

The Application of Fair Value Measurement in Investment Real Estate

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Abstract

Investment real estate has the characteristics of large investment scale and slow monetization speed. Many enterprises usually adopt a cost measurement model. With the establishment of China's market economy system, the difference between the construction price and sale price of investment real estate under the cost measurement model is relatively large, far greater than the fair value and sale price of investment real estate, which cannot adapt to the development of modern real estate industry. The use of fair value model has improved the timeliness and quality of accounting information, and objectively reflects the market value of real estate enterprises. This article focuses on fair value measurement and analyzes the advantages and disadvantages of this model in the application of investment real estate. At the same time, corresponding suggestions are proposed for the problems that arise during the use process.

Keywords

Fair Value; Investment Real Estate; Application.

1. The Necessity for Real Estate Enterprises to Use Fair Value Measurement

In recent years, China's real estate market has flourished, and the market value of real estate has been increasing year by year. However, under the cost measurement model, its book value cannot reflect the real market value, which reduces the market value of real estate enterprises and cannot reflect the real situation of enterprises. When using the fair value measurement model, real estate enterprises can adjust their book value according to market value when evaluating, and accounting information is more in line with the actual situation. At the same time, it truly reflects the performance of the enterprise, making the enterprise value change from static measurement to dynamic measurement, making the use of fair value measurement by real estate enterprises a trend.

For the application of fair value, there is one aspect that needs special attention. The new standards stipulate that a company's balance sheet must usually use the historical cost method for future valuation. The use of the fair value model requires evidence or indications that the measurement method is reliable, that is, investment real estate has an active trading market in the local area and a clearly identifiable fair price. In accounting practice, if a company chooses a measurement model, it cannot change it in future accounting periods unless there is a significant change in the company's financial condition. Enterprises that adopt the fair value measurement model are not allowed to change to the historical cost measurement model in future accounting periods. At the same time, the fair value measurement model also increases the instability of the company's operating results. If the fair value model is adopted, the performance of investment real estate enterprises will be affected, such as market transactions, government supervision, and the professional level of practitioners. Therefore, how to

appropriately use the fair value measurement model has become a major focus at present. Therefore, this article will focus on exploring the impact of adopting the fair value measurement model on enterprises, analyzing its advantages and disadvantages, and finally providing corresponding solutions.

2. Advantages and Disadvantages of Adopting Fair Value Measurement Model for Investment Real Estate

2.1. Advantages of Fair Value Measurement Model

(1) In terms of financial information. Most real estate enterprises in our country initially adopted the historical cost measurement model, but due to the rapid growth of real estate prices in recent years, the current market prices have significantly deviated from historical costs. Therefore, the historical cost method can no longer accurately reflect the current prices of investment properties, which will have a certain impact on the financial statements of enterprises and underestimate the asset value of enterprises. When using fair value measurement, current market conditions and various future influencing factors can be taken into account, which can keep the asset value within a reasonable range. Therefore, the more widely used fair value measurement is in Chinese enterprises, the more accurate accounting information can be obtained and the financial status of the enterprise can be reflected in a timely manner.

(2) In terms of financial statements. Under the historical cost method, depreciation and impairment provisions for a company's real estate are required for each accounting period, followed by amortization and other processing. However, after adopting fair value measurement, only the gains and losses from changes in fair value need to be processed, and there is no need for further processing. In the current economic environment of our country, there is a huge difference between the market price of investment real estate and its purchase cost. Therefore, converting from the historical cost method to the fair value method can significantly increase the current operating profit of the enterprise, while improving the operating performance in the financial report. This will make investors feel that the enterprise is thriving and will continue to support the enterprise in the future. When the impact of fair value changes on profit and loss is not considered, the fair value method can directly reduce the operating costs of enterprises, resulting in a significant increase in profits compared to historical cost models. When market prices continue to increase, the impact of investment real estate on total profits will be more significant.

(3) In terms of business conditions. Due to the existence of the ST system in the current stock market in China, some ST companies choose to change their measurement model and convert historical cost measurement to fair value measurement in order to maintain their listing qualifications, in order to change their profits. Due to the fact that the current market prices of investment properties owned by enterprises are often higher than the original purchase prices, adopting the fair value method can significantly increase profit indicators, improve operating conditions in the short term, transform from losses to profits, successfully remove the "hat" of ST, and regain the trust of consumers.

2.2. Disadvantages of Fair Value Measurement Model

(1) In terms of execution ability. As early as the early 1950s, the United States proposed the concept of fair value, and subsequently, the fair value measurement model began to be introduced into international accounting standards and eventually became an important component. In recent years, as China's economy has begun to integrate with the world, China has also introduced this model into investment real estate. But because the current real estate transactions in our country are not very active, the development of the market economy is at a

bottleneck stage, and the relevant laws and regulations are not perfect enough. It is very troublesome to assess the appropriate fair value of assets at the same time, and accounting personnel need to have a high level of professional ability and sharp judgment ability. However, the number of such professional talents in China is far less than the demand, so it is not easy to provide reliable fair value information.

