ACCOUNTING
FOR INVESTMENT
PROPERTIES

edited by
P Weetman and S J Gray

Pauline Weetman is Professor of Accountancy and Finance,
University of Stirling

Sid Gray is Professor of Accounting, University of Glasgow

Published by
The Institute of Chartered Accountants of Scotland
27 Queen Street, Edinburgh EH2 1LA
First Published 1992
The Institute of Chartered Accountants of Scotland

© 1992

ISBN 1 871250 22 6

This book is published for the Research Committee of The Institute of Chartered Accountants of Scotland and does not necessarily represent the views either of the Research Committee or of the Council of the Institute.

No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication can be accepted by the author or publisher.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior permission of the publisher.
Foreword

This publication is the fifth of an “Emerging Issues” series which has been initiated by the Research Committee of The Institute of Chartered Accountants of Scotland. The series is addressed to everyone with an interest in accounting and financial management - and in today’s world that is an extensive constituency!

At a time of change and of increasing interest in accounting and financial matters, the Research Committee believes that the series will provide an explanation of issues which are particularly topical. The books in the series will, however, be written in such a way as to be understandable to readers who are not familiar with extensive academic theoretical literature. Although primarily intended for accountants, treasurers, bankers, civil servants, directors, managers and investors and their advisers, they have also been found useful for students and the interested layman.

This particular publication reports the results of an investigation into the experiences and problems involved in accounting for investment properties in accordance with Statement of Standard Accounting Practice 19 and makes recommendations in the light of the research findings. The Committee commends this book for study and discussion in the interests of better understanding of the issues involved in accounting for investment properties.

The Institute of Chartered Accountants of Scotland

Professor J P Percy
Convener
Research Committee
## Contents

### Acknowledgments

### Chapter:

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>The Research Brief</td>
<td>1</td>
</tr>
<tr>
<td>2.</td>
<td>Executive Summary</td>
<td>5</td>
</tr>
<tr>
<td>3.</td>
<td>Interview Report</td>
<td>15</td>
</tr>
<tr>
<td>3.1</td>
<td>Approach to interviews and background of interviewees</td>
<td>15</td>
</tr>
<tr>
<td>3.2</td>
<td>Need for the Standard</td>
<td>16</td>
</tr>
<tr>
<td>3.3</td>
<td>Coverage</td>
<td>17</td>
</tr>
<tr>
<td>3.4</td>
<td>Valuation</td>
<td>21</td>
</tr>
<tr>
<td>3.5</td>
<td>The surveying profession and the accountancy profession</td>
<td>32</td>
</tr>
<tr>
<td>3.6</td>
<td>Accounting implications: profit and loss account and balance sheet</td>
<td>33</td>
</tr>
<tr>
<td>3.7</td>
<td>Accounting implications: disclosure of information on the valuation assumptions or opinions</td>
<td>37</td>
</tr>
<tr>
<td>3.8</td>
<td>Summary</td>
<td>43</td>
</tr>
<tr>
<td>Chapter</td>
<td>Page</td>
<td></td>
</tr>
<tr>
<td>---------</td>
<td>------</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.11</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.12</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.7</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4. Literature Review 49
4.1 Introduction 49
4.2 Sources of data 50
4.3 History 52
4.4 User needs and the objectives of financial reporting in the context of SSAP 19 55
4.5 Economic factors 57
4.6 Coverage of SSAP 19 59
4.7 Valuation 62
4.8 Accounting measurement issues 73
4.9 Company law and current accounting issues 84
4.10 Some international comparisons: USA, New Zealand, Australia and IASC pronouncements 88
4.11 Conceptual issues 93
4.12 Summary of the literature survey 99
5. Overview and Recommendations 105
5.1 Introduction 105
5.2 Opinions on coverage of SSAP 19 106
5.3 Opinions on valuation 109
5.4 Opinions on the surveying profession and the accountancy profession 115
5.5 Opinions on accounting issues 116
5.6 Opinions on conceptual issues 121
5.7 Conclusions and recommendations of the working party 123
References

Appendix A: Interview Questions 141

Appendix B: List of Statements of Asset Valuation Practice 147

Appendix C: List of Abbreviations and Definitions used in this Report 151

Appendix D: Statement of Standard Accounting Practice 19 157
# Acknowledgments

## Members of the Working Party

<table>
<thead>
<tr>
<th>Name</th>
<th>Position and Affiliation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eric F Sanderson</td>
<td>Director &amp; Chief Executive, The British Linen Bank Limited (Convener)</td>
</tr>
<tr>
<td>Richard Baldwin</td>
<td>BSc FRICS, Partner, Weatherall Green &amp; Smith</td>
</tr>
<tr>
<td>Aileen Beattie</td>
<td>Director, Accounting and Auditing, The Institute of Chartered Accountants of Scotland</td>
</tr>
<tr>
<td>Les Campbell</td>
<td>Principal, Coopers &amp; Lybrand Deloitte</td>
</tr>
<tr>
<td>Andrew Fearn</td>
<td>Partner, BDO Binder Hamlyn</td>
</tr>
<tr>
<td>John Laurie</td>
<td>Group Treasurer, Scottish &amp; Newcastle plc</td>
</tr>
<tr>
<td>Pauline Weetman</td>
<td>Professor of Accountancy and Finance, University of Stirling</td>
</tr>
</tbody>
</table>
Participants in interviews

The Working Party is grateful to the following persons for providing a frank range of views on aspects of SSAP 19:

John Austen  UK Financial Controller, London and Edinburgh Trust plc
Andrew Cherry  Partner, Healey and Baker, and Chairman of the Assets Valuation Standards Committee of the RICS
Jim Clark  Chairman, English & Overseas Properties plc
Ian Ellis  Partner, Richard Ellis
Adrian Elwood  Property Research Analyst, SG Warburg Securities Ltd
Bob Hayden  Group Accountant, London and Edinburgh Trust plc
Andrew Huntley  Partner, Richard Ellis
James Jerram  Board Member, Finance & Planning, British Railways Board
David Erskine  Principal Investment Analyst, The Standard Life Assurance Company
Basil King  Chairman of the Financial Reporting Panel of the Association of British Insurers
Graeme Knox  Managing Director, Scottish Amicable Investment Managers Ltd
Colin Leslie  Assistant General Manager, Corporate Division, Bank of Scotland
Nick Light  Commercial Director, Chartwell Land plc
Stuart McDonald  Joint Managing Director, London and Edinburgh Trust plc
Gavin Masterton  General Manager - UK Banking, Bank of Scotland
Roger Moore    Director of The Equity Division of SG Warburg Securities Ltd
Alan Murray    Director and Head of Banking, The British Linen Bank Limited
Alastair Nicholls Financial Controller of Letinvest, London and Edinburgh Trust plc
Trevor Rimmer  Principal Management Accountant, British Rail Property Board
David Sill      Senior Property Investment Surveyor, London and Edinburgh Trust plc
Neil Sinclair  Joint Managing Director, Sinclair Goldsmith plc
Deryck Wright  Financial Reporting Manager, The Association of British Insurers

The Working Party also expresses its thanks to: Professor Charles Ward, Professor of Property Finance and Investment, University of Reading, for comments on the valuation process; Professor Bob Parker, Professorial Research Fellow of ICAS, and Professor Steve Zeff, International Research Adviser of ICAS, for comments on various drafts of the report; and the technical departments of some of the major accountancy firms for responses on a confidential basis.

Researchers

The interviews were conducted by Pauline Weetman. The literature survey was undertaken by John McKernan, lecturer in the Department of Accounting and Finance, University of Glasgow and written jointly with Pauline Weetman.
Chapter 1
The Research Brief

As part of its review of existing Statements of Standard Accounting Practice, the Accounting Standards Board (ASB) invited the Research Committee of The Institute of Chartered Accountants of Scotland (ICAS) to undertake a review of SSAP 19 *Accounting for Investment Properties* (issued November 1981). A copy of the text of SSAP 19 is contained in the Appendix to this report.

The research involved two main aspects:

* a literature review of the development of SSAP 19 as seen in published articles, papers and commentaries; and

* discussion, with relevant contacts, of the practical problems of accounting for investment properties.

The types of problems identified by the ASB as being of interest were:
ACCOUNTING FOR INVESTMENT PROPERTIES

* coverage and existing definitions, in terms of the types of property and types of enterprise to which SSAP 19 applies;

* valuation, particularly during the recession being experienced at this time;

* valuation in relation to development decisions or future plans for investment properties;

* the basis of valuation and the assumptions or opinions applied within that basis;

* the cost implications of more rigorous valuation procedures;

* the scope for greater liaison and understanding between the surveying and the accountancy professions;

* the various accounting implications of the foregoing; and

* relevant experience elsewhere in the world.

A Working Party was established by the Research Committee to supervise the investigation and to draw out some findings. The practical problems of applying SSAP 19 were explored by means of in-depth interviews with experts ranging over the fields of professional property valuation firms; property investment companies; other enterprises holding investment properties; property analysts;
and bankers lending to the property sector. The interviews were limited in number but were planned carefully so as to reflect a wide range of views indicative of those which might be expected in a larger sample. The contribution of those who participated in these interviews has been acknowledged at the start of this report and the outcome of the interviews is reported in Chapter 3. The advantage of the selective interview approach is that issues may be explored in greater depth and the context of problems becomes more readily apparent. The Research Committee is most appreciative of the time and care which interviewees gave to the investigation. In addition the Working Party received information, on a confidential basis, from some of the technical departments of the major accountancy firms. This information reinforced some of the comments in Chapter 3 which arose from other sources. Appendix A to the report contains the list of questions used as a basis for the interviews.

The development of the Standard and its subsequent application were traced through a literature review of relevant publications, the results of which are contained in Chapter 4. The Working Party considered all the evidence from this wide range of sources and formed a list of recommendations to the ASB which are presented in Chapter 5.

The report contains repeated references to the Statements of Asset Valuation Practice (SAVPs) issued by the Royal Institution of Chartered Surveyors (RICS) and fully supported by The Incorporated Society of Valuers and Auctioneers (ISVA) and The Institute of Revenues Rating
ACCOUNTING FOR INVESTMENT PROPERTIES

and Valuation (IRRV). For ease of reference a full list of SAVPs is given in Appendix B. It will be apparent from these opening paragraphs that abbreviations are likely to appear throughout the research report. To avoid repetition the full definition will be given only on the first occasion that the abbreviation is used. Thereafter reference may be made to the list of abbreviations in Appendix C.

Before moving into the detail of the project, Chapter 2 presents a brief summary of the results of the project and an indication of the main findings of the Working Party.
Chapter 2
Executive Summary

As explained in Chapter 1 the purpose of the project was to inform the Accounting Standards Board of experiences and problems in the application of SSAP 19 and to make recommendations in the light of the research findings.

On the basis of the research, which encompasses an interview report, a literature review and the experience of the members of the Working Party, the following recommendations are made in Chapter 5 of this report:

Depreciation of investment properties is not an issue of concern at a practical level and it is unlikely that there would be support at present for any proposal to require depreciation of investment properties through the profit and loss account. Accordingly the conceptual basis of SSAP 19 should be clarified in the context of the ASB Statement of Principles.
ACCOUNTING FOR INVESTMENT PROPERTIES

The Working Party found that the academic literature, in contrast to attitudes in practice, does evidence some concern about the lack of a depreciation charge. The Working Party recommends the ASB to clarify the purpose of depreciation within the Statement of Principles and to consider the depreciation of investment properties within this overall framework.

An external valuation, if required in order to establish public confidence in the published information, should be performed at least every three years where the investment property portfolio is material to the profit and loss account or the balance sheet.

The Working Party found that there was a range of views on the purpose of the external valuation. It could be seen as ensuring that experts of adequate calibre carry out valuations at reasonably frequent intervals. If this is the case, then it would be acceptable to rely on qualified internal valuers where these are employed. If the purpose is to establish greater confidence through external verification then the five-year frequency of SSAP 19 is inadequate and the reassurance provided by the external valuer cannot be supplied by internal staff, however well qualified they may be. It may be appropriate to distinguish those situations where the investment property portfolio is material to profit and loss account or balance sheet from those situations where it is not material.
EXECUTIVE SUMMARY

In order to increase confidence in the Open Market Value basis of valuation, a revised standard should explain more clearly the valuers’ professional guidance and there should be an informative Note to the published accounts explaining the principles of Open Market Value.

The Royal Institution of Chartered Surveyors (RICS) has a set of guidelines which must be followed by its members and the members of the Incorporated Society of Valuers and Auctioneers (ISVA) and the Institute of Revenues Rating and Valuation (IRRV). The ASB should liaise with the RICS to ensure that the wording is sufficiently tightly drawn without encroaching unnecessarily on professional judgment, and the accounting standard should contain relevant wording from the RICS Guidelines. A practice is emerging of publishing the valuer’s report in the annual accounts and it would be helpful to readers to know more of the Open Market Value basis of valuation.

The ASB should address the question of whether the coverage of SSAP 19 could be extended to owner-occupied properties and group occupied properties. The issue is clearly controversial but requires examination.

The Working Party found a considerable diversity of views on the potential for widening the definition of an investment property, ranging from
strong opposition to equally convincing arguments that, for definition purposes, the nature of the property should be considered separately from the identity of the tenant. The valuation would take account of the identity of the tenant, and there could be a note to the accounts quantifying the proportion of the portfolio in group occupation. Opposition was based on the risks and scope for manipulation of leases within a group to suit whatever circumstances were desired.

There is a need, as a separate project, for a Standard dealing with accounting for development properties.

Interviews and the literature review have revealed considerable concern about several aspects of accounting for development properties - a concern heightened by the present depression in the property market. This is clearly an issue which needs to be addressed in the standard setting process but the Working Party identified a preference for a separate Standard rather than amendment to SSAP 19.

Accounting issues which affect the profit and loss account and balance sheet, and which should be addressed, include in particular:

* the definitions and accounting treatments of permanent and temporary diminutions in value;
EXECUTIVE SUMMARY

Auditors' difficulties, in discussions with clients, as to whether diminutions should be considered on an individual basis or on a portfolio basis and the problem within group accounts of setting off the revaluation deficit of one subsidiary against the revaluation surplus of another;

the calculation of the gain or loss on disposal and any consequent transfers between reserves;

guidance on whether realised profit on the sale of investment properties should pass through profit and loss account at all;

the scope for manipulation, in a company concerned with its trading profits and earnings per share, to switch between group occupancy and third party occupancy prior to realisation of a property;

lack of guidance on the treatment of revaluation losses in reserves of associated companies and on the treatment of joint ventures where any default by a joint venturer could affect the value of an investment property held jointly;

the proposed EC Directive on Insurance Company accounts which will allow all
ACCOUNTING FOR INVESTMENT PROPERTIES

investment revaluation gains and deficits to pass through the profit and loss account; and

* the proposal in the same Directive which places investments in a special category of assets which is neither fixed nor current.

Improved disclosure should be considered in the following respects -

Relating to the definition of an investment property:

* a statement of the intentions of the directors of individual companies with regard to the holding of investment and development properties;

* a statement of the intentions of the directors of the group with regard to the holding of investment and development properties; and

* a more informative note on accounting policy which would explain the definitions used within the enterprise.
EXECUTIVE SUMMARY

Relating to the valuation process:

* the valuer's report should be published alongside the audit report;

* potentially controversial, but worthy of consideration, could be disclosure of:
  - the opinion taken on the "reasonable period" for realisation
  - the opinion formed about rentals and yields.

Relating to the investment portfolio:

(Some of the following items are already found in the annual reports of some of the property investment companies on a voluntary basis, usually in the form of pie diagrams or bar charts)

* quality of portfolio as indicated by:
  - the type of property
  - location
  - nature of tenure
  - type of use
  - type of tenant

* explanation of causes of changes in current values;
ACCOUNTING FOR INVESTMENT PROPERTIES

* gross increases and gross decreases in values distinguished;

* five-year growth in rental, income and asset value; and

* statement on investment policy regarding:
  - mix of portfolio
  - average period for holding investments.

The legal position of companies which apply SSAP 19 in the context of meeting the requirements of the Companies Act 1985 remains unclear. Clarification should be provided by the ASB, based on legal opinion.

The Companies Act 1985 requires depreciation of all fixed assets of finite life. SSAP 19 creates an exception for investment properties, invoking the "true and fair override" to justify the standard in general terms, but developments since SSAP 19 was issued appear to indicate that the "true and fair override" should more properly be used to justify departure from the statutory requirements in individual cases. Companies comply with the requirements of the legislation, stating in their annual reports that the departure has taken place and providing the necessary information, but this does not provide adequate clarification of the position of the Standard itself.
EXECUTIVE SUMMARY

The range of views and opinions obtained in its various investigations leads the Working Party to recommend full consultation and careful explanation of any proposals for change to the existing SSAP 19.
Chapter 3
Interview Report

3.1. APPROACH TO INTERVIEWS AND BACKGROUND OF INTERVIEWEES

As explained in Chapter 1 the Research Brief for this project, agreed with the ASB, specified the types of problem which should be addressed in the interview phase of the project. These ranged over the coverage of the Standard, valuation issues, liaison between the surveying and accountancy professions, and accounting implications.

