A critical analysis of US real estate appraisal methods when used for financial reporting according to the International Financial Reporting Standards (IFRS)

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Authors:
F. Ferdinand Spies
Dipl.-Kfm.
Daniel B. Wilhelm
MSRE

EUROPEAN BUSINESS SCHOOL (**ebs**)
International University Schloss Reichartshausen
Deparment of Real Estate
65375 Oestrich-Winkel/Germany
Phone: +49 6723 995045
Facsimile: +49 6723 995035
E-Mail: spies@ebs-immobilienakademie.de

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Abstract:
As a result of an ongoing globalization process it is important to uniform financial and valuation standards to provide a standardized financial reporting system. With the International Financial Reporting Standards (IFRS, former IAS) a promising attempt is being made. While the IFRS are mandatory for listed companies in the European Union since 2005, the IFRS have not been accepted by the US Security and Exchange Commision (SEC) yet. But the private sector Financial Accounting Standards Board (FASB), which is responsible for the US-GAAP standards, and the International Accounting Standards Board (IASB) have agreed to converge their standards. This is an important step in the standardization process of the financial reporting standards, as it might lead to an acceptance of the IFRS by the SEC. But as the US have their own national valuation methods, it is important that these are compatible with the requirements for asset valuation of the IFRS.
The goal of this paper is to examine the requirements for valuation methods in accordance with the IFRS and what possible conflicts could arise between the IFRS and the US valuation methods. After looking at the appraisal of real estate in the US and the financial reporting for real estate according IAS, the compatibility will be analyzed by looking at the criteria regulatory framework, valuation process, valuation method and value concept, before coming to a conclusion.

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II List of abbreviations

DCF	Discounted Cash Flow
EU	European Union
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Practices
HBU	Highest and best use
HGB	Handelsgesetzbuch
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IVSC	International Valuation Standards Committee
MVEU	Market Value for the Existing Use
RICS	The Royal Institution of Chartered Surveyors
SEC	Securities and Exchange Commission
US	United States
UK	United Kingdom
USPAP	Uniform Standards of Professional Appraisal Practice

1 Introduction

1.1 Goals and objectives

Until now, many different accounting standards exist in the various countries: US-Generally Accepted Accounting Principles (GAAP) in the United States, UK-GAAP in the United Kingdom or HGB in Germany. As a result of an ongoing globalization process and the increase of international investors it is important to uniform financial standards to provide a standardized financial reporting system which allows a direct comparison of financial performances across country borders.

With the International Financial Reporting Standards (IFRS), former International Accounting Standards (IAS)) a promising attempt is being made. While the IFRS are mandatory for listed companies in the European Union (EU) starting 2005, the IFRS have not been accepted by the US Securities and Exchange Commission (SEC) yet. But the private sector Financial Accounting Standards Board (FASB), which is responsible for the US-GAAP standards, and the International Accounting Standards Board (IASB) have agreed to the convergence of both standards.[1] This is an important step in the standardization process of the financial reporting standards, as it might lead to an acceptance of the IFRS by the SEC. But even today many companies recognize the need to supplement their US-GAAP financial reports with IFRS commentaries to foster the transparency for international investors.

In the light of the approach of both standards, the valuation of real estate assets plays an important role as appraisal methods and their value measurements differ between the countries. The convergence of US-GAAP and the IFRS will therefore urge more and more US appraisers to conduct appraisals for companies which report according to the IFRS, like European Real Estate investors investing in the United States. But as the US have their own national valuation methods, it is important that these are compatible with the requirements for asset valuation according to IFRS. The goal of this paper is to examine the requirements for valuation methods to be in accordance with the IFRS and what possible conflicts could arise between the IFRS and the US valuation methods.

1.2 Structure of the paper

To allow a detailed and profound analysis of the US real estate appraisal methods when being used in conjunction with the IAS/IFRS, the US real estate appraisal methods and their specific characteristics will be introduced in the next chapter. Then the general structure of the International Accounting Standards and its related boards will be presented. In this context it will be examined how real estate has been seen by the IFRS and how the different value concepts, which are applicable for real estate, are defined. Chapter 4 combines the essential findings of the previous two chapters and uses them to analyze possible conflicts or advantages when using the US real estate valuation methods for a financial reporting according to IFRS. Finally, the future threats of US appraisers will be discussed in the light of the implementation of the IFRS in Europe.

[1] Memorandum of Understanding - The Norwalk Agreement, Norwalk (USA), 18.11.2002.

2 The appraisal of real estate in the United States

2.1 Structure of the local appraisal institutions

In the United States the 1986 founded *Appraisal Foundation* is the authority concerned with establishing and improving the appraisal practices and their quality. The *Appraisal Standard Board* (ASB), a sub-organization of the Appraisal Foundation, develops and amends the so-called *Uniform Standards of Professional Appraisal Practice* (USPAP). The real estate professions working together with Congress led to the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) of 1989 which recognizes USPAP as the generally accepted standards and requires each appraiser "to be licensed or certified in the state in which the property being appraised is located"[2]. Moreover, many clients require a certified appraiser who complies with these standards. Today, the USPAP are revised annually and consist of definitions, standards, statements and several rules to "address the ethical and performance obligations of appraisers"[3].

2.2 The appraisal process framework

The appraisal process can be seen as "an organized method for solving a problem"[4] similar to traditional problem-solving concepts. The goal of an appraisal is thereby, the estimation of the property value. The eight steps in the US valuation process as shown in figure 1 are (1) Definition of the Problem, (2) Scope of Work, (3) Data Collection and Property Description, (4) Data Analysis, (5) Land Value Opinion, (6) Application of the Approaches to Value, (7) Reconciliation and Final Opinion of Value and (8) the Report of Defined Values.[5] The purpose of this whole process is to determine "a well-supported value conclusion that reflects all of the pertinent factors that influence the market value of the property being appraised"[6] with the same quality and structure across all appraisers.

