IVSC

GLOBAL VALUATION ISSUES

IVSC NEWS

MESSAGE FROM THE CHAIRMAN

An objective of the IVSC Standards Project was to produce international valuation standards that supported the rigorous application of International Financial Reporting Standards (IFRSs). The growing number of 'endorsements' (see page 6) from others highlights IVSC success in this area.

Although valuation for financial reporting purposes is a key area of interest for the IVSC, it is by no means the only one.

There is growing worldwide interest in (and in a number of countries adoption of), the International Public Sector Accounting Standards (IPSASs). The IVSC has received an invitation to be represented on the newly constituted Consultative Group established by the International Federation of Accountants, Public Sector Committee (who produce IPSASs). Equally important to the IVSC is the statement in the Public Sector Committee's work plan for 2004 that it *"will be involved in relevant forums including international standard setting bodies such as the IASB and IVSC".*

The importance of real estate valuation for bank lending purposes is receiving increasing recognition, particularly resulting from proposals for a new Basel Capital Accord. In June, delegates from IVSC member – the Appraisal Institute in the US – delivered a seminar on 'The Valuation of Real Estate' at the invitation of the Financial Stability Institute in Basel. AI speakers took the opportunity to present the new edition of IVS to the audience of banking regulators. The IVSC has also been invited to speak at the BIS/IMF conference, 'Real Estate Indicators and Financial Stability' in Washington DC in October. IVSC vice chairman Elvin Fernandez (Malaysia) will deliver the paper.

The IVSC continues to assist in the development of the real estate provisions of the Global Investment Performance Standards (GIPS). Equity and bond fund managers around the world are adopting GIPS. Where they lead (as in the 80s) property investors will no doubt follow. Standardisation at an international level for the investment performance calculation and reporting of property will once again highlight the need for international valuation standards.

JOHN EDGE *FRICS*
IVSC Chairman

IN THIS EDITION

IVSC NEWS

IVS 2003

The 6th edition of the International Valuation Standards (2003) became available at the beginning of June. For the first time the standards can be freely viewed on the IVSC web site (www.ivsc.org), representing the commitment by the International Valuation Standards Committee that all valuers, from both developed and emerging economies, have access to its standards. Over 1000 people logged on to the web site to view the standards during the first month of availability.

The printed version is available at a cost of US$50 (inclusive of postage and handling charges) and can be ordered on-line. The IVSC has also introduced a subscription service for the first time (at a modest cost of US$25) so that subscribers can be sure of notification of proposed and adopted changes to the standards.

John Edge, IVSC Chairman, said in launching the new edition, "The International Valuation Standards have an important role to play in the effective functioning of global markets. Wide and easy access to our standards will encourage global acceptance of the standards and will improve uniformity of practice by professional valuers throughout the world."

The outright adoption of the International Valuation Standards or convergence with these standards is now gathering pace.

- The South African Institute of Valuers is to reproduce IVS 2003 in its 2003 Members' Handbook as national standards. Copies of the standards will also be made available to valuers in Tanzania and Malawi (where no standards exist) at the request of the respective institutes;
- The Slovenia Institute of Auditors is to translate and reproduce IVS 2003 again as national standards. Slovakia and Georgia have made similar requests;
- Russia, Poland, Latvia, Romania are just some of the countries who have sought permission to translate IVS 2003 to assist in convergence;
- The Royal Institution of Chartered Surveyors has adopted the key standards and applications from IVS 2003 in the new edition of its Appraisal and Valuation Manual;
- Australia and New Zealand are to adopt and reproduce key standards and applications from IVS 2003 as national standards in the 2003 Professional Practice Manual.

IVSC NEWS

US SUPPORT FOR INTERNATIONAL VALUATION STANDARDS

On May 3 2003, the four main appraisal organisations in North America - Appraisal Institute of Canada; Appraisal Institute; American Society of Appraisers; and American Society of Farm Managers and Rural Appraisers – signed a Memorandum of Understanding to encourage a positive environment that will influence the development of the valuation and valuation consulting profession. The first items of agreement under the Memorandum are that the organisations:

- Recognize and support the International Valuation Standards promulgated by the IVSC;
- Recognize and support the Appraisal Foundation in its efforts to coordinate their standards with other nations and international standards from the IVSC;
- Recognize and support the objectives of the World Association of Valuation Organizations

VALUATION OF OWNER-OCCUPIED PROPERTIES

The IVSC has issued a Consultation Paper seeking to clarify guidance on the valuation of owner-occupied property under International Accounting Standard, IAS 16, Property, Plant and Equipment.

John Edge, IVSC Chairman said, "Although IAS 16 allows property to be carried at fair value in the accounts, it has no guidance on how to arrive at that fair value. Yet the national accounting and valuation standards in those countries that currently permit revaluation of assets, have some significant differences. For example, 'depreciated replacement cost' is defined differently in different countries. Or, in some countries owner-occupied property is valued as if vacant; in others, it is valued on the basis of a capitalised notional lease. This can lead to differing valuation conclusions although all will be reported as 'fair value'."