The questionnaire used as a basis for each interview was designed to address these problems by using a series of more detailed questions under each heading. (The full list of questions is reproduced in Appendix A.) The questionnaire formed the agenda for the meeting but respondents were encouraged to speak freely rather than being constrained to the specific list of questions. Taking this approach may result in respondents selecting particular areas for their main comments, rather than spreading their
ACCOUNTING FOR INVESTMENT PROPERTIES

comments over the full range, but has the advantage of eliciting specialist knowledge in those particular areas. The limited number of interviews means that the views obtained cannot be held to be representative in any statistical sense but the choice of respondents, in terms of experience and seniority in their respective areas, gives considerable insight into current opinions. Because of the sequential nature of the interviews it was not always possible to test a wider reaction to a new idea which emerged at a later interview. Consequently the report provides a range of views for consideration but generally does not attempt to measure the degree of consensus.

Thirteen interviews were held, involving a total of 22 persons because in some cases experts from within the organisation were also present at the interview. They have all given permission for their names to be listed in the opening Acknowledgements section of this report but have requested that they should not be quoted and that particular views should not be attributed to named individuals.

3.2. NEED FOR THE STANDARD

The full text of the Standard is contained in Appendix D. All respondents agreed that there was a continuing need for SSAP 19 and that in general terms it was a Standard which did not of itself evoke major criticism. On a practical point of
writing a document which meets the test of time, there is a need to make more explicit the background to the Standard. The justification for SSAP 19 is contained in paragraphs 1 and 2 which were written at the time of debate on the applicability of SSAP 12. While those who remember that debate have no difficulty with paragraphs 1 and 2, there is a younger generation which does not remember and finds these paragraphs are a coded message. With the passage of time, the explanation of the need for SSAP 19 could be expanded for clarity.

3.3. COVERAGE

Owner occupied and group occupied properties

Respondents were asked about coverage in relation to the types of investment property included within the scope of SSAP 19 and about the type of company to which it applies.

There was some concern about the types of property excluded from investment properties by paragraph 8 of SSAP 19. It was pointed out that many groups which own investment property will have some of the group's own member companies as tenants. If the rental is negotiated at arms-length it is difficult to see why the property ceases to be an investment property.
The example was given of composite insurance companies which carry on both general and long-term insurance business. In this case properties may be occupied by general business staff although owned by the long-term business or vice-versa. It is necessary, because of the requirement to keep the two types of business separate in these cases, for the arrangement between user and owner to be at arm's-length as though they were not members of the same company. In such circumstances, the exclusion of owner-occupied property from the definition of an investment property seems unrealistic.

Another example given was where one member company of a group holds all the properties where there is owner occupation. In this case SSAP 12 would require these properties to be depreciated and failure to do so would result in an audit qualification. This could result in a significant extra workload in determining a theoretical amount of depreciation which is likely to be difficult to justify and which might well not be significant at the consolidated accounts level.

From the opposite viewpoint, one respondent expressed concern about potential exposure to risk if a high proportion of investment properties was let to group companies, but other respondents felt this risk could be dealt with by a requirement to disclose the extent of group occupancy. A valuer was doubtful about valuing a property occupied by a
INTERVIEW REPORT

group company because the value was highly dependent on the nature of the tenancy which could relatively easily be ended. Some felt that there could be scope for abuse in writing leases for rental within a group.

In similar vein, respondents pointed out the difficulty of dealing with a property which is partly owner-occupied and partly let to third parties. It would seem that, under current practice, such a property might well be recorded as an investment property with the agreement of the auditor.

Development properties

Comments were made on the difficulty of defining the border between a development property and an investment property, especially in a situation where a property is held as an investment, vacated by the tenant and redeveloped, and then let again at a higher rental. At present, when a development property cannot be sold, there seems to be a practice of reclassifying it as an investment property. There are similar problems in switching from trading properties to investment properties. It was felt that the Standard could do more to define the limits of development and investment, although there was no enthusiasm for bringing development properties within the scope of SSAP 19.

It was pointed out that the market leaders in the property investment company sector apply different
ACCOUNTING FOR INVESTMENT PROPERTIES

accounting policies to the valuation of development properties. Consequently it is difficult to identify an existing best practice. The RICS Statement of Asset Valuation Practice 14 (SAVP 14) lists five different methods for valuing development properties, ranging from actual cost at the date of valuation to open market value on the assumption that the development works have been completed and fully let, less the estimated cost to complete the development. The valuation approach used is often not disclosed adequately in the annual report. There appears to be a need for a separate Standard dealing with development properties.

Type of property or type of business

There was no desire to change the present coverage by excluding non-investment companies. The unanimous view was that it is the investment property which is of interest, not the nature of the business which owns the property. Respondents generally did not seem aware that, in the history of SSAP 19, there had ever been any debate on the possible restriction to investment property companies only. One respondent remarked that he could see no reason for excluding charities from the requirements of the standard. Another pointed out that, for non-investment property companies, the assessment of performance on the basis of earnings per share often leads to misinterpretation or lack of understanding of the effect of increases in asset values which are taken direct to reserves, but did
not see this as a reason for changing the scope of SSAP 19.

3.4. VALUATION

Valuation basis

The valuation basis prescribed in SSAP 19 is Open Market Value (OMV). The RICS Assets Valuation Standards Committee publishes a series of SAVPs, fully supported by ISVA and IRRV. These are binding on members of the RICS, ISVA and IRRV and are commended by the Presidents of all three professional bodies as essential to all those who undertake and all those who use the assets valuations which come within the remit of the Statements.

Particular interest during the interviews focused on SAVP 2, dealing with OMV. (A full list of SAVPs is contained in Appendix B and there is further reference to specific SAVPs in subsequent sections of this chapter.)

In the present situation of a depressed property market, OMV has been difficult to establish because there are few, if any, comparisons available. The level of vacancies is high. The range of yields obtainable has fluctuated more widely than it has historically, so that different valuers looking at the same property on the same rental may produce very different values because of different opinions about
ACCOUNTING FOR INVESTMENT PROPERTIES

yield, quality of tenancy, and other conditions attaching to the property.

Views on OMV depended on the background of the respondent. The valuers pointed out the difficulties with OMV in the lack of comparable data and in estimating how long a sale might take to arrange. The "reasonable period" allowed by SAVP 2 for a sale to be negotiated had to be extended, so that they might at present be thinking of 9 to 12 months rather than a more usual 3 to 6 months. Valuers admitted to being relatively conservative at the present time because of fear of litigation in the event of giving a valuation which could not be realised within a reasonable period. "Forced sale" values are not permitted under the OMV guidelines.

Those who receive the valuers' reports were concerned about the range of valuations at any time, not merely in depressed markets. The bankers' view was that the values were too high and gave no realistic indication of realisability, while others felt that the values were too low in relation to a business which intended to hold the assets for the longer term. It was also felt that two different valuers could come up with completely different answers without breaching the RICS Guidelines. Respondents made various suggestions for narrowing the range of potential valuations. One felt that the RICS would only tighten up its SAVP guidelines if encouraged to do so by the ASB through the mechanism of an accounting standard.
INTERVIEW REPORT

Another felt that, if the "reasonable period" used for the valuation were disclosed, that might at least encourage uniformity.

One respondent felt that OMV was not appropriate to assets held on a long-term basis and that a value based on discounted future income would be more useful and less open to variability. The discounted cash flow approach was generally not greeted with enthusiasm, although two respondents pointed to calls for a discounting approach made by the Chairman of Capital and Counties in that company's Annual Report and in its Rights Issue document.

Valuers' reports in the USA

Two examples were provided, on a confidential basis, of valuers' reports in the USA. These are lengthy documents which apply three different approaches to valuation and then make a recommendation based on analysing the relative merits of each. The three methods are:

- The Cost Approach
- The Sales Comparison Approach
- The Income Approach

The cost approach is based on the value of the land plus the depreciated replacement cost of the building. The sales comparison approach is based on detailed records of recent sales in the area. The income approach is a discounted value of estimated
future cash flows over a 10 year period in one instance and 15 years in the other. In both cases (a hotel and an office block) the valuers recommended the income approach because the purchaser would be investing in the future income of the property. (Both reports were to bankers in relation to raising finance for redevelopment.) The valuers’ reports contained detailed workings and explanations of the approach taken.

Valuation: land and buildings having development potential

Valuers, preparers and users of accounts all saw relatively little difficulty in dealing with land containing buildings which were detrimental to its development potential. For an investment property the property is valued as a whole, based primarily on rental and yield but also taking into account the type of tenure, quality of tenant and factors such as development potential. Responses seemed to be cautious on valuing development potential. An element of “hope value” would be added (as permitted by SAVP 2 para 1.10) if there was a realistic development potential. In general, if it seemed preferable to take down a building then the owner would make a deal with the tenant, pay compensation for the loss of a tenancy, and demolish the building. Commercial considerations seemed more significant than accounting issues.
Assumptions in valuations

There are different levels and types of assumptions in valuation and these caused some initial confusion in discussions with valuers, since their particular interest is in what they call “special assumptions”.

The position is probably best summarised by quoting para 3.6 of SAVP 1:

“Open Market Valuations should be made only on such assumptions as the Valuer reasonably and realistically could expect to be made by prospective purchasers (other than a ‘purchaser with a special interest’ - see IP No 7) in the open market...”

In defining OMV, SAVP 2 stipulates the assumption of:

(a) a willing seller;
(b) a reasonable period in which to negotiate the sale taking into account the nature of the property and the state of the market;
(c) that values will remain static during that period;
(d) that the property will be freely exposed to the open market; and
(e) that no account will be taken of any additional bid by a purchaser with a special interest.
ACCOUNTING FOR INVESTMENT PROPERTIES

The valuers appear to regard these "assumptions" as matters of judgment or opinion for their expertise, particularly so far as the "reasonable period" of item (b) is concerned.

There are also what the valuers refer to as "special assumptions", explained as follows (SAVP 1 para 3.7):

"In exceptional circumstances it may therefore be necessary, in order to advise fully upon the potential value of a property, to report an additional value on a 'special assumption'. This may be defined as an assumption which, in the actual circumstances prevailing in the market at the time of the valuation, could not reasonably be expected by the Valuer to be made by prospective purchasers other than purchasers with a special interest."

SAVP 7 provides more detail on these special assumptions.

The impression gained from the interviews was that the members of the surveying profession think primarily of the special assumptions when asked about "assumptions" in valuation, while the preparers and users of accounts are chiefly concerned about the variability of opinion on valuations which exists within the basic assumptions specified in SAVP 2, particularly regarding the "reasonable period".
INTERVIEW REPORT

In addition, it was discovered that valuers work with another set of "assumptions", in situations where they are instructed by the client to carry out a valuation based on information provided by the client. Thus the client might specify the floor area, or the tenancy conditions, in the valuation instructions. The valuer would not necessarily check these matters in all cases. These would also be "assumptions" from the viewpoint of the valuer.

In the matter of investment property valuation, the valuer is usually instructed by a director of the company, either the property director or the finance director to whom detailed negotiations or discussions on the valuations would be confined. Presentations to the board as a whole do not seem common, although all members of the board of directors receive information on valuation. It seems likely that, at meeting of boards of directors, only those with specialist knowledge, such as qualified valuers and some experts in accountancy and finance, would be aware of the potential for variation in valuations by external valuers.

Auditors include scrutiny of the valuations in their audit programme but seem on the whole to be more concerned about assumptions where the valuation is internal or is prepared for an investment property within a trading concern. The auditing guideline "Reliance on other specialists" covers the work of the auditor in relation to expert valuations, but the respondents did not seem aware of what could

27
reasonably be expected of the auditor. One valuer thought that the auditor ought to see the letter of instruction from the client, but did not know whether this happened in practice. He also thought it would be useful if on occasions he could approach the auditors directly to discover the accounting implications of the valuation.

The banking view was that auditors should be more challenging in their investigations of valuations and should probe more deeply into the opinions and assumptions on which the valuation was based.

Specialist analysts in the property sector clearly have a strong grasp of the detail of valuation and accounting and will ask questions which provide more information about the valuation process and the accounting policies. There is a feeling that analysts of non-property companies such as a retail business which holds some investment properties may have a relatively poor understanding of the accounting procedures for dealing with investment property revaluations.

**Frequency of external valuation**

There is considerable variation in practice within the rule of SSAP 19. It appears that within the property investment sector some companies ensure that all investment properties are valued externally at least every five years, while others go through the process at least every three years. It appears to be
regarded as acceptable, within the wording of the standard, to agree with auditors that, while major assets are valued externally at least every five years, smaller items of investment property may be valued internally by professionally qualified staff, each year, without any external verification.

Those enterprises which have qualified internal valuation staff and which monitor valuation continuously for management purposes see no additional benefit in incurring the cost of an external valuation at periodic intervals. Such enterprises would not wish to see paragraph 6, which explains the need for external valuation every five years at least, moved into the standard section of SSAP 19. The issue of materiality was also raised in the context of insurance companies where statistics show that investment properties represent only a relatively small proportion of the total investment portfolio and it is unlikely that the benefits of regular external valuation would justify the extra cost.

One analyst pointed out that the valuer's report is addressed to the directors rather than the shareholders and therefore it is questionable whether the valuer's report can give shareholders the same quality of assurance as the auditor's report which is addressed to the shareholders. Other respondents agreed that the requirement for external valuation could be in the standard section of SSAP 19 rather than in the Explanatory Note,
ACCOUNTING FOR INVESTMENT PROPERTIES

although one only agreed to this in the context of five-yearly external valuations and another wanted to preserve the ability to negotiate with the external auditor in respect of using internal valuation staff for items which were not material to the overall portfolio.

Responses produced no cohesive recommendation on frequency of external valuation. Recommendations ranged from remaining at the present five-year rule as stated in SSAP 19 to implementing annual external valuations. It was pointed out that best practice within the leading property investment companies is already to have external valuations on an annual basis.

Cost of valuation

Cost does not seem to be a major issue in the context of more frequent valuations, at least for the major property investment companies, because they agree fees with their valuers and are willing to look around for a competitive quote. Those preparers of accounts who were opposed to more frequent external valuation already have their own qualified valuation staff internally and, as mentioned above, are monitoring valuations for management purposes. They see no additional benefits to compensate for the extra cost of obtaining external valuations.
INTERVIEW REPORT

Qualifications of the valuer

All respondents agreed that it would be reasonable to link SSAP 19 with the RICS SAVP 8 on the qualifications of valuers. One suggested this might be a problem for the smaller private companies where the directors who carry out valuations may be expert at their work but have never qualified professionally in valuation.

It was pointed out that the definition of an internal valuer in SAVP 8 requires the director or employee to have “no significant financial interest in the company or organisation”. It was suggested that this could mean a salary or a director’s shareholding which was significant in terms of the individual’s total wealth, but it would appear that the RICS intention was to exclude a shareholding which was significant in terms of total equity of the company. Some clarification of wording would be required here.

Respondents seemed favourably inclined towards having more specific reference in SSAP 19 to relevant parts of the RICS SAVPs. It was pointed out that if compliance with the RICS guidance became a requirement of SSAP 19 then that would effectively make the RICS guidance mandatory on non-qualified valuers beyond RICS, ISVA and IRRV membership.
ACCOUNTING FOR INVESTMENT PROPERTIES

One particular problem raised was in relation to overseas properties. Interviewees said that, in practice, such valuations are carried out initially by a local valuer but for UK purposes they are appraised by a professionally qualified valuer. SSAP 19 does not at present deal specifically with the valuation of overseas investment properties.

3.5. THE SURVEYING PROFESSION AND THE ACCOUNTANCY PROFESSION

Respondents generally identified no obvious lack of communication between the two professions, but that may well be explained by their contact being primarily with accountants or auditors or valuers working in the same specialist field. There was some speculation, but no first-hand evidence, that there might be problems for auditors of trading companies holding isolated investment properties.

No respondent specifically mentioned either the auditing guideline “Reliance on other specialists” or the RICS information paper “The valuer’s relationship to the auditor and information required from a valuer by an auditor”. The range of views expressed about the work of the auditors (referred to earlier in section 3.4) suggests that auditors are not sufficiently clear in demonstrating how they carry out their work.
3.6. ACCOUNTING IMPLICATIONS: PROFIT AND LOSS ACCOUNT AND BALANCE SHEET

As mentioned at the start of this chapter, the initial reaction of all respondents was basically one of satisfaction with SSAP 19. Closer questioning revealed that this may at least in part be due to its general nature which leaves considerable scope for interpretation. The extent to which respondents then provided the foregoing comments on aspects of valuation has implications for the primary financial statements and for the accompanying notes to the accounts. Apart from the implied needs which may be deduced from the comments, specific accounting problems were also identified.

Scope for manipulation of earnings figures

It was pointed out that the distinction between property occupied by group companies and that occupied by third parties creates scope for manipulation which may be significant in magnitude for companies which are judged primarily on their trading performance. Gains on disposal of an investment property would go through the reserves but gains on disposal of a group-occupied property would go through profit and loss account as an exceptional item. For a group judged on earnings per share performance there could be pressure to switch occupancy to achieve a higher earnings figure.
ACCOUNTING FOR INVESTMENT PROPERTIES

One respondent who pointed out this problem favoured taking all gains and losses on investment properties, realised and unrealised, through profit and loss account. Others were firmly of the view that gains on disposal of the investment property are part of the capital of the business, whether that is a property investment business or a trading business.

Diminutions in value

All respondents were aware of the problem of accounting for diminutions in value, but all seemed to regard the present problem of lower property values as one which could be dealt with through reserves rather than through the profit and loss account.

Some suggested that the ASB should establish clearer guidelines on the distinction between temporary and permanent diminutions in value. At present, one in particular found himself in debate with auditors who seemed to take a different time perspective from that which he would take. Valuers said they had on occasions been asked by a client to give an opinion on whether a diminution was permanent or temporary but found it difficult to assess in the absence of any guidance. They regarded this as primarily an accounting issue.

