

## Core Element 5 – Financial Transparency

*“Financial transparency means timely, meaningful and reliable disclosures about a company's financial performance. Companies need to provide transparent financials to raise capital. Investors need transparent financials to make informed investment decisions. Therefore, financial transparency is important not only because it is the bedrock of our financial markets, but also because it is absolutely essential to today's investors.”*

- Cynthia A Glassman, Commissioner, U.S. Securities and Exchange Commission, Opening remarks to the Symposium on Enhancing Financial Transparency, June 4, 2002.

Property markets, like all markets, go through cycles. Value continually cycles through expansion, contraction, recession and recovery. To avoid severe recessions financial mediators need to not only have accurate information about the real value of underlying collateral, but they must pay attention to the warnings of regulators and analysts during market expansion. As markets stabilize either after a recession or political conflict, financial liberalization can lead to credit expansion that exceeds the ability of financial intermediaries to assess risk. Deregulation and competition must be matched by the continued development of market participants across the entire spectrum including regulators, asset valuers, rating agencies and data providers.

Accurate and transparent financial reporting of companies and management disclosures are critical to market stability and sophistication. Bankruptcy laws and processes must be efficient and reasonably allow individuals to obtain a fresh start or trouble businesses to reorganize. Throughout the entire cycle, independent, highly trained and ethical asset valuers are critical to market stability. As markets continue to develop, standardized data needs to be collected, aggregated and used to provide feedback to the markets on current and historical trends. The continued international expansion of financial and capital markets requires that all these financial transparency measures take on a global scale.

### Core Element Goal

A well developed and transparent financial system that includes strong supporting institutions and highly trained and ethical professionals that contribute to effective financial intermediation and deep and broad access to capital and financial services

### Lead Indicator 5.1 – Market Stability

Core Question: Are market risks sufficiently transparent and diversified so that efficient capital allocation can occur?

#### Sub-Indicator 5.1.1 – Financial Reporting

**What is the strength of the country's auditing and reporting standards?**

International Financial Reporting Standards (IFRS) are critical to the transparent operation of financial markets. These standards must be accepted and enforced by any country that wishes to participate in global capital markets. National accounting standards need to converge toward IFRS. In addition to developing IFRS, the International Accounting Standards Board is working to help emerging markets and small and medium sized entities participate in global markets.

- Step 1 Visit the *Global Competitiveness Report* Web site:  
<http://gcr.weforum.org/gcr2010/>
- Step 2 Click "Rankings."
- Step 3 From the "Index" dropdown select Table 1.18 – "Strength of auditing and reporting standards"
- Step 4 Find your country on the table.
- Step 5 Record the ranking and numeric score.
- Step 6 Determine the Sub-Indicator score:

Very Strong	1 <sup>ST</sup> – 34 <sup>TH</sup> countries
Strong	35 <sup>TH</sup> – 69 <sup>TH</sup> countries
Weak	70 <sup>TH</sup> – 104 <sup>TH</sup> countries
Very Weak	105 <sup>TH</sup> – 139 <sup>TH</sup> countries

### **Sub-Indicator 5.1.2 – Market Sophistication**

#### **What is the overall level of financial market sophistication in the country?**

An efficient financial sector allocates the resources saved by a nation's citizens as well as those entering the economy from abroad to their most productive uses. It channels resources to those entrepreneurial or investment projects with the highest expected rates of return, rather than to the politically connected. Competitive economies require sophisticated financial markets that can make capital available for private-sector investment from loans, venture capital and other financial products. To fulfill all these functions, the banking sector needs to be trustworthy and transparent, and financial markets need appropriate regulation to protect investors and other actors in the economy at large.

- Step 1 From the GRC Index select Table 8 – "Financial market development"
- Step 2 Find your country on the table.
- Step 3 Record the ranking and numeric score.
- Step 4 Determine the Sub-Indicator score:

Very Strong	1 <sup>ST</sup> – 34 <sup>TH</sup> countries
Strong	35 <sup>TH</sup> – 69 <sup>TH</sup> countries
Weak	70 <sup>TH</sup> – 104 <sup>TH</sup> countries
Very Weak	105 <sup>TH</sup> – 139 <sup>TH</sup> countries

### Sub-Indicator 5.1.3 – Insolvency Process

Debt is one of the most useful contracts in every economy since it enables firms to finance investment. To enforce debt contracts, societies create a variety of legal mechanisms or institutions that allow lenders to go after a defaulting borrower's income and assets without resorting to violence. Some foreclosure proceedings do not require courts. However many societies rely on courts to enforce debt contracts on firms with multiple creditors through bankruptcy or insolvency procedures. Despite the importance of debt enforcement, insolvency institutions are generally perceived to perform poorly, even in advanced market economies but especially in developing countries.

