

## Changes in International Valuation Standards (IVS) from latest edition (31 January, 2021) to this edition (31 January, 2022)

New Standards Issued at 31 January 2022			
Standard/ Amendment/ Insertion/ Deletion	Effective date	Text before correction	Text after correction applied
Insertion in <i>Introduction</i>	31 January, 2022	None	<p>The IVSC Standards Boards have taken into account the following core principles when drafting the International Valuation Standards. Core Principles of Valuation Standard Setting:</p> <ol style="list-style-type: none"> <li>1. Purpose (Objective): The purpose of valuation standards is to promote and maintain a high level of public trust in valuation practice by establishing appropriate requirements for valuers.</li> <li>2. Valuation Standards: Valuation Standards should be principle based and adequately address the development of a credible opinion of value and the communication of that opinion to the intended user(s).</li> <li>3. Development and Revisions of Standards: Standards are to be created and revised, when necessary, by way of a transparent process after appropriate exposure.</li> <li>4. Jurisdiction: Departures from the standards to comply with legislative and regulatory requirements that are in conflict with the standards are allowed.</li> </ol> <p>Core Principles of Valuation:</p> <ol style="list-style-type: none"> <li>1. Ethics: Valuers must follow the ethical principles of integrity, objectivity, impartiality, confidentiality, competence and professionalism to promote and preserve the public trust.</li> <li>2. Competency: At the time the valuation is submitted, valuers must have the technical skills and knowledge required to appropriately complete the valuation assignment.</li> <li>3. Compliance: Valuers must disclose or report the published valuation standards used for the assignment and comply with those standards.</li> <li>4. Basis (ie, Type or Standard) of Value: Valuers must select the basis (or bases) of value appropriate for the assignment and follow all applicable requirements. The basis of value (or bases) must be either defined or cited.</li> </ol>

		<p>5. Date of Value (ie, Effective Date/Date of Valuation): Valuers must disclose or report the date of value that is the basis of their analyses, opinions or conclusions. Valuers must also state the date they disclose or report their valuation.</p> <p>6. Assumptions and Conditions: Valuers must disclose significant assumptions and conditions specific to the assignment that may affect the assignment result.</p> <p>7. Intended Use: Valuers must disclose or report a clear and accurate description of the intended use of the valuation.</p> <p>8. Intended User(s): Valuers must disclose or report a clear and accurate description of the intended user(s) of the valuation.</p> <p>9. Scope of Work: Valuers must determine, perform, and disclose or report a scope of work that is appropriate for the assignment that will result in a credible valuation.</p> <p>10. Identification of Subject of Valuation: Valuers must clearly identify what is being valued.</p> <p>11. Data: Valuers must use appropriate information and data inputs in a clear and transparent manner so as to provide a credible valuation.</p> <p>12. Valuation Methodology: Valuers must properly use the appropriate valuation methodology(ies) to develop a credible valuation.</p> <p>13. Communication of Valuation: Valuers must clearly communicate the analyses, opinions and conclusions of the valuation to the intended user(s).</p> <p>14. Record Keeping: Valuers must keep a copy of the valuation and a record of the valuation work performed for an appropriate period after completion of the assignment.</p>
Insertion in <i>Glossary</i>	31 January, 2022	<p><b>20.2. Basis (bases) of Value</b> The fundamental premises on which the reported values are or will be based (see IVS 105 Valuation Approaches and Methods, para 10.1) (in some jurisdictions also known as standard of value).</p> <p><b>20.4. Cost(s) (noun):</b> The consideration or expenditure required to acquire or create an asset.</p> <p><b>20.5. Discount Rate(s):</b> A rate of return used to convert a monetary sum, payable or receivable in the future, into a present value.</p>

