

# GLOBAL VALUATION ISSUES

**IVSC**



## MESSAGE FROM THE CHAIRMAN

It is a great privilege to be IVSC chairman for the next three years. The hard work in producing a comprehensive set of International Valuation Standards (IVS) will be complete with the April publication of the new edition of the IVS. This will be freely available on the IVSC web site. The IVSC now needs to take a further quantum leap forward building on the success of the past three years. Promotion of the standards and harmonisation of national and international valuation standards are two key themes for my chairmanship.

The growing demand and acceptance of the IVS is due largely to the development of other international standards, notably the International Accounting Standards (IAS). Outright adoption of IAS or convergence with these standards is now a global phenomenon that is rapidly gathering pace. Australia, Russia, the European Union, Estonia, Ukraine, several countries in the Middle East and Africa, and others have decided on a wholesale, mandatory change to IAS. The USA, South Africa, Singapore, Turkey and Malaysia, to name but a few are committed to convergence with the international benchmark.

The change to IAS is complex for the many companies concerned but opens opportunities for the valuation profession. We must be confident in our ability to prepare clients for the challenge and to smooth the way for IAS transition.

So, as valuers we need to ensure that we are aware of the requirements of IAS as they impact on asset valuation and the changes these may impose on current valuation practice carried out under our national standards.

The 'unique selling point' of the IVS is that they have been developed to accord with the IAS. Deloitte Touche Tohmatsu recognise this in their 2002 Model IAS Illustrative Financial Statements. These state that the valuations of both property, plant and equipment, and of investment property, conform to International Valuation Standards.

**JOHN EDGE** FRICS  
IVSC Chairman

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# IVSC 2003



## ELECTIONS

A number of elections took place at the 2002 Annual General Meeting of the IVSC. John Edge, **UK** representative, became IVSC chairman for the three years 2002-2005. In accepting the position, John paid tribute to his predecessor, Greg McNamara, **Australia**. Greg has been a member of the IVSC Management Board for the past 12 years with the last three as chairman. Under his chairmanship the IVSC had initiated and all but completed the three-year Standards Project. The success of the Project, John concluded, was due in large part to Greg's wisdom, influence and non-controlling style as IVSC Chairman.

Joe Vella (**USA**) and Elvin Fernandez (**Malaysia**) were appointed as IVSC Vice-Chairmen, with Joe Vella as Chairman-Designate, for the next year. Chairman of the IVSC Standards Board is to be John Dunckley (**New Zealand**) with Julio Torres Coto (**Mexico**) as vice chairman.

Interest in IVSC Board membership continues to grow. The annual election for Elected Board members saw **Romania** represented by the National Association of Romanian Valuers, and **Thailand** represented by the Thai Valuers Association, re-elected as Board members for a further three-year period. **Hong Kong SAR, China** represented by the Hong Kong Institute of Surveyors, and Korea represented by the **Korea** Appraisal Board, were elected as Board members for the first time for a three-year period.

**STRENGTHENING THE IVSC GLOBAL PRESENCE**  
Once again a number of countries sought closer involvement with the IVSC at the 2002 AGM. **Austria**, represented by the Austrian Institute of Property Valuation and Valuation Standards, **Slovenia**, represented by the Slovenian Institute of Auditors, and **Turkey**, represented by the Appraisers' Association, were admitted as IVSC Members. The **Barbados** Association of Professional Valuers was admitted as an Observer and the **Palestinian** Auditors and Accountants Association as a correspondent. A new organisation, the Lithuanian Association of Property and Business Valuation Enterprises (LTVVIA) will represent **Lithuania** on the IVSC with current member, the Lithuanian Association of Property Valuers as associate.

## IVS 2003

The new edition of IVS to be available in April is the final edition to be prepared under the IVSC Standards Project. The Project had as an objective the preparation of a set of comprehensive and robust international standards by 2002. Editions of the standards were published in both 2000 and 2001 under the Project. It is anticipated that the new edition will remain unchanged for a period of stability (unless of course changes are forced by the requirements of related international standard setters). To allow maximum time for review and comment, and to ensure that the new edition fully reflected the changes to the International Accounting Standards due to be published in 2003, the IVSC Management Board agreed to a 2003 rather than 2002 publication date.

The new edition will contain a number of editing changes, particularly to reduce the repetition in the text. Blacklining, i.e. the use of bold type to indicate the main principles, is to be introduced to make the IVS more user-friendly. However, the introduction will emphasise that paragraphs in both bold and plain type have equal authority. Commentaries will no longer be published as part of the Standards but will be available separately.

