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## PHYSICAL INSPECTION OF ASSETS FOR VALUATION

Valuation of assets is the process of determining the value of assets, considering factors such as market conditions, asset condition, and regulatory environment.

Asset valuation is one of the important factors which impacts investment decisions, financial reporting, and risk management strategies. A correct asset valuation is vital for prudent decision making in finance, including investment strategies and risk management.

### **Factors influencing asset valuation:**

#### **Market conditions:**

Market conditions refer to the prevailing economic environment, including factors such as supply and demand dynamics, interest rates, inflation, and overall economic growth. Variation in these factors can significantly change asset values. For instance, during periods of high demand and limited supply, asset prices tend to rise, whereas, during economic downturns, prices may decline due to decreased demand.

Full knowledge of current market conditions is crucial for correct valuation of assets, as it provides background for assessing their worth relative to prevailing economic trends.

#### **Asset Condition:**

The physical condition of an asset plays a vital role in determining its value. Assets that are well maintained and in good condition typically command higher prices than those that are dilapidated or in need of repair. Factors such as wear and tear, maintenance history, age, and functionality are considered when assessing asset condition. A meticulous evaluation of the asset's physical state is necessary to accurately determine its value, as it provides accurate and deep understanding of potential maintenance costs, depreciation rates and future performance.

#### **Regulatory Environment:**

The regulatory environment refers to the legal and regulatory framework governing asset valuation practices. Different locations may have varying regulations which can impact valuation methodologies, reporting requirements, and compliance obligations. For example, regulatory changes related to accounting standards or tax laws can affect how assets are valued and reported on financial statements. It's essential for valuation professionals to stay abreast of regulatory developments and ensure compliance with applicable laws and standards when valuing assets.

Understanding these factors and their interplay is crucial for conducting accurate asset valuations. Market conditions, asset condition and the regulatory environment all influence the determination of asset values and must be carefully considered by valuation professionals to ensure fair and reliable valuations.

## What is physical inspection?

Physical inspection involves conducting on- site examinations of assets to assess their condition, quality and usability. It allows valuation professionals to directly observe the physical characteristics of assets, such as their structural integrity, maintenance status and overall condition. This unmediated approach of getting first-hand information about the assets makes the valuer stand in the better position than other valuation methods such as desktop reviews and financial analysis alone.

Through physical inspection valuer gets complete knowledge about the asset and this helps him to reach a correct valuation which has enduring accuracy and strong reliability.

By physically inspecting assets, evaluators can identify any discrepancies between reported and actual conditions, verify assets specifications and assess factors such as wear and tear, damage, or obsolescence.

What are the current IVS requirements on inspection?

In the general standards IVS 101 scope of work, IVS states as follows in relation to inspection:

"20. Valuation Requirements

20.01 The scope of work must specify the following:

...

(i) The nature and extent of the valuer's work and any limitations thereon: In the valuation process any restrictions or limitation imposed on the valuer with regard to inspection, enquiry and /or analysis in the value must be pointed out. These limitations and restrictions are of two types:

1. Restrictions due to conditions imposed by the client.

2. Restrictions due to circumstances beyond control.

Valuer must clearly make a mention of the restriction or limitation in the report.

...

This is extended by the following paragraphs within the tangible asset standard series( being IVS 300 Plant, Equipment and Infrastructure, IVS 400 Real Property Interest, and IVS 410 Development Property ) when considering investigations and evidence.

"Sufficient investigations and evidence must be assembled by means such as inspection, inquiry, research, computation or analysis to ensure that the valuation is properly supported. Valuer makes a professional judgement for determining the required level of investigation and evidence to ensure accurate valuation...

...

" If, during the course of a assignment, it becomes clear that the investigations or limitations included in the scope of work will not result in a credible valuation, or information to be provided by third parties is either unavoidable or inadequate, or limitations on investigations such as inspection are so substantial that it will not result in a valuation outcome that is adequate for the purpose of the valuation, the valuation must explicitly state that the valuation is not in compliance with IVS ( see IVS 100 Valuation Framework, section 40 and IVS 101 Scope of work, para 20.03)"

And finally, within the General Standards, IVS 106 makes it explicit within paragraph 30.06 that:

"30.06 Valuation reports must convey the following, at a minimum:

(a) Agreed scope of the work,

....

(l) sources and selection of significant data and inputs used,

..."

For IVS compliant valuation, IVS promotes transparency in relation to inspection but it does not mandate physical inspection.

During the process of valuation, physical inspection of asset is one of the common ways for the valuer to conduct investigations and assemble evidence, with the intention of ensuring that the valuation is properly supported.

While starting the valuation process, valuer makes a professional judgment with regards to-requirement/extent of investigation and evidence needed for completing the valuation. The valuer should clearly state as to why the chosen type of inspection/investigation and evidence is most suitable for use in order to provide an IVS compliant valuation.

Important points which need to be taken care while inspecting the asset.

1. Proper planning of inspection visit should be done, before proceeding for the visit, copies of ownership documents of the property, copies of approved plan/floor plan etc. should be obtained.

2. A meeting should be held with the customers/ owner of the property and address/location/identification of the property should be ascertained from him. The map of the way to reach to property, boundaries of the property, landmark near the property, positive or negative feature of the property or its neighborhood should also be ascertained.

3. During the inspection the asset which is to be valued should be identified properly. Care should be taken that exactly the same property for which the documents are provided by the client is inspected and valued.

4. The valuer should carefully observe the elements affecting the valuation of the property like presence of Nallah/river, high tension cables, dumping sites of waste, low lying area with risk of flood, flood prone area, pest prone area, water quality and availability, communication, digital connectivity, roads availability and its wideness, quality of population in the area and note the same.

5. Photographs of the asset/property should be taken at site for use in reports. Valuer should ensure that a photograph of the owner of property with valuer at site is also captured for record.

In Case of Plant & Machinery:

Copies of invoice, insurance, warranty/guarantee card, details of availability of after sale service etc. to be called for and valuer should go through the same before going for inspection.

During the inspection, the plant and machinery should be properly inspected and the detail of the same should be compared and confirmed with the copies of invoice or the description provided by the client from their books.

In case of Securities or Financial Assets:

Visit to the office of the company is not necessary for valuation of Securities or Financial Assets, more particularly if company is reputed or well known. However, inspection visit to the company's office gives a proper understanding of its status and the valuer becomes aware of its level of activities and whether it is a running or defunct concern. It is more important if it is a new venture or a start-up.

Reference:

1. IVSC Perspective Paper – Inspections
2. Various Websites