		<p><b>20.6. Equitable Value:</b> This is the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.</p> <p><b>20.7. Fair Market Value:</b></p> <p>1. The Organisation for Economic Co-operation and Development (OECD) defines “fair market value” as the price a willing buyer would pay a willing seller in a transaction on the open market.</p> <p>2. For United States tax purposes, Regulation §20.2031-1 states: “The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts”</p> <p><b>20.8. Fair Value:</b> (International Financial Reporting Standards) IFRS 13 defines “fair value” as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.</p> <p><b>20.11. Investment Value:</b> The value of an asset to the owner or a prospective owner given individual investment or operational objectives (may also be known as worth).</p> <p><b>20.13. Liquidation Value:</b> The amount that would be realised when an asset or group of assets are sold on a piecemeal basis. Liquidation value should take into account the costs of getting the assets into saleable condition as well as those of the disposal activity. Liquidation value can be determined under two different premises of value (see IVS 104 Bases of Value, section 80): (a) an orderly transaction with a typical marketing period; or (b) a forced transaction with a shortened marketing period.</p> <p><b>20.14. Market Value:</b> The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.</p> <p><b>20.18. Price (noun):</b> The monetary or other consideration asked, offered or paid for an asset, which may be different from the value.</p>
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		<p><b>20.23. Synergistic Value:</b> The result of a combination of two or more assets or interests where the combined value is more than the sum of the separate values. If the synergies are only available to one specific buyer, then synergistic value will differ from market value, as the synergistic value will reflect particular attributes of an asset that are only of value to a specific purchaser. The added value above the aggregate of the respective interests is often referred to as marriage value.</p> <p><b>20.24. Valuation:</b> The act or process of determining an opinion or conclusion of value of an asset on a stated basis of value at a specified date in compliance with IVS.</p> <p><b>20.25. Valuation Approach:</b> In general, a way of estimating value that employs one or more specific valuation methods (see IVS 105 Valuation Approaches and Methods).</p> <p><b>20.26. Valuation Method:</b> Within valuation approaches, a specific way to estimate a value.</p> <p><b>20.29. Value (noun):</b> The opinion resulting from a valuation process that is compliant with IVS. It is an estimate of either the most probable monetary consideration for an interest in an asset or the economic benefits of holding an interest in an asset on a stated basis of value.</p> <p><b>20.30. Valuer:</b> A “valuer” is an individual, group of individuals or a firm or individual within an entity, regardless of whether employed (internal) or engaged (contracted/ external).</p> <p><b>20.33. Worth</b> See investment value.</p>
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<p>Insertion in <i>IVS Framework</i></p>	<p>31 January, 2022</p>	<p><b>20.1.</b> The standards can be applied to the valuation of both assets and liabilities</p> <p><b>30.1.</b> Valuer has been defined as “an individual, group of individuals, or a firm</p> <p><b>50.1.</b> Valuations must be prepared by having the appropriate technical skills, experience and knowledge of the subject of the valuation, the market(s) in which it trades and the purpose of the valuation.</p>	<p><b>10.2.</b> In order for a valuation to be compliant with IVS the valuer must comply with all the requirements contained within IVS.</p> <p><b>10.3.</b> A valuer can only depart from International Valuation Standards (IVS) as described in section 60 of this Framework.</p> <p><b>20.1.</b> The standards can be applied to the valuation of both assets and liabilities and present and future claims on assets and liabilities.</p> <p><b>30.1.</b> Valuer has been defined as “an individual, group of individuals, or a firm individual within an entity, regardless of whether employed (internal) or engaged (contracted/external)</p> <p><b>50.1.</b> Valuations must be prepared by an individual, group of individuals or individual within an entity, regardless of whether employed (internal) or engaged (contracted/external), possessing the necessary qualifications, ability and experience to execute a valuation in an objective, unbiased, ethical and competent manner and having the appropriate technical skills, experience and knowledge of the subject of the valuation, the market(s) in which it trades and the purpose of the valuation.</p>
<p>Insertion in <i>Allocation of Value IVS 104 (Bases of Value), Paragraph 220.</i></p>	<p>31 January, 2022</p>		<p><b>220.1.</b> Allocation of value is the separate apportionment of value of an asset(s) on an individual or component basis.</p> <p><b>220.2.</b> When apportioning value, the allocation method must be consistent with the overall valuation premise/basis and the valuer must: (a) follow any applicable legal or regulatory requirements, (b) set out a clear and accurate description of the purpose and intended use of the allocation, (c) consider the facts and circumstances, such as the relevant characteristic(s) of the items(s) being apportioned, (d) adopt appropriate methodology (ies) in the circumstances.</p>
<p>Insertion in <i>Introduction IVS 105 (Valuation Approaches and Methods), Paragraph 10.</i></p>	<p>31 January, 2022</p>	<p>Consideration must be given to the relevant and appropriate valuation approaches. The three approaches described and defined below are the main approaches used in valuation. They are all based on the economic principles of price</p>	<p><b>10.1.</b> Consideration must be given to the relevant and appropriate valuation approaches. One or more valuation approaches may be used in order to arrive at the value in accordance with the basis of value.</p> <p>The three approaches described and defined below are the main approaches used in valuation. They are all based on</p>