Other changes are:

- A new standard, IVS 3 **Valuation Reporting**, is to be introduced. The reporting of the valuation is considered as essential and fundamental as the valuation process. This decision also ensures that the IVS are in line with standards of other major national standard setters and thus promotes convergence.
- IVA 1 **Valuation for Financial Reporting** has been subject to a number of changes, some of which are to ensure consistency with the International Accounting Standards.
- Following issue of exposure drafts, new Guidance Notes are to be included on:
  - **Depreciated Replacement Cost**
  - **Discounted Cash Flow Analysis**
  - **Reviewing Valuations**
  - **Personal Property Valuation**
  - **Agricultural Valuation**, which discusses the implications of International Accounting Standard, IAS 41, Agriculture

## IVSC WORK PROGRAMME

Progress on other issues on the IVSC work programme is as follows:

- Exposure Draft IVA 3, **Valuation for Financial Reporting of Public Sector Assets** is expected to be issued during February. Just as IVA 1, Valuation for Financial Reporting discusses the requirements of the International Accounting Standards, IVA 3 is drafted in the context of the requirements of the International Public Sector Accounting Standards.
- An exposure draft guidance note on **Specialised Trading Properties** has been prepared and should be available shortly.
- **Mass Appraisal**. The IVSC Standards Board is to consider responses to the Exposure Draft issued in August 2002. The draft currently covers Mass Appraisal for Property Taxation. The Board will discuss whether the coverage should be expanded and the most appropriate way in which to publish the guidance.
- **Valuation of Mortgage Portfolios for Securitisation Purposes**. An Exposure Draft was issued in July 2002. This draft was the first instalment of an ongoing IVSC project on securitisation-related valuation issues. Comments to date on the exposure draft have focused on two issues raised in the ED – the concept of sustainable net asset value and the proposed sample checklists. The IVSC is seeking additional industry input before proceeding further with this topic.
- **Extractive Industries**. Work is underway within an Expert Group to develop valuation guidance for extractive industries. The IVSC Standards Board will receive the first report from the Group at its March meeting.

**ARABIC VERSION OF IVS**

In 1999, USAID initiated a program to facilitate the adoption of internationally accepted accounting and auditing standards in the West Bank and Gaza. In 2001 the chief of the project requested permission to translate IVS into Arabic in support of the project. This request was readily granted and the translation was released by the USAID program together with the Palestinian Association of Accountants and Auditors in mid-2002. During the period July – September 2002, over 350 people undertook a course on the IVS run as part of the program. The IVSC is now hoping to make the Arabic version freely available on the IVS website.

**WORLD TRADE ORGANISATION CONSULTS WITH IVSC**

The IVSC is one of only 22 international professional services organisations to be consulted by the World Trade Organisation (WTO) as it seeks to reduce restrictions on trade in professional services under the terms of the General Agreement on Trade in Services (GATS). The work of the WTO is focusing on the development of disciplines to ensure that national measures relating to licensing requirements and procedures, technical standards and qualification requirements and procedures to not constitute unnecessary barriers to trade in services. In 1998, WTO Members adopted the Accountancy Disciplines. An important element of the decision was the statement that WTO Members would continue their work, aiming to develop general disciplines for professional services while retaining the possibility to develop additional sectoral disciplines. The WTO is currently consulting on the potential applicability of elements of the Accountancy Disciplines to other professions.

**USE OF INTERNATIONAL VALUATION STANDARDS ENCOURAGED**

Deloitte Touche Tohmatsu encourages the use of International Valuation Standards with the publication in December 2002 of Model Financial Statements for the year ended 31 December 2002. The model statements address the presentation and disclosure requirements of International Financial Reporting Standards (IFRS), previously known as International Accounting Standards.

The Model Financial Statements carry the statement that the valuations of both property, plant and equipment, and of investment property, conform to International Valuation Standards. This represents a significant change from the 2001 Model Financial Statements produced by Deloitte Touche Tohmatsu. The 2001 Statements referred to revaluation of land and buildings on an open market existing use basis and to revaluation of investment property on an open market basis with no reference to either international or national valuation standards.

