Executive summary of the public audit report

STATE SUPERVISION OF PROPERTY AND BUSINESS VALUATOR ACTIVITY

01 October 2015 No. VA-P-60-14-13

Full audit report in Lithuanian is available on the website of the National Audit Office: www.vkontrole.lt

DEFINITIONS[1]

Property refers to material, immaterial and financial valuables, which may become and object of market transactions.

Market value of property or business refers to a calculated amount of money, which could be exchanged for property or business on their evaluation day, upon entering into a direct commercial contract between the persons willing to sell property or business and persons willing to purchase them after the appropriate presentation of this property or business to the market when both of the parties act constructively without violence and not bound by other transactions and interests.

Value of property or business refers to the measure of usefulness of the property or business at a certain time, according to a particular property or business valuation method, the procedure of application of which is defined by the Property and business evaluation methodology.

Property or business valuation company refers to a legal person established in the Republic of Lithuania, a legal person established in another member state, or an organisation or their subsidiaries engaged in property or business valuation activity according to the law of the Republic of Lithuania.

Customer ordering property or business valuation services refers to a natural person, legal person or another organisation or their subsidiaries, which have a right to enter into contracts according to their articles of association, that have entered into an asset or business valuation contract with an asset or business valuation company.

Property or business valuation refers to determining the value of a property and (or) business at a certain time, according to a particular property or business valuation method, the procedure of application of which is defined by the Property and business evaluation methodology.

Property or business valuator refers to a citizen of the Republic of Lithuania or another country, another natural person, using the rights of free movement in the member states conferred to him by the law of the European Union, providing property or business valuation service.

Business refers to an activity of a natural person, legal person or another organisation or their subsidiaries, the purpose of which is to achieve revenue and profit by using economic resources.

Abbreviations

Court of Honour refers to the Court of Honour of asset or business valuators.

Service refers to Property Valuation Oversight Agency.

Property valuator refers to a property or business valuation company and a property or business valuator.

Property valuation report refers to a report of property or business valuation.

The Law, the Law on Bases of Property and Business Valuation refer to the Law on Bases of Property and Business Valuation of the Republic of Lithuania.

Methodology refers to Property and Business Valuation Methodology.

[1] The definitions are indicated in the Law on Bases of Property and Business Valuation, 25-05-1999 No. VIII-1202 (amendment 22-06-2011 No. XI-1497), art. 2.

EXECUTIVE SUMMARY

Property evaluation is needed to determine its value: in case of changing owners (selling, inheritance, transferring property as non-monetary contribution); insurance or mortgage; acknowledgement as ownerless, etc. The results of property valuation are particularly important to citizens, as well as public and private sectors:

- individual property valuation determines the tax value of real estate, which is important both to taxpayers and the state calculating and collecting taxes;
- if the property is taken for the public needs[2], the owner is compensated in cash according to the market valueindicated by the property valuators;
- the value of state land plots can be determined by performing a property valuation[3].

In 2014 the state budget received 47.3 million euros of land sales revenue[4].

In the public domain there were numerous discussions about agreements between customers and some of the property valuators. There are claims about unreasonable increase of property value in reports, when debtors seek to artificially increase their property value in order to cover as much of the debt as possible. Other cases involve transferring property of unreasonably low value inside certain circles[5]. Discussions became even more intensive after the bank collapse, claiming that the value of some of the objects was ten times higher[6]. Unreasonable high or low property values were discussed in committees of the Seimas as well[7].

Reasonable property valuation is a legitimate expectation of all customers, while the duty of the state institutions is to ensure that these interests are protected. Therefore, the Ministry of Finances has been instructed to formulate the policy of property and business valuation, as well as organise and control its implementation, while the Property Valuation Oversight Agency has been obliged to perform state supervision of the property valuators. The purpose of this audit was to evaluate the state supervision of the activity of property and business valuators in Lithuania. Seeking to find out the practitioners' opinion, we conducted a survey of business valuators. Moreover, we also analysed the practice of foreign countries and courts. The audit covered the period of 2012 and the first half of 2015.

As of 1 May 2012 Lithuania experienced significant changes in property valuation area: the service has been appointed with an important function to examine, whether property valuation reports meet the requirements of the law; the establishment of the pre-trial institution — the Court of Honour — appointed to apply sanctions for property valuators violating the law; definition of more detailed requirements for improving the qualifications of property valuators, etc. However, the results of the audit showed that the state supervision of the activity of property valuators remains insufficient and must be improved.

