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March 18, 2004

International Valuation Standards Committee
12 Great George Street
London SW1P 3AD
United Kingdom

Re: Valuation of Assets for Financial Statements

Dear Committee Members:

On behalf of the more than 27,000 members of the Appraisal Institute, American Society of Appraisers, and American Society of Farm and Rural Appraisers we thank you for this opportunity to respond to your January 2004 Position Statement (PS), as referenced above. We are pleased to respond to what we believe is a most important statement of fundamentals that are of greatest importance in financial reporting to the United States and, we believe, all other countries of the world.

We strongly support the IVSC's activities in the areas of harmonization of valuation standards among all countries, and public disclosure of individual country differences where they may occur. We also support your activities with the International Accounting Standards Board (IASB) and various other world bodies to increase their knowledge about and reflection of current market values in financial reporting.

We presume that your Paper will be added to IVSC's published materials when complete, and we offer the following comments and recommendations.

General Comments

1. When addressing any issue of international scope the element of *language* becomes central. Although the vocabulary of valuation often appears to be similar around the world, the distinctions and assumptions behind the concepts and standards may vary according to the pertinent jurisdiction (country) in which they are being used. (It is our understanding that one of the more prominent obligations of the IVSC is to make known to the world community any countries not complying with IVSC standards.) It is our concern that some of the important distinctions have been passed over. If we do not address them now, they have the potential to create immense difficulties during and after the convergence of accounting standards.

Language is of particular concern as the U.S. Financial Accounting Standards Board (FASB) moves away from its reliance on historical cost and other non-market values for financial reporting. Terms and concepts that have long been used in the United Kingdom and the rest of Europe might seem so familiar as to be assumed, but in the United States, which is just moving to a value reporting standard, we cannot make these assumptions; instead, terms must be clarified

and reconciled to different practices. There are a number of concepts in this position statement that bear clarification just for this reason.

An example of such an important conceptual difference has to do with the definition of 'assets.' Although not mentioned in prior writings, areas of concern in the international and domestic accounting standards and regulatory movements include the need to recognize that 'assets' are valued as *Ownership rights*, what one actually owns, even if they are physically manifested in real estate, machinery and equipment, and the like. Thus, when organizations like the National Council of Real Estate Investment Fiduciaries (NCREIF) and American Institute of Certified Public Accountants (AICPA) seek to promulgate new standards for valuation and reporting of assets in the context of ownership rights, it is imperative that the IASB, FASB, IVSC, and others more accurately account for rights of asset ownership, not the physical assets alone.

The concept of 'going concern' presents another challenge that deserves comment by the IVSC in its final statement. There is confusion over terminology between the valuation discipline and others, apparently including IASB, FASB, and AICPA. The notions of a going concern or the use of property within a going concern in the United States are different from a valuation of an asset based upon its value to a going concern (the latter being what we define as 'going concern value' – value to the particular user). The fact that the reporting entity is a 'going concern' is separate from the basis for value reporting of an asset if the standards make clear that the standard is not a subjective, arbitrary, and potentially misleading opportunity for the going concern to choose a value that is useful to them, but different from what others are reporting.

2. This position statement is an important opportunity for the IVSC to more forcefully clarify its position on 'fair value.' We argue that, in fact, 'fair value' is not a 'fair standard' because the notion of 'fairness' is subjective and in application provides opportunity for a violation of the goals of transparency, reliability, objectivity, consistency, and protection of the public interest. 'Fairness' may be interpreted as 'fairness to my client,' 'fairness to a cause,' or 'fairness to my company's ability to earn fees.' Those obviously are not a part of the definition, but the point is that fairness is not by itself a standard. IVSC should take a strong stand forward on behalf of market value and its long history of fairness as a result, not as a subjective internal element.

IASB and FASB are working under a premise that 'fair value of land and buildings is *usually determined* [emphasis added] from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers.' This is perhaps the most important opportunity AND hurdle that we face. IVSC should seek clarification of the specific situations that would give rise to the use of 'usually determined' and should suggest clarifying language. For example, the statement would be stronger and the standards would be more definite if it said, '...are determined from market-based evidence where such evidence is available, and by other market evidence processed in accordance with generally accepted valuation principles when not, in each instance undertaken by professionally qualified valuers.' We view the continued emphasis upon market evidence, even in the instance of limited or non-market properties, as a crucial component of financial reporting standards that are based upon market value concepts. It is our belief that this distinction has not been generally recognized among accountants and regulatory bodies, but is an especially important element of the Position Statement to be made by IVSC.