One preparer of accounts pointed to the reserves note and indicated that there was plenty of scope for write-offs through the revaluation reserve
before he needed to look further afield. Once that was exhausted he would use retained profits, but would resist having to show diminutions in the profit and loss account.

Auditors mentioned difficulties, in discussions with clients, as to whether diminutions should be considered on an individual basis or on a portfolio basis and the problem within group accounts of setting off the revaluation deficit of one subsidiary against the revaluation surplus of another.

**Revaluation gains and losses**

Those specialising in the preparation of accounts referred to the continuing problem of a lack of definitive guidance on the calculation of gains and losses on disposal and any consequent transfers between reserves. There was also a need for guidance on whether realised profit on sale of investment properties should pass through profit and loss account at all, with opinion divided as to whether this was a revenue item or a capital item.

More specifically they also noted the lack of guidance on accounting in the group accounts for revaluation gains and losses in the reserves of associated undertakings and on the treatment of joint ventures where any default by a joint venturer could affect the value of an investment property held jointly.
ACCOUNTING FOR INVESTMENT PROPERTIES

Insurance company accounts

On the specific subject of insurance company accounts it was noted that the proposed EC Directive on insurance company accounts will allow all investment revaluation gains and deficits to pass through profit and loss account. There is a further proposal in the same Directive which places investments in a special category of assets which is neither fixed nor current.

Depreciation

The interviews produced no evidence of any desire to account in the profit and loss account for depreciation of investment properties. All agreed that depreciation takes place for a variety of reasons of obsolescence through physical factors, location, economic changes, function, environment and design.

Valuers take a view of the property as a whole and depreciation is only one part of the overall judgment. They do not quantify the depreciation in arriving at the valuation. They will apportion value between land and buildings if asked to do so, but regard it as somewhat arbitrary.

The views of users and preparers were that depreciation in a profit and loss account was not relevant, although their reasons varied. Some held that depreciation was already allowed for in the
valuation and therefore a profit and loss account charge would penalise equity twice for the same cause. Others said that property investment companies are judged on net asset value, the earnings figure being relevant only as a proxy for cash flow. Others felt that depreciation figures would be immaterial to the overall view and are too arbitrary to have any meaning.

On the particular issue of insurance company accounts, it was pointed out that the economic reality is that investments are held in a portfolio managed as an interlinked whole. The distinction between fixed and current assets is not relevant and it would be more appropriate to regard investment properties as another form of investment which might be addressed in a future standard on accounting for investments. This would break the link between SSAP 19 and SSAP 12. The EC Insurance Accounts Directive shows investments under a separate heading and does not seek to allocate them between fixed and current assets.

3.7. ACCOUNTING IMPLICATIONS: DISCLOSURE OF INFORMATION ON THE VALUATION ASSUMPTIONS OR OPINIONS

There seemed to be general agreement that the greatest causes of variability in valuation are:

(a) the opinion formed on the "reasonable period" for disposal; and
ACCOUNTING FOR INVESTMENT PROPERTIES

(b) the opinion formed on the yield.

Proposals for remedies varied considerably, but included

* encouraging the ASB to use a revised SSAP 19 as a means of encouraging the RICS to tighten up its own definitions of OMV;

* disclosure of the "reasonable period" used in the valuation process, partly in the interests of providing more information, but also in the hope of encouraging a more uniform approach by valuers (although others claimed this disclosure would be difficult because they held properties in different parts of the world, where different "reasonable periods" applied); and

* paying rigorous attention to disclosure, particularly with regard to any "special assumptions" made by the valuer, and ensuring that there is full access to any valuation reports provided.

With regard to the variability of yield, one respondent suggested that the change in value during a period should be divided into three elements:
INTERVIEW REPORT

* that due to a rental increase caused by general price changes;

* that due to a rental increase caused by specific price changes in that property beyond that expected from general price changes; and

* that due to a change in the yield assumptions.

Others held the view that assumptions about yields are sensitive information which property investment companies would not readily disclose to competitors.

Other disclosures proposed

SSAP 19 at present requires little in the way of disclosure regarding investment properties, with the result that some accounts are informative, others less so. One respondent commended, as a source of ideas on improvement in disclosure, the Stoy Hayward Award 1990 for the best set of property company accounts. The award winner was MEPC plc, with close runners up in Capital and Counties plc and Land Securities plc. A relatively small company, A and J Mucklow plc, was also highly commended. (Subsequent to carrying out the interview research it was announced that the 1991 award winner was Land Securities. A summary of the report on the 1991 competition is contained in the section of Chapter 4 which reviews the literature.
ACCOUNTING FOR INVESTMENT PROPERTIES

on property company accounts.) The judges in the 1990 competition emphasised four areas requiring improvement (confirmed as a continuing need by the 1991 judges):

* choice of accounting policies and the clarity with which they are stated, particularly on the treatment of

- valuation of property investments;
- treatment of unrealised surplus on revaluation;
- transfers between fixed and current assets; and
- the disposal of investment properties;

* analysis of business activities, assets and liabilities;

* accounting for all the company's activities;

* presentation and organisation of the report and accounts.

Detailed proposals from that award contest were:

* a clear distinction between property held for investment and property held for dealing, with a clear statement of how much property was under development in each case;
ACCOUNTING FOR INVESTMENT PROPERTIES

* analysis of each category of profit by location, type, tenure, age and rent review type;

* in the case of property companies, a list of all properties worth over 5% of the total portfolio value;

* a capital profit and loss account subdivided to show realised and unrealised capital surpluses; and

* an estimate of rental income over the next ten years.

It was pointed out by one interview respondent that, when an investment property company seeks a listing, the Stock Exchange requires considerable information to be made public (Yellow Book Section 10). That seems to be the time at which investment property companies discover a great deal of information about competitors. Generally there was a feeling that to repeat this level of detail subsequently would be too beneficial to competitors.

Other suggestions from the interviews were:

* report the average period for which investment properties are held, to give a feel for how actively the company turns over its portfolio;
ACCOUNTING FOR INVESTMENT PROPERTIES

* include the valuer’s report alongside the auditor’s report;

* provide a statement on the directors’ investment policy and their intentions regarding development and investment properties;

* explain the reasons for changes in current value;

* distinguish gross increases in value from gross decreases in value;

* distinguish vacant property from let property; and

* include a five-year summary of growth in rental income and asset value.

Statement of Movement on Reserves

Responses on the ASB’s proposals for a statement of movement on reserves varied from enthusiastic support to a preference for the status quo. The reason given for leaving things as they are is that experts who want the information will find it in the notes to the balance sheet, while non-experts will not understand the information wherever it appears. Some users claim not to pay much attention to details of reserves, being more interested in net asset values and gearing.
3.8. **SUMMARY**

The foregoing sections set out at some length the comments received in the interviews, as an indication of the degree of detail which rapidly emerges when a subject is explored in depth. From this detail the following items in particular are highlighted for the attention of the ASB and are referred to again in the conclusions of the Working Party contained in Chapter 5.

Those who meet SSAP 19 in their work, whether as preparers, users or valuers, identify no major problems with the Standard itself and clearly see its main purpose as permitting investment properties to be held in the balance sheet at valuation and without depreciation being charged in the profit and loss account. No respondent showed any wish to restore depreciation of investment properties and one suggestion was that the investment properties should be seen as investments rather than as properties, so as to break the link with SSAP 12.

Some suggestions on coverage of SSAP 19 have been put forward, emphasising particularly the situation of occupancy of properties by other group companies and also the situation of partial owner-occupancy with the remainder of the property being let to third parties.

There is concern that the definition of development properties is not specified, with consequent blurring
ACCOUNTING FOR INVESTMENT PROPERTIES

of the boundaries between development and investment properties. Switching categories from development to investment seems to lack adequate control. The valuation of development properties has also been criticised because of the many different methods available. There appears to be a need for an accounting standard dealing with development properties, although it does not necessarily have to be an extension of SSAP 19.

From the viewpoint of preparers and users, the greatest problem seems to lie in the perceived variability of valuation. Those spoken to were aware of the reasons for variability but doubted whether all users of their companies' accounts would be aware of that variability. (Chapter 4 contains further discussion of the problem of variability of valuation and reviews some research which suggests that the problem may not be so significant when viewed overall.) The preparers and users seemed to desire a reduction in what they perceived to be the considerable subjectivity attaching to valuation.

The valuers did not seem to have any particular views on the technical accounting matters of SSAP 19. That included definitions, which they regarded as the work of the accountant, although they were aware of problems such as partial ownership. Even within the property investment companies, those who were most conversant with the accounting issues were those with operational responsibility for the preparation of accounts.
INTERVIEW REPORT

There is agreement that showing investment properties at revaluation is more relevant than using historical cost information but there is considerable concern about the range of valuations which may be produced within the rules for OMV. No consensus exists on the solution but there is clearly scope for the ASB to work with the RICS to improve confidence in the reliability of the valuation. There has been a recent call from one director of an investment property company for a discounted cash flow approach to valuation. This does not at present appear to command widespread support for SSAP 19 purposes. The discounted cash flow approach is used in the USA as well as the sales comparison (similar to OMV) and the depreciated replacement cost. For purposes of SSAP 19, there is no direct comparison of UK with USA valuation practice because there is no equivalent accounting practice in the USA, the valuers' reports being provided for other purposes such as raising finance.

A move towards requiring external valuation at least every three years would find some, although not universal, support. Those preparers which have internal staff with appropriate qualifications regard themselves as having the resources to equal an external valuer and would not welcome an attempt to move the external valuation recommendation into the standard section of SSAP 19, especially where the extra costs outweigh the perceived benefits.
ACCOUNTING FOR INVESTMENT PROPERTIES

The definitions of internal and external asset valuer in SSAP 19 could be brought into line with those in the RICS SAVP 8, subject to discussion of some details of wording regarding the internal valuer and to clarification of the valuation of overseas properties.

There is scope for improving communication between the surveying and accountancy professions by linking SSAP 19 more directly to the RICS SAVPs and there is scope for some closing of the audit expectations gap by making more widely known the role of the auditor in relation to reliance on the work of other specialists.

Accounting issues which directly affect the reported earnings of an enterprise, and which are not adequately dealt with in SSAP 19 at present, are:

* potential for switching between group occupancy and third party occupancy;

* potential for switching between development and investment property;

* diminutions in value: lack of clarity regarding temporary and permanent diminutions;

* calculating and reporting gains and losses on disposal;
INTERVIEW REPORT

* revaluation gains and losses in associated undertakings and joint ventures.

Areas for potential improvement of disclosure are:

* controversially, and with concern about providing too much information to competitors, there could be more explanation about the assumptions of valuation, particularly the "reasonable period" involved and the assumed yield;

* less controversially, there could be more information about the nature of the investment property portfolio.

The ASB's proposed Statement of Movements on Reserves was supported by some and met a lack of interest from others. Even some of those in favour thought that changing the presentation of the information would not improve any basic misunderstanding as to the meaning of the revaluation reserve, particularly for trading companies where performance is judged primarily on earnings per share.
Chapter 4

Literature Review

4.1. INTRODUCTION

This literature review examines the debate leading up to the issue of SSAP 19 as well as subsequent discussions with particular reference to the current economic climate. Of especial interest at this time are the problems of valuation, particularly in a depressed property market where there is relatively little activity. The overall conclusions and recommendations of the Working Party as set out in Chapter 5 are intended to have general application and not be confined to one particular set of economic circumstances.

While SSAP 19 in itself has not aroused a great deal of controversy in the literature, related issues (such as valuation of assets, measurement of depreciation and the reporting of gains and losses on realisation of fixed assets) have aroused stronger controversial
debate and are accordingly visited in this review in the context of SSAP 19. The review, therefore, explores a range of issues related to: the coverage of the Standard and the interface between investment properties and development properties; valuation, including the basis of valuation, frequency of external valuation and the qualifications of valuers; and accounting issues, including diminutions in value, the treatment of gains and losses on disposal, the use of the revaluation reserve, the lack of a depreciation charge, and a collection of matters relating specifically to the accounts of property companies. Relevant developments in company law and current accounting issues under debate are reviewed for links with SSAP 19. Current practices and developments in several countries are reported and finally, having regard to the development of conceptual frameworks since SSAP 19 was first issued, some conceptual questions are explored.

4.2. SOURCES OF DATA

A search was made of the Accountant’s Index and Anbar for references to SSAP 19, property depreciation and the accounting treatment of property/real estate for the period from 1975 to date. It was expected that this period would cover the debate over SSAP 12 Accounting for Depreciation (ASC 1977) which led to SSAP 19 Accounting for Investment Properties (ASC 1981a) and would bring out any subsequent papers or articles on SSAP 19. The results of the search led
LITERATURE REVIEW

predominantly to two UK sources of articles: Accountancy and The Accountant's Magazine. It seems clear that issues emanating directly from SSAP 19 have not generally attracted the attention of academic researchers to the extent of producing papers for the refereed journals. A particularly interesting feature of the development of SSAP 19 is the lobbying of the Accounting Standards Committee by the British Property Federation (BPF) and for the purposes of this project a detailed comparison was made of the text of SSAP 19 and the submissions of the British Property Federation on property investment companies (BPF 1978). Selected reference is made to this in the review. The submissions to the Accounting Standards Committee on the Exposure Draft ED 26 (ASC 1981b) also provide interesting material and were reviewed in detail as part of the project. Selected references to those comments also appear in this review.

Although there is a general lack of recent articles dealing directly with SSAP 19, there are issues raised elsewhere which may impinge on SSAP 19. These issues are, in particular, property company accounts, property revaluations of all types, calculation of gains or losses on disposal of revalued properties, and depreciation of properties. The search of the professional accountancy journals was therefore broadened to cover such issues. Other sources of reference were found on valuation, including the professional valuation journals and
ACCOUNTING FOR INVESTMENT PROPERTIES

some specialist text books. A very useful source of material on property company accounts may be found in Tillett and Hunt (1991), which will be cited as a source of practical examples at various stages of this review.

In this review of the literature on SSAP 19 and related issues, particular attention is paid to those aspects of the historical development of the Standard where circumstances may have changed over time, and in particular:

- changes in the investment property market;
- definitions of investment property;
- valuation practices;
- heightened awareness of the significance of property depreciation and obsolescence;
- subsequent changes in company law; and
- subsequent attempts to define a conceptual framework for accounting practice.

4.3. HISTORY

The exposure draft ED 15 Accounting for Depreciation, issued by the Accounting Standards Committee, included a requirement to depreciate all property of finite economic life (ASC 1975). When the Standard on depreciation, SSAP 12, was issued (ASC 1977) a special exemption from this requirement was given to all property investment companies pending a further amendment to SSAP 12 dealing with property companies. In the event,
rather than making an amendment, SSAP 19 was issued as a separate Standard (ASC 1981a). The statement by the ASC which accompanied Exposure Draft ED 26 (the precursor of SSAP 19) justified the use of current values for investment properties in terms of the relative usefulness of current values and the lack of usefulness of a separate depreciation charge (ASC 1980). It was also argued that depreciation, although not separately identified, would be taken into account in dealing with changes in current value (Davies et al, 1990, pp 457-458).

An illustration of contemporary views may be observed in the leader of October 1977 in Accountancy, quoting the views of the British Property Federation (BPF) expressed by Sir Eugene Melville, Director General, arguing against depreciation; in that the concept was not applicable to investment property companies and that calculation was a practical impossibility.

The early lobbying against SSAP 12 by the BPF was acknowledged in a further leader in Accountancy (November 1977), which noted that the ASC initially rejected the views of the BPF and the property companies. When the text of the proposed SSAP 12 came before the Council of the Institute of Chartered Accountants in England and Wales (ICAEW) it was referred back to the ASC for further consideration of the whole question of property company accounting - not merely depreciation but the totality of accounting
ACCOUNTING FOR INVESTMENT PROPERTIES

procedures chosen by property investment companies. The leader discussed the dangers for the ASC in backing down in the face of pressure groups.

The BPF views, as reflected in its discussion document submitted to the ASC in 1978, were closely mirrored in ED 26 which, with only minor amendments, became SSAP 19. The BPF discussion document was broader ranging than SSAP 19, covering other matters relating to the financial statements of investment property companies. Philip Sober (1982) (partner in Stoy Hayward and chairman of the Accounting Practices Committee of the BPF), reviewing the development of SSAP 19, set out the BPF views on SSAP 12 and explained that the ASC was sufficiently impressed with the objections to ED 15 to grant the property investment industry exemption from SSAP 12. He said:

"It is only through regular valuations that the success or otherwise of the company can be measured. In arriving at a valuation, the valuer will take into account the age and degree of obsolescence of the building; it is therefore unnecessary and, in some instances, positively misleading, to provide for depreciation again in the accounts of property investment companies".
LITERATURE REVIEW

Baxter (1980b) traced the ASC's various developing thoughts, prior to the issue of ED 26, on how to account for investment properties, ranging from: a totally permissive approach allowing either valuation at cost with depreciation or revaluation with no depreciation; through a less permissive requirement to revalue all investment properties but with optional depreciation; to the single rule of ED 26 requiring revaluation with no depreciation. Baxter claimed some credit for The Institute of Chartered Accountants of Scotland (ICAS) in that its criticism of the permissive approaches ensured that the exposure draft at least led to consistency in the recommended practice.

