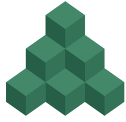

REPORT: Recognising energy efficiency in value properties: impact on financial accounting and auditing

Marco Koot
Vanhier

The REVALUE project has received funding from the European Union's Horizon 2020 research and innovation programme under grant agreement No 649705. The sole responsibility for the content lies with the authors. It does not necessarily reflect the opinion of the European Union. Neither the EASME nor the European Commission are responsible for any use that may be made of the information contained therein.

Executive Summary

The REVALUE project aims to lead the development of appraisal norms and standards that recognise energy efficiency (EE) value in social and private residential real estate.

The role of Vanhier in the project was to consult with the other team members, to provide feedback and input and more specifically to investigate the possible impact in the future on financial accounting and auditing standards in regard to the valuation of residential properties.

In this report, the aspects of financial accounting and auditing in regard to the valuation of properties are discussed. The accountant (also called auditor) will have to rely, to a large extent, on valuation reports from the valuers in regard to the value of the properties. If investments in EE lead to a higher value of the properties in the valuation reports of the valuers, the following matters are important for the accountant:

- does the higher value in the reports of the valuers also lead to a higher value in the annual accounts according to the current accounting standards?
- what (additional) audit activities should the auditor perform in regard to the (higher) value of the properties?

Especially in the future, investments in EE can potentially have an (positive) impact on the value of properties or a lack of investments can have a negative effect on the value (brown discount). Accountants must be aware of this development.

In our opinion, there is no problem, on the basis of the current accounting standards, to include a potentially higher value of the properties due to investments in EE in the annual accounts. Changes in the value of the properties as a result of investments in EE can be included in the annual accounts if it meets the definition of an element and satisfies the following criteria for recognition: "it is probable that any future economic benefit associated with the item will flow to or from the entity and the item's cost or value can be measured with reliability". If the valuation reports of the valuers show that these conditions are met, the higher value can be included in the annual accounts. Hence, there is no need to adjust the current accounting standards regarding this topic.

In principle, the auditor does not have to perform additional or other audit procedures in regard to the potential higher value of the buildings as a result of investments in EE. However, the auditor must be aware that valuers could deal with this topic differently, which may depend on their expertise in this area. The accountant will have to pay special attention to the experience and knowledge of the valuer in this area (in accordance with ISA 500 paragraph 8a) and the terms of the assignment for valuation.

It is especially important that the auditor understands the outcomes of the valuations. In order to be able to assess this properly (in accordance with ISA 500 paragraph 8b), they could decide to include a property specialist (valuer) in the audit team more often.

It is essential that the audit team (preferably supported by a property specialist) should discuss the approach, terms of engagement and the results of the valuations with the valuer. This prevents the valuation process from becoming a black box for the accountant.

REVALUE

vanhier
accountants | advisors

Table of Contents

Executive Summary 2
Chapter 1. Introduction 4
Chapter 2. Financial Accounting 5
2.1 General 5
2.2 Conceptual Framework 5
2.3 IAS 40 7
Fair value model 7
2.4 IFRS 13 8
Fair value hierarchy 8
2.5 Conclusions 10
Chapter 3. Auditing 12
3.1 General 12
History 13
3.2 ISA 500 13
3.3 Practices 17
3.4 Conclusions 17

Chapter 1. Introduction

Vanhier is participating in a project which is co-funded by the EU. The REVALUE project aims to lead the development of appraisal norms and standards that recognise energy efficiency (EE) value in social and private residential real estate.

For this project, Vanhier worked together with Savills, RICS, Maastricht University, Luwoge Consult and Bax & Company. The role of Vanhier in the project was to consult with the other team members, to provide feedback and input and more specifically to investigate the possible impact in the future on financial accounting and auditing standards in regard to the valuation of residential properties.