- Step 1 Visit the *Doing Business* Web site: [www.doingbusiness.org](http://www.doingbusiness.org)
- Step 2 From the "select an economy" drop down select your country.
- Step 3 Record your country's rank for "Closing a Business" for the current and previous year.
- Step 4 Click on "Closing a Business"
- Step 5 Record the answers and scores to the following questions:
  - 5.1.3.1 What is the average time to complete bankruptcy proceedings?**
  - 5.1.3.2 What is the cost of the bankruptcy proceedings as a percentage of the estate?**
  - 5.1.3.3 What is recovery rate of bankruptcy proceedings?**
- Step 6 Determine the Sub-Indicator Score and Trend.
 

Very Strong	1 <sup>ST</sup> – 46 <sup>TH</sup> countries
Strong	47 <sup>TH</sup> – 92 <sup>ND</sup> countries
Weak	93 <sup>RD</sup> – 137 <sup>TH</sup> countries
Very Weak	138 <sup>TH</sup> – 183 <sup>RD</sup> countries

Trend either ↑ or ↓ compared to previous year.

### Determine the Lead Indicator Score for Market Stability

- Step 1 Review the Sub-Indicator scores.

Step 2 Determine the Lead Indicator Score based on the aggregate of the Sub-Indicator scores.

## Lead Indicator 5.2 – Independent Asset Valuers

Core Question:	Do highly trained, independent and ethical valuers exist for real property, natural resources, machinery and equipment and intangible assets?
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Independent asset valuers are the axis around which property information flows. They touch every aspect of development from collateral value confirmation for mortgage loans and feasibility studies at the beginning of projects to the determination of value when an asset is taken by the government to make way for new growth or assets are redistributed through the insolvency process. International valuation standards, generally accepted methods of valuation practice and the development of and enforcement of a code of conduct for valuers are critical to the functioning of property markets.

Stronger transnational ties between valuers and valuation organizations will assist everyone in making sound investment decisions and reducing investment risk. Clear, consistent and transparent valuation standards and the targeted development of valuation professionals raise the understanding of and confidence in financial reporting. Such efforts will also facilitate expeditious and reliable audits and provide a consistent approach to portfolio and asset management as a way of reducing the risks associated with possible future economic crises.

### Sub-Indicator 5.2.1 – Standards

**Survey Question 19**      **How easy is it to find a valuer who implements International Valuation Standards?**

**Civil Society Resource** – [www.ivsc.org](http://www.ivsc.org)

#### **International Valuation Standards Council – IVSC**

The IVSC has been in existence for more than 25 years. Its origins were in the need identified by a number of professional bodies from around the world for uniformity in the valuation approaches used in real estate markets. Over the past decade it has evolved and expanded and now produces standards for many types of assets, including plant and equipment, intangible assets and businesses. IVSC has also worked in liaison with the International Accounting Standards Board in producing guidance on valuations required under International Financial Reporting Standards.

- Step 1 Visit the IVSC Website to determine if a member association exists in your country. Contact them and seek cooperation with the Scorecard and the improvement of valuation standards, training and the development of a code of conduct. [www.ivsc.org](http://www.ivsc.org)
- Step 2 Consult with local real estate valuers and ask about the valuation standards they use when conducting asset valuations.
- Step 3 From the interviews answer Survey Question 21.
- Step 4 Determine the Sub-Indicator Score:
- |             |   |
|-------------|---|
| Very Strong | The country has adopted International Valuation Standards as the National Valuation Standards.          |
| Strong      | The country's National Valuation Standards are largely compliant with International Valuation Standards |
| Weak        | The country has no uniform national standards but standards do exist within banks and other firms.      |
| Very Weak   | The country has no valuation standards.   |

### Sub-Indicator 5.2.2 – Training

#### Survey Question 20 What is the level of training of valuers?

Generally Accepted Valuation Principles are laid out by the IVSC. They include the concept of market value, highest and best use and the three marked-based approaches to value – the cost approach, the sales comparison approach and the income capitalization approach. Valuers should have training in and experience applying all three approaches to value.

#### Civil Society Resource – Appraisal Institute [www.appraisalinstitute.org](http://www.appraisalinstitute.org)

The Appraisal Institute was organized in 1932 and is a global membership association of professional real estate appraisers. The Appraisal Institute is the acknowledged worldwide leader in residential and commercial real estate appraisal education. Its extensive curriculum of courses and specialty seminars provides a well-rounded education in valuation methodology for both the novice and seasoned practitioner. As the world's largest publisher of real estate appraisal literature, the Appraisal Institute offers a wide range of books and other materials on subjects ranging from basic valuation theory and techniques to advanced applications. It also publishes two quarterly periodicals, *The Appraisal Journal* and *Valuation* magazine.

