JANUARY 2002 NEWSLETTER

GLOBAL VALUATION ISSUES

IVSC

INTERNATIONAL VALUATION STANDARDS COMMITTEE

MESSAGE FROM THE CHAIRMAN

Over the past two years, the IVSC has experienced unprecedented change as it responds to the challenges of globalisation on behalf of the valuation profession.

The necessity for such change was forecast in the current IVSC business plan, **'Global Valuation Standards, Target 2002'**. The IVSC has largely delivered on that plan and the Management Board is now developing a new plan to take the IVSC forward as from 2003.

When the IVSC met in early October, the terrorist attacks of 11 September were still very fresh in many minds. According to James Wolfensohn, President of the World Bank, one good thing to emerge is a "growing, but still fragile, new asset: an international recognition of global interdependence".

The new IVSC business plan will reflect this global interdependence. It is based on the concept of a strong partnership between IVSC, its member bodies, other national valuation or appraisal standard setters, regional groups of valuers, and others who use, rely on or regulate valuation services. The plan also recognise the need to ensure that all have the possibility of access to the standards. That means making the IVS widely available at minimal cost.

The IVSC will also continue to involve as many countries as possible in its activities. In particular, it will ensure that the developing world has a voice in its deliberations.

Finally, the plan seeks to strengthen further IVSC standard-setting activities as it becomes a truly global standard setter.

Inevitably, all of the above carry significant resource implications. When deciding their response, IVSC member institutes and the valuation profession need to consider two key issues:

- How important are global valuation standards to the future of the profession;
- Is there scope for a reallocation of resource from national to international valuation standard setting?

GREG McNAMARA
LFAPI, A.I.Arb
IVSC Chairman

IN THIS EDITION

IVSC 2002

ELECTIONS AND NEW MEMBERS

The 2001 Annual General Meeting of the IVSC saw a number of elections take place. John Edge, UK representative, was elected Chairman-Elect and will take up the position as IVSC chairman for the three years following the 2002 AGM. John remains as IVSC Vice Chairman for the current year.

Felician Komu, Tanzanian Institution of Valuers and Estate Agents, was elected as the Developing Country Representative on the IVSC Management Board for a two year period. Felician's enthusiasm and energy is already much in evidence. He was greatly involved in the arrangements for the three-day conference of the African Real Estate Society that took place in Tanzania in late October 2001. In her opening address, the Deputy Minister of Lands and Housing Settlements indicated that the Tanzanian government was intending to adopt the International Valuation Standards.

Interest in IVSC Board membership continues to grow. The annual election for Elected Board members saw Malawi, represented by the Surveyors Institute of Malawi, reelected as a Board member for a further three-year period. Brazil, represented by the Instituto Brasiliero de Avaliacoes e Pericias de Engenharia, and Singapore, represented by the Singapore Institute of Surveyors and Valuers, were elected as Board members for the first time for a three-year period.

STRENGTHENING THE IVSC GLOBAL PRESENCE

Two organisations were welcomed into IVSC membership at the 2001 AGM. Nigeria, represented by the Nigerian Institution of Estate Surveyors and Valuers, has joined as a full Member. The Association for Authorized Real Estate Valuation, Finland, joined as an Observer Member. And already the IVSC secretariat is in contact with a further seven countries who have indicated that they will be seeking IVSC membership at the 2002 AGM.

2001 EDITION OF INTERNATIONAL VALUATION STANDARDS

The 2001 edition of the International Valuation Standards was launched in July. The 2001 IVSC AGM received the following report from the IVSC Lead Editor, Mike Milgrim, on the changes between the 2000 and 2001 editions of IVS.

The revisions in IVS 2001 can be broken down into five areas or categories:

- new features that make the book more reader-friendly,
- existing components that underwent extensive reformatting,
- new components drafted for the Standards document,
- existing content areas that saw further conceptual development, and
- existing content areas that underwent fine-tuning or updating.

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New features that make the book more reader-friendly include a two-page summary of the principal changes between the 2000 and 2001 editions, a new index, and further development of the glossary. Differences in terminology used by valuers in English-speaking communities of the Commonwealth and North America are now identified in the Glossary. Explanations have been provided for those terms without exact equivalents, e.g., vacant possession, service potential, trading potential, and specialised trading property. Equivalent terms have been identified where they exist, e.g., assessment/rating, contract rent/passing rent, sandwich leasehold/head leasehold, operating expenses/outgoings, overall capitalisation rate/all risks yield, and investment value/worth.