The first step in performing an appraisal is the definition of the problem, which mainly involves the identification of the property, the appraisal's purpose, the required value definition (e.g. Market Value, Use Value, Going-concern value etc.) and the date of the value opinion. It is further necessary to evaluate the property's characteristics.
In the second step the appraiser determines "the amount and type of information researched and the analysis applied in an appraisal assignment"[7] to structure and plan the appraisal process. After establishing the basis for the appraisal, the field work begins by collecting the necessary data on the market area, on the subject property and on the comparable properties in step three. As soon as the necessary data is complete, in the fourth step the appraiser analyzes this information using two methods: the *Market Analysis* and the *Highest and Best Use Analysis*. Both procedures are crucial to the valuation process as they strongly influence the value and are the basis for further investigations.

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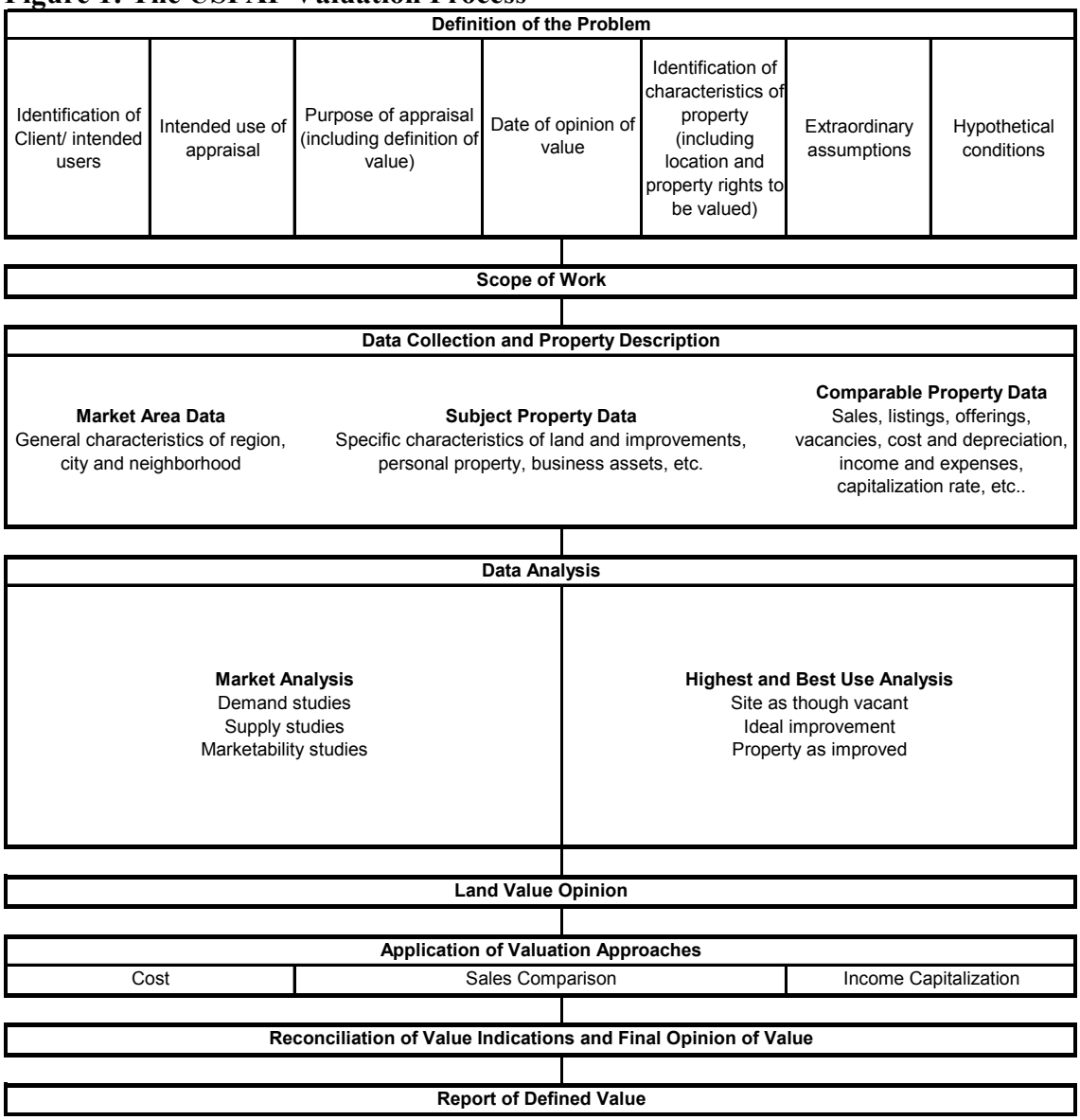
[2] GELBTUCH (1997), p. 8.
[3] THE APPRAISAL STANDARDS BOARD OF THE APPRAISAL FOUNDATION (2004), p. 6.
[4] FANNING/ GRISSOM/ PEARSON (1994), p. 11.
[5] APPRAISAL INSTITUTE (2001).
[6] APPRAISAL INSTITUTE (2001), p. 49-50.
[7] APPRAISAL INSTITUTE (2001), p. 56.

Figure 1: The USPAP Valuation Process



Source: The Appraisal of Real Estate, 12th Edition, p. 51.