In this report, we will discuss the aspects of financial accounting and auditing in regard to the valuation of properties. The accountant (also called auditor) will have to rely, to a large extent, on valuation reports from the valuers in regard to the value of the properties. If investments in EE lead to a higher value of the properties in the valuation reports of the valuers, the following matters are important for the accountant:

- does the higher value in the reports of the valuers also lead to a higher value in the annual accounts according to the current accounting standards?
- what (additional) audit activities should the auditor perform in regard to the (higher) value of the properties?

In the second chapter, we describe the theoretical frame work for financial accounting. IFRS is used as the basis for this. Subsequently, we indicate whether possible changes in the value of the properties as a result of investments in EE can be included in the annual accounts on the basis of the current accounting standards.

Chapter 3 explains which standards apply for the audit of accountants in regard to valuation reports. Furthermore, the activities which the auditors perform in practice are described. The chapter concludes with a description whether the auditor should perform (additional/other) audit activities in regard to the potential higher value of the buildings as a result of investments in EE.

The report concludes with recommendations, presented in chapter 4.

Chapter 2. Financial Accounting

2.1 General

For the valuation according to accounting standards, we examined IFRS on this subject. IFRS (International Financial Reporting Standards) is the collection of financial reporting standards developed by the International Accounting Standards Board (IASB). Standards that were issued by IASC (the predecessor of IASB) are still within use today and go by the name International Accounting Standards (IAS), while standards issued by IASB are called IFRS. IAS were issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC). On 1 April 2001, the new International Accounting Standards Board (IASB) took over from the IASC the responsibility for setting International Accounting Standards. During its first meeting, the new Board adopted existing IAS and Standing Interpretations Committee standards (SICs). The IASB has continued to develop standards calling the new standards "International Financial Reporting Standards".

The purpose of IFRS is to provide a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements. IFRS standards have been implemented or permitted in almost 100 countries worldwide. Listed companies, and sometimes unlisted companies, are required to use the standards in their financial statements in those countries which have adopted them. The EU regulation 1606/2002 on the application of these standards made this a requirement for listed companies in the European Union.

Within IFRS, the most relevant standards with respect to the valuation of residential real estate are the conceptual framework, IAS 40 and IFRS 13.

2.2 Conceptual Framework

The IFRS Framework describes the basic concepts that underlie the preparation and presentation of financial statements for external users. The IFRS Framework serves as a guide to the Board in developing future IFRSs and as a guide to resolving accounting issues that are not addressed directly in an International Accounting Standard or International Financial Reporting Standard or Interpretation.
In the absence of a Standard or an Interpretation that specifically applies to a transaction, management must use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable. In making that judgement, IFRS requires management to consider the definitions, recognition criteria, and measurement concepts for assets, liabilities, income, and expenses in the IFRS Framework.

In the conceptual framework definitions are given of assets, liabilities, equity, income and expenses (these are all considered to be "elements" within IFRS). The definitions of these elements are described below:

- Asset. An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
- Liability. A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

- Equity. Equity is the residual interest in the assets of the entity after deducting all its liabilities.
- Income. Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.
- Expense. Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the following criteria for recognition:

- It is probable that any future economic benefit associated with the item will flow to or from the entity; and
- The item's cost or value can be measured with reliability.

Based on these general criteria:

- An asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.
- A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably.
- Income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).
- Expenses are recognised when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets (for example, the accrual of employee entitlements or the depreciation of equipment).

The IFRS Framework acknowledges that a variety of measurement bases are used today to different degrees and in varying combinations in financial statements, including:

- Historical cost
- Current cost
- Net realisable (settlement) value
- Present value (discounted)

2.3 IAS 40

IAS 40 Investment Property applies to the accounting for property (land and/or buildings) held to earn rentals or for capital appreciation (or both). Investment properties are initially measured at cost and, with some exceptions, may be subsequently measured using a cost model or fair value model, with changes in the fair value under the fair value model being recognised in profit or loss.

Investment property should be recognised as an asset when it is probable that the future economic benefits that are associated with the property will flow to the entity, and the cost of the property can be reliably measured.