Two components that had appeared as exposure drafts in IVS 2000 were extensively overhauled and reorganised in IVS 2001. IVA 1 (Valuation for Financial Reporting) was reformatted to conform to the nine-part organisation of the two Standards (IVS 1 and IVS 2) and the other Application (IVA 2, Valuation for Lending Purposes). The material in IVA 1 on the accounting background was moved to an addendum and the essential points in the Commentary on International Accounting Standard 40 (Investment Property) were incorporated into IVA 1. GN 8 on Depreciated Replacement Cost (DRC) was also reformatted and revised.

Two new GNs and three new Commentaries were developed for IVS 2001. These were GN 9 on Valuation Reporting, GN 10 on Discounted Cash Flow Analysis, the Commentary on Valuation in Emerging Markets, the Commentary on the Possible Impact of Standards and Statements of the Basel Committee on Banking Supervision (BCBS) on Valuation for Loan Purposes, and the Commentary on Public Sector Asset Valuation. New technical terms defined in these GNs and Commentaries also made their way into the Glossary—60 new terms in all.

IVS 2001 reflects the Management Board's decision that Market Value for the Existing Use (MVEU) represents an essential component of DRC methodology. IVA 1, GN 8 (DRC), and the Commentary on Public Sector Asset Valuation were revised to accord with this decision. Further discussion, however, may produce further conceptual refinements involving the issue. The Standards document can best be described as a work in progress, a living document responsive to continuing dialectical discourse. A second area involving concept was the Committee's decision to withdraw GN 5 (Going Concern Concept of Valuation) and expand the discussion in GN 6 of Going Concern as a valuation premise.

Finally, fine-tuning was done throughout IVS 2001 to ensure that the text reflects current banking and accounting practice, e.g., the definition of mortgage lending value added to IVS 2 (Valuation Bases Other Than Market Value) and the recognition given by GN 7 (Consideration of Hazardous and Toxic Substances in Valuation) that the presence of such materials may contribute to impairment loss.

All IVSC Exposure Drafts are available on the IVSC web site – www.ivsc.org. The official date for receipt of comment is 31 December 2001 but the Board would be happy to receive comments up to end March 2002.

IVSC WORK PROGRAMME

The 2002 edition of IVS is the final edition to be prepared under the IVSC Standards Project. The Project had as an objective the publication of a set of comprehensive and robust international standards by 2002. To allow maximum time for review and comment, the Board has agreed a later launch date than has been customary in the last couple of years. IVS 2002 is planned to be launched to coincide with the 2002 IVSC AGM to be held in Brussels, Belgium in late October/early November. New areas where guidance is being developed for possible inclusion in IVS 2002 are:

- **Real Estate Valuations for Commercial Mortgage Backed Securities.**

An IVSC Expert Group, under the chairmanship of Raymond Trotz, HypoVereinsbank, is developing guidance in this area. The Group includes representatives from the rating agencies and investment banks as well as valuers.

- **Mass Appraisal**

IVSC technical consultant, Ray Westwood, has reviewed the draft on Mass Appraisal produced by The Appraisal Foundation. A draft commentary is to be presented to the April Board meeting.

- **Agricultural Valuation**

Commentary paper being developed which discusses implications of International Accounting Standard, IAS 41, Agriculture

- **Extractive Industries**

Awaiting outcome of current IASB project on Extractive Industries before decision on further action to be undertaken by IVSC.

- **Personal Property**

Chairman of Expert Group, Richard Raymond Alasko, has prepared the first draft of a guidance note for discussion by Group.

- **Specialised Trading Properties**

Commentary being developed

- **Valuer/Auditor Relationship**

Guidance to be developed that reflects relevant International Standards on Auditing.

- **Retrospective and Prospective Reports**

Commentary being developed.

- **Reviews and Desktop Updates**

Small working group developing draft Guidance Note.

IVSC RESEARCH PROJECT ON REVALUATION OF LEASED LAND

Companies using International Accounting Standard, IAS 40, Investment Property and that adopt a fair value approach to investment property are required to revalue freehold investment properties but are not allowed to report long leasehold property investments at fair (market) value in the balance sheet. Instead, they are required to account for the long leasehold interest in accordance with IAS 17, Leases. As most, if not all, long-term leases are operating leases, this means that the amount paid for a lease must be amortised over the period of the lease, in other words long leasehold properties must be carried at depreciated cost.

