Financial Reporting: The Drive for Global Convergence of Valuation & Accounting Standards

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This paper was originally developed to present at International Valuation Forum in Bankok 2001. It has been updated to reflect the current situation.

While it is arguable that internationalisation or globalisation has been taking place for the last century or two[1], 'globalisation' has become a catch phrase of the modern era - variously called the modern age, the post modern age, the post-post modern age or the global age. As well as the increasing popular and governmental focus on globalisation, over the last decade or two there has been a proliferation of international standards. International standards for accounting and valuation are the primary focus for this paper.

If globalisation is the distinctive feature of our age, then the link between international standards and globalisation determines the level of relevance that standards may have. The need for standards recognises that a number "911" is meaningless without context and structure. The need for international standards recognises that "911" can be misleading if people approach it with different contexts and structures in mind.

International accounting and valuation standards are focused on information and, more importantly, on providing context and structure to that information. Their goal is to provide balance to situations where there is asymmetrical access to information. Where information is imperfect an arms-length market will not function efficiently, since an arms length market runs on actors' rational economic decisions. A non-arms length market may not require professional institutions to regulate information, since there may be social, political and cultural constraints on actors that regulate transactions and prices.

With the increasing emphasis in globalisation, free-markets and deregulation are becoming more widespread, and the need for information, context and structure, to enable arms-length transactions increases, as does the relevance of international standards.

[1] Roseneath; McInnes

This is the common background for International Accounting Standards (IAS) and International Valuation Standards (IVS). Convergence and divergence have been observed as typifying the globalisation landscape,[2] and fragmentation as typifying the global age. In this regard the IVS and IAS are truly children of globalisation. This paper will examine areas of convergence, particularly the financial reporting standards, and of divergence between the two frameworks that aim to structure and place in context information, with the goal of balancing asymmetry in access to information. It will focus on the importance of consistency in principle and application and examine the implications of the observations and offer suggested mechanisms for consistency.

Integration of Valuation and Accounting in Financial Reporting

In financial reporting, valuers' and accountants' roles are integrated. As measurers, valuers are charged with the responsibility of providing consistent valuations for inclusion in financial reporting statements. As reporters, accountants have the responsibility for understanding the regulatory framework, ensuring the valuer's instructions are clear and the values adopted are in fact completed on the correct basis. Difference in detail can make it difficult to understand what "911" means, however, these differences are not generally fundamental. As the International Accounting Standards Board (IASB) moves to a 'fair value' basis the potential for divergence increases (refer IAS 16 below). The USA has an 'historic cost' approach which currently is an allowed alternative to fair value. Historic cost does not require valuer assessments, unless impairment is likely. As many other countries allow both modified historic cost and or historic cost so the reader of accounts must be astute.

There are also differences from a valuation perspective. Unlike IAS 16, valuation standards do not allow an "either / or" option, but they do enable the application of an alternative method with the proviso that non-compliance with standards be disclosed.

International Accounting Standard 16

For valuers, international debate has heightened since the removal of the Market Value for the Existing Use (MVEU) concept from International Accounting Standard (IAS) 16. It raised a number of questions, and challenged existing international valuation practice.

The relevant amended section of IAS 16 is:

[2] Appadurai

Benchmark Treatment

28 *Subsequent to initial recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses*

Allowed Alternative Treatment

29 *Subsequent to initial recognition as an asset, an item of property, plant and equipment should be carried at a revalued amount, being its fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations should be made with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.*

Revaluations

30 *The fair value of land and buildings is usually its market value. This value is determined by appraisal normally undertaken by professionally qualified valuers.*

31 *The Fair Value of items of plant and equipment is usually their market value determined by appraisal. When there is no evidence of Market Value because of the specialised nature of the plant and equipment and because these items are rarely sold, except as a part of a continuing business, they are valued at their depreciated replacement cost.* [3]

The revisions to IAS 16 have created a divergence in theory and in practice. First, the IAS reference to fair value as usually being market value is a theoretical divergence in definition. Second, "Market Value for the Existing Use" remains a cornerstone in valuation practice.