Mr Edge continued, "The IVSC has a responsibility to ensure that when property is valued to be reported at 'fair value' under IFRS, it is done so on a basis that produces a consistent and comparable valuation conclusion."

The Paper can be viewed on the IVSC web site and comments are requested by 31 October 2003.

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 Secor Assets** is expected to be issued shortly. Just as IVA 1, Valuation for Financial Reporting discusses the requirements of the International Accounting Standards, IVA 3 drafted in the context of the requirements of the International Public Sector Accounting Standards.

- **Extractive Industries.** Work is underway within an Expert Group to develop valuation guidance for extractive industries. The Groupmet in London in June and were joined for part of the meeting by a representative from the IASB. The IASB isdeveloping guidance on the application of the IASB Framework and IASs 16 and 36 to entities incurring exploration and evaluation costs, and is considering the publication of an exposure draft in the fourth quarter of 2003. The IVSC Standards Board will be asked to approved a draft Guidance Note for exposure at its meeting in October.

- **Valuation in Emerging Markets**. There is concern in some countries, particularly in Central and Eastern Europe and Asia, that the International Valuation Standards model the behaviour of a buyer and seller in markets that are transparent, competitive, have symmetrical information, etc. Although there is a market in emerging economies, it would not necessarily have these characteristics. A small group chaired by IVSC vice chairman, Elvin Fernandez (Malaysia) and with representatives from China, Indonesia, Malawi, Romania and Venezuela has been set up to discuss the issue and the need for guidance.

- New groups are to be constituted to look at issues arising from **valuation for insurance purposes and forestry valuation.**

JAPANESE VALUATION STANDARDS

The Japan Real Estate Institute has just published an English version of the Japanese Real Estate Appraisal Standards. The standards were revised in July 2002, twelve years after the last revision *"in order to cope with the drastic conceptual changes in real estate investment. The burst of the bubble economy and the stream of economic globalisation destroyed the land myth and forced real estate investors to put more emphasis on income gains than capital gains".*

EPRA BEST PRACTICE RECOMMENDATIONS

In October 2001 the Best Practices Committee of the European Real Estate Association (EPRA) published the Best Practices Policy Recommendations. EPRA has recently embarked on a project to review and update the Best Practice guidelines to meet the challenges posed by the introduction of International Financial Reporting Standards (IFRSs) in Europe. The IVSC was represented at a series of meetings of chief financial officers of EPRA member companies held in various European cities during June. These meetings provided an overview of the issues facing EU real estate companies. A three-day workshop is to be held during August for invited CFOs and a number of investment analysts with the objective of producing updated Best Practice guidance. The workshop will be facilitated by KPMG and, again, the IVSC will be represented.

Although the deadline for implementation of IFRS is 2005, those companies with December year-ends will in practice need to prepare opening balance sheets that comply with IFRS as at 31 December 2003 as a starting point for transition to IFRSs. To meet these deadlines, EPRA is hoping to adopt the revised guidelines by the end of the year.

To view the 2003 update of the Best Practices Recommendations visit www.epra.com

US APPRAISAL REGULATORY STRUCTURE UNDER REVIEW

The Appraisal Institute, American Society of Appraisers, American Society of Farm Managers and Rural Appraisers and National Association of Realtors sent a joint letter to the US Congress calling for further investigation into the appraisal regulatory structure. The letter was in response to the May 14 release of the General Accounting Office's investigation into the effectiveness of the current regulatory structure. The four associations urged Congress to hold hearings to examine the impact of "such an ineffective regulatory system" on the safety and soundness of our nation's financial institutions.

"With a patchwork of state laws and ineffective federal oversight allowing for only 'minimum' qualifications criteria for licensing and certification in some cases, states and the federal oversight bodies too often have not carried out their specific intended responsibilities to enforce the standards as required by the federal law," the joint letter stated.

In addition to the GAO Report, the letter also addressed the findings of the Appraisal Subcommittee of the Federal Financial Institutions Examinations Council, whose 2002 Annual Report to Congress, required by Title XI of the Financial Institution Reform, Recovery and Enforcement Act (FIRREA), stated that nearly half of the state appraisal regulatory agencies reviewed in 2002 failed to resolve complaints against real estate appraisers expeditiously; were inconsistent in applying disciplinary sanctions; failed to pursue all alleged violations of the Uniform Standards of Professional Appraisal Practice or did not adequately document enforcement-related files.

The letter called this finding "troubling (but) not surprising." The organizations noted that since Title XI was enacted, it has been difficult to achieve necessary consistency among the states for enforcement of both standards and certification requirements. "Whether through a lack of resources or a lack of will by those charged with providing oversight, the current system allows some unscrupulous and unqualified appraisers to continue practising with little or no recourse for their actions."

"Having provided for only 'minimum' qualification requirements, the implementation of FIRREA has failed to offer incentives for appraisers to seek additional training, education and experience. In the end, we believe the public would be better served by a system that encourages appraisers to excel through appropriate professional development," the letter concluded.