The *Market Analysis* inspects the economy (macro- and microeconomic factors) surrounding the subject property and tries to identify "logical patterns"[8]. These patterns help to identify future market changes and the behaviour of supply and demand which dramatically influences the value estimate. The *Highest and Best Use Analysis* (HBU) is typical for the US valuation method. It assumes that the current use is not necessarily the best use for the examined location and therefore tries to identify the use that is legally permissible, physically possible, financially feasible and maximally productive. Under these limitations the appraiser tries to come up with two different value scenarios: What is the highest and best use if the property is vacant and what is the highest and best use if it is improved? The highest and best use can therefore be seen "as a constrained optimization problem […] to identify the use that maximizes the net present value of the land"[9]. With the help of these additional scenarios the appraiser not only extends his range of possible comparables, but also identifies which kind of

[8] WINCOTT/ MUELLER (1995), p. 27.
[9] DOTZOUR/ GRISSOM/ LIU/ PEARSON (1990), p. 27.

scenario he should follow in the appraisal. In the fifth step, the *Land Value Opinion*, the value of the land without any improvements is estimated. This approach helps to identify "whether an existing use is the highest and best use of the land"[10]. The value can thereby be determined through the application of various sources like the sales comparison, extraction, allocation, subdivision development, land residual or the ground rent capitalization.[11]

The sixth step is the *application of the approaches to value*, where the appraiser uses one or more of three possible methods: the cost approach, the sales comparison and the income capitalization. The selection of the appropriate method depends on the kind of property and is a subjective choice of the appraiser, which the appraiser has to constitute.[12]
The *Cost Approach* is mainly used for new buildings, where the value of the property for a potential buyer equals the reconstruction costs. A value is thereby estimated through summing up all costs necessary to rebuild the same property minus a possible value depreciation due to normal wear and tear or other value reducing facts (e.g. economic changes).
The *Sales Comparison Approach* is mostly used when recent transaction prices for similar properties are available, which is most often the case for single-family residential housing. If the properties have small differences (which they normally have), the appraiser tries to value these differences to level them off. As this is a subjective process, the "adjustments should be justified with evidence based on recent experience with highly comparable properties"[13]. Finally he weights the different properties according to their degree of similarity to the subject property and uses the mean as the estimated subject property value.
The third method is most often used for income producing properties (e.g. offices, theme parks) and is called the *Income Capitalization Approach*. It "considers the monetary returns a property can be expected to produce and converts that into a value the property should sell for if placed on the market today"[14]. The main two techniques are the Direct Capitalization and the Yield Capitalization. The Direct Capitalization uses the stabilized net income and a market derived cap-rate. The Yield Capitalization on the other hand is a more advanced Discounted-Cash-Flow model (DCF) of explicit future cash flow assumptions. Compared to the other two valuation methods the Income Capitalization Approach provides a high flexibility as the appraiser can model future changes in rental income or operating costs according to his subjective estimations.

The last two steps combine the previous findings into a final property value. During the seventh step, the *reconciliation,* the appraiser compares differences in the result of the applied valuation methods and attempts to explain them. He might also use the weighted average of the resulting value to reconcile them. After all, the valuation process and the *defined value*, which is the eighth step and can be a specific value or a value range, are reported orally or in writing to the client. The scope of this report is hereby dependent on the chosen reporting format.[15]

[10] APPRAISAL INSTITUTE (2001), p. 61.
[11] APPRAISAL INSTITUTE (2001), p. 61.
[12] APPRAISAL INSTITUTE (2001), p. 62.
[13] BRUEGGEMANN/ FISHER (2001), p. 228.
[14] JACOBUS (1999), p. 363.
[15] JACOBUS (1999), p. 368 ; APPRAISAL INSTITUTE (2001), p. 606.

2.3 What is the "value" as defined by the USPAP?

The USPAP allow the usage of different values like the "market value, liquidation value or investment value"[16] whereas the appraiser must include the type and definition of the value. Because the definition of value plays a major role for the informational value of the appraisal, the USPAP emphasize the importance of an accurate value definition. Especially when a common *Market Value Appraisal* is conducted, it must be clear that the definitions of Market Value differ. The USPAP themselves use a very broad definition, by classifying the *Market Value* as "a type of value, stated as an opinion, that presumes the transfer of a property […] as of a certain date, under specific conditions"[17]. Only a further reference to the market value definition of the FIRREA and the comments unambiguously mention the marketplace perspective by characterizing the market value as "the most probable price which a property should bring in a competitive and open market". This statement underlines the objective perspective used for assessing the market value in contrast to the subjective perspective as used for the determination of other values like the investment value or use value.[18]

3 The financial reporting of real estate performances according to the International Accounting Standards

3.1 The IASB and the IVSC and their standard setting process

The *International Accounting Standards Board* (IASB, former *International Accounting Standards Committee* IASC) was founded in 1973 as a result of an agreement by accountancy bodies in several countries with the objective to "develop … a single set of high quality, understandable and enforceable global accounting standards"[19]. Until now the IASB has included all 143 professional accountancy bodies from 104 countries that are members of the International Federation of Accountants (IFAC) and has therefore gained worldwide recognition. Although the IFRS is mandatory for all European listed companies since 2005[20], the SEC has refused to approve the proposed rules until now.[21] But there is still hope that either the SEC will accept the IFRS in the future and/or that the *Financial Accounting Standards Board* (FASB) will adjust their rules to a "fair value" concept similar to the one used by the IFRS.[22] The development of new standards "is [thereby] a dynamic international process which involves most countries"[23]. As the IASB has no national authority, it is the task of the national bodies to adopt these standards into their local jurisdiction.[24]

To ensure compliance with the financial reporting regulatory background and due to other pressuring factors, it is further necessary to define a uniform set of valuation standards as a guideline for the valuation of assets. The IASB therefore works together

