

GLOBAL VALUATION ISSUES

NEWSLETTER FROM

THE
INTERNATIONAL
VALUATION STANDARDS
COMMITTEE

MARCH 2000



MESSAGE FROM THE CHAIRMAN

The IVSC ‘Standards Project’ was launched in January 2000 following unanimous endorsement of the IVSC business plan - **Global Valuation Standards – Target 2002** – at the 1999 AGM held in Beijing. Work is well underway to meet our key objective – the publication of a comprehensive set of high quality standards and guidance by the year 2002 that require the disclosure of relevant, significant, reliable, transparent and comparable information which will help participants in capital markets and others to make economic decisions.

An estimated US\$675,000 is needed to complete the Project. A call for funds was issued and, within the first three months, a substantial sum has been promised by member institutes, global providers of valuation services, and international agencies.

The Appraisal Institute was an early contributor allowing the IVSC Management Board to appoint technical writers to begin drafting the new standards.

The Royal Institution of Chartered Surveyors

of Marianne Tissier as the first full time IVSC Executive Director. The IVSC is also grateful to the American Society of Appraisers, the Appraisal Institute of Canada, the Australian Property Institute, the Institut Francais de l’Expertise Immobilière, and the National Association of Romanian Valuers who have already confirmed contributions to the Project.

The new Standards Project will build on the current International Valuation Standards. We must not underestimate the work by over 50 countries in the development of these standards, nor the dependence placed upon them in international commerce and as a benchmark for the establishment of national standards in many countries.

In 1985, a World Bank representative, Maurice Molds, cited in an international conference what he termed “the miracle of international valuation standards.” He later explained that he was referring to:

(1) the notion that valuation standards could

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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.

Further information may be obtained from

<p>sponsored the appointment be established at all internationally;</p> <p>(2) the rapidity with which TIAVSC (now IVSC) had agreed its first set of standards;</p> <p>(3) the harmonisation that was evidenced in the efforts of diverse countries and interests working together; and</p> <p>(4) the importance of those standards as a firm basis for accounting and for international trade.</p>	<p>The first publication arising from the IVSC Standards Project will be launched at the Valuation 2000 Conference, being held in July in Las Vegas.</p>	<table border="1"> <tr><td><i>Marianne Tissier</i></td></tr> <tr><td><i>Executive Director</i></td></tr> <tr><td><i>12 Great George Street</i></td></tr> <tr><td><i>London SW1P 3AD</i></td></tr> <tr><td><i>Tel/Fax: +44 1442 879306</i></td></tr> <tr><td><i>e-mail: mtissier@ivsc.org</i></td></tr> <tr><td> </td></tr> </table>	<i>Marianne Tissier</i>	<i>Executive Director</i>	<i>12 Great George Street</i>	<i>London SW1P 3AD</i>	<i>Tel/Fax: +44 1442 879306</i>	<i>e-mail: mtissier@ivsc.org</i>	
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<p>The first IVSC standards got the show on the road, were responsive to immediate needs, and provided a first step in the harmonisation of valuation standards. The first standards were outstanding and they accomplished their stated purpose for the time. Likewise, the current standards have served their purpose and it is crucial to review IVSC standards in the light of the new global financial landscape.</p>	<p>I am immensely proud to have become the IVSC chairman for the next three years. Thank you for your support.</p>	<p>Appraisal Practice closer together.</p>							
	<p>It has been a busy first few months. In October '99, I gave the opening address at the 50th anniversary congress of the Union of Pan American Valuers (UPAV) held in Tijuana, Mexico. There is strong support growing for the adoption of IVSC standards in Central and South America.</p>	<p>Philippe Malaquin (France) chaired the IVSC from 1996-99. It was his determination that led to the launch of the Standards Project. His wonderful sense of humour helped us through many a long or difficult meeting. Thank you, Philippe, on behalf of all IVSC members, for your contribution to international valuation standard setting.</p>							
	<p>In February, I am attending the North American Conference of Appraisal Organisations to discuss moves to bring IVS and US Principles of</p>	<p>I was greatly saddened to learn of the death in February of Norman Bowie, aged 85. It was Norman, together with Sir Idris Pearce, who in the late 1970s, took the initiative to create the IVSC. Our sympathies go to Norman's widow, Kathleen.</p> <p>GREG McNAMARA IVSC Chairman</p>							

FORTHCOMING MEETINGS AND SEMINARS

30 Mar/1 Apr 2000	IVSC Management Board, Auckland
2 - 7 April 2000	Twentieth Pan Pacific Congress, Auckland, New Zealand. For more information see New Zealand Institute of Valuers homepage http://www.nziv.org.nz or fax +64 4 382921410

13 July 2000	Valuation 2000, Las Vegas An international conference sponsored by the American Society of Appraisers, the American Society of Farm Managers and Rural Appraisers and the Appraisal Institute. See http://www.appraisers.org.val2000
3/4 October 2000	IVSC Management Board and 2000 AGM, London

IVSC NEWS

THE IVSC STANDARDS PROJECT

The IVSC Management Board has appointed a team of technical writers to draft the new IVSC Standards and Guidance. Mike Milgrim (US) is the lead editor. He is assisted by John Rich (UK), and Ray Westwood (Australia).

The writers are drafting under the direction of an Editorial Board, receiving advice and comment from the IVSC Standards Sub-Committee (which has wide geographic representation). The IVSC Management Board approves the release of drafts for formal Exposure.

The first documents to be produced under the IVSC Standards Project are to be launched at the Valuation 2000

conference to be held in Las Vegas in July.

Final Exposure Drafts will be agreed at the March Management Board meeting. To meet the July publication deadline, the exposure period for these drafts will, exceptionally, be reduced to three months. Member institutes are advised to timetable meetings of national committees to allow full consideration of these important drafts.

The proposed content of the 2000 edition is below. This is however still dependant on Board approval and some drafts may appear later in the year.