4.4. USER NEEDS AND THE OBJECTIVES OF FINANCIAL REPORTING IN THE CONTEXT OF SSAP 19

SSAP 19 purports, in its opening paragraphs, to meet the perceived needs of users in relation to one very specific issue. Since SSAP 19 was issued, conceptual frameworks of various kinds have emerged from the accountancy profession around the world and all begin with analysis of user needs.

The concept of user needs is at the core of the International Accounting Standards Committee's (IASC) Framework and is contained within the exposure draft of Chapter 1 of the Statement of Principles issued by the ASB (1991).
ACCOUNTING FOR INVESTMENT PROPERTIES

A literature review on user needs and objectives of external reporting was commissioned by ICAS for the project Making Corporate Reports Valuable (Weetman and Gordon 1988). This issue will not be explored further in the present review; but the importance of considering user needs should not be overlooked. On the specific subject of depreciation, Nobes (1984 pp 1 & 2) has emphasised the importance of taking account of user needs.

An indication of recent thinking on the purposes of financial reporting has been provided by Solomons (1989 p 9), who defined the purposes of financial reporting as follows:

"The function of general purpose external financial reporting by a profit-seeking enterprise is to provide information that will be useful to a variety of users who have an interest in:

(1) assessing the financial performance and the position of the enterprise

(2) assessing the performance of those responsible for its management

(3) making decisions about investing in, lending or extending credit to, doing business with or being employed by the enterprise."

56
LITERATURE REVIEW

4.5. ECONOMIC FACTORS

Tillett and Hunt (1991) have traced the fortunes of the property companies as coming full circle in slightly less than 20 years, from the worsening economic situation of 1973, through the slump in the property market in 1974, via the boom conditions of the 1980s to the high interest rates and depressed economic conditions at the end of the 1980s and the start of the 1990s, which caused prices to fall dramatically.

The research departments of the major firms of surveyors provide information on trends in investment property values. The following information is extracted from the Quarterly Property Index (Spring 1991) issued by Weatherall Green and Smith.

Their index of capital growth, taking a base of 100.00 at December 1979, had reached 193.59 at March 1991, confirming a long-term upward trend. Superimposed on this trend, however, was a peak of 226.57 in September 1989, with a steady fall thereafter. In percentage terms, capital values fell by 10.4% in the year to March 1991 as compared with a fall of 12.2% in the previous year. The March 1991 index value of 193.59 had previously been attained in the period between September and December 1988. Subdivision of the index into shops, offices and industrial property confirmed that the same trends were evident in each type of
ACCOUNTING FOR INVESTMENT PROPERTIES

investment property. The index was calculated on an Open Market Value basis.

The following table indicates yields at 28 March 1991:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Shops</td>
<td>6.26%</td>
</tr>
<tr>
<td>Offices</td>
<td>7.04%</td>
</tr>
<tr>
<td>Industrials</td>
<td>8.25%</td>
</tr>
<tr>
<td>Total</td>
<td>7.19%</td>
</tr>
</tbody>
</table>

Rental values increased from an index of 100.00 at December 1979 to 237.40 at March 1991. The most rapid period of growth was from December 1986 to December 1989, with an overall levelling-off thereafter and a fall in the rental value index for offices.

The oversupply of offices in Central London at March 1991 was indicated by vacancy rates standing at over 16% in the City, 8% in the West End and 11% in Midtown. Only about 20% of this available space was top quality, so that a clear two-tier market was seen by the experts to be emerging. This trend was evident in other regional office centres, with significant rental and demand differences between secondhand and new space. In such conditions Weatherall Green and Smith saw little immediate prospect of rental growth in the office market.
LITERATURE REVIEW

As an example of the way in which comment depends so much on market sentiment at the time, Mundy (a property finance specialist) suggested in 1987 that, in a climate of lower inflation, cheaper property prices and disillusionment with onerous lease terms had revived the owner-occupier market to the extent that companies might prefer to continue to own surplus commercial property as an attractive asset at 1987 yields (Mundy 1987).

Thus there is a need to be cautious in interpreting views expressed on the accounting treatment of investment properties, and to observe the dates relevant to each literature source in the context of high inflation of the mid and late 1970s followed by lower inflation in the 1980s and accompanied by a property boom which peaked and then started to fall in 1988 and 1989, leading to depressed markets and a lack of property market activity.

This review now turns to specific aspects of SSAP 19 in its present-day application.

4.6. COVERAGE OF SSAP 19

Definition of investment property

The comments on ED 26 (ASC 1980) referred to:

the distinction between investment and dealing;
ACCOUNTING FOR INVESTMENT PROPERTIES

- extension to owner-occupation;
- the arbitrary use of a 20-year cut-off for leaseholds;
- application to non-property companies;
- application to small or private companies.

These themes are explored in the following paragraphs since they form a useful link between the origins of SSAP 19 and the current debate as evidenced in the interview reports of Chapter 3.

The wording of SSAP 19 in defining an investment property is less rigorous than that of ED 26, which required the property to be held for the purpose of letting to produce a rental income. Commentators on ED 26 thought that an investment property could be held vacant for purposes of capital appreciation without falling into the category of "dealing" and SSAP 19 accommodated this view in the wording "held for its investment potential" (para 7). There is reference in Chapter 3 to the comments of interviewees on the resulting occasional lack of control over the boundaries of the definition of an investment property.

Commentators on ED 26 instanced situations where the owner might, for convenience, occupy some part or all of a property but the particular property was not critical to the operation of the business since another similar property was readily obtainable. In such circumstances the property currently owned and occupied could well have been purchased for
LITERATURE REVIEW

the primary purpose of holding as an investment. Such comment was not accommodated in SSAP 19, which retained a ban on treating owner-occupied properties as investment properties. As the interview responses of Chapter 3 indicate, this remains a matter for debate.

The 20-year cut-off for leasehold properties appears to be an arbitrary limit chosen as less than the 50 years recommended by the BPF in its submission on ED 15, but greater than zero. Some commentators on ED 26 did not like the 20-year limit, while others thought it was an improvement on a 50-year cut-off.

Some commentators on ED 26 recommended that its requirements should be optional for companies whose main operations are of a manufacturing or commercial nature, while others thought it should not apply where the investment properties did not form a material part of the assets and the main business was not concerned with holding properties. Reasons included the lack of a conceptual basis for not charging depreciation and the possible confusion of having mixed valuations of assets in historical cost accounts.

There were references by commentators to the burden on small companies in terms of obtaining professional valuation. It was pointed out that, in private companies, information in annual accounts will not be particularly useful since the shareholders
ACCOUNTING FOR INVESTMENT PROPERTIES

will be familiar with the valuations in any event and lenders will seek valuations for their own purposes.

The coverage of SSAP 19 does not seem to have aroused a great deal of recent comment in the literature, since attention to property company accounting has focused on other issues, particularly accounting for development properties. The issue of capitalisation of interest on development properties is dealt with in section 4.8 of this chapter. It has already been seen in Chapter 3 that there are wide-ranging and some strongly held views on owner occupation and group occupancy of investment properties.

4.7. VALUATION

RICS guidance

In the UK the ‘Red Book’ of the Royal Institution of Chartered Surveyors, Statements of Asset Valuation Practice and Guidance Notes, 3rd Edition (RICS 1990) is mandatory for members of the RICS, following a rule change approved at a meeting in autumn 1990 and applies also to ISVA and IRRV members. Any qualified valuer undertaking a valuation must normally follow the Guidance Notes. Departure is permitted but the member must describe the departure and may subsequently be asked by the professional body to justify the action. (A list of the Statements of Asset Valuation Practice is appended to this research report.) The Red Book
LITERATURE REVIEW

is strict on the basis of valuation to be applied but discretionary regarding the amount of disclosure by the valuer.

SAVP 10, dealing specifically with the valuation of land and buildings held as an investment, requires a valuation on the basis of Open Market Value as defined in SAVP 2, which contains the following wording:

"The definition of Open Market Value means the best price at which an interest in the property might reasonably be expected to be sold at the date of the valuation assuming:

(a) a willing seller;

(b) a reasonable period in which to negotiate the sale taking into account the nature of the property and the state of the market;

(c) that values will remain static during that period;

(d) that the property will be freely exposed to the open market; and

63
(e) that no account will be taken of any additional bid by a purchaser with a special interest.”

It was explained when this wording was introduced (Adam 1982 p 86) that the stipulation (b) above was introduced at a time when the market for properties was extremely limited and the previous assumption of a willing buyer was regarded as unrealistic. Use of the expression ‘willing buyer, willing seller’ was prohibited by these rules.

The RICS Guidelines also stipulate the qualifications of a valuer. SAVP 8 specifies an Asset Valuer as being a member of the RICS, the ISVA or the IRRV and having appropriate post-qualification experience. The statement also defines Internal Valuer, External Valuer and Independent Valuer (see Appendix C for precise definitions). It provides guidance on independence in valuations, the Independent Valuer being the most distanced from the client in terms of a prohibition on undertaking other work for that client. The Stock Exchange requires, in the listing particulars provided by a new applicant property company, the use of an external valuer as defined by the RICS. The Council of The Stock Exchange will waive this condition where companies maintain a qualified surveyor’s department (Admission of Securities to Listing, Section 10, Chapter 1 para 3).
LITERATURE REVIEW

Approach to valuation

Anecdotal evidence travels best and has considerable impact, so that there is wide knowledge of eye-catching headlines such as:


which provides an illustration of the extent to which property valuations depend on the opinion of the valuer. In the course of a takeover of Scott’s Group by BS Group, two professional valuations of the Scott’s Group properties were made, one on behalf of the Group and the other on behalf of minority shareholders in BS Group. The valuations were very different: £6.425M at 20 September 1990 compared with £2.33M at 31 October 1990. At the request of the Takeover Panel the RICS examined the valuations and reported that the appropriate rules had been complied with, that it was satisfied with the basis of the valuations and that:

“The difference between the amounts of the two valuations is wholly attributable to a difference in valuation opinion”.

There have been calls in the accounting press (Glover 1985) for a more scientific approach to valuation in the UK, reflecting that already taken in the USA. Among the academic texts appearing in the UK is one edited by MacLeary and
Nanthakumaran (1988) which provides a series of readings on issues in property investment theory. Their reasons for producing their text included concern about the adequacy of techniques being used in valuation and appraisal of property investments. In Chapter 3 the report on the interviews undertaken for this project includes reference to valuations carried out in the USA which employ more mathematical approaches.

Sykes (1983) pointed out the dangers of making short-term performance evaluations incorporating property valuations which are inherently uncertain. His concern lay particularly in the evaluation of the performance of individual properties but he added a warning to fund managers on the uncertainties attaching to any capital valuation. Hager and Lord (1985) experimented by asking a team of valuers to give a valuation for two properties and from the range of answers counselled caution about the accuracy of property valuations. Their method was criticised by Reid (1985) for the lack of realism in the data provided and the artificiality of a non fee-earning exercise which might lack the usual standard of professionalism. Using a random sample of 29 properties Brown (1985) suggested that performance measurement based on valuations is as valid as using prices.

In defence of the valuation process, there have been more wide-ranging statistical analyses of the accuracy of property valuations which lead to the
conclusion that the anecdotal evidence may have received undue emphasis. One example provided to
the Working Party came in two publications from the research department of a firm of professional
valuers (Drivers Jonas 1988 and 1990) using the Investment Property Databank. In their 1988 report
two tests were devised using regression techniques. The first was designed to test the valuation
surveyor’s ability to assess the current level of the local property market through the measurement of
capital valuations as estimates of subsequent sales prices. The sample consisted of 1400 properties sold
between 1981 and 1987. The second test was designed to measure the investment surveyor’s
ability to forecast both the direction and subsequent rate of rental growth levels in the local property
market. The sample consisted of 1600 properties which had been in single ownership between 1981
and 1987. The results of the study supported the conclusion that valuation surveyors are efficient at
assessing the market more precisely through looking to the immediate past, and they are quite successful
at capturing the broad structure of future rental growth.

In the 1990 report Drivers Jonas examined valuations and transactions in the period 1982 to
1988 and concluded that during 1987 and 1988 it was the rapid growth in values, rather than a
tendency towards conservatism, which accounted for the growing discrepancy between valuations and
subsequent sales prices during that period. The
regression results were claimed to confirm that valuation surveyors continued to achieve a high degree of accuracy in assessing the level of the market.

The following analysis and discussion of variability in valuations was written for this project by Professor Charles Ward:

"At first sight there are two distinct issues which are controversial when considering the accounting for investment properties; depreciation and valuation. On closer inspection they are interrelated; the difficulty of accounting for depreciation is compounded by the perception that valuation may capture neither the market 'price' nor the economic value of the property.

"The shortcomings of valuation stem from two kinds of study. Anecdotal research comparing the valuations made by one firm of surveyors and another has reportedly revealed significant differences in value. Critics of valuation refer to these reports in arguing that the valuations are so unreliable that they should not be used in reporting changes in value in the accounts. Another type of study has been the comparison of a valuation with the subsequent price of the property when sold in the market. These
LITERATURE REVIEW

comparisons have revealed that valuers tend to underestimate the value when compared simply with the later market price. Errors have however been rather smaller than those implied by the comparative research.

"The errors made by valuers may be either biased or unbiased. Unbiased errors may arise simply through disagreement by valuers on the state of the market or on the special characteristics of the property which may make it difficult or easy to sell in the market. Biased error may arise either through the conservatism suggested above or through the valuation process itself. (The conventional method of valuation of short term leaseholds has long been recognised to have caused significant anomalies in valuation.)

"These two types of error also infect the accounting for depreciation. Depreciation of an investment property should, if the valuation is accurate, be captured in the change of value. This would be as true for depreciation caused by technical obsolescence as for depreciation caused by general wear and tear. It is probably correct that it is more difficult to estimate the extent of depreciation in future years which will be caused by external factors than it is for other assets but nevertheless it is an issue
ACCOUNTING FOR INVESTMENT PROPERTIES

which should be assessed by asking 'Have these factors been taken into account when carrying out the valuation?'

This comment leads into the complex subject of whether there is a need to account through the profit and loss account for depreciation of investment properties, an issue which is explored in section 4.8.

Market value or investment worth

The market value of a property is not necessarily the same as its investment worth (Sykes 1983). The implied rate of rental growth in the yield figure used may not accurately represent the investor's view of future rental trends but may instead reflect pressure of money in a restricted market. Damant (1990) discussed issues of market value compared with discounted present values of cash flows in a wider context of brand names and company net worth but, despite a dislike of any accounting use of net present values based on company-generated assessment of cash flows, appeared to accept the greater objectivity of real estate values based on expected future incomes.

Frequency of external valuation

In their authoritative text on property company accounts, Tillett and Hunt (1991 p 9) favoured a valuation by an external valuer every year in the
LITERATURE REVIEW

case of a listed property company, because the valuation figure is price sensitive in the stock market. Their survey of 20 companies found a lack of clarity on the exact policy regarding frequency of external valuation, a finding confirmed by Davies et al (1990 p 462).

Tillett and Hunt also found from their survey that the stated policy on valuation will generally refer to SSAP 19 or to OMV but will not make specific reference to a professional or external valuation, so that even where the reader knows there has been a recent valuation the mix of external and internal may not be revealed.

In the comments on the exposure draft ED 26 (ASC 1981) there were some calls for triennial external valuations in the case of property companies.

Separation of land and buildings

As a contribution to the contemporary debate prior to the issue of SSAP 19, Noke (1979) asked whether there was any logical basis on which land and buildings could be viewed as separate, distinct assets. One answer would be that an asset could be regarded as a store of financial services used to generate revenue; but a building could not generate revenue independently of the land on which it stood. Even though an undeveloped piece of land could be let by its owner, once it had a building on it there was probably little to be gained by assuming
that the land could provide financial services independently of the building. This argument led to the view that there was no good economic reason for looking at the building in isolation. For property companies this could mean that, so long as the increase in money value of the land was sufficient to offset the loss in money value of the building, no further provision was necessary. Capital maintenance under the historic cost convention would be satisfied.

Noke's discussion illustrates the effect the high inflation rates of the mid 1970s had on thinking on valuation and capital maintenance. That conventional wisdom of the 1970s, under which SSAP 19 was written, may not apply in periods of time when the inflation rate is lower and continuing specific rises in the value of land are not guaranteed.

Mixed valuations in accounts

There is a view in some quarters that it may be confusing for trading companies which have various categories of property, including investment properties, to be using different valuation methods for the different properties, with the result that unlike items are being added together in the balance sheet. Roberton (1983) suggested that the answer was to make sure that users understand the different approaches. Holgate and Hodgson (1987) argued that the valuation problem could be solved by
supplementary statements on a company's market capitalisation and the fair value of its assets and liabilities. Harvey (1991) suggested, in the context of ED 51, that all asset valuation could move gradually and systematically in the direction of a current value convention.

4.8 ACCOUNTING MEASUREMENT ISSUES

Diminutions in value: Permanent and temporary deficits

SSAP 19, taking a portfolio approach, does not require deficits on individual properties to be charged to the profit and loss account. The Companies Act (CA 1985 Sch 4 paras 19 and 34) requires permanent deficits below historical cost on individual properties to be charged to the profit and loss account but permits temporary valuation deficits to be included in revaluation reserve, even where this would result in a negative reserve. SSAP 19 requires an overall deficit on revaluation reserve to be charged to the profit and loss account but makes no distinction between permanent and temporary deficits. Milnes and Tillet (1987) noted that SSAP 19 goes further than the Act in that it does not allow the revaluation reserve to go into deficit, while the Act appears to allow the possibility of a temporary deficit. They suggested:

"With some properties built in the 1960s suddenly losing value fast, and never likely
ACCOUNTING FOR INVESTMENT PROPERTIES

to recover, it would appear that this paragraph [para 19(2), Sch 4, CA 1985] has the potential of an unexploded bomb for the industry."