(2) In terms of execution costs. So far, there are still some vague definitions for the use of fair value in China's corporate accounting standards, and there is also a lack of corresponding operational guidelines, which makes it necessary for enterprises to pay a certain "cost" if they want to use this method. At the same time, compared to Western countries, China's real estate market started relatively late and transactions were not active enough. Therefore, how to define the size of fair value has become a new issue. According to the new accounting standards, if a listed company adopts the fair value measurement model, it is necessary to regularly evaluate the fair value of assets. However, most companies do not have their own professional valuation teams, so they need to hire a third party to conduct evaluations in society. Regular evaluations require higher costs, which also increases additional operating costs and imposes a burden on business operations.

(3) In terms of financial condition. When using the historical cost method, the depreciation of investment properties by enterprises is basically consistent with the depreciation on tax. However, under the fair value measurement model, enterprises do not need to make any further depreciation or impairment provisions, and only need to recognize the difference between fair value and historical cost in the fair value change profit and loss for each accounting period. The profit or loss recognized in accounting is classified as unrealized income or expense in tax and should be subject to tax reduction or increase, resulting in deferred income tax.

(4) In terms of market trading. Due to the relatively late start of China's real estate industry compared to other Western countries, market transactions are not active enough, and relevant laws and regulations are not yet perfect. Due to the lack of active market transactions, enterprises are unable to provide more valuable information to the outside world. Therefore, when conducting fair value valuation of investment real estate, relevant personnel cannot use market conditions for valuation, which seriously hinders normal business activities between enterprises. However, in the practical operation of accounting practice, it is required that the value of investment real estate must be publicly disclosed, so relevant valuation personnel can only estimate a value through other methods, such as the geographical location of the asset location, building area, and other factors. Although this method can obtain a specific valuation, in reality, due to the insufficient professional ability of the valuation personnel or the too single analogy object, there is a difference between the assessed value and the actual value, which is unfavorable for users of financial information.

(5) In terms of government supervision. Due to the current market economy situation in our country, it is difficult to obtain publicly recognized prices for investment real estate due to insufficient disclosure of relevant transaction information. Therefore, after the relevant values are announced by the enterprise, the relevant audit department is also unable to verify the enterprise data, which is not conducive to the supervision of the government management department on the enterprise. Severe data deviation may cause chaos in the market economy.

3. The Current Situation and Main Problems of Fair Value Application in Real Estate Enterprises

3.1. High Application Costs

Under the cost measurement model, investment real estate enterprises are generally recorded at cost and depreciated over time, so the book value of real estate enterprises is generally lower than the investment cost. Adopting the fair value measurement model, the book value of the

enterprise can be adjusted based on the market price of the house at the time of transaction or rental. In recent years, property prices have been continuously rising, and adopting the fair value measurement model has to some extent increased the investment income of enterprises, while also increasing their income tax and tax burden. In addition, under the fair value measurement model, investment real estate requires enterprises to invest a large amount of manpower and material resources to value investment real estate each year, and to hire professional evaluation companies to evaluate geological formations, which will increase application costs.

3.2. Insufficient Information Disclosure

At present, when listed companies in our country adopt the fair value measurement model, they need to evaluate the real estate through professional social evaluation institutions. Due to differences in evaluation technology and the comprehensive quality of evaluation personnel, there may be significant differences in the value of the real estate, so evaluation can only be used as a reference. According to international accounting standards, investment properties need to disclose important assumptions and methods used to determine fair value under the fair value measurement model. Enterprises that adopt the cost measurement model also need to disclose fair value. However, the current Enterprise Accounting Standards in China have not made clear provisions. This broad condition has to some extent relaxed the management of the fair value measurement model, resulting in incomplete disclosure of information for investment properties under the fair value measurement model and insufficient play to the role of fair value. Under the fair value measurement model, insufficient disclosure of real estate information leads to asymmetric information among market entities, which to some extent affects the value judgment of the buyer's market and is not conducive to transactions in the entire investment market.

3.3. Insufficient Market Completeness Makes it Difficult to Accurately Measure Fair Value

In the process of applying fair value measurement methods, it is necessary to ensure the maturity of market economic conditions, and the capital structure must also have a high degree of completeness. In the new accounting standards, if enterprises strengthen the application of fair value measurement models, they can smoothly obtain market prices of real estate in the real estate trading market and estimate the fair value of investment properties based on this. However, in reality, China's capital market itself is still in its early stages of development, and the level of perfection in capital operation needs to be improved. At the same time, when estimating value, it also has a high degree of subjectivity, which can easily mislead financial personnel and lead to profit manipulation behavior, making it difficult to fully demonstrate the superiority of fair value measurement.