Property companies in countries that are moving to adopt the International Accounting Standards are increasingly worried that IAS 40 could wipe tens of millions of dollars off the value of land and buildings in their balance sheets The issue is particularly relevant to companies in the UK, Hong Kong, Singapore, Netherlands, Sweden and Ireland.

Hongkong Land adopted IAS 40 for the first time for its first half 2001 financial report. The effect was to eliminate US$6.1 billion (88%) of shareholders' equity from the balance sheet at 31 December 2000. Hongkong Land also published modified financial statements reflecting the valuation of its long leasehold assets. This method increased net profit for 2000 from US$0.3 billion to US$2.2billion.

The International Valuation Standards Committee (IVSC) believes that this treatment is inconsistent, misunderstands the special characteristics of long leasehold property and in consequence prevents the presentation of a true and fair view of fixed assets of an entity. Although it is inappropriate for IVSC, as a standard setter, to act as a lobby group for particular interests, it is entirely appropriate for IVSC to promote property generally and its accurate measurement at fair (market) value, as opposed to historic cost.

The IVSC has undertaken a research project the aim of which is to inform this debate and collate data useful to the judging of the implications of IASB's current stance on the issue. This project is being led by IVSC Technical Consultant, John Rich. The timing is particularly good as it is hoped that IASB may consider any amendments under its current Improvements Project.

Many countries do not have a form of leasehold tenure nor a mature and developed property market where investment properties are traded. Inevitably in these countries the impact of IAS 40 on leaseholds will have no consequence and therefore is unlikely to invoke the interest of their standard setters. There are countries where leasehold tenure is prevalent or even dominant but where either the property markets are relatively undeveloped or where accounting is conventionally on a cost basis. The implications of IAS 40 will not become manifest until sometime in the future when these countries embrace IAS. Conversely, the matter does have a significant impact in certain countries and carries the potential to influence and distort markets to the detriment of leasehold property. The IVSC has supplied to the IASB the results of a survey of some 40 randomly selected countries to illustrate the incidence of leaseholds. In those countries where it is a material feature, and where there are developed investment markets, indicators have been supplied as to the extent of the problem using data extracted from company accounts of major investors and Investment Property Databank.

The IASB is to consider the issue at its December 2001 Board meeting.

"It is relatively easy to adopt regulations such as capital adequacy ratios; it is much more difficult to implement the underlying procedures (such as measuring the value of capital) that give meaning to these rules."

World Development Report 2002 – Building Institutions for Markets
Published by the World Bank

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'CANADIAN ENDORSEMENT FOR INTERNATIONAL VALUATION STANDARDS'

Canada has joined the growing list of countries that endorse the International Valuation Standards promulgated by the International Valuation Standards Committee (IVSC). At its most recent meeting, the National Governing Council of the Appraisal Institute of Canada (AIC) passed a motion endorsing the current Standards. The motion is reproduced below.

Institute President, John Clark, said, "The AIC has long recognised the need for international valuation standards and has actively supported the IVSC Standards Project. I applaud the IVSC on its achievements. It has established its legitimacy across a wide number of countries and has developed as a truly credible standard setting, gaining increasing recognition for its standards within other international regulatory frameworks."

APPRAISAL INSTITUTE OF CANADA

National Governing Council Meeting
October 2001 NGC Meeting. Ottawa. Ontario

Motion No. 6 - ENDORSEMENT OF IVS 2001

Whereas the Appraisal Institute of Canada is a member of the IVSC and is represented on their Management Board; and
Whereas the Appraisal Institute of Canada has continually supported and assisted the IVSC in producing robust International Valuation Standards.

It is duly moved, seconded and approved that Council endorse the current IVS 2001 Standards and recommend them to our members for reference when doing assignments where our Canadian Standards are silent; and
Further that Council request the Standards Board to review the IVS Standards giving consideration to the possibility of inclusion of appropriate subjects in the Canadian Standards and promote closer partnering between the respective Standards Boards.

EUROPEAN REAL ESTATE INDUSTRY SUPPORTS IVS

The European Public Real Estate Association (EPRA) has referred its members to the IVSC in its 'Best Practices Policy Recommendations' issued in October 2001.

