

SOCIETY OF CHARTERED SURVEYORS

Explanatory Memorandum – The RICS Valuation Standards (6th Edition)

1.0 Introduction

The purpose of this paper is to assist members in becoming more aware of the requirements of the Red Book (6th Edition) and the obligations it places on individuals involved in carrying out valuation work. Compliance with the Red Book is mandatory for all members and firms and as stated in the Red Book valuations are subject to monitoring by the RICS. This document should be read in conjunction with The Red Book and we would further recommend members refer to a book written by Andrew Cherry – “A Valuer’s Guide to the RICS Red Book 2010” for additional explanation and guidance. This is available from RICS books (www.ricsbooks.com)

This explanatory memorandum is not a guidance note or National Practice Statement.

The SCS will provide further information papers on future Red Book updates for members.

2.0 Background

The 5th edition of the RICS Appraisal and Valuation Standards was published in May 2003. Due to the primarily global application and revised format adopted in that version, the Society of Chartered Surveyors considered that the production of an Irish Edition was unnecessary. Instead it was decided to amend the relevant UK sections within it in order to have an Irish equivalent. This had the status of a National Practice Statement as defined in the standards. Since then various updates have been issued and although the structure and general content of the standards has stood the test of time a number of matters arose that led the RICS Valuation Standards Board to commission a review. That review has been completed and the RICS Valuation Standards 6th Edition is the result. The Society still considers it would unnecessarily duplicate the majority of the 6th edition if it were to publish an Irish Edition.

This explanatory memorandum highlights the main changes between the 5th and 6th editions for members and should be read in conjunction with the Red Book. Compliance with the 6th Edition is mandatory for all members and firms and became effective from 1 January 2008. It applies to all valuation reports issued on or after that date.

Various matters were considered by the review board and these include:

- The 5th Edition had extensive references to the RICS Rules of Conduct. Although the new Rules of Conduct have been considerably reduced in length, the provisions of the current standards that relate to professional conduct are still relevant. The new edition contains the same professional requirements but these are now presented as guidance to the application of the Rules of Conduct within the valuation process. While the Society retains its own rules/codes of conduct, they essentially mirror the spirit of the RICS rules and hence it is still applicable here in Ireland.
- Feedback from the Monitoring process, and road shows, identified some doubts about the application of the Valuation Standards in some circumstances. The current Red Book deals with status, application and departures in the Introduction and it may not have been clear that those matters apply to all valuations. To clarify the position three new standards have been introduced covering these points.
- The full title of the Red Book has been changed to ‘RICS Valuation Standards’.
- The division of the Red Book into Parts and Chapters was seen to be an unnecessary complication and caused confusion in page numbering. The new edition does not have these divisions.
- The format has also been changed. The new Red Book is smaller in size and spiral bound rather than loose leaf. Future updates may be either by issuing a supplement or by re-issuing the whole book. This change will provide cost savings that are expected to be reflected in the subscription.
- A number of changes have been made to the appearance of the text. Defined terms are in italic font and quotations from other sources appear in shaded boxes.

- Various revisions of the text have been made, but, so far as possible, the numbering of the individual standards has been left the same.
- The links with International Valuation Standards (IVS) have been reinforced. RICS adopts IVS and although they are presented in a different way, because of the regulatory role of RICS, the principles, objectives and defined terms are identical and compliance with the Red Book will also be compliant with IVS.

The Sixth Edition is arranged as follows:

- Introduction
- Practice Statements (1 to 6)
- Guidance Notes (1 to 5)
- UK Practice Statements (1 to 5)
- UK Guidance Notes (1 to 5)

3.0 Changes between the fifth and sixth editions

In addition to the changes in the format of the Red Book, the following changes have been made to the Standards.

Introduction

The Introduction has been reduced by removing the comments on the application, exceptions and departures to Practice Statement 1 (PS1).

The relationship between the RICS Standards and other Standards (e.g., National/Regional standards that may apply) has been clarified to confirm that even where other Standards are adopted the valuer is still required to have regard to the Red Book Standards, with appropriate disclosures.