		equilibrium, anticipation of benefits or substitution.	the economic principles of price equilibrium, anticipation of benefits or substitution.
Insertion in and deletion of <i>Introduction IVS 200 (Businesses and Business Interests)</i> , Paragraph 20.		<p><b>20.1.</b> The definition of what constitutes a business may differ depending on the purpose of a valuation. However, generally a business conducts a commercial, industrial, service or investment activity. Businesses can take many forms, such as corporations, partnerships, joint ventures and sole proprietorships. The value of a business may differ from the sum of the values of the individual assets or liabilities that make up that business. When a business value is greater than the sum of the recorded and unrecorded net tangible and identifiable intangible assets of the business, the excess value is often referred to as going concern value or goodwill.</p> <p><b>20.2.</b> When valuing individual assets or liabilities owned by a business, valuers should follow the applicable standard for that type of asset or liability (IVS 210 Intangible Assets, IVS 400 Real Property Interests, etc).</p> <p><b>20.3.</b> Valuers must establish whether the valuation is of the entire entity, shares or a shareholding in the entity (whether a controlling or non-controlling interest), or a specific business activity of the entity. The type of value being provided must be appropriate to the purpose of the valuation and communicated as part of the scope of the engagement (see IVS 101 Scope of Work). It is especially critical to clearly define the business or business interest being valued as, even when a valuation is performed on an entire entity, there may be different levels at which that value could be expressed. For example:</p>	<p><b>20.1.</b> The definition of what constitutes a business may differ depending on the purpose of a valuation, but generally involves an organisation or integrated collection of assets engaged in commercial, industrial, service or investment activity. Generally, a business would include more than one asset (or a single asset in which the value is dependent on employing additional assets) working together to generate economic activity that differs from the outputs that would be generated by the individual assets on their own.</p> <p><b>20.2.</b> Individual intangible assets, or a group of intangible assets might not constitute a business but would nonetheless be within the scope of this standard if such assets generate economic activity that differs from the outputs that would be generated by the individual assets on their own. If the assets do not meet these criteria, a valuer should defer to IVS 210 Intangible Assets and IVS 220 Non-Financial Liabilities.</p> <p><b>20.3.</b> The commercial, industrial, service or investment activity of the business may result in greater economic activity (ie, value), than those assets would generate separately. The excess value is often referred to as going concern value or goodwill. This excess value may constitute a separate asset under certain bases of value in certain situations. The absence of excess value does not automatically mean that the asset or group of assets does not constitute a business. In addition, economically, substantially all of the value of assets within a business may reside in a single asset.</p> <p><b>20.4.</b> Businesses can take many legal forms, such as corporations, partnerships, joint ventures and sole proprietorships. However, businesses could take</p>