EPRA is based in The Netherlands. Its members include many of the largest quoted real estate companies in Europe together with the largest investors in the sector and some major advisors. Harmonisation and improved transparency are the keys to making the sector more accessible, leading to better coverage and greater investment volumes. Thus EPRA endeavours to develop policies concerning standards of reporting disclosure, ethics and industry practices Although not a disciplinary body, EPRA actively encourages adherence to these policies.

In October 2001, the Best Practices Committee of EPRA released a set of policy recommendations aimed at pushing the industry forward by making the financial statements of public real estate companies in Europe, clearer, more transparent and comparable across Europe. The recommendations state that there is at present no consistently agreed basis for valuing the assets held by public real estate companies based in Europe. "In some countries, a book value of the assets on the balance sheet is reporting, and this will not normally reflect an open market valuation of the portfolio. In countries that do require open market valuations, methodologies differ." EPRA notes that it is not an accounting body or a valuation body. Consequently it says it is not in a position to dictate specific accounting treatment or valuation approaches. Therefore it refers its members to relevant accounting bodies and to the International Valuation Standards Committee.

EPRA notes that accounting standards in Europe are in a state of transition from national standards to International Accounting Standards and seeks to help that transition by encouraging consistent supplemental reporting of income, net asset values and fair value reporting of other assets and liabilities. Its recommendation are intended to be carried out through a supplemental EPRA page to be included in the financial statements of each company although as and when companies move to report under IAS there may be no need for a supplemental pages as EPRA considers that its recommendations are fully consistent with IAS.

EPRA believes there is room to improve the overall level of disclosure by public real estate companies in areas such as the timing and frequency of disclosure. Although not yet adopted as a recommendation, there is a strong consensus on the benefits of semi-annual valuations. Currently EPRA recommends that asset valuations be disclosed at least once a year. Once all public real estate companies are providing annual, external valuations, ERA will move to adopt a recommendation for semi-annual valuations and forecast such a recommendation in 2003.

The Best Practices Policy Recommendations were produced by a committee under the chairmanship of Jon H Zehner, Managing Director JPMorgan and consisting of members from real estate companies, investors and advisors throughout Europe.

For more information and to download a copy of the Best Practices Policy Recommendations, visit the EPRA web site – www.epra.com

SIGNIFICANCE OF REAL ESTATE VALUATION TO THE FINANCIAL SECTOR

Raymond Trotz, Director, HypoVereinsbank AG, and a representative from Germany on the IVSC Management Board, spoke to the 2001 IVSC AGM on the subject "The significance of real estate valuation to the financial sector with emphasis on calculating the mortgage lending value or a value at risk approach".

Using figures produced by the Federal Authority for Statistics and others, Raymond demonstrated that more than every second dollar, euro or yen is spent on real estate. He speculated that the global direct and indirect real estate volume to be valued each year in the financial sector might be in the region of 1,000 billion euro. If only 10% of these valuations were incorrect due to poor valuation standards, lack of market knowledge, or poor training in real estate valuation, the 'damage' to the global economy would be in the regional of around 100 billion euro year on year.

Startling figures!

A full copy of Mr Trotz's paper is available to view on the IVSC web site – www.ivsc.org

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INTERNATIONAL ACCOUNTING STANDARDS – AN UPDATE

In July, following extensive consultation, the International Accounting Standards Board (IASB) announced its agenda of technical projects. In addition to an initial agenda of nine technical projects, the IASB has a further 16 other issues that are being worked on by one or more of the IASB national standard setting partners. The IASB is working with these partners, or at least monitoring these efforts, to ensure that any differences among national standard setters or with the IASB are identified and resolved as quickly as possible.

BUSINESS COMBINATIONS

– is one of the projects on the agenda. Business combination accounting is an area of considerable divergence across jurisdictions. The project is to be run in two phases with the likely outcome amendment or replacement of current IAS 22, Business Combinations. Of particular interest to the IVSC is the growing consensus that assets contributed to a joint venture or other entity should be measured at their fair value rather than at the amount at which they were measured in the transferor's financial statements (carryover basis). The following article on the subject appeared in the October 2001 issue of the UK Accounting Standards Board's newsletter 'Inside Track' and is reproduced with the permission of the UK ASB.

