FAIR VALUE MEASUREMENT OF INVESTMENT PROPERTY UNDER IAS 40: ISSUES AND PRACTICAL IMPLICATIONS

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Abstract

This article examines the fair value measurement of investment property in accordance with International Accounting Standard (IAS) 40. Investment property represents an important category of assets that can significantly influence the financial position and performance of companies. The study analyzes the theoretical foundations of fair value measurement and its role in improving the transparency and reliability of financial reporting. Particular attention is paid to the advantages and challenges associated with the application of the fair value model in practice. The research also discusses common issues faced by companies in determining the fair value of investment property, including the lack of active markets, valuation subjectivity, and the availability of reliable market data. In addition, the paper considers the practical implications of fair value measurement for financial decision-making and financial reporting quality. Based on the analysis, several recommendations are proposed to improve the reliability and effectiveness of investment property valuation under IAS 40.

Keywords: Investment property, IAS 40, fair value measurement, financial reporting, valuation methods, accounting standards, financial transparency.

Introduction

In modern economic conditions, investment activity plays a crucial role in ensuring sustainable economic growth and improving the efficiency of business entities. Investments contribute to the development of production capacities, the modernization of infrastructure, and the expansion of economic opportunities. In this context, investment property has become an important component of corporate assets and a significant source of long-term income for many companies. Investment property is generally acquired with the aim of obtaining rental income, capital appreciation, or both, which distinguishes it from property used in production or administrative activities (1).

The growing importance of investment property in corporate asset structures has increased the need for reliable accounting and valuation methods. International Financial Reporting Standards (IFRS) provide a comprehensive framework for the recognition, measurement, and disclosure of investment property. In particular, International Accounting Standard 40 (IAS 40) regulates the accounting treatment of investment property and allows entities to choose between the cost model and the fair value model for subsequent measurement (2). The fair value model is widely recognized for its ability to provide more relevant and timely information

about the current economic value of assets, thereby enhancing the transparency and usefulness of financial statements for investors and other stakeholders.

However, the application of fair value measurement for investment property also presents several practical challenges. Determining fair value requires reliable market data, professional judgment, and appropriate valuation techniques. In many cases, especially in emerging economies, the lack of active real estate markets and limited availability of comparable transactions complicate the fair value estimation process (3). As a result, the reliability and comparability of financial information may be affected.

A number of scholars have examined the theoretical and practical aspects of investment property accounting. Muzrapova emphasizes that investment activity is a key factor in business development and that effective accounting of investment property contributes to the improvement of corporate financial management (4). Similarly, Akhmadaliyeva notes that investment property represents a specific category of assets that generates independent cash flows and therefore requires a distinct accounting approach in accordance with IFRS (5).

International empirical studies also highlight the importance of fair value accounting in the real estate sector. Olante and Lassini found that companies often prefer the fair value model when the proportion of investment property in total assets is significant and when market conditions allow reliable valuation (6). At the same time, researchers have pointed out that the use of fair value measurement may increase the volatility of reported earnings due to unrealized gains and losses arising from changes in property values (7). This issue has attracted considerable attention in accounting research, as it directly affects financial reporting quality and financial decision-making.

Furthermore, recent studies emphasize the role of external auditing and valuation professionals in improving the reliability of fair value estimates. Independent auditors and professional appraisers help ensure that valuation procedures comply with established standards and reflect market realities more accurately (8). Their involvement enhances the credibility of financial statements and reduces the risks associated with subjective valuation judgments.

Despite the growing body of research on investment property accounting, several issues related to fair value measurement remain insufficiently explored, particularly in the context of emerging markets and developing economies. Differences in market conditions, institutional frameworks, and accounting practices may significantly influence the application of fair value measurement under IAS 40.

Therefore, the purpose of this study is to analyze the main issues associated with the fair value measurement of investment property under IAS 40 and to evaluate its practical implications for financial reporting and financial decision-making. The study also aims to identify existing challenges in the valuation process and to propose recommendations for improving the reliability and effectiveness of investment property accounting.

Research Methodology

This study employs a qualitative research approach to analyze the theoretical and practical aspects of fair value measurement of investment property under International Accounting Standard 40 (IAS 40). The research is based on a comprehensive review of international

accounting standards, academic literature, and empirical studies related to investment property accounting.