March 2009 amendment – The March 2009 amendment extended the mandatory remit of the Red Book to apply to all valuations prepared by firms registered for regulation by RICS, not just to individual members. Therefore, compliance with the Red Book is mandatory for both members as well as firms registered for regulation by RICS. This is a global requirement and, therefore, applies to members and registered firms in whatever state they operate.

PS 1 – COMPLIANCE AND ETHICAL REQUIREMENTS

This section contains much of the material that was originally included in the Introduction but it was not previously clear that it had mandatory application. To remove any such doubt the material has been rewritten as Standards and has mandatory application.

PS 1.7 Additional criteria for independence

This is a new Standard that replaces *PS 2.2 Independent Valuer*. Although the fifth Edition included a definition of 'Independent Valuer' it was clear that for many purposes there were other criteria (not detailed) that the valuer must meet in order to achieve a defined state of independence. In the sixth Edition the definition has been removed and this PS recognises in more general terms that specific criteria may have to be met to achieve Independent valuer status.

Appendix 1.1

This Appendix has been revised following the introduction of the new RICS Rules of Conduct in June 2007. Apart from removing the references to the previous Rules of Conduct, and associated clarification, the guidance remains unchanged.

March 2009 amendment – In this amendment changes were made to PS1.1 "Compliance with these Standards" – so that it is clear that the standards apply to firms registered for regulation by RICS worldwide as well as members worldwide. It should be noted that the RICS Valuation Standards have been written as they apply to a member. Therefore, where it is necessary to consider the application of a standard to a firm registered for regulation by RICS, the standards need to be interpreted accordingly.

July 2009 amendment – This was concerned with the removal of the exception for antiques and fine arts.

PS 2 - AGREEMENT OF TERMS OF ENGAGEMENT

The list of minimum terms in PS 2.1 has been amended. The previous requirement for 'disclosure of previous involvement and valuer status' has been separated into two parts:

h) Disclosure of any previous involvement, or a statement that there has not been any previous involvement.

This item has been extended to require the valuer to make a positive statement that there has been no previous involvement (if that is the case).

i) If required, a statement of the status of the valuer.

This item is unchanged.

A new requirement is:

t) A statement that the valuation may be subject to monitoring under the institutions conduct and disciplinary regulations.

The table in Appendix 2.1 has been revised to match the new list of terms.

March 2009 amendment - There is a new PS2.1(q) – RICS realise that although the various requirements of PS1 "Compliance and Ethical Requirements" are incorporated into the minimum terms of engagement referred to in PS2.1, there was no requirement to make a comment about the knowledge and skills of the member as set out in PS1.5. Accordingly, the list of minimum terms has been extended to include a requirement to make a statement that the member has the appropriate knowledge, skills and understanding to undertake the valuation competently. (Please note that the new Red Book includes a typo and the word "competently" reads incorrectly as "completely".)

July 2009 amendment – Includes clarification that the terms of engagement requires a reference to the firm's complaint handling procedure, but not a requirement to include a copy of this procedure.

This amendment also provides clarification that the RICS monitoring is of "compliance with these standards" and not monitoring of the opinion of value.

PS 3 - BASIS OF VALUE

The changes to this PS are as a consequence of changes in the 8th Edition of IVS published August 2007.

PS 3.1 Basis of value has been rewritten to clarify the distinction between a core basis and any accompanying assumptions and to reinforce the requirement for an appropriate basis of valuation to be adopted in any valuation.

The commentary to **PS 3.2 - Market Value** has been revised and extended to clarify the difference between "special value" and "hope value".

PS 3.4 Worth and Investment Value is a new statement based on what was PS 5.13 in the fifth Edition but it has been located here as it relates to basis of value.

PS 3.5 Fair Value is a new standard and provides a definition of Fair Value (IVSC, IVS 2, para. 3.2).