1) Theoretical divergence: Fair Value vs Market Value

Fair Value is defined by reporters as

"the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction" [4]

Market value is defined by measurers as

"The estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arms length transaction after proper

[3] IAS 16 Para 31, "Revaluations"
[4] IAS 16 (1998) Definitions

marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.[5]

This definition of market value has international acceptance and forms the single most important foundation of valuation practice.

Market value of a property is based on the premise of highest and best use, as described in IVS 2001, Concepts and Principles:

6.0 Highest and Best Use

> *6.1 Land underlies all existing things and, with rare exception, has a permanence beyond the life of individuals. Because of the immobility of land, each real estate parcel possesses a unique location. Land's permanence also means that it will normally be expected to outlast those uses and those improvements imposed on it by human societies.*
>
> > *6.1.1 The unique characteristics of land determine its optimal utility. When improved land is valued separately from improvements to or upon the land, economic principles require that improvements to or on the land be valued as they contribute to or detract from the total value of the property. Thus,* Market Value *of land based upon the "highest and best use" concept reflects the utility and permanence of land in the context of a market, with improvements constituting the difference between land value alone and total* Market Value *as improved.*
>
> *6.2 Most properties are valued as combination of land and improvements. In such cases, the Valuer will normally estimate* Market Value *by considering the highest and best use of the property.*

Discussion

The market value standard is contained in IVS2001 Standard 1. "Market Value Basis of Valuation". It is fundamental to the practice of valuation internationally and yet the accounting industry constantly tries to bend it to fit fair value. If valuers are to be subject to any form of accountability for the figures reported then there must be a consistent reference point. Market value is that reference point. Market value is at a specified date and therefore it is unnecessary to refer to it as current market value. Market value assumes the property has been properly marketed and therefore it is unnecessary to refer to it as an open market value. Convergence will be achieved when market value is never

[5] International Valuation Standards IVS 1, 2001

qualified by such words as 'open' and 'current', although it may be necessary to use net market value when determining the market value less disposal costs.

Fair value in accounting standards has historically been an amorphous term and it still has various applications in various circumstances. Valuers are not expert in the accounting applications or circumstances and their effects on fair value and hence there is potential for misunderstanding of figures to be supplied. In other words, the '911' reported may not be the '911'requested.

2) Practical Divergence: The Persistence of Market Value for the Existing Use

Market value for the existing use was defined by IVS as:

"The Market Value of an asset based on continuation of its existing use, assuming the asset could be sold in the open market for its existing use, and otherwise in keeping with the Market Value definition regardless of whether or not the existing use represents the highest and best use of the asset."[6]

The normal valuation practice did not apply to valuations for financial reporting, as the highest and best use principle was put aside in this context. The IVSC standards previously set the existing use valuation policy as follows:

The previous IVSC 3-7 (1995)

4.3 *"Generally, the need for asset valuations conducted in conjunction with the preparation of financial statements and related accounts implicitly requires that owner-occupied assets be valued in accordance with their existing use and in consideration of the enterprise continuing in operation. If they are declared by the Directors as surplus to the needs of the enterprise, such assets would be valued at their highest and best use rather than under the existing use concept. Similarly, assets owned by the enterprise ordinarily classified as investments are valued at their highest and best use rather than for their existing use."*[7]

"The rationale for distinguishing existing use assets from other assets in the valuation process is that a business cannot, as a practical matter, sell assets

[6] Valuation Standards 1995 Revision.