PROPOSED CONTENT OF 2000 EDITION OF INTERNATIONAL VALUATION STANDARDS AND GUIDANCE

- ?? Introduction, Concepts and Principles
- ?? Code of Conduct and Disclosure
- ?? Property Types – Real Property, Personal Property, Businesses, Financial Interests
- ?? Standard 1 – Market Value Valuations
- ?? Standard 2 – Non-Market Value Valuations
- ?? Relationship Standard – Financial Statements and Related Accounts Valuations
- ?? Relationship Standard – Loan Security, Mortgages and Debentures Valuations
- ?? Guidance Notes:
 - Real Property Valuation
 - Lease Interests
 - Going Concern Valuation
 - Consideration of Hazardous and Waste Substances in Valuation
 - Business Valuation
 - Valuation of Plant, Machinery, and Equipment
 - Intangible Assets
- ?? Commentaries:
 - Market Value for Existing Use
 - Investment Property
- ?? Glossary of Terms

NEW IVSC OFFICERS

The 1999 Annual General Meeting of the IVSC held in October elected the following as IVSC officers:

IVSC Chairman - Greg McNamara (Australia)
IVSC Vice Chairman – John Edge (UK)
IVSC Treasurer – Harold Moore (Canada)

IVSC APPOINTS EXECUTIVE DIRECTOR

Marianne Tissier was appointed as the first full-time IVSC Executive Director on 4 January 2000. Marianne has many years experience of international working. In 1989 she established a European Department for the UK Royal Institution of Chartered Surveyors, then moved to head the RICS International Department. In 1997, she joined a firm of international construction consultants and was director responsible for initiating a major change management programme. As Executive Director, IVSC, one of her most important tasks will be managing the IVSC Standards Project.

There are two new secretariat appointments consequent to the election of a new IVSC chairman. Carol Collins, Australian Property Institute, will act as IVSC Executive Secretary, assisting Greg McNamara in his role as chairman. Carol will also have responsibility for all meeting arrangements. The IVSC Financial administrator is Elsie Slater, also from the Australian Property Institute.

NEW IVSC MEMBERS

At the 1999 AGM, the following countries became members of the IVSC Management Board:

China, represented by the China Appraisal Society, and the **Netherlands**, represented by the Nederlandse van Makelaars, became Full Board Members.

Romania, represented by the Romanian National Association of Valuers, and **Thailand**, represented by the Thai Valuers Association, became Elected Board Members.

The AGM also welcomed **Tanzania**, represented by the Tanzania Institution of Valuers and Estate Agents (TIVEA), as an IVSC member. TIVEA was officially launched on 4 April 1997. Its members were originally members of the Institution of Surveyors of Tanzania. TIVEA membership has grown from the original 109 to 215 in June 1999. TIVEA works closely with the National Council of Professional Surveyors in Tanzania, the registration board for valuers, and has links with other valuer associations in the East African region.

As the influence of international standards continues, so interest in IVSC membership shows no signs of abating. The IVSC has been supporting the development of the Georgian Federation of Professional Assets Valuers. In Feb. 1999, the Georgian parliament adopted 'the law on Accounting and Accounting Activity Regulation' which resulted in

Georgia adopting International Accounting Standards as its national accounting standards. The Federation now sees an urgent need for the adoption of International Valuation Standards promulgated by the IVSC and has submitted a formal application to become an IVSC member.

CHINA

The 1999 IVSC Annual General Meeting was welcomed, in a letter, by H.E. Mr Xiang Huaicheng, Minister of Finance, PRC

“On behalf of the Ministry of Finance of the People’s Republic of China, I would like to extend my warm congratulations to the convocation of 99’ Annual Meeting of International Valuation Standards Committee in Beijing.

For a long time in the past, the International Valuation Standards Committee has provided strong support to the work of China’s asset appraisal. I would like to avail myself of this opportunity to express my heartfelt thanks to the International Valuation Standards Committee. With steady and continuous development, China’s asset appraisal work has become an indispensable and important intermediary force in China’s socialist market economy. We will actively learn from and make use of the experiences of international appraisal so as to establish administration framework and operation mechanism of asset valuation, which suits China’s country

specific. Efforts will be made to improve rules and regulation, standardize appraisal sector, and improve quality of practitioners so as to make contributions to China’s reform and opening up as well as socialist construction undertaking. We hope to have continued support of International Valuation Standards Committee for the development of China’s asset appraisal work.”

A conference ‘Strengthening the Banking System in China’, sponsored by the Bank for International Settlements and the People’s Bank of China, also took place in Beijing in October 99. Michael Pomerleano, Senior Capital Markets Specialist, The World Bank, spoke at some length on commercial real estate markets and the importance of real estate appraisers. “Comprehensive laws, regulation, and supervisory standards need to be complemented by private sector support in the form of sound legal, banking, accounting and appraisal professions,” he said. Mr Pomerleano talked of the supporting ‘eyes’ of accountants, lawyers and appraisers in strengthening the banking sector’s professional capacity and integrity. As China’s commercial construction boom is fuelled in great part by increased bank lending, he advised the regulatory authorities to develop more fully the nation’s appraisal profession. Mr Pomerleano concluded, “China’s real estate markets would benefit from the enhanced capacity of the appraisal profession”

VISIT THE IVSC WEB SITE

www.ivsc.org

NEWS FROM IVSC MEMBER INSTITUTES AND REGIONAL ASSOCIATIONS

IVSC MEMBER INSTITUTES MERGE

The UK was represented on the IVSC by two member institutes – the Incorporated Society of Valuers and Auctioneers (ISVA), and The Royal Institution of Chartered Surveyors (RICS). However, following significant votes in favour by members of both institutes, ISVA merged with the RICS at the beginning of 2000.

