# Deliberation on IFRS

**IAS-1,2,,7, 8,10, 12,16,17,18,19,20, 23, 24,27,28,31,32,36,37,38,39,40**

**IFRS -5,6,7, 8**

## by


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# IAS-40

# Investment Property

# What is investment property

is property held to earn rentals or for capital appreciation or both.

Rather than for -

- Use in the production or supply
- Sale in the ordinary course of business

# Investment property

Owner

Lessee under financial lease

Lessor under operating lease

Lessee under operating lease in Exceptional circumstances

→

Holds land or building or even part of the building for earning rentals or capital Appreciation

Assets can be under operating lease

→

Apply IAS-40

# **Scope**

- Recognition
- Measurement
- Disclosure

of investment property.

# <u>Investment property</u> (IP) inclusion and exclusion

| **Property classified as IP under IAS-40** | **Property which are not IP under IAS-40** |
|---|---|
| • Land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business | • Property held for use in the production or supply of goods or services or for administrative purposes. |

# <u>Investment property</u> (IP) inclusion and exclusion

| **Property classified as IP under IAS-40** | **Property which are not IP under IAS-40** |
|---|---|
| • Land held for a currently undetermined future use | • Property held for sale in the ordinary course of business or in the process of construction or development for sale – IAS-2, Inventories applies |

# <u>Investment property</u> (IP) inclusion and exclusion

| **Property classified as IP under IAS-40** | **Property which are not IP under IAS-40** |
|---|---|
| • A building owned and leased out under one or more operating leases | • Property being constructed or developed on behalf of third parties – IAS-11, Construction Contract applies |

## <u>Investment property</u> (IP) inclusion and exclusion

| **Property classified as IP under IAS-40** | **Property which are not IP under IAS-40** |
|---|---|
| • A vacant building which is held to be leased out under one or more operating lease | • Owner-occupied property, including property intended to be used as owner occupied property – IAS-16, Property, Plant and Equipment applies |

# <u>Investment property</u> (IP) inclusion and exclusion

| **Property classified as IP under IAS-40** | **Property which are not IP under IAS-40** |
| --- | --- |
| | • Property that is being constructed or developed for future use as investment property. This is a development property until construction or development is complete – IAS-16 applies at which time the property becomes investment property |

# **Investment property** (IP) inclusion and exclusion

| **Property classified as IP under IAS-40** | **Property which are not IP under IAS-40** |
|---|---|
| | • Property leased out under finance lease- IAS-17, Lease applies |

# Recognition

- it is probable that the future economic benefits that are associated with the investment property will flow to the entity

- The cost of the investment property can be measured reliably

# Measurement

an investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement.

# Measurement of leased property

The assets shall be recognised at the lower of the its fair value of the property and the present value of the minimum lease payment

# Measurement after recognition

As an entity shall choose as its accounting policy either the fair value model or the cost model

# Fair value model

The entity that chooses the fair value model shall measure all of its investment property at fair value with exception of inability to determine fair value reliably.

# Accounting in fair value model

A gain or loss arising from a change in the fair value of investment property shall be recognised in profit or loss for the period in which it arises.

# Fair value

- The fair value of investment property is the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction.

- Fair value without any deduction for transaction costs it may incur or sale or other disposal.

# Continuance of Fair value model

If an entity has previously measured an investment property at fair value, it shall continue to measure the property at fair value until disposal (or until the property becomes owner-occupied property or the entity begins to develop the property for subsequent sale in the ordinary course of business) even it comparable market transactions become less frequent or market prices become less readily available.

# Cost Model

An entity that chooses the cost model shall measure all of its investment property in accordance with IAS-16's requirements for that model, other than those that meet the criteria to be classified as held for sale.

