

## Features of Russian Companies Real Estate Appraisal in the Accounting System

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### Abstract

The article is concerned with current requirements to determining the value of accounting items and the order of cadastral value formation. The authors found out differences in fair value definitions; researches its distinction from cadastral and market value; justified an interest in a specific variant of the object appraisal of different groups of internal and external users of financial information by the example of land valuation. Accession of Russia to the WTO dictates new requirements for determining the value of accounting items[1], and, thus, the choice of optimal valuation approach to reflect the actual value of the accounting items through methods understandable to internal and external users. Attraction of investors to the production branches is possible only when business entities provide adequate reflection of financial performance and property status.

**Keywords:** Cadastral value, fair value, market value, accounting and tax accounting.

### 1. Introduction

Under current economic conditions a great emphasis is placed on problems of rational use of material resources. Among most important resources of business entities there are land and capital facilities.

What type of value should be applied for the purposes of accounting or financial accounting and taxation? Should it be cadastral, market, or probably fair value? Let's try to gain insight into possible positive aspects of each particular value.

This article is referred to land or, rather, its appraisal approaches.

### 2. Literature Review

Currently, there are several approaches to land value appraisal:

- Book value was used for taxation purposes. It is subject to Russian Accounting Standards.
- Market value is used in some cases, for example, when determining the size of participants' contribution. It is subject to the Federal Valuation Standards.
- Cadastral value is currently used for taxation purposes. It is subject to the RF Government Decree, the Land Code of the Russian Federation, Federal Valuation Standards and a number of other regulatory documents.
- It is typical that recently - a fair value has been associated with the implementation of IFRS in national accounting practices. It is subject to the International Financial Reporting Standards[2].

The book value approach is more or less clear: it is formed as a result of acquisition. But other approaches should be considered more closely.

Real estate appraisal is a process of determining market value of property or certain rights therein. The real estate appraisal includes: valuation of property rights or other rights, such as a right to lease, a right to use, etc. for various real property items. [3]

Determination of market value of the subject property presumes determination of the most probable price at which the property may be alienated on an open and competitive market as of the valuation date, provided that parties to the transaction act reasonably and possess all the necessary information, and assuming the transaction price does not depend on any extraordinary circumstances. That is when:

- one of the parties is not obliged to dispose of property being valued, and the other is not obliged to accept

performance;

- parties to the transaction are aware of the subject of the transaction and act in their own interests;
- subject property is brought to the open market through a public offer, typical of similar properties being appraised;
- transaction price is a reasonable consideration for the property being appraised with no compulsion of the parties to transaction settlement from third parties;
- payment for the subject property is expressed in monetary terms.

Determination of cadastral value of the subject property presumes determination by methods of mass appraisal of market value established and approved in accordance with laws governing the cadastral valuation conduction. Cadastral value is determined by an appraiser[4], in particular, for tax purposes. [5] The essence of cadastral value of property its determination on the basis of average value of objects in each cadastral unit. With no consideration for specific individual features of land plots, such as: legal history of the plot; access features; encumbrances and restrictions on economic activity of the plot, special importance of real estate located on the plot. As a result, practically, the difference between actual market value of a particular object and its cadastral value can be very significant. [6]

There is another definition of cadastral value supplementing the first one. Cadastral value is a fixed market value of property determined in the process of state cadastral valuation by the mass appraisal method, or market value determined individually for a specific property in accordance with the legislation on appraisal activity in cases, where the appliance of mass appraisal method is impossible. [7]

Meanwhile, in case of determining market value of the land plot, its cadastral value is set as equal to its market value. [8]

In recent times a revaluation in the process of arguing cadastral value of the land plot has become frequent. This revaluation takes into account individual characteristics of the subject property. This results in a reduction in the value of the subject property, and, hence, in the size of tax payments. But this procedure is costly (evaluation, appraisal expertise [9], court costs and etc.) and time consuming.

In current accounting practice cadastral value has no effect on the data recognized in the financial statements. And market value is used:

- in determining the value of allotted shares of the Company purchased by the Company[10] by the decision of the General Meeting of Shareholders or of the Board of Directors (Supervisory Board) of the Company;
- in determining the value of non-cash contributions to the authorized (share) capital;
- in determining the value of donated property;
- and in other cases not affecting directly the financial statements.