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WHAT THE WORLD SAYS ABOUT IVS

- **Deloitte Touche Tohmatsu: Model IAS Financial Statements** (Dec 2002) "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."

- **Deloitte & Touche: Investment Property – the future for UK property accounting under IAS** (Feb 2002; available on global web site Feb 2003) *"IVS will represent best practice in the valuation profession. IVS should therefore be followed by the valuers when revaluing investment property."*

- **PricewaterhouseCoopers: Applying IFRS** (March 2003) An interactive electronic publication to illustrate how the standards should be applied in practice. *"Management should consider the guidance provided by International Valuation Standards (IVS) issued by the International Valuation Standards Committee."*

- **European Public Real Estate Association: Best Practices Policy Recommendations** (issued Oct 2001, update Jan 2003) *"At present, there is no consistently agreed basis for valuing the assets held by public real estate companies based in Europe. …EPRA … defers to the work of the International Valuation Standards Committee."*

- Applying International Accounting Standards (3rd Edition), Author: David H. Cairns, with Brian Creighton and Anne Daniels of BDO Stoy Hayward (Nov 2002 Written by a former IASC Secretary-General, and a foreword by Sir David Tweedie, Chairman of IASB, this book is the most authoritative and practical book in this area. It has extensive coverage of IVS

- **International Federation of Accountants Public Sector Committee: Study 14, Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities.** (April 2002) *"The International Valuation Standards Committee issues internationally acceptable international valuation standards."*

- **RICS, 5th edition of Red Book (effective 1 May 2003)** *"Practice Statement 3.6 Financial Statements: Valuations for Financial Statements shall be in accordance with the IVSC International Valuation Application 1 (IVA 1). Practice Statement 3.7 Lending: valuations for lending purposes shall be in accordance with IVSC International Valuation Application 2 (IVA 2)."*

- **Australian Property Institute** to reproduce General Valuation Concepts & Principles; Property Types; IVS 1; IVS 2; IVA 1 and IVA 2 in 2004 edition of Professional Practice

- **New Zealand Treasury Guidelines: Valuation Guidance for Property Plant and Equipment** (May 2002, revised March 2003) *"The authors acknowledge the use of material from the following documents: International Valuation Standards 2001, issued by the IVSC"*

THE DISCOUNTED CASH FLOW (DCF) ANALYSIS FOR MARKET AND NON-MARKET BASED VALUATIONS

This article has been written by IVSC vice-chairman, Elvin Fernandez (Malaysia),

Much of the work of an ordinary valuer revolves around carrying out market value estimates for various purposes. Such estimates are needed by most market economies. It has been no surprise then that almost the first task that the International Valuation Standards Committee (IVSC) set for itself, upon its formation in the early 1980's, was to arrive at an international consensus as to the definition of market value. After much debate, at times heated, and mostly centred on differing cross-border legalistic emphases, a common definition acceptable to all was arrived at. Today this definition is not only the accepted definition by the global valuation fraternity, but it is also accepted by most regulators and users of valuation, including the courts.

The widespread use of market value in the valuation profession is central and established, and equal in importance to the "fair value" and "mark to market" movements that are now taking place in the accounting and investment circles.

The IVSC has since, gone from strength to strength, and has now introduced, for the international community, the 6th edition of the standards, IVS 2003.

Even before the introduction of IVS 2003 it has been a central feature of the Standards that market value is the main basis of valuation. Where bases other than market value are required, IVS 2 entitled "Valuation Bases Other than Market Value" applies. IVS 2 makes it a cornerstone requirement to distinguish that the valuation is not a market value estimate if the estimate is made on a basis other than market value.

The IVS Standards recognise three traditional methods or approaches to valuation, namely the sales comparison approach, the income approach and the cost approach. Used in arriving at a market value, each of these methods or approach requires its constituent elements to be market derived. The underlying logic is that if the constituents are not market derived, than the answer cannot be market value.

The Discounted Cash Flow Method of Valuation is an income based method or approach and has a growing following around the world due to its easy use that has come about because of computer spreadsheets and computing power. The method which essentially comprises three major elements, namely the cash inflows, the cash outflows and the discount rate can be applied to most complex, investment properties. Where the Comparison Method falls short in its ability to take into account explicitly the differences between the comparable sale and the property being valued the DCF triumphs, as it can make explicit in the cash flows, the differences.

It has however been said that the method can be misused because of its explicit assumptions made throughout its formulation. This argument however may be equally applicable to any of the other methods and is usually a disguised reluctance to enter into complexity rather than anything else.

Due to the need to address the issues and to ensure the proper use of DCF analyses in valuation, the IVSC set itself the task of coming up with a Standard and set up an Expert Group (a usual approach) to look into the issues and to draw up a Standard.