PS 4 - APPLICATIONS

This is a new section that separates applications from basis of value. It contains, unchanged, the text of PS 3.5 to 3.7 and Appendix 3.3 from the fifth edition.

A new **PS 4.3 Valuations for Public Sector Assets for Financial Reporting** provides that valuations for this purpose shall be in accordance with IVSC International Valuation Application 3.

March 2009 amendment

A new Appendix 4.4 was added which contains new requirements for valuations for Commercial Secured Lending. It is important to note that the old Secured Lending protocol, UK PS3.1 and Appendix 3.1 have been replaced by this new global Appendix 4.4, which applies to members and firms regulated by RICS across the world.

Appendix 4.4 should be read in full and considered carefully by those Members undertaking Secured Lending.

The new Appendix provides more information on the identification and handling of conflicts of interest when providing valuations for Commercial Secured Lending.

In all cases, any previous, current or anticipated involvement with the prospective borrower or the property to be valued must be disclosed to the lender. Appendix 4.4 then goes on to include examples of such involvement which need to be disclosed. (See 3.5 of Appendix 4.4).

Appendix 4.4 further states that when considering if any anticipated, current or recent involvement is sufficient to create a conflict with a member's duty to be independent and objective, then matters such as the quantum of any financial interest in a connected party, the scope for the member or firm to materially benefit from a particular valuation outcome and the level of fees earned from any connected party as a proportion of total fee income may all be material. In the event that a member considers any involvement creates a conflict with their duty to the potential client that cannot be avoided, the instruction should be declined.

However, if the member and client agree that any potential conflict can be avoided by introducing arrangements for managing the instruction, that arrangement must be recorded in writing and included in the terms of engagement and referred to in the report.

Whereas a member may take into account the views of a prospective client in deciding whether involvement creates a conflict, it still remains the member's professional responsibility, to decide, whether or not to accept the instruction having regard to the principals of the Rules of Conduct.

PS 5 - INVESTIGATIONS

PS 5.1 Inspections and investigations, is based on the fifth edition PS 4.1. This Standard has been revised to confirm that the extent of inspection and investigation has to be agreed within the terms of engagement.

PS 6 - VALUATION REPORTS

PS 6.1 Minimum Content of Valuation Reports, and the associated appendix, has been amended in line with PS 2.1.

PS 6.3 Reporting the Basis of Value is a new standard that explicitly requires the valuer to state the basis of valuation and also make a comment if that value differs from Market Value. It is not necessary to provide the Market Value.

March 2009 amendment - There is a new PS6.1(r), which requires a valuation report to include a statement that the valuer has the knowledge, skills and understanding to undertake the valuation competently. This is consistent with the statement that now needs to be made in the Terms of Engagement.

4.0 GUIDANCE NOTES

GN 1 Trade related valuations has been rewritten to clarify the type of valuation to which it applies and provide some information on apportionments of transaction prices into their various elements.

GN 2 Plant and Equipment. The introduction has been revised to accord with IVSC GN 3 but otherwise there is no change.

There are no changes to the remaining Guidance notes.

5.0 UK Practice Statement (These are not obligatory, but are considered to be best practice).

UKPS 1 – Valuations for Financial Statements

UKPS 1.1 The bases of valuation has been extended to provide information about Statements of Recommended Practice (SORPs) which give certain sectors additional information to assist the application of the UK accounting standards to those sectors. An additional paragraph has been included to give a reference to an example of a draft statement where the valuation will be referred to in a publication. This draft statement is UK Appendix 1.6 and it repeats the example originally included in PS 5.11 but amended to reflect UK practice.

UK Appendix 1.2 has had paragraph 3.8 *Land and buildings in course of development*, rewritten (and subsequently re-written again in the September 2008 Amendment) to simplify it and confirm that if a valuation is required the approach to Market Value must be stated in the report.

UKPS 1.15 Central Government Asset Valuations is a new UKPS that was added in the September 2008 Amendment. It is not applicable in Ireland.

The Accounting Principles and Standards adopted by the Institute of Chartered Accountants in Ireland are similar to those adopted by UK accounting bodies in respect of valuations for Financial Statements; therefore UKPS1 should generally be followed.

