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GLOSSARY OF VALUATION TERMS

Extract from International Valuation Standards Seventh Edition 2005.

Depreciated

An application of the cost approach used in

Replacement Cost

assessing the value of specialized assets for financial reporting purposes, where direct market evidence is limited or unavailable.

The current cost of reproduction or replacement of an asset less deductions for physical deterioration and all relevant forms of obsolescence and optimization¹.

Depreciation

In the context of asset valuation, depreciation refers to the adjustments made to the cost of reproducing or replacing the asset to reflect physical deterioration and functional (technical) obsolescence in order to estimate the value of the asset in a hypothetical exchange in the market when there is no direct sales evidence available. In financial reporting, depreciation refers to 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 market².

¹ See, International Valuation Standards Seventh Edition (2005) Page 335.

² See, International Valuation Standards Seventh Edition (2005) Page 335.

Economic Life

Either

- The period which an asset is expected to be economically usable by one or more users;

or

- The number of production or similar units expected to be obtained from the asset by one or more users.

**Economic
Obsolescence**

A loss in value due to factors outside the subject asset.

Economic obsolescence is also called external, environmental or vocational obsolescence. Examples of economic obsolescence are changes in competition or in surrounding land uses like an industrial plant near a residential area. It is deemed incurable as the expense to cure the problem is impractical³.

Fair value

The amount for which an asset could be exchanged or a liability settled, between knowledgeable willing parties in an arm's length transaction. In accounting, fair value anticipates a sale which may occur in differing circumstances and in conditions other than those prevailing in the (open) market for the normal, orderly disposition of assets. These include the possibility of a sale under short term distress situations or other circumstances not contemplated in the Market definition.

³ See, International Valuation Standards Seventh Edition (2005) Page 339.

The term fair value is also used in legal actions to derive a settlement in disputes between the parties, the circumstances of which may not meet the definition of Market value. Hence fair value is not synonymous with Market Value.

Fair value may represent the service potential of an asset, i.e., the future economic benefits embodied in the asset in terms of its potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity⁴.

**Forced Sale
(Liquidation)
Value**

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 too short to meet the marketing time frame of the Market value definition. In some States forced sale value in particular may also involve an unwilling seller and a buyer who buy with knowledge of the disadvantage of the seller.

Market Value, with a proviso that the vendor has imposed a time limit for a completion of the sale, which cannot be regarded as a reasonable time period, taking into account the nature of the asset, its location, and the state of the market⁵.

**Going Concern
Value**

The value of a business as a whole. The concept involves valuation of a continuing enterprise from which allocations, or

⁴ See, International Valuation Standards Seventh Edition (2005) Page 344.

⁵ See, International Valuation Standards Seventh Edition (2005) Page 350.

apportionments, of overall going concern value may be constituent parts as they contribute to the whole, but none of the components in themselves constitute a basis for Market Value.

If the premises used are owned by the business they form part of the going concern value on the basis of their value to the business. The concept involves valuation of a continuing entity from which allocations or apportionments of overall going concern value may be made to constituent parts as they contribute to the whole, but none of the components of themselves constitute market value⁶.

Intrinsic value

In some States, the amount considered, on the basis of an evaluation of available facts, to be the "true" or "real" worth of an item. A long-term, Non –Market Value concept that smoothes short term price fluctuations⁷.

Machinery

A machine is an apparatus using or applying mechanical power, having several parts each with a definite function, and together performing certain kinds of work⁸.

Net Current Replacement Cost

Cost that would be incurred in the market place in acquiring an equally satisfactory substitute asset.

It is the cost of purchasing, at the least cost, the remaining service potential of the asset at

⁶ See, International Valuation Standards Seventh Edition (2005) Page 353.

⁷ x

⁸ x

the balance sheet date; it is an entry value.

Simply put, it is the replacement cost less depreciation⁹.

Obsolescence

A loss in value due to a decrease in the usefulness of property caused by decay, changes in technology, peoples behavioural patterns and tastes or environmental changes. Obsolescence is sometimes classified according to items of outmoded design and functionality, items with structural design unable to meet current code requirements, and factors arising outside the asset, such as changes in user demand¹⁰.

Oral Report

The results of a valuation verbally communicated to a client or presented before a court either as expert testimony or by means of deposition. A report communicated orally to a client should be supported by a work and at a minimum followed up by a written summary of the valuation¹¹.

Plant

An assemblage of assets that may include specialised non permanent buildings, machinery and equipment¹².

Plant and Equipment

Assets intended for use on a continuing basis in the activities of an entity including specialised, non permanent buildings: machinery (individual

⁹ X

¹⁰ X

¹¹ X

¹² X

machines or collections of machines, trade fixtures, and leasehold improvements) and other categories of assets suitably identified.

Tangible assets that:

- are held by an entity for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- are expected to be used over a period of time¹³.