		<p>(a) Enterprise value: Often described as the total value of the equity in a business plus the value of its debt or debt-related liabilities, minus any cash or cash equivalents available to meet those liabilities.</p> <p>(b) Total invested capital value: The total amount of money currently invested in a business, regardless of the source, often reflected as the value of total assets less current liabilities and cash.</p> <p>(c) Operating Value: The total value of the operations of the business, excluding the value of any non-operating assets and liabilities.</p> <p>(d) Equity value: The value of a business to all of its equity shareholders.</p> <p><b>20.4.</b> Valuations of businesses are required for different purposes including acquisitions, mergers and sales of businesses, taxation, litigation, insolvency proceedings and financial reporting. Business valuations may also be needed as an input or step in other valuations such as the valuation of stock options, particular class(es) of stock, or debt.</p>	<p>other forms such as a division, branch, line of business, segment, cash generating unit, and asset group that can consist of parts of one or more legal entities.</p> <p><b>20.5.</b> Interests in a business (eg, securities) can also take many forms. To determine the value of a business interest, a valuer should first determine the value of the underlying business by applying these standards. In such instances, business interests should be within the scope of this standard but depending on the nature of the interest certain other standards may be applicable.</p> <p><b>20.6.</b> Valuers must establish whether the valuation is of the entire entity, shares or a shareholding in the entity (whether a controlling or non-controlling interest), or a specific business activity of the entity. The type of value being provided must be appropriate to the purpose of the valuation and communicated as part of the scope of the engagement (see IVS 101 Scope of Work). It is especially critical to clearly define the business or business interest being valued as, even when a valuation is performed on an entire entity, there may be different levels at which that value could be expressed. For example:</p> <p>(a) Enterprise value: Often described as the total value of the equity in a business plus the value of its debt or debt-related liabilities, minus any cash or cash equivalents available to meet those liabilities.</p> <p>(b) Total invested capital value: The total amount of money currently invested in a business, regardless of the source, often reflected as the value of total assets less current liabilities and cash.</p> <p>(c) Operating value: The total value of the operations of the business, excluding the value of any non-operating assets and liabilities.</p> <p>(d) Equity value: The value of a business to all of its equity shareholders.</p> <p><b>20.7.</b> Valuations of businesses are required for different purposes including acquisitions, mergers and sales of businesses, taxation, litigation, insolvency proceedings and financial reporting. Business valuations may also be needed as an input or step in other valuations such as the valuation of</p>
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			stock options, particular class(es) of stock, or debt.
<i>IVS 230 (Inventory)</i>	31 January, 2022	None	See the attachment (1)
Insertion in and deletion of <i>Introduction IVS 400 (Real Property Interests)</i> , Paragraph 20.	31 January, 2022	<p><b>20.1.</b> Property interests are normally defined by state or the law of individual jurisdictions and are often regulated by national or local legislation. Before undertaking a valuation of a real property interest, a valuer must understand the relevant legal framework that affects the interest being valued.</p> <p><b>20.2.</b> A real property interest is a right of ownership, control, use or occupation of land and buildings.</p>	<p><b>20.1.</b> Property interests are normally defined by state or the law of individual jurisdictions and are often regulated by national or local legislation. In some instances, legitimate individual, communal/community and/or collective rights over land and buildings are held in an informal, traditional, undocumented and unregistered manner outside of a modern land administration and governance system. Before undertaking a valuation of a real property interest, a valuer must understand the relevant legal framework that affects the interest being valued.</p> <p><b>20.2.</b> A real property interest is a right of ownership, control, use or occupation of land and buildings. A real property interest includes informal tenure rights for communal/community and or collective or tribal land and urban/rural informal settlements or transition economies, which can take the form of possession, occupation and rights to use.</p>

## IVS 230 Inventory

Contents	Paragraphs
Overview	10
Introduction	20
Bases of Value	30
Valuation Approaches and Methods	40
Market Approach	50
Income Approach	60
Cost Approach	70
Special Considerations for Inventory	80
Identification of Value-Added Processes and Returns on Intangible Assets	90
Relationship to Other Acquired Assets	100
Obsolete Inventory Reserves	110
Unit of Account	120

### 10. Overview

- 10.1. The principles contained in the General Standards apply to *valuations* of inventory and *valuations* with an inventory component. This standard contains additional requirements for *valuations* of inventory.

