

Workshop on IND AS – Investment Property

WIRC of the ICAI – April 23, 2016

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BACKGROUND

Background

- ▶ Main amendment from earlier standard – to allow property held under a lease to be accounted for under the fair value model (provided lease accounted for as a finance lease)
 - ▶ Classification alternative (fair value v/s cost model) are available on a property by property basis. But once an alternative is selected should be consistently followed for all properties.
 - ▶ Covers disclosures to be made – including valuation assumptions, reconciliation of amount in financial statements if different from valuation obtained
 - ▶ In exceptional cases acknowledges that fair value may not be measurable on a continuing basis (cost model used in that situation)
 - ▶ Change in model can only be made from cost to fair value – not vice versa
 - ▶ IND AS does not permit fair value model
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Scope

- ▶ Applied in the recognition, measurement and disclosure of investment property
 - ▶ Does not apply to
 - Biological assets related to agricultural activity (covered by IAS 41)
 - Mineral rights and mineral reserves
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DEFINITIONS

Definition

Investment Property (is)

- ▶ property (land or a building-or part of a building-or both)
- ▶ held (by the owner or by the lessee under a finance lease)
- ▶ to earn rentals or for capital appreciation or both,
- ▶ rather than for use in the production or supply of goods or services or for administrative purposes; or sale in the ordinary course of business

Owner-occupied property (is)

- ▶ property held (by the owner or by the lessee under a finance lease)
 - ▶ for use in the production or supply of goods or services or for administrative purposes
 - ▶ Definition of fixed asset in existing AS 10 is “asset held with the intention of being used for the purpose of producing goods or providing services . . .”
 - ▶ Entity whose main objective is renting – is it fixed asset or investment property?
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Examples of investment property

- ▶ land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business
 - ▶ a building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases.
 - ▶ a building that is vacant but is held to be leased out under one or more operating leases.
 - ▶ property that is being constructed or developed for future use as an investment property
 - ▶ land held for a currently undetermined future use. (If an entity has not determined that it will use the land as owner-occupied property or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation.)
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Examples of what is not investment property

- ▶ property intended for sale in the ordinary course of business or in the process of construction or development for such sale (see [IAS 2](#) Inventories), for example, property acquired exclusively with a view to subsequent disposal in the near future or for development and resale.
 - ▶ property being constructed or developed on behalf of third parties (see [IAS 11](#) Construction Contracts).
 - ▶ owner-occupied property (see [IAS 16](#)), including (among other things) property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal.
 - ▶ property that is leased to another entity under a finance lease.
 - ▶ Mixed use properties?
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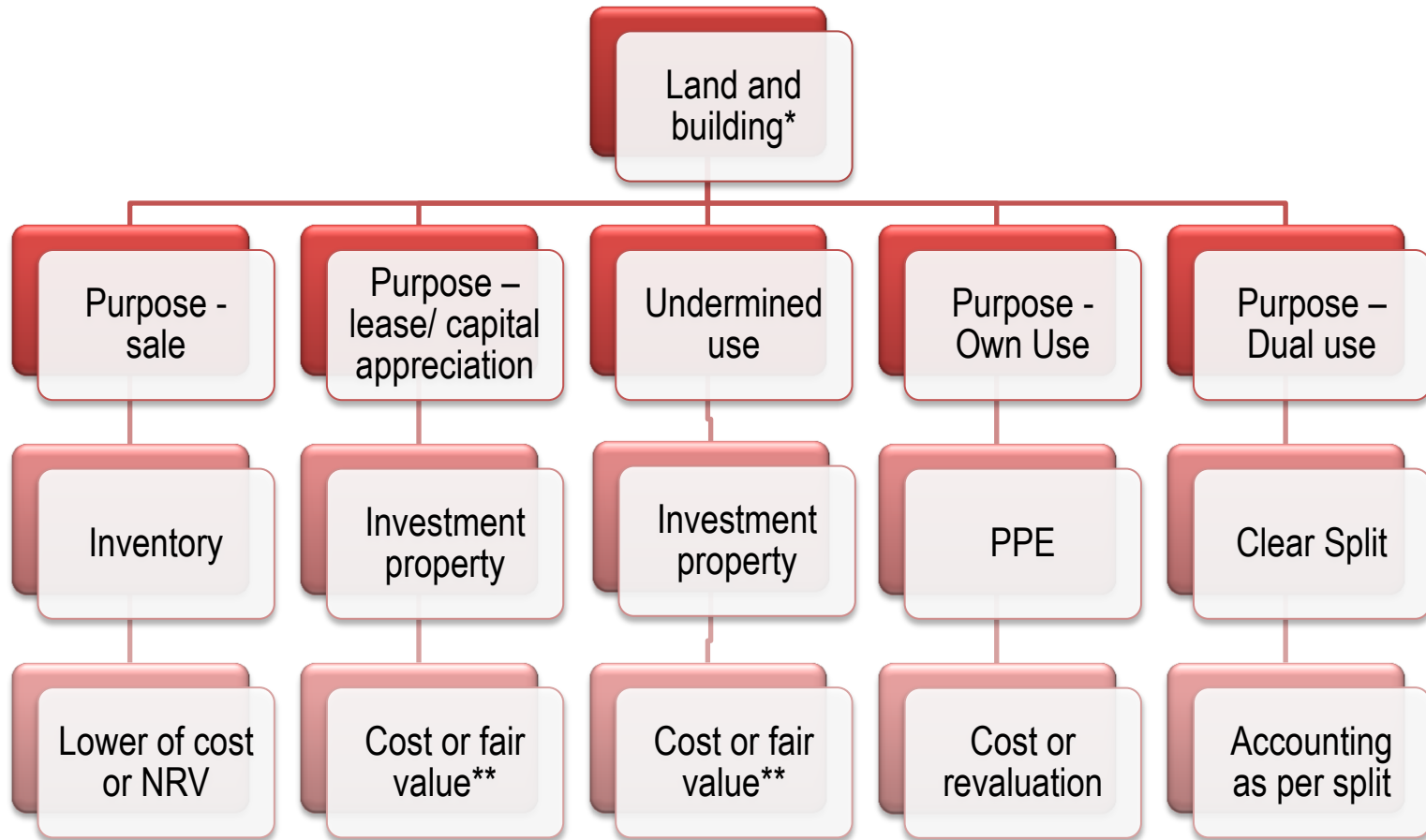
Definition – some practical aspects