- Step 1 Consult with local bankers, large investors, real estate developers, brokers and agents and ask about the competency of the valuers in the market.
- Step 2 Conduct an Internet search using the terms “valuation [country]” or “real property valuation [country]”
- Step 3 From the interviews and research answer Survey Question 22.
- Step 4 Determine the Sub-Indicator Score:
- Very Strong Valuers are highly trained and experienced in the application of the three market-based approaches to value and continually upgrade their skills.
- Strong Valuers are trained in the application of the three market-based approaches to value and have some experience in their application.
- Weak Valuers are trained and experienced but focus primarily on the cost approach to value.
- Very Weak No separate, independent valuation profession exists.

### **Sub-Indicator 5.2.3 – Ethics**

#### **Survey Question 21 Are opinions offered by valuers free of influence from parties to the transaction?**

Valuers must perform their assignments with the strictest independence, objectivity and impartiality. For the highest market transparency, a large corps of independent valuers outside of banking, real estate development and government must be in place to provide verification of value conclusions.

- Step 1 Consult with local accountants, bankers, real estate developers, brokers and agents and ask about the independent valuation services available in the market.
- Step 2 Consult local valuers and ask about the existence of a code of conduct and the enforcement of the code.
- Step 3 From the interviews answer Survey Question 23.
- Step 4 Determine the Sub-Indicator Score:

Very Strong	A well-developed, independent valuation profession exists and an IVSC compliant code of conduct exists and is rigorously enforced.
Strong	A developing, independent valuation profession exists and an IVSC compliant code of conduct exists and is sporadically enforced.
Weak	The independent valuation profession is small and a code of conduct either does not exist or is not enforced.
Very Weak	No separate, independent valuation profession exists.

### Determine the Lead Indicator Score for Independent Asset Valuers

- Step 1            Review the Sub-Indicator scores.
- Step 2            Determine the Lead Indicator Score based on the aggregate of the Sub-Indicator scores.

### Lead Indicator 5.3 – Data Standards

Core Question:	Is accurate property information available electronically in formats that are consistent with international standards?
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Property market analysts must have access to accurate transaction data. A distortion in market data to hide value from taxing authorities or to perpetuate fraudulent property flipping schemes has serious negative consequences when those distortions are amplified by securitization. Even in developed countries the real estate industry is still very fragmented and there is a lack of timely data sharing, transparency and trust. Sales information and vital performance knowledge on buildings and portfolios is often not shared. Processes remain very manual and paper dependent. This leads to high integration costs and poor productivity as the same data is re-entered into multiple database systems. Instead, managers and analysts need open, free, industry-wide digital standards to improve business analysis and enable more intelligent operations in an increasingly automated and web-based world.

#### Sub-Indicator 5.3.1 – Sales & Operating Data

**Survey Question 22            A multiple listing service is an electronic exchange system where brokers and agents can widely share contracted real estate listings of properties that are for sale. Do multiple listing type services exist?**

**Survey Question 23      Do resources exist for obtaining building income and expense estimates?**

- Step 1      Consult with local real estate brokers, agents, managers or valuers and ask about the availability of sales and operating data in the market.
- Step 2      Conduct an Internet search using the terms “property listings [country]”, “sales listings [country]”, “building operating expenses [country]”
- Step 3      From the interviews and research answer Survey Questions 24 & 25.
- Step 4      Determine the Sub-Indicator Score:
- Very Strong      Uniform, standardized property listing services and building income and expense estimates based on surveys are widely available throughout the country.
- Strong      Uniform, standardized property listing services and building income and expense estimates based on surveys are available for the largest cities in the country.
- Weak      Some property listings services and operating data are available but they are not standardized.
- Very Weak      No data is available.

**Sub-Indicator 5.3.1 – Interchange Formats**

**Survey Question 24      Do electronic data interchange formats conform to international standards (ebXML – electronic business using extensible markup language)?**

- Step 1      Consult with local real estate managers, valuers or investment managers and analysts and ask about the electronic exchange of data in the market.
- Step 2      Conduct an Internet search using the terms “electronic data exchange [country]” or “ebxml [country]”
- Step 3      From the interviews and research answer Survey Question 26.
- Step 4      Determine the Sub-Indicator Score:
- Very Strong      Real estate data is primarily exchanged electronically according to international standards
- Strong      Real estate data exchange is transitioning to electronic formats

Weak            Some data is being exchanged electronically but the majority of transactions are paper based.

Very Weak      No data is available or exchanged.