# Transfers

| | |
|---|---|
| • Commencement of owner occupation – Transfer from investment property to owner - occupation | • Fair value of the investment property at the date of change in use is treated as deemed cost of the property under IAS-16 |

# Transfers

| | |
|---|---|
| • Commencement of development for sale – transfer from investment property to inventories | • Fair value of the investment property at the date of change in use is treated as deemed cost of the property under IAS-2 |

# Transfers

| | |
|---|---|
| • End of owner – occupation – Transfer from owner-occupied property to investment property | • Fair value of the property is measured at the date of change in use<br>- if fair value is less than the carrying amount<br>- if the fair value is higher than the carrying amount |

# Transfers

| | |
|---|---|
| • Commencement of operating lease – Transfer from inventories to investment property | • Fair value of the property is measured at the date of change in use.<br>• The difference between fair value and carrying amount (gain or loss) is recognised in the profit or loss |

# Transfers

| | |
|---|---|
| • End of construction or development – Transfer from Capital Work-in-progress covered by IAS-16 to investment property | • Fair value of the property is measured at the date of change in use<br>• the difference between fair value the carrying amount (gain or loss) is recognised in the profit or loss. |

# **Disposal**

An investment property shall be de-recognised on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.

## Gain or loss on disposal

Gain or loss arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the net asset and shall be recognised in profit or loss (unless IAS-17 requires otherwise on a sale and leaseback) in the period of the retirement or disposal.

# Disclosure
# for both fair value & cost model

- fair value or the cost model
- property interests held under operating leases are classified as investment of property
- criteria it uses to distinguish investment property from owner-occupied property
- Assumption applied in determining the fair value of investment property

# Disclosure
## for both fair value & cost model

- fair value based on a valuation by a qualified independent valuer
- In profit loss for –

  - Rental income
  - Direct operating expenses arising from IP that generated rental income during the period
  - Direct operating expenses arising from IP that did not generate rental income during the period
  - Cumulative change in fair value arising out of sale from pool

# Disclosure

## for both fair value & cost model

- the existence and amounts of restrictions on the reliability of IP or the remittance of income
- Contractual obligations to purchase, construct or development property or for repairs, maintenance or enhancements.

## Additional disclosure – Fair value

- additions arising from subsequent expenditure and arising from acquisitions
- Additions arising from business combinations
- Assets classified as held for sale and other disposals
- Net gains or losses from fair value adjustment

## Additional disclosure – Fair value

- Exchange difference arising from translation of the financial statements into different currency
- Value investment property using cost model when fair value cannot be determined reliably

  - description of IP
  - explanation why fair value cannot be measured
  - range of possible fair value, if possible
  - on disposal, carrying amount, gain or loss

## **Additional disclosure – Cost value**

- Depreciation method used
- Useful lives or the depreciation rate used
- Gross carrying amount and the accumulated depreciation
- A reconcilaition of the carrying amounts of IP at the beginning and end of the period

## Case Study-1

An entity owns a hotel that it leases out (as lesser) under an operating to a hotel management group.The hotel is situated on land leased by government to the entity (as lessee) for a period of 999 years with no transfer of title to the entity at the end of the lease. The hotel building's useful life is expected to be approximately  40 years. There are no provisions in the lease to return the land with the building intact at the end of the 999 years lease.Whether land and building both IP?

## Case Study-1

In this situation, the land should be accounted for as operating lease under IAS-17 and can be recognised as an investment property only if it meets the definition of investment property and the entity has chosen the fair value model for investment property. The building, however, meets the definition of investment property and should be accounted for under IAS-40. A building is recognised as an investment property if the lease of land extends beyond the building's expected useful life and there are no provisions in the lease to return the land with the building intact.

## Case Study-2

Entity A is a supplier of industrial products. In 2003, the entity purchase a plot of land on the outskirt of a major city. The area has mainly low-cost public housing and very limited public transport facilities. The government has plans to develop the area as an industrial park in 5 years time and the land is expected to greatly appreciate in value if the government proceeds with plan. Entity A’s management has not decided what to do with the property. How should management classify such a property that is held for undermined future use?