[16] THE APPRAISAL STANDARDS BOARD OF THE APPRAISAL FOUNDATION (2004), p. 5, Definitions.
[17] THE APPRAISAL STANDARDS BOARD OF THE APPRAISAL FOUNDATION (2004), p. 3, Definitions.
[18] THE APPRAISAL STANDARDS BOARD OF THE APPRAISAL FOUNDATION (2004), p. 212, AO-22., Standard Rule 1-2 (c), p. 3, Definitions; LENNHOFF (2001), p. 219.
[19] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), page C-2.
[20] Regulation (EG) No. 1606/2002, ABl. L 243, 11.11.2002.
[21] SECURITIES AND EXCHANGE COMMISSION (2000).
[22] FASB (2003).
[23] DUNCKLEY (2000), p. 214.
[24] CAIRNS (1998); EPSTEIN/ ALI (2001), Chapter 1; BUMUNK (2002), p. 356.

with the *International Valuation Standards Committee* (IVSC), which issues the widely accepted *International Valuation Standards* (IVS). The IVSC was founded in 1981 and is a non-government-organization that works together with well-known organizations such as the World Bank, OECD, the Appraisal Institute, the Royal Institute of Chartered Surveyors or the IASB. The primary purpose of the IVS is to uniform the valuation standards across country borders by establishing a superset of rules that are applicable in all countries and which increase the transparency for international investors. The IVS rules have therefore a broader character compared to domestic standards like the USPAP, to take care of differing laws between countries. Similar to the IFRS concept, it is the undertaking of the domestic standard setting bodies to adopt these general standards.[25]

3.2 The recognition of real estate by the IFRS

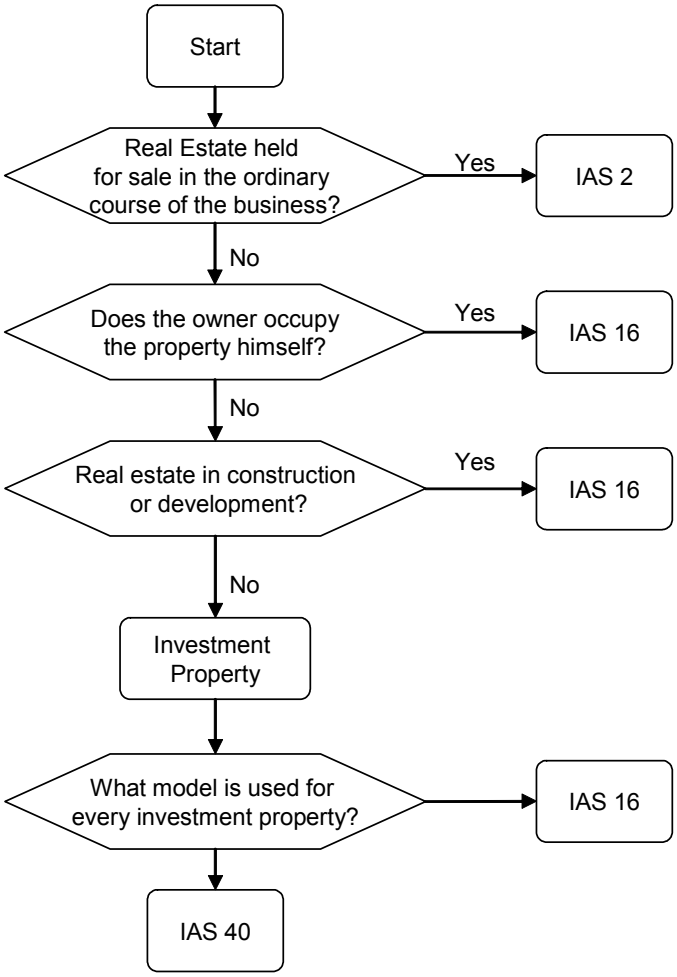
Within the International Financial Accounting Standards, there are several sections which relate to real estate depending on the use and function of it within the company. The six real estate relevant sections are IAS 2 Inventories, IAS 11 Construction Contracts, IAS 16 Property, Plant and Equipment, IAS 17 Leases, IAS 36 Impairment of Assets and IAS 40 Investment Property. The focus of this paper we will be on the most important sections IAS 16, 36 and 40. To help with the classification of the properties and the corresponding IAS section, the IFRS provide a schematic decision tree (see figure 2).

IAS 16 – Property, Plant and Equipment
This section applies to all properties "that are held by an enterprise for use in the production or supply of goods or services, for rental to others, or for administrative purpose and [that] are expected to be used during more than one period"[26]. While the initial measurement of the property are the construction costs, the company can choose between two alternatives for the subsequent measurement: The *Benchmark Treatment* or the *Allowed Alternative Treatment.*[27]
The *Benchmark Treatment* carries the property at its cost less any accumulated depreciation and any accumulated impairment losses and is also a recognized method in the German HGB or US-GAAP.
The *Allowed Alternative Treatment* on the other hand is a peculiarity of the IFRS principle of a "true and fair view" and represents a mark-to-market approach. Hereby the property "should be carried at a revalued amount, being its fair value […] less any subsequent accumulated depreciation […] and impairment losses"[28]. To keep this value up-to-date a "sufficient regularity" of revaluations is required. Any gains or losses through revaluation adjustments have generally no direct impact on the income statement as long as it is possible to show them directly in the stockholder's equity.[29]
Furthermore, IAS 16.34 prohibits the revaluation of a single property by requiring the company to use the same measurement methods within an asset class. The new 2005 version of the standards will further require a separate depreciation for each part of the property with a significant share of the total costs. This will lead to a separate

[25] EDGE (2001), p. 87; DORCHESTER/ VELLA (2000), p. 82..
[26] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 16.6 a, b.
[27] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 16.28 and 16.29.
[28] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 16.29.
[29] GRÜNBERGER/ GRÜNBERGER (2002), p. 10.