[7] International Valuation Standards: Principles, Standards and Applications and Performance Guidance, International Valuation Standards Committee, 1997, IVS 3-7

which are necessary to its operation and still be productive. The sale of such assets would be inconsistent with continuation of the business. By contrast, estimating the Market Value of existing use assets correctly represents the market-based contribution of those assets and is consistent with Market Value methods applied in valuing other assets."8

4.5 *"Continuation of the business is fundamental to accountancy and to the valuation presumption that the particular enterprise will continue in operation for the foreseeable future ..."*

6.1.4 *" ... Existing use contemplates continued use of the asset for its same application as of the date of valuation having regard to the asset's capacity to continue contributing to the value of the enterprise, but not considering alternative, more probable uses, if sold."*

Discussion

The fair value model adopted in the International Accounting Standards does not allow property, plant and equipment to be valued by any method other than Market Value. Here there are two levels of potential divergence, firstly if a country does not adopt the principle as in the case of the UK, and secondly, if valuation practice does not embrace, or embraces in part the change, as is the subject of current debate in Australia and New Zealand.

In addition, MVEU does not fit within the IAS application of Fair Value to both the land and improvements. That is, both components should be assessed at their highest and best use value the land as if vacant, and the improvements at the added value they provide to the land. This is discussed further later in this paper.

I believe that the reason for the reluctance by national bodies and practitioners to adjust to the change to market value is mostly due to uncertainty of application and outcome in the Fair Value model.

Areas of Debate

Other divergences which may cause confusion in the context and structure of financial reporting are:

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[8] International Valuation Standards: Principles, Standards and Applications and Performance Guidance, International Valuation Standards Committee, 1997, IVS 3-7

- The assumption that, all asset types are separable. i.e. Land can be separated from improvements

- The conflict between the going concern assumption and Fair Value .

- That valuation of some classes of assets assume occupancy based on normalised cashflows which can be allocated to asset components, whilst another category, owner occupied property should be treated differently.

- The confusion created by the market value-MVEU debate when calculating DRC

Separating these issues from one another can be problematic as they all involve aspects of the problem of separability of land.

The following examples illustrate the accepted valuation treatment for differing property types and highlight potential issues in that treatment.

Example One: Rest Home

It is common practice to capitalise a normalised cash flow based on market rates and apportion value to the components;

- the land and buildings on a market rate (usually based on a dollar value per bed);

- then land at market value highest and best use;

- and residual as goodwill.

What about a chain of resthomes? What would be the value if vacant? What if the land value is higher than the going concern value?

Motel and hotels fall into the same general category of property and are valued at the highest and best use value.

Example Two: Investment Property

An investment property is valued at market on the basis of the existing leases, and the current demand for any vacant space. Land value is apportioned at highest and best use, improvements at their added value based on sales. No attempt is made to assign goodwill, even for property which is overleased.

Example Three: Airport
An airport built on partially reclaimed land is valued on the basis of its components. Valuation practice requires valuers to value the land on the basis of comparison with adjoining land, but the land for the specific use may have a higher cost and be supported by cashflows from the business.

Example Four: University
This example is based on a University Campus, or other institution (in public or private ownership) providing a specialist service, situated on a prime central city site, which has a land value disproportionately high when compared to the modern equivalent site. However, the scope and quality of the improvements dictates that the rational decision is for the retention of the site in the long term. Current valuation practice requires the write down of improvements to the economic level, unless MVEU is adopted.

Example Five: Developments in a Rural Location
Rural developments, such as a specialist research campus, or sawmill, or dairy factory, have a large investment in the application for planning consent and community consultation phase. The holding costs over this period are capitalised into the financial statements and form part of the land. These consents are often applicant specific, and almost use specific, having the same economic characteristics as the other improvements on the campus. Valuers currently value the land on the basis of its allowed use and the likelihood of that use continuing. The resulting value should reflect reduction in value of the land component in real terms as the site nears the end of its economic life. In real terms, the land is depreciating in value.

Example Six: Leasehold Estates
In the case of leased land, there are two interests created: The lessor's interest and the lessee's interest. Both can be valued with reference to the market. The lessor's interest is based on the future rental streams. The lessee's interest is based on what the market is prepared to pay for the interest subject to the lease. In both cases, market parameters are applied to the specific lease document. It usually involves a discounted cashflow calculation, and the two components of value do not equate the market value freehold when summed. Are part or all of these interests' financial instruments? The Measurers currently report these interests as land. The Reporters are not clear in the treatment of this category of property.