Recoverable Amount

The recoverable amount of an asset or a cash generating unit is the higher of its fair value less costs to sell and its value in use¹⁴.

Replacement Cost (New)

A replacement cost estimate envisions constructing a structure of comparable utility, employing the design and materials that are currently used in the market.

The current cost of a similar new item having the nearest equivalent utility as the item being appraised.

The cost of replacing an asset with an equally satisfactory substitute asset; normally derived from the current acquisition cost of a similar asset, new or used, or an equivalent productive capacity or service potential. Replacement cost

¹³ X

¹⁴ X

assumes the use of modern materials, techniques and designs¹⁵.

Reproduction Cost New

The cost to create a virtual replica of the existing structure, employing the same design and similar building materials.

The current cost of an identical new item.

In the market for fine art, reproduction cost is equivalent to the cost of creating a facsimile of ten original item¹⁶.

Salvage value

The value of property, 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 costs and, in the latter case may equate to net realisable value.

The expected value of the asset at the end of its economic life. The concept of salvage is that the asset is valued for salvage disposal rather than its originally intended purpose¹⁷.

Scrap Value

The value a wasting asset will have at the end of its predictable life, as known or ascertainable at the time when the asset was acquired or provided by the person making the disposal¹⁸.

Technical

Term used by PP&E Valuers for Functional

¹⁵ X

¹⁶ X

¹⁷ X

¹⁸ X

Obsolescence

Obsolescence.

Valuation Report

A document that records the instructions for the assignment, the basis and purpose of the valuation, and the results of the analysis that led to the opinion of value. A Valuation report may also explain the analytical process undertaken in carrying out the valuation, and present meaningful information used in the analysis. Valuation Reports can be either oral or written. The type, content and length of a report vary according to the intended user, legal requirements, the property type and the nature and complexity of the assignment.

Cost approach

One of the approaches to value commonly applied in Market Value estimates and many other valuation situations. Depreciated replacement cost is an application of the cost approach used in assessing the value of specialized assets for financial reporting purposes, where direct market evidence is limited.

A comparative approach to the value of property or another asset, that considers as a substitute for the purchase of a given property, the possibility of constructing property that is an equivalent to the original or one that could furnish equal utility with no undue cost resulting from delay. The Valuer's estimate is based on the reproduction or replacement cost of the subject property or asset, less total (accrued) depreciation.

The cost approach establishes the value of the real property by estimating the cost of acquiring land and building a new property with an equal utility or adapting an old property to the same use with no undue cost due to delay. An estimate of entrepreneurial incentive or developer's profit/loss is commonly added to land and construction costs. For older properties the cost approach develops an estimate of physical depreciation including items of physical deterioration and functional obsolescence¹⁹.

Cost Approach for Valuing Fine Art

A comparative approach to the value of fine art that considers as a substitute for the purchase of a given work of fine art the possibilities of creating another work of fine art that replaces the original. The valuers estimate is based on the reproduction cost of the subject work of fine art, and the nature of the replacement, i.e. whether it be new for old, indemnity basis, a replica, or a facsimile.

"New for old" refers to the cost of purchasing the same item or, if unavailable, an item similar in nature and condition in the retail market for new works of fine art.

"Indemnity basis" refers to the cost of replacing an item with a similar condition in the second-hand retail market for art and antiques.

¹⁹ See International Valuation Standards Seventh Edition (2005) Page 329.

A “replica” is a copy of the original item as near as possible to the original in terms of nature, quality, and age of materials but created by means of modern construction methods.

A “facsimile” is an exact copy of the original item, created with materials of a closely similar nature, quality, and age and using construction methods of the original period²⁰.

**Income
Capitalization
Approach**

A comparative approach to value that considers income and expense data relating to the property being valued and estimates value through a capitalization process. Capitalization relates income (usually net income) and a defined value type by converting an income amount into a value estimate. This process may consider direct relationships (whereby an overall capitalization rate or all risks yield is applied to a single year’s income), yield or discount rates (reflecting measures of return on investment) applied to a series of incomes over a projected period, or both. The income approach reflects the principles of substitution and anticipation²¹.

**Sales Comparison
Approach**

A comparative approach to value that considers the sales of similar or substitute properties and related market data and establishes a value estimate by process involving comparison. In general, a property being valued (a subject

²⁰ See International Valuation Standards Seventh Edition (2005) Page 359.

²¹ See International Valuation Standards Seventh Edition (2005) Page 331.

property) is compared with sales of similar properties that have been transacted in the open market. Listing and offerings may also be considered.

A general way of estimating a value indication for personal property or ownership interest in personal property, using one or more methods that compare the subject to similar properties or to ownership interests in similar properties. This approach to the valuation of personal property is dependent upon the Valuer's market knowledge and experience as well as recorded data on comparable items.