

International Valuation Professional Board
Proposed Technical Information Paper 2
Depreciated Replacement Cost

response to exposure draft

26 May 2011

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

Our ref: Responses/110531 SC0159

International Valuation Professional Board,
41 Moorgate,
London EC2R 6PP,
United Kingdom
By email to CommentLetters@ivsc.org

May 2011

Dear IVSC Secretariat

International Valuation Professional Board Exposure Draft

Proposed Technical Information Paper 2

Depreciated Replacement Cost

CIPFA is a professional accountancy body in the United Kingdom which specialises in the public services. CIPFA considers the development of guidance and standards on financial reporting, auditing and other matters; in some cases we consider the implications of consultation materials for all sectors of the economy, while in other cases we focus primarily on the effect on the public sector or the wider public benefit sector. While we represent our membership of accountants, we liaise on key issues with other stakeholders including standard setters, government bodies, regulators, and representatives of other professions and specialisms such as economists, actuaries and valuers.

The public sector uses DRC extensively for financial reporting purposes in many jurisdictions and under a variety of financial reporting frameworks. CIPFA has considered the IVPB exposure draft from the point of view of preparers of financial statements under local, international and international public sector financial reporting standards.

General comment

The ED proposals are helpful. We have no concern over the widening of the guidance to apply for purposes other than financial reporting, although financial reporting is of course the aspect of the guidance which we consider particularly relevant.

We note that the exposure draft does not refer to either IFRS or IPSASs when discussing financial reporting, and we support this drafting approach. The paper will be therefore be useful to valuers in a wider range of locations and circumstances.

We have one particular comment which relates to how the TIP sets out the financial reporting context within the wider DRC valuation context.

The ED explains (p5, para 1) that DRC can be used to estimate a variety of bases of value. However, the discussion of valuation bases (p13, para 55) and the first Question for Respondents (p3, question 1) might be read as implying that, for financial reporting purposes, the only valuation basis to which DRC might apply is the market approach or market value. 'Market value' does capture a key approach used in International Financial Reporting Standards (IFRS fair value as currently formulated), and is the starting point for most IPSAS fair value measurement. However, it is not the only financial reporting basis. Nor is it the only financial reporting basis to which DRC applies. Furthermore, even within the limited context of IFRS and IPSAS, issues relating to valuation and measurement are not static. The IASB has only recently issued IFRS 13 on Fair Value measurement, and plans to consult on more general measurement issues as part of its conceptual framework project. The IPSASB has also issued a Consultation Paper *Measurement of Assets and*

Liabilities as part of its programme to develop a conceptual framework for public sector financial reporting, and this explores a number of financial reporting bases, several of which are grounded in a Value in Use approach which is different to the IFRS Fair Value / market value approach. Consequently, while the IPSASB will review IFRS 13 as part of its convergence programme, it is by no means clear that the IASB's market exit value approach will be applied to all instances of IPSAS fair value.

In the light of these factors, it would be useful if the TIP could, for example, briefly explain that in some financial reporting frameworks, DRC may be used to derive the value of an asset to its owner rather than a potential purchaser. This is particularly significant in a public sector 'non-exchange' context where some assets are held to provide services for the benefit of citizens, rather than to generate income in contractual exchanges at market rates. IPSASs measure the value in use of such assets having regard to their service potential, which is a narrower concept than used by the IVSC and IVPB, inasmuch as the IPSAS concept does not encompass the service potential of income-generating assets held for profit. IPSAS 21 provides guidance on valuing such assets by reference to Depreciated Replacement Cost, and in some cases (such as heritage assets) this may be further constrained as Reproduction Cost. The relevant service potential to be considered in such public sector non-exchange contexts is the service potential that the asset will afford to the current owner, rather than to a potential purchaser; and the relevant replacement cost is that which would be incurred by the current owner rather than by a potential purchaser.

The Exposure Draft already provides enough guidance to inform such owner focussed valuations, but as currently drafted these might be considered to be valuations for purposes other than financial reporting.

Response to specific questions

CIPFA responses to the questions on which the IVPB would particularly value comment are attached.

I hope this is a helpful contribution to the development of the Board's guidance in this area. If you have any questions about this response, please contact Steven Cain (e:steven.cain@cipfa.org.uk, t: +44(0)20 7543 5794).

Yours faithfully

Paul Mason
Assistant Director
Professional Standards and Central Government
CIPFA
3 Robert Street
London WC2N 6RL
t: 020 7543 5691
e: paul.mason@cipfa.org.uk
www.cipfa.org.uk

Specific Matters for Comment

1 It is proposed that this Exposure Draft will replace the current GN8 "The Cost Approach for Financial Reporting - (DRC)". As the name suggests GN8 only covers the use of the cost approach for financial reporting purposes. This exposure draft proposes that a properly applied cost approach can be applied in a wide variety of circumstances.

Do you agree with the argument that the cost approach, if properly applied, can be used as a method to arrive at market value for a variety of purposes other than financial reporting?

CIPFA agrees.

In addition, we would note that for financial reporting purposes, it will sometimes be appropriate to consider the valuation of assets as an exit value, reflecting the views of purchasers in the market, and sometimes from an entry value, assessing the value of the asset to the current owner by reference to the amount which the current owner would need to pay for an asset of equivalent service potential.

2 This Exposure Draft identifies depreciated replacement cost as the most common method of valuation under the Cost Approach. An alternative view is that this is the only method of applying the cost approach.

Which of these views do you support? If you believe that there are other valuation methods that fall under the Cost Approach, please describe them.

We agree that DRC is the most common method of valuation under the cost approach, and may in practice be the only method.

3 GN8 in the 2007 edition of IVS identifies the three main types of deduction for obsolescence as physical deterioration, functional obsolescence and external obsolescence. In this Exposure Draft external obsolescence has been replaced with economic obsolescence. Supporters of the proposed change argue that the term economic obsolescence is most commonly used to describe this form of obsolescence.

Those who support the existing definition argue that the term external obsolescence more clearly requires all factors that arise from changes to the environment in which the asset operates to be considered, regardless of whether they have a direct economic impact.

Which of these views do you support?

CIPFA has no strong view on this topic.

However, CIPFA notes that the environment in which entities operate can be affected by regulations (such as planning regulations) that might not seem immediately to have a direct impact on the economics of the industry within the sense of paragraphs 36 et seq and it might be helpful if the TIP could make this clear.

4 The exposure draft provides that where the purpose of the valuation is governed by regulations that preclude adjustment for all forms of obsolescence, for example valuations for tariff setting purposes of regulated monopoly assets, the outcome does not represent market value and should not be described as such.

Do you agree that a cost approach valuation that does not identify and quantify all forms of obsolescence is not a measure of market value?

CIPFA agrees that a cost approach valuation that does not identify and quantify all forms of obsolescence is not a measure of market value as defined. However, as indicated in our covering letter, it is important to note that market value is not the only valuation base used for financial reporting purposes, and DRC valuation is relevant to some of the other bases.