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IAS® Standard 40 Investment Property

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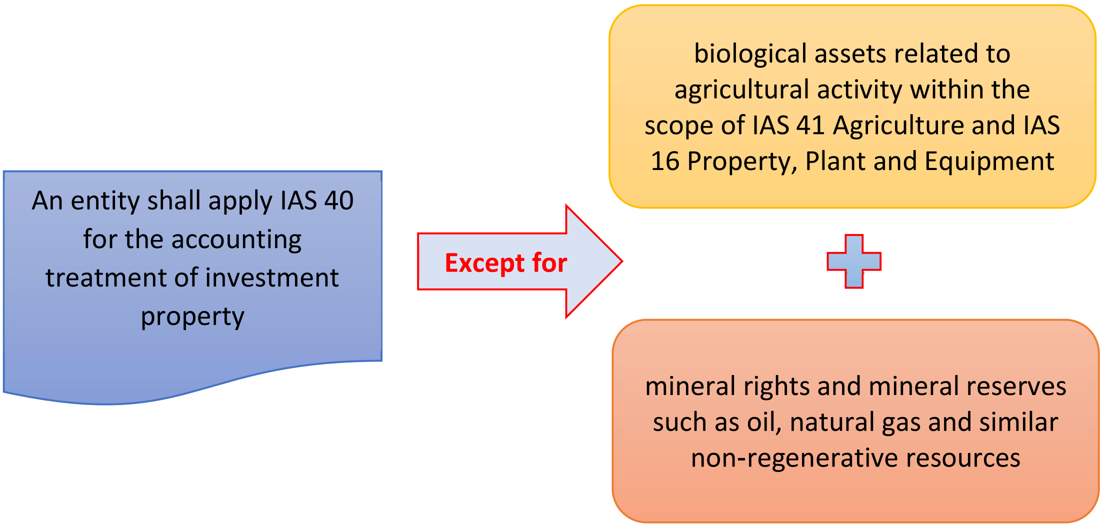
IAS® Standard 40 Investment Property

SCOPE AND KEY DEFINITIONS

Entities apply IAS Standard 40 Investment Property for the recognition, measurement and disclosure of their investment properties, except for biological assets related to agricultural activity, mineral rights and mineral reserves, as shown in Figure 1 (IAS 40.4).

Figure 1. Scope of IAS 40



The distinction between investment property and owner-occupied property is critical in applying IAS 40 (Figure 2). Investment property as defined in the standard (IAS 40.5) is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both, rather than for (a) use in the production or supply of goods or services or for administrative purposes; or (b) sale in the ordinary course of business. Owner-occupied property is property held (by the owner or by the lessee as a right-of-use asset) for use in the production or supply of goods or services or for administrative purposes.

Figure 2. Investment property or owner-occupied property (IAS 40.7)

Investment property	Owner-occupied property
held to earn rentals or for capital appreciation or both; generates cash flows largely independently of the other assets held by an entity.	held for use in the production or supply of goods or services or for administrative purposes; generates cash flows that are attributable not only to the property, but also to other assets used in the production or supply process.

For example, considering the concepts defined above, we analyse and decide on the correct classification of the following assets:

Property	Classification	Applicable standard
A building or land intended for rental / held to be leased out under operating lease(s)	Investment property	IAS 40
A building used by the entity to conduct its operating activities	Owner-occupied property	IAS 16
A building acquired exclusively for development and resale in the ordinary business cycle	Inventory / Merchandise	IAS 2
Land or a building held for long-term capital appreciation	Investment property	IAS 40
A building being constructed for future rental or capital appreciation	Investment property	IAS 40
A building being constructed for future sale in the ordinary course of business	Inventory / Finished goods	IAS 2
A building that is occupied by the entity's employees	Owner-occupied property	IAS 16
Land held for a currently undetermined future use (such property is regarded as held for capital appreciation)	Investment property	IAS 40

Let's assume the case of an entity that operates the following assets: a piece of property intended for sale in the ordinary course of business, a property being constructed for selling it to a customer, a property being used in the normal operating cycle of business, and a property owned and leased out to third parties. Which one(s) of these assets will be classified as investment property? Only the last asset (owned and leased out to third parties) will be classified as investment property.