The Expert Group, in coming up with the Guidance Note that is published in the 6th Edition, made the following distinctions:

> In arriving at market value, a DCF valuation must recognise market derived

inflows, outflows and the discount rate. In practice this will be achieved by a valuer constructing DCF models for known sale comparables and then applying the "market derived" inflows, outflows and discount rate to value the property under consideration. Should the valuer adhere to this he cannot abuse the DCF as the value is based on market derived data. In past valuations there has been some confusion among valuers when they have not being focussed in ensuring that for the estimation of market values, just as in any of the other methods of valuation, they ought to base it on market derived data In many instances valuers did differ in the construction of inflows and outflows without reference to models of previous known sales and in the determination of discount rates it was not strictly based on market analyses of known sales.

A DCF valuation to arriving at Market Value on the one hand and a DCF valuation for the determination of a non-market value on the other must be distinguished. For example where a valuer is asked to do a valuation based on a certain rate of return specific to the requirements of the client, it is a non-market valuation and he must distinguish this valuation from a market valuation.

The GN distinguishes between market and non-market valuations done by a valuer and a value-in-use (using the DCF) done by Accountants under the International Accounting Standards (IAS). A value-in-use valuation is a non-market estimate based on a strict continuing use of the asset in its existing use whereas a market value estimate (value-in-exchange) done by a valuer will include not only the continued use of the asset in its existing use but its full potential use. Inherent in a market value estimation is the concept of the highest and best use.

The GN distinguishes between valuations for market and non-market valuations and the use of the DCF for investment analyses purposes where the merits of one property investment or project with another are assessed. The GN notes that it relates only to valuation (market or non-market) and does not relate to investment analyses.

The GN distinguishes between the use of DCF valuations for real property and businesses.

Perhaps most important of all it requires all data used in the method to be adequately substantiated.

In arriving at its recommendations the Expert Group took particular pains to steer away from being prescriptive, which is an underlying principle upon which the other Standards in IVS have been constructed. This will allow valuers to employ the latest techniques in computing cash flows including the use of various probability techniques, such as the Monte Carlo Simulation technique to establish more accurately the certainty of cash inflows.

In emerging markets, the use of the DCF for valuation is perhaps even more popular and this is because there is usually a lack of sale comparables in sufficient numbers to undertake accurate valuations based on the Comparison Method. With the limited sale comparables however models can be constructed from the limited known sales for application in various similar situations.

The IVSC is acutely aware that for specialised properties such as forests and mineral rights, valuers around the world find that the use of the DCF is the principal means to the determination of value. Like in the case of all other approaches, more day to day use of the DCF method or approach to valuation will usually lead to higher levels of proficiency. Lastly, it is not the method itself that provides an accurate answer; rather it is the knowledge and skill of the person using it that is more important to the level of accuracy desired.

INTERNATIONAL FINANCIAL REPORTING STANDARDS - AN UPDATE

IFRS 1

The first International Financial Reporting Standard (IFRS) has been published, appropriately entitled 'First-time Adoption of International Financial Reporting Standards'. The objective of the IFRS is to ensure that an entity's first IFRSs financial statements contain high quality information that is transparent for users and comparable over all periods presented; provides a suitable starting point for accounting under IFRSs; and can be generated at a cost that does not exceed the benefits to users.

As a general principle, IFRS 1 requires that a first-time adopter should measure all assets and liabilities recognised in its opening IFRS balance sheet on the basis required by the relevant IFRSs. Therefore, if an entity adopts IFRS for the first time in its annual financial statements for the year ended 31 December 2005, in general it would use the measurement principles in IFRS in force at 31 December 2005.

However there are some permitted exceptions to this general principle. For example

- an entity may elect to measure an item of property, plant and equipment at the date of transition to IFRSs at its fair value and use that fair value as its deemed cost at that date

- an entity may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to IFRSs as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to: Fair value, or Cost or depreciated cost under IFRS

- 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 privatisation or initial public offering. Such event-driven fair value measurements may be used as deemed cost for IFRSs at the date of that measurement.

Deloitte Touche Tohmatsu (Australia) has prepared a Discussion Paper explaining how the principles of IFRS 1 would apply in making the transition from existing Australian GAAP to the converged Australian GAAP. It warns that the basis of all prior revaluations should be reviewed to confirm that the basis is consistent with fair value under IFRS. For example, when Australian accounting standard AASB 1041, 'Revaluation of Non-Current Assets' came into effect, Australian entities were permitted to use a previous revaluation as 'deemed cost'. However, apparently not all 'deemed costs' created on the adoption of AASB 1041 fall into the IFRS exemption. The previous and superseded Australian standard AASB 1010 'Accounting for the Revaluation of Non-Current Assets' (issued 1993) did not specify the basis on which revaluations had to be performed (as required under IFRSs) and as such not all revaluations will fall into the above exemptions. Revaluations/'deemed costs' which were based on conservative (directors') valuations or included the effects of expected capital gains tax are also not considered broadly comparable to fair value.

The discussion paper can be read in full on www.deloitte.com.au:

IFRS

THE IMPROVEMENTS PROJECT

The objective of the IASB Improvements Project was to add clarity and consistency to the requirements of existing Standards issued by the Board's predecessor, the International Accounting Standards Committee. In May 2002, the IASB published for comment proposals to revise 12 of its 34 active standards. Previous editions of this newsletter have reported on proposed changes, particularly to IAS 16, 17 and 40.