UK GOVERNMENT SUPPORT FOR IVSC

Copies of the IVSC Business Plan – **Global Valuation Standards – Target 2002** – were sent to members of the Interim Committee of the Board of Governors of the IMF who, in 1998, called for the development of asset valuation standards to strengthen both domestic and international financial stability. The chairman of the Committee, now renamed the International Monetary and Financial Committee of the Board of Governors is Gordon Brown, Chancellor of the Exchequer of the UK. Responding on his behalf, Melanie Johnson, UK Member of Parliament and Economic Secretary to the Treasury, said:

“.. the UK is firmly committed to the development and implementation of a range of codes and standards designed

to enhance the stability of the international financial system.

We recognise the importance of asset valuations to decision making and reporting, and the need to ensure that valuations are based on appropriate standards which are applied internationally to achieve comparability and transparency. Accordingly, I welcome the Committee’s development of a framework to ensure that comprehensive and robust valuation standards are in place by the year 2002, and wish you well in your endeavours.”

TEGoVA

The European Group of Valuers (TEGoVA) launched a new European quality mark “Approved by TEGoVA” at end of January. The aim of the pan-European certification system is to set a new standard in professional knowledge and competence in valuation. The “Approved by TEGoVA” quality mark can be awarded by TEGoVA to national certification bodies across Europe which fulfill its criteria for the education, training and development of valuers.

MARKET VALUE INITIATIVE – WHITE PAPER ISSUED BY THE APPRAISAL INSTITUTE

Extracts from a discussion paper issued by the Appraisal Institute are reproduced below. The full text is available on the AI web site www.appraisalinstitute.org.

Introduction

Appraisers, their professional organizations, regulators, client groups and others have expressed increasing concern regarding changes in the demand for appraisers' services, appraisers' abilities to adapt and respond to those changes under the Uniform Standards of Professional Appraisal Practice (USPAP) and the enforcement of USPAP. The Appraisal Institute shares these concerns. The Appraisal Standards Council has determined that only through substantive changes to USPAP can the profession address these complex issues while protecting the public.

We recognize that the world has changed drastically since the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) and the adoption of USPAP because of the breathtaking advances in technology, globalization, and securitization. As these forces have taken hold, clients have requested an ever-increasing range of services for which real estate appraisers have excellent training, knowledge, and skills. Such services may differ greatly from the classic Market Value estimates that FIRREA addresses and which form the foundation of the profession. The increasing demand for varied services and the desire to address all of them in a single set of

appraisals and which are not; which activities are covered under USPAP and which are not; and how appraisers can develop products that meet the changing needs of our clients.

The problems are complex, interrelated and require a comprehensive solution. These problems cannot be resolved through half measures such as the issuance of even more guidance in the form of Statements, Advisory Opinions, and/or educational material. Such documents will take time to produce and the market will have moved on before they are issued. Such documents will only add to the large volume of confusing guidance that already exists, USPAP is already 172 pages long. If USPAP does not enable appraisers to easily address rapidly changing demands for market services, the future of the entire appraisal profession is at risk. A simplified flexible USPAP will enable appraisers to immediately adjust to changing market demands.

Given these trends, the Appraisal Institute's Board of Directors has adopted the position that:

1. USPAP must enhance and strengthen Market Value to eliminate confusion in the marketplace and clearly address the goals of FIRREA;

detailed standards has led to numerous problems, including which products can be considered Market Value to meet market needs while subjecting such values to clear and enforceable Standards; and

3. USPAP should provide general and enforceable principles of ethics and competence that govern appraisers in providing consulting services, but also provide appraisers with the flexibility to meet unique client requirements and to compete with other professional who see to provide like services.

With these proposed changes, we envision a revitalized USPAP that will clearly address the initial concerns that led to its creation but also a USPAP that is easily adaptable to the rapidly changing needs of the marketplace. The changes we propose will ensure that the valuation work of appraisers is performed in accordance with clear and enforceable ethics and standards, and that the non-valuation work of appraisers is performed in an ethical and competent manner.

Changing Demand for Services

When FIRREA and USPAP were initially adopted, the real estate market was considered notoriously inefficient. Since that time, change has become a constant as numerous intertwining forces have significantly impacted the efficiency of the real estate market and the services that appraisal professionals are most qualified to provide. These forces include Technology, Securitization, and Globalization. The rate of changes that these forces have created is and will continue to be dramatic. Rather than attempt to develop detailed rules to dictate every step of every possible service, appraisers and regulators need to develop rules that will ensure competency and

2. USPAP should clearly distinguish other types of value from Market Value, providing appraisers with the flexibility demands.

The following is a summary of some of the forces impacting the appraisal profession.

A Technology

When FIRREA and USPAP were adopted (merely ten years ago), the Internet and email were barely known and used and appraisers had to travel to government buildings and other physical locations to perform research. New technologies have allowed a dramatic increase in the efficiency of the real estate market, in part because it has allowed real estate data to be easily accessible, electronically available, and extensively analyzed. New technologies have also led to a dramatic change in how appraisal professionals perform their services. Appraisers are now able to gather and analyze data in ways that could not even have been envisioned back when FIRREA and USPAP were initially adopted. With their education, training and experience, appraisers have the ability to develop valuation and non-valuation based services that new technologies allow that do not fall within the traditional view of appraiser services. However, the force of technology has not changed the basic procedures for developing an appraiser's opinion of Market Value. The past 65 years of practice and evolution have proven the validity of the appraisal practice as it relates to Market Value.

B Securitization

As the real estate market has become more efficient, investment risks have become more quantifiable, world-wide markets have opened, and the securitization

integrity when appraisers provide the services, while providing appraisers with the flexibility to meet changing market Market Value opinions increases, as does the need for opinions other than Market Value, and related services that do not require a valuation. Commercial real estate investors and rating agencies are increasingly seeking information that provides detailed market analysis and insight to future revenue projections. Services being sought include: underwriting, environmental assessment, engineering, site inspections, servicer reviews, tax appeals, due diligence, portfolio analysis, litigation, highest and best use studies, specialty properties and market and feasibility studies. Many appraisers and potential clients have the perception that USPAP either does not allow or impedes an appraiser's ability to compete for these assignments.