RECOGNITION

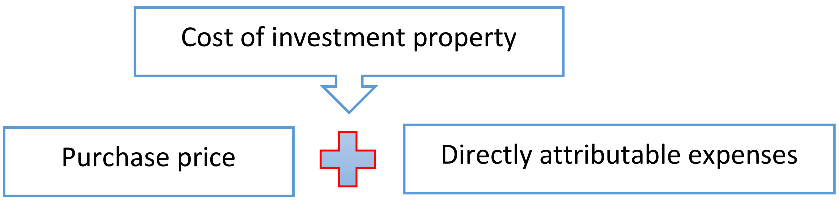
Consistent with the general recognition criteria for assets, an owned investment property shall be recognised as an asset when, and only when: (a) it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and (b) the cost of the investment property can be measured reliably (IAS 40.16).

MEASUREMENT

1. Measurement at recognition

Investment property is initially measured at cost, including transaction costs. Therefore, the cost of a purchased investment property is determined as presented in Figure 3.

Figure 3. Determining the cost of investment property for initial recognition



The items directly related to the acquisition include all the costs that are incurred to bring the property to the condition necessary for it to be capable of operating in the manner intended by management, such as professional fees for legal services, property transfer taxes and other transaction costs.

For instance, an entity purchases a piece of land for CU50,000 with the purpose of renting it as a parking lot to a local hypermarket. The contract is drafted by a notary office for a fee of 5% of the land's price. The property transfer is also bearing non-refundable taxes paid to the state authorities of 10% of the transaction's amount. In this case, the initial value that the land will be recognised at by the business as investment property is calculated as follows:

Cost of the investment property = Purchase price + Notary fee + Non-refundable taxes =

= CU50,000 + 5% x CU50,000 + 10% x CU50,000 = CU57,500.

The initial cost should not include start-up costs, abnormal waste, or initial operating losses incurred before the investment property achieves the planned level of occupancy (IAS 40.23).

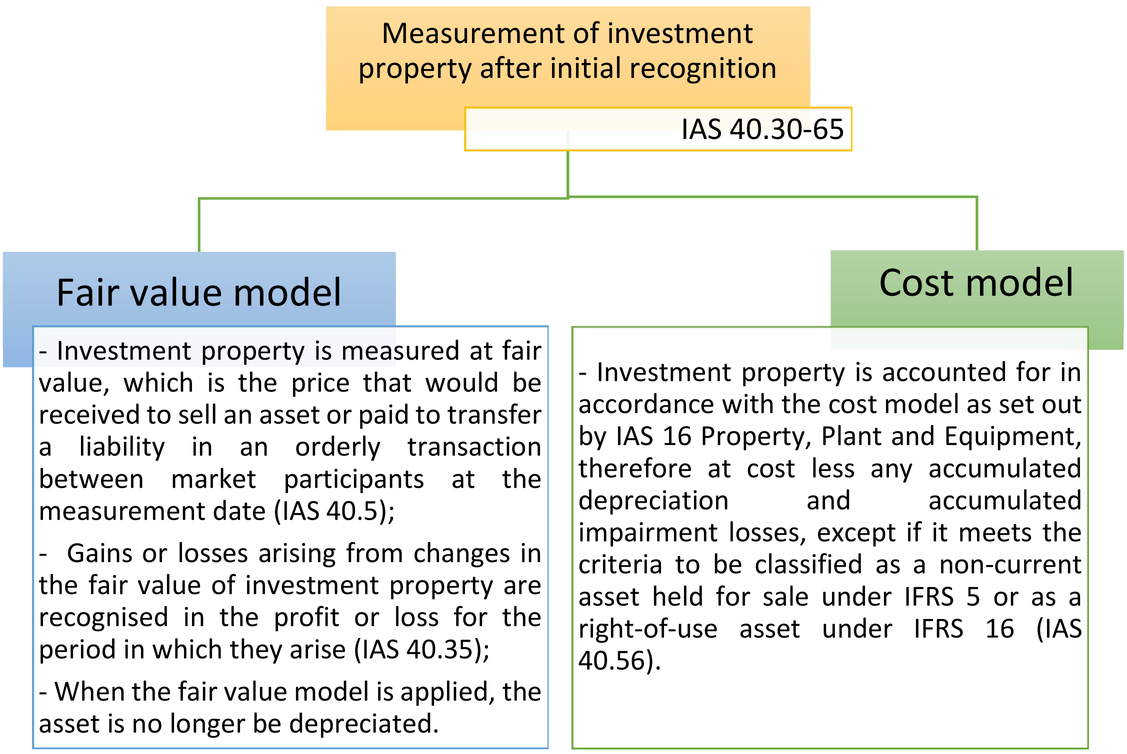
2. Measurement after recognition

In accordance with IAS 40, entities may choose between a fair value model and a cost model for the measurement of their investment properties after their initial recognition (IAS 40.30). Once the choice that fits better the economic circumstances is made, that accounting policy shall be applied to all investment properties of the business.