Dealing with revaluations more generally, ED 51 proposed (ASC 1990a para 79) that a permanent diminution in value below the carrying amount (whether carried at historical cost or valuation) should be recognised in the profit and loss account, while a temporary diminution should be taken to the revaluation reserve unless this creates a debit balance on revaluation reserve, in which case the debit balance should be taken to profit and loss account (Davies et al 1990 pp 460-461).

There is an inevitable difficulty in write-down decisions (Egginton 1984 p 188), because diminution in asset value rarely becomes clear overnight and because it is difficult in practice to know if a reduction in value will be permanent.

In discussing the problem of distinguishing a permanent from a temporary deficit, Tillett and Hunt (1991) suggest that examples of permanent deficits would include a deficit on a building which is structurally sound but fails to meet modern requirements, or a change to adjacent premises which makes the location undesirable. They regard a deficit due to general market sentiment as temporary because, although there have been
ACCOUNTING FOR INVESTMENT PROPERTIES

fluctuations in property values, the overall trend has been upwards.

Treatment of gains and losses on disposal

In 1990 Accountancy reported that Barclays de Zoete Wedd had decided to exclude profits from property disposals in their quoted earnings per share figures and in their published profits and earnings estimates on brewers and distillers because:

there is almost invariably no net realisable profit for shareholders as the assets are rolled over into other pub property; and

a majority of brewers take property disposal profits to the profit and loss account of the year of sale with respect to original cost.

The journal commented:

“EPS is surely meant to measure the annual increment to shareholder wealth, but in the case of property disposal profits taken with respect to original cost, the vast majority of shareholder wealth is already represented on the balance sheet.”
(Accountancy, November 1990, p 35)

Elsewhere it has been noted (Adam 1982 p 87) that among the most obvious gaps in the Standard was its omission to make reference to the accounting
treatment of disposals of investment properties. He recommended that profits or losses on disposal of investments should be dealt with in the property revaluation reserve since they were the ultimate adjustment to the valuation.

In their survey Tillett and Hunt (1991) found that 15 out of a sample of 20 property company accounts indicated how such surpluses on disposal were calculated. Eight of these included in the profit and loss account the excess of sales proceeds over original cost. The remaining seven recorded the surplus by reference to book value. They also noted a variety of practice in determining the point at which sale of an investment property is recognised, ranging from completion of the contract and receipt of cash to an unconditional exchange of contracts. In general they found reticence, with only five out of the 20 disclosing the point of recognition.

Tillett and Hunt regard inconsistent presentation of the realised profits or losses and unrealised revaluation surpluses as one of the most serious weaknesses in the property industry’s present accounting practices. Their preference is for the ‘capital account’ combining realised and unrealised gains, found in only six of the 20 examples surveyed.

A detailed discussion of accounting methods on disposal of fixed assets has been provided by Davies et al (1990, Chapter 6).
LITERATURE REVIEW

Revaluation reserve

In the accounts of property companies the reporting of movements on revaluation reserve is disclosed in a variety of places (Tillett and Hunt 1991) including: a remote note to the accounts; a statement of reserve movements placed immediately below the profit and loss account; a consolidated capital account; and a capital profit and loss account. The realised distributable reserves were identified in 11 out of the 20 examples surveyed by Tillett and Hunt. In relation to SSAP 19, Davies et al (1990 p 461) have also pointed out some inconsistencies in naming and presenting the revaluation reserve.

More generally, there are significant issues of principle concerning reserve accounting which impinge on SSAP 19. These are summarised in section 4.11 on conceptual issues.

Depreciation

It was explained earlier that the opponents of accounting for depreciation of investment properties have argued that it is too difficult to assess and that depreciation is allowed for in the market valuation. Bowie (1982) asserted that depreciation is too important to be ignored and that SSAP 19 effectively masks the depreciation position, particularly as regards profit performance. He advocated segregating the market values of investment properties by age groupings and also

77
ACCOUNTING FOR INVESTMENT PROPERTIES

proposed the disclosure of the depreciation charge which would have arisen under SSAP 12.

That article by Bowie, raising many points of debate on property depreciation, was a catalyst leading to a major research report on property depreciation (Salway 1986), identifying and analysing the various causes of depreciation. Further updating on the issue was provided by Baum (1991), an economist, who identified the 1990s as the decade of “quantitative property economists”, as opposed to the 1980s as a decade of “the urban geographer turned property researcher”.

The difficulty for users in estimating a depreciation cost which has been omitted from the profit and loss account is similar to the problem of estimating amortisation of goodwill where this has been written off directly to reserves (Hastie 1990). Nobes (1984) contended that the reasoning of SSAP 19 contains no convincing argument against depreciation of property. The argument of SSAP 19 (para 2) is that it is the “current value” which is of prime importance and not the calculation of systematic annual depreciation. Nobes pointed out that neither SSAP 12 nor the Companies Act precludes using current value and charging depreciation in the profit and loss account. He also pointed out that the requirement to follow SSAP 19 also implies that following SSAP 12 will not give a true and fair view.
LITERATURE REVIEW

Nobes further contended (1984 and 1985) that under historic cost accounting there is no conclusive argument in favour of allowing *ad hoc* revaluations in the balance sheet, nor in favour of basing depreciation on the revalued amounts that result. Although this was primarily a justification of "split depreciation", subsequently outlawed by a revised SSAP 12, it does leave open the possibility of recording current values of investment properties in the balance sheet while recording some measure of depreciation in the profit and loss account, as an indication of asset consumption but not necessarily calculated as an allocation of current cost.

There is a significant issue of principle as to whether a depreciation charge is necessary in value based accounts. This issue is discussed in section 4.11 on conceptual issues.

**Property company accounts**

Although the lobbying against SSAP 12 and against the depreciation of investment properties came from the property industry, the Standard was issued as applying to all investment properties rather than to the investment property industry sector. There were those at the time whose comments on ED 26 indicated that they would have preferred a Standard confined to the industry and there are those who have since called for a Statement of Recommended Practice (SORP) for investment properties which would deal with accounting problems beyond
SSAP 19 (Davies et al 1990 pp 464-470). A flavour of those wider issues is given in the following paragraphs in order to indicate how much SSAP 19 would need to alter if it were to become more relevant to the property companies in particular.

The interview report in Chapter 3 refers to the Stoy Hayward Property Accounts Award 1990, which was cited by one respondent as a useful source of material on the highest standards of accounting by property companies. Subsequent to the interview research the 1991 Award winner was announced as Land Securities plc (Purdy and Barkham 1992). The panel’s main conclusions were (Purdy and Barkham 1991) that there should be: a full external valuation every year stating that the RICS Guidelines had been followed; a statement of accounting policy regarding unrealised surpluses, ideally recorded in a separate property revaluation reserve; a statement of policy relating to realised gains on investment properties, with any movements due to disposal or valuation changes passing into a capital reserve; realised and unrealised gains encapsulated in one capital performance statement; information distinguishing investment property from dealing property and the amount of development property included within each of these categories; and details of accounting treatment where a property was transferred between current and fixed assets; and, where an investment property is transferred to dealing property and subsequently sold, a calculation of the gain based on the
LITERATURE REVIEW

difference between the selling price and the previous balance sheet value.

As explained earlier, the detailed reference work by Tillett and Hunt (1991) contains commentary on a range of aspects of property company accounts and includes detailed analysis of the accounting practices of 20 leading property companies. Earlier reference material is available in Tillett and Bacchus (1990), Mellows and Hudson (1988) and Milnes and Tillett (1978, 1986 and 1987). In addition, articles have appeared from time to time in the professional press such as Accountancy, reviewing the accounts of specific property companies.

The form of presentation which brings together the group profit and loss account and the group capital accounts, distinguishing realised from unrealised surpluses or deficits on capital account, has been commended (Tillett and Bacchus 1990) because it gives the figure of revaluation surplus or deficit more prominence than it would receive as a note to the financial statements.

The unclear boundary between capital and revenue in the accounts of property companies has been highlighted by a finance director of a property company (Hughes 1985), a comment echoed elsewhere in discussions of property company accounting.
ACCOUNTING FOR INVESTMENT PROPERTIES

A pamphlet entitled Regulation of Issuers, published by the Quotations Department of The Stock Exchange in 1987, showed that in 1985/86 there were four qualifications relating to SSAP 19, falling to three in 1986/87. Since 1987 it appears that the Primary Markets division has not received any companies' accounts which have been qualified for non-compliance with SSAP 19.

The Stock Exchange has specific listing requirements for property companies (Admission of Securities to Listing Section 10 Chapter 1). New applicants for listing must provide detailed information on property valuations. The form of presentation required in the valuation certificate is designed to isolate the valuers’ estimation of the essential elements which make up the valuations of each property - eg rental values, capitalisation rates and the resultant capital values - and also to provide the essential facts of each property which would be taken into account in reaching valuation opinions. This degree of detail is only available for investors and other interested parties at the time of the application for listing, but provides an instance of disclosures which could be made available on a more regular basis.

Capitalisation of interest on development properties appears to be attracting more attention than does SSAP 19 with regard to the accounts of property development companies. The following examples
LITERATURE REVIEW

are taken from recent commentary directed at professionals in business:

A circular published by UBS Phillips & Drew (1991) entitled Accounting for Growth listed 15 major UK companies whose capitalised interest exceeded 14% as a percentage of pre-tax profits in the nearest year to 31 December 1989.

Great Portland Estates announced that it was to stop capitalising interest paid in the cost of its properties under development - to give "a clear and unfettered indication of the group's performance..." (Accountancy, March 1991 p 39)

"Greycoat, Land Securities and London & Edinburgh all capitalise interest but the quality of disclosure is different. Clear disclosure of charges saves the reader a lot of calculation when trying to work out the overall borrowing." (Accountancy, March 1990 p 37).

A lengthy discussion on practical aspects of capitalisation of interest on development properties is provided by Tillett and Hunt (1991).
4.9 COMPANY LAW AND CURRENT ACCOUNTING ISSUES

Company Law

SSAP 19 (para 17) invokes the true and fair view override as justification for general application of the Standard and for the resulting failure to depreciate an asset of finite life. When SSAP 19 was issued in 1981 it represented the general consensus in the UK of the way in which the "true and fair override" could be applied (although this consensus is referred to by Davies et al (1990 p 457) as a "political expedient" which allowed SSAP 19 to be published). Subsequent debate has altered that view to the extent indicated by a note in Accountancy (November 1990 p 11), in referring to accounting harmonisation in the European Community, summarising the views of the Contact Committee which concluded that the "true and fair view override" must be applied in relation to a given company and not in relation to all companies or a given category of companies.

Where the "true and fair override" is used, the Companies Act requires disclosure of particulars of the departure, the reasons for it and its effect. At present, companies who apply SSAP 19 use a form of wording which explains the approach taken under SSAP 19, invokes the true and fair view as the reason and points out that depreciation, as only
LITERATURE REVIEW

one factor in the valuation, cannot be separately identified or quantified.

As a second point on which SSAP 19 requires clarification, it was noted earlier that there are inconsistencies between SSAP 19 and the Companies Act regarding the treatment of diminutions in value.

Accounting exposure drafts

At the time of writing this report a number of exposure drafts exist which were issued shortly before the cessation of the ASC and on which the ASB has not yet given a definitive view. Current exposure drafts which have implications for SSAP 19 or which deal with related issues are:

ED 51 Accounting for fixed assets and revaluations (ASC 1990a)
ED 52 Accounting for intangible fixed assets (ASC 1990b)
ED 53 Fair value in the context of acquisition accounting (ASC 1990c)
ED 55 Accounting for investments (ASC 1990d)

In relation to ED 51 there is a view (Harvey 1991, p 26) that ED 51 institutionalises an unsatisfactory compromise between historical and non-historical cost accounting by extending to all fixed assets the option for companies to carry assets in the balance sheet at valuations. In particular Harvey found ED
51's emphasis on the market selling price as the normal valuation base disturbing (ED 51 does not rule out depreciated net replacement cost). He suggested that at present we have no evidence that current market selling price is so valuable to users that it is preferable to historical cost or current replacement cost, and if user needs are to direct standards they should be researched.

The problems of recoverable amounts as defined in ED 51 attracted the attention of Rutherford (1990), who questioned whether a diminution in carrying amount could ever be temporary under the ED 51 definition. He recommended further guidance on the concept of recoverable amount as a forward-looking concept. The extreme option of banning all revaluations has also been discussed (Ebling 1990).

ED 52 (para 40) provides that, on the occasions where it is permissible to carry an intangible fixed asset at a valuation, that valuation should be based on the depreciated replacement cost of the asset so long as that exceeds the net amount recoverable from use of the asset. If ED 52 were implemented the mixture of valuation methods could grow, with depreciated replacement cost alongside open market value and historical cost.

Further indications of extended mix of valuations are hinted at in ED 53 (paras 68 and 69), which seems to provide that the values attributed to
identifiable assets in the context of acquisitions will usually be replacement cost of the individual items.

ED 55 is intended to apply to all investments except those covered by SSAP 19. Para 1.9 presents the rationale for restricting the application of "marking to market" to readily marketable investments held as current assets. The rationale reflects the view that:

reliability of measurement underlies the concept of realisation (as is argued by Carsberg and Noke (1989) p 42)

the current market value of fixed asset investments "is of less immediate relevance for measuring performance..." (ED 55 para 1.12)

The implication is that user needs, in the shape of performance measures, are a driving force in determining accounting treatment. Macve and Jackson (1991) suggested that this distinction between fixed and current assets is essentially one of intention. Such a distinction is therefore open to evasion by directors.

ED 55 and ED 51 both require that revaluations should be credited to reserves. The amount to be recorded in the profit and loss account with respect to permanent diminutions and gains and losses on disposal of revalued investments is to be based on
ACCOUNTING FOR INVESTMENT PROPERTIES

the carrying value (the new cost) of the investment rather than on its historical cost. This is a further difference from the already diverse practices in accounting for diminutions in values of investment properties, described earlier in this chapter. Elwell (1990) noted that the effect of ED 55 is that the good news (revaluation surplus) goes to reserves and the bad news (diminutions and smaller gains and larger losses on disposal) goes to the profit and loss account. He argued that the approach recommended by ED 55 appeared to have been developed in a vacuum, particularly as regards diminutions. Hodgson (1990) also pointed out inconsistencies in ED 51 in dealing with diminutions.

4.10 SOME INTERNATIONAL COMPARISONS: USA, NEW ZEALAND, AUSTRALIA AND IASC PRONOUNCEMENTS

United States of America

In the USA the revaluation of assets is not allowed (except for the use of fair values for most business combinations), nor is the charging of supplementary depreciation against profit (Nobes 1984 p 23). There is no special treatment for investment properties.

Recent developments have led the American Institute of Certified Public Accountants (AICPA) real estate committee to establish a task force to develop guidance for the real estate industry on the
presentation of supplementary current value information. Searfoss and Weiss (1990) noted that recently there has been a growing interest by American property companies in presenting supplementary current value information. They also identified some of the accounting presentation and audit issues currently under consideration, eg:

**Measurement:** what methods are acceptable: entry value, exit value, or value in use?

**Comprehensive v piecemeal presentation:** should it be necessary to revalue all the assets and liabilities or only selected ones?

**Stand-alone or side-by-side:** should it be permitted for supplementary current value financial statements to be published on their own?

**Complete set of financial statements:** should the supplementary current value statements be presented only as part of a complete set of financial statements comprising balance sheet, income statement, and reconciliation to historical cost equity, or should it be permissible to issue a balance sheet on its own?

**Individual assets and liabilities or the entire entity:** should the supplementary current value information represent the amounts of
ACCOUNTING FOR INVESTMENT PROPERTIES

individual assets and liabilities, or should it represent the value of the entity as a whole?

An account of the current value experiences of The Rouse Company (a real estate company) has been provided by Schwarzbach and Vangermeersch (1991), analysing developments over a period from 1973 to 1989. An appendix to that paper provides further examples of the supplementary disclosures made by some real estate companies and hotel groups. In an earlier paper Palmon and Seidler (1978) examined current value reporting by a small number of real estate companies in the context of possible market inefficiency and observed that there was no perceptible market reaction to the release of current value figures. Unfortunately the small sample size meant that they could not use statistically valid techniques of analysing price movements, so that their observations were primarily intuitive. It is quite likely that the market had already anticipated the current value information.

New Zealand

The New Zealand SSAP 17(a), issued in 1985, applied to investment property companies only, whereas the prior exposure draft ED 29 had applied to all companies. SSAP 17(a) required unrealised gains from investment properties to be included in the profit and loss statements of investment property companies. This idea was supported by
ACCOUNTING FOR INVESTMENT PROPERTIES

Tweedie (1985), who favoured the approach of taking unrealised gains and losses to profit and loss account rather than to an investment reserve. SSAP 17(a) never gained widespread acceptance and compliance was low (Ryan 1989). It was reluctantly withdrawn in June 1988.

The reason given by the NZSA was:

"As the income statement is intended to report information useful in assessing performance, it is appropriate that property investment revaluations should be reported as part of income. However, [President Ron] Eglinton said it is not realistic for the Society to impose a standard which a significant proportion of the investment community does not accept."