The Model Financial Statements for the year ended 31 December 2002 contain the following under the notes to the consolidated financial statements:

**PROPERTY, PLANT AND EQUIPMENT**

*Land and buildings were revalued at 31 December 2002 by Messrs. Lacey & King, independent valuers not connected with the Group, on the basis of market value. The valuation conforms to International Valuation Standards.*

**INVESTMENT PROPERTY**

*The fair value of the Group's investment property at 31 December 2002 has been arrived at on the basis of a valuation carried out at that date by Messrs R P Trent, independent valuers not connected with the Group. The valuation, which conforms to International Valuation Standards, was arrived at by reference to market evidence of transaction prices for similar properties.*

John Edge, IVSC Chairman welcomed the publication, "The IVSC has long maintained that use of International Valuation Standards can help in the rigorous and consistent application of International Financial Reporting Standards (IFRS). Valuers who are called upon to prepare a valuation for IFRS accounts should be aware that the auditing profession may require the valuation under International rather than national valuation standards."

The **Model Financial Statements and Presentation and Disclosure Checklist** reflecting International Financial Reporting Standards and Interpretations effective for 2002 and the third edition of **International Financial Standards: A Practical Guide** are available on the Deloitte Touche Tohmatsu web site – [www.iasplus.com](http://www.iasplus.com)

**EUROPEAN REAL ESTATE INDUSTRY SUPPORTS IVS**

In October 2001 the Best Practices Committee of the European Real Estate Association (Epra) published the Best Practices Policy Recommendations. One of Epra's goals is to assist in pushing the industry forward by making the financial statements of public real estate companies in Europe clearer, more transparent and comparable across Europe so that the Epra members, collectively and individually, improve the reception amongst the investment community.

To encourage the improvement of the quality of reporting by real estate funds, Epra decided to introduce the Award for the Best Annual Report, sponsored by PGGM, a pension fund for the health and welfare industry in the Netherlands. The first award was presented in September 2002 and Epra has issued the report of the 'jury' who examined the entries. In deciding the award, two areas identified in the best practices policy recommendations were looked at specifically: (i) accounting and valuation issues and (ii) additional disclosure.

The jury noted that Epra is not in a position to dictate specific accounting treatment or valuation approaches and therefore Epra refers members to relevant

accounting bodies and to the International Valuation Standard Committee. It also notes that accounting standards are in a state of transition from national standards to International Accounting Standards (IAS), and that Epra is seeking to help that transition by encouraging consistent, supplemental reporting of income and of net asset values and fair value reporting of other assets and liabilities.

The jury identified eight 'mortal sins' based on the Epra recommendations. Mortal sins are the omission of those items which, according to the jury, have to be present in an annual report of a real estate fund in order to provide a minimum required insight and transparency to the reader of the report in the light of comparison with other real estate funds' annual reports. Annual reports that committed these mortal sins were not considered candidates for the 2002 Best Annual Report Award.

The mortal sins are:

- 1 If fair value is used, all changes in fair value are not recognised in the income statement.
- 2 No adequate disclosure of the chosen valuation principle is included.



- 3 The chosen valuation principle is not applied to all investment property.
- 4 Book value of borrowings is not used in the balance sheet.
- 5 The annual report is not available in English.
- 6 Asset valuation is not performed at least once a year.
- 7 All valuations are not conducted by external appraisers to maximise investors' level of confidence in the objective nature of valuation.
- 8 Balance sheet date of the annual reports submitted should be
- 9 1 January 2001 or later.

In total 75 annual reports were considered for the Award. The winner was German

company, IVS Holding AG; runner up was Swiss Prime Site; with The British Land Company PLC in third place.

One of the issues that the jury considered was whether the choice of valuation principles applied was adequately identified. In the future, the jury is to focus more closely on this issue, looking for all relevant factors to be disclosed, not just some! For investors, this is one of the most important elements in the annual accounts.

To download a copy of the jury's report or the EPRA Best Practices Policy Recommendations, visit the EPRA web site – [www.epra.com](http://www.epra.com)

## INTERNATIONAL ACCOUNTING STANDARDS - AN UPDATE

IASs or IFRSs?

There is some confusion as to whether to talk about International Accounting Standards (IASs) or International Financial Reporting Standards (IFRSs). Officially, any statements of International Accounting Standards issued by the Board of the International Accounting Standards Committee (1973-2001) are designated "International Accounting Standards" (IAS). The International Accounting Standards Board announced in April 2001 that its accounting standards would be designated "International Financial Reporting Standards"

The new preface to IFRSs makes it clear that any reference to IFRSs also includes International Accounting Standards. The change in terminology for financial statements will be required when revised IAS 1 Presentation of Financial Statements comes into effect. The revised Standard will be effective for annual financial periods beginning on or after 1 January 2004 although earlier application is encouraged.