C. Globalization

When FIRREA and USPAP were adopted, the focus was on resolving a specific national problem: the savings and loan crisis. Since that time national economies have become increasingly intertwined through advances in technology, the free flow of capital across national borders, and the increasing availability of information. In addition, international investors are seeking consistency in analytic approaches, standards, and investment ratings, which can overcome cultural differences and free the flow of international capital.

The international community of appraisers has recognized the need for common standards the need for flexibility to meet varying market requirements, and the special nature of Market Value. The IVSC has promulgated Appraisal Standards reflecting the collective experiences and judgements of valuers from over 40 nations.

of real estate has increased dramatically. As the securitization of real estate evolves, the need for reliable specifically to the "Market Value Basis of Valuation" and then addressing "Valuation Bases Other Than Market Value" in its Standard 2.

USPAP needs to help integrate appraisers into the world economy by moving towards consistency with international standards.

Recommended Solutions

We propose the following solutions to the trends described in this White Paper.

1. *Focus Standards 1 and 2 on the development and reporting of Market Value opinions of real property interests.*

These recommended changes will: a) strengthen, clarify and consolidate the use of Market Value, the benchmark of real estate valuation world-wide, and eliminate confusion in the marketplace over differences in types of value; b) ensure that USPAP contains Standards that focus on the original concerns FIRREA sought to address, namely ethical and competent appraisals on the market value of real estate serving as collateral for federally insured transactions; c) increase enforceability of Standards relating to appraisals governed by FIRREA through such clarity; and d) bring consistency to world-wide standards and understanding, thereby helping to open global markets to appraisers.

2. *Develop Standards relating to the development and reporting of values other than Market Value.*

These recommended changes will: a) ensure that types of value will be clearly

IVSC Standards recognize the special nature of Market Value by devoting its Standard 1 and expertise to provide the diversified valuation services that clients require for a myriad of business decisions; c) provide a clear set of enforceable rules governing values other than Market Value, ensuring that such values are provided in a competent and ethical manner; d) provide real estate appraisers with the flexibility to quickly respond to changing market demands; and e) enable real estate appraisers to better compete with less qualified individuals in providing services requiring valuation related skills (i.e. price opinions).

3. *Eliminate the existing standards governing consulting assignments from the USPAP document. Make provisions so that everyone required to comply with USPAP even if providing services other*

distinguished from Market Value; b) enable real estate appraisers to fully utilize their training, knowledge, skills,

than valuation will be subject to Ethics, Rules of Conduct, management confidentiality, record keeping and competency.

These recommended changes will: a) ensure that real estate appraisers perform consulting assignments in an ethical and competent manner; b) enable regulators to oversee consulting activities of appraisers; c) provide real estate appraisers with the flexibility to quickly respond to changing market demands; d) enable real estate appraisers to fully utilize their training, knowledge, skills, and expertise to provide the diversified services that clients require; and e) enable real estate appraisers to better compete with less qualified individuals in providing services requiring valuation related skills.

US SECURITIES AND EXCHANGE COMMISSION ISSUES CONCEPT RELEASE ON INTERNATIONAL ACCOUNTING STANDARDS

In February, the US Securities and Exchange Commission (SEC) issued for public comment a concept release on the use of international accounting standards. The release:

- ?? Seeks feedback from domestic and foreign parties regarding both acceptance of IASC standards and the broader issue of shaping a global

financial structure for increasingly globalised capital markets;

- ?? Solicits comment regarding the quality of IASC standards and raises questions regarding what supporting infrastructure is necessary in an environment where issuers and auditors often are multinational organisations, providing financial information in many countries;

- ?? Seeks to identify what important concerns would be raised by acceptance of IASC standards; and then asks for comment on whether the SEC should modify its current requirement for all financial statements to be reconciled to US GAAP; and
- ?? Emphasises the SEC's desire to gain knowledge of first hand experience that issuers have had with applying IASC standards when preparing financial statements, public accountants have had with auditing the application of IASC standards and investors have had with using financial statements prepared using IASC standards.

International Accounting Standards Committee chairman, Stig Enevoldsen, welcomed the decision by the SEC. *“I am delighted that the SEC has issued this concept release inviting comments on a topic of such vital importance. I invite all parties around the world with an interest in financial reporting to respond to the concept release”*.

The US SEC is a member of the International Organization of Securities Commission (IOSCO). In 1995, IASC agreed with IOSCO that IASC would develop a set of “core standards”, as identified in a list established by IOSCO in 1993. IOSCO agreed that it would consider endorsing International Accounting Standards for cross-border capital raising and listing purposes in all global markets, if the completed core standards satisfy IOSCO. IOSCO has now begun its assessment of whether the core standards will enable IOSCO to endorse the set of core standards as a whole. The view of the US SEC is obviously crucial to this decision.

The following is an abbreviated version of the Concept Release:

“With the activities of investors, lenders and companies becoming increasingly global, the Commission is increasing its involvement in a number of forums to develop a globally accepted, high quality financial reporting framework. Our efforts, at both a domestic and international level, consistently have been based on the view that the only way to achieve fair, liquid and efficient capital markets world-wide is by providing investors with information that is comparable, transparent and reliable. That is why we have pursued a dual objective of upholding the quality of financial reporting domestically, while encouraging convergence towards a high quality global financial reporting framework internationally. In this release, we are seeking comment on the necessary elements of such a framework, as well as on ways to achieve this objective. One aspect of this is seeking input to determine under what conditions we should accept financial statements of foreign private issuers that are prepared using the standards promulgated by IASC.

Over the last two decades, the global financial landscape has undergone a significant transformation. These developments have been attributable, in part, to dramatic changes in the business and political climates, increasing global competition, the development of more market-based economies, and rapid technological improvements. At the same time, the world's financial centers have grown increasingly interconnected.

