The Application of the Fair Value Model in Investment Properties In Cyprus

Time to change?

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IAS40 – “INVESTMENT PROPERTY”, Issued in April 2001 and revised in December 2003 deals with the recognition, measurement and disclosures of Investment Properties.

“Investment property” is property (land or a building – or part of a building or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes or sale in the ordinary course of business.

“Fair value” is 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.

“Cost” is the amount of cash or cash equivalent paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction or where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRS , e.g. IFRS 2- Share based payments.

“Measurement at initial recognition”. An investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement.

“Measurement after initial recognition”. The standard permits entities to choose either:

(A) a fair value model under which an investment property is measured after initial recognition, at fair value with the changes in fair value recognised in profit or loss

or

(B) a cost model (i.e. cost less depreciation less any accumulated impairment losses). An entity that chooses the cost model discloses the fair value of its investment property.

The above choice must be followed consistently.

Need to note that , the fair value model differs from the revaluation model that is permitted for some non- financial assets (under the revaluation model , increases in carrying amount above a cost-based measurement are recognised as revaluation surplus. However, under the fair value model, all changes in fair value are recognised in Profit and Loss).

If an entity has previously measured an investment property at Fair Value, it shall continue to measure the property at Fair Value until disposal even If comparable market transactions become less frequent or market prices becomes less readily available.

A change from one model to the other is made only if the change results in a more relevant presentation. The standard states that this is highly unlikely to be the case for a change from the fair value model to the cost model.

Although the standard seems to be rather strict on the consistency of the measurement basis, we need to appreciate that, back in years 2001 and 2003, when the Standard was drafted, the impact of the Non Performing Loans (NPLs) and the huge market price fluctuations were not YET visible parameters in the EU.

However, the Standard refers to IAS 8 –"Accounting policies , changes in accounting estimates and errors" where by it is stated that a voluntary change in accounting policy shall be made only if the change results in the Financial Statements providing reliable and more relevant information about the effect of transactions, other events or conditions on the entity's Financial position, financial performance, or cash flows.

It is the personal belief of the underwriter that the Fair Value model for Investment Properties in Cyprus, bearing in mind the Cyprus Real Estate environment in the last 10 years or so, has proven to be not suitable for the preparation of reliable Financial Statements.

The statistical diagram below (Source: Central Bank of Cyprus) determines indicatively the "turbulence" in the Cypriot real estate market prices, in the last years, even before the new trend for the "high rise buildings" in Limassol and other cities.

Year	Q	Residential Property Price Index	Fluctuations	Year	Q	Residential Property Price Index	Fluctuations
2006	Q1	68.1		2013	Q1	88.4	(2009-2013)
	Q2	72.2			Q2	86.3	-16.0%
	Q3	73.4			Q3	84.2	
	Q4	78.2			Q4	82.1	
2007	Q1	82.7		2014	Q1	80.0	
	Q2	89.5			Q2	78.4	
	Q3	92.0			Q3	77.1	
	Q4	95.5			Q4	75.6	
2008	Q1	103.6		2015	Q1	74.8	
	Q2	106.9			Q2	74.5	
	Q3	107.7			Q3	74.2	
	Q4	104.8			Q4	74.2	
2009	Q1	99.3		2016	Q1	73.6	(2009-2016)
	Q2	100.1			Q2	73.2	-27.3%
	Q3	100.7	(2006-2009)		Q3	73.3	
	Q4	102.8	51.1%		Q4	73.5	
2010	Q1	100.0		2017	Q1	73.7	
	Q2	99.6			Q2	74.1	
	Q3	99.7			Q3	74.3	
	Q4	99.1			Q4	74.6	
2011	Q1	98.1		2018	Q1	75.0	
	Q2	97.0			Q2	75.3	
	Q3	95.9			Q3	75.6	2.7%
	Q4	94.2					
2012	Q1	93.2					
	Q2	91.3					
	Q3	90.4					

By applying the Fair Value model consistently (as IAS 40 requires) the annual changes in the market values would hit the Profit and Loss thus disrupting the performance and financial position of an entity , where as a cost based model wouldn’t impact the Profit and Loss (apart from the annual depreciation charge).

The recent debate about the future of the Real Estate in Cyprus, the changes in the citizenship program, the new “High Rise Buildings” trend and the latest Land Registry general valuation as at 1.1.2O18 which resulted (as stated in public) in low Market Prices, justify that there are valid and arguable (In my opinion) circumstances for a change in the accounting policy from the Fair Value basis to the Cost basis, in order to secure a more reliable presentation of the Financial Statements of an entity.

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