### THE IMPROVEMENTS PROJECT

The IASB in May 2002 published for comment proposals to revise 12 of its 34 active standards in an Exposure Draft, Improvements to International Accounting Standards. Following the consultation, some of the changes agreed by the IASB are:

#### **IAS 16, Property, Plant and Equipment**

- All exchanges of items of property, plant and equipment (regardless of whether the assets are similar) are in future to be measured at fair value, except that when the fair value of neither of the assets exchanged can be determined reliably, the cost of the asset acquired in the exchange is measured at the carrying amount of the asset give up.
- Changes have been made to the disclosure provisions where items of property, plant and equipment are stated at revalued amounts. In future the following must also be disclosed: The methods and significant assumptions applied in estimating the assets' fair values, and the extent to which the assets' fair values were determined directly by reference to observable prices in an active markets or recent market transactions on arm's length terms or were estimated using other valuation techniques.

#### **IAS 17, Leases**

- For a lease of both land and buildings, the land and buildings elements is to be considered separately for the purpose of lease classification, unless title to both elements is expected to pass to the lessee by the end of the lease term. The buildings element should be classified as a finance lease or an operating lease in accordance with the criteria in IAS 17. When the land has an indefinite economic life, the land element is classified as an operating lease unless title passes in accordance with IAS 17, para 11.

#### **IAS 40, Investment Property**

- The definition of investment property is to be changed to permit a lessee to classify a property interest held under an operating lease as an investment property provided that the rest of the definition of investment property is met, the lessee uses the fair value model in IAS 40 and the property interest held under an operating lease is accounted for as if it were a finance lease.



- Commentators also concurred with the IASB recommendation that the choice between the cost model and fair model should not be eliminated in the Improvements Project but that the matter should be kept under review with a view to reconsidering the option to use the cost model in due course.

The IVSC will be reflecting these changes in the International Valuation Standards at the appropriate time.

### FIRST TIME APPLICATION OF IFRS

In July 2002, the IASB issued ED1 First-time Application of International Financial Reporting Standards. The eventual Standard will be crucial to guide those many companies who have to adopt IFRS. The problems faced by an entity that adopts an entire accounting regime for the first time are very different to those faced when adopting individual changes in an existing body of accounting standards. In developing a standards, the IASB had to steer a course between the ideal of full comparability between all IFRS companies and the practical difficulties arising from a huge number of companies moving to IFRS at the same time.

In outline, the ED proposes to allow a company a choice:

**Follow existing requirements** which requires retrospective restatement using the Standards applicable at the date of transactions (and their subsequent revisions and transitional provisions if applicable).

or

**Use the new alternative (an "opening balance sheet approach"):** each IFRS in force at the date of the closing balance sheet in the first IFRS financial statements will be applied for the whole of the period covered by those financial statements, i.e. including all comparative years. No account is taken of standards that were in force in earlier periods. The proposed option is intended to relieve the extensive burden that can arise from restating old business combination transactions and recovering old records of the historical costs of fixed assets in particular.

Companies must now make the critical decision whether to take advantage of the exemptions proposed (in their entirety) or whether the benefits of comparability with existing IFRS preparers outweigh the costs involved.

The ED contains the following specific references to Property, Plant and Equipment

- If determining a cost-based measurement under IFRSs for an item of property, plant and equipment at the date of transition to IFRSs involves undue cost or effort (e.g., if an entity did not maintain a register of property, plant and equipment, reconstructing reliable cost-based measurements for all or some items may involve undue cost or effort) then an entity can measure those items at the date of transition to IFRSs at their fair value and use that fair value as their deemed cost at that date.
- If an entity has revalued an item of property, plant and equipment at or before the date of transition to IFRSs by applying, for example, a general or specific price index to a cost that is broadly comparable to cost determined under IFRSs, or have revalued the items to an amount that is broadly comparable to fair value determined under IFRSs, then these revalued amounts can be treated as deemed cost under IFRSs at the date of the revaluation. Under proposed revisions to IAS 16, the use of price indices to arrive at a revalued amount is no longer permitted.

- In some cases, an entity may have established a deemed cost under previous GAAP for some or all of its assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatization of initial public offering. Such event-driven measurements shall establish a deemed cost at that date for subsequent accounting under IFRSs.

Under the allowed alternative treatment in IAS 16 if an entity revalues an asset, it must revalue all assets in that class. This restriction prevents 'cherry-picking' - selective revaluation of only those assets whose revaluation would lead to a particular result. Similarly an entity will need to be consistent in concluding whether cost-based measurements involve undue cost or effort and not 'cherry-pick'.