The IASB recently discussed accounting for leases of land, which currently under IAS 17 must be accounted for as an operating lease. As a result, long-term leases could not be classified as an investment property under IAS 40, Investment Property.

The board tentatively agreed to amend IAS 40 and to require either operating or finance leases of investment property to be accounted for as investment property in accordance with IAS 40. This may also result in a review of the definition of investment property.

The discussion also raised the issue of whether there is a requirement to separately account for land and building leases. It was tentatively agreed that in assessing whether a lease is financing or operating, where the lease contains multiple components, the lease should be split into those components (subject to ability to split) for the purpose of assessment. If the lease cannot be split, accounting as a finance lease, where in substance that is its nature despite the land element, was raised as a potential accounting method and is to be discussed with the national standard setters.

It will be interesting to see what emerges n the revised IAS.

Putting Structure to this Confusion

If nothing else clarity of principle emerges from debate. In the following section the issues discussed are put in the context of the existing structure for International Reporters and Measurers.

Value is derived from the use and potential uses a property can be put to. Some properties have clearly defined cashflows and hence value derivatives. Others such as universities and hospitals may rely on public funding requiring valuation to be based on market modeling. Whilst reporters consider land is separable, in the market place it is not.

1. Separation of land and improvements

The Accounting Standards view land and buildings as separable assets. Economically, they are not. Land can be enhanced or blighted by the "improvements". Valuation law is generally supportive of the notion that the value of improvements is the added value that they give to the land. Some improvements, those of a lasting and permanent nature, are classified as land and are not depreciated. As the world becomes more complex, questions are being asked, for example, how to record land reclaimed from the sea? Should it be at the rate of the surrounding land similarly zoned? It is the logical solution, but what if there is no other land say for airport expansion and the cost of reclamation is tenfold the closest replacement land. How do you treat a resource consent cost? When it is associated with a permanent change in use potential then it forms part of the land, when it is entity specific, or use specific, then it expires with that use. That is, sometimes the consent is of a lasting and permanent nature, running with the land, and sometimes it is not. Where there is a market for land with consents, there is no issue.

2. Going Concern

The financial statements are to be prepared on a going concern basis. The Reporters place the Measurers assessments in the balance sheet on the presumption that the asset is correctly classified as property, plant and equipment and that the entity requires that resource in order to continue in operation.

IAS 1 para.23

When preparing financial statements, management should make an assessment of an enterprise's ability to continue as a going concern. Financial statements should be prepared on a going concern basis unless management either intends to liquidate the enterprise or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions which may cast significant doubt upon the enterprise's ability to continue as a going concern, those uncertainties should be disclosed. When the financial statements are not prepared on a going concern basis, that fact should be disclosed, together with the basis on which the financial statements are prepared and the reason why the enterprise is considered not to be a going concern.

In the Measurers' terms, Property Value is created by the future usefulness of an asset in its highest and best use. The level of value is influenced by the profitability or future service potential which an asset contributes to an entity. Often the IAS requires the Reporters to separately report the components of value, whereas for a valuer it maybe difficult to separate/allocate the income earning potential from/to the land and buildings.

3. Owner Occupation

Valuers worldwide differ in the treatment of an owner occupied property. The two common treatments are:

- reference to a market for occupied leased property, or:
- Reference to a market for vacant property.

The outcomes can be quite different depending on which is applied.

UK valuers follow the vacant possession model, i.e. the price that would be paid in the market for vacant premises. Australia and NZ valuers follow a prescribed notional lease model. There is a lot of discussion on merits of each and consistency of application. I support the notional lease stance as having greater consistency and more accurately reflecting the reality of the situation for the following reasons:

Consistency with analogous valuation principles:

- A notional lease approach is consistent with the treatment of owner occupied property such as hotels and motels where the asset is essential to continuing business.

- Other non market methods of valuation (for example, DRC) are on an occupied basis, subject to the adequate potential profitability or service potential of the enterprise.