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors states 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 effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows. It is highly unlikely that a change from the fair value model to the cost model will result in a more relevant presentation (IAS40.31).

The accounting treatment and procedures applied for each model are presented in Figure 4.

Figure 4. Measurement of investment property after recognition



For example, Tropical Sights Ltd. purchases for CU100,000 an asset that it classifies as an investment property on 01.02.2020. Tropical Sights determines the fair value of the asset to be CU150,000 on 31.12.2020, and CU80,000 on 31.12.2021. How will these changes in the fair value of the asset be presented in the entity's financial statements, if the entity carries its investment properties at fair value in accordance with IAS 40?

These changes will be reported in profit or loss for the respective year, as value adjustments resulting from fair valuing investment property. Specifically, Tropical Sights will recognize a gain of CU50,000 from fair valuing these investments on 31.12.2020, and losses of CU70,000 resulting from fair valuing investment property on 31.12.2021.

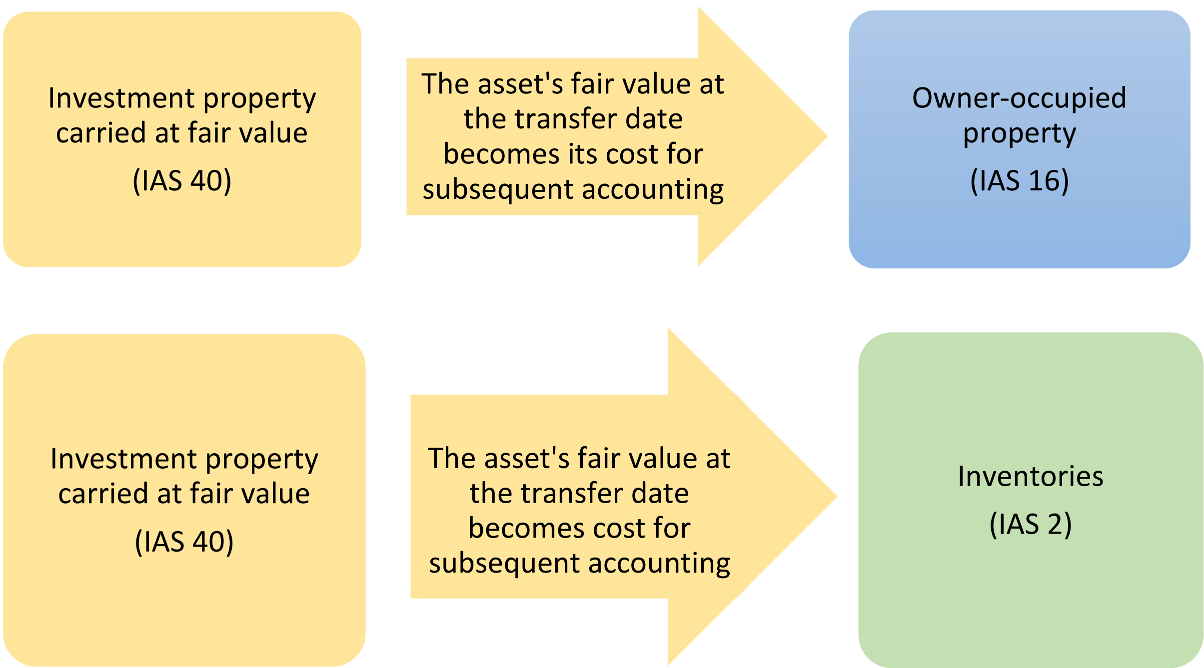
Let's also consider the case of Hook Ltd. purchasing investment property for CU200,000 on 15.01.20X1. On 31.12.20X1, Hook determined the fair value of the investment property to be CU225,000. In accordance with IAS 40, knowing that the fair value model is used for the measurement of the asset, Hook Ltd. will recognize on 31.12.20X1 a gain resulting from the change in fair value and will journalise this change as follows:

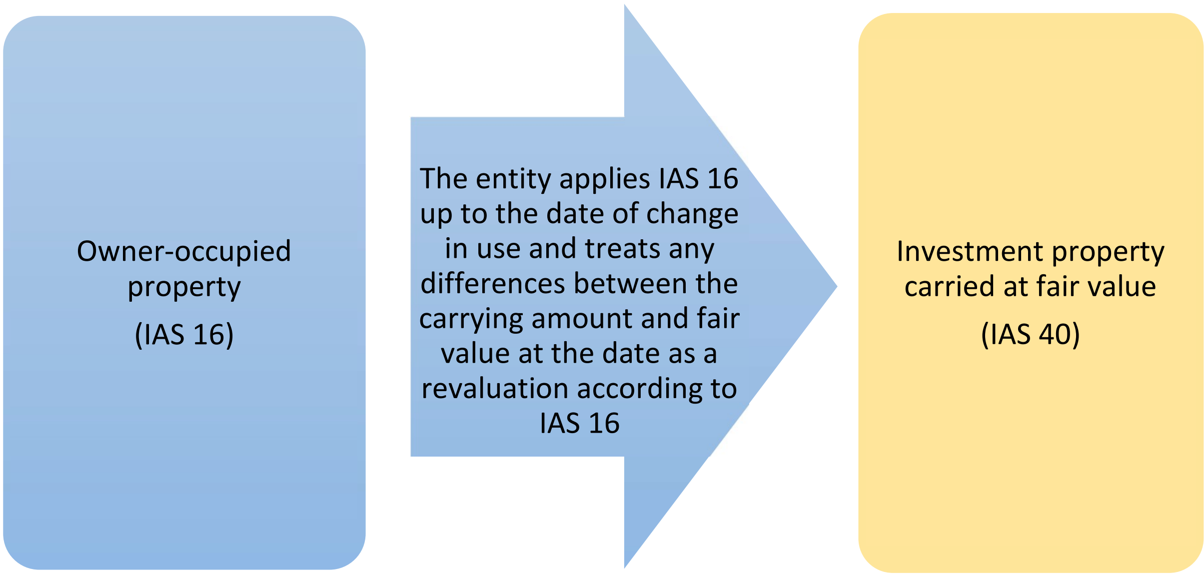
Dr. Investment property 25,000
    Cr. Gains from fair valuing investment property CU25,000

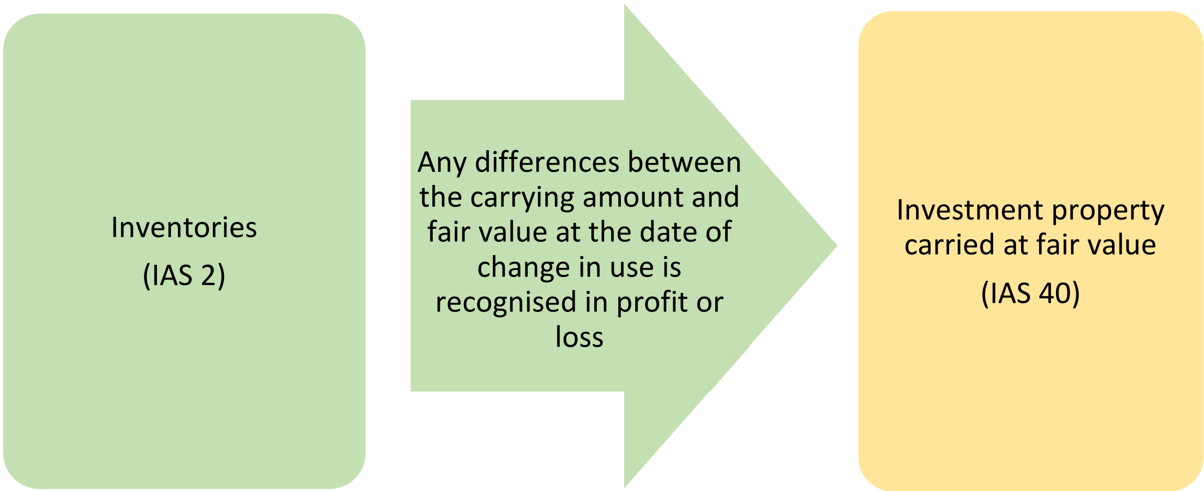
3. Transfers to or from investment property

In accordance with IAS 40, transfers to, or from, investment property, should only be made when there is a change in use. Such a change in use occurs when the property meets, or ceases to meet, the definition of investment property, and there is evidence of the change in use (IAS 40.57) (see Figure 5).