The concept of "undue cost or effort" has caused some concern with many believing that it is open to very wide interpretation, leading to conflicting interpretations which would undermine overall reliability and comparability of IFRS financial statements. As a result, the IASB is to issue some discussion into the final IFRS on the meaning based on the Basis for Conclusions issued with the ED. This states that in balancing benefits and costs, the Board's benchmark was an entity that plans the transition well in advance and is able to collect most of the information needed for its opening IFRS balance sheet at, or very soon after, the date of transition to IFRSs.

### THE REVALUATION GROUP

The IVSC is taking a very close interest in the Revaluation Group. Standard-setters and IASB members from those countries that currently permit revaluation of fixed assets (Australia, New Zealand, South Africa and the UK) are represented on the 'Revaluation Group'. This Group has been considering a convergence model to provide a consistent basis of revaluation internationally. The Group presented its recommendations to IASB at its meeting with national standard setters in October 2002, when it was asked to develop the text of a possible amendment to IAS 16, Property, Plant and Equipment. IVSC representatives are meeting with members of the Revaluation Group as this work progresses.

The IVSC is also following the work of a separate group led by the Canadian standard-setter that has been asked by IASB to consider the conceptual foundation that should underpin the measurement of assets. Its work is initially focusing on the basis that should be used when assets are first recognised.

### OTHER ISSUES

#### Business Combinations, Impairment of Assets, Intangible Assets

In December 2002, the IASB published ED 3 *Business Combinations*, and an Exposure Draft of Proposed Amendments to IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*. The most significant proposals are to prohibit the use merger accounting for business combinations and to require that goodwill and other intangible assets with indefinite lives be tested for impairment but not amortised. Current IAS 22, *Business Combinations* includes a benchmark and an allowed alternative treatment for the initial measurement of the identifiable net assets acquired in a business combination. The ED concludes that this 'mixed' measurement approach should no longer be permitted and that all the acquiree's identifiable assets, liabilities and contingent liabilities should be measured at their fair values (the alternative treatment under IAS 22). The IVSC is currently studying the drafts and will be responding to the IASB.

## Performance Reporting

This is a joint UK ASB/IASB project. The main focus of the project is the development of a single statement of comprehensive income, which would report total recognised gains and losses for the period. Of particular interest to the IVSC is the fact that the IASB has tentatively agreed to develop a single statement of comprehensive income with two primary categorisations. The first is the separating of financing from operating; the second is the addition of a second column to capture income or expenses arising whenever an existing asset or liability is remeasured –e.g. when property is revalued. An exposure draft is scheduled for publication in the first half of 2003.

## Insurance Accounting

Present models for insurance accounting world-wide are all different. In discussion over the past year or more, the IASB has considered the difficult issues of definition, measurement and recognition (particularly profit recognition). Because of the complexity of the project, it is to be split into two phases. The first phase will cover what must be done to make it possible for insurance companies (particularly in the EU and Australia) to apply international standards by 2005. The second phase is likely to deal with.

International Financial Reporting Standards -  
Consequences for Investment Funds in Europe

*This is an extract from a report published by Ernst & Young and available on [www.ey.nl](http://www.ey.nl)*

The implementation of IFRS can also have major consequences for investment funds that invest directly in property. Under IFRS, investment funds must value property using one of two methods: the cost model (under which depreciation is based on cost and the fair value is disclosed in the notes) or the fair value model (under which property is valued at fair value without depreciation and all movements in value are taken to the profit and loss account). Most investment funds will opt for the second model, with the consequence that the annual results as reported in the profit and loss account in general will be significantly more volatile than under most of the current local country law and regulations, under which movements in value are usually taken direct to the revaluation reserve. With regard to the deferred taxation on these revaluations, IFRS stipulates that the provision for deferred taxation should be calculated at the standard rate without discounting. In some countries property investment funds that record deferred taxation at its present value, application of IFRS may therefore lead to significantly lower net asset value.

## COUNTRY ROUND-UP

## BULGARIA

As of 1 January 2003, all listed companies, banks, insurance companies, and pension funds in Bulgaria must use International Financial Reporting Standards. Other companies may choose to apply IFRS. Bulgarian GAAP will remain an alternative for them until 2005.

## ESTONIA

A new Estonian law allows domestic companies to use either Estonian GAAP or International Financial Reporting Standards for accounting periods beginning 1 January 2003. Listed companies have already been using IFRS, generally complying at the same time with Estonian GAAP by choosing the accounting policy prescribed by Estonian GAAP where IFRS allows a choice. Estonian credit institutions and insurance companies, as well as listed companies, will be required to apply IFRS as of 1 January 2005.