Investment property is initially measured at cost, including transaction costs. Such cost should not include start-up costs, abnormal waste, or initial operating losses incurred before the investment property achieves the planned level of occupancy.

IAS 40 permits entities to choose for measurement subsequent to initial recognition between:

- a fair value model, and
- a cost model.

One method must be adopted for all of an entity's investment property.

Fair value model

Investment property is measured at fair value, which is the amount for which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction. Gains or losses arising from changes in the fair value of investment property must be included in net profit or loss for the period in which it arises.
Fair value should reflect the actual market state and circumstances as of the balance sheet date. The best evidence of fair value is normally given by current prices on an active market for similar property in the same location and condition and subject to similar lease and other contracts. In the absence of such information, the entity may consider current prices for properties of a different nature or subject to different conditions, recent prices on less active markets with adjustments to reflect changes in economic conditions, and discounted cash flow projections based on reliable estimates of future cash flows.

There is a rebuttable presumption that the entity will be able to determine the fair value of an investment property reliably on a continuing basis. However:

- If an entity determines that the fair value of an investment property under construction is not reliably determinable but expects the fair value of the property to be reliably determinable when construction is complete, it measures that investment property under construction at cost until either its fair value becomes reliably determinable or construction is completed.
- If an entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably determinable on a continuing basis, the entity shall measure that investment property using the cost model in IAS 16. The residual value of the investment property shall be assumed to be zero. The entity shall apply IAS 16 until disposal of the investment property.

Where a property has previously been measured at fair value, it should continue to be measured at fair value until disposal, even if comparable market transactions become less frequent or market prices become less readily available.

2.4 IFRS 13

IFRS 13 Fair Value Measurement applies to IFRSs that require or permit fair value measurements or disclosures and provides a single IFRS framework for measuring fair value and requires disclosures about fair value measurement. The Standard defines fair value on the basis of an 'exit price' notion and uses a 'fair value hierarchy', which results in a market-based, rather than entity-specific, measurement.

IFRS 13 defines fair value as: the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Fair value hierarchy

IFRS 13 seeks to increase consistency and comparability in fair value measurements and related disclosures through a 'fair value hierarchy'. The hierarchy categorises the inputs used in valuation techniques into three levels. The hierarchy gives the highest priority to (unadjusted) quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

If the inputs used to measure fair value are categorised into different levels of the fair value hierarchy, the fair value measurement is categorised in its entirety in the level of the lowest level input that is significant to the entire measurement (based on the application of judgement).

Figure 1. An overview of the IFRS 13 - Fair Value Hierarchy

Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the

entity can access at the measurement date. A quoted market price in an active market provides the most reliable evidence of fair value and is used without adjustment to measure fair value whenever available, with limited exceptions. If an entity holds a position in a single asset or liability and the asset or liability is traded in an active market, the fair value of the asset or liability is measured within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held by the entity, even if the market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Level 2 inputs are inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
Level 2 inputs include:

- quoted prices for similar assets or liabilities in active markets
- quoted prices for identical or similar assets or liabilities in markets that are not active
- inputs other than quoted prices that are observable for the asset or liability, for example
    - interest rates and yield curves observable at commonly quoted intervals
    - implied volatilities
    - credit spreads
- input that is derived principally from or corroborated by observable market data by correlation or other means ('market-corroborated inputs').

Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs are used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. An entity develops unobservable inputs using the best information available in the circumstances, which might include the entity's own data, taking into account all information about market participant assumptions that is reasonably available.

The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. A fair value measurement requires an entity to determine all of the following:

- the particular asset or liability that is the subject of the measurement (consistently with its unit of account);
- for a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use);
- the principal (or most advantageous) market for the asset or liability;
- the valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.