3. As a further example of the use of market information, we recommend that IVSC standards recognize the importance of valuers' research in determining how buyers and sellers consider future benefits of ownership, if such research reflects they are considered at all. For instance, valuers or others who use projection techniques to hypothesize a 'residual value' upon future sale of a property would introduce speculation and, perhaps, personal perceptions and biases rather than those of the market. Market research can, however, permit the discovery or determination of the processes used in market transactions and, where sufficient data are available, opportunity to consider the markets' own actions in the valuation process.
4. We recommend that the IVSC use this opportunity to engender discussion of principles, market realities, and the positive role of the IASB in value-based reporting. With the current and past experiences of Europe and many other portions of the world in use of market value as a financial reporting standard, we believe that joint cooperative efforts between the IASB and the IVSC are essential to world standards and that they will assist in convergence of standards with North America.

Specific Comments

3.1 Bullet 3

This point is another example of the terminology and language problem mentioned previously. This paragraph concludes that in the absence of market-based evidence of *fair value* [emphasis added], fair value must then be estimated. This statement could be strengthened by adding a comment from the IVSC that starting from market value is the strongest position a valuer can take and precisely the reason why a market value standard is necessary.

'Fair value' in the absence of market evidence can leave a hole for abuse; instead, valuers and clients for valuations should be encouraged to adhere to a more precise market value standard to achieve consistency, relevance, and the other goals mentioned above. Further, by signing off without strong commentary about the income and depreciated replacement cost (DRC) approaches being **methods**, not **standards**, and/or by failing to emphasize that even with limited and non-market properties it is necessary to attempt an application of **all three approaches** (which may be an even more important trioka than when ample sales data are available), the IVSC would leave the record and IVSC standards muddled. This is an opportunity for significant correction/clarification of IASB and FASB concepts.

3.1 Bullet 3

The previous IAS 16 made no reference to the use of depreciated replacement cost for land and buildings, the only reference being in relation to plant and equipment. Now it provides that *"If there is no market-based evidence of fair value because of the specialized nature of the item of property, plant and equipment and the item is rarely sold, except as part of a continuing business, an entity may need to estimate fair value using an income or a depreciated replacement cost approach"*.

4.0 and 4.2

Since IVSC is commenting upon, or may comment upon, accounting standards convergence, it would be helpful to the UNITED STATES if IVSC would add comments regarding section 4.0 of its PS generally, and paragraph 4.2 (with its bullets) in particular. As phrased, the emphasis is on 'valuation techniques,' but there is no mention of 'valuation principles.' IVSC should emphasize that the IASB/FASB should recognize worldwide Generally Accepted Valuation Principles (GAVP) as expressed through the IVSC and supplemented by various countries just as they recognize U.S. Generally Accepted Accounting Principles (US GAAP). As it stands, there is too much confusion between 'principles' and 'techniques,' and we believe the language should be better distinguished in IVSC statements and in its advisories to IASB and others.

4.2 Bullet 3

This point bears further clarification. Why would the valuation of an asset for financial reporting purposes be conditioned by a 'hypothetical condition'? It would be useful to distinguish the definition of market value from hypothetical conditions that might be established for the given property rights appraised for legal or other purposes than financial reporting. It is extremely important that the 'going concern or in-use valuation premise' language be clarified and corrected, citing international valuation standards. This is especially important given that our goal on behalf of the public is to assert market value as the basis for valuing all assets in financial reporting.

The IVSC statement should make clear that, as international and U.S. accounting and reporting convergence continues, potential for misunderstanding or abuse must be avoided wherever possible, and this is an excellent place for IVSC to assist both groups by clarifying language. This is also a logical place for discussion of assets held as investments, not just for use or as surplus to use, so as to distinguish between surplus and investment properties. If they are to be the same, the market loses an opportunity to see where a reporting entity is purposely acquiring for investment purposes, or in mergers and acquisitions, opportunity to see what is not operational property (as examples).

4.2

A summary of FASB decisions on Fair Value Measurement are published on its web site.

Amongst the tentative decisions reached by December 2003 are:

- That all estimates of fair value should be based on the results of valuation techniques that maximize market inputs in active markets, even if the asset (or liability) being measured is not exchanged in an active market.
- That valuation techniques consistent with a market approach, an income approach, and, where applicable a cost approach may be used for all fair value estimates.
- That the valuation premise describes the actual or hypothetical condition and location of an asset affecting the exchange price at which willing parties would agree to transact and provides additional guidance for selection of relevant market inputs. In general:
 1. a going concern or in-use valuation premise should be used to estimate the fair value of assets held and used and,
 2. an in-exchange valuation premise should be used to estimate the fair value of assets held for sale.