At its most recent meeting in July, the IASB debated the interaction between IAS 17 Leases and IAS 40 Investment Property as a result of concerns raised particularly by the UK real estate industry. Following its debate, the IASB agreed the following:

- to clarify in IAS 40 that IAS 17 should be applied to determine the classification of a lease prior to applying IAS 40.

- to clarify in the revised IAS 17 that the allocation of the minimum lease payments at the inception of a lease of both land and buildings is based on the relative fair values at the inception of the lease of the leasehold interests in the land element and the buildings element.

In November 2002, the Board confirmed its proposal to permit lessees whose interests in a property comprising both land and buildings is held under a long-term lease (often classified as operating lease under the existing requirement in IAS 17) to classify the leased asset as investment property provided: the rest of the definition of an investment property is met, the lease is accounted for as a finance lease, and management applies the fair value model in IAS 40. The Board noted that the terms of some leases that may now be classified as investment property contain 'upward only rent reviews' clauses that meet the definition of contingent rent in IAS 17. The Board instructed the staff to research the interrelation, if any, between IAS 39 in its treatment of embedded derivatives and the treatment of contingent rents in IAS 17.

The IASB also decided to clarify in the revised IAS 40 that the fair value of a property interest held under a long-term lease, classified as an investment property asset under the fair value model in IAS 40, should be determined by reference to the rights given by the lease and that the obligation under the lease should be accounted for as a liability.

The revised standards resulting from the Improvements Project are due for publication in fourth quarter 2003.

ACCOUNTING FOR INSURANCE CONTRACTS

The IASB has taken the first step towards improving insurance accounting practices by publishing proposals for greater transparency. The proposals are set out in Exposure Draft ED 5 *Insurance Contracts*. The Exposure Draft proposes guidance for insurance companies that will be expected to comply with International Financial Reporting Standards (IFRSs) in 2005. At present there is no IFRS that addresses insurance contracts, and insurance contracts are excluded from some existing standards that would otherwise be relevant. Furthermore, accounting for insurance contracts varies widely throughout the world and is often inconsistent with accounting practices for other industries.

ED 5 marks only the first phase of the IASB's insurance project. It is aimed at introducing improved disclosures for insurance contracts. In addition, the proposals are intended to introduce modest improvements to recognition and measurement practices, without requiring extensive changes that might need to be reversed when the IASB completes the second phase of this project.

In the second phase, the IASB will address broader conceptual and practical issues related to insurance accounting.

The Exposure Draft can be viewed on the IASB website – www.iasb.org.uk

ASSET DISPOSAL AND DISCONTINUED OPERATIONS

The IASB has published for public comment proposals on reporting asset disposals and discontinued operations. The proposals are set out in Exposure Draft ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations.*

The proposals are the first to arise from the IASB's joint short-term convergence project with the Financial Accounting Standards Board (FASB) in the US. Convergence of accounting standards around the world is one of the IASB's prime objectives and the project aims to reduce the differences between International Financial Reporting Standards (IFRSs) and US GAAP.

The Exposure Draft results from the IASB's review of the FASB standard SFAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*, which was issued in 2001. The Exposure Draft proposes that assets that are expected to be sold and meet specific criteria should be measured at the lower of carrying amount and fair value less costs to sell, should not be depreciated and should be presented separately in the balance sheet. It also proposes that any operation with separately identifiable cash flows should be classified as 'discontinued' once the assets involved in the operation meet the criteria to be classified as held for sale if the cash flows of the operation will be eliminated from the ongoing operations of the entity and there will be no continuing involvement in the operation after its disposal. These proposals, when implemented, would achieve convergence with the equivalent requirements in US GAAP.

The Exposure Draft can be viewed on the IASB website – www.iasb.org.uk

IFRS

MEASUREMENT

At the July IASB meeting, the staff At the July IASB meeting, the staff of the Canadian Accounting Standards Board (AcSB) tabled a preliminary report Measurement Bases for Financial Accounting.The research was commissioned by the IASB and identifies, considers, and makes recommendations on issues related to the selection of an appropriate measurement basis, or set of bases, for assets and liabilities recognised in financial statements. At this stage, the project is intended to provide the basis for the IASB and its national standard-setting partners to initiate active projects:

- to revise and expand the measurement aspects of their conceptual frameworks
- to improve the measurement requirements of their financial reporting standards by grounding those requirements on a coherent conceptual basis.

A large part of the measurement project will involve an examination of entry and exit value and under what circumstances each is an appropriate measurement attribute.

The paper is not yet publicly available but an outline of its contents was provided to observers at the IASB meeting.

Measurement on initial recognition

The paper acknowledged that there are various possible measurement bases that are used on initial measurement, including historical cost, replacement cost, net realisable value, value in use and fair value. Deprival value, favoured by some, is a combination of replacement cost, value in use and net realisable value. The AcSB staff proposed working definitions of each of the basic measurement bases to facilitate analysis. There was general agreement with this approach. The analysis would help to identify the various bases, when and how they are used and what causes a change in the measurement attribute.