IFRS 13 provides the guidance on the measurement of fair value, including the following:

- An entity takes into account the characteristics of the asset or liability being measured that a market participant would take into account when pricing the asset or liability at measurement date (e.g. the condition and location of the

asset and any restrictions on the sale and use of the asset);
- Fair value measurement assumes an orderly transaction between market participants at the measurement date under current market conditions;
- Fair value measurement assumes a transaction taking place in the principal market for the asset or liability, or in the absence of a principal market, the most advantageous market for the asset or liability;
- A fair value measurement of a non-financial asset takes into account its highest and best use;
- A fair value measurement of a financial or non-financial liability or an entity's own equity instruments assumes it is transferred to a market participant at the measurement date, without settlement, extinguishment, or cancellation at the measurement date;
- The fair value of a liability reflects non-performance risk (the risk the entity will not fulfil an obligation), including an entity's own credit risk and assuming the same non-performance risk before and after the transfer of the liability;
- An optional exception applies for certain financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk, provided conditions are met (additional disclosure is required).

An entity uses valuation techniques appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants and the measurement date under current market conditions. Three widely used valuation techniques are:
- market approach – uses prices and other relevant information generated by market transactions involving identical or comparable (similar) assets, liabilities, or a group of assets and liabilities (e.g. a business)
- cost approach – reflects the amount that would be required currently to replace the service capacity of an asset (current replacement cost)
- income approach – converts future amounts (cash flows or income and expenses) to a single current (discounted) amount, reflecting current market expectations about those future amounts.

In some cases, a single valuation technique will be appropriate, whereas in others multiple valuation techniques will be appropriate.

2.5 Conclusions

To indicate whether possible changes in the value of the properties as a result of investments in EE can be included in the annual accounts on the basis of the current accounting standards, we examined IFRS. IFRS standards have been implemented or permitted in almost 100 countries worldwide and are a requirement for listed companies in the European Union. Within IFRS the most relevant standards with respect to the valuation of residential real estate are the conceptual framework, IAS 40 and IFRS 13.

Within IFRS the valuation of EE is not specifically addressed. Therefore, the general condition for recognition applies to this. Changes in the value of the properties as a result of investments in EE can be included in the annual accounts if it meets the definition of an element and satisfies the following criteria for recognition: "it is probable that any future economic benefit associated with the item will flow to or from the entity and the item's cost or value can be measured with reliability". If the valuation reports of the valuers show that these conditions are met, the higher value can be included in the annual accounts. Hence, there is no need to adjust the current accounting standards regarding this topic.

Chapter 3. Auditing

3.1 General

Practically every member of the EU has chosen to apply International Standards on Auditing (ISAs) for all audits. We therefore examined the ISAs for the guidelines in regard to the audit of the valuation reports of valuers. ISAs are professional standards for the performance of the audit of financial information. These standards are issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB).

The International Auditing and Assurance Standards Board (IAASB) is an independent standard-setting body that serves the public interest by setting high-quality international standards for auditing, quality control, review, other assurance, and related services, and by facilitating the convergence of international and national standards. In doing so, the IAASB enhances the quality and uniformity of practice throughout the world and strengthens public confidence in the global auditing and assurance profession.

The IAASB's Strategy for 2015-2019 and the IAASB Work Plan for 2015-2016 set the direction and priorities for its activities. The IAASB's efforts are focused on development, adoption and implementation of international standards addressing audit, quality control, review, other assurance, and related services engagements.

The IAASB's medium-term strategy addresses the following three main themes in the public interest:

- Supporting global financial stability;
- Enhancing the role, relevance and quality of assurance and related services in an evolving world; and
- Facilitating adoption and implementation of the standards.

The IAASB follows a rigorous due process in developing its pronouncements. Input is obtained from a wide range of stakeholders including the IAASB's Consultative Advisory Group national auditing standard setters, IFAC member bodies and their members, regulatory and oversight bodies, firms, governmental agencies, investors, preparers, and the general public. Exposure Drafts of proposed pronouncements are posted on the website and comments are invited; final pronouncements are accompanied by a Basis for Conclusions with respect to comments received. The Public Interest Oversight Board (PIOB) oversees the work of the IAASB and its CAG to ensure that the activities of the IAASB follow due process and are responsive to the public interest.