## EUROPEAN UNION

(1) The European Parliament has approved amendments to the European Accounting Directives that would complement the Accounting Regulation adopted in June 2002. The Regulation requires virtually all 7,000 listed European companies to follow IFRS starting in 2005. The amended Directives would remove inconsistencies of the existing Directives with IFRS and would address accounting by the estimated 5 million European companies that are not subject to the IFRS Accounting Regulation.

(2) Adoption of an Accounting Regulation by the European Union in June 2002 did not, of itself, legally require the 7,000 European listed companies to follow IFRS starting in 2005. Two further steps are required: (1) translation of IFRS into the European languages and (2) endorsement of the IFRS by a new Accounting Regulatory Committee established by the European Commission to give them legal standing in Europe. Both the translation and endorsement processes are now under way. A recent Commission Announcement indicates that their goal for completing both steps is Spring 2003.

## NEW EU MEMBERS

Ten countries have been approved for EU membership as of 1 May 2004: **Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia**. IAS/IFRS are already required in Cyprus and Malta and permitted in several others. If the EU finalises the memberships of these countries, listed companies in all 10 countries will have to adopt IAS/IFRS in 2005.

## EURONEXT

Euronext (the pan-Europe stock exchange combining the exchanges in Amsterdam, Brussels, Lisbon, and Paris) has published rules for transition to IFRS/IAS by its Next Prime and Next Economy listed companies. A company that has not yet adopted IFRS as of the start of 2004 or earlier will be required to disclose, in its second quarter financial statements for 2004 at the latest, information on the effects of applying IFRS on its opening balance sheet of the year 2004 and on its performance.

## FRANCE

The French National Accounting Council (CNC) has released an exposure draft on the definition of assets. The aim is to seek convergence between the current French accounting plan (PCG) and IFRS in this area. The ED comes out a short time after the new text on amortization and depreciation of assets adopted by the CNC in June 2002 and will be followed in the near future by another text giving details on the valuation of these assets. The exposure draft also takes IAS definitions on tangible assets (IAS 16), intangible assets (IAS 38) and stocks (IAS 2).

For further information see [www.finances.gouv.fr](http://www.finances.gouv.fr)

## THE NETHERLANDS

A new accounting standard RJ213 Investment Property has been issued effective for periods beginning on or after 1 Jan. 2003. The standard is almost completely based on IAS 40, Investment Property.

A comparative study of IAS and Dutch law and regulations found a large number of differences particularly for the reporting of property, plant and equipment. One difference discussed in the study is that under the Asset Valuation Decree, the replacement cost, the recoverable amount and the realisable value are mentioned as the possible basis for determining the current value. IAS 16 refers to the fair value as a basis for determining an assets current value. The fair value of land and buildings is the market value. The study is available at [www.ey.nl](http://www.ey.nl)

## NEW ZEALAND

Following consultation, the Accounting Standards Review Board intends to broaden the scope of its earlier decision to recommend to the Government the compulsory adoption of International Financial Reporting Standards (IFRS) by listed issuers by 1 January 2007 and extend the recommendation to both the public and private sectors with entities having the option to adopt IFRSs from 1 January 2005.

## RUSSIA

Russian Finance Minister has announced government approval of a plan to require all listed holding companies in Russia to prepare consolidated financial statements using IFRS starting in 2004. For banks, not only would consolidated statements under IFRS be required starting in 2004, but also individual banks will have to prepare IFRS financial statements in addition to Russian GAAP statements. IFRS reporting would be extended to additional classes of companies in stages through 2007, though not to small companies. At the same time, the Finance Ministry will work to bring Russian GAAP more in line with international accounting standards.

## TANZANIA

All listed companies and non-listed international companies in Tanzania will be required to prepare their financial statements using International Financial Reporting Standards starting in 2004.

## TURKEY

The Capital Market Board, who set standards for publicly traded companies, issued exposure drafts of new accounting standards in Oct. 2002. The new drafts which mirror IFRS would replace existing Turkish accounting regulations.

## UKRAINE

All companies in Ukraine will be required to prepare their financial statements using International Financial Reporting Standards starting in 2003. At present, only banks in Ukraine are required to follow IFRS.

## INTERNATIONAL FEDERATION OF ACCOUNTANTS (IFAC)

### ACCRUAL ACCOUNTING

An increasing number of governments and government entities are adopting, or considering the adoption of, the accrual basis of accounting to enhance the accountability and transparency of the financial statements of governments and government agencies and provide better information for planning, and management purposes.

