A Digital Learning Platform for Generation Z: Passport to IFRS®

IAS® Standard 40 Investment Property

Funded by the Erasmus+ Program of the European Union. However, European Commission and Turkish National Agency cannot be held responsible for any use which may be made of the information contained therein.

CASE STUDY- IAS 40 INVESTMENT PROPERTY

Introduction

Many entities hold land or buildings to earn rentals or for capital appreciation. These assets represent investment property and different measurement principles apply to them than to items of property, plant and equipment, the category in which land and buildings used in production or for administrative purposes are included.

Aim of this case study is to discuss the consequences of the measurement of assets classified as investment property on the financial statements.

The Case Information

You work for NiceHotels Co., an entity managing several hotels. Some buildings are used as hotels by NiceHotels, while others are rented out, usually on the short term, to entities that are expected to use the building for similar purposes. Therefore, it is not costly for NiceHotels to change the use of the buildings. This flexibility (enhanced by the flexibility of the staff to move from one location to another) provides management with the opportunity to make decisions in line with the market evolution. Decisions are made based on the prospects for sales (resulting from the use as hotels) and on the expected impact of the measurement of the building on the financial statements.

You are asked to assess each of the following cases (all amounts in CU):

Property	20X1 Carrying amount	20X1 Fair value	Estimated amount for the end of 20X2	Estimated amount for the end of 20X3
Sea Sun	120,000	130,000	125,000	128,000
Mountain View	85,000	80,000	78,000	81,000
Central	65,000	67,000	64,000	68,000

- The Sea Sun is used by NiceHotels as a hotel and is located at the seaside. The building was purchased 10 years ago, and is depreciated annually for CU10,000. The rainy summer of 20X1 shortened the summer season and the hotel generated losses. Thus, NiceHotels considers renting the Sea Sun to a large car manufacturer that is in search of a location to organise regular in-house team building sessions.
- The Mountain View hotel has been rented out until this year. NiceHotels considers using it again as a hotel, given the good prospects of attracting tourists in the near future. The estimated remaining useful life of the building is 20 years.
- The Central is a former hotel that NiceHotels owns in the city centre. The building is rented out and management intends to keep it rented for at least 3 years.

- The accounting policies of NiceHotels are to use the cost model and the straight-line depreciation method for its property, plant and equipment assets, and the fair value model for investment properties.

Discussion Questions

Calculate and discuss the implications on the financial statements of NiceHotels Co. of the scenarios considered by the management for each asset. In doing so, you must also assess the implications of the transfer from one category to another that would take place at the end of 20X1, should management decide to make the transfer.

SOLUTION OF CASE STUDY- IAS 40 INVESTMENT PROPERTY

The Sea Sun is used as an asset by NiceHotels in the sale of accommodation services, and is therefore classified as property, plant and equipment. Being used for 10 years by the end of 20X1, it was depreciated for CU10,000 * 10 years = CU100,000. Therefore, the initial cost of the building was CU220,000 (the current carrying amount of CU120,000 + CU100,000 of accumulated depreciation). The asset will be measured as follows under the two scenarios that are considered by management for it (all amounts are in CU):

Scenario	**Use the Sea Sun as a hotel**	**Rent the Sea Sun out**
Type of asset	Owner-occupied property (Property, plant, and equipment)	Investment property
Measurement	Cost (depreciated amount)	Fair value
20X1	120,000	The building is transferred from property, plant and equipment to investment property. The asset should be measured at fair value before the transfer; hence it is revalued at its fair value (of 130,000) and a revaluation reserve of 10,000 is therefore recognized.
20X2	120,000 – 10,000 (depreciation) = 110,000	125,000 (a loss of 5,000 is recognized from fair valuing the investment property)
20X3	110,000 – 10,000 (depreciation) = 100,000	128,000 (a gain of 3,000 is recognized from fair valuing the investment property)

The Mountain View has been rented out; therefore, it is currently treated as investment property. If it is kept as investment property, it will continue to be measured at fair value. If it is transferred to owner-occupied property, the fair value at that date becomes the cost that will be depreciated thereafter. The asset will be measured as follows under the two scenarios that are considered by management for it (all amounts are in CU):

Scenario	**Rent the Mountain View out**	**Use the Mountain View as a hotel**
Type of asset	Investment property	Owner-occupied property (Property, plant, and equipment)
Measurement	Fair value	Cost (depreciated amount)

20X1	80,000 (a loss of 5,000 is recognized from fair valuing the investment property)	The building is transferred from investment property to property, plant and equipment, at its fair value (of 80,000) (a loss of 5,000 is recognized during this transfer). Starting 20X2, the building will be depreciated over 20 years.
20X2	78,000 (a further loss of 2,000 is recognized from fair valuing the investment property)	80,000 – 4,000 (depreciation; 80,000/20 years) = 76,000
20X3	81,000 (a gain of 3,000 is recognized from fair valuing the investment property)	76,000 – 4,000 (depreciation) = 72,000

In terms of the decisions that NiceHotels' management considers for these two buildings, management must assess the prospects of each of them to generate sales revenue and cash inflows, and compare them to the forecast expenses and expenditures, under the 'owner-occupied' scenario. The prospective profit and cash figures that result from this option should thereafter be compared to the profit or loss impact of fair valuing investment properties in the alternative scenarios.

The Central is rented out and therefore it is classified as investment property. It is therefore measured at fair value. There are no other scenarios for this asset. Therefore:

- At the end of 20X1: the asset is measured at CU67,000 (a gain of CU2,000 is recognized from fair valuing the investment property)
- At the end of 20X2: the asset measured is at CU64,000 (a loss of CU3,000 is recognized from fair valuing the investment property)
- At the end of 20X3: the asset is measured at CU68,000 (a gain of CU4,000 is recognized from fair valuing the investment property).