On the grounds of concepts of cadastral and market value it is obvious that market value has wider application.

According to IFRS 40 *Investment Property*[11], a fair value is the price that would be received to sell an asset or paid to settle a liability in an orderly business transaction between market participants at the measurement date. That is the price at which a company would sell an asset or debt of a third party. [12]

This formulation is close to the definition of the market price given in the Russian valuation standards mandatory for practitioners of valuation activities and, therefore, for all market participants. Thus, according to the said standards, market value of the subject property is the most probable price at which it can be sold on the open market in a competitive environment [13].

According to IFRS 13 *Fair Value Measurement*[14], there are three approaches to fair value measurement (market approach, income approach, and cost approach) and three levels of hierarchy of the inputs used to measure the fair value of assets and liabilities based on the application of judgement. [12] All of the foregoing complies with requirement of the clause 20 of the Federal Valuation Standard No. 1 "General Valuation Concepts; Approaches and Requirements to Valuation (FVS No. 1)", according to which the appraiser must apply market, income and cost approaches in the process of value measurement [15].

As can be seen from the definitions, the market and fair values are similar enough and essentially duplicate each other.

The similarity of market value and fair value concepts are typical for the world practice of accounting. IFRS 16 *Property, Plant and Equipment* states [16] fair value is the price that would be received to sell an asset or paid to transfer a liability in conducting operations on a voluntary basis between market participants at the measurement date.

Thus, a similar concept of market value (which is used in the cases mentioned above) appeared in domestic practice.

### 3. Unresolved Issues

In general, considering the above mentioned types of value it is possible to build the following sequence of values (in descending order): cadastral value → market (fair) value → balance-sheet value (this hierarchy is typical of market functioning conditions in the case of property overcosting as it currently happens to be).

This provision also will be typical in the near future for measurement of cadastral value of capital facilities.

Let us create a table 1 "Identification of the value types in relation to the intended use" for illustration of defined value types and preferences of its users:

**Table 1.** Identification of the object value type in relation to the intended use

User	Value for accounting purposes	Value for tax purposes
Owners	Market (fair) value - reflects the real value of financial assets	Balance-sheet value - reduces the burden in the form of tax payments
Tax authorities	Balance-sheet value - is supported by primary accounting documentation	Cadastral value - increases the amount of budget revenues
Investors	Market (fair) value - reflects the real value of financial assets	Market (fair) value - reflects the real value of financial assets
Banking structures	Market (fair) value - reflects the real value of financial assets	Market (fair) value - reflects the real value of financial assets
Creditors	Market (fair) value - reflects the real value of financial assets	Have no preferences

As the table shows, the greatest preference should be given to market (fair) value which satisfies the maximum interests of the most of users.

But for budgetary policy cadastral value would be preferable despite the increase in the tax burden on a market participant even under the stipulation that it does not reflect the real value of the property being appraised.

Thus, to increase tax revenues we need to use cadastral value.

What are the solutions?

### 4. Conclusion

More effective, in our opinion, will be determination of market value within statutory prescribed intervals by a business entity itself[17]. Firstly, the material cost will be significantly lower (appraisal price for Kazan is about RUR6,000-15,000 without a mandatory requirement for expert examination of the appraisal report, the cost of which in a number of Russian self-regulatory organizations of appraisers amounts to RUR80,000 - 100,000). Secondly, each business entity will be personally interested to meet the deadlines of market value determination; otherwise the value will be determined by the state without the right of appeal up to the next period which, according to current legislation, is 5 years [13].

No less effective method is to determine cadastral value using a method lying in its definition, namely, through interaction with the Federal Service for State Registration, Cadastre and Cartography as related to a regular exchange of information contained in the Uniform State Register of Real Property Rights and Transactions Therewith. Statistical data can be obtained on the basis of the results of specific real estate transactions which are recorded by the Registration Chamber on a daily basis. [18]

An average price within a specific cadastral unit will be the most reliable one as it is a result of the needs of the buyer and seller. Also, the price of the transaction will correspond to the definition of fair value, which, within the accounting reform, contributes to easy transition to IFRS, and the property status of business entities will increase their attractiveness to investors.

And the objects' value determined by state bodies will cease to be considered as extremely overpriced, i.e. a kind of quit rent.

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