A new exposure draft, ED 45, was issued in August 1988, allowing unrealised gains to be excluded from the profit loss statement and to be credited directly to an investment property revaluation reserve. This became SSAP 17(b) in February 1989. A comparison of the requirements of the various exposure drafts and standards is contained in Rahman et al (1990).

Australia

Australia has had no specific Standard dealing with accounting for investment properties. Instead,
ACCOUNTING FOR INVESTMENT PROPERTIES

guidance has been drawn from AAS 4 Depreciation of Non-Current Assets (ICAA 1974) and AAS 10 Accounting for the Revaluation of Non-Current Assets (ICAA 1981). Recently 'investment properties' (defined substantially as in the UK SSAP 19) have been exempted from the provisions of AAS 4, including the requirement to provide depreciation. There are no specific requirements concerning the valuation of investment properties contained in AAS 10 (or in any other Australian standard).

An unsatisfactory diversity of accounting practice among Australia's major property trusts was identified by Boll (1991), who hoped "that an appropriate accounting standard will be issued shortly with regard to investment properties".

IASC: IAS 25 Accounting for Investments (IASC 1986)

As a result of the review of International Accounting Standards, the Statement of Intent (IASC 1990) proposed that IAS 25 should adopt, as a 'benchmark treatment', the requirement that investment properties should be carried at cost and depreciated in accordance with IAS 4, Depreciation Accounting (IASC 1976). The Statement of Intent also proposed an "allowed alternative treatment" of carrying investment properties in the balance sheet at revalued amounts. Thus it seems unlikely that
LITERATURE REVIEW

any pressure for change in SSAP 19 will come from the direction of the IASC.

The disclosure requirements of IAS 25 in its present form are similar to those of SSAP 19 apart from an additional requirement that enterprises whose main business is the holding of investments should provide an analysis of the portfolio of investments. IAS 25 requires provision for permanent diminution in value on the basis of individual investments, with reductions below cost to be charged to the profit and loss account (Davies et al 1990 pp 462-463).

4.11 CONCEPTUAL ISSUES

Since SSAP 19 was issued, there have been developments in concepts of accounting practice. In particular, conceptual framework documents have been produced by The Institute of Chartered Accountants of Scotland (1988), Solomons (1989) and the International Accounting Standards Committee (1989). Additionally, there are the Financial Accounting Standards Board (FASB) Concepts Statements in the USA and conceptual framework documents in Canada and Australia. There have been numerous commentaries and papers related to these. From various sources a number of conceptual issues have been identified which, while covering a wider range, may be relevant to a review of SSAP 19. These issues are summarised in the following paragraphs.
ACCOUNTING FOR INVESTMENT PROPERTIES

The first question is a fundamental issue of measurement of income. Should it be derived by a balance sheet approach or a profit and loss account approach? Solomons (1989) argued for measurement of profit as a change in the net worth based in changes in assets and liabilities over a period of time. This approach emphasises the balance sheet and one consequence is the importance attached to valuations. The alternative view is that profit results from a matching of revenue and costs, one consequence of which is that depreciation may be emphasised as a measure of consumption of assets used to earn profits.

Moving on to the conceptual framework being devised by the Accounting Standards Board, relevance and reliability have been identified as primary characteristics of accounting information (ASB 1991). These are seen by other conceptual frameworks as important qualitative characteristics of financial statements (IASC Framework 1989, Solomons 1989). In the context of asset valuation they may work against each other so that, while the need for relevance would support revaluation, concern about loss of reliability might cast doubt on the prudence of the accounting approach. Supplementary disclosure about uncertainties may be the appropriate solution (Levites 1990). The views of those commenting on ED 26 supported the greater relevance of current value reporting as outweighing the risks of loss of reliability in departing from historical cost accounting.
LITERATURE REVIEW

Another fundamental aspect of a conceptual framework is the establishment of rigorous recognition criteria. Much has been written on the principles of recognition of assets and liabilities. The most common thread running through all is that relative certainty of measurement is an important criterion for recognition of an asset in the balance sheet (Solomons 1989, IASC 1989). It has been pointed out (Macve 1989) that using reliability of measurement as the dominant criterion could have unintended results in terms of assets whose value fluctuates, since that fluctuating value might lead to exclusion of the asset from recognition.

Moving from recognition of assets and liabilities to recognition of revenue and the realisation concept, Weetman (1980 and 1982) drew attention to the fact that the realisation concept as expressed in SSAP 2 and in the Companies Act created a barrier to the recognition of income. A statement of unrealised gains accompanying the conventional profit and loss account would clarify the sources of changes in equity. Carsberg and Noke (1989) also called for a statement of total gains in order to indicate the overall financial performance.

The general deficiencies of historical cost accounting are well documented, but in the context of investments Solomons (1989) and Macve and Jackson (1991) have noted the dangers of using historical cost accounting, with its emphasis on realised profit, since realisation can readily be
planned to arise in a period which is most in need of the profit.

Only one practical basis of valuation, OMV, is in use and, although the RICS valuation rules have attempted to achieve practical consistency in valuation of investment properties, a broader issue of principle remains in regard to the overall valuation model to be used in accounting. It could, for instance, be deprival value (Solomons 1989) or net realisable value (ICAS 1988) or an eclectic mix (Arnold et al 1991).

The choice of level of aggregation of assets has led to discussion in the USA in relation to the problem of concealing a diminution in asset value by careful grouping of assets to match rises with falls in value (Searfoss and Weiss 1990, Braun et al 1991, and Miller and Carnegie 1990).

The literature contains a range of works relating to reserve accounting. Paterson (1984) pointed out the proliferation of reserve accounting and the resulting loss of information. Weetman (1984) found diversity of accounting practice in reserve accounting by value based companies, including property development companies. There have been calls for statements of gains and losses and for a measure of comprehensive income (FASB Concepts Statements and ICAS 1988).
LITERATURE REVIEW

Capital maintenance, inflation and income determination are conceptual matters which have been the subject of major debate in the years since SSAP 19 was issued. One feature of that debate has been establishing the capital maintenance concepts used or implied in accounting standards, particularly in the context of SSAP 16 and its predecessors. If there is a clear conclusion, it is that attention should be paid to the capital maintenance concept underlying any accounting approach and to distinguishing apparent gains from real (inflation adjusted) gains in value.

The debate on the depreciation of investment properties has already been explored in this chapter and, as explained there, the rejection of depreciation for investment properties is justified in SSAP 19 by a judgment on the relative merits of current value information as compared with depreciating historical cost. In the light of subsequent companies legislation there is probably a need for a more sound base of reasoning to justify the continuance of the depreciation exemption in SSAP 19.

Taking some examples to give a flavour of the range of views prevailing in conceptual frameworks, ICAS (1988) asserted that no depreciation charge would be necessary in value based accounting where net realisable values were applied, whereas Solomons (1989) took the view that depreciation has an important role to play in maintaining real financial
capital. Baxter (1980a & b) supported the British Property Federation's arguments. Nobes (1984) argued that the decision to depreciate, and the amount of depreciation, was independent of the decision to revalue. SSAP 12 is based on a matching of costs with revenues rather than on a valuation based approach. Finally Salway (1986) identified the many aspects of depreciation of investment property and the need to recognise the importance of property depreciation in the management of investment property.

Uncertainty is a prevalent feature surrounding accounting practice. Historically, prudence in accounting has been interpreted as a reaction to uncertainty which results in a tendency to understate assets and profits and overstate liabilities and losses. Conceptual frameworks are now encouraging a more neutral attitude by interpreting prudence as a need to account for and disclose uncertainties. In the context of SSAP 19 there is scope for informative disclosures about the main uncertainties surrounding the valuation of investment properties.

This is by no means an exhaustive list of the conceptual issues which impinge on SSAP 19 but it is indicative of the kind of discussion which would be required if SSAP 19 were to be seen to fit logically within a conceptual framework of the type being prepared by the Accounting Standards Board.
SUMMARY OF THE LITERATURE SURVEY

Changing circumstances since SSAP 19 was issued

The initial impression gained from a review of the literature is that SSAP 19 has not evoked a great deal of attention since its implementation. It was introduced to satisfy a persistent and effective lobbying against SSAP 12 by the property investment companies. Having satisfied the demand for exemption of investment properties from any depreciation requirement, the Standard seems to be regarded as having succeeded in its aim.

When the search turns away from SSAP 19 itself to issues which are relevant to it, the story is very different. Valuation of assets, on a basis other than historical cost, has been explored extensively during the decade since SSAP 19 was introduced. This exploration has uncovered accounting issues which are not confined to SSAP 19 but are of relevance to that Standard.

The surveying profession has been active in developing its professional standards on valuation. The ‘Red Book’ of the RICS is now mandatory for its members.

Internationally there have been developments, particularly in New Zealand’s experience of initially requiring all gains and losses, realised or unrealised, to pass through the profit and loss account. The
ACCOUNTING FOR INVESTMENT PROPERTIES

accounting profession, in the face of opposition from the industry, reluctantly withdrew to a position of allowing unrealised gains and losses on investment properties to flow through reserves, if preferred. The United States does not allow the revaluation of assets but there is some interest in developing a supplementary statement of valuation of investment properties. The IASC is still ambivalent, even where allowance is made for the proposals in the IASC Statement of Intent.

SSAP 19 was developed without the benefit of a logical or consistent basis of accounting concepts on valuation and related issues. Subsequently attempts have been made, in some other countries and by the IASC, to formulate frameworks of accounting principles. The Accounting Standards Board is in the process of carrying out a similar task for UK purposes. SSAP 19, although specialist in the assets it deals with, needs to be slotted into a framework in order to give its recommendations more authority based on matters of principle.

The main economic feature is the twenty-year cycle in the property market from depression to boom and back to depression at the time of writing.

Issues to be addressed in a revision of SSAP 19

In relation to the coverage of the Standard, the definition of an investment property may require reconsideration, particularly where there is owner
ACCOUNTING FOR INVESTMENT PROPERTIES

occupation of what is regarded as an investment property or where a trading group has set up a separate property subsidiary which lets a building to group companies at commercial rents. The distinction between investment property, dealing property and development property also requires further clarification.

Anecdotal experience of the valuation process has suggested that professional valuation opinion varies considerably within the definition of Open Market Value, but this may be due to a lack of understanding of the assumptions of the OMV basis. A revised Standard could usefully clarify the approach taken by valuers.

The specific accounting issue of diminution in value appears repeatedly in the professional literature. A revised Standard needs to distinguish permanent from temporary diminutions and to make recommendations on the extent to which diminutions should pass through the profit and loss account in compliance with the statutory requirements.

The reporting of profit on disposal of any revalued fixed asset has provided a difficult subject for the standard setters. Commentators see as a major omission from SSAP 19 the lack of a ruling on how the gain or loss should be calculated and how it should be reported.
ACCOUNTING FOR INVESTMENT PROPERTIES

Consideration should be given to requiring, in SSAP 19, more informative disclosures on a regular basis regarding the investment property portfolio. When a property investment company first seeks a listing, a considerable amount of information is made available. Although this is one extreme of the spectrum of possible disclosure, the present position in annual reports is at the other extreme of providing very little information. There are examples of good practice in selected annual reports and these could provide the basis for a standard for others.

It was known when SSAP 19 was issued that failure to depreciate a fixed asset of finite life was contrary to the Companies Acts requirements but it was thought at that time that the ‘true and fair’ override would be adequate to justify SSAP 19. Subsequent experience and legal decisions have led to the view that while the ‘true and fair’ override may be invoked for published accounts of a company or a group, it cannot be used to justify a Standard which is in conflict with the law. SSAP 19 justifies the exemption from depreciation as a matter of opinion on the lack of usefulness of depreciation information to users of accounts. It might be useful to have in SSAP 19 a stronger statement of principle justifying the non-depreciation of investment properties in terms of a conceptual framework.

Other conceptual issues need to be addressed, particularly the balance of relevance and perceived
LITERATURE REVIEW

reliability since the ASB has selected these as the two primary characteristics. Relevance and reliability do not necessarily work together in asset valuation. SSAP 19 is a useful area in which to test the practical balance of the two. The role of recognition criteria, in reporting the asset and in reporting the change in asset value, needs to be considered in the context of SSAP 19. Capital maintenance, including the distinction of real gains from inflationary gains, is also worthy of attention.

These are the major issues which emerge from the literature review, but the extent of detail contained in the foregoing chapter is indicative of how accounting problems from one area interact with those of another. The review also indicates the range of issues which may be uncovered by approaching an investigation from oblique angles rather than by the direct approach. The experience of the literature review was similar to that of the interview research in that the initial reaction was that there is not a great deal wrong with SSAP 19. The subsequent discovery in both cases was that there is a rich variety of issues to explore. Interestingly, the two investigations complement each other in that the practical issues emerge from the interviews while the conceptual issues emerge more strongly from the literature review. Perhaps one conclusion is that a great deal of useful insight is not recorded because those active in business do not have the time to publish their ideas, while those who address the conceptual issues do not always
ACCOUNTING FOR INVESTMENT PROPERTIES

have the opportunity to explore the practicalities. It is to be hoped that Chapters 3 and 4 of this research report have gone some way towards bringing the two experiences closer together.
Chapter 5
Overview and Recommendations

5.1. INTRODUCTION

The interviews undertaken for this project have identified key issues which should be considered in the context of any revision of SSAP 19. They have also revealed the diversity of opinion which exists on a range of accounting matters. Technical departments of the major accountancy firms have confirmed, in their responses, some of the accounting problems identified from the interviews. The review of published articles and commentaries has shown that there is relative satisfaction with SSAP 19 in its routine operation but that there are issues of concern about some practical aspects, particularly with regard to the accounts of property investment companies. There is little or no published commentary on the accounts of non-property companies which hold an investment property portfolio. The literature review has also
ACCOUNTING FOR INVESTMENT PROPERTIES

identified issues which should be addressed if SSAP 19 is to be a part of a coherent conceptual framework of accounting.

The present market conditions applying to investment properties have highlighted particular problems, especially with regard to the relevance of valuations in a depressed market, but the recommendations of the Working Party are intended to be of general application whatever the market conditions.

The Working Party found it far from easy to arrive at any firm conclusions on the balance of opinions presented to them. Accordingly, this chapter presents in sections 5.2 to 5.6 an overview of those opinions which the Working Party perceived as being particularly significant. On some of the more contentious issues, the range of opinions is presented without any firm conclusions on the balance of opinion. Where there did appear to be relative unanimity, that is indicated. Section 5.7 presents the recommendations of the Working Party.

5.2. OPINIONS ON COVERAGE OF SSAP 19

Owner-occupation and occupancy by group companies

Paragraph 8(a) of SSAP 19 excludes properties which are owned and occupied by a company for its own purposes. Interviewees commented on the
OVERVIEW AND RECOMMENDATIONS

problems of accounting for a property where a minor part is occupied by the owner and the major part is let to third parties. In practice, it appears that such a situation may be reported as an investment property with the approval of the auditor. Some interviewees went further in suggesting that a property could be an investment property, despite owner occupation, where the owner could relatively easily move from that property to another. The examples provided were in the area of financial services or administrative headquarters, operating from offices in the centre of large cities.

Paragraph 8(b) excludes properties occupied by other group companies. This provoked a wider range of views, ranging from those who saw no reason for this exclusion, to those who approved of it remaining.

Those who were opposed to the exclusion argued that, in economic substance, the lease to a subsidiary need be no different from a lease to a third party. In many cases the lease to a subsidiary company will be on terms comparable to a lease to a third party, and the valuer will take into account the nature of the tenancy in producing the valuation.

Those who supported the exclusion were mainly concerned about risk. A lease covenant between two members of a group could more easily be broken at a future time, and there was a possibility
of writing leases which would have the legal appearance of being at arms length but the economic effect would be different. It was pointed out that the valuation of the lease would depend mainly on the quality of the tenant, and again might be at risk if the lease could be broken without significant penalty.

Even without this potential risk of manipulation of lease arrangements, there was some concern about the commercial risk of leasing within the group, although it was felt that the commercial risk aspects could be dealt with by disclosure of the extent of group occupancy.

The Working Party, in its discussions, mirrored the range of views which emerged from the interviews and it became apparent that, while owner-occupation and group occupancy by group companies are issues which should be explored in any revision of SSAP 19, it was likely that wider consultation would reflect the breadth of opinion already discovered.

**Development properties**

There was widespread concern about the lack of an accounting standard dealing with development properties, although there was no strong feeling that this subject had to be dealt with in SSAP 19 itself.
OVERVIEW AND RECOMMENDATIONS

Problems of definition were identified in the decision on when a development property became an investment property and there was concern at the ease with which an unsaleable development property could be redefined as an investment property. Intention appeared to be a significant element of identification in practice.

More specifically on development properties, problems of variability of valuation were also instanced, not always apparent from the published accounts. “Cost” appears to be capable of widespread variety of interpretation quite apart from the specific issue of whether interest costs should be capitalised. There was no strong view from respondents that detailed provisions relating to development properties should come within SSAP 19.

It was evident to the Working Party that a Standard dealing with development properties is required in order to narrow the present differences in practice.

5.3. OPINIONS ON VALUATION

Open Market Value

Considerable concern is expressed as to the potential variability of valuations by different valuers and the difficulty of reflecting market conditions at a time when there is effectively no market. Some are concerned because the values at present are higher
than the amount which might be realisable in the near future. Others are concerned because the values are lower than seems reasonable in relation to an asset being held on a long-term basis. Yet there is no desire to return to historical cost and little enthusiasm for the ideas of discounted cash flows which are being aired in some quarters at the present time.