- A notional lease is consistent with the treatment of Investment property where the strength of the tenant is what underpins the value. Investment property is not viewed as vacant, on a least cost replacement basis.

Accuracy in reflecting the economic situation reported is significant in practice and in the IAS standards, which notes relevance as being important[9]:

- The reporters assume that the entity is a going concern. The value measured should be between the Net Selling Price and Value in Use. To be meaningful, this must be Fair Value: i.e. the amount a similar business would pay for the use of the asset on an ongoing basis. The value is essentially an apportionment of the normalised enterprise value.

- Where an entity occupies leased premises then an annual commitment is transparently included in the accounts. If an entity were valued on the presumption of relocation each balance date then it would require complex and artificial recalculations.

- Vacant possession ignores the time and cost of fitout and other costs of adaptation.

- The entity has the option of transferring the "risks and rewards of ownership" through creating a lease without affecting the business value.

  IVSC is working to get the Australian Property Institute (API) and Royal Institute of Chartered Surveyors (RICS)to agree a joint position on this and seeking clarification from the accountants. This falls within the remit of the 'Revaluation Group' of the accounting standard setters from Australia, NZ, South Africa and UK. According to the UK ASB, these are the first tentative conclusions from the first meeting of the Group:

[9] International Accounting Standards, 2001, Framework – Qualitative Characteristics of Financial Statements, para 26

a). 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.

b) depreciated replacement cost has some application for specialised assets, for which there is no active market.

c) 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.

d) 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.

e) there is a case for supplementary disclosure where historical cost is used and there is a significant difference between it and current values.

4. Depreciated Replacement Cost

Should DRC be based on the MVEU of land? If not, how is the element of economic obsolescence measured?

There are two fundamental valuation standards: First, market value and, second, non-market value. When a property is sufficiently specialised, **valuers** make the judgement to adopt a non-market approach. Depreciated Replacement Cost (DRC) is the primary method for estimating non-market value assessments.

Valuers are currently calculating land either at MVEU or at market value when estimating Depreciated Replacement Cost. The following is the IVSC current version;

"DRC is an acceptable method used in financial reporting to arrive at a surrogate for the market value for specialised or limited market properties, for which for which market evidence is unavailable. DRC is based on an estimate of the current Market Value of land for the existing use plus the current gross replacement (or reproduction) costs of improvements less allowances for physical deterioration and all relevant forms of obsolescence and optimisation.

The result, which includes a non-Market value component, is referred to as the Depreciated Replacement Cost estimate. This result is subject to the adequate potential profitability or service potential of the enterprise."[10]

The reference to **Market Value of Land for the Existing Use** has no basis in the IAS financial reporting standards. This incompatibility of IAS and IVS creates a risk for measurers and for those seeking to rely on reported values. It does not comply with the highest and best use principle of IVS 2001. Harmonisation is very important and is urgently required on this matter.

A direct reference within IAS 16 would solve this problem. It could be worded as follows;

Fair value shall reflect the market value of the asset based on its highest and best use assuming continued occupancy by an entity requiring a similar service potential to that embodied in the particular asset. In the case of property, market based evidence might exist for either the land component or the property in aggregate. Depreciated replacement cost is used as an estimate of the fair value only where the fair value of the property in aggregate cannot be reliably determined using market based evidence.

The issue of land being a separable asset is raised again in IAS 16, para 45

Land and buildings are separable assets and are dealt with separately for accounting purposes, even though they are acquired together. Land normally has an unlimited life and, therefore, is not depreciated. Buildings have a limited life and, therefore, are depreciable assets. An increase in the value of land on which a building stands does not affect the determination of the useful life of the building.

If the value of the land increases, and the value of the property does not increase at the same rate, then the value of improvements must change. There is a strong likelihood that the improvements will be affected by economic obsolescence. The IAS apportionment of land at market value accurately reflects the position of the land. However, the problem of the effect of land value increase on the useful life of the building (economic) is overlooked and this adds confusion.