depreciation and cost measurement for the main property parts like the ground, walls, windows, heating, ventilation, air conditioning or the elevators.[30] Finally, IAS 16 and IAS 40 require a detailed disclosure of the used valuation methods and their underlying assumptions.[31]

Figure 2: Decision tree



Source: International Accounting Standard Board (2003), IAS 40, Appendix A

IAS 36 – Impairment of Assets

Section 36 of the current IFRS extends IAS 16 and IAS 40 (if not measured at fair value) and requires the recognition of an impaired asset if "the carrying amount exceeds the recoverable amount". In this case the asset must be written-down to the recoverable amount. Thereby, the recoverable amount is defined as "the higher of an asset's *net selling price* and its *value in use*"[32]. This results in a write-down of IAS 16 assets in two cases: (1) a decrease of its fair value or (2) a decrease of its recoverable amount.[33]

IAS 40 – Investment Property

An Investment Property according to the IAS 40 "is property […] held […] to earn rentals or for capital appreciation or both, *rather than* for use in production or supply of

[30] BECK (2004).
[31] SCHULTE (2003) and INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 16.6-16.66.
[32] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 36.5.
[33] BUCHHOLZ (2004), p. 292.

goods or services or for administrative purposes [IAS 16] or sale in the ordinary course of business [IAS 2]". The new IAS 40 was introduced in 2000 and replaced the former IAS 25 which reduces the possible accounting treatments for investments. Similar to the IAS 16, the IAS 40 uses the property costs (including possible transaction costs) as the initial measurement. For measurements subsequent to the initial recognition the company can choose between two alternative methods: The *Cost Model,* which is equal to the *Benchmark Treatment* in IAS 16, and the *Fair Value Model*. The Fair Value Model is slightly different from the *Allowed Alternative Treatment* in IAS 16: It not only forces the company to revaluate the property each time the books are closed, but also has an impact on the net profit by including any profits or losses caused by a revaluation in the income statement.[34]

3.3 The value concepts of the IFRS

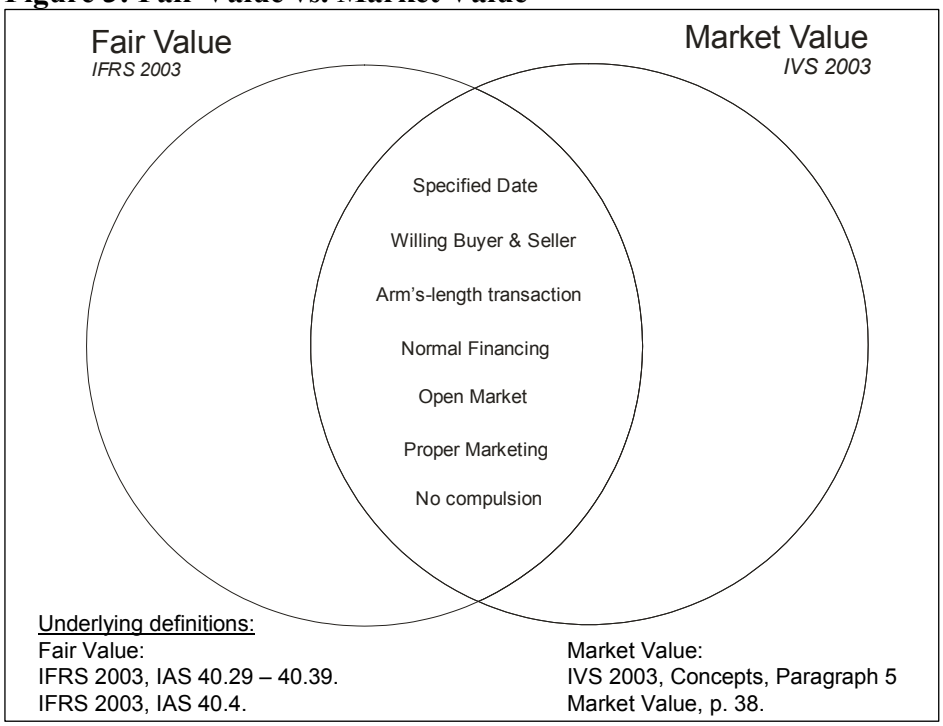
The IASB uses different value concepts in their Financial Reporting Standards but unfortunately does not give any support or information on how these should be determined in the "real-world". Further interpretation problems arise through the sometimes unclear and dichotomous wording of the standards. The next paragraphs will therefore relate the used value concepts to current interpretations and discussions to encircle the most common meaning of the discussed concepts.

The IFRS are using a market approach that is new to some countries (e.g. Germany or the United States), that have used the historical cost approach. As stated above, the IFRS are using the so-called *fair value* as their mark-to-market measurement. The interpretation of the *fair value* in terms of the IFRS was unclear for a long time and could only be assumed by referencing to other fair value definitions, mainly used in the accounting language. It was ambiguous whether the fair value is equal to the market value, but now the current version of the IFRS states that "the fair value of land and buildings is *usually* its market value"[35]. It is determined by an "appraisal normally undertaken by professionally qualified valuers"[36] and represents the "amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction"[37]. In contrast to the previous version of the IFRS, where the IVS definition of market value was the logical interpretation for assessing the fair value, the revised "accounting standard has […] moved away from specifying a single basis to describing the process necessary to establish fair value"[38]. This new definition is somehow unclear in the wording, as the IFRS do not specify the situations in which fair value is "usually" the market value.[39] Concerning the fair value definition, the subjectivity of fairness is a problem which is often discussed as it might lead to different values depending on the viewer's attitude.[40] Nevertheless, the market value definition of the IVS *usually* equals the fair value. It characterizes the market value as "the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each

[34] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 40.28.
[35] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 16.30.
[36] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 16.30.
[37] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 16.6.
[38] INTERNATIONAL VALUATION STANDARDS COMMITTEE (2004), p. 3.
[39] APPRAISAL INSTITUTE (2004), p. 2.
[40] DORCHESTER (2004).

acted knowledgeably, prudently, and without compulsion"[41]. The comparison of the characteristics of market value and fair value shows, that the recent versions of the IFRS and the IVS have very similar approaches to market value and fair value.[42]

Figure 3: Fair Value vs. Market Value



Source: Own Visualization.