3.4. Insufficient Market Supervision Makes it Difficult to Improve the Operability of Fair Value Measurement

Based on the fair value measurement model, the fair process of real estate value relies to a certain extent on a sound asset evaluation system, market supervision supporting system, etc. The construction of China's market economy is in its early stages of development, and due to the impact of the financial crisis, it is necessary to reconsider the structural issues of the capital market. However, in reality, there is a significant gap between the maintenance and construction of the market in the later stage and the development process of the market economy. The completeness of many institutional constructions needs to be improved, and illegal and irregular behaviors have not yet been severely punished. Some listed real estate companies, in order to maintain their market image, use fair value to make unauthorized changes to financial data, making it difficult to ensure the authenticity and accuracy of

accounting statements. In addition, under the influence of the lack of market regulatory system, the supervision and inspection efforts have not been effectively implemented, and it is difficult to provide effective guidance in the actual application process of investment real estate, which in turn makes it difficult to ensure good operational results.

4. How to Make the Fair Value Measurement Model more Perfect

The improvement of the fair value model can mainly be approached from two aspects: internal management and external intervention.

4.1. Internal Management Measures

(1) From the perspective of accounting personnel. Due to the particularity of the fair value measurement model, it requires a large amount of market information to be processed, thus requiring accounting personnel to have certain professional abilities. Especially in areas without active trading markets, the determination of fair value further tests the accounting personnel's ability to process accounting information. Due to the continuous improvement of China's position in international finance in recent years, accounting standards have gradually begun to approach international accounting standards. In addition, with the rapid development of China's market economy in recent years, the country is also encouraging enterprises to adopt more fair value measurement models. However, the fair value method is currently not widely used in China, and its valuation process requires the support of big data and is very complex, which poses a great challenge to the professional level of accounting personnel. Therefore, in order to obtain accurate and reliable fair value, it is necessary to improve the professional ability of staff and test it through the following two aspects: on the one hand, a training department should be established within the enterprise to strengthen the learning of current policies by financial and accounting personnel, so that they can proficiently grasp and apply knowledge about fair value, improve work efficiency, and provide reliable fair value for real estate. On the other hand, China needs to encourage and support the development of third-party evaluation institutions, cultivate more high-quality and high-level talents, and specialize in providing fair value valuation services to alleviate market demand. At present, the professional abilities of accounting professionals in our country are not yet able to meet the needs well. Therefore, we must improve the requirements for the abilities of practitioners, especially in the annual continuing education, which requires a lot of time and energy to ensure that accounting professionals can adapt to the development of the times and better engage in related work. Accounting professionals should strive to learn new knowledge, explore broader fields, and enrich their lives. Education in ideological and moral aspects should also be strengthened. Those engaged in accounting work should maintain professional ethics, not be tempted by money and power, and do what they should do within their responsibilities.

(2) From the perspective of accounting supervision. There is no strict regulation on the use of fair value in our country, and there are even deficiencies. This is mainly reflected in the following two aspects: on the one hand, accounting standards clearly indicate the information that needs to be disclosed in accounting reports, but a few investment real estate enterprises conceal data disclosure. In practical operations, in order to make the company's performance more "attractive", enterprises tend to avoid disclosing enterprise information and deliberately avoid some unfavorable data. On the other hand, the standards clearly stipulate that under certain conditions, the measurement model of the enterprise can be changed, but the reverse operation of converting the fair value method to the historical cost method is not allowed. However, there are still a few companies that will reverse the two models in order to manipulate profits, which indirectly reflects the negligence of China's regulatory authorities. At the same time, it is difficult for regulatory authorities in our country to verify the true fair value of investment real estate of enterprises, and some companies use this loophole to manipulate

profits. There is not much punishment for listed companies in China to arbitrarily use fair value measurement, and the vast majority of punishments are only limited to time limit changes. The low cost of illegal activities has led to the frequent occurrence of illegal behavior by enterprises. Therefore, self supervision within enterprises is particularly important. Only through sound internal management can the fair value measurement model play its due role.

4.2. External Intervention Measures

(1) From the perspective of market management. At present, China does not have strict requirements for real estate transactions, which leads to significant fluctuations in real estate prices in the market and incomplete transparency of transaction information. Therefore, it is difficult for enterprises to make accurate valuations of the fair value of their real estate holdings, which poses a great obstacle for some smaller enterprises. Therefore, a unified real estate information platform should be established based on information technology. Real estate enterprises across the country should publicly disclose their financial statement data on the information platform, ensuring that the real estate trading market information is open and transparent, and reducing the risks of real estate transactions between buyers and sellers. Through the information platform, it is possible to understand which enterprises have adopted the fair value measurement model, whether the financial information disclosed by real estate enterprises is complete and accurate, as well as to understand the value of houses in different regions and locations, valuation situations, market participants, and other information. Establishing an open and transparent trading platform for the fair value measurement model can help regulate transaction behavior in the real estate market and promote the healthy development of China's real estate market.