The methodological framework of the study includes several research methods. First, the method of scientific analysis is applied to examine the conceptual foundations of investment property accounting and the principles of fair value measurement established by IAS 40 and IFRS 13 *Fair Value Measurement*. This approach allows the identification of the key characteristics and requirements of fair value accounting in the context of financial reporting.

Second, comparative analysis is used to evaluate different measurement models applied to investment property, particularly the cost model and the fair value model. Through this comparison, the study identifies the advantages and limitations of each approach and examines their implications for financial reporting transparency and decision-making.

In addition, the study applies a systematic approach to analyze the relationship between fair value measurement and the quality of financial information. Particular attention is given to the role of valuation techniques, professional judgment, and market data availability in determining the reliability of fair value estimates.

The research also relies on secondary data sources, including international academic publications, professional accounting standards, and previous empirical studies on investment property accounting. These sources provide a theoretical and analytical basis for identifying the main issues associated with the application of fair value measurement in practice.

Results and Discussion

Investment property represents a specific category of assets that generates economic benefits primarily through rental income or capital appreciation. The application of fair value measurement under IAS 40 has significantly influenced the accounting practices of companies operating in real estate and investment sectors. This section analyzes the main characteristics of fair value measurement, its advantages, and the challenges associated with its practical application.

According to IAS 40 *Investment Property*, investment property refers to land or buildings held to earn rental income, for capital appreciation, or both. Unlike property used in production or administrative activities, investment property generates independent cash flows and is accounted for separately in financial statements.

Investment property can include various types of real estate assets such as leased office buildings, land held for long-term capital appreciation, and commercial properties rented to third parties. The classification of assets as investment property is essential for determining the appropriate accounting treatment and measurement method.

Table 1 Classification of Real Estate Assets under IAS 40

Type of Property	Purpose of Use	Accounting Standard Applied
Owner-occupied property	Production or administrative use	IAS 16 Property, Plant and Equipment
Investment property	Rental income or capital appreciation	IAS 40 Investment Property
Property held for sale	Sale in the ordinary course of business	IAS 2 Inventories

As shown in Table 1, investment property differs from other real estate assets primarily in its economic purpose and accounting treatment.

IAS 40 allows entities to choose between two different measurement models after initial recognition: the cost model and the fair value model. The choice of measurement model significantly affects financial reporting and the presentation of asset values.

Table 2 Measurement Models for Investment Property under IAS 40

Measurement Model	Key Characteristics	Impact on Financial Statements
Cost Model	Property is recorded at historical cost less depreciation and impairment	Stable asset values but may not reflect current market conditions
Fair Value Model	Property is measured at fair value with changes recognized in profit or loss	Reflects current market value but may increase earnings volatility

The fair value model has become increasingly popular among companies because it provides more relevant information about the economic value of assets. However, the choice between these models depends on various factors such as market conditions, valuation reliability, and regulatory requirements.

Fair value measurement is defined in IFRS 13 *Fair Value Measurement* as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. This concept reflects the market-based value of assets rather than entity-specific estimates.

The fair value of investment property is typically determined using one of the following valuation approaches:

1.   Market approach
2.   Income approach
3.   Cost approach

Table 3 Common Valuation Approaches for Investment Property

Valuation Approach	Description	Application
Market Approach	Based on market prices of comparable properties	Suitable in active real estate markets
Income Approach	Based on expected future rental income and cash flows	Common for commercial real estate
Cost Approach	Based on replacement cost of the asset	Used when market data is limited

Among these approaches, the income approach is often applied for commercial real estate, as it focuses on the future economic benefits generated by the property.

The fair value model offers several advantages in financial reporting. First, it allows companies to present assets at their current market value, which improves the relevance of financial information. Investors and stakeholders can better assess the economic value of real estate assets and make more informed decisions.

Second, fair value measurement enhances transparency in financial reporting by reflecting real-time market conditions. This is particularly important in industries where property values fluctuate significantly.

Third, fair value accounting improves comparability between companies operating in similar markets, as it reduces the distortions caused by historical cost accounting.

Table 4 Advantages of Fair Value Accounting for Investment Property

Advantage	Explanation
Relevance	Reflects current market value of assets
Transparency	Provides more accurate information to investors
Comparability	Improves comparison between companies
Decision usefulness	Supports better investment decisions

Despite its advantages, fair value measurement also presents several challenges. One of the main difficulties is the lack of reliable market data in certain real estate markets. In developing economies, property markets may not be sufficiently transparent, making it difficult to determine accurate fair values.