The former concept for the valuation of owner owned properties, the *market value for the existing use* (MEVU), which limited the possible use of the property for valuation purposes to its current use.[43] This concept stressed the fact that "a particular owner occupies and uses a parcel of real estate in its business, that owner cannot sell the property at its highest and best use and continue to operate its business as it is currently operated"[44] at the same time. Although the MEVU was used in several countries, it has been dropped from the IFRS because it was seen as being incompatible with the fair value concept.[45] The revised standards now support the value of the *highest and best use* of a property which equals the market value of the property in the open market for all possible uses. The MEVU is only used for the determination of the land value in conjunction with the Depreciated Replacement Cost (DRC), which is used instead of the fair value in cases "when there is no evidence of market value"[46] as for special purpose properties. In these cases the DRC is used as an estimate of the Market Value and determines the value of the property by subtracting allowances for physical deterioration from the sum of the current gross replacement costs of improvements and the 'market value for the existing use' of the land.

[41] INTERNATIONAL VALUATION STANDARDS COMMITTEE (2003), p. 38.
[42] Appendix IV.2, Figure II, Market Value vs. Fair Value.
[43] DUNCKLEY (2000).
[44] DORCHESTER/ VELLA (2000), p.82.
[45] SAYCE/ CONNELLAN (2001) and Appendix IV.3.
[46] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 16.31.

The last concept is the *Value in Use*, which is used for the impairment test of IAS 36. This value is a non-market assessment and equals the present value of the estimated future cash flows including the properties disposal.

4 Using the US appraisal methods for a financial reporting according to the IAS/IFRS

The key question of this section is, whether the US appraisal methods are applicable for a financial reporting according to the IFRS. As the US appraisal standards and the IFRS are not only two simple sets of rules which can be compared chapter by chapter, but very complex linkages between different concepts and rules, it is necessary to consider all compatibility criteria. These can be determined as the regulatory framework, the valuation process, the value determination approaches and finally the value concepts.

4.1 Regulatory framework

The *regulatory framework* plays a major role in the compatibility of the US appraisal methods for a financial reporting according to the IFRS as it dramatically influences not only their flexibility, but also the consistency of their application. In the case of the United States the USPAP are not only supported but enforced by the government. Being the de facto appraisal standard in the United States, the USPAP definitely represent the perfect foundation for our analysis. Although the application of the USPAP is required for each appraisal assignment of a certified US appraiser, the standards grant certain flexibility for other assignment conditions. According to the Jurisdictional Exception rule the appraiser might "void the force of a part of parts of the USPAP, when compliance with part or parts of USPAP is contrary to law or public policy applicable to the assignment"[47]. This exception for example allows an US appraiser to conduct an 'market value for the existing use' valuation for the European market, although this concept is not defined by the USPAP. In the context of our analysis this concept ensures that the USPAP will always be applicable, even in situations where the standards do not match with the requirements of the IFRS.

A weak point of the USPAP's regulatory framework might rsult from their history: As they were constructed for the mortgage lending industry, most definitions and methods are very specific for this kind of industry. The US appraisers are also not used to having a close relationship with accounting firms for the preparation of financial statements as it is common in other countries.[48] This does not hinder the application of USPAP for an IFRS financial reporting, but complicates the collaboration between both professions. Inherently, this is less important for individual USPAP appraisals but much more important in the case of an acceptance of the IFRS through the SEC or the implementation of a mark-to-market concept in US-GAAP, which would massively increase the work for US appraisers.

