situation where an entire business is transferred as an operational entity.

**Liquidation value:** This describes a situation where a group of assets employed together in a business are offered for sale separately, usually following the closure of the business.

**Salvage value:** This describes the value of an asset that has reached the end of its economic life for the purpose it was made. The asset may still have value for an alternative use for recycling.

In today's economic climate, appraisers are often faced with providing appraisals for 'power of sale' or 'forced sale' proceedings. *IVS* contains some valuable insight which is worth repeating. The term 'forced sale' is often used in circumstances where a seller is under compulsion to sell and/or a proper marketing period is not available. The prices obtainable in these circumstances may not meet the definition of market value. It will depend upon the nature of the pressure on the seller or the reasons why proper marketing cannot be undertaken. It may also reflect the consequences for the seller of failing to sell within a specified period. Unless the nature of, and reason for, the constraints on the vendor are known, the price obtainable in a forced sale will reflect its particular circumstances, rather than those of the hypothetical willing seller in the market value definition. The price obtainable in a forced sale will bear only a coincidental relationship to market value, or any of the other bases defined in *IVS-2*. 'Forced sale' is not a basis of valuation. It is a description of the situation under which a transfer takes place, not a distinct measurement objective.<sup>4</sup>

As with *IVS-1*, in addition to a 'compliance' or 'certification' statement that acknowledges conformity to *IVS*, there are certain disclosure requirements that are required over and above the requirements of *CUSPAP*. For example, an in-house appraiser (or internal valuer) must, within the report, disclose the existence and nature of the relationship between the internal valuer and the entity controlling the asset.

It is important to recognize that *CUSPAP Appraisal Standard Rule 6.2.3* requires that "an appraiser must identify the purpose of the assignment, including a relevant definition of value." The comments go on to require that the appraiser must identify the source of the definition. In other words, *CUSPAP* does not require a definition of market value, just value. So, depending on the assignment, *IVS* can be referenced for a valuation basis and related appropriate value definitions, other than market value. 📄

### End notes

- 1 *IVS*, 8th Edition – Standard 1
- 2 International Valuation Standards (*IVS*) – 8th Edition – *IVS-2* Discussion
- 3 International Valuation Standards (*IVS*) – 8th Edition – *IVS-2*
- 4 International Valuation Standards (*IVS*) – 8th Edition – *IVS-2* 6.11

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