### 20. Introduction

- 20.1. Inventory broadly includes goods which will be used in future production processes (ie, raw materials, parts, supplies), goods used in the production process (ie, work-in-process), and goods awaiting sale (ie, finished goods).
- 20.2. This standard focuses on *valuation* of inventory of physical goods that are not real property, as the numerous and varied aspects of real property inventory were not considered or contemplated in the preparation of this standard. The *valuation* of real property is covered in IVS 400 *Real Property Interests*.
- 20.3. While the book value of inventory only includes historical costs, the profits earned in the production process, which reflect returns on the *assets* utilised in manufacturing (including working capital, property, plant, and equipment, and intangible assets), are not capitalised into book value. As a result, the *market value* of inventory typically differs from, and is usually higher than, the book value of inventory.
- 20.4. As inventory is seldom transacted at an interim stage (eg, work-in-process) or *may* not be frequently sold to a third party to conduct the selling effort (eg, finished goods sold via distributor networks), the valuation techniques and considerations for inventory frequently vary from those of other *assets*.
- 20.5. Inventory valuations are performed for a variety of *purposes*. It is the *valuer's* responsibility to understand the *purpose* of a *valuation* and whether the inventory *should* be valued, whether separately or grouped with other

assets. A non-exhaustive list of examples of circumstances that commonly include an inventory valuation component is provided below:

- (a) For financial reporting *purposes*, *valuations* of inventory are often required in connection with accounting for business combinations, asset acquisitions and sales, and impairment analysis.
- (b) For tax reporting *purposes*, inventory valuations are frequently needed for transfer pricing analyses, estate and gift tax planning and reporting, and ad valorem taxation analyses.
- (c) Inventory valuation *may* be the subject of litigation, requiring valuation analysis in certain circumstances.
- (d) *Valuers* are sometimes asked to value inventory as part of general consulting, collateral lending, transactional support engagements and insolvency.

### **30. Bases of Value**

- 30.1. In accordance with IVS 104 *Bases of Value*, a *valuer must* select the appropriate *basis(es) of value* when valuing inventory.
- 30.2. Often, inventory valuations are performed using *bases of value* defined by entities/organisations other than the IVSC (some examples of which are mentioned in IVS 104 *Bases of Value*) and the *valuer must* understand and follow the regulation, case law, and other interpretive guidance related to those *bases of value* as of the valuation date.

### **40. Valuation Approaches and Methods**

- 40.1. The three valuation approaches described in IVS 105 *Valuation Approaches* can all be applied to the *valuation* of inventory. The methods described below simultaneously exhibit elements of the cost approach, market approach, and income approach. If necessary for the *valuer* to classify a method under one of the three approaches, the *valuer should* use judgement in making the determination and not necessarily rely on the classification below.
- 40.2. When selecting an approach and method, in addition to the requirements of this standard, a *valuer must* follow the requirements of IVS 105 *Valuation Approaches*, including para 10.3.

### **50. Market Approach**

- 50.1. The market approach, ie, reference to market activity involving identical or similar goods, has only narrow direct application for the *valuation* of inventory. Such applications typically include 1) inventory of commoditised products, or 2) inventory in which a market exists for the inventory at an interim stage in the production process. For non-commodity traded products or products that a market exists at an interim production stage, such selling prices *must* be adjusted downward to account for the disposal effort and related profit.
- 50.2. While the market approach is not directly applicable in most instances, *valuers should* consider market-based indications to determine the selling price as an input for other methods.