Business combinations and goodwill–a new model under debate

In June the US Financial Accounting Standards Board adopted two new accounting standards: FAS 141 'Business Combinations' and FAS 142 'Goodwill and Other Intangibles'. Applicable for business combinations from 1 July 2001, these introduce major changes in US accounting, notably:

- *a ban on pooling (i.e. merger accounting); all business combinations are to be treated as purchases (i.e. acquisitions)*
- *no amortisation of goodwill*
- *in most cases, annual testing for goodwill impairment*
- *impairment testing rather than amortisation, for acquired intangible assets with indefinite lives.*

The Canadian standard-setter was a partner with the FASB in the development of FAS 141 and FAS 142 and has issued similar standards. In Australia, merger accounting is already outlawed. International Accounting Standards (IASs) at present recognise both merger accounting and acquisition accounting. The guidance for differentiating the circumstances in which either is applied is, however, not robust; it is substantially less developed than the material in the UK's Financial Reporting Standard (FRS) 6 'Acquisitions and Mergers'. IASs also mandate the amortisation of goodwill, in contrast to the UK standard under which goodwill may be either amortised or systematically tested for impairment.

Given this variety of accounting treatments across the world (and a few more variations in other jurisdictions), business combinations and related questions of accounting for goodwill and acquired intangible assets were seen as urgent priorities for the international agenda when standard-setters met earlier this year. There was concern that diversity in accounting for business combinations was creating competitive advantages in terms of deal-making.

The IASB has already started its work on these questions. Perhaps not surprisingly, it is focusing on the recent work by the FASB. It will, however, also be considering various aspects of accounting associated with business combinations where UK standards have moved 'ahead' of international thinking. Acquisition provisions are perhaps the most important example, where, compared with UK standards, IAS 22 allows some flexibility in charging costs to the acquisition balance sheet. An international exposure draft is expected in the early part of 2002.

The banning of merger accounting

Initial signs from the IASB are that it is minded to follow Australia and the USA in banning merger accounting (i.e. combining the assets and liabilities of both entities at their book values). In every business combination, an acquirer would have to be identified for the purpose of accounting, with the assets and liabilities of the target being fair valued and a balance calculated for goodwill.

Identifying the acquirer may not be easy, though, when a business combination is equally balanced, or when a new entity is formed to issue shares to shareholders of both parties. To identify an acquirer, the new US literature calls for consideration of all facts and circumstances, including: relative voting rights; the existence of a large voting minority interest; the composition of the governing body of the combined entity; the composition of the senior management; and the terms of exchange of equity securities.

UK readers will find this list familiar; it is similar to considerations required under FRS 6 for identifying mergers. Concern has already been expressed that the effect of banning merger accounting would be to swap a situation where, in some cases, there is a 'fine line' between merger and acquisition accounting, for a situation where there is a 'fine line' in choosing one party or the other as the acquirer for accounting purposes.
Meanwhile, UK commentators in meetings with the IASB have continued to explain the view that there are some, albeit relatively few, business combinations which are true mergers. Accounting standards should not deny this. It may be, though, that our merger accounting methodology does not adequately reflect the nature of a merger as the creation of a new economic entity. 'Fresh start accounting'—fair valuing at least the tangible and financial assets and liabilities of the two combining entities—may be the way forward for accounting for mergers, as equally it may be for accounting for the creation of joint ventures.

Goodwill—amortisation or impairment testing?

The UK might rightfully claim to have led the world's thinking on accounting for goodwill. In particular, in the development stages of FRS 10 'Goodwill and Intangible Assets', the ASB recognised that goodwill was in many cases not a wasting asset and that, where goodwill has an indefinite life, amortisation does not measure any economic reality. In FRS 10 the ASB in effect left companies the choice of amortisation or systematic testing for impairment. In practice, relatively few companies seem to have taken the latter option.

The USA, in FAS 142, has banned the amortisation of goodwill. Instead, goodwill is to be tested for impairment in an annual comparison of the fair value of a reporting unit with its carrying amount. The exceptions to annual review are where an event occurs which seems likely to have caused impairment (in which case immediate review is required) and where recent tests have shown a substantial excess of fair value over carrying amount with no significant change in the assets and liabilities of the entity (in which case the review is deferred).
Indications are that the IASB will favour the US route, ban goodwill amortisation and mandate

impairment testing. An issue for the IASB will be whether to follow the FASB in applying impairment tests at a fairly high 'reporting unit' level or to use the existing standard, IAS 36, which requires testing at the generally lower level of cash-generating units. If the IASB maintains the use of IAS 36, then it may also want to consider inclusion of a test involving the subsequent monitoring of cash flows, as required in the UK's FRS 11 'Impairment of Fixed Assets and Goodwill'.