5.1.1

Although we generally agree with the IVSC's comments here, we would suggest that it be more precisely stated that the 'specific context' is also a market (market value) context.

5.1.1

...that while the fair value definitions used by both IASB and FASB are superficially similar to the definition of Market Value in IVS, they are not synonymous. Each may refer to a hypothetical exchange, but that exchange has to be considered in a specific context in order for a figure to be reliably estimated.

5.1.2

This is an area for possible misunderstanding. The IVSC should consider including the definition of market value here so as to avoid a reader's belief that the discussion *is* the definition of market value.

We also recommend adding a strong statement about why market value should be the preferred standard, and why fair value intentions are made more possible of an achievement through adoption of IVSC's market value definition and recognition of IVSC standards and GAVP applicability.

5.1.2

...that in the case of owner occupied property, the IVSC definition of Market Value, unless modified by any additional limiting or qualifying assumptions, reflects the price obtainable for the highest and best use of the property in an arm's-length transaction unfettered by any enterprise currently in occupation.

5.1.3

The wording here presents a potentially major problem. We would recommend this statement be reworded to make clear that preparation of statements on a 'going concern basis' does *not* equate to getting rid of 'market value' or 'fair value' as we know it. One could argue that this is yet another language problem, where professionals from the United States are simply misunderstanding the 'going concern' concept used elsewhere, but we do not believe that to be an accurate statement. This area *must* be clarified if the new convergence standards and practices are to have full meaning and are to avoid the problems they attempt to correct. This is not a small issue, but one that requires immediate and forceful attention.

5.1.3

...that references to fair value in accounting standards should reflect that financial statements are prepared on a "going concern" basis, unless management intends to either liquidate the enterprise or to cease trading.

5.1.4

Again we are concerned with the 'continuing enterprise' concept, which can be taken as shorthand for 'going concern value.' In any event, to achieve market value reporting, an asset's value should not be measured based upon its service potential to a given continuing enterprise—that is a language/concept issue that has been confused in the valuation profession and with other professionals for years. A market standard should require measurement of the asset's value for existing or continuing use **regardless of who the user may be**. Thus, it should not be the continuation of use by this particular enterprise that is the basis of value, but such continuation is instead a determination of whether the Market Value for Existing Use (MVEU) trigger should be pulled. This may seem esoteric, but it is not. The words 'existing use, subject to continuing profitability' have a historical meaning, but still need further refinement. This paragraph as written complicates rather than improves on the situation.

5.1.4

...that there can be a difference between the fair value of an asset that is held and used as part of a continuing enterprise and the Market Value of an asset that is surplus and held for disposal. In the context of owner occupied real estate this arises because the entity owns the property as a means to achieving a wider objective, rather than as an objective in its own right. The value of the service potential of a property as part of the continuing enterprise may well differ from its value for another purpose on the assumption that the operations had ceased and it had been declared surplus.

5.1.5

The concept here is good, but the language needs clarification to assure that we are not dealing with a 'value to the reporting entity.'

5.1.5

In cases where there is a significant difference between the value of an asset as part of the continuing enterprise and its value if had been declared surplus, this essential information should be provided by the valuer when reporting, as it may be relevant to future decisions made by the entity in relation to the asset.

5.1.6

We would recommend this paragraph be significantly revised. Implicit in the language, and in the general direction of some of the IASB/FASB language, is that market value is a spot price. In the absence of a spot price, their theory seems to posit or permit, one can rely upon theoretical concepts of income or cost methodologies to replace a non-existent market. This can be a dangerous approach. The IVSC should take steps to emphasize that as markets grow thinner, and sometimes reach a point of no transactions, other market evidence is necessary. Sales transactions can be used (where available) in an attempt to at least find the boundaries of reasonableness in valuation. It must be remembered that the income and cost approaches are also dependent upon a market basis, else they would be subjective and theoretical.

5.1.6

...that wherever possible, fair value should be determined using market based data, although it must be recognised that for some categories of assets there may be no market based evidence available. In these circumstances, other techniques, e.g. income analysis or depreciated replacement cost may be used to determine fair value.

5.2-6

The introduction of Continuing Use Value as a new valuation basis is confusing and even counterproductive. The semantics of this term allow the implication of a going concern value concept, or leave room for one to be substituted. Furthermore, the term is intended as a form of *market* value. To leave the word 'market' out of such a pivotal term allows for further misunderstanding. Market Value for Continued Use or the time honored MVEU would be far better since it has a history of successful use despite its recent exclusion from the IASB standards. We do not favor the confusion a new term may create, especially one that does not specify the market as its basis.