Another challenge is the reliance on professional judgment and valuation estimates. The determination of fair value often requires the involvement of professional appraisers who use complex valuation models. As a result, different valuation methods may produce different estimates for the same asset.

Furthermore, fair value accounting can lead to increased volatility in financial statements. Changes in property values are recognized in profit or loss, which may significantly affect reported earnings.

Table 5 Key Challenges in Fair Value Measurement

Challenge	Description
Limited market data	Lack of reliable information about comparable property transactions
Valuation subjectivity	Dependence on professional judgment
Earnings volatility	Changes in property values affect financial results
Market fluctuations	Real estate prices may vary significantly

The application of fair value measurement under IAS 40 has important implications for financial reporting quality. When applied correctly, fair value accounting can enhance the transparency and usefulness of financial statements. However, improper valuation practices may reduce the reliability of financial information.

To improve the effectiveness of fair value measurement, companies should adopt consistent valuation methodologies, ensure adequate disclosure of valuation assumptions, and engage qualified independent appraisers. Strengthening the regulatory framework and improving market transparency can also contribute to more reliable fair value estimates.

Discussion

The analysis of fair value measurement of investment property under IAS 40 demonstrates that this accounting approach plays an important role in improving the relevance and transparency of financial reporting. Unlike historical cost accounting, the fair value model reflects current market conditions and provides stakeholders with more up-to-date information about the economic value of real estate assets.

One of the main advantages of the fair value model is its ability to provide more relevant financial information for investors and financial analysts. Real estate assets often experience significant changes in value due to fluctuations in market demand, economic conditions, and urban development. By recognizing these changes in financial statements, fair value accounting allows investors to better assess the financial position of companies and evaluate potential risks and opportunities.

However, the application of fair value measurement is also associated with several practical difficulties. One of the most significant challenges is the lack of reliable market data for comparable properties, particularly in developing economies where real estate markets may be less transparent. In such situations, valuation estimates may rely heavily on professional judgment, which can reduce the objectivity and comparability of financial information.

Another important issue concerns the volatility of financial results. Since changes in the fair value of investment property are recognized in profit or loss, fluctuations in real estate prices may significantly affect reported earnings. While this approach improves transparency, it may also create challenges for financial analysis and performance evaluation.

The findings also highlight the importance of professional valuation practices and external audit procedures in ensuring the reliability of fair value estimates. Independent appraisers play a crucial role in determining property values using recognized valuation techniques. In addition, auditors help verify the accuracy of valuation methods and ensure compliance with international accounting standards.

To address these challenges, companies should strengthen internal accounting systems related to investment property measurement. This includes the development of clear valuation policies, regular monitoring of real estate market trends, and improved disclosure practices in financial statements. Greater transparency regarding valuation assumptions and methodologies can significantly enhance the credibility of financial reporting.

Furthermore, regulators and standard-setting bodies may consider providing additional guidance on fair value measurement in markets where reliable valuation data is limited. Such guidance would help reduce inconsistencies in accounting practices and improve the comparability of financial information across companies and jurisdictions.

Conclusion

Investment property represents a significant category of assets for many companies, particularly those operating in real estate and investment-related industries. The application of fair value measurement under IAS 40 has substantially improved the relevance and transparency of financial reporting by allowing companies to reflect current market conditions in their financial statements.

The study shows that the fair value model provides more informative financial data for investors and decision-makers compared to the cost model. By presenting investment property at market value, companies can offer stakeholders a clearer understanding of their financial position and asset performance. This approach also enhances the usefulness of financial information for investment analysis and strategic planning.

At the same time, the research identifies several challenges associated with the practical implementation of fair value measurement. These include the limited availability of reliable market data, the subjective nature of valuation estimates, and the potential volatility of financial results caused by fluctuations in property values.

Addressing these issues requires improvements in valuation methodologies, greater involvement of professional appraisers, and enhanced disclosure practices in financial reporting. Companies should also strengthen their internal accounting systems and ensure compliance with international accounting standards to improve the reliability of fair value estimates.

Overall, the effective application of fair value measurement can significantly enhance the quality of financial reporting and support better financial decision-making. Continued development of accounting standards and valuation practices will play a crucial role in improving the transparency and credibility of investment property accounting in the future.

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