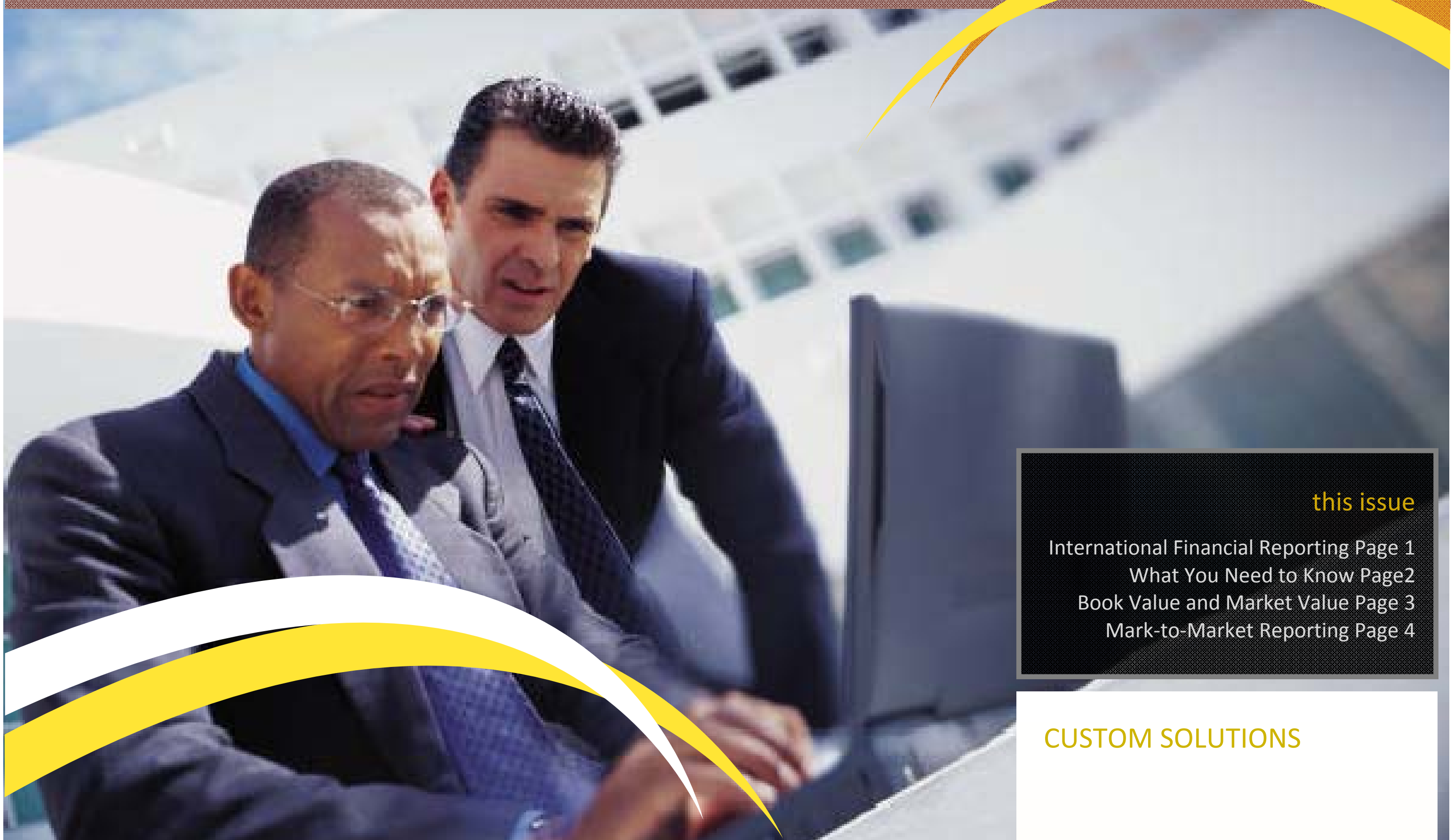
PetroMARK®

Implementing International Financial Reporting Standards (IFRS)



this issue

International Financial Reporting Standards

International Financial Reporting Standards are regulatory standards of practice for accountants in how assets and liabilities are reported on a company's financial statements, such as the balance sheet. The world is moving toward the common practice of reporting assets at market value. This has always been the case. In the case, particularly in the United States, assets were frequently reported at book value. Book value is an accounting concept that quite different from market value. Because real estate is an asset whose value is reported as part of property, plant and equipment on the balance sheet, appraisers are now involved in the process of appraising real estate for the purposes reporting the value of these assets on the company's financial statements.