## Case Study-2

Management should classify the property as an investment property. Although management has not determined a use for the property after the park’s development takes place, in the medium-term the land is held for capital appreciation. IFRS considers land as held for capital for capital appreciation, if an entity has not determined that it will use the land either as owner-occupied property or for short-term sale in the ordinary courses of business [IAS-40 Para 8(b)]

## Case Study-3

Entity A is financial services entity that is involved in a real estate development. Entity A has purchased land in London through the exercise of a purchase options that had been acquired some years ago. The purchase price was INR 10m and the land's fair value as determined by an independent value is INR 23.70m. The entity is undecided about whether to develop the land for sale to a third party or sell it, but will determine a use within the next accounting period. How should management recognise land held for a currently undetermined future use?

## Case Study-3

In this scenario, the land should be classified as inventory. Although the entity has not determined a use, the property is being held either for sale or for further development and eventual sale in the ordinary course of business. Had the entity decided to hold the land for long-term capital appreciation rather than short-term sale in the ordinary course of business, then it would be classified as an investment property.

## Case Study-4

Entity A owns hotel resort, which includes a casino, housed in separate building, that is part of the premises of the entire hotel resort. Its patrons would be largely limited to tourists and non-resident visitors only.

The owner operates the hotel and other facilities on the hotel resort, with the exception of the casino, which can be sold or leased out under a finance lease. The casino will be leased to an independent operator. Entity A has no further involvement in the casino. The casino operator will not be prepared to operate it without the existence of hotel and other facilities.

## Case Study-4-How casino be treated ?

In this scenario, management should classify the hotel and other facilities as property, plant and equipment and the casino as investment property., the casino can be sold separately or leased out under a finance lease.

## **Case Study-5**

Entity A owns a hotel. Entity B, a fellow subsidiary of Entity A, manages a chain of hotels, and receives management fees for operating its chain, except for the hotel owned by entity A. Entity A’s owned hotel is leased to entity B for Rs. 20 lakh a month for a period of 5 years. Any profit or losses from operating entity A’s hotel rests with entity B. The hotel that entity A owns has an estimated remaining useful life of 40 years

## **Case Study-5**

In the consolidated financial statements, the hotel should be classified as property, plant and equipment. This is because it is both owned and managed by the group from the perspective of the group and, therefore, it should be recognised as owner-occupied for the use in the supply of goods or services.

# **Case Study-5**

In the standalone entity accounts of entity A the property (subject to an operating lease) should be classified as an investment property whereas entity B should recognise the transaction as an operating lease arrangement in its individual financial statement and charges the rental payment to the income statement over the period of the lease.

## **Case Study- 6**

In 2007 an investment property with a carrying amount of Rs. 10 lakhs is destroyed by fire. The building element of the property was carried at Rs.300,000. A claim is made for compensation of the entity’s insurers, but has not been agreed at the time that the financial statement for 2007 are issued.

In 2008 the claim is agreed and the entity receives Rs.500,000 in compensation. Also, in 2008 a replacement building is constructed at a cost of Rs. 400,000.

## Case Study- 6

In 2007, the entity recognizes an impairment loss of Rs. 300,000 in respect of the loss of the building. The land element is not impaired, but the entity would continue to account for that element as investment property. The insurance claim has not been agreed at the end of 2007 and so no compensation is receivable at end of 2007 and none can be recognised. In 2008 compensation of Rs. 500,000 is receivable and so is recognised in the income statement for the year. The compensation may not be offset against the cost of the replacement building. Instead, the cost the replacement building of Rs. 400,000 is capitalized and added to the carrying amount of the investment property

## Case Study- 6

Overall, the income statement for the years has shown a net gain of Rs. 200,000 (compensation of Rs. 500,000 less the impairment of Rs.300,000). Had the compensation been receivable in 2007 it would not have been acceptable to net the impairment and the compensation and disclose only a gain of Rs. 200,000, because, as explained above, IAS 40 requires that each of the two economic events be accounted for separately. This differs somewhat from a normal sale or disposal of an asset where only the profit or loss is disclosed in accordance with the rule set out in IAS-40

