



VALUATION UNDER INTERNATIONAL FINANCIAL REPORTING STANDARDS

Issued by the IVSC 26 March 2007

1. Introduction

Over 8000 European listed companies now prepare their financial statements under the International Financial Reporting Standards (IFRS) published by the International Accounting Standards Board rather than using national accounting rules. The 2005, or in some cases 2006, financial statements were the first published year end audited IFRS accounts.

The move to IFRS was a major challenge and early studies indicate that the introduction of the new reporting regime went surprisingly well. However with so many countries and companies adopting IFRS there are bound for a while to be some differences in application and interpretation. As the new requirements become more familiar it is likely that there will be further changes and improvements, and a move towards achieving much greater consistency in application.

As a global valuation standard setter, it is one of the IVSC objectives to help minimize differences in how companies and auditors in different countries interpret and apply the IFRS and in particular to promote consistency in the measurement of assets and liabilities for IFRS financial reporting purposes.

The IVSC initiated a project to better understand how this process has been proceeding. The IVSC reviewed the annual reports of a number of leading European property investment companies to identify the impact of the introduction of International Financial Reporting Standards (IFRS), in particular the impact of IAS 40, Investment Property. In the majority of cases the 2005 financial statements were the first audited IFRS statements. However in the case of three UK companies, the first audited IFRS financial statements were included in the 2006 annual reports. The companies included in the survey are all members of the European Public Real Estate Association (EPRA), whose financial statements could easily be accessed, in English, via the EPRA website.

The purpose of the research was to examine the level of consistency in the valuation standards applied and the value definitions used for the valuation of real estate assets. The valuation methodology that may have been used was not examined. The objective of the research is to present facts and not to make judgements.

2. The Companies

The financial statements of 59 companies were examined. The geographical distribution of the companies is as shown:

Country	No. of companies	Country	No. of companies
Austria	4	Italy	3
Belgium	5	The Netherlands	5
Denmark	1	Spain	3
Finland	2	Sweden	4
France	7	Switzerland	3
Germany	5	UK	16
Greece	1	Total	59

IAS 40 permits companies to choose between a fair value model and a cost model, although if the cost model is chosen the fair value of the investment property should be shown. Unsurprisingly, given the sector's focus on asset values, the overwhelming majority of the companies in the sample used the fair value model in IAS 40 for their investment property.

3. Valuation standards

- The majority of companies surveyed (65%) disclosed that the valuation was carried out in accordance with named valuation standards/guidance. In some cases, two or more standards/guidance were referred to in one set of financial statements.
- Ten different sets of valuation standards and guidance were referred to:
 - International Valuation Standards
 - Appraisal and Valuation Manual of the RICS (the "Red Book")
(Note: The RICS Red book requires its members undertaking valuations under IFRS to follow International Valuation Application 1, and to state that the valuation is in accordance with IVS.)
 - French Autorité des Marchés Financiers (Financial Markets Authority) recommendations (referred to three times)
 - 1998 property appraisal and valuation charter and the 2000 report published by the joint working group of the Commission des Opérations de Bourse (COB) and the Conseil National de la Comptabilité (CNC) (referred to three times)
 - Uniform Standards of Professional Appraisal Practice - The Appraisal Foundation (referred to twice)
 - American Society of Appraisers - Principles of Appraisal Practice and Code of Ethics (referred to once)
 - Belgian Asset Managers Association press release issued 6 Feb 06 (referred to once)
 - The Committee of European Securities Regulators (CESR) Guidance on property valuations (referred to once)
 - Appraisal directive in the ROZ/IPD Vastgoedindex (Property Index) (referred to once)
 - TEGoVA standards (referred to once)

3. Valuation standards contd/...

- The International Valuation Standards were specifically mentioned in 18 cases; the RICS Red Book in 19 cases.
- In the UK, 10 companies referred to RICS Red Book and 3 to IVS; conversely in Europe 15 references were to IVS and 9 to Red Book.
- The use of IVS was strongest in Austria, Belgium, Germany and Finland.
- Three companies included had references to out-of-date editions of the standards. The valuers report included by Italian company specifically refers to an early edition of the Red Book that is now out of date; a valuers report included by a second Italian company quotes a definition of 'Open Market Value' that is no longer applicable. The notes to the financial statements of on Belgian company make reference to the valuation being carried out in accordance with the 2001 edition of the International Valuation Standards.

4. Value definitions

Just under half of the companies surveyed (29 in number) reproduced a definition of *Market Value* or of *Fair Value* within their financial statement yet only 10 accurately reproduced either the IVS definition of *Market Value* (also adopted by the RICS) or the IASB definition of *Fair Value*. The IVSC defines *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 acted knowledgeably, prudently, and without compulsion".

The IASB definition of *Fair Value* is "The amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arm's-length transaction".

Some of the more minor differences where for example, 'estimated amount' became 'most probable price' or the 'most likely value' might be the result of translation of the annual report into English.