Possible measurement bases

The paper noted that there were dimensions to the possible measurement bases: market versus entity-specific values and entry versus exit values. The preliminary position taken by the AcSB staff is that market value is probably better, but it acknowledged that there was a great deal of support for entity-specific measures.

The AcSB plans to present its findings to the meeting of national accounting standard-setters in September 2003.

BUSINESS COMBINATIONS PART II

The US Financial Accounting Standards Board (FASB) and the IASB have agreed to use fair value as the measurement objective for valuing the assets acquired and liabilities assumed in a business combination. They have develop tentative guidance to ensure consistent application of this principle known as the 'fair value hierarchy'.

The hierarchy reflects the general principle that fair value is reflective of the interaction of knowledgeable unrelated willing parties. Accordingly, market prices, when available, are considered to be the best evidence of this behaviour. At its June meeting, the IASB agreed to amendments to its previously agreed hierarchy to reflect changes made by FASB. For example, a definition of marketplace participants is to be introduced:

"A marketplace participant is an entity that has utility for the item (or group of items) being valued, has the legal and financial ability to complete a transaction in the form contemplated, and it willing to complete the transaction (the willing parties in the definition of fair value). The marketplace participant is hypothetical and does not represent the biases of a particular participant, but rather reflects the notional consensus of the market."

The fair value hierarchy has also been clarified to emphasise the general principle that fair value estimates should be determined based on the result of valuation techniques that maximise market inputs and minimise entity-specific inputs. Specifically, the hierarchy will emphasis the preference for multiple valuation techniques consistent with a market, income, and, if applicable, cost approach for level 3 fair value estimates.

In brief, the three levels of the hierarchy are:

Level 1—The estimate of fair value shall be determined by reference to observable prices of market transactions for identical assets or liabilities at or near the measurement date whenever that information is available.

Level 2—If observable prices of market transactions for identical assets or liabilities at or near the measurement date are not available, the estimate of fair value shall be determined by adjusting observable prices of market transactions for similar assets or liabilities that occur at or near the measurement date.

Level 3—If observable prices of market transactions for identical or similar assets or liabilities at or near the measurement date are not available, the estimate of fair value shall be determined using other valuation techniques.

IASB and FASB exposure drafts which will include the proposed fair value hierarchy are anticipated 4th quarter 2003.

LEASES

In May, the IASB discussed a leasing project plan prepared in conjunction with staff of the UK Accounting Standards Board. It was tentatively agreed that the IASB should undertake a leasing project with the objective of developing a single method of accounting for leases that is consistent with IASB's Framework. The single method would not rely on a distinction between operating and finance leases. The Board tentatively agreed with the proposal that the project should first address leases of property, plant and equipment. The application of the principles derived for leases of tangible assets would be addressed subsequently for intangible assets The Board also tentatively agreed that the project would include consideration of the accounting for: both lessees and lessors; contingent rentals; guaranteed residual values; lease options; sale and leasebacks.

IFRS

COUNTRY ROUND-UP

BELGIUM
The Belgian Commission for Accounting Standards (CBN/CNC) is proposing that IFRS be mandatory for all consolidated annual accounts starting from 2007. More than 600 Belgian non-listed entities would be affected. The Commission is also planning to converge Belgian Accounting Law with IFRS as from 2007.

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.

CANADA
The Canadian Securities Administrators have invited comments on a proposal (NI 52-107 and 52-107CP), *Acceptable Accounting Principles, Auditing Standards and Foreign Currency*, that would allow foreign issuers and foreign registrants to use either IFRS or US GAAP without reconciliation to Canadian GAAP.

ESTONIA
The European accounting regulation requires listed companies in Estonia to use IFRS in their *consolidated* financial statements starting in 2005. Estonia has extended that requirement to require all listed companies to apply IFRS in their separate company accounts from 1 January 2005.

EUROPEAN UNION
The European Commission has published a 10-point plan for improving and harmonising the quality of independent audits throughout the EU. Approximately two million European companies are required by statute to have an annual audit. One of the priorities is to require the use of International Standards on Auditing for all EU statutory audits from 2005.

GERMANY
1) The German Accounting Standards Board has revised its work programme to make cooperation with IASB and other major national standard setters Its primary objective. Projects to further German financial reporting will take a lesser role.
2) Non-listed companies in Germany will be permitted to use IFRS, rather than German GAAP, in preparing their consolidated financial statements starting in 2005.

GUATEMALA
Guatemala has replaced its national GAAP with IFRSs effective for 2002 financial reports.

ICELAND, LIECHTENSTEIN, NORWAY
The EU legislation requiring use of IFRSs will also apply to three countries that are members of the European Economic Area. There are approximately 60 listed Icelandic companies and 200 listed Norwegian companies.

IRELAND
The Institute of Chartered Accountants in Ireland (ICAI) has called for the government to decide quickly whether the IFRSs requirement for all listed companies from 2005 onwards will be extended to non-listed companies and to individual company accounts.

