

Fair and square

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Alexander Aronsohn lays out the different meanings of fair value and the importance of distinguishing between them

It is rare to find a technical term capable of having two quite distinct meanings. But as the global [RICS Valuation ? Professional Standards 2014 \(the Red Book\)](#) records, there are currently two recognised definitions of fair value and so it is vital that the valuer explicitly states which is being used in each individual valuation assignment. The two definitions are:

- "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." Adopted by the International Accounting Standards Board in [International Financial Reporting Standard 13](#)
- "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." Adopted by the International Valuation Standards (IVS) Council in [International Valuations Standards 2013](#) .

Although the overall context and particular purpose for which the valuation is being prepared should make the choice straightforward, as Valuation Practice Statement (VPS) 1.5.2 in the Red Book emphasises, it is essential that "the valuer establishes the correct definition for the purpose and sets it out in full in the terms of engagement and the report."

Definition of fair value

As the IVS recognises, in paragraph 39 of the IVS Framework, and the Red Book supports, the International Financial Reporting Standards (IFRS) definition of fair value is generally consistent with the definition of market value, which is:

"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."

More detail on valuations for financial reporting in a global context is to be found in IVS 300 and in Red Book VPG Applications 1. As IVS 300 cautions:

"Valuations for inclusion in financial statements require particular care as they must comply strictly with the applicable financial reporting standards adopted by the entity."

It further states that:

"In all cases, valuers are reminded that both IFRS and non-IFRS financial reporting standards continue to evolve ? they should always refer to the standards current at the date to which the financial statements relate."

Bearing in mind that auditors in conjunction with management ultimately take responsibility for the interpretation and adoption of accounting related valuations, it is good practice to discuss the precise interpretation of fair value at the valuation engagement stage.

Valuers are therefore advised to clarify at the outset with their clients (and ideally with the clients' auditors) which accounting regime they are to adopt and the level and degree of valuation work and later disclosure required to accompany the valuation to ensure that the precise accounting prerequisites and responsibilities are met.

Purpose of valuation

Turning to fair value, where the purpose of the valuation is other than financial reporting, the end result may show some distinct variance from market value. This is because the IVS definition of fair value includes the phrase "that reflects the respective interests of those parties". This means that one is not looking at the market as a whole, but at the specific circumstances of the two parties to the hypothetical transaction. So, in some cases the IVS-defined fair value can have a higher value than market value, for example if a special purchaser is involved, the latter being defined in IVS and the Red Book as "A particular buyer for whom a particular asset has a special value because of advantages arising from its ownership that would not be available to other buyers in a market." When undertaking valuations of this nature, valuers will need to be careful to identify and have due regard to the two parties' circumstances and motivations.

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An additional note of caution should be sounded. Clauses may be found in shareholder and other commercial agreements that make reference to "fair value" but do not in fact intend that one or other of the definitions above, i.e. the IFRS accounting standards definition or the IVS valuation standards definition, be followed. In such cases, the specific provisions and context of such clauses must always be carefully examined in order to determine the intended meaning. Similarly, caution must also be exercised when other seemingly similar phrases, e.g. fair market value are used ? they must again not be confused with the IFRS and IVS definitions.

In relation to recent changes in financial reporting requirements for the UK and the Republic of Ireland (UK GAAP) it should be noted that Red Book sections have been rewritten in order to reflect new accounting standards that became mandatory on 1 January 2015, and with mandatory application to entities with accounting periods beginning on or after that date.

The new standards affect [UKVS 1](#) and UK appendices [1](#), [2](#), [4](#) and [6](#). More detail is given in the [revised introduction](#) but users are advised to review the complete text of the affected portions.

Finally, it should also be noted that Valuation for Financial Statements is a specialist area

and that [PS2](#) of the Red Book on ethics, competency and disclosure states in paragraph 3.1:

"The test of whether an individual is appropriately qualified to accept responsibility for or supervise the inputs into a valuation, involves satisfying the following criteria:

- appropriate academic/professional qualifications, demonstrating technical competence
- membership of a professional body, demonstrating a commitment to ethical standards
- sufficient current local, national and international (as appropriate) knowledge of the asset type and its particular market, and the skills and understanding necessary, to undertake the valuation competently
- compliance with any country or state legal regulations governing the right to practise valuation
- where the valuer is a member of RICS, compliance with the RICS valuer."

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Further information

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- Related competencies include: [Valuation](#)
- This article was taken from the RICS *Property journal* (March/April 2015).