The IAASB is dedicated to operating as transparently as possible. IAASB meetings are open to the public and meeting agendas, agenda papers, and meeting highlights are posted on the website. In addition, the website includes project histories, audio recordings of the IAASB meetings, IAASB Exposure Drafts and all comments made on those drafts by stakeholders.

History

The International Auditing and Assurance Standards Board (IAASB) was founded in March 1978. It was previously known as the International Auditing Practices Committee (IAPC).

The IAPC's initial work focused on three areas: object and scope of audits of financial statements, engagement letters, and general auditing guidelines. In 1991, the IAPC's guidelines were recodified as International Standards on Auditing (ISAs).

In 2001, a comprehensive review of the IAPC was undertaken, and in 2002, the IAPC was reconstituted as the International Auditing and Assurance Standards Board (IAASB). In 2003, IFAC approved a series of reforms designed, among other things, to further strengthen its standard-setting processes, including those of the IAASB, so that they are responsive to the public interest.

In 2004, the IAASB began the Clarity Project, a comprehensive program to enhance the clarity of its ISAs. This program involved the application of new conventions to all ISAs, either as part of a substantive revision or through a limited redrafting to reflect the new conventions and matters of clarity generally.

In principle, within the ISAs the standard ISA 500 apply for the audit of accountants in regard to valuation reports and then specifically paragraph 8 of ISA 500.

3.2 ISA 500

A valuer is not explicitly mentioned in ISA 500. However, in this standard a management expert is mentioned. A valuer is considered to be a management expert.

In paragraph 8 of ISA 500 the following is indicated:
If information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

a) Evaluate the competence, capabilities and objectivity of that expert;
b) Obtain an understanding of the work of that expert; and
c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

In paragraph A34-A36, an explanation is included if paragraph 8 applies.

Paragraph A34 provides the following explanation. The preparation of an entity's financial statements may require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. The entity may employ or engage experts in these fields to obtain the needed expertise to prepare the financial statements. Failure to do so when such expertise is necessary increases the risks of material misstatement.

Paragraph A35 gives the following instructions. When information to be used as audit evidence has been prepared using the work of a management's expert, the requirement in paragraph 8 of ISA 500 applies. For example, an individual or organization may possess

expertise in the application of models to estimate the fair value of securities for which there is no observable market. If the individual or organization applies that expertise in making an estimate which the entity uses in preparing its financial statements, the individual or organization is a management's expert and paragraph 8 applies. If, on the other hand, that individual or organization merely provides price data regarding private transactions not otherwise available to the entity which the entity uses in its own estimation methods, such information, if used as audit evidence, is subject to paragraph 7 of this ISA, but is not the use of a management's expert by the entity.

Finally, in paragraph A36 the following is indicated. The nature, timing and extent of audit procedures in relation to the requirement in paragraph 8 of this ISA, may be affected by such matters as:

- The nature and complexity of the matter to which the management's expert relates
- The risks of material misstatement in the matter
- The availability of alternative sources of audit evidence
- The nature, scope and objectives of the management's expert's work
- Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services

The extent to which management can exercise control or influence over the work of the management's expert depends on:

- Whether the management's expert is subject to technical performance standards or other professional or industry requirements
- The nature and extent of any controls within the entity over the management's expert's work
- The auditor's knowledge and experience of the management's expert's field of expertise
- The auditor's previous experience of the work of that expert

With regards to the competence, capabilities and objectivity of a management's expert (reference paragraph 8a) paragraphs A37-A43 provide further instructions.