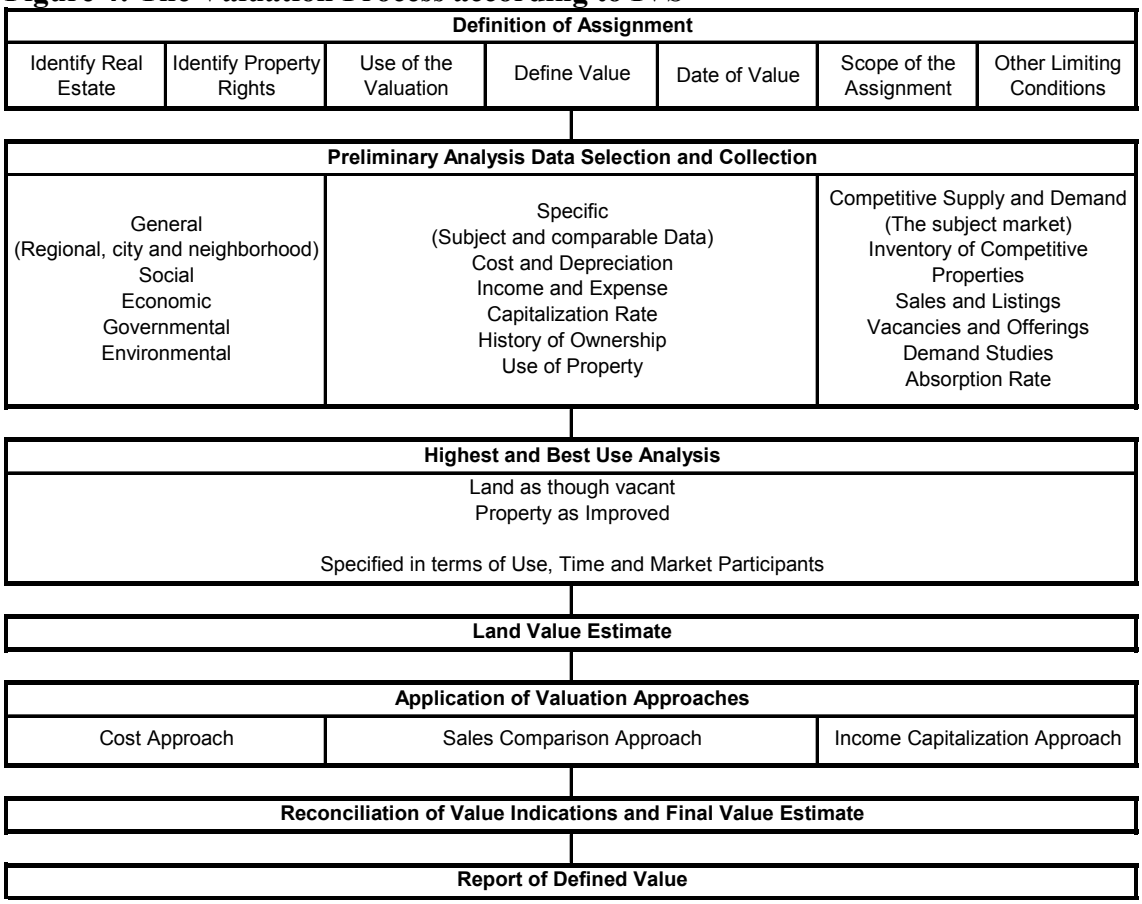
4.2 Valuation process

The *valuation process* is the next influencing criteria for the compatibility of the U.S. appraisal methods and the IFRS. As the financial reporting standards do not describe the

[47] THE APPRAISAL STANDARDS BOARD OF THE APPRAISAL FOUNDATION (2004), p. 3.
[48] MILGRIM (2001), p. 1.

process in detail that is necessary to come up with a valid value estimate, there remain only the widely-accepted IVS as a comparison reference to determine the applicability of the USPAP valuation process. The IVS separates the valuation process in seven steps: (1) The Definition of the Assignment, (2) Preliminary Analysis Data Selection and Collection, (3) Highest and Best Use Analysis, (4) Land Value Estimate, (5) Application of Valuation Approaches, (6) Reconciliation of Value Indications and Final Value Estimate and finally (7) the Report of Defined Value (see figure 4).[49]

Figure 4: The Valuation Process according to IVS



Source: International Valuation Standards Committee (2003), p. 206.

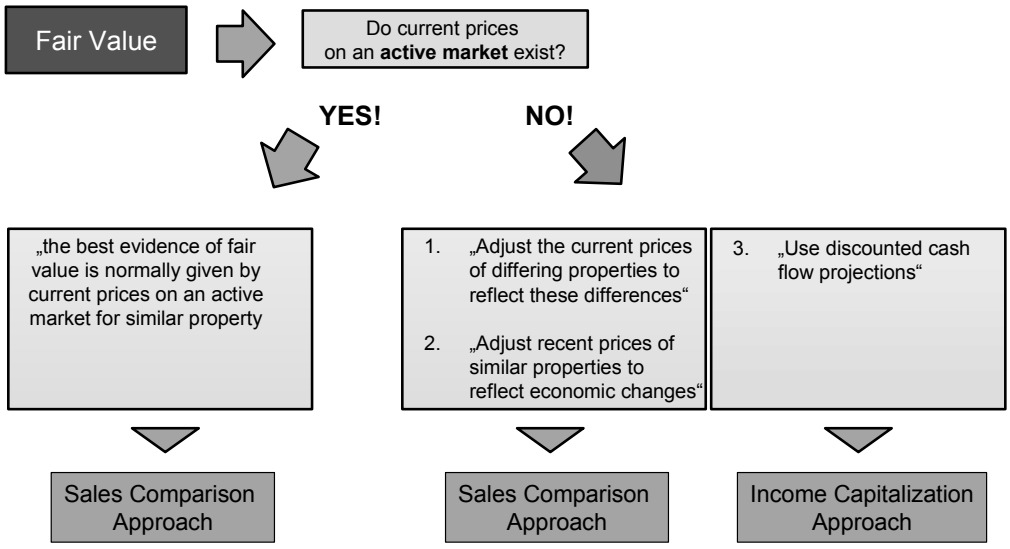
A comparison with the in introduced appraisal process in chapter 2.2 shows, that both processes are very similar. The market based preliminary analysis is used in both standards as a foundation for the following analysis and also the 'highest and best use' concept is used in both for the determination of the optimally property utilisation. One conceptual difference is the additional analysis of the *ideal improvement* under the 'highest and best use' approach as used by the USPAP. Since the IFRS have dropped the former 'market value for the existing use' (MVEU) concept and now use the 'highest and best use' approach, the USPAP seem to be very compatible with the IFRS in this point. As the IVS have been declared as compatible with IFRS and as the comparison shows no meaningful differences between the USPAP and the IVS, it seems legitimate to confirm the compliance of the US valuation process with the IFRS.

[49] INTERNATIONAL VALUATION STANDARDS COMMITTEE (2003), p. 206.