(2) From the perspective of government departments. As mentioned earlier, Chinese enterprises do not have their own professional evaluation groups, so they cannot provide accurate fair value for investment real estate. Therefore, it is necessary to hire a third party in society for evaluation. However, in the estimation process, due to the insufficient professional level of relevant personnel and the lack of supervision from relevant departments, the result is that the data provided by third-party organizations often lacks reference value. This is not only a useless asset evaluation for enterprises, but also incurs additional operating costs. In recent years, China has successively issued many industry standards and regulations, but a complete system has not yet been formed for the management of third-party organizations and their staff. In response to this phenomenon, China should strengthen the supervision and management of third-party institutions, and also require the cooperation of relevant government departments in order to standardize the operation of the industry.

(3) From the perspective of laws and regulations. The relevant government departments should increase the intensity of supervision and management in the implementation of accounting standards, implement class supervision according to the degree of impact of fair value on different financial information, timely formulate corresponding rules and regulations, and clearly provide standardized operational requirements, and improve the detailed rules for fair value measurement. For the relevant regulations on fair value measurement, it is recommended to conduct a trial operation period. During the trial operation period, two modes of fair value measurement and cost measurement can be used, and it is allowed to use fair value measurement. If the real estate enterprise fails to achieve satisfactory results, it is given the opportunity to change to the cost measurement mode, relax the width of fair value measurement standards, and identify problems during the trial operation period. Based on the problems and actual difficulties, Improve relevant regulations, actively promote and assist real estate enterprises in using the fair value measurement model. If the third and fourth tier projects of real estate enterprises do not meet the conditions for using the fair value measurement model, they should be allowed to use the fair value measurement model for

projects that meet the conditions, while the cost measurement model should be used for third and fourth tier projects. In addition, for real estate enterprises that cannot adjust all projects to the fair value measurement model at once, a change periodic table should be established, allowing for gradual adjustments according to the periodic table, Reduce the one-time investment costs of real estate enterprises. In addition, clear definition scope should be provided for the relevant details in the accounting standards, so that the fair value measurement model can be targeted and completed efficiently by real estate enterprises in the early preparation stage. The definition requirements should not only be written explanations, but also given certain quantitative standards, such as activity standards. The use of quantitative standards also makes the standards clearer, Enhance the enthusiasm of real estate enterprises to use the fair value measurement model.

(4) From the perspective of external environment. Although the current accounting standards in our country stipulate that enterprises can choose either the historical cost method or the fair value method, there are many prerequisites for the use of the fair value method, so most enterprises will not actively choose to use this method. From the perspective of standard orientation, historical cost is still a better choice at present, but fair value measurement will inevitably become the mainstream model in the future. Therefore, strengthening the supervision of third-party evaluation agencies should become inevitable. The main channel for real estate enterprises to obtain fair value information is third-party evaluation institutions, and information is the basis of measurement. In order to obtain true and effective fair value measurement, it is necessary to strengthen the supervision of third-party evaluation institutions. The regulation of the evaluation industry in foreign countries relies on the constraints on evaluators, thereby strengthening the restrictions on evaluation institutions. China can also draw on this approach to strengthen the independence of evaluators, clarify their relevant legal responsibilities, establish audit and verification requirements for evaluation reports, and impose severe penalties once evaluation fraud is found. If significant losses are caused, relevant legal responsibilities should also be pursued, Enable evaluators to no longer blindly cater to customer requirements, correct or reject unreasonable requests from customers, and maintain the independence of the evaluation. In addition, strengthen the qualification review of evaluators, and for evaluators who must hold a certificate to work, relevant institutions can establish a multi-level certification model. For example, after passing the primary evaluation exam, newcomers can hold a certificate to work, gradually upgrading from junior to intermediate, senior, etc. Through asset review of evaluators, enhance their professional ability and risk awareness, and ensure the authenticity and effectiveness of evaluation reports from a personnel structure perspective, To lay the foundation for fair value measurement.

5. Conclusion

In summary, the application of fair value measurement in China's real estate accounting practice has improved the accounting information efficiency of real estate enterprises and truly reflects the actual situation of real estate enterprises. However, there are still some shortcomings in the current practical application process. Through continuous optimization by government departments and enterprises, the application environment of fair value measurement mode will be continuously improved, and the practicality of fair value measurement in real estate enterprises will be strengthened, Ensure the improvement of practical efficiency in real estate accounting.

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