International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

10 January 2008

Dear Sirs

Response to the Improvements Project 2007

We refer to your Exposure Draft dated October 2007 and titled "Improvements to International Financial Reporting Standards". In response to your invitation to comment we offer you the following answers and comments, as on the attachment.

RICS is a longstanding and experienced professional body representing over 130,000 members and has an increasing global reach in over 121 countries. RICS members practise in a wide range of capacities across the land, property and construction sectors. The obligations of its Royal Charter demand that RICS always places the public interest at the forefront of policy formulation and ensures the integrity of our position.

The valuation of assets, especially real estate assets, is one of the prime functions of our members and therefore changes to accounting standards that impinge upon valuation matters are of great interest to us.

We are offering responses only on those questions which relate to the valuation of real estate assets, with which are members are principally involved. The questions upon which we offer responses are therefore those relating to IAS 16, IAS 17 and IAS 40.

If you would like to discuss our responses in more detail, please contact Stanley Booton, who chairs the working party on valuation standards and financial reporting, as follows:

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Yours Sincerely

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RICS

RESPONSES TO QUESTIONS ON IAS 16 – PROPERTY, PLANT AND EQUIPMENT

Question 9

Should the definition of recoverable amount in IAS 16 be amended to remove the perceived inconsistency with 'recoverable amount' used in other IFRSs? If not, why?

We support the proposed amendment.

Question 10

Do you agree with the proposal to amend paragraph 68 of IAS 16 and paragraph 14 of IAS 7? If not, why?

We have no comment to make.

RESPONSES TO QUESTIONS ON IAS 17 – LEASES

Question 11

Do you agree with the proposal to amend paragraphs 14 and 15 of IAS 17 to eliminate a perceived inconsistency between the specific classification guidance for leases of land and buildings and the general lease classification guidance in IAS 17? If not, why?

We do not support the suggested amendments to paragraphs 14 and 15 and request that these should not be confirmed.

The Observer Notes for the meeting of 18 July 2007 include the following comment at paragraph 6 in relation to IAS 17 paragraph 14:

> "There is concern that this additional guidance is unnecessary and potentially hinders the application of the general lease classification guidance in paragraphs 8 to 12. The consequence of the current wording is that more leases of land and buildings are bifurcated between an operating lease for the land and a finance lease for the building than might otherwise arise from a simple application of the criteria in paragraphs 8 to 12."

If the intention (of the proposed changes) was to reduce the number of occasions when a lease of land and buildings would be 'bifurcated' into separate land and buildings elements for accounting purposes, then the retention of the first and last sentences of paragraph 15 defeats this objective.

Similarly the irritation that the sale of a long leasehold interest in land for a premium cannot be booked as 'profit' in the accounting year in which the sale takes place is retained by the new paragraph 19A. Long lease interests in real estate are traded as capital assets and have an observable value that usually is sufficiently understandable for valuers to estimate reliably the value of similar assets. This value usually bears little resemblance to any notional split of value between 'land' and 'buildings' elements.

If the intention (of the proposed changes) was to more commonly allow the classification of the land as a finance lease, this may not be the case in practice. Firstly, even if the land element is classified as a finance lease, this does not necessarily mean that all entities will treat the land and buildings elements as a single asset. There may be occasions when the land element should be treated as having an economic life as long as the whole lease term, but the buildings should be depreciated over a shorter period. Secondly, even for 'long' leases valuers do not automatically assume that the buildings will be a finance lease, because the longevity of large 'trophy' building assets, the implications of laws to preserve certain buildings, and the lease requirements on repairs and alterations all might mean that the buildings will have an economic life extending beyond the lease term, even if this is 99 years or more. Thirdly, the classification will usually follow the requirements of the entity to reflect reality in financial statements. So if a central London lessor grants a 99 year lease on a property at a premium and a nominal ground rent (something which is common on the private estates where the lessor wishes to retain the integrity of their land holdings), they will seek to retain a saleable and appreciating asset (the fee simple) on the balance sheet, and therefore treat the lease as an operating lease.

In effect, the classification of the lease will be construed as far as possible to show what the reporting entity desires. In the above case both the lessor and lessee have assets because that is what accords with the reality of the situation, at least in valuation terms. For real estate valuers, all interests in land are simply bundles of use rights and the distinctions imposed by accounting standards between 'finance' and 'operating' leases, and even 'land' and 'buildings', are sometimes artificial.

In our opinion the proposed changes will not, therefore, improve the accounting treatment of leased real estate assets. Whilst the status quo is not ideal (for reasons which it is not within the scope of this response to discuss) it is understandable and workable. The proposed changes will introduce a further element of potential inconsistency in the application of IAS 17 without any material improvements in the underlying accounting treatment. This can only be achieved by a more radical overhaul of the treatment of real estate leased assets, which we suggest should be deferred until and included within the conclusions of the on-going Leases Project.

Question 12

Do you agree with the proposal that contingent rent relating to an operating lease should be recognised as incurred? If not, why?

We support these proposed amendments.

RESPONSE TO QUESTIONS ON IAS 40 – INVESTMENT PROPERTY

Question 35

The exposure draft proposes to include property under construction or development for future use as an investment property within the scope of IAS 40. Do you agree with the proposal? If not, why?

The RICS supports the changes to IAS40 (and the consequential change to paragraph 5 of IAS 16) to allow the consistent treatment of investment assets that are under construction, whether or not they have previously been categorised as investment property.

However, the RICS believe that further guidance is necessary to ensure a consistent approach to the fair value of such assets, and in particular an amendment may be required to paragraph 51 of IAS 40.

The problem is that the market value of an investment property with development potential does reflect the ability of the purchaser to enhance the investment by future capital expenditure and the related future benefits from this. It may, therefore, be appropriate to clarify the basis of valuation for assets in the course of construction by the addition of the following sentences to paragraph 51:

> **However, the fair value ascribed to the asset should reflect its value in exchange in its existing condition at the date of valuation. If knowledgeable willing parties would reflect, in an unconditional price offer for the asset, the potential of the asset to be enhanced by future expenditure, then this should be reflected in its fair value.**

Question 36

Do you agree with the proposal to conform terminology used in paragraph 31 of IAS 40 to the terminology used in IAS 8? If not, why?

We have no comment to make.

Question 37

Should paragraph 50(d) of IAS 40 be amended to clarify the accounting for investment property held under a lease? If not, why?

The RICS welcomes the amendment to paragraph 50(d) of IAS 40 as it is clear to us that that 'fair value' of a leasehold investment should be net of the associated lease liabilities, and therefore the 'carrying amount' (derived by adding back these lease liabilities) needs to be distinguished clearly.