## Case Study- 7

A property was earlier used as office building by E Ltd.. The property was acquired on 01.01.2002 for Rs. 60 million and depreciated @5% p.a. under straight-line method. Because of diversion of the main road, the locational advantage of property is partly lost and its market value got reduced. Therefore, impairment loss to the extent of Rs. 10 million as charges in 2004.

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## Case Study- 7

The company, thereafter, decided to shift its office to a new building in a better location and leased the building for 5 years to a newspaper publisher (evaluated as operating lease). The fair value of the property on the date on which the lease contract commenced (01.01.2006) was Rs. 42 million.

Find out the profit or loss arising out of the transfer and explained accounting thereof

# Case Study- 7 - Solution

Carrying amount of the owner –occupied property

| | | Rs. in Million |
|---|---|---|
| 01.01.2002 | Cost | 60.00 |
| Less: Dep. for 2002 & 2003 @ Rs.3 million | | 6.00 |
| Depreciated value as on 01.01.2004 | | 54.00 |
| Less: Impairment loss | | 10.00 |
| Less: Dep. for 2004 & 2005 @ Rs.2.2 million | | 4.40 |
| Depreciated value as on 01.01.2006 | | 39.60 |
| Fair value as on 01.01.2006 | | 42.00 |
| Gain | | 2.40 |

## Case Study- 7 - Solution

The entire amount of gain shall be charges to profit or loss since the impairment charge was higher than this gain

## Case Study-8

The fair value of an investment property at the beginning of the year 2006 is Rs. 25 million and at the end of 2006 is Es. 32 million. There is air conditioning plant which was purchased at the beginning of 2001 for Rs. 1 million. It is depreciated @ 10% p.a. The lift installed at the beginning of 2000 costing Rs. 1.2 million is also depreciated @ 10% p.a. Fair value of investment property does not include value of equipment. As per Para 50 of IAS-40, the company wishes to present an all-inclusive fir value of investment property. Assume that depreciated book value of equipment represents fair value at the beginning of the year whereas the fair value of investment property at the year end includes value of equipment.

# Case Study-8

| | |
|---|---|
| Gain on revaluation | Rs. 6 million |

Gain should be recognised in the profit or loss for the year

# <u>Case Study -9 Liberty International PLC, 2007</u>

Investment properties are properties owned or leased by the group which are held for long-term rental income and for capital appreciation. The group has elected to use the fair value model. IP is initially recognised at cost and subsequently revalued at the balance sheet date to fair value as determined by professionally qualified external valuers on the basis of market value. Market value is arrived at after deducting notional acquisition costs  In accordance with IAS-40, “Investment Property”, property held under leases is stated gross of the recognised finance lease liability

# <u>**Case Study-9 Liberty International PLC, 2007**</u>

Gains or losses arising from changes in the fair value of investment property are recognised in the income statement of the period in which they arise. Depreciation is not provided in respect of investment properties including integral plant.

When the group redevelops an existing investment property for continued future use as an investment property, the property remains an investment property measured at fair value and is not reclassified

## Case Study -9 Liberty International PLC, 2007

Interest is capitalized (before tax relief), on the basis of the average rate of interest paid on the relevant debt outstanding until the date of practical completion.

When the use of the property changes from that of trading to investment, that property is transferred at fair value, with any resulting gain being recognised as property trading profit.

## Case Study -9 Liberty International PLC, 2007 Development Property

The group has elected to use the fair value model as reliable estimates are available. Property under development and land are initially recognised at cost and subsequently revalued at the balance sheet date to fair value as determined by professionally qualified external valuers. Cost includes interest and other directly attributable outgoings, except in the case of properties and land where no development is imminent, in which case no interest is included.