- 50.3. Other observable markets *may* provide insights on the returns attributable to the manufacturing and disposition of *assets* that can also be leveraged for inputs into other methods. Such returns are typically considered to exclude returns attributable to intellectual property. For example:
- (a) Distributor profit margins represent a meaningful market proxy for returns on the disposition process, if an appropriate base of comparable companies is identified.
  - (b) Contract manufacturers, to the extent available, *may* provide a proxy for margins earned through the manufacturing process.
- 50.4. *Valuers must* comply with paras 20.2 and 20.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the market approach to the *valuation* of inventory. In addition, *valuers should* only apply the market approach to value inventory if both of the following criteria are met:
- (a) information is available on arm's length transactions involving identical or similar inventory on or near the valuation date, and
  - (b) sufficient information is available to allow the *valuer* to adjust for all *significant* differences between the *subject* inventory and those involved in the transactions.
- 50.5. Where evidence of market prices is available, *valuers should* make adjustments to these to reflect differences between the *subject* inventory and those involved in the transactions. These adjustments are necessary to reflect the differentiating characteristics of the *subject* inventory and those involved in the transactions. Such adjustments may only be determinable at a qualitative, rather than quantitative, level. However, the need for *significant* qualitative adjustments *may* indicate that another approach would be more appropriate for the *valuation* (see IVS 105 *Valuation Approaches and Methods*, paras 10.1-10.10).

## 60. Income Approach

- 60.1. The *valuation* of inventory using the income approach requires the allocation of profit (value) contributed pre-valuation date versus the profit (value) contributed post-valuation date.
- 60.2. *Valuers must* comply with paras 40.2 and 40.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the income approach to the *valuation* of inventory.

### **Top-Down Method**

- 60.3. The top-down method is a residual method that begins with the estimated selling price and deducts remaining costs and estimated profit.
- 60.4. The top-down method attempts to bifurcate the efforts, and related value, that were completed before the measurement date versus those efforts that are to be completed after the measurement date.
- 60.5. The key steps in applying the top-down method are to:
- (a) Estimate the selling price. The *valuer should* rely on direct observations of selling prices when the information is available. However, such data is

often not available and the selling price is often estimated by applying an appropriate gross profit margin to the net book value of finished goods at the product level or aggregate level. Typically, the projected gross profit margin in the period the inventory will be sold is used.

- (b) Estimate the *costs to complete* (for work-in-process only). Completion costs *should* include all of the expenditures directly or indirectly remaining to be incurred post-valuation date in bringing the work in progress inventory to its finished condition. *Costs to complete should* be adjusted to remove expenses benefitting future periods.
  - (c) Subtract the *costs of disposal*. *Costs of disposal* represent *costs* that would be incurred post-valuation date in order to deliver the finished goods to the end customer. *Costs of disposal should* be adjusted to remove expenses benefitting future periods. Disposal costs generally include selling and marketing expenses while procurement and manufacturing expenses have typically already been incurred for finished goods inventory. In order to properly determine *costs of disposal*, each expense in the inventory cycle (including indirect overhead) *should* be categorised as having been incurred and, therefore, contributed to the *value* of the finished goods inventory or remaining to be incurred during the disposal process.
  - (d) Subtract the profit allowance on the completion effort (for work-in-process only) and the disposal process. An initial starting point *may* be to utilise the operating profit of the company. However, this methodology assumes the profit margin would be proportional to the *costs* incurred. In most circumstances there is rationale to assume profit margins which are not proportional to *costs* (see section 90).
  - (e) Consider any necessary holding costs. Holding costs *may* need to be estimated in order to account for the opportunity cost associated with the time required to sell the inventory. Additionally, the *valuer should* consider the risk born during the holding period when determining the required rate of return. Risks *may* be a function of the length of inventory life cycle and the contractual arrangements with end customers (eg, manufacturer bears the risk of fluctuation in *costs of completion and disposal*). Holding costs *may* be immaterial if the inventory turnover is high and/or the borrowing rate is low.
- 60.6. When determining the *cost to complete*, *costs of disposal* and profit allowance, the *valuer should* identify and exclude any expenses that are intended to provide future economic benefit and are not necessary to generate the current period revenue. Examples of future-benefit expenses *may* include research and development (R&D) related to new product development; marketing for a new product; recruiting to increase the size of the workforce; expansion into a new territory; depreciation of an R&D facility dedicated to future research; or restructuring costs.
- 60.7. Internally developed intangible assets *should* either be modelled as 1) a *cost* as if they were hypothetically licensed, and therefore included in either the *cost of production or disposal*, or 2) considered as part of a functional apportionment when determining the appropriate profit allowance.
- 60.8. When utilising the top-down method, *valuers should* consider whether sufficient data are available to appropriately apply the key steps. If sufficient