PORTUGAL
Portugal's Accounting Standards Commission has decided to extend the use of IFRSs to the individual accounts of publicly traded companies; accounts of other companies obliged to undergo a statutory audit; accounts of government companies obliged to have an audit; and the accounts of other non-listed companies that elect to follow IFRS.

RUSSIA
In January, the Russian Finance Minister announced a tentative plan to adopt IFRSs. All listed holding companies and banks would be required to prepare consolidated financial statements under IFRSs from 2004.

IFAC

SOUTH AFRICA
The JSE Securities Exchange South Africa (JSE) has approved substantial amendments to its listing rules that will require all companies listed on the exchange to comply with International Financial Reporting Standards (IFRS) for years commencing on or after 1 January 2005.

SWITZERLAND
Starting with annual reports for 2005 and interim reports for 2006, All Swiss companies whose equity shares are listed on the main board of the Swiss Exchange will be required to prepare their financial statements using either IFRS or US GAAP as from 2005. Swiss GAAP will not be permitted.

UK
EU law requires listed companies to use IFRS from 2005 when preparing their consolidated accounts. The UK government has decided extend the scope of the EU regulation to permit publicly traded companies in the UK to use IFRS in their individual accounts and all other companies and limited liability partnerships to use IFRSAS in both their individual and consolidated accounts from the same date.

INTERNATIONAL FEDERATION OF ACCOUNTANTS (IFAC)

The IVSC has been invited to participate in the IFAC Public Sector Committee (PSC) Consultative Group. This is an important link as there are a number of items on the PSC agenda of interest to the valuation profession. Among them are:

IMPAIRMENT OF ASSETS
An Exposure Draft is expected third quarter 2003. The Draft will propose requirements for the identification, recognition, measurement, reversal and disclosure of an impairment loss in respect of public sector non-cash flow assets.

GFS/ESA95/SNA/IPSAS CONVERGENCE WORKING GROUP
GFS – Government Finance Statistics
ESA95 European System of National Accounts 1995
SNA – System of National Accounts
IPSAS – International Public Sector Accounting Standards.

In June, the PSC chaired a meeting of representatives from the IMF, OECD, Eurostat, the Australian Accounting Standards Board and the UK Treasury and ONS. The objective of the meeting was to ascertain whether harmonization and convergence is possible for the different frameworks used by statisticians and accountants. Papers also were presented on experiences in the move to accrual accounting in Australia, the UK, and South Africa. A common view emerged that where appropriate and possible convergence of the requirements of GAAP and the requirements of statistical reporting models should be pursued. with a general acknowledgement that increased co-operation and co-ordination of activities was desirable.

Among the technical issues discussed was asset valuations (in particular non-financial assets and whether for non-cash flow assets, valuation can be determined by depreciated replacement cost or value in use or some other basis. Other issues to be considered include: indexing versus comprehensive valuations; frequency of valuations and "rolling valuations".

BANKING

PITY THE BANKERS!

By 2005, banks and financial institutions in a number of countries will have to meet the deadline of amending their accounting systems to adopt International Accounting Standards in place of national standards. By the end of 2006, the new Basel Capital Accord comes into effect. The new Basel Accord represents the most complex regulatory changes to hit financial markets in decades. For a start the current proposals and accompanying guidance run to over 200 pages. The current Accord stands at 38 pages! Implementing both the Accord and International Accounting Standards are not just technical-systems led exercises. They will affect how financial institutions behave and how they do business, and it will affect the markets in which they operate.

Since 1988, banking regulators around the world have been assessing banks' capital adequacy using a common blueprint, set out in the Basel Accord of that year. The document has no legal status, but represents an agreement between the banking supervisors of the G-10 countries to adopt a common standard. Since these supervisors, covering most of the world's large financial institutions, set the standard for others to follow, over 100 countries now adopt the Basel Accord as the basis for capital adequacy assessment.

The current Basel Accord is elegant in its simplicity. The mechanics can be quite complex, but the principle is simple. The claims a bank may have on others (loans, guarantees, overdraft facilities, etc) are first sorted according to their relative riskiness, and are assigned one of four 'risk weights' - zero per cent, 20 per cent, 50 per cent or 100 per cent. The amount of the claims is multiplied by these risk weights, and the resulting 'risk-weighted assets' are added together. A bank then has to maintain a minimum level of capital as a proportion of the total risk-weighted assets. The Basel Accord set a minimum of 8 per cent capital (i.e. total capital must be at least equal to 8 per cent of the risk-weighted assets), but individual country supervisors can set a higher level.

But the original Accord has started to show its age. The 'one-size fits all' approach adopted by the Accord is a rather simplistic approach which no longer reflects the way financial markets operate. At the same time, the leading banks have developed much more sophisticated risk management systems.

For the past few years, work has been in progress in developing a new Accord - 'Basel II'. The new approach tries to take more account of the actual riskiness of individual exposures, at various levels of sophistication. Banks with good risk management systems should, in theory, benefit from a closer convergence of their internal risk systems with the regulatory standard. In April the third and final Basel consultative paper was issued with comments due by 31 July.