Clear guidance within the IAS 16 is needed. For example;

Land is to be reported at fair value as determined by reference to market based evidence. Where there is no market, cost based methods are to be applied, provided that all

[10] IVSC Valuation Standards 2001 Revision, IVS 2-3.8.

elements of cost are of a permanent and lasting nature. These include costs associated with, reclamation, resource consents, and demolition.

Costs associated with the land of a non-permanent basis are to be classified as improvements. These include resource consents for specialist properties, such as timber mills and nuclear power plants, where the consent clearly has the same economic life as the improvements.

Other Valuation Issues Raised in IAS

So far the focus of this discussion has been predominately the interplay of IAS 16 and the International Valuation Standards. There are, however, other relevant accounting standards that valuers ought to be aware of. Valuation issues raised by some of these are briefly highlighted below.

IAS 23 Borrowing Costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard.

Under the allowed alternative treatment, borrowing costs that are directly attributable to the acquisition, construction or production of an asset is included in the cost of that asset. Such borrowing costs are capitalised as part of the cost of the asset when it is probable that they will result in future economic benefits to the enterprise and the costs can be measured reliably. Other borrowing costs are recognised as an expense in the period in which they are incurred.

Valuers may be required to include a component for borrowing costs in the calculation of the depreciated replacement cost. There is no guidance as to the assumptions necessary in respect of debt equity ratios, or for the appropriate cost of capital rate. This guidance is essential for measurers to be consistent.

IAS 36 Impairment of Assets

This standard applies to all balance sheet assets whether carried at cost, or at the revalued amount (Fair Value) under the International Accounting Standards.

"Recoverable amount is the higher of an asset's net selling price and its value in use. ... WHERE

Value in use is the present value of estimated cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. ... AND

Net selling price is the amount obtainable from the sale of an asset in an arms length transaction between knowledgeable, willing parties, less the costs of disposal." [11]

The recoverable amount "test" is applied if there is any indication of impairment to the carrying amount to ensure that the fair value disclosed in the accounts does not exceed the likely cash inflows from the asset. The standard requires that enterprise (the Directors) assess the position at each balance sheet date.[12]

Under IAS 16 when reporting Fair Value the asset will always be impaired because the selling cost have not been deducted. Whilst this is not material it may cause confusion to the diligent reader of the reported values.

IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Entities are required to separately report any contingent liabilities or cost provisions, which may be incurred in future; for example reinstatement of contaminated land. The Valuer should report the asset at its value prior to incurring the cost, and make disclose of this approach. The entity then has the responsibility for reporting the extent of the liability.

IAS 40, Investment Property

Fair values are to be reported even if a cost approach is followed.

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).

Convergence – Putting it all together

A) Regulatory framework

The **instructing body** is to provide the valuer with the correct regulatory background.

The value to be reported is first determined by the ultimate use the asset is to be put to.

Ref	Standard	Property Type	Reporting of Land and

[11] IAS 36, June 1998, Section 5, Definitions
[12] IAS 36, June 1998, Paragraph 8

			Buildings
IAS 2	Inventories	Surplus Property	Net current value
IAS 16	Property Plant and Equipment	Owner Occupied property	Fair value
IAS 17	Leases	Leasehold interests	Fair value
IAS 22	Business Combinations	Uniting of Interests Purchase	Book Value market value
IAS 23	Borrowing Costs	Specialised owner-occupied	Consider in cost approach
IAS 36	Recoverable amount	Enterprise	Net Selling Price
IAS 37	Provisions, Contingent Liabilities and Contingent Assets	All	Cost provision
IAS 38	Intangibles	Non Physical, Non Monetary	Fair value
IAS 40	Investment Property	Investment Property	Fair value
IAS 41	Agriculture	Biological assets	Vines, fruit trees, forestry – fair value

This list is not exhaustive and gives an indication of the complexity of the financial reporting environment in which a valuer must operate.