Corporations and borrowers look beyond their home country's borders for capital. An increasing number of foreign companies routinely raise or borrow capital in U.S. financial markets, and U.S. investors have shown great interest in investing in foreign enterprises. This globalisation of the securities markets has challenged securities regulators around the world to adapt to meet the needs of market participants while maintaining the current high levels of investor protection and market integrity.

Our efforts to develop a global financial reporting framework have been guided by the cornerstone principle underlying our system of regulation – pursuing our mandate of investor protection by promoting informed investment decisions through full and fair disclosure. Financial markets and investors, regardless of geographic location, depend on high quality information in order to function effectively. Markets allocate capital best and maintain the confidence of the providers of capital when the participants can make judgements about the merits of investments and comparable investments and have confidence in the reliability of the information provided.

Currently, issuers wishing to access capital markets in different jurisdictions must comply with the requirements of each jurisdiction, which differ in many respects. We recognise that different listing and reporting requirements may increase the costs of accessing multiple capital markets and create inefficiencies in cross-border capital flows. Therefore, we are working with other securities regulators around the world to reduce these differences. To encourage the development of accounting standards to

be considered for use in cross-border filings, we have been working primarily through IOSCO, and focusing on the work of IASC.

High quality accounting standards are critical to the development of a high quality global financial reporting structure. Different accounting traditions have developed around the world in response to varying needs of users for whom the financial information is prepared. In some countries, for example, accounting standards have been shaped primarily by the needs of private creditors, while in other countries the needs of tax authorities or central planners have been the predominant influence. In the United States, accounting standards have been developed to meet the needs of participants in the capital markets.

High quality accounting standards consist of a comprehensive set of neutral principles that require consistent, comparable, relevant and reliable information that is useful for investors, lenders and creditors, and others who make capital allocation decisions. High quality accounting standards are essential to the efficient functioning of a market economy because decisions about the allocation of capital rely heavily on credible and understandable financial information.

When issuers prepare financial statements using more than one set of accounting standards, they may find it difficult to explain to investors the accuracy of both sets of financial statements if significantly different operating results, financial positions or cash flow classifications are reported under different standards for the same period. Questions about the

credibility of an entity's financial reporting are likely where differences highlight how one approach masks poor financial performance, lack of profitability, or deteriorating asset quality.

The efficiency of cross-border listings would be increased for issuers if preparation of multiple sets of financial information was not required. However, the efficiency of capital allocation by investors would be reduced without consistent, comparable, relevant and reliable information regarding the financial condition and operating performance of potential investments. Therefore, consistent with our investor protection mandate, we are trying to increase the efficiency of cross-border capital flows by seeking to have high quality, reliable information provided to capital market participants.

However, ensuring that high quality financial information is provided to capital markets does not depend solely on the body of accounting standards used. An effective financial reporting structure begins with a reporting company's management, which is responsible for implementing and properly applying generally accepted accounting standards. Auditors then have the responsibility to test and opine on whether the financial statements are fairly presented in accordance with those accounting standards. If these responsibilities are not met, accounting standards, regardless of their quality, may not be properly applied, resulting in a lack of transparent comparable, consistent financial information.

Accordingly, while the accounting standards used must be high quality they

also must be supported by an infrastructure that ensures that the standards are rigorously interpreted and applied, and that issues and problematic practices are identified and resolved in a timely fashion.

Audit firms should have a responsibility to adhere to the highest quality auditing practices – on a world-wide basis – to ensure that they are performing effective audits of global companies participating in the international capital markets. To that end, we believe all member or affiliated firms performing audit work on a global audit client should follow the same body of high quality auditing practices even if adherence to these higher practices is not required by local laws.

Accounting and auditing standards, while necessary, cannot by themselves ensure high quality financial reporting. Audit firms with effective quality controls are a critical piece of the financial reporting infrastructure. Historically, audit firms have developed internal quality control systems based on their domestic operations. However, as clients of audit firms have shifted their focus to global operations, audit firms have followed suit and now operate on a world-wide basis. Therefore quality controls within audit firms that rely on separate national systems may not be effective in a global operating environment. We are concerned that audit firms may not have developed and maintained adequate internal quality control systems at a global level.

The Concept Release raises concerns that comparability between IASC-based and U.S. GAAP-based financial statements may be hindered if one

standard explicitly permits a choice among alternative approaches for a particular topic and the other (1) requires a single approach that is somewhat like one of the alternatives, or (2) also permits a similar choice of approaches. Such alternatives may relate to recognition, measurement, display, or disclosure requirements. Free choice alternatives not only create problems comparing financial statements based on different standards, but also in comparing financial statements based on the same set of standards.

In some cases, the IASC standard permits a choice and U.S. GAAP does not. For example, under IAS 16, *Property, Plant and Equipment*, an enterprise can choose to measure its property, plant and equipment following either the benchmark treatment, that is, to carry those assets at cost (less accumulated depreciation and accumulated impairment losses), or the allowed alternative treatment, that is, to periodically revalue its property, plant, and equipment to fair value (less subsequent accumulated depreciation and subsequent accumulated impairment losses). Revaluation increases under the allowed alternative treatment are credited directly to equity as revaluation surpluses unless they reverse a revaluation decrease that was previously recognised as an expense, in which case they are credited to income. Revaluation decreases are first charged against any surpluses for the same asset, then they are recognised as expenses. Upon disposal of a revalued asset, the amount recognised in the income statement under IAS 16 as gain or loss on disposal differs from that which would be recognised for a similar asset that was accounting for at historical cost. IAS 16 also permits a choice for

presentation of revalued assets: gross assets and accumulated depreciation can be proportionately restated to equal the revalued amount or the gross assets and accumulated depreciation accounts can be eliminated and the net revalued amount presented.