- 'open market value' is still referred to as the basis of value in five reports. In the report of one major UK company although the notes to the accounts refer to the valuation conforming to IVSC, a definition of 'Open Market Value' (which is not recognised in the IVS) is quoted in an accompanying glossary.
- 'Market Value for Existing Use' is used on one occasion for the valuation of the operating properties of one UK company. This has been discontinued as a basis of value under IFRS.
- Other definitions quoted include:

Open Market Value is the price at which an asset or property right can be sold at any given time under normal market conditions. The open market value is expressed as "disposal value" when transfer taxes and acquisition-related expenses are excluded and "replacement value" when they are included. (French company)

All investment properties are calculated at reasonable value. (Spanish company)

This value (i.e. fair value) is referred to as investment value, corresponds to the price that a third-party investor would be disposed to pay in order to acquire each of the properties making up the portfolio of assets and in order to benefit from their rental income while assuming the related charges, without deduction of transfer taxes. (Belgian company)

Fair Market Value (quoted in valuer's report) as: The most probable price, as of a specified date, in cash, or in terms equivalent to cash, or in other precisely revealed terms, for which the specified property rights should sell after reasonable exposure in a competitive market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowingly, and for self-interest, and assuming that neither is under undue duress. (Greek company).



5. Conclusions

As stated at the beginning, the objective of this review was to present the facts on policies and practices adopted by companies and their disclosures, not to make judgments about them. Some of the differences discussed above may be merely cosmetic. However there would appear to be the need for greater consistency. The reference to the ten different sets of valuation standards/guidance creates the potential for confusion and inconsistent application of valuation practices. It has always been the view of the IVSC that the ultimate objective to improve consistency of valuation reporting for IFRS purposes is the adoption of one single set of uniform global valuation standards.

The debate on the use of fair value accounting for investment property is likely to intensify in the coming year. It has been identified as an issue for short term convergence under the Memorandum of Understanding between the Financial Accounting Standards Board (FASB) and the IASB. Similarly it has also been identified as an item for resolution under the convergence project between the IASB and the Accounting Standards Board of Japan.

Disclaimer

This publication contains information in a summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgement. The IVSC cannot accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication.



EXAMPLES OF PUBLISHED BEST PRACTICE RECOMMENDATIONS FOR VALUATION REPORTING FOR IFRS PURPOSES

1. European Public Real Estate Association (EPRA)

Best Practices Policy Recommendations Jan 2006

Recommendation:

Valuation - the valuation of investment property held by real estate companies should be at fair value (market value), assessed in accordance with International Valuation Standards (IVS), as set out by the IVSC. The valuation should be aggregated on an ungeared basis to include all property and related interests held, and should be performed by a valuer meeting the definitions as laid down by IVS. Where local regulations impose a departure from IVS, the difference should be explained and quantified. If the value accounted for in the financial statements deviates materially from the value as assessed by the valuer, this fact and the rationale behind should be disclosed.

See www.epra.com

2. Ernst & Young

2006 Good Group (International) Limited International GAAP® Illustrative Financial Statements
(the consolidated financial statements of a fictitious manufacturing company incorporating all IFRS in issue at 30 June 2006.)

Notes to consolidated financial statements

Investment properties are stated at fair value, which has been determined based on valuations performed by Chartered Surveyors & Co. an accredited independent valuer, as at 31 December 2005 for the current and previous years respectively. Chartered Surveyors & Co. is an industry specialist in valuing these types of investment properties. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards Committee standards.

See www.ey.com



3. Deloitte

International Financial Reporting Standards - Model Financial Statements 2006.

Notes to the consolidated financial statements

Freehold land and buildings carried at fair value

An independent valuation of the Group's land and buildings was performed by Messrs R & P Trent to determine the fair value of the land and buildings. The valuation, which conforms to International Valuation Standards, was determined by reference to discounted cash flows using a discount rate of 10%. The effective date of the valuation is 31 December 2006 (2005: 31 December 2005).

Investment Property

The fair value of the Group's investment property at 31 December 2006 has been arrived at on the basis of a valuation carried out at that date by Messrs R & P Trent, independent valuers that are not related to the Group. Messrs R & P Trent are members of the Institute of Valuers of A Land, and they have appropriate qualifications and recent experience in the valuation of properties in the relevant locations. The valuation, which conforms to International Valuation Standards, was arrived at by reference to market evidence of transaction prices for similar properties.

See www.iasplus.com

4. PricewaterhouseCoopers

International Financial Reporting Standards

Illustrative consolidated financial statements 2006 - investment property

Notes to the consolidated financial statements

The Group's investment properties were revalued at 31 December 2006 by independent professionally qualified valuers [name of external valuers]. Valuations were based on current prices in an active market for all properties except for the properties located in [name of country] because this information is not available there. For these properties, the Group used discounted cash flow projections.

See www.pwc.com

5. European Association for Investors in Non-listed Real Estate Vehicles (INREV)

INREV Reporting Guidelines

Pro forma financial statements

Investment property. After initial recognition, investment property is carried at fair value. Fair value is based on active market prices, adjusted, if necessary, for any difference in the nature, location or condition of the specific asset. If this information is not available, the Fund uses alternative valuation methods such as recent prices on less active markets or discounted cash flow projections. These valuations are performed in accordance with the guidance issued by the International Valuations Standards Committee (IVSC). These valuations are reviewed annually by [name of the external valuers]. Investment property being redeveloped for continuing use as investment property or for which the market has become less active continues to be measured at fair value.