Paragraph A37 provides the following explanation. Competence relates to the nature and level of expertise of the management's expert. Capability relates the ability of the management's expert to exercise that competence in the circumstances. Factors that influence capability may include, for example, geographic location, and the availability of time and resources. Objectivity relates to the possible effects that bias, conflict of interest or the influence of others may have on the professional or business judgment of the management's expert. The competence, capabilities and objectivity of a management's expert, and any controls within the entity over that expert's work, are important factors in relation to the reliability of any information produced by a management's expert.

The following directions are given in paragraph A38. Information regarding the competence, capabilities and objectivity of a management's expert may come from a variety of sources, such as:

- Personal experience with previous work of that expert
- Discussions with that expert
- Discussions with others who are familiar with that expert's work

- Knowledge of that expert's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that expert
- An auditor's expert, if any, who assists the auditor in obtaining sufficient appropriate audit evidence with respect to information produced by the management's expert

Paragraph A39 provides the following instructions. Matters relevant to evaluating the competence, capabilities and objectivity of a management's expert include whether that expert's work is subject to technical performance standards or other professional or industry requirements, for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation.

According to paragraph A40, other matters that may be relevant include:

- The relevance of the management's expert's competence to the matter for which that expert's work will be used, including any areas of specialty within that expert's field. For example, a particular actuary may specialize in property and casualty insurance, but have limited expertise regarding pension calculations
- The management's expert's competence with respect to relevant accounting requirements, for example, knowledge of assumptions and methods, including models where applicable, that are consistent with the applicable financial reporting framework
- Whether unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures indicate that it may be necessary to reconsider the initial evaluation of the competence, capabilities and objectivity of the management's expert as the audit progresses

The following information is given in paragraph A41. A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats and intimidation threats. Safeguards may reduce such threats and may be created either by external structures (for example, the management's expert's profession, legislation or regulation), or by the management's expert's work environment (for example, quality control policies and procedures).

Paragraph A42 provides the following explanation. Although safeguards cannot eliminate all threats to a management's expert's objectivity, threats such as intimidation threats may be of less significance to an expert engaged by the entity than to an expert employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, an expert employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity.

In paragraph A43 the following information is provided. When evaluating the objectivity of an expert engaged by the entity, it may be relevant to discuss with management and that expert any interests and relationships that may create threats to the expert's objectivity, and any applicable safeguards, including any professional requirements that apply to the expert; and to evaluate whether the safeguards are adequate. Interests and relationships creating threats may include:

- Financial interests

- Business and personal relationships
- Provision of other services

The paragraphs A44-A47 provides further directions in regard to the topic obtaining an understanding of the work of the management's expert (reference paragraph 8b).

In paragraph A44 the following information is given. An understanding of the work of the management's expert includes an understanding of the relevant field of expertise. An understanding of the relevant field of expertise may be obtained in conjunction with the auditor's determination of whether the auditor has the expertise to evaluate the work of the management's expert, or whether the auditor needs an auditor's expert for this purpose (in this case ISA 620 "Using the Work of an Auditor's Expert" applies).

According to paragraph A45 aspects of the management's expert's field relevant to the auditor's understanding may include:
- Whether that expert's field has areas of specialty within it that are relevant to the audit.
- Whether any professional or other standards, and regulatory or legal requirements apply.
- What assumptions and methods are used by the management's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes.
- The nature of internal and external data or information the management's expert uses.

Paragraph A46 provides the following instructions. In the case of a management's expert engaged by the entity, there will ordinarily be an engagement letter or other written form of agreement between the entity and that expert. Evaluating that agreement when obtaining an understanding of the work of the management's expert may assist the auditor in determining the appropriateness of the following for the auditor's purposes:
- The nature, scope and objectives of that expert's work;
- The respective roles and responsibilities of management and that expert; and
- The nature, timing and extent of communication between management and that expert, including the form of any report to be provided by that expert.

According to paragraph A47, it is less likely there will be a written agreement by the entity in the case of a management's expert employed by the entity. Inquiry of the expert and other members of management may be the most appropriate way for the auditor to obtain the necessary understanding.