Figure 5. Transfers to or from the investment property category







For example, Cleaning Services Ltd. owns as at 31.12.2019 a building which is used for the entity's administrative purposes. The building's cost is CU175,000 and depreciation has accumulated up to date for CU25,000. On the same date, the entity's management decides to rent the building, its fair value being determined to be CU180,000. On 31.12.2021, the asset's fair value is CU160,000. How will these changes be reflected in the entity's financial statements?

At the transfer date (31.12.2019), the difference between the asset's carrying amount established in accordance with IAS 16 (CU150,000) and its fair value (CU180,000) is treated as a revaluation (a revaluation surplus of CU30,000 is recognized). Thereafter, IAS 40 principles apply, and the asset is initially recognized at CU180,000. If the fair value model in IAS 40 is used by Cleaning Services Ltd., on 31.12.2021, an investment property of CU160,000 is reported in the statement of financial position and losses resulting from fair valuing investment properties of CU20,000 are reported in the statement of profit or loss.

Let's also consider the case of General Rentals Ltd. who owns investment property (an office building) which was rented to third parties. On 31.12.20X2, managers of General Rentals Ltd. decided to start using this building for administrative purposes. The building's fair value on 31.12.20X1 is estimated to CU22,000, and to CU22,500 on 31.12.20X2. The carrying amount of the investment property on 31.12.20X1 is CU20,000. At the date of the change in use, the estimated useful life of the building is 20 years.

Based on the information provided, the entity will apply the accounting treatment for investment property measured at fair value for financial years 20X1 to 20X2 according to IAS 40. On 31.12.20X2, the building will be reclassified from investment property to owner-occupied property - buildings used by the entity (a change from IAS 40 to IAS 16). Starting 01.01.20X3, the building will be held for the entity's own use and will be valued at cost less any accumulated depreciation and accumulated impairment adjustments under IAS 16 Property, plant, equipment.

Consequently, General Rentals Ltd.'s financial statements will be impacted as follows:

On 31.12.20X1 – Fair valuing the investment property at CU22,000 (according to IAS 40)

Since the asset's carrying amount is CU20,000 and its fair value is CU22,000, the asset's value should increase by CU2,000. The entity journalises

Dr. Investment property 2,000
Cr. Gains from fair valuing investment property 2,000

On 31.12.20X2 – Reclassification of the investment property to owner-occupied property (a switch from IAS 40 to IAS 16). According to IAS 40, the fair value of the building at the date of the change in use is the deemed cost of the property under its new classification. As such, the deemed cost of the owner-occupied property is CU22,500 (the new fair value). Since the asset's carrying amount before the transfer was CU22,000 (previous fair value), the entity should further increase the asset's value by CU500 and then transfer the asset to property under IAS 16. Therefore, the journal entry will be:

Dr. Buildings 22,500
Cr. Investment property 22,000
Cr. Gains from fair valuing investment property 500

On 31.12.20X3, the entity recognizes the annual depreciation of the building for one year of use, according to IAS 16. The building's annual depreciation = Carrying amount / Useful life = CU22,500 / 20 years = CU1,125.

Dr. Depreciation expense 1,125
Cr. Accumulated depreciation of buildings 1,125

DERECOGNITION

An investment property shall be derecognised (eliminated from the statement of financial position) upon disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal (IAS 40.66).

Gains or losses 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 asset, and shall be recognised in profit or loss (unless IFRS 16 requires otherwise for activities of sale and leaseback) for the period of the retirement or disposal (IAS 40.69).

Let’s consider the case of an entity that owns on 31.12.2021 a garage for rental purposes. The asset was accordingly classified as investment property in accordance with IAS 40 and was measured at fair value in the amount of CU20,000. On 25.01.2022, the entity decided to withdraw the property from use, as the agreement with the lessee terminated on the date and the garage can no longer be used. Therefore, the entity will record the disposal of the garage as follows:

Dr. Expenses with the disposal of investment property 20,000

Cr. Investment property 20,000

DISCLOSURES

IAS 40 includes a number of disclosure requirements for investment property, presented in Figure 6.