All the information in this article is of course 'indications' at this stage, rather than decisions; there are some months to go before a new international exposure draft on business combinations is concluded.

Jenny Carter would be pleased to recieve comments on any aspects of business combination accounting - j.carter@asb.org.uk

REVALUATIONS

– is a topic on the IASB agenda that is being developed by national standard setters. The project seeks to converge the various approaches in different jurisdictions to accounting for revaluations for assets. It is a limited-scope project to ensure that whenever and wherever revaluations are permitted they are measured and reported consistently and in a comparable fashion. The initial focus would be on agreeing on consistent measurement objectives for a revaluation. For example, even if it is agreed that the objectives of all revaluations should be to measure at "fair value," there may be different views as to what is "fair value." This project could result in amendments to those IAS that permit revaluations of assets (IAS 16, Property, Plant and Equipment, IAS 38, Impairment of Assets, and IAS 40, Investment Property). It is obviously a crucial issue for the IVSC and meetings have been held with the relevant national standard setters. A report on the first meeting of the Revaluation Group appeared in the October 2001 issue of the UK Accounting Standards Board newsletter 'Inside Track' and is reproduced with the permission of the ASB.

Revaluation Group meeting in London

On 7 September, the ASB hosted a meeting of the 'Revaluation Group'. Chaired by Liz Hickey of the Financial Reporting Standards Board of New Zealand, the meeting included representatives of national standard-setters from countries where revaluation of fixed assets is permitted (Australia, New Zealand, South Africa and the UK). IASB liaison members for these countries were also in attendance, as was a representative from the IFAC Public Sector Committee.

The IASB had asked the Revaluation Group to compare the requirements for revaluation in their standards, and to develop proposals for international convergence. Despite significant differences between members' domestic standards, the Group reached a wide measure of agreement.

In no country is revaluation required; rather, it is optional. As accounting continues to evolve towards wider use of current values, there seems little case for reverting to historical cost. On the other hand, a general requirement to revalue would be onerous, and probably would not command international support.

Among its other conclusions, the Group reached tentative agreement that:

- *where the current value of an asset exceeds its existing use value, for example because of the possibility of development for an alternative use, that value should be recognised in the balance sheet. This differs from the requirements of FRS 15, under which such an asset, if revalued, would be recorded at existing use value and the higher open market value would be disclosed in the notes to the accounts.*
- *depreciated replacement cost has some application for specialised assets, for which there is no active market.*
- *where an asset in a class is revalued, the whole class should be revalued and at each balance sheet date the assets should be shown at their current value.*
- *where a policy of revaluation had been adopted, in general, there should not be an option of reverting to historical cost at a future time.*
- *there is a case for supplementary disclosure where historical cost is used and there is a significant difference between it and current values.*

More discussions are needed to review these preliminary conclusions and to discuss other issues, and it has been agreed that the Group should meet again in 2002. One issue for discussion will be the valuation of assets that are not specialised—could the use of value to the business (incorporating depreciated replacement cost) have a wider application than to specialised assets, or is exit value (net realisable value) a more appropriate measure of current value?

If you have any comments on revaluation issues, Jenny Carter would be pleased to recieve them - j.carter@asb.org.uk

"The IVSC standards become increasingly important as accounting relies on measurement of assets and liabilities at fair value."

Deloitte Touche Tohmatsu IAS Plus newsletter, October 2001, circulated to staff and clients in Asia-Pacific, Europe and Africa

Harvey L. Pitt, chairman,
U.S Securities & Exchange Commission
in his first public remarks on IAS in a speech delivered on 14 Nov 2001

"We stand on the threshold of remarkable changes in our capital markets. If there ever was a time when we could view U.S. Capital Markets as if they existed in a vacuum, that time is long past. We live in a global economy, with global markets, engaged in fierce global competition, with boundaries that are expanding exponentially given the Internet and changing technology.

If there ever was a time when we could view the world solely through the prism of U.S. securities regulation, that time is also long past. Major financial markets operate around the globe, governed by local securities regulators under local rules. No one regulator's experience can, or should, dictate the responses or approaches others take. We can, and must, learn from each other, especially in circumstances where we are attempting to expand the universe of securities traded in our markets; we need to recognize that we in the U.S. will have to make appropriate accommodations to differing regulatory and accounting standards worldwide.