4.3 Value determination approaches

The *value determination approaches* are similar, as both standards use the cost approach, the sales comparison approach and the income capitalization approach. But while the USPAP *require* the appraiser to use all three approaches under normal circumstances[50], the IVS only *recommend* using all three approaches.[51] It remains questionable whether the exact application of these approaches according to the USPAP conforms to the IFRS. Again, the IFRS only give little detail about the process and suggest that "the best evidence of fair value is normally given by current prices on an active market for similar property"[52]. The sales comparison approach, as defined by the USPAP, requires the appraiser to "analyze such sales data as are available to indicate a value conclusion"[53]. Therefore the appraiser "must analyze pending and recent sales of comparable properties"[54]. That these transactions should happen in an active market is derived through the USPAP's understanding of the market value, as stated in chapter 2.2.2. The USPAP therefore seem to be in harmony with the IFRS requirement while the transparent market of the US definitely supports the sales comparison approach as IFRS's favourite approach.[55] For the case of "the absence of current prices on an active market"[56], the IFRS give three opportunities: (1) To adjust the current prices of differing properties to reflect these differences, (2) to adjust the recent prices of similar properties to reflect economic changes or (3) to use discounted cash flow projections (see figure 5).

Figure 5: Value determination approach according to IFRS



Source: Own Visualization.

Cases (1) and (2) are supported by the USPAP's understanding of the Sales Comparison Approach. Although the valuation standards do not give details about the exact process

[50] THE APPRAISAL STANDARDS BOARD OF THE APPRAISAL FOUNDATION (2004), Departure Rule, p. 12.
[51] INTERNATIONAL VALUATION STANDARDS COMMITTEE (2003), p. 209.
[52] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 40.39.
[53] THE APPRAISAL STANDARDS BOARD OF THE APPRAISAL FOUNDATION (2004), p. 19.
[54] THE APPRAISAL STANDARDS BOARD OF THE APPRAISAL FOUNDATION (2004), p. 127.
[55] GELBTUCH (1997), p. 17 and Jones Lang LaSalle, Global Real Estate Transparency Index 2004
[56] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 40.40.

of this approach, the literature clearly supports both procedures to adjust current prices.[57] The described usage of a DCF projection in case (3) is backed up by the Income Capitalization Approach. Here the Statement on Appraisal Standards No.2[58] within the USPAP clearly underlines the required market evidence for valid assumptions as required by the IFRS.[59] As a conclusion, the USPAP's valuation approaches can be seen compatible with the IFRS requirements to determine the fair value.

4.4 Value concepts

The fourth and most important compatibility criteria are the used *value concepts*. The significance derives from the fact, that the resulting value is the central element of an appraisal. But value is not value, as the depiction of the various IFRS value concepts in chapter 3.3 shows. It is therefore essential to make sure that the USPAP appraiser and the IFRS accountant are talking about the same kind of value. The IFRS are using the concept of fair value, which usually equate the market value. The USPAP allow the usage of the market value, although they do not require it. Due to the lack of a profound definition of market value within the USPAP, it is necessary to use FIRREA's definition or the IVS definition. This is valid as the USPAP allow the application of various value definitions, as long as they are defined within the appraisal. As a result, a so-called market value appraisal according to the USPAP that uses the widely-accepted IVS market value definition can be classified as well-suited for a financial reporting according to the IFRS.

5 Conclusion

The IFRS are currently in a dynamic development, caused by the ongoing convergence between US-GAAP and the IFRS and by the upcoming implementation of the IFRS in Europe. This development process can be seen in several IAS sections, where the wording used is sometimes still unclear and the meaning therefore frequently discussed in specialized journals. In the light of the appraisal of real estate, the current version of the IFRS does not prescribe a detailed method for the valuation of fixed assets, nor does it give exhaustive requirements for the determination of "fair value". Although this might seem inaccurate at first sight, it is also crucial for international standards to increase the compatibility with national practices and methods.

The analysis showed that the USPAP are very similar in their structure and methods to the IVS, which mainly result from the origin of the IVS. In its former versions the IFRS used the *market value for the existing* use approach to value owner occupied properties. While this concept does not match with the 'highest and best use' approach of the USPAP, the latest version of the IFRS substitutes 'market value for the existing use' by the 'highest and best use', which clearly supports a valuation according to the USPAP. As the USPAP do not specify *market value* themselves, it is important to use an accepted market value definition like the IVS definition in an USPAP appraisal. The valuation methods of the USPAP do clearly fulfil the IFRS's requirements of a fair value determination, which should be derived from market evidence. The USPAP have

[57] APPRAISAL INSTITUTE (2001), p. 425.
[58] THE APPRAISAL STANDARDS BOARD OF THE APPRAISAL FOUNDATION (2004), p. 86.
[59] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), IAS 40.40c.

already been used by a few real estate companies in their recent financial reports, to value US real estate.[60] The active participation of the Appraisal Institute in the international standardization discussion will certainly make sure, that the US appraisers have a compatible set of valuation standards in the future. But although the US appraisal methods can be seen as compatible with the IFRS, the US appraisal profession is regionally scattered and is not used to having a close relationship with the accountants. These structural problems will certainly take some time to be solved, but this process is very important – not only for a constant valuation according to the IFRS, but also in the light of the implementation of a mark-to-market approach in US-GAAP.

Finally, it remains exciting how the international financial reporting landscape will develop: Whether the United States accept and integrate the IFRS and the IVS, or whether they only adjust their local standards to the international standards. Europe has made a first important step in this landscape, and more countries can be expected to follow, which is "likely to increase transparency, encourage investors to diversify [out of their home town] and […] lower the cost of capital"[61]. For US appraisers it is therefore important to watch Europe closely in the next years as changes overseas might influence them as well.

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[60] E.g.: Annual Report 2003/2004 (IFRS), Immofinanz AG.
[61] LO (2004), p. 14.

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