Respondents frequently quoted the phrase "a reasonable period in which to negotiate the sale", taken from the list of basic assumptions of SAVP 2, which they instanced as permitting too much variation in the values which could be derived.

The discounted cash flow approach is used in valuation reports in the USA, as well as the sales comparison (similar to OMV) and the depreciated replacement cost. There is no direct comparison with USA valuation practice because there is no equivalent accounting practice to SSAP 19 in the USA, the valuers' reports being provided for other purposes such as raising finance.

There were suggestions from preparers and users of accounts that the ASB should discuss with the RICS ways of narrowing the perceived variability of valuations, perhaps by defining the basic assumptions more narrowly or by encouraging more published information in accounts on the valuation process. Professional valuers felt the evidence on variability of valuations is largely anecdotal and that
OVERVIEW AND RECOMMENDATIONS

in general over a period of time the OMV has been a reasonable measure of realisable value. There is a view, expressed by some of those who receive investment property valuations for accounts purposes, that professional valuers are being conservative in valuation at the present time, but the valuers’ explanation is that in giving their opinion they are taking the cautious approach while remaining within the OMV rules as set out in SAVP 2.

The Working Party has been informed that the RICS is currently considering a revised draft of SAVP 2 which does not change the basic principles but seeks to make more explicit the approach which is being taken. In particular, it will make clear that the reasonable period allowed for marketing the property is assumed to have taken place before the date of valuation, so that the OMV is clearly stated at the date of valuation based on all relevant facts known at that time.

Separate values of land and buildings

Under OMV the property is valued as a whole and there is no need to separate the valuation of buildings from that of the land. All commentators agreed that any attempt to do so would be artificial and would have little or no information value. Where a holding of land would have a higher value were it not for the building standing on it, a view
ACCOUNTING FOR INVESTMENT PROPERTIES

would be taken of the property as a whole based on the circumstances at the time of valuation.

**Specification of the approach to valuation and assumptions**

The directors of a company will normally instruct the valuer to produce a valuation at OMV, in which case the valuer will apply the rules of SAVP 2, exercising judgment on the opinions required. The directors would not be expected to give any specific instructions on how those opinions should be formed, since these are for the professional judgment of the valuer. The detailed approach will be specified in the valuer’s report, if requested, and will be explained to the directors if enquiries are made.

Auditors appear to pay more attention to detailed derivations of internal valuations than to external valuations, where they rely primarily on the professional expertise of the external valuer. This is regarded as quite acceptable by the valuers but is questioned by bankers as not being sufficiently probing in establishing the opinions on which the valuations are based. There appears to be something of an expectations gap as regards the role of the auditor.
OVERVIEW AND RECOMMENDATIONS

Frequency of external valuation

It proved impossible to ascertain a consensus on the frequency of external valuation. Some property investment companies already carry out annual external valuations, while others use three-year valuations, sometimes on a rolling sample basis of one third each year.

Beyond the property investment sector, preparers were less convinced about the usefulness of the external valuation when they were monitoring valuations internally on a continuing basis, using qualified internal valuers. Users of accounts commented on the independent verification aspect of the external valuation but one pointed out that the valuer reports to the directors, not to the shareholders, and therefore does not perform the kind of independent verification process provided by the audit.

The valuers suggested that the expertise gathered from other aspects of their work meant that there was more realism in their values than might be found in the internal valuation where the valuers were not so close to the market.

The Working Party felt that there was a need first of all to clarify the purpose of the external valuation. If the main purpose was to ensure that the valuation was carried out by experts of adequate standard then it should be acceptable to take the
ACCOUNTING FOR INVESTMENT PROPERTIES

internal valuation when prepared by a professionally qualified team. If the main purpose was to provide independent verification then the external valuer would be required in all situations. The Working Party also discussed the question of whether a three-year external valuation could be carried out on a rolling basis of a different one-third sample each year and concluded that flexibility in the pattern of valuation would be acceptable provided the sample was representative of the whole.

Cost of valuation

There is no ready formula which would relate cost of external valuation to frequency of valuation. It depends on the nature of the portfolio, the balance between initial valuations and repeat valuations, the extent to which the valuer gains experience through other work for the client, the extent to which desk valuations may be used rather than visiting the property on each occasion, and many other factors. Tendering for valuation contracts is increasingly prevalent and competition appears to be reducing fees for major contracts. At the other end of the scale, more frequent external valuations would undoubtedly place a greater burden on enterprises which hold a relatively small portfolio of investment properties.
OVERVIEW AND RECOMMENDATIONS

Qualifications of valuers

The RICS statement SAVP 8 defines a valuer and distinguishes internal, external and independent valuers. No respondents offered any significant objections to using similar definitions in SSAP 19, except that the definition of the internal valuer is unclear in its reference to the internal valuer having “no significant financial interest”. This would probably require clarifying in discussions between the ASB and the RICS.

5.4. OPINIONS ON THE SURVEYING PROFESSION AND THE ACCOUNTANCY PROFESSION

Comments here were mainly directed at the audit function. It would appear that the role of the auditor in relation to the work of another expert is not well understood. This is probably an aspect of the expectation gap which needs to be dealt with by explaining to users the nature of the audit function, although part of the problem may be a wish to extend the responsibility of the auditor beyond existing limits. There exists the auditing guideline “Reliance on other specialists” but the perceptions of the actual work carried out by the auditor were not readily reconcilable with the specifications of the guideline. There is also an Information Paper, IP 8, issued by the RICS, entitled “The valuer’s relationship to the auditor and information required from a valuer by an auditor”.

115
ACCOUNTING FOR INVESTMENT PROPERTIES

There was general agreement that SSAP 19 could usefully refer directly to relevant SAVPs of the RICS and that, by requiring OMV in compliance with SAVP 2, it could ensure that all valuers, whether professionally qualified or not, would apply the same standards. As mentioned earlier, there was a view that the ASB should encourage the RICS to look at the wording of SAVP 2 in the context of apparent variability of valuation.

5.5. OPINIONS ON ACCOUNTING ISSUES

The primary financial statements

Chapter 3 contains a detailed list of the accounting issues which were discussed in the interviews. Some of these items, particularly the question of permanent and temporary diminutions, were confirmed by the literature review. The Working Party identified, for the attention of the ASB, the following list of matters which affect the primary financial statements:

- the definitions and accounting treatments of permanent and temporary diminutions in value;

- auditors' difficulties, in discussions with clients, as to whether diminutions should be considered on an individual basis or on a portfolio basis and the problem within group accounts of setting off the revaluation
OVERVIEW AND RECOMMENDATIONS

deficit of one subsidiary against the revaluation surplus of another;

the calculation of the gain or loss on disposal and any consequent transfers between reserves;

guidance on whether realised profit on sale of investment properties should pass through profit and loss account at all, with opinion divided as to whether this was a revenue item or a capital item;

the scope for manipulation, in a company concerned with its trading profits and earnings per share, to switch between group occupancy and third party occupancy prior to realisation of a property;

lack of guidance on the treatment of revaluation losses in reserves of associated companies and on the treatment of joint ventures where any default by a joint venturer could affect the value of an investment property held jointly;

the proposed EC Directive on Insurance Company accounts which will allow all investment revaluation gains and deficits to pass through the profit and loss account; and
the proposal in the same Directive which places investments in a special category of assets which is neither fixed nor current.

Disclosures

SSAP 19 was not written as a disclosure standard but it was clear from comments on the standard that there is a perceived need for disclosure although there is a wide range of ideas as to what would be relevant. From the lists set out in Chapter 3 and the items identified in the literature review, the Working Party identified the following for the attention of the ASB:

Relating to the definitions:

* a statement of the intentions of the directors of individual companies with regard to the holding of investment and development properties;

* a statement of the intentions of the directors of the group with regard to the holding of investment and development properties; and

* a more informative note on accounting policy which would explain the definitions used within the enterprise.
OVERVIEW AND RECOMMENDATIONS

Relating to the valuation process:

* the valuer's report should be published alongside the audit report;

* potentially controversial, but worthy of consideration, could be disclosure of:

- the opinion taken on the "reasonable period" for realisation
- the opinion formed about rentals and yields.

Relating to the investment portfolio:

(Some of the following items are already found in the annual reports of some of the property investment companies on a voluntary basis, usually in the form of pie diagrams or bar charts)

* quality of portfolio as indicated by:

- the type of property
- location
- nature of tenure
- type of use
- type of tenant

* explanation of causes of changes in current values;
ACCOUNTING FOR INVESTMENT PROPERTIES

* gross increases and gross decreases in values distinguished;

* five-year growth in rental, income and asset value; and

* statement on investment policy regarding:
  - mix of portfolio
  - average period for holding investments.

The Working Party, in its discussions, placed particular emphasis on the proposal that directors should have to explain their intentions with regard to holding investment and development properties.

Statement of Movement on Reserves

There was generally support for the ASB proposals for a Statement of Movements on Reserves as being a useful improvement. Some property investment companies already produce a capital profit and loss account which shows realised gains and losses. At the most negative, some felt that it would not provide any more information, either because the reserves are already there for those who look, or because it is the asset portfolio which is more important to the user than a breakdown of reserves.
OVERVIEW AND RECOMMENDATIONS

5.6. OPINIONS ON CONCEPTUAL ISSUES

Depreciation

The interviews produced no evidence of any desire to account in the profit and loss account for depreciation of investment properties. All agreed that depreciation takes place for a variety of reasons of obsolescence through physical factors, location, economic changes, function, environment and design. These factors are taken into account collectively in arriving at OMV but are not specifically identified. In practice, depreciation of investment properties is not seen as being sufficiently material to require separate identification and a profit and loss account charge. In contrast to the overwhelming view of respondents, there are detailed theoretical and academic studies of the nature of property depreciation, as set out in the literature survey, some of which suggest that depreciation of investment properties is a significant item which warrants separate identification.

Valuers take a view of the property as a whole and depreciation of an investment property is only one part of the overall judgment. They do not quantify the depreciation in arriving at the valuation. They will apportion value between land and buildings if asked to do so, but regard it as somewhat arbitrary.
ACCOUNTING FOR INVESTMENT PROPERTIES

The views of users and preparers were that depreciation of investment properties in a profit and loss account was not relevant, although their reasons varied. Some held that depreciation was already allowed for in the valuation and therefore a profit and loss account charge would penalise equity twice for the same cause. Others said that property investment companies are judged on net asset value, the earnings figure being relevant only as a proxy for cash flow. Others felt that depreciation figures in respect of investment properties would be immaterial to the overall view and are too arbitrary to have any meaning.

Most respondents qualified their remarks with a clear indication that their views related only to investment properties and that they were not addressing the wider issue of property depreciation in general.

Other conceptual issues

The interviews generally did not raise conceptual issues since the respondents were mainly commenting on their practical experiences. The literature survey did bring out a number of issues relevant to SSAP 19 but having wider implications. These included: relevance and reliability; valuation method; recognition criteria; reserve accounting; capital maintenance; and the accounting approach to uncertainty. It also highlighted those issues on which SSAP 19 needs to be considered in relation to
OVERVIEW AND RECOMMENDATIONS

other developments currently at exposure draft stage, particularly ED 51 and ED 55.

5.7. CONCLUSIONS AND RECOMMENDATIONS OF THE WORKING PARTY

From the variety of responses by a small but influential group of interviewees, the Working Party concluded that views on depreciation of investment properties appear largely unchanged from those which were held when SSAP 19 was first issued. Preparers, users and valuers all saw no relevance in charging depreciation of investment properties in the profit and loss account. Depreciation of investment properties is not an issue of any concern at this time at a practical level, and it seems unlikely that there would be support at present for a proposal to depreciate investment properties. The Working Party recommends that the ASB should initially consider depreciation of investment properties within the overall framework of accounting, noting that on grounds of relevance to the needs of users it does not appear to be a significant issue.

The Working Party concluded that there would be strong support for aligning the qualifications required of external asset valuers with those required by the RICS under its professional guidelines. On the question of external valuation, the Working Party took the view that five years was too infrequent an interval and that perhaps three
years would be a reasonable improvement. The Working Party recommends that there should be an indication in the accounts of when the next external valuation would take place. An external valuation of some kind is almost certainly required to give confidence in the published information.

The Working Party concluded that other issues which have arisen during the operation of SSAP 19 do warrant attention in the standard setting process. It was not possible, from the limited sample studied, to draw definitive conclusions but the high level of experience and influence of the respondents means that their range of views is likely to be reflected in a wider population.

In particular, the Working Party recommends that the following issues should be given attention in a revision of SSAP 19:

* Valuation was always cited by respondents as being the most significant issue, although within the existing OMV basis. It would be useful if the Notes to published accounts drew attention to the principle that the valuation was based on circumstances existing at the date of valuation and not on possible changes of circumstances in the future.

* SSAP 19 could usefully explain the difference between the normal assumptions
which are regarded as opinions to be applied by the valuer as a matter of normal practice, and those “special assumptions” which might require more careful attention. In particular, there should be stress on the meaning of the phrase “a reasonable period to negotiate the sale” because the valuer’s scope may not be as flexible as some of the interviewees imagined it to be.

* It would be useful to explain, in a revised Standard, why the external valuation is needed. Is it required for independent confirmation, or for obtaining a greater level of expertise than might be found internally, or for some materiality considerations? Such issues should be clarified before deciding whether paragraph 6 of the present Standard needs the force of inclusion in the standard section. In any event there would need to be some flexibility to accommodate existing practices in the mix and timing of internal and external valuations, many of which appear to have merit even although they differ widely.

* In respect of definitions, the question of group occupancy needs to be addressed in any revision of SSAP 19, with further investigation of the risks of including group occupied properties as investment properties.
ACCOUNTING FOR INVESTMENT PROPERTIES

If they were to be included, then at the very least there would need to be disclosure of the proportion of group occupancy.

The question of changes of classification from development to investment property could best be dealt with by providing more information on the intentions of directors with regard to investment properties and development properties.

There should be a Standard dealing with all aspects of accounting for development properties but this should not come within a revised SSAP 19.

In the matter of the relationship between the surveying and accountancy professions, it would appear that, if there is a need for better communication, it may be in relation to auditing rather than accounting matters where consideration could be given to more formal direct communication between the auditor and the valuer.

The accounting issues identified by respondents related, in the main, to lack of consistency of practice and lack of disclosure regarding the valuation process and the nature of the investment property asset. A revised version of SSAP 19 should address the issues of accounting and disclosure listed
OVERVIEW AND RECOMMENDATIONS

earlier in this chapter, with a view to improving the overall quality and consistency of information.

* The legal position of companies which apply SSAP 19 in the context of meeting the requirements of the Companies Act 1985 remains unclear. Clarification should be provided by the Accounting Standards Board, preferably based on legal opinion.

Finally, the Working Party recommends that there should be consultation and careful explanation of any proposals for change to the existing SSAP 19.
REFERENCES


ACCOUNTING FOR INVESTMENT PROPERTIES


BPF (1978) Consultative paper on accounts of public property investment companies, British Property Federation (paper submitted to the ASC)

REFERENCES


Carsberg B and Noke C (1989) The Reporting of Profits and the Concept of Realisation, Research Board of the Institute of Chartered Accountants in England and Wales

Damant D (1990) “Brands, the balance sheet and company value”, Accountancy, October p 29
ACCOUNTING FOR INVESTMENT PROPERTIES

Davies M, Paterson R and Wilson A (1990) UK GAAP: Generally Accepted Accounting Practice in the United Kingdom, Ernst and Young / Longman

Drivers Jonas (1988) The Variance in Valuations and Technical Appendix, Research Department, Drivers Jonas, Suffolk Street, London


Ebling P (1990) "Fixed assets: The lull before the storm", Accountancy, May pp 30-31


Egginton D (1986) "When is a fixed asset overvalued?" Accountancy, September pp 101-102

Elwell R (1990) "Accounting Strangely For Investments - The treatment of diminutions proposed in ED 55 is both unpopular and unprecedented", Accountancy, December p 26


132
REFERENCES

Glover T (1985) “Cutting out the educated guesswork”, Accountancy, February pp 138-139


Harvey D (1991) “The Seductive Charms of Valuation - ED51 lacks the intellectual consistency to be seriously considered as an option” Accountancy, January p 26

Hastie S (1990) “Goodwill - Are we really making progress?”, Accountancy, October p 28


IASC (1976) Depreciation Accounting, International Accounting Standard No 4, The International Accounting Standards Committee

IASC (1986) Accounting for Investments, International Accounting Standard No 25, The International Accounting Standards Committee

133
ACCOUNTING FOR INVESTMENT PROPERTIES


IASC (1990) Statement of Intent, The International Accounting Standards Committee


REFERENCES


Mundy S (1987) “Corporate Property Finance and Owner-Occupation”, Accountancy, June pp 82-83

135
ACCOUNTING FOR INVESTMENT PROPERTIES


Purdy D and Barkham R (1991) Improving Property Company Accounts, Stoy Hayward and University of Reading


RICS (1990) Statements of Asset Valuation Practice and Guidance Notes, 3rd edition, Royal Institution of Chartered Surveyors

REFERENCES


Roberton T (1983) “Apples, pears and bananas”, Accountancy, November pp 63-64


ACCOUNTING FOR INVESTMENT PROPERTIES


Tillett D and Bacchus M (1990) Property Companies: Accounting and Auditing, Business Briefing Series 18, Institute of Chartered Accountants in England and Wales, Autumn


Tweedie D (1985) "All Blacks 4, Lions 0: Investment Property Accounting", The Accountant’s Journal, July pp 20-23

UBS Philips and Drew (1991) Accounting for Growth, Report by Global Research Group, January


REFERENCES


APPENDIX A

INTERVIEW QUESTIONS

1. Background of the respondent

1.1. In what capacity have you encountered SSAP 19 (eg, as preparer of accounts, property valuer, user of accounts, etc)?