Similarly, we are inspired and encouraged by all of the cooperative efforts aimed at crafting high quality international accounting standards. While work remains to be done, we are certainly well on the road toward creating the type of standards in which investors can have confidence. Looking into the future, we also must appreciate that compatible core accounting standards will lose some of their value unless we work together toward consistency among nations in interpretation and application of these standards."

SEC Chief Accountant Robert K. Herdman stressed the importance of convergence of global accounting standards. Speaking before the AICPA's 29th National Conference on Current SEC Developments in Washington on December6, 2001, the new Chief Accountant said:

Another issue facing standard-setters is the need for convergence of domestic and international accounting standards. Converging accounting standards is critical to a continued, efficient expansion of our global capital markets. Standard -setters should be cognizant of the effects on international accounting as they carry out their activitiesin the future, and I hope that convergence becomes a more near-term objective. Time does not permit a full discussion of my viewson international accounting today, but it will be a major focus for the Chief Accountant's Office.

IMPACT OF FAIR VALUE ACCOUNTING ON VALUATION PRACTICE

Earlier this year the Appraisal Institute met with the Financial Accounting Standards Board (FASB) to discuss the implications of fair value (or market value) accounting. Discussions with FASB dealt directly with valuation methodology and issues relating to marking assets and liabilities to market value. The United States is one of a very few countries currently on a depreciated book basis of measuring assets and liabilities. A variety of forces are influencing this movement towards fair value accounting including: (1) the intent of the Securities and Exchange Commission to increase the transparency of information available on investments; (2) the SEC is also considering listing foreign companies on U.S. exchanges and wants comparability; (3) The European Union quickly requiring use of international standards which embrace present value accounting; and (4) demand by capital markets and other users of financial statements for more accurate measures of value.

FASB has issued Statement of Financial Accounting Concepts No. 7 - Using Cash Flow Information and Present Value in Accounting Measurements, No. 206-C, published February 2000, as a means to more fully discuss the concept of fair value measurement. The statement and subsequent follow-ups are the basis for future regulations. Statement 7 provides a framework for using future cash flows as the basis for accounting measurements at initial recognition or fresh-start measurements and for the interest method of amortization. It provides general guidance for the use of present value calculations. This concept does not address measurement issues, which are or will be addressed by the Financial Accounting Standards Board in the future. Statement 7 has caused concern to some in the accounting profession. However FASB has affirmed its ultimate goal of requiring essentially all financial assets and liabilities to be measured at fair value in financial statements. Some movement has already been made, particularly in the area of financial derivative products.

Since standards relating to measurement of market or fair value significantly involve methodology, definitions and role of valuation profession, the Appraisal Institute was encouraged to comment on Statement 7. Six members of the Appraisal Institute and one CPA participated in developing a white paper to express their personal views to FASB. The authors of the white paper noted definition and methodology differences between Statement 7 and practices in the real estate valuation profession, which were primarily developed through the Appraisal Institute's 60 year history. FASB should be commended for moving towards a more accurate measure of value in financial statements; however, when moving to this new territory it should also be cautious of potential conflict with the existing body of knowledge. The Appraisal Institute believes the white paper accurately portrays the issues without recommending solutions to a complex issue at this early stage.

Clearly there is need for continued dialogue and exploration of other issues surrounding these changes. The Appraisal Institute does not recommend a wholesale movement to market value accounting without first determining the cost and benefits to users of the financial statements. However, at the end of this determination we believe there will be a benefit to capital markets, owners, creditors, investors and others. The Appraisal Institute will continue to comment to FASB and other standards relating to fair value accounting. We hope that this white paper will establish a continuing dialog between the Appraisal Institute and the Financial Accounting Standards Board.

A copy of the White Paper can be downloaded from the Appraisal Institute's web site – www.appraisalinstitute.com

INTERNATIONAL FEDERATION OF ACCOUNTANTS (IFAC)

IFAC PUBLIC SECTOR COMMITTEE (PSC)

The PSC's current activities are focused on the development of International Public Sector Accounting Standards (IPSASs) for financial reporting by governments and other public sector entities. A core set of IPSASs for application in the preparation of accrual based financial reports is being developed. They are based, where appropriate, on International Accounting Standards (IASs). IPSAS 16, Investment Property is to be published in December 2001; it is likely that IPSAS 17, Property, Plant and Equipment will also be published by the end of 2001.