In April 2002, the IFAC Public Sector Committee published a new study to assist public sector entities with the transition from cash basis to accrual basis of accounting – Study 14, Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities. The study identifies the key issues to be addressed in the migration from the cash to the accrual basis of accounting and alternate approaches that can be adopted in implementing the accrual basis in an efficient and effective manner in the public sector. Chapter 6 of the study deals with 'Assets'. Much of the chapter is devoted to the consideration of property, plant and equipment as most entities have at least some such assets, and they are usually represent a significant proportion of an entity's total assets. The chapter deals with the following valuation issues – valuation policies; instructions for valuers; information required by valuers; selection of valuers; management review of valuations; and examples of approximations. The Study also refers to the work of the IVSC in developing valuation standards.

In January 2003, the **European Commission** indicated that it is going to move its own accounting system from a cash basis to a new accounting framework that will be based on International Public Sector Accounting Standards (IPSAS), including accrual accounting. The **OECD** and **NATO** have also adopted IPSAS for their financial reports.

At its meeting in November 2002, IFAC Public Sector Committee were approving the final draft of an Occasional Paper for publication entitled '**The Modernization of Government Accounting in France**' written by Lionel Varielle of the French Ministry of Finance and Philippe Adhemar of the Cour des Comptes. Accrual accounting is to be adopted for the financial statements of the French central government. by 2006.

Amongst the reasons given for this decision are:

- many governments of major industrial countries are committed to introducing accrual accounting; and
- France cannot ignore the development of International Public Sector Accounting Standards.

Of particular interest to fellow Europeans, the paper quotes the following European influences on the decision by the French government:

- The European System of Accounts (ESA 95) has defined new accounting standards on an accrual basis; and
- ESA 95 adopts an accrual financial reporting framework which can be used to calculate the "Maastricht" budget balance (this is the economic and budget criteria set forth in the Maastricht Treaty).

The paper discusses the benefits of accrual accounting. For example it states that in a cash-based system, fixed assets are recognized at the time they are acquired and are immediately amortized. Information about the existing stock of assets available to support service delivery is therefore not available for the manager. In this environment, it is difficult to, for example, manage the real estate base effectively and make informed decisions about renting or owning a property such as an office building. Under the proposals, a number of non-military properties are to be subject to an annual revaluation.

New public accounting standards are to be proposed by the Ministry of Finance who will consider the existing International Public Sector Accounting Standards as part of the process of developing its recommendations; For further details visit [www.ifac.org](http://www.ifac.org)

**INTERNATIONAL BANKING: THE BASLE CAPITAL ACCORD:  
ITS RELEVANCE TO SECURED LENDING VALUATIONS**

John Rich MA, FRICS

In the spirit of "know your client", enunciated in the 1994 Mallinson Report, it beholds us to know a little of the constraints within which our banking clients operate and the context in which valuations of property collateral are used.

Since 1992 most internationally active banks have observed the Basle Capital Accord. It sets a minimum capital adequacy ratio of 8% of capital to risk weighted assets (RWA). The Accord defines capital and RWA and sets a framework within which it operates and is supervised. Capital adequacy attempts to ensure that banks are always sufficiently solvent to enable depositors to be repaid even in times of economic hardship. Hence a minimum ratio, 8%, is set between the banks capital and the value of its loans, referred to as assets.

Each loan made by a bank does not carry the same measure of risk. For instance a loan made to a Sovereign Government is considered a lesser risk (0 – 10%) to one made to a local trader (100%). So we have the concept of risk weighted assets. Residential mortgages to owner-occupiers get a 50% weighting thus requiring only 4% capital.

Consultations are under way to refine and develop the accord leading towards a new accord, Basle II, scheduled for implementation in early 2007. The aim of Basle II is to encourage banks to be more analytical about the risks they routinely carry and to reward them by allowing lower risk weightings where evidence supports a sound lending record.

Much of the focus of Basle is on Credit risk, i.e. that of borrower default and the likely loss that will arise. Property, taken as collateral, is an accepted risk mitigant, although not all property is perceived in the same light. Residential mortgages have a sound long-term record as low risk lending. Most lending on commercial property carries a 100% weighting as it has historically been seen as high risk. However, an Exceptional Treatment is introduced into Basle II whereby certain types of Commercial Real Estate lending qualify for a 50% weighting provided it meets rigid criteria, one of which is prescriptive valuation rules. To qualify for the 50% weighting the loan to value ratio must be the lower of 50% of Market Value or 60% of Mortgage Lending Value (MLV). Therefore we may have to learn to live with MLV.