1.2. Is your knowledge of SSAP 19 a detailed working knowledge/background awareness?

2. Coverage of SSAP 19

2.1. The scope of SSAP 19, and exclusions, are set out in paras 7 and 8 of the Standard. Do you think that the scope needs to be wider/narrower/is about right?

2.2. Are there any types of investment properties which are included within SSAP 19 but which you think should be excluded from its scope?

2.3. Are there any types of investment properties which are not included within SSAP 19 but which you think should be included within its scope?
ACCOUNTING FOR INVESTMENT PROPERTIES

2.4. Are there any types of companies/businesses which are included within SSAP 19 but which you think should be excluded from its scope?

2.5. Are there any types of companies/businesses which are not included within SSAP 19 but which you think should be included within its scope?

2.6. Do you agree with the explanations given in paras 1 and 2 of SSAP 19 regarding the need for the Standard?

2.7. Should SSAP 19 be extended to include development properties?

2.8. If development properties were included, what requirements for them should there be in the SSAP?

2.9. The coverage of SSAP 19 is defined in terms of investment properties rather than investment companies. Do you agree with this approach?

3. Valuation

3.1. Basis of valuation

What valuation bases are available for investment properties?
APPENDIX A

Do you favour any particular approach to valuation?

What particular problems have arisen because of the recession?

3.2. Land and buildings

Have you encountered any problems in distinguishing between the fabric of the building and the land on which it stands?

Have you encountered any situations in which the land might have a greater value if the building were not present, to the extent that the valuation would suggest that demolition of the building would be preferable?

3.3. Assumptions on which valuations are based

Who, in your experience, specifies the assumptions to be made?

Are the assumptions stated in the published accounts?

Do all directors of the company discuss and approve the assumptions?

Is sufficient attention paid to the assumptions made?

143
3.4. Frequency of external valuation

What are your views on the frequency of external valuation suggested in para 6 of SSAP 19? How would you react to the idea of more frequent external valuations?

Para 6 is not part of the standard section. Should it have the greater force of being included as a standard requirement?

3.5. Cost of external valuations

What view do company directors take of the cost of obtaining periodic external valuations?

Would valuation costs increase significantly if the frequency of external valuation were to be increased from that suggested in para 6 of SSAP 19?

3.6. Qualifications of valuer

Is SSAP 19 sufficiently rigorous in ensuring that the valuer is adequately qualified?
APPENDIX A

4. The surveying profession and the accountancy profession

4.1. Need for liaison on a one-to-one basis

Are there matters which should be included in the correspondence between valuers and accountants/auditors which would improve understanding of particular situations?

4.2. Need for liaison at professional level

The accounting standard SSAP 21, which deals with accounting for leases, is accompanied by Guidance Notes setting out detailed practice in the leasing industry.

If Guidance Notes were drafted to accompany SSAP 19, what subject matter should they contain? (eg, could they be based on the RICS Statements of Asset Valuation Practice?)

5. Accounting for revaluations of investment properties

5.1. Do you have any suggestions for modifying any of the accounting procedures for dealing with investment properties?
ACCOUNTING FOR INVESTMENT PROPERTIES

5.2. Is there adequate disclosure, regarding investment properties, in published accounts?

5.3. What are your views on the ASB proposals to give greater prominence to the statement of Movements on Reserves?

6. Any other matters

Are there any other matters relating to SSAP 19 which you think should be considered in the context of this research project?
APPENDIX B

LIST OF STATEMENTS OF ASSET VALUATION PRACTICE

RICS HANDBOOK (the Red Book)

published by The Royal Institution of Chartered Surveyors

SAVP 1 General Principles to be observed in preparing asset valuations
SAVP 2 Open Market Value and other bases of market valuation
SAVP 3 The Depreciated Replacement Cost basis of valuation
SAVP 4 The Valuation Certificate
SAVP 5 Reviewing of valuations
SAVP 6 Valuations made without adequate inspection or information
SAVP 7 Additional Valuations made on special assumptions
SAVP 8 The Asset Valuer
<p>| SAVP 9 | Valuation of Land and Buildings owner-occupied for the purposes of the business |
| SAVP 10 | Valuation of Land and Buildings held as an investment |
| SAVP 11 | Valuation of Land and Buildings held as trading stock and work in progress (in preparation) |
| SAVP 12 | Valuation of Land and Buildings fully equipped as an operational entity and valued having regard to trading potential |
| SAVP 13 | Valuation of Land and Buildings held for development |
| SAVP 14 | Valuation of Land and Buildings in course of development |
| SAVP 15 | Valuation of mineral-bearing land and other wasting assets |
| SAVP 16 | Valuation of Plant and Machinery Assets |
| SAVP 17 | Valuation of Company Assets as a security for a loan, debenture or mortgage |
| SAVP 18 | Accounting for Depreciation |</p>
<table>
<thead>
<tr>
<th>SAVP Code</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAVP 18(S)</td>
<td>Accounting for Depreciation (Scottish version)</td>
</tr>
<tr>
<td>SAVP 20</td>
<td>Valuations for incorporation or reference in International Stock Exchange prospectuses and circulars</td>
</tr>
<tr>
<td>SAVP 21</td>
<td>Valuations under the City Code on Takeovers and Mergers</td>
</tr>
<tr>
<td>SAVP 22</td>
<td>Valuations of Assets owned by Pension and Superannuation Funds</td>
</tr>
<tr>
<td>SAVP 23</td>
<td>Valuation of Assets for Business Expansion Schemes (in preparation)</td>
</tr>
<tr>
<td>SAVP 24</td>
<td>Valuation of Public Sector Assets (in preparation)</td>
</tr>
<tr>
<td>SAVP 25</td>
<td>Valuations of Unit Linked Property Assets of Life Assurance Companies</td>
</tr>
<tr>
<td>SAVP 26</td>
<td>Valuation of Assets owned by Unauthorised Property Unit Trusts (in preparation)</td>
</tr>
</tbody>
</table>
ACCOUNTING FOR INVESTMENT PROPERTIES

There is also a series of Information Papers, of which one is of particular interest to this project, namely:

IP 8 The Valuer's relationship to the Auditor and Information required from a Valuer by an Auditor

Other reference material:

The Valuation of Fixed Assets - Guidance Notes and Background Papers, published by The International Asset Valuation Standards Committee (available from The Administrator, TIAVSC, 12 Great George Street, Parliament Square, London SW1P 3AD)

The Valuation of Fixed Assets - Guidance Notes and Background Papers, published by The European Group of Valuers of Fixed Assets, (available from The Administrator, TEGOFOVA, 12 Great George Street, Parliament Square, London SW1P 3AD)
APPENDIX C

LIST OF ABBREVIATIONS AND DEFINITIONS USED IN THIS REPORT

ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAS</td>
<td>Australian Accounting Standard</td>
</tr>
<tr>
<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>ASB</td>
<td>The Accounting Standards Board</td>
</tr>
<tr>
<td>ASC</td>
<td>The Accounting Standards Committee (predecessor to the ASB and issuer of Statements of Standard Accounting Practice)</td>
</tr>
<tr>
<td>BPF</td>
<td>The British Property Federation</td>
</tr>
<tr>
<td>CA 1985</td>
<td>The Companies Act 1985 (as amended by the Companies Act 1989)</td>
</tr>
<tr>
<td>EC</td>
<td>European Community</td>
</tr>
<tr>
<td>ED</td>
<td>Exposure draft issued by the Accounting Standards Committee</td>
</tr>
<tr>
<td>EPS</td>
<td>Earnings per share</td>
</tr>
<tr>
<td>FASB</td>
<td>Financial Accounting Standards Board</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Description</td>
</tr>
<tr>
<td>------------</td>
<td>-------------</td>
</tr>
<tr>
<td>IAS</td>
<td>International Accounting Standard (issued by the International Accounting Standards Committee)</td>
</tr>
<tr>
<td>IASC</td>
<td>The International Accounting Standards Committee</td>
</tr>
<tr>
<td>ICAEW</td>
<td>The Institute of Chartered Accountants in England and Wales</td>
</tr>
<tr>
<td>ICAS</td>
<td>The Institute of Chartered Accountants of Scotland</td>
</tr>
<tr>
<td>IP</td>
<td>Information Paper (issued by the Royal Institution of Chartered Surveyors)</td>
</tr>
<tr>
<td>IRRV</td>
<td>The Institute of Revenues Rating and Valuation</td>
</tr>
<tr>
<td>ISVA</td>
<td>The Incorporated Society of Valuers and Auctioneers</td>
</tr>
<tr>
<td>MCRV</td>
<td>Making Corporate Reports Valuable: A discussion document published by The Institute of Chartered Accountants of Scotland (ICAS 1988)</td>
</tr>
<tr>
<td>NZSA</td>
<td>New Zealand Society of Accountants</td>
</tr>
<tr>
<td>OMV</td>
<td>Open Market Value (see definition in the following section)</td>
</tr>
</tbody>
</table>
### APPENDIX C

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>RICS</td>
<td>The Royal Institution of Chartered Surveyors</td>
</tr>
<tr>
<td>SAVP</td>
<td>Statement of Asset Valuation Practice (issued by the Royal Institution of Chartered Surveyors)</td>
</tr>
<tr>
<td>SORP</td>
<td>Statement of Recommended Practice (document of best accounting practice in a specific industry, franked by the Accounting Standards Committee)</td>
</tr>
<tr>
<td>SSAP</td>
<td>Statement of Standard Accounting Practice (issued by the Accounting Standards Committee and subsequently adopted by the Accounting Standards Board)</td>
</tr>
</tbody>
</table>
ACCOUNTING FOR INVESTMENT PROPERTIES

DEFINITIONS

Open Market Value (the basis of valuation of investment properties) is defined in SAVP 2 as follows:

The definition of Open Market Value means the best price at which an interest in the property might reasonably be expected to be sold at the date of the valuation assuming:

(a) a willing seller;
(b) a reasonable period in which to negotiate the sale taking into account the nature of the property and the state of the market;
(c) that values will remain static during that period;
(d) that the property will be freely exposed to the open market; and
(e) that no account will be taken of any additional bid by a purchaser with a special interest.

Asset Valuer (as defined in SAVP 8)

An ‘Asset Valuer’ is a Corporate Member of one or more of the following: The Royal Institution of Chartered Surveyors, The Incorporated Society of Valuers and Auctioneers or the Institute of Revenues Rating and Valuation (formerly the Rating and Valuation Association), with appropriate post-qualification experience and with knowledge of valuing land and buildings and/or plant and
APPENDIX C

machinery in the location and of the class and category of the asset.

**Internal Valuer** (as defined in SAVP 8)

An ‘Internal Valuer’ is an asset valuer who is a director (or of equivalent status thereto) or an employee and who has no significant financial interest in the company or organisation.

**External Valuer** (as defined in SAVP 8)

An ‘External Valuer’ is an asset valuer who is not an internal valuer and where neither he nor any of his partners or co-directors are directors or employees of the company or of another company within the same group of companies or have a significant financial interest in the company or group, or where neither the company nor the group has a significant financial interest in the Valuer’s firm or company. ‘Company’ includes any other form of organisation, *eg.* a Trust.

**Independent Valuer** (as defined in SAVP 8)

An ‘Independent Valuer’ is an external valuer who has no other recent or foreseeable potential fee earning relationship concerning the subject property(ies) apart from the valuation fee and who has disclosed any past or present relationship with any of the interested parties or any previous involvement with the subject property(ies).
APPENDIX D

STATEMENT OF STANDARD ACCOUNTING PRACTICE 19

ACCOUNTING FOR INVESTMENT PROPERTIES

Contents

<table>
<thead>
<tr>
<th>Part</th>
<th>Description</th>
<th>Paragraphs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part 1</td>
<td>Explanatory note</td>
<td>1-6</td>
</tr>
<tr>
<td>Part 2</td>
<td>Definition of terms</td>
<td>7-8</td>
</tr>
<tr>
<td>Part 3</td>
<td>Standard accounting practice</td>
<td>9-16</td>
</tr>
<tr>
<td>Part 4</td>
<td>Legal requirement in UK and Ireland</td>
<td>17-18</td>
</tr>
</tbody>
</table>
ACCOUNTING FOR INVESTMENT PROPERTIES

(Issued November 1981)

The provisions of this statement of standard accounting practice should be read in conjunction with the Explanatory Foreword to accounting standards. The provisions apply equally to financial statements prepared under the historical cost convention and to financial statements prepared under the current cost convention. They need not be applied to immaterial items.

Part 1 - Explanatory note

1. Under the accounting requirements of SSAP 12 ‘Accounting for depreciation’, fixed assets are generally subject to annual depreciation charges to reflect on a systematic basis the wearing out, consumption or other loss of value whether arising from use, effluxion of time or obsolescence through technology and market changes. Under those requirements it is also accepted that an increase in the value of such fixed asset does not generally remove the necessity to charge depreciation to reflect on a systematic basis the consumption of the asset.

2. A different treatment is, however, required where a significant proportion of the fixed assets of an enterprise is held not for consumption in the
APPENDIX D

business operations but as investments, the disposal of which would not materially affect any manufacturing or trading operations of the enterprise. In such a case the current value of these investments, and changes in that current value, are of prime importance rather than a calculation of systematic annual depreciation. Consequently, for the proper appreciation of the financial position, a different accounting treatment is considered appropriate for fixed assets held as investments (called in this standard ‘investment properties’).

3. Investment properties may be held by a company which holds investments as part of its business such as an investment trust or a property investment company.

4. Investment properties may also be held by a company whose main business is not the holding of investments.

5. Where an investment property is held on a lease with a relatively short unexpired term, it is necessary to recognise the annual depreciation in the financial statements to avoid the situation whereby a short lease is amortised against the investment revaluation reserve whilst the rentals are taken to the profit and loss account.

6. This statement requires investment properties to be included in the balance sheet at open market value. The statement does not require the valuation to be
ACCOUNTING FOR INVESTMENT PROPERTIES

made by qualified or independent valuers; but (in paragraph 12) calls for disclosure of the names or qualifications of the valuers, the bases used by them and whether the person making the valuation is an employee or officer of the company. However, where investment properties represent a substantial proportion of the total assets of a major enterprise (eg, a listed company) the valuation thereof would normally be carried out:

(a) annually by persons holding a recognised professional qualification and having recent post-qualification experience in the location and category of the properties concerned; and

(b) at least every five years by an external valuer.

Part 2 - Definition of terms

7. For the purposes of this statement, but subject to the exceptions in paragraph 8 below, an investment property is an interest in land and/or buildings:

(a) in respect of which construction work and development have been completed; and

(b) which is held for its investment potential, any rental income being negotiated at arm's length.
APPENDIX D

8. The following are exceptions from the definition:

(a) A property which is owned and occupied by a company for its own purposes is not an investment property.

(b) A property let to and occupied by another group company is not an investment property for the purposes of its own accounts or the group accounts.

Part 3 - Standard accounting practice

9. This statement does not apply to investment properties owned by charities.

10. Investment properties should not be subject to periodic charges for depreciation on the basis set out in SSAP 12, except for properties held on lease which should be depreciated on the basis set out in SSAP 12 at least over the period when the unexpired term is 20 years or less.

11. Investment properties should be included in the balance sheet at their open market value.

12. The names of the persons making the valuation, or particulars of their qualifications, should be disclosed together with the bases of valuation used by them. If a person making a valuation is an employee or officer of the company or group which owns the property, this fact should be disclosed.
13. Subject to paragraph 14 below, changes in the value of investment properties should not be taken to the profit and loss account but should be disclosed as a movement on an investment revaluation reserve, unless the total of the investment revaluation reserve is insufficient to cover a deficit, in which case the amount by which the deficit exceeds the amount in the investment revaluation reserve should be charged in the profit and loss account. In the special circumstances of investment trust companies (as mentioned in paragraph 10 of SSAP 6) and of property unit trusts it may not be appropriate to deal with such deficits in the profit and loss account. In such cases they should be shown prominently in the financial statements.

14. Paragraph 13 does not apply to the financial statements of pension funds and the long-term business of insurance companies where changes in value are dealt with in the relevant fund account.

15. The carrying value of investment properties and the investment revaluation reserve should be displayed prominently in the financial statements.

Date from which effective

16. The accounting and disclosure requirements in this statement should be adopted as soon as possible and regarded as standard in respect of financial statements relating to accounting periods starting on or after 1 July 1981.
APPENDIX D

Part 4 - Legal requirement in UK and Ireland

17. The insertion by section 1 of the Companies Act 1981 of a new section 149 of the Companies Act 1948 is likely to have the effect, among other things, that where this standard is applied certain disclosures will need to be made in the notes to the accounts. The application of this standard will usually be a departure, for the over-riding purpose of giving a true and fair view, from the otherwise specific requirement of the law to provide depreciation on any fixed asset which has a limited useful economic life. In this circumstance there will need to be given in the notes to the accounts ‘particulars of that departure, the reasons for it, and its effect’.

18. A similar legal requirement is expected to be enacted in the Republic of Ireland.