B) Classification of Assets

The **instructing body** is to provide the valuer with one of the following classifications for an item of Property, Plant and Equipment, which determines the value reported and the measurement criteria

Surplus Property

IAS 2 - Property that is no longer required by an entity is to be reported at Net Realisable Value or Net Selling Price i.e. Market Value less disposal costs.

Investment Property

IAS 40 Reported being at Fair Value i.e. Market Value (note no deduction for disposal costs).

Owner Occupied Property

IAS 16 Reported at Fair Value

where there is a market – market value
OR where the valuer determines the property is specialised Depreciated Replacement Cost

Specialised Property

Property that cannot be valued through reference to an active and ready market is to be assessed at depreciated replacement cost. DRC reflects the modern equivalent asset requirement, has an element of financing costs, and has no deduction of disposal costs.

Component Level Reporting
Where there is a need for greater detail in the recording of financial assets, reporters may instruct the measurers to provide that detail.

Public Sector Owner Occupied Property
While it is tempting to see this as a classification, it is a category of assets under the IAS and does not fall within the allowable classifications above. It is reported at Fair Value as per IAS 16, with the same treatment as for Owner Occupied Property.

However the International Public Sector Accounting Standards have recently been released which provide greater explanation and clarification for Public Sector users.

IVS 2001 includes a discussion paper on the valuation of Public Sector property. It continues to promote Market Value for the Existing Use for the assessment of land when DRC is adopted. Whilst this is consistent with the current wording of DRC in IVS 2 it is inconsistent with the fair value requirement in IAS 16. However a valuer practising in the UK would need to use this method to comply with the local financial reporting standards. It is essential to eliminate these areas of potential confusion, and the focus has to be an international one.

Recoverable Amount Test
The measurer should understand the implications of IAS 36 although the directors are charged with the responsibility of applying it.

Conclusions

Key areas of divergence identified as requiring attention are:

- Fair Value vs Market Value – Greater integration
- MVEU vs Market Value – Resolution of Technical issues
- Separability of land and buildings assets – Clarity and direction
- DRC – Clarity and direction

If you choose to operate a market economy, let alone a global market economy, then the valuation principle chosen must resolve issues of asymmetrical information. This means that when people talk numbers to each other, those numbers must truly reflect the property in the market. The principle must be applied consistently. This means that when people talk numbers they know what is meant. The need for consistency and predictability is a requirement for arms-length transactions, which principles provide it and what part of the world they come from does not matter.

IVSC has endeavoured to select principles that achieve consensus across a range international expertise. This process acknowledges that there are many principles from which to choose, but the global market environment necessitates that one be chosen. We have tried to choose the most generally acceptable one, the one that does the best job, generally. Just as social, political and cultural principles serve to regulate non-market economies, where a principle may work well in one particular country, albeit with a market economy, it does not necessarily mean that the principle is adequate on its own to resolve asymmetrical information. It could mean that there is a culture in the market educating participants to add compensatory meaning to the information promulgated. A culture specific principle to international standards could fail to translate effectively across borders into other cultures.

The goal of standards is to develop accounting and valuation principles that provide consistent and accurate context and structure to reporting. The IASB and IVSC have endeavoured to achieve this together. The goal of consistency and accuracy specifically requires a strong cross-reference to market value definition within IAS publication (rather than fair value) and a direct reference in IAS 16 to assessment of land at market value based on highest and best use (to avoid the MVEU confusion). By working more closely together on these and other issues, convergence on important issues will help us to achieve our mutual goals.

Convergence of Standards is not just a theoretical issue these days. Countries are beginning to impose use of IAS which carries with it implications for national valuation standards. The European Union is possibly the leader in this because of the need for one set of accounting standards and reluctance to develop regional standards. There is Growing pressure for valuers in the EU to value under IVS rather than national standards which is evidence by the recent release from the European Public Real Estate Association which is calling for use of IVS from end of 2002. Singapore has also just recently announced that it is to adopt IAS to bolster its position as international financial center. This is going to put pressure on other countries in the region.