# **Case Study- 9 Liberty International PLC, 2007**

## **Development Property**

In accordance with IAS 16 – “Property, Plant and Equipment”, gains and losses arising from changes in the fair value of development property are dealt with in reserves to the extent that fair value exceeds cost and are otherwise recognised in the income statement. Upon completion, development property to be held for long-term rental income and capital appreciation are transferred to investment property.

# Case Study-9 Liberty International PLC, 2007

## Leases

Leases are classified according to the substance of the transaction. A lease that transfers substantially all the risks and rewards of ownership to the lessee is classified as a finance lease. All other leases are normally classified as operating leases.

# Case Study-9 Liberty International PLC, 2007 Group as lessee

In accordance with IAS 40, finance and operating leases of investment property are accounted for as finance leases and recognised as an asset and an obligation to pay future minimum lease payments. The investment property asset is included in the balance sheet at fair value, gross of the recognised finance lease liability. Lease payments are allocated between the liability and finance charges so as to achieve a constant financing rate. Other finance-leased assets are capitalized at the lower of the fair value of the leased asset or the present value of the minimum lease payments and depreciated over the shorter of the lease term and the useful life of the asset. Rentals payable under operating leases are charged to the income statement on a straight-line basis over the lease term.

## Case Study-9 Liberty International PLC, 2007
## Group as lessor

Assets leased out under finance leases are recognised as receivables at the amount of the group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant rate of return on the net investment. Assets leased out under operating leases are included in investment property, with rental income recognised on a straight-line basis over the lease term.

# Investment & development property

| | Freehold | Leasedhold over 50 years | Total $ million |
|---|---|---|---|
| At January 2007 | 4,699.40 | 3,487.70 | 8,187.10 |
| Additions | 424.90 | 636.90 | 1,061.80 |
| Disposals | (157.40) | (146.00) | (303.40) |
| Foreign exchange fluctuations | (6.20) | - | (6.20) |
| Deficit on valuation | (155.40) | (161.10) | (316.50) |
| At 31December 2007 | 4,805.30 | 3,817.50 | 8,622.80 |

# Investment & development property

| | Freehold | Leasedhold over 50 years | Total $ million |
|---|---|---|---|
| At January 2006 | 3,904.70 | 3,033.10 | **6,937.80** |
| Additions | 496.20 | 243.00 | **739.20** |
| Disposals | (102.70) | (14.20) | **(116.90)** |
| Transfers from trading propeties | 92.40 | 16.30 | **108.70** |
| Foreign exchange fluctuations | (40.20) | - | **(40.20)** |
| Gain on valuation | 349.00 | 209.50 | **558.50** |
| At 31December 2006 | 4,699.40 | 3,487.70 | **8,187.10** |

# Investment & development property

| | As at 31 Dec 2007 ($million) | As at 31 Dec 2006 ($ million) |
|---|---|---|
| Balance sheet carrying value of investment and development properties | 8,622.80 | 8,187.10 |
| Adjustment in respect of head leases and incentives | 12.10 | 18.90 |
| **Market vlaue of investment and development properties** | 8,634.90 | 8,206.00 |

# Investment & development property

| | UK ($ million) | US ($ million) | Total ($ million) |
|---|---|---|---|
| **Geographical analysis** | | | |
| At 31 December 2007 | 8,245.50 | 377.30 | **8,622.80** |
| At 31 December 2006 | 7,833.50 | 353.60 | **8,187.10** |

Included within investment and development properties is $13.8 million (31 Dec 2006 - $3.3 million) of interest capitalized on development and redevelopment in progress. The group's interests in investment and development properties were valued as at 31 Dec 2007 by independent external valuers in accordance with the Appraisal and Valuation Manual of RICS, on the basis of market value represents the figure that would appear in a hypothetical contract of sale between a willing buyer and a willing seller.

***THANK YOU***

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