data is not available, it *may* be appropriate to apply other methods or techniques.

- 60.9. The *valuer may* use the bottom-up method (see para 60.10) to corroborate the *value* derived from the top-down method (see paras 60.3 to 60.9).

#### **Bottom-Up Method**

- 60.10. The key steps in applying the bottom-up method are to:

- (a) Determine the book value of the *subject* inventory. The book value *may* need to be adjusted for multiple considerations (see para 70.4 and section 110).
- (b) Add any *cost* of buying and holding already incurred.
- (c) Add any *cost* toward completion already incurred. Such *costs* typically include procurement and manufacturing expenses
- (d) Add profit on total *costs* already incurred. An initial starting point *may* be to utilise the operating profit of the company. However, this methodology assumes the profit margin would be proportional to the *costs* incurred. In most circumstances there is rationale to assume profit margins which are not proportional to *costs* (see section 90).

- 60.11. When determining the *costs* already incurred, *valuers should* consider internally developed intangible assets that have contributed toward the completion effort.

### **70. Cost Approach**

- 70.1. The primary method to value inventory is the replacement cost method. Raw materials inventory is typically valued using the current replacement cost method.
- 70.2. *Valuers must* comply with paras 60.2 and 60.3 of IVS 105 *Valuation Approaches and Methods* when determining whether to apply the cost approach to the *valuation* of inventory.

#### **Current Replacement Cost Method**

- 70.3. The current replacement cost method (CRCM) *may* provide a good indication of *market value* if inventory is readily replaceable in a wholesale or retail business (eg, raw materials inventory).
- 70.4. The *market value* of raw materials and other inventory *may* be similar to the net book value as of the valuation date but certain adjustments *should* be considered.
- (a) The book value *may* need to be adjusted to FIFO basis.
  - (b) If raw material prices fluctuate and/or the inventory turnover is slow the book value *may* need to be adjusted for changes in market prices.
  - (c) The book value of raw materials *may* also be decreased to account for obsolete and defective goods.

- (d) The book value *may* also need to be decreased for shrinkage, which is the difference between inventory listed in the accounting records and the actual inventory due to theft, damage, miscounting, incorrect units of measure, evaporation, etc.
- (e) The book value *may* need to be increased for any costs incurred in connection with raw material preparation (eg, purchasing, storage and handling).

## **80. Special Considerations for Inventory**

- 80.1. The following sections address a non-exhaustive list of topics relevant to the *valuation* of inventory.
  - (a) Identification of value-added processes and returns on intangible assets (section 90).
  - (b) Relationship to other acquired assets (section 100).
  - (c) Obsolete inventory – reserves (section 110).
  - (d) Unit of account (section 120)