There is a degree of scepticism about MLV in the UK and other parts of the English speaking world. This technique has an established tradition in Germany and may be catching on in other parts of Europe. However, we tend to regard it as subjective, incapable of the objective market test and unsustainable in a court of law. It is not by accident that MLV has found its way into EU law and Basle. Germany is one of the principle players at each table and it is one of the world's major economies. German banks are amongst the biggest and most active in the world. If they believe they have a good system which has, in the past, protected them from losses in some of the worst economic downturns, then it is surely reasonable to try and persuade others of the merits of their case. So to dismiss this as a purely German fixation is short sighted and to overlook the fact that all standards draw on best practice developed first in one region or country.

However there are other implications too. Bank capital is expensive to maintain and therefore anything that reduces risk weighting which in turn reduces the amount of capital that has to be reserved, reduces costs to banks. The ratio also acts as a brake to the amount of lending a bank can engage in, unless they can contrive a means to get the "assets" off the balance sheet perhaps through "Securitisation".

If a whole portfolio of loans were to be aggregated, such that individual risk of default was spread across a large pool, then a bank might then be able to sell such a bond at a premium figure. A good rating by a Credit Rating Agency might further enhance that. At a stroke the bank would remove the "asset" from its balance sheet thus freeing capital. In Germany there has been a tradition of vehicles known as Pfandbriefe which are securitised portfolios of residential mortgages and have a long history as secure investments. There is a growing industry in commercial property backed securities.

Basle II will create an incentive on banks to improve their understanding of risk and its management and to remove packageable loan portfolios from the balance sheet. They will, as a result, become more demanding of their valuers. Not only does the Exceptional Treatment prescribe the use of Mortgage Lending Value but it also stipulates the qualities of competence and independence for valuers. Further, if achievement of a good price for a securitisation entails the services of a rating agency, they too will seek comfort that the valuations have been properly carried out by competent valuers of repute. It is in this context that the concept of Certification has arisen. Finally, the valuers liability may have to be extended to parties other than the original client bank if what starts out as a simple valuer/bank client relationship on a single property, ends up as part of a securitised sale? I would suggest therefore that there are serious implications arising for valuers out of Basle.

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**FORTHCOMING MEETINGS AND SEMINARS**

20 March 2003	Corporate Valuation Conference Appraisers' Association supported by Capital Market Board, Istanbul Turkey <a href="http://www.dud.org.tr">www.dud.org.tr</a>
29 - 30 March 2003	IVSC Standards Board, Cape Town, South Africa
31 March 2003	IVSC Management Board meeting Cape Town, South Africa
21 - 24 July 2003	X World Valuation Congress, Cambridge, UK <a href="http://www.worldvaluationcongress.org">www.worldvaluationcongress.org</a>
18 - 20 August 2003	International Property Tax Institute, 6th Annual Conference, Vancouver, British Columbia, Canada <a href="http://www.ipti.org">www.ipti.org</a> (and see below for further information)
13 - 14 October 2003	IVSC Standards Board VSC Annual General Meeting
15 October 2003	IVSC Management Board meeting
16 October 2003	IVSC Annual General meeting IVSC October meetings are being held in Seoul, South Korea

*Evolution of Property Taxes— Pathway to Success*

The 6th Annual Conference of the International Property Tax Institute in co-operation with Public Works and Governments Services Canada

It is a widely held belief that a well-designed and efficient property assessment/taxation system will provide the means to improve the revenue flow and stability needed to finance local government. With this in mind, many countries have embarked upon valuation work, mapping projects, computerized regression analysis and like activities. Are we approaching these tax reform efforts correctly? Do we have the right strategies? Can we improve our performance by learning from past efforts?

What is an efficient assessment and tax system? These types of issues will be debated by international experts and practitioners from both developed and developing countries at the Conference.

The International Property Tax Institute (IPTI) is a non-profit organization of tax professionals representing taxpayers, government, academia and taxation and assessment professionals worldwide. Previous conferences were held in Hong Kong in co-operation with Hong Kong Rating and Valuation Department in 2002; Cambridge, England in co-operation with the Institute of Rating and Revenue Valuers in 2001; Cape Town, South Africa in co-operation with UNISA and the City of Cape Town; Cracow, Poland in conjunction with CREI and the City of Cracow.

More information on IPTI and the conference as well as previous conferences can be found at our website at [www.ipti.org](http://www.ipti.org)



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**IVSC**



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