CUSTOM SOLUTIONS

PetroMARK® is the most innovative development in the downstream petroleum industry to help you implement the market value-based reporting requirements of IFRS. Nothing is faster or more efficient. And, this means less cost to you for compliance.

What Financial Managers Need to Know

Financial Reporting Requirements Are Changing

The *International Accounting Standards Board* (IASB, former *International Accounting Standards Committee* IASC) was founded in 1973 as a result of an agreement by accountancy bodies in several countries with the objective to “develop … a single set of high quality, understandable and enforceable global accounting standards”

Until now the IASB has included all 143 professional accountancy bodies from 104 countries that are members of the International Federation of Accountants (IFAC) and has therefore gained worldwide recognition. Although the IFRS is mandatory for all European listed companies since 2005, the SEC has refused to approve the proposed rules until now.

But there is still hope that either the SEC will accept the IFRS in the future and/or that the *Financial Accounting Standards Board* (FASB) will adjust their rules to a “fair value” concept similar to the one used by the IFRS. The development of new standards “is [thereby] a dynamic international process which involves most countries”

The IASB has no national authority. It is the task of the national bodies to adopt these standards into their local jurisdiction.

The choice of reporting today falls under two options. Publicly-traded companies can report the value of their assets at book value or fair market value. In the future, assets will be reported at fair market value.

The example at right is an actual company in the U.S. Here, the stock price of the company increased by 34 percent in a single day because of reporting the real estate at fair market value instead of book value. Marsh Supermarkets is a dramatic example of how book value and market value can be quite different. Below is a reprint of actual news article describing this case.

The Toronto Valuation Accord was held in 2003. It was agreed that *“…the move toward market value in financial reporting is in the best interest of the public, investors, government, and business decision makers.”* The Toronto Accord went on to say that an acceleration can be expected in the market value reporting of fixed and intangible assets. Fixed assets includes real estate.

Because all companies are adopting the accounting methods specified in the International Financial Reporting Standards, the appraisal reports you are ordering today should be in compliance with International Valuation Standards as well as International Financial Reporting Standards. In the future, all real estate assets will be reported at market value. In this changing financial environment, there is no need to duplicate the need for appraisals. Appraisal reports that are in compliance with these new standards can be used for better real estate management and well as accounting and financial reporting.

Principles for Project Management Success

Real Estate Appraisal of Supermarket’s Land Causes Stock to Soar

After an appraisal of its real estate holdings revealed an increase of $100 million to $150 million more than the book value reflected in its financial statements, the stock of Marsh Supermarkets in Indianapolis shot up in early March, according to Supermarket News.

Marsh owns the real estate and buildings for 34 supermarkets and 44 convenience stores, as well as a distribution center, company headquarters and other properties, and is currently searching for a buyer for the company as part of a strategic review. The real estate appraisals were performed in connection with the ongoing review, as well as for recent loans secured by various properties, the company said. The book value, determined by subtracting liabilities and depreciation from assets on the balance sheet, and reported most recently in Marsh's annual report last June, was $15.72 per share: Marsh Class A shares were trading as low as $6.25 in recent weeks.

Doug Dougherty, executive vice president and chief financial officer for Marsh, speculated that the real estate news might have been a factor in Marsh stock skyrocketing last week, with Class A shares gaining more than 23 percent to close at $8.89 and Class B shares climbing nearly 34 percent to $7.90, in a single day. The lightly traded stocks did 10 times their average daily volume. "The asset value of the company may be higher than some people may have believed, or they hadn't focused on it," Dougherty said.

Book Value and Market Value

The Effects of Reporting Book Value Versus Market Value

Book value is an accounting term. As reported on a company's balance sheet, an asset's book value is the original acquisition cost less accumulated depreciation. Here, depreciation is a financial allowance that is deducted as a theoretical loss in useful because of aging of the asset. In reality real estate assets increase in value over time. So, book value often understates the value of real estate. In other words, the current reported book value of a company's real estate is usually lower than the current market value. Often it is significantly lower. This disparity can distort the overall reported value of a company as the two examples below illustrate.