U.S. GAAP requires accounting similar to IAS 16's benchmark treatment and does not permit revaluation accounting for fixed assets. The financial statements of an enterprise choosing to revalue its assets under the IASC standards would not be readily comparable to those of an enterprise following U.S. GAAP, nor would they be comparable to the financial statements of an enterprise following IASC standards that chose not to revalue its assets. The impact of revaluation on the financial statements may not be obvious or easy to trace, depending on how often the assets are revalued, how they are grouped for revaluation, and what choices are made for their presentation in the balance sheet. Nor can financial statements prepared under U.S. GAAP be easily adjusted to compare with revalued amounts for property, plant, or equipment in IASC-based financial statements. For financial statement users making comparison, there may be uncertainty related to the determination of revalued amounts, the validity of certain asset ratios, and the ability to evaluate performance.”

The full text of the US SEC Concept Release is available on the SEC web site – www.sec.gov

EUROPEAN UNION MOVES TO ADOPT FAIR VALUE ACCOUNTING

The European Commission has proposed to modernise European Union (EU) accounting rules by introducing the "fair value" accounting method. The proposed amendment to the EU's Accounting Directives aims to take account of developments in markets (such as widespread use of so called derivatives), business and international accounting standards. Under the proposed amendment, which must be approved by the Council of Ministers and the European Parliament, Member States would have to permit or, if they preferred, require fair value accounting for certain financial assets and liabilities.

Internal Market Commissioner Frits Bolkestein, said: "Adoption of this proposal would help European companies to prepare financial statements that are accepted and understood around the world. Aligning the provisions of the Accounting Directives with existing international standards on fair value accounting will help European companies compete in international capital markets on equal terms with their non-European competitors."

The Fourth Company Law Directive (78/660/EEC) harmonises the content of annual accounts required by Member States of limited liability companies. The Seventh Company Law Directive (83/349/EEC) co-ordinates the content of consolidated accounts of groups of companies. These Accounting Directives

also provide a frame of reference for the accounts of financial institutions that prepare their accounts under the provisions of the bank accounts Directive (86/635/EEC) and the Insurance Accounts Directive (91/674/EEC).

Financial markets have changed since these Accounting Directives were adopted. In addition to traditional financial instruments such as shares and bonds, companies are using complex derivative instruments such as futures, options, and swaps. These derivatives, used often for risk management, may in themselves bring significant associated risks for the companies that use them and may transform a company's financial position or its risk profile.

In response to the increasingly widespread use of these complex financial instruments, the most influential accounting standards setters, including the IASC, have been working hard to adapt accounting standards in order to ensure that the financial impacts of these instruments are reflected in company financial statements appropriately and with full transparency. The proposed solutions have a common theme of moving away from the historical cost valuation model on which the Accounting Directives are based, towards a method of valuing balance sheet items not currently permitted by the Directives, i.e. that of "valuation at fair value" or "fair value accounting". The IASC has now

introduced fair value accounting in a new standard on financial instruments, which requires certain financial assets and liabilities to be valued in the balance sheets of companies at fair value. This will have a particularly significant impact in the case of derivative financial instruments, which often have no historic cost, but can have very material fair values.

Since the publication of the Commission's New Accounting Strategy, the Commission's declared policy has been to keep the European Accounting Directives in line with IAS. This is in the interests of those typically large EU companies that wish to report using IAS. Maintaining consistency of the Accounting Directives with IAS enable those companies to meet the capital market requirements and the requirements of the Accounting Directives using only one set of financial statements, which avoids inefficiencies and the potential for market confusion. Any further consolidation and integration of EU capital markets will only increase the pressure for EU companies participating in those markets to report under internationally recognised accounting standards.

The support for this policy at Member State level is evidenced by the fact, that since 1998, seven Member States have already amended national legislation to permit publicly traded companies to prepare their consolidated accounting in line with IAS instead of national legislation, as long as these accounts are in conformity with the Accounting Directives.

The proposal is drafted in a way that will modernise the Accounting Directives as a framework which will enable European

companies to report in line with current international developments, whilst also leaving some scope to enable them to follow further international developments. They will be able to report in line with the current IASC requirements without the very precise IASC requirements having been adopted into the Directives.

The proposal restricts the requirement to permit or require fair value accounting to those items where there is a sufficiently developed international consensus that fair value accounting is appropriate, rather than allowing blanket application of fair value accounting to all financial instruments. There is an international consensus that this method of valuation is appropriate – but only insofar as it relates to certain financial assets and liabilities. The Commission considers that it would be premature for the Accounting Directives to make provision for something on which there is no international agreement. Consequently, the modernisation of the Accounting Directive is not intended to replace historical cost as the basis for the Accounting Directives. Fair value will therefore not be permitted for all balance sheet items. The method of valuation of items which are not financial instruments, such as fixed assets (for e.g., land and buildings, plant and equipment,) will be unchanged. Under the Directives, companies are required to value their assets at purchase price or production costs. However, Member States may allow or require companies to re-value certain assets, or to value certain assets at replacement costs. However, just as in the US (see previous article), greater emphasis is being placed on comparability and the maintenance of options such as this will be increasingly challenged.

INTERNATIONAL ACCOUNTING

STANDARDS COMMITTEE – AN UPDATE

INVESTMENT PROPERTIES

In December, the IASC Board reached agreement on the content of a final standard to be effective for periods beginning on or after 1 January 2001. The Board will consider the final text at its next meeting on 13-17 March.