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[2] For example, as in land taken for the purposes of the strategic projects Rail Baltica and the Trans-European Network — the works of Vilnius bypass.

[3] Resolution of the Government of the Republic of Lithuania No. 205 "On Evaluation of Land" of 24-02-1999.

[4] Operational data of consolidated revenue of the state budget and municipal budgets (January-December 2014), (http://www.finmin.lt/finmin.lt/failai/nacionalinio_biudzeto_surinkimas/ketv/2014_metai_LT_.pdf).

[5] Švirinas K. "Nepatikima vertinimo ataskaita turto vertę gali sumažinti ar išpūsti milijonais litų" (http://www.delfi.lt/verslas/verslas/k-svirinas-nepatikima-vertinimo-ataskaita-turto-verte-gali-sumazinti-ar-ispusti-milijonais- litu.d?id=65452782#ixzz3SZPkwDyx).

[6] "Kaip įmanoma milijardais įvertinti orą" (http://www.veidas.lt/kaip-imanoma-milijardais-ivertinti-ora).

[7] Metings of the audit committee 10-12-2014 and 17-12-2014 (http://www3.lrs.lt/pls/inter/w5_show?p_r=8826&p_d=153793&p_k=1, http://www3.lrs.lt/pls/inter/w5_show?p_r=8826&p_d=153798&p_k=1).

The service checks on average 0.3% of all property valuation reports every year and the rate of non-compliance to legislative requirements in these reports is puzzling: out of 473 reports checked by the service, 383 (81%) did not meet the legislative requirements. Moreover, compared to 2014, the average number of violations identified by the service in these reports during the first half of 2015 increased twice. According to the Ministry of Finances, all cases of violations to the law in the property valuation reports influence the value of the property. However, the clients are not informed about the fact that the property valuation report that they have ordered did not meet the requirements of the law.

As it seems, the number of property valuation reports that did not meet the requirements of the law is high, but the service does not accumulate or systematise any data on how many reports were checked, how many and what type of violations were identified, which of them are the most common, etc. Without such analysis it is impossible to make a reasonable evaluation of the necessity to make amendments to the legislation applicable to this area, as well as the demand for improving the qualifications of the property valuators. Moreover, the service should make this data public in order to make it available for property valuators as well. This would also undoubtedly improve the quality of property valuation reports.

There are no regulations (except for defining the tax value of the real estate), which property valuation reports must be checked by the service before using them for making decisions in the public sector. The demand for checking is illustrated by the fact that 114 out of 179 (64%) of the reports checked by the service did not meet the legislative requirements and the property valuation was not reasonable enough. This position is shared by the Special Investigation Service as well.

Because of different legal regulations some of the valuators, whose property valuation reports fail to comply with statutory requirements, were brought to the Court of Honour and were subjected to sanctions, while others were simply provided with a written notification.

We saw a lack of responsibility of the valuators themselves because in 2016 the service will have to suspend the validity of qualification licences of 80 property valuators (which makes 25% of their total number) and 174 assistant valuators (59%), because all of them failed to comply with the requirement introduced in 2013 to improve their qualifications for at least 35 hours in the recent three years.

Of course, the major victims of all of these problems are the clients of property valuators, while failure to solve the issues listed in the audit report will only result in more of them in the future. Therefore, upon evaluation of the evidence gathered during the public audit, we provide conclusions and recommendations, appropriate implementation of which will make the state supervision of property and business valuator activity wider and more effective. In the long term this will benefit the customers of property valuators.

CONCLUSIONS

Property Valuation Oversight Agency does not ensure state supervision of property valuators in order to achieve appropriate property valuation quality and protection of the public rights and their legitimate interests:

1. The number of valuation reports checked by the service in a year is small — on average 0.3% of all reports. In the period from 1 May 2012 to 30 June 2015 the service checked 473 reports and 81% did not meet the requirements of the law. This had an impact on valuation of property, i.e. the value of the evaluated property could have been set higher or lower than it should be (subchapter 1.2).
2. The service does not analyse the most common violations of the law in valuation reports and does not accumulate data about identified violations to the law. This analysis is particularly important and useful for preparation of amendments to legal acts, coordination of qualification improvement of property valuators, etc. (subchapter 1.2).
3. The legislation does not oblige to inform the customers if their reports did not comply with statutory requirements. Therefore, customers do not know that their property evaluation was not sufficiently substantiated. Although the service agreed that the customers should be informed, however, up to this date the service did not take any initiative to put this requirement into the legal acts (subchapter 1.3).
4. We found that more than half (114 out of 179) of the property valuation reports checked by the service and used by the public sector in making decisions regarding selling property, taking property for the public needs, asset contribution, etc. did not comply with the statutory requirements and the property valuation in them was insufficiently substantiated, which may have resulted in determining too high or too low value. The legal acts do not indicate an obligation for the service to check these reports before entering into a contract (subchapter 1.4).
5. If there is information about violations of the law committed by a property valuator, the Law on Bases of Property and Business Valuation imperatively obliges the service to address the Court of Honour regarding disciplinary proceedings for the property valuator. We have found that the service addresses the Court of Honour only after determining that a certain valuation report does not comply with the statutory requirements, based on received applications and complaints. However, having determined this by primary scheduled inspections, the service does not address the Court of Honour, because it is not indicated in the Regulations for inspecting the activity of the property or business valuators and property and business valuation companies, approved by the order of the Minister of Finances (subchapter 1.5).
6. The criteria defined by the Minister of Finances, according to which the service selects the property valuators for scheduled inspection, shows signs of subjectivity and do not ensure the inclusion of the most risky property valuators into the list for inspection (subchapter 1.1).
7. 80 business valuators (25%) and 174 assistant business valuators (59%) do not keep to the requirement of improving their qualifications at least 35 hours in the past three years, introduced in 2013. Therefore, in 2016 the service will have to suspend their qualification licences (part 2).

As of 1 January 2016 the Property Valuation Oversight Agency, the Authority of Audit and Accounting and the Department of Enterprise Bankruptcy Management under the Ministry of Economy will be reorganised into a new budget institution — the Service for Audit, Accounting, Property Valuation and Insolvency Management, which will receive all of their rights and obligations[8]. Therefore, the audit recommendations are focused on the Government and the Ministry of Finances of the Republic of Lithuania.

RECOMMENDATIONS

To the Government of the Republic of Lithuania:

1. It is necessary to define a procedure in the legal acts, according to which the institutions of the public sector would be obliged to submit their property valuation reports to the Property Valuation Oversight Agency, in order to check if these reports regarding property sales, property contribution, taking land for the public purposes, etc. meet the statutory requirements before entering into a contract (conclusion 4).

[8] The Resolution of the Government of the Republic of Lithuania No. 458 of 06-05-2015, "Regarding the agreement to reorganise the Property Valuation Oversight Agency, the Authority of Audit and Accounting and the Department of

Enterprise Bankruptcy Management under the Ministry of Economy".

To the Ministry of Finances of the Republic of Lithuania:

1. In order to ensure information distribution and improve the qualifications of property valuators, it is necessary to oblige the Property Valuation Oversight Agency (conclusions 1 and 2):

    1.1. to accumulate, systematise and analyse the data about the inspected property valuation reports and the indicated violations of the legal acts;

    1.2. to ensure periodical publishing of the summarised data about the most common violations in property valuation reports on the website of the service;

    1.3. based on the systematised data about the most common violations in property valuation reports, to prepare recommendations for property valuators, which would help to develop a general property valuation practice.

2. There must be a legislative requirement to inform customers in case a property valuation report, checked by the Property Valuation Oversight Agency, did not comply with statutory requirements and the property valuation was insufficiently substantiated (conclusions 1 and 3).

3. It is necessary to amend the pt. 16 of the Regulations for inspecting the activity of the property or business valuators and property and business valuation companies, approved by the order of the Minister of Finances No. 1K-422 of 11 December 2012, by including the statement that if a property valuation report does not comply with the statutory requirements, the Property Valuation Oversight Agency must address the Court of Honour (conclusion 5).

4. Seeking for more efficient and wider state supervision of property and business valuators, it is necessary to define the selection criteria for primary scheduled inspections, based on which the selection would include the most risky property valuators (conclusion 6).

The measures and terms of the implementation of recommendations are provided in the appendix 2 “The plan of implementation of recommendations”.