- ▶ Mixed use properties? Portion used to earn rentals/capital appreciation and another owner occupied (eg office building)
 - If the portions can be sold or leased separately under a finance lease account for the portions separately.
 - Single building split into two line items on the financial statements.
 - How to split common facilities/cost – construction cost (foundation work), HVAC systems, elevators, fire fighting equipment, etc
 - If cannot be separated property is investment property only if owner occupied portion is insignificant
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Definition – some practical aspects

- ▶ Ancillary services provided. Often used as an argument to avoid straight lining of lease rentals
 - Property is investment property if the services are insignificant to the arrangement as a whole (shopping malls, office buildings rented out)
 - Hotel property investment property (services provided are significant)
 - ▶ Judgement required in case of a hotel property whether investment property or not (from the perspective of the lessor)
 - Hotel property let out under a management contract, eg managed by hotel chains (Hyatt, Marriot, etc.) but owner owns the asset
 - Judgement may also be required in case of shopping malls
 - ▶ Investor v/s exposure to variability of cash flows (revenue share situations in malls)
 - ▶ Criteria to be developed to assess classification. Criteria disclosed in the financial statements when classification difficult
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Land and building – classification in inventory and investment property (IFRS Model)



* Including under construction building

** Fair value not permitted in IND-AS

RECOGNITION & MEASUREMENT

Recognition

- ▶ Investment property to be recognised only when
 - Probable that future economic benefits will flow to the entity
 - Cost of the property can be measured reliably
 - ▶ Initial recognition at cost
 - ▶ Principles are similar to those used for property, plant and equipment
 - ▶ Investment property acquired in exchange in a barter recognised at fair value similar to accounting for barter transactions in other IFRSs
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Recognition

Initial measurement at cost including transaction costs

Situation	Initial cost
Purchased investment property	▶ Purchase price and any directly attributable expenditure
Self-constructed investment property	▶ Cost at the date when the construction or development is complete
Property interest held under a lease and classified as an investment property	▶ As prescribed for a finance lease

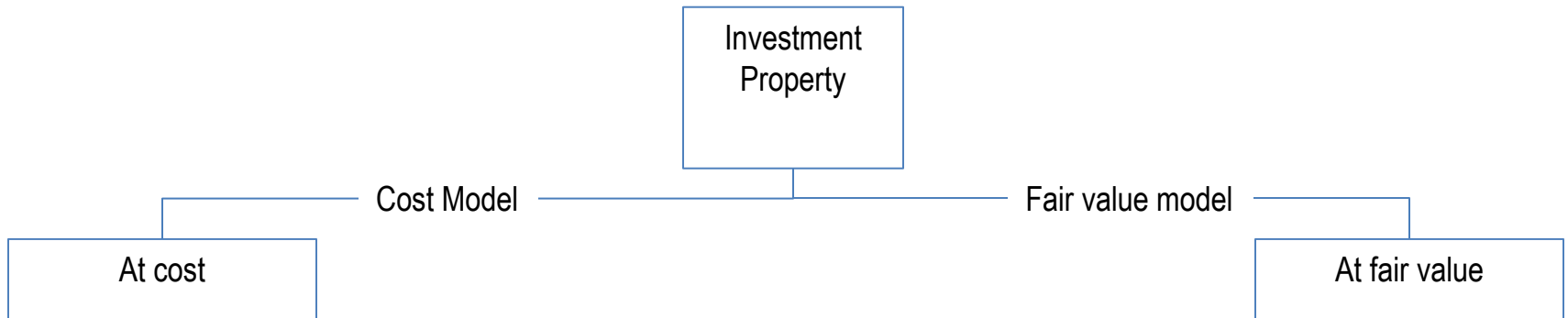
Recognition

Property interest held under an operating lease and classified as investment property