Final Standard –Scope

- ?? The Standard will cover investment property held by all enterprises and will not be limited to enterprises whose main activities are in this area.
- ?? Investment property is property (land or a building, or part of a building, or both) held to earn rentals or for capital appreciation.
- ?? Investment property does not include:
 - a) property held for use in the production or supply of goods or services or for administrative purposes (see IAS 16)
 - b) property being constructed for third parties (see IAS 11)
 - c) property held for sale in the ordinary course of business (see IAS 2)
 - d) an interest held under an operating lease, even if the interest was a long-term interest acquired in exchange for a large up-front payment (see IAS 17). In its response, IVSC disagreed with this, saying “*We believe most strongly that a lessee’s interest in property held under*

an operating lease should be capable of treatment as an investment property. The test is not one of type of tenure but one of use or intention – i.e. is the interest held for owner-occupation (IAS16) or for investment (E64)? The IVSC urges a fundamental review of the relevant section of lease accounting (IAS 17) in order to resolve this correctly. We consider the suggestion that an operating lease cannot be eligible for investment accounting to be quite wrong and out of synch with actual practice.” (NB Accounting for Leases is now under review by IASC – see later).

Final Standard: Accounting Models

- ?? The Standard will permit enterprises to choose between a fair value model and a cost model. The introduction of a cost model is a change from Exposure Draft 64, which proposed a fair value model only. This is the first time that IASC Board has introduced a fair value accounting model for non-financial assets. The comment letters on E64 showed that although many support this step, many others still have significant conceptual and practical reservations about extending a fair value model to non-financial assets. Also, some enterprises felt that they operate in property markets that are not yet sufficiently mature for a

fair value model to work satisfactorily. Thus the Board believed that it is impracticable, at this stage, to require a fair value model for investment property. At the same time, the Board believes that it is desirable to permit a fair value model. This evolutionary step forward will allow preparers and users to gain greater experience working with a fair value model and will allow time for certain property markets to achieve sufficient maturity.

?? The fair value model is the model proposed in E64: investment property should be measured at fair value and changes in fair value should be recognised in the income statement. The IASC Board has recognised that the valuation profession will have an important role in implementing this Standard. Accordingly, in developing guidance on the fair value of investment property, the Board considered IVS issued by IVSC. The Board believes that IASC's concept of fair value is similar to the IVSC concept of market valued. Thus the guidance on fair value is in substance, and largely in wording, as well identical with guidance in IVS 1.

?? The cost model is the benchmark treatment in IAS 16, Property, Plant and Equipment: investment property should be measured at depreciated cost (less an accumulated impairment losses). An enterprise that chooses the cost model should disclose the fair value of its investment property.

?? An enterprise should apply the model chosen to all its investment property. A change from one model to the other model should be made only if the change will result in a more appropriate presentation of events or transactions. The Standard will state

that this is highly unlikely to be the case for a change from the fair value model to the cost model.

?? There is a rebuttable presumption that an enterprise can determine the fair value of investment property reliably on a continuing basis. However, in exceptional circumstances when this is not so, the enterprise should measure investment property using the benchmark treatment in IAS 16 until disposal of the investment property.

IVSC will be issuing a Commentary on Valuation of Investment Property, alerting valuers to the introduction of this new International Accounting Standard. The IVSC Commentary will be available in July and will be followed by the development of formal guidance in this area.

IASC PUBLISHES STUDY OF BUSINESS REPORTING ON THE INTERNET

The International Accounting Standards Committee in November 1999 published a study of business reporting on the Internet as the first step in a possible project to develop standards in that area. The study examines:

?? The current technologies available for electronic business reporting

?? What companies around the world are actually doing (this involved a detailed analysis of the Web sites of the 30 largest countries in each of 22 countries, 660 companies in all);

?? The sort of standards for electronic business reporting that are needed

now, within the constraint of today's technologies;

- ?? The shortcomings of business reporting on the Internet within current technologies; and
- ?? The technological changes that are on the horizon and how can they improve electronic business reporting (particularly the ability to go beyond the Internet as "electronic paper" to facilitate downloading and analysis of financial data).

"Technology has altered irreversibly not only the physical medium of corporate financial reporting but also its traditional boundaries," commented Sir Bryan Carsberg, Secretary-General of IASC. "Paper reports are being supplemented – and, for many users, replaced – by electronic business reporting, primarily via the Internet. And while we accounting standard-setters have, even to this day, tended to focus primarily on the traditional financial statements and related note disclosures, investors and lenders have moved far beyond that," Sir Bryan said.

Four experts from academe authored the IASC study. Paul Pacter, who is managing the project for IASC, said: "This is a pioneering study. It illustrates to accounting policy makers the nature of changes occurring in business reporting and explains how those changes are affecting the dissemination of accounting and business information. The study also identifies the effects those changes may have on accounting standard setting in the future. And, by recommending a set of measures to address those changes in Internet corporate reporting occurring now and currently anticipated, the report charts a sensible course for IASC to help

ensure the availability of high quality data in electronic form to the users of business and financial information."

Among other recommendations, the study urges IASC to adopt a Code of Conduct for Web-based business reporting. A complete draft of a proposed Code is included in the report. The study also recommends that IASC join a consortium effort – which would include information intermediaries, software companies, securities regulators, national accounting standard setters, international accounting firms, and others – to develop a global electronics business reporting language to meet the needs of investors, regulators, and others who look to the Internet for financial and operating information about business enterprises.

IASC PUBLISHES INTERNATIONAL DISCUSSION PAPER ON LEASES

IASC published, on 13 March, a Discussion Paper entitled Leases: Implementation of a New Approach. The principal authors of the Paper are members of staff of the UK Accounting Standards Board. It presents a Position Paper that has been developed by the G4+1 international group of accounting standard-setters and sets out an agreed approach to the treatment in financial reporting of leases, which differs in fundamental respects from that which is required by existing standards of members of the G4+1.

IASC last revised its Standard on leasing, IAS 17, Leases, in 1997. That revision

was a limited one and addressed only those matters considered essential to bring the standard into line with other standards and make it suitable for use in financial statements filed in cross-border securities transactions. At the time IAS 17 (revised 1997) was approved, the IASC Board agreed to continue working on a more complete revision of the Standard in conjunction with other standard setters. IAS 17 requires radically different accounting (both in the lessee's and the lessor's financial statements) for transactions classified as finance leases and those classified as operating leases. In the financial statements of lessees, a finance lease will result in the recognition of an asset and an obligation for the leased asset and related financing. However, the same transaction structured as an operating lease will not give rise to either an asset or liability and the regular lease payments are recorded as they are incurred. A lessor in a finance lease records the asset associated with the lease receivables; under an operating lease this asset is not recognised.