### **Sub-Indicator 5.3.3 – Technical Standards**

#### **Survey Question 25            Do building codes and office building measurement standards (ANSI/BOMA Z65.1) conform to international standards?**

Step 1            Consult with local real estate developers, managers or valuers and ask about building codes and measurement standards in the market.

Step 2            Conduct an Internet search using the terms “building codes [country]” “office building measurement [country]”

Step 3            From the interviews and research answer Survey Question 27.

Step 4            Determine the Sub-Indicator Score:

Very Strong      National building codes and measurement standards conform to international standards.

Strong            National building codes and measurement standards are in place but do not conform to international standards.

Weak             National building codes and measurement standards are being developed.

Very Weak       No national codes or standards are in place or planned.

### **Determine the Lead Indicator Score for Data Standards**

Step 1            Review the Sub-Indicator scores.

Step 2            Determine the Lead Indicator Score based on the aggregate of the Sub-Indicator scores.

### **Determine the Core Element Score for Financial Transparency**

Step 1            Review the Lead Indicator scores.

Step 2            Determine the Core Element Score based on the aggregate of the Lead Indicator scores.

## Civil Society Resources

Property markets in the United States and around the world are supported by several strong associations that help to set data standards and offer advice and support for professionals looking to improve data access and transferability.

### **International Consortium of Real Estate Associations – ICREA**

[www.worldproperties.com](http://www.worldproperties.com)

ICREA is comprised of more than 30 leading national real estate associations and provides assistance by setting standards for international real estate practice and facilitates worldwide real estate transactions.

### **Institute for Real Estate Management – IREM [www.irem.org](http://www.irem.org) & IREMFIRST Knowledge Center [www.iremfirst.org/if/knowledgebase](http://www.iremfirst.org/if/knowledgebase)**

IREM has been serving as a resource for more than 75 years and together with the IREMFIRST Knowledge Center provides information and resources for finance and asset analysis including building operating and expense estimates in the U.S.

### **Open Standards Consortium for Real Estate – OSCRE [www.oscre.org](http://www.oscre.org)**

OSCRE drives the creation and adoption of data standards for real estate focusing on data exchanges within the business process.

### **Building Owners and Managers Association International – BOMA**

[www.boma.org](http://www.boma.org)

BOMA was founded in 1907 and is a primary source of information on office building development, building codes and office and industrial building measurement standards.

## Core Element Linkages

Financial Transparency ↔ Access to Credit

The financial sector and capital markets command excited attention in times of recovery and expansion and headlines of gloom during times of contraction and recession. The profit of banks and rise of stock markets have traditionally lead to speculation and derivative instruments designed to squeeze more profit from the

same core assets. This in turn leads to further loosening of credit and less regulation of financial intermediaries.

Market stability requires the avoidance of extreme asset price bubbles that burst and freeze credit markets. More consideration and influence must be given throughout the cycle to the development of independent analysts and the core asset values they report. Every effort must be made to support and implement International Valuation Standards. Systems of assessing country risks must include the health of property markets and international data standards and systems of data sharing must be developed so that property markets can become more integrated, efficient and transparent.

Please refer to the information for Access to Credit on page 23.

## **Field Assessment**

Civil society is the counterweight between the aggressive private sector and the restrictions of government. Market stability requires that a separate independent valuation profession be in place to analyze the vital links between property and capital. These valuers must have access to accurate market data to complete their work.

- Step 1 Partner with an outside expert with property market experience – preferably someone with transactional experience in a formal market outside your region.
- Step 2 Together with the expert, visit local property attorneys, brokers, agents and valuers and ask them to tell you about recent experiences in obtaining sales data and independent valuation reports. Be sure to include information about both residential and commercial properties.
- Step 3 Determine the answers to the following questions:

## **Market Stability**

**Field Question 9** How stable has the property market been over the last several years?

## **Valuation Profession**

**Field Question 10** How many independent valuers exist in the market?

**Field Question 11** How many companies exist and what is the average size of valuation companies?

- Field Question 12** What are the valuation standards and do they conform to international and regional standards?
- Field Question 13** What valuation methods and techniques are used in the market?
- Field Question 14** Are there valuer associations in the market? What number and percentage of practitioners belong?
- Field Question 15** What training programs are available to upgrade the quality of valuers?
- Field Question 16** Are peer review mechanisms in place to assist in enforcing ethical behavior?
- Field Question 17** What is the quality of valuation reports?

#### **Data Availability**

- Field Question 18** What is the status of proprietary databases that include property information?
- Field Question 19** What is the status of existing data sharing mechanisms for properties that are for sale or that have sold?
- Field Question 20** Do valuers have established data sharing mechanisms?
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# Core Element Map for Financial Transparency

**Legend** – colors indicate the strength of institutions that support property markets.

- Very Strong
- Strong
- Weak
- Very Weak
- Unknown