March 2009 amendment

Revision of UK Appendix 1.1 – the Accounting Standards Board issued revised guidance in 2008 on the accounting standards to be adopted by small companies (FRSSE). A significant change to the valuation rules is that the basis of valuation shall be Market Value but the company may elect to value on the basis of current value (EUV). This is a reversal of the position previously noted in paragraph 4 of UK Appendix 1.

UKPS 2 – Valuations for Financial Statements – specific applications

The original **UKPS 2.5 Pension Schemes**, and **Appendix 2.4** in the fifth edition has been deleted following the revision of the SORP which does not add any further requirements to UKPS 1.1

The IRL Chapter 2 of the fifth edition still applies as the remainder of UKPS2 remains unchanged.

March 2009 amendment

Revision of **UK PS2.3** and **UK Appendix 2.3 – Collective Investment Schemes**. The Financial Services Authority has revised the valuation rules for collective investment schemes so they now refer to the Red Book (or IVS if relevant to where the property is outside the UK). The effect of this change is that previous reservation in the Red Book relating to “Open Market Value” is no longer relevant because the basis of value is Market Value. The Appendix has been revised to incorporate quotes from the FSA Handbook rather than paraphrasing their requirements, but there are no changes to any of the detailed requirements.

UKPS 3 – Valuations for loan facilities

This PS has not been amended but a small change has been made to **Appendix 3.2** to include the comment on HIPS, in paragraph 6.3.1, which was published in July 2007 (*not applicable in Ireland*).

UKPS 3.1 Commercial Secured Lending is not applicable in Ireland as it refers to the protocol agreed between RICS and the British Bankers Association. *However, the Society believes that the approach represents best practice and should be followed by Irish Valuers.*

UKPS 3.2 and **UKPS 3.3** are not applicable in Ireland and *attention is drawn to the joint publication issued by the SCS/IAVI Residential Mortgage Valuations Guidance Notes for Valuers.*

UKPS 3.4 – Not applicable in Ireland.

UKPS 3.5 – Not applicable in Ireland.

March 2009 amendment

New Practice Statement– UKPS3.6. Deals with the procedures to be followed where members are asked to provide retype reports for Residential lending purposes. – *Not applicable in Ireland.*

UKPS 4 – Residential Property Valuations (other than for mortgage purposes)

UKPS 4.1 – *Not applicable in Ireland. However the Society is of the view that this represents best practice and should be adhered to by Irish Surveyors.*

UKPS 4.2 and UKPS 4.3 – *Not applicable in Ireland.*

March 2009 amendment

New UK PS4.4. Brings into the Red Book a reference to the Scottish Home Report in a similar way to that for the HSV in UK PS4.1. – *Not applicable in Ireland.*

UKPS 5 – Regulated Purpose Valuations

The list of Regulated Purpose Valuations in **UKPS 5.1** has been amended to exclude any reference to Pension Schemes. Valuations for Pension Schemes will be the same as for the scheme's financial statement and as this is covered by **UK PS 1.1**. It will be a Regulated Purpose Valuation under that heading in the bullet points.

While UKPS 5 is not applicable in Ireland at the moment, the Society considers it represents best practice and should generally be followed with exceptions/appropriate modifications in terms of Irish legislation.

6.0 UK Guidance Notes

UKGN1 – Inspections and Material Considerations – *Not applicable in Ireland.*

UKGN2 – Shared Ownership of Residential Property – *Not applicable in Ireland.*

7.0 Conclusions

Members should be aware that there is a personal obligation on individuals to comply with the Red Book and to keep up to date with the changes. The Society has no liability or responsibility in connection with this and it is up each individual Member to ensure they are fully up to date with the requirements and Irish Legislation as appropriate.

The effective date is important and members must be aware that the Red Book is dynamic in that it changes reasonably regularly.

The Society would also like to remind members that there are various valuation information papers issued by RICS that may provide background assistance.