In its response to the consultation paper , the IVSC welcomed the fact that a number of the issues raised in its response to a previous consultation had been addressed. Principally these have been a clarification in the term and usage of Commercial Real Estate, a clearer recognition of Income Producing Real Estate, and a refinement of the Exceptional Treatment. However, the IVSC expressed disappointment that the Basel Committee had not adopted the IVSC definition of Market Value together with the supporting guidance. Instead, the draft document uses the term 'objective market value of collateral' alongside its own definition. The IVSC has drawn attention to the fact that the IVSC definition is widely accepted throughout the real estate valuation world and is reproduced in many national standards. The term 'market value' is also used in the International Financial Reporting Standards and there is a commitment in the Basel paper to promote consistency between disclosure frameworks.

GIPS

The IVSC also drew attention to a recent paper (Sept 23, 2002) prepared by staff of World Bank and IMF. The paper reviewed Fund/Bank experience in conducting Basel Core Principles assessments but also taking into account the pending revision of the Capital Accord.

One of the key reform themes emerging from the review was that "Guidance on good practices in loan classification and provisioning is urgently needed.... Without more accurate asset valuation and provisioning, profitability, capital and capital adequacy figures are seriously flawed." The paper called for the development of more precise guidelines on collateral valuation.

Recognition by the Basel Committee of the International Valuation Standards would not only strengthen the provisions of the Capital Accord but would also strengthen the ability of valuation standard setters to develop and further improve their standards and gain wider global recognition and adherence.

GLOBAL INVESTMENT PERFORMANCE STANDARDS - GIPS

The financial markets and the investment management industry are becoming increasingly global in nature. Given the variety of financial entities and countries involved, this globalization of the investment process and the exponential growth of assets under management led to the need to standardize the calculation and presentation of investment performance.

The Global Standard was adopted by the Investment Performance Council of the Association for Investment Management and Research (AIMR) over three years ago (April 1999). The GIPS standards are ethical standards to be used by investment managers for creating performance presentations that ensure fair representation and full disclosure. Global standardization of investment performance reporting will allow investors to compare investment managers and will allow managers to compete for new business in foreign markets.

National standards for reporting equity and bond portfolio returns have rapidly fallen into line and adopted and/or refined GIPS.

Working groups were then established to explore the implications of stretching the core model to the more complex asset classes of venture capital, derivatives and property.

In autumn 2001, the draft GIPS real estate provisions were published for comment. The Real Estate Subcommittee is in its final round of editing the provisions for the GIPS standards. The final draft is not expected to vary significantly from the document that was originally released for public comment. However, the Subcommittee is deliberating one issue raised by the commentors: whether the Real Estate provisions should include valuation and disclosure requirements for indirect investments that differ from those for direct investments.

The original Real Estate proposal made a distinction between direct real estate – where the investor/manager has control over valuation policy – and indirect real estate (e.g., commingled funds and/or joint venture investments) – a where the investor/manager may not have control over valuation policy. The proposal permitted a lower standard for indirect real estate, with the key differences being:

GIPS

- For direct real estate investments, external valuations required at least once every three years. For indirect real estate there is no external valuation requirement.

- For direct real estate, several disclosures are required which include the source of the valuation (i.e., whether valued by external valuation or internally valued), percent of total real estate assets valued externally and frequency of external valuation. These are not required or recommended for indirect real estate.

- Annual external valuations are recommended for direct real estate investments. This is not mentioned for indirect real estate investments.

It is important to note that certain proposed provisions did apply to both direct and indirect real estate. For example, the proposal stated that all real estate investments must be valued at market at least once every twelve months. It is recommended that all real estate investments be valued at least quarterly and by January 1, 2005, this would become a requirement. Additionally, the proposal identified certain disclosure requirements that would apply to both direct and indirect real estate including:

- calculation methodology for component returns,
- the firm's definition of discretion,
- valuation methods and procedures, and
- range of returns for individual accounts in the composite.

The Real Estate Subcommitteeissued a questionnaire with responses due by the end of July (to which the IVSC responded) on the issues related to direct versus indirect real estaterequirements prior to finalising the GIPS Real Estate provisions.

EVENTS

FORTHCOMING MEETINGS AND SEMINARS

29 - 30 September 2003	Washington Appraisal Summit (for details visit www. appraisalinstitute.org)
9 October 2003	TEGoVA Annual Conference, London
13 - 14 October 2003	IVSC Standards Board
15 October 2003	IVSC Management Board Meeting
16 October 2003	IVSC Annual General Meeting
	IVSC October meetings are being held in Hong Kong, China
6 November 2003	2nd Annual RICS Valuation Faculty Conference, London (for details visit www. rics.org)
March/April 2004	IVSC Standards Board and Management Board meetings, Vancouver, Canada

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(Association of German Mortgage Banks)

This Newsletter is produced on behalf of The International Valuation Standards Committee (IVSC) twice a year. The views expressed are not necessarily those of the IVSC Board or of the members of IVSC.
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