IPSAS 16, *Investment Property* is based on IAS 40, Investment Property, and provides guidance on identifying investment properties in the public sector. The Standard:

- requires that investment property initially be recognised at cost and explains that where an asset is acquired a no or nominal cost, its cost is its fair value as at the date it is first recognised in the financial statements;
- requires that subsequent to initial recognition investment property be measured consistent with either the fair value model or the cost model.

Proposed IPSAS 17, *Property, Plant and Equipment* is based on IAS 16, *Property, Plant and Equipment,* but includes variations to deal with public sector specific circumstances. It includes requirements that property, plant and equipment be:

- recognized and measured initially at cost and explains that where assets are acquired at no or nominal cost, its cost is the fair value of the asset as at the date the asset is first recognized in the financial statements; and
- subsequently measured at cost (the benchmark treatment) or revalued to fair value (the allowed alternative treatment) less any accumulated depreciation or impairment losses in both cases.
- The IPSAS does not require, or prohibit, the recognition or measurement of heritage assets and provides a 5 year transitional period in respect of the recognition and measurement of other items of property, plant and equipment.

IVSC representatives were invited to attend part of the PSC meeting in Washington DC in November to discuss issues arising from the development of IPSAS for fixed assets. The PSC is to issue, early in 2002, guidance to assist governments in making the transition from a cash basis to the accrual basis of accounting. This guidance will refer readers to the International Valuation Standards. The PSC has also invited the IVSC to participate in a project on the recognition and measurement of heritage assets.

INTERNATIONAL STANDARDS ON AUDITING (ISA)

The demand for a global set of auditing standards is gaining momentum and support. With the growth of global capital markets, high quality internationally recognised auditing standards are seen to be essential for the effective and efficient functioning of the markets. The International Organization of Securities Commissions (IOSCO) is expected to begin a review of current ISAs to determine whether, and under what conditions to endorse ISAs, particularly in relation to cross-border security offerings.

PUBLIC SECTOR ACCOUNTING

The European Commission is considering the possibility of using ISAs as a tool for harmonising auditing standards in Europe. The US Panel on Audit Effectiveness recently wrote: "One set of 'international' standards that could serve as minimum benchmarks for auditors regardless of domicile would be especially useful when an entity's financial statements are used by investors outside of the country where the entity is domiciled."

Auditing Fair Values

To address the increasing number of complex accounting pronouncements containing measurement and disclosure provisions based on fair value, IAPC has developed a proposed International Standard on Auditing (ISA) on fair value measurements and disclosures.

The Exposure Draft (ED) addresses audit considerations relating to the valuation, measurement, presentation and disclosure for material assets, liabilities, and specific components of equity presented or disclosed at fair value in financial statements.

Specifically, the ED provides guidance on assessing the appropriateness of fair value measurements and disclosures, how to design the audit approach, and management's process for determining fair value and management representations. It also discusses when and how the auditor should use the work of an expert on such engagements.

One of the key recommendations in the draft is that the auditor should obtain sufficient appropriate audit evident that fair value measurements and disclosures are in accordance with the entity's identified financial reporting framework. As it says different financial reporting frameworks require or permit a variety of fair value measurements and disclosures in financial statements. They also vary in the level of guidance provided on the basis for measuring assets and liabilities. A key recommendation in the IVSC response to the Exposure Draft is that for companies reporting under International Accounting Standards, the appropriate fair value measurements for property, plant and equipment are those contained in the International Valuation Standards.

For further details visit www.ifac.org

EVENTS

FORTHCOMING MEETINGS AND SEMINARS

24 – 27 April 2002	IVSC Standards Sub Committee and Management Board meeting, Washington DC
19-26 April 2002	FIG XXII Congress ‘Geomatics and Property Valuation for Global Sustainable Development’, Washington DC www.fig2002.com
Autumn 2002	Launch IVS 2002 IVSC Annual General Meeting IVSC Management Board meeting All above to be held in Brussels, Belgium
13-17 Oct 2001	21st Pan Pacific Congress of Real Estate Appraisers Valuers and Counselors Kuala Lumper Malaysia www.ism.org.my

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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.
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