The first example is a hypothetical company showing how the financial differ under book value reporting and market value reporting. The only difference is amount reported in the balance sheet (Table 1) under *land, buildings and equipment.* John Dorchester, a member of the Appraisal Institute published one of the first papers that explained these issues. Here, he shows that the common measurements of financial performance can be greatly distorted by reporting real estate assets at book value instead of fair market value.

The Major Issue

In particular, the reporting treatment of business assets in the U.S. would move away from historical cost to market value based reporting.

International Financial Reporting Standards have not been accepted by the US Security and Exchange Commission yet. However, the globalization of the world's economies is driving the need toward a consistent and transparent measurement of asset value. This standardization would allow a direct comparison between investments across the globe. Recently, the Financial Accounting Standards Board (US) and the International Financial Accounting Standards Board (most of the world) have agreed to converge their standards. This convergence will standardize valuation methods and reporting throughout the world.

An Expert's Interpretation

John Dorchester, a member of the Appraisal Institute published one of the first papers that explained these issues. Here, he shows that the common measurements of financial performance can be greatly distorted by reporting real estate assets at book value instead of fair market value.

Dorchester explains:

A simple return-on-equity ratio can be developed by dividing the sum of common stock and retained earnings values into the year's earnings before interest, taxes, depreciation, and amortization (EBITDA). For the calculation of book value, data from Tables 1 and 2 indicates that $830 divided by the sum of $2,231 plus $3,963 equals 13.4%. Under conventional cost accounting, this is the simple return-on-equity ratio most investors would see. However, the same calculations for market value reporting result in the following: $830 divided by the sum of $2,231 plus $13,655 equals 5.2%. This simple measure based on market value is significantly less than the earlier calculated result

Effects on the Balance Sheet

Property, Plant and Equipment

Table 1
ABC Company
Consolidated Balance Sheets
Year 2008

	Book Value (in millions)	Market Value (in millions)
Assets		
Cash and cash equivalents	$1,750	$1,750
Accounts receivable, net	2,269	2,269
Finance receivables, net	4,392	4,392
Inventories	1,983	1,983
Deferred taxes and other current assets	1,078	1,078
Total Current Assets	$11,472	$11,472
Finance receivables due after one year, net	$6,406	$6,406
Equipment on operating leases, net	1,266	1,266
Land, buildings, and equipment	**5,340**	**15,032** ⇦
Investments in affiliates, at equity	1,270	1,270
Intangible and other assets, net	3,763	3,763
Goodwill, net	1,549	1,549
Total Long-Term Assets	$19,594	$29,286
Total Assets	$31,066	$40,758

Mark-to-Market Reporting

The Best Evidence of Market Value

According the IFRS, the **"best evidence of fair value is normally given by current prices in an active market for similar property"** (IAS 40.39). In the U.S. this is referred to as the sales comparison approach. In the absence of current prices in an active market, the IFRS give three alternatives: (1) to adjust the current prices of differing properties to reflect these differences. (2) to adjust the recent prices of similar properties to reflect economic change or (3) to use discounted cash flow projections. These alternatives to the sales comparison approach are shown in the illustration below.

PetroMARK® is Your Solution

Whether you need the market values of 100 convenience stores, or 5,000, PetroMARK® is the answer. This is the fastest, most efficient valuation software available for appraising convenience store and retail fuel channel assets, allowing you to obtain reportable results in minutes. Save up 70% of the time and cost of producing traditional appraisal reports. Clinically tested in hundreds of convenience store market value appraisals performed by qualified MAI appraisers. Software licensing available.

For Multi-Site Petroleum Retail Properties

Designed specifically for generating the market values of convenience store and retail fuel multi-site properties for the International Valuation Standards and Valuation for Financial Reporting (VFR).

Recognition of Real Estate

Within the International Financial Accounting Standards, there are several sections which relate to real estate depending on the use and function of it within the company. The six real estate relevant sections are IAS 2 Inventories; IAS 11 Construction Contracts; IAS 16 Property, Plant and Equipment; IAS 17 Leases; IAS 36 Impairment of Assets; IAS 40, Investment Property.

IFRS 2009

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