## **90. Identification of Value-Added Processes and Returns on Intangible Assets**

- 90.1. The *valuation* of inventory involves an allocation of profit between the profit earned pre-measurement date and the profit earned post-measurement date. In practice, profit earned *may* not be proportional to expenses. In most cases the risks assumed, value added, or intangibles contributed to the inventory pre-measurement date are not the same as those contributed post-measurement date.
- 90.2. *Valuers* typically *should* not simply allocate profit in proportion to disposition and manufacturing costs. This assumption can misallocate profit, as it presupposes that a company's production process earns profit on a pro-rata basis based on *costs* incurred. For manufacturers, this method is inappropriate if the *costs* of materials represent an initial outflow without significant efforts. Such an assumption also fails to recognise the contribution of internally-generated intangible assets with minimal associated costs.
- 90.3. *Valuers should* distinguish between value-added costs and those that are not value-added. The materials portion of COGS may not be a value-added cost because it does not contribute any of the profit to the inventory.
- 90.4. For a company that owns internally developed intangible assets that contribute to an increase in the level of profitability, the return on and of those intangible assets would be included in the total profit margin of the business. However, whether intangible assets are owned or licensed, the *market value* of the inventory *should* be the same.
- 90.5. The *valuer should* determine the extent to which the technology, trademarks, and customer relationships support the manufacturing and distribution processes and whether the returns are applicable to the entire base of revenue. If the intangible asset has been utilised to create the inventory (eg, a manufacturing process intangible), then the *value* of the inventory would

be increased. Conversely, if the intangible asset is expected to be utilised in the future, at the time of disposal, the *value* of the inventory would be decreased.

- 90.6. For marketing intangibles, the determination of whether the intangible is an attribute of the inventory *may* be difficult. To assist with the determination, the *valuer may* consider how the inventory would be marketed by a market *participant* to its customers – pull vs push model. A push model requires significant disposal efforts for inventory and is less reliant on marketing intangibles, while a pull model depends on strong brand development and recognition to pull customers to the product.
- 90.7. A non-exhaustive list of other considerations for evaluating when intangible assets are contributed *may* include the amount of marketing spend, whether products are sold through a distributor, level of attrition for customer relationships, and any legal rights associated with the intangible assets.
- 90.8. In some cases, the intangible asset may consist of several elements that contribute to various aspects of the value creation, such as a pharmaceutical product intangible asset that is comprised of technology and tradename. This requires an assessment of how the overall profit related to each element of the intangible asset *should* be apportioned to manufacturing the inventory versus in the disposal effort.
- 90.9. Similarly, although a single intangible asset may only contribute to either the manufacturing or disposal effort, it is possible for a portion of the intangible to be contributed pre-measurement date and a portion contributed post-measurement date. For example, when assessing the contribution of symbolic IP for finished goods, although the product bears the respective branding associated with the symbolic IP, the related right to sell the branded product *may* not be conveyed with the transfer of inventory. As such, it *may* be appropriate to consider such rights in the *costs* of disposal.

#### **100. Relationship to Other Acquired Assets**

- 100.1. The *valuer should* maintain consistency, as appropriate, between assumptions used in the inventory valuation relative to *valuation* of other assets or liabilities.

#### **110. Obsolete Inventory Reserves**

- 110.1. The *valuer should* account for obsolete inventory reserve balances. The inventory reserve balances *should* be applied to the inventory in which the reserve applies, rather than netted against the entire inventory balance.
- 110.2. Typically, the obsolete inventory adjusted for the inventory reserve would not be valued as it has been adjusted to net realisable value. However, the *valuer may* need to consider further write-downs if *market value* is lower than net realisable value.

#### **120. Unit of Account**

- 120.1. For *purposes* of inventory valuation, it is often appropriate to assume inventory is one homogenous set of assets. However, it is possible for the profit margins, risk, and intangible asset contributions to vary by product or product group.

- 120.2. If the profit margins, risk, and intangible asset contributions vary by product or product group, and the relative mix of inventory being valued does not match the assumed sales mix used to develop the assumptions for the *valuation*, the *valuer should* assess the different groups of inventory separately.