5.2

In the light of these conclusions the IVSC working party will be proposing that changes are made to IVS 2003 to incorporate a new valuation basis (reflecting its understanding of an 'in-use' premise), Continuing Use Value (CUV) and to make consequential alterations to IVA 1, Valuations for Financial Reporting.

6.0 Continuing Use Value (CUV)

6.1 Scope:

A basis of valuation to be used only to establish the fair value of property assets owned and occupied by an entity for use in Financial Statements under International Accounting Standard IAS16. Surplus property is to be valued to Market Value. Investment Property is valued in accordance with IAS 40.

6.2 Definition:

6.2.1 CUV is 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 acted knowledgeably, prudently and without compulsion, subject to the following additional assumptions:

1. The buyer requires the property in its current state for the continued operation of the enterprise, and
2. That enterprise will continue for the foreseeable future.

We also recommend that you require a discussion of highest and best use, as this seems to be the stumbling block for many. In many cases, highest and best use will be identical to the asset's 'continuing use.' Where that is not so, a valuation professional needs to disclose the highest and best use while using the 'continuing use' value for reporting purposes.

This ties to the issue of ownership rights in that it is difficult to book an asset as a physical entity when that asset is actually a divided ownership right. CUV will have some difficulty in being understood outside our profession because many are not yet familiar with GAVP and the role of rights of ownership as the subject of valuations. This is particularly evident in current financial and accounting discussions pertaining to the treatment of leases, tranches, and the like.

6.3.2

This statement should refer to 'methods' not just 'method' to remain consistent with IVSC's own principles.

6.2.2 This definition is the same as that of Market Value, and should be applied in accordance with the conceptual framework set out in International Valuation Standard IVS 1 (para. 3.2), except as modified by the additional assumptions cited above.

6.2.3 Where there is insufficient evidence to reliably assess the CUV using market comparison, as for example in the case of Specialised Property, CUV may be determined using an income or depreciated replacement cost approach.

6.3 Additional Reporting Requirements for CUV:

6.3.1 Where the valuer considers that the Market Value of property owned and occupied by the entity is materially different from the CUV, this shall be disclosed in the report.

6.3.2 The method adopted and any significant assumptions made in the valuation shall be disclosed, together with the extent to which the CUV was determined either directly by reference to observable prices in an active market, to recent market transactions on arm's-length terms, or by means of another valuation approach.

6.3.3 The CUV of a cash generating asset using depreciated replacement cost methodology should be accompanied by a statement that it is subject to the adequate potential profitability of the enterprise, having due regard to the value of the total assets employed.

6.3.4 The CUV of a non cash generating asset using depreciated replacement cost methodology should be accompanied by a statement that it is subject to the prospect and viability of the continued occupation and use.

6.3.3

There seems to be little basis for this statement and without further explanation it appears potentially misleading and subject to abuse. It is dangerously vague at a point when it is particularly important to be explicit. Why is the profitability of the reporting enterprise an issue? We again emphasize that one must distinguish the valuation of the asset from the valuation of the enterprise. What does 'having due regard to the value of the total assets employed' mean? Going concern value? What is 'due regard'? What 'value' of the total assets—going concern value? Portfolio value? What are the 'total assets employed'? Does this exclude surplus and investment property? What does 'employed' mean in this context? As stated these are shorthand statements for unidentified concepts that leave the

reader to surmise and invent—contrary to the purpose of standards. We recommend the obvious rewording.

In addition to these suggestions, we commend the IVSC working party for developing this Position Statement. Our organizations believe the issues addressed in this document are of significant importance to the IVSC and the success of the convergence project. When finalized, your Position Statement provides a very real and important vehicle for the issues to be refined and addressed for application in financial reporting and in valuations generally.

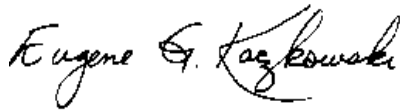
We will continue to support your work in providing consultative assistance to the IASB convergence. We would also suggest that you delve into the work of FASB as it influences the IASB in its efforts to bring about worldwide convergence in financial reporting standards, especially as they apply to international valuation standards.

Thank you for considering our comments and requests. A member of our staff will be in touch with your office shortly to arrange a time to discuss these issues in more detail. Should you have any questions, please contact Don Kelly, Vice President of Public Affairs, Appraisal Institute, at 202-298-5583 or dkelly@appraisalinstitute.org; Ted Baker, Executive Vice President, American Society of Appraisers, at 703-733-2019 or tbaker@appraisers.org; or Doug Slothower, Executive Vice President, American Society of Farm and Rural Appraisers, at 303-758-3513 or dslothower@agri-associations.org.

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