Accounting for leases was the subject of a previous G4+1 Discussion Paper entitled '**Accounting for Leases: A New Approach**', which was published in 1996. The 1996 Discussion Paper, which dealt mainly with accounting by lessees, concluded that the distinction between operating leases and finance leases that is required by existing accounting standards is arbitrary and unsatisfactory. The main deficiency noted in the 1996 Discussion Paper is that existing standards do not provide for the recognition in lessees' balance sheets of material assets and liabilities arising from operating leases. How leases are classified has important implications, for example, for reported

levels of indebtedness, debt-to-equity ratios, return on assets employed and interest coverage. The 1996 Discussion Paper suggested that the comparability (and hence usefulness) of financial statements would be enhanced if the present treatment of operating leases and finance leases were replaced by an approach that applied the same requirements to all leases.

The new Discussion Paper develops the approach proposed in 1996. It explores the principles that should determine the extent of the assets and liabilities that lessees and lessors would recognise under leases, and how those principles might be applied in new accounting standards to account for many of the complex features that are found in lease contracts (such as options, contingent rentals and residual value guarantees).

The main recommendations are as follows:

- ?? For lessees, the objective should be to record, at the beginning of the lease term, the fair value of the rights and obligations that are conveyed by the lease.
- ?? Leases that are at present characterised as operating leases (and therefore not included in the balance sheet) would give rise to assets and liabilities - but only to the extent of the fair values of the rights and obligations that are conveyed by the lease. Thus where a lease is for a small part of an asset's economic life, only that part would be reflected in the lessee's balance sheet.
- ?? The fair value of the rights obtained by a lessee would in general be measured as the present value of the

minimum payments required by the lease, plus any other liabilities incurred.

- ?? Lessors should report financial assets (representing amounts receivable from the lessee) and residual interests as separate assets, since they are subject to quite different risks. The amounts reported as financial assets by lessors would, in general, be the converse of the amounts reported as liabilities by lessees.

Sir Bryan Carsberg, IASC Secretary-General, welcomed the publication of the 2000 Discussion Paper, noting that: *"there is a significant international leasing industry, covering everything from cars to aircraft. Finance companies often operate in many markets around the world, taking advantage of variations in interest rates, tax regulations and, unfortunately, accounting rules. But leasing is a very flexible form of finance. The challenge for IASC and national standard setters is to capture the effects of flexibility in the assets and liabilities recorded by lessees and lessors. The approach proposed in this Paper is that lessees and lessors would each account for the rights and obligations that arise from all the contracts they have entered into. The existing model adopted by all G4+1 members is very much an 'all or*

nothing' approach and users have expressed support for treating operating leases and finance leases more consistently in financial statements for some time. The practice of structuring leases to avoid showing leased assets and the resulting liabilities on the balance sheet is a natural consequence of a standard that draws a bright line between similar transactions. The G4+1 Discussion Paper is the next step in IASC's consideration of a new Standard on leases. If we can achieve convergence on matters of principle in this significant area, I believe that global capital markets will have been well served by the G4+1's efforts. However, a change in lease accounting would have wide-ranging effects and IASC will listen to comments on the Discussion Paper, consult widely and co-operate with national standard setters in the course of deciding what further action to take."

All the organisations that participate in the G4+1 have agreed to publish the Position Paper in their own jurisdictions. They will consider, in the light of comments received in response to the Position Paper, whether its proposals should form a basis for developing new accounting standards. The IASC Board is expected to receive a report on the comments received at its meeting in October 2000.

To obtain IASC publications, please contact Publications Dept, International Accounting Standards Committee, 166 Fleet Street, London EC4A 2DY, UK. Tel: +44 (171) 427-5927, Fax: +44 (171) 353-0562, <http://www.iasc.co.uk>

INTERNATIONAL FEDERATION OF ACCOUNTANTS

IFAC and International Firms to Work Together in Raising International Standards

At a meeting in London on Monday 10 January, The International Federation of Accountants (IFAC) and the large international firms launched a major new initiative which is designed to raise standards of financial reporting and auditing globally, thereby protecting the interests of cross-border investors and promoting international flows of capital. A key component of this initiative is the establishment of a new IFAC-sponsored grouping of firms that will work closely with IFAC in developing and encouraging implementation of international accounting and auditing standards. The proposals also provide for independent oversight of IFAC's public interest activities.

Participation in the new IFAC grouping of firms will be open to any firm having transnational clients and undertaking to comply with rigorous quality obligations that will include:

- ?? having policies and practices in compliance with International Standards on Auditing (ISAs) and the IFAC Code of Ethics
- ?? the maintenance of appropriate internal control procedures including intrafirm practice review

- ?? agreement to implement training on international accounting and auditing standards including the Code of Ethics
- ?? agreement to subject assurance work to periodic external quality assurance
- ?? agreement to support the development of the professional bodies and implementation of international standards of accounting and auditing in developing countries

Welcoming these proposals, IFAC president Frank Harding commented: *"This initiative represents a significant step towards the achievement of harmonisation of financial reporting and auditing at a global level. The commitment by the international firms to work with IFAC in ensuring compliance with international standards and consistent quality of internal procedures in all their countries of operation will promote transparency, reliability, and comparability of financial information across national borders, facilitate the international transfer of public and private capital, strengthen business transactions, and ultimately contribute to the broader public interest through wealth creation and the strengthening of civil societies."*

The greater part of the funding for the IFAC grouping of firms will be provided by participating firms, who will also contribute additional resources to strengthen IFAC's audit standards setting and monitoring work.