Figure 6. Disclosure provisions for investment property

Both fair value and cost models (IAS 40.74-75)	Fair value model (IAS 40.76-78)	Cost model (IAS 40.79)
whether the fair value model or the cost model is applied; the criteria used to distinguish investment property from owner-occupied property and from property held for sale in the normal course of business; if the fair value is based on a valuation by an independent certified valuer; the amounts recognised in profit or loss for rental income, direct operating expenses and the cumulative change in fair value recognised in profit or loss.	In addition to the previous disclosures (IAS 40.75), a reconciliation between the carrying amounts of investment property at the beginning and end of the period.	In addition to the previous disclosures (IAS 40.75), the depreciation methods used; the useful lives or the depreciation rates used; the gross carrying amount and the accumulated depreciation and impairment losses at the beginning and end of the period; a reconciliation of the carrying amount of investment property at the beginning and end of the period; the fair value of investment property.

EXAMPLE

Green Developers Co. deals with the purchase and resale of buildings. On 31.12.20X1, the carrying amount of its buildings is CU3,000,000 and their net realisable value is CU2,800,000. On 01.07.20X2, management of Green Developers Co. decided to withhold half of its buildings from sale and to use them for rental purposes instead. The fair value of the reclassified buildings at the date of the change in use is CU1,750,000, and CU1,600,000 on 31.12.20X2.

Analyse all events related to these buildings for both 20X1 and 20X2 and determine the impact of these events on the entity’s financial statements.

Solution

As the entity's main field of activity consists in trading buildings, the accounting treatment used for their accounting is based on IAS 2 Inventories, as they are classified as merchandise. Therefore, Green Developers Co. will be applying the treatments applicable to inventories in IAS 2 before the change in use date, and the treatments in IAS 40 for the buildings that are reclassified as investment property after their change in use.

1) 31.12.20X1 Valuing the building inventories in the statement of financial position (according to IAS 2)

Merchandise is valued on 31.12.20X1 in the statement of financial position at the minimum between their cost and net realisable value. So, this is the minimum between CU3,000,000 and CU2,800,000, that is CU2,800,000. Since their cost exceeds their net realisable value, the inventories are written down by CU200,000.

Dr. Write down expense for inventories 200,000
    Cr. Write down of merchandise 200,000

2) 01.07.20X2 Transferring half the merchandise inventory (IAS 2) to investment property (IAS 40).

These reclassified buildings become accounted for as investment property recognised at the fair value of CU1,750,000. At the same time, the merchandise inventory decreases by half their cost, i.e., by CU1,500,000. The difference consists in a gain of CU250,000 resulting from fair valuing investment property.

Dr. Investment property 1,750,000
    Cr. Merchandise 1,500,000
    Cr. Gains from fair valuing investment property 250,000

3) 01.07.20X2 For the transferred merchandise, ½ of the impairment adjustment previously recorded is no longer justified, therefore it will be reversed for CU200,000 / 2 = CU100,000

Dr. Write down of merchandise 100,000
    Cr. Reversal of write downs for inventories 100,000

4) 31.12.20X2 Valuing the investment property at fair value (IAS 40)

Carrying amount ……………………………CU1,750,000
Fair value ………………………………………CU1,600,000
  Decrease of the asset's value by CU150,000

Dr. Losses from fair valuing investment property 150,000
    Cr. Investment property 150,000

In terms of disclosure in the entity's financial statements, the impact of these events is the following (financial statements excerpt only for the affected items):

- For the financial year 20X1

Statement of financial position prepared on 31.12.20X1

Item	Amounts (CU)
Current assets	
Inventories	
Merchandise(*)	2,800,000
[…]	

*) Merchandise disclosed at carrying amount = cost – impairment adjustments = 3,000,000 – 200,000 = CU2,800,000

Statement of profit or loss as at 31.12.20X1

Item	Amounts (CU)
[…]	
Expenses	
Write down expense for inventories	200,000
[…]	

- For the financial year 20X2

Statement of financial position prepared on 31.12.20X2

Item	Amounts (CU)
Current assets	
Inventories	
Merchandise(*)	1,400,000
[…]	
Non-current assets	
[…]	
Property, plant, equipment	
Investment property(**)	1,600,000
[…]	

*) Merchandise disclosed at carrying amount = cost – impairment adjustments = 1,500,000 – 100,000 = CU1,400,000 (only half of the buildings remain classified as merchandise in 20X2)

**) Investment property measured at fair value according to IAS 40.

Statement of profit or loss as at 31.12.20X2

Item	Amounts (CU)
Revenues	
Reversal of write downs for inventories	100,000
Gains from fair valuing investment property	250,000
[…]	
Expenses	
Losses from fair valuing investment property	150,000
[…]	