With regards to evaluating the appropriateness of the management's expert's work (reference paragraph 8c) paragraph A48 provides a further explanation.
According to this paragraph, considerations when evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion may include:
- The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;
- If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and

- If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

3.3 Practices

In order to find out how accountants in practice perform the audit of the valuation reports, we have had contact / interviews with 2 accountants, which are specialised and have a lot of experience in regard to the audit of valuation reports. These accountants are working for 2 of the big 4 accounting firms.

Both accountants confirmed that they apply standard ISA 500 paragraph 8 when performing an audit on the valuation of the properties, due to the fact that the valuation reports of the valuers ("management's experts") are used as audit evidence.

The audit activities regarding the valuation reports of the valuers mainly consists of:

- assessing the competence, capabilities and objectivity of the appraisers, among other things by;
    - verifying if the valuer is a member of a professional organization
    - evaluate the experiences from the past with this valuer
    - examining if the valuer is known as acknowledged and experienced
- often prior discussion with the valuer about the approach, type of assignment and peculiarities
- often afterwards discussion with the valuer about the results of the valuation; also, outcomes of specific premises are discussed
- verifying the accuracy and completeness of the input of the valuations
- examine the arithmetical accuracy of the calculations
- check on output: are the outcomes logical and understandable?
- use of data analysis
- comparison with outcomes previous years
- comparison with external market data

Further, at one of the big four accounting firms a property specialist (valuer) is part of the audit team and this specialist assesses a number of valuations in detail.

3.4 Conclusions

Due to the fact that practically every member of the EU has chosen to apply International Standards on Auditing (ISAs) for all audits, we examined the ISAs for the guidelines in regard to the audit of the valuation reports of valuers. ISAs are professional standards for the performance of the audit of financial information. These standards are issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB).

Within the ISAs, the standard ISA 500 apply for the audit of accountants in regard to valuation reports and then specifically paragraph 8 of ISA 500.
In this paragraph it is indicated that, in case that information which has been prepared using the work of a valuer ("management's expert") is to be used as audit evidence, the auditor shall:

a) Evaluate the competence, capabilities and objectivity of that expert;

b) Obtain an understanding of the work of that expert; and
c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

Contact / interviews with several accountants have shown that standard ISA 500 paragraph 8 is applied when performing an audit on the valuation of the properties.

The audit activities regarding the valuation reports of the valuers mainly consists of:

- assessing the competence, capabilities and objectivity of the valuers, among other things by;
  - verifying if the valuer is a member of a professional body
  - evaluate the experiences from the past with this valuer
  - examining if the valuer is known as acknowledged and experienced
- often prior discussion with the valuer about the approach, type of assignment and peculiarities
- often afterwards discussion with the valuer about the results of the valuation; also outcomes of specific premises are discussed
- verifying the accuracy and completeness of the input of the valuations
- examine the arithmetical accuracy of the calculations
- check on the output of the valuations: are the outcomes logical and understandable?
- use of data analysis
- comparison with outcomes previous years
- comparison with external market data

Further, at one of the big 4 accounting firms, a property specialist is part of the audit team and this specialist assesses a number of valuations in detail.

Does a potential higher value of the properties as a result of investments in EE, taken into account the relevant audit standards, lead to additional or other audit activities?
In principle, this does not have to lead to additional or other audit procedures. However, the auditor must be aware that these investments may have an impact on the value of the properties or that not investing can have a negative effect on the value (especially in the future). Further the accountant must be aware that valuers could deal with this topic differently, which may depend on their expertise in this area. The accountant will have to pay special attention to the experience and knowledge of the valuer in this area (in accordance with ISA 500 paragraph 8a) and the terms of the assignment for valuation.

It is especially important that the auditor understands the outcomes of the valuations. In order to be able to assess this properly (in accordance with ISA 500 paragraph 8b), they could decide to include a property specialist (valuer) in the audit team more often.