IFRS ONLY

- ▶ Fair value model is must for property interest held by a lessee
 - ▶ The lessee accounts for the property interest as if it were a finance lease
 - ▶ Initial measurement:
 - Lower of fair value of the property and the present value of the minimum lease payments
 - An equivalent amount recognised as a liability
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Measurement after recognition



The company must choose a policy of either:

- ▶ Carrying all its investment property on a cost basis (as in IAS 16)
 - ▶ Carrying all its investment property at fair value, movements in value taken to P&L
 - ▶ Fair value model is must for property interest held by a lessee (if property is to be accounted as IP)
 - ▶ An investment property shall be measured initially at its cost (incl transaction costs)
 - ▶ Cost of purchased investment property - purchase price & any directly attributable expenses
 - ▶ The initial cost of a property interest held under a lease and classified as an investment property shall be as accounted for as a finance lease
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Measurement after recognition

	IND AS	IFRS (Rs.)	
	(Rs.)	Cost option	Fair value option
Building (cost price - 100,000)			
Year 1	95,000	95,000	100,000
Year 2	90,000	90,000	135,000
Year 3	85,000	85,000	155,000
Year 4	80,000	80,000	125,000
Depreciation/ Fair value gain/ (loss)			
Year 1	(5,000)	(5,000)	0
Year 2	(5,000)	(5,000)	35,000
Year 3	(5,000)	(5,000)	20,000
Year 4	(5,000)	(5,000)	(30,000)

Determining fair value

The value should

- ▶ Represent the most probable price reasonably obtainable in the market between knowledgeable and willing parties in an arm's length transaction
 - ▶ Reflect the actual market state and circumstances at the balance sheet date
 - ▶ Ignore any factors specific to the reporting company
 - ▶ Be calculated without deduction for transaction cost
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Transfers

Transfer from	Transfer to	Date of transfer & value
Investment property under the fair value model	Owner occupied property	<ul style="list-style-type: none"> ▶ When owner occupation commences ▶ Transfer at fair value on date of transfer ▶ Change in fair value taken to p&l
Owner occupied property	Investment property to be carried at fair value	<ul style="list-style-type: none"> ▶ As above, except change in value taken to equity (revaluation surplus) ▶ Depreciation charged upto date of transfer
Investment property	Inventory	<ul style="list-style-type: none"> ▶ Transferred when property starts to be redeveloped for sale ▶ Fair value at date of transfer is cost of inventory, diff to p&l
Inventory	Investment property to be carried at fair value	<ul style="list-style-type: none"> ▶ Transferred when leasing commences ▶ Transferred at fair value on date of transfer, difference to p&l

IMPLICATIONS OF SOME OTHER STANDARDS ON INVESTMENT PROPERTY

Implications of some other standards

- ▶ Accounting for refundable security deposits

Implications of some other standards

Amount of interest free deposit	10,000,000
Period	5 years
Market interest rate	12%
PV factor	0.5675
Initial recognition of deposit	5,675,000

What should be the appropriate treatment for difference of INR 4,325,000?

Period	Lease Deposit	Interest expense	Def'ed Lease Rent	Lease income
0	5,675,000	-	4,325,000	
1	6,355,180	680,912		865,000
2	7,117,802	762,622		865,000
3	7,971,938	854,136		865,000
4	8,928,571	956,633		865,000
5	10,000,000	1,071,429		865,000

Implications of some other standards

- ▶ Accounting for refundable security deposits
 - ▶ Under IAS 23 - Borrowing costs, entity is not required to apply the Standard to borrowing costs directly attributable to construction of qualifying asset measured at fair value.
 - ▶ Hence, entities can as a matter of accounting policy choice may chose whether to capitalise borrowing costs if investment properties under construction are measured at fair values
 - ▶ Implication of the above?
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DISCLOSURES

Disclosure requirements

- ▶ The measurement basis used, i.e. cost or fair value
 - ▶ If classification is difficult, the criteria used to distinguish investment property from owner-occupied property and property held for sale within inventory
 - ▶ The methods and significant assumptions used in valuing investment property, and the extent of reliance on market data or other (disclosed) factors
 - ▶ The extent to which valuations were made by an appropriately qualified independent valuer
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Disclosure requirements

- ▶ The amounts included in the income statement for:
 - Rental income from investment property
 - Direct operating expenses for property, both those that did and did not generate rental income
 - ▶ The existence and extent of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal
 - ▶ Material contractual obligations to purchase, construct, or develop investment property or for repairs, maintenance, and enhancements
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Disclosure requirements

Where the fair value model is used:

- ▶ Movements in investment property in the period
 - Additions, distinguishing purchases, subsequent expenditure and business combinations
 - Assets classified as held for sale and other disposals
 - Net gains and losses from fair-value adjustments
 - Foreign exchange differences
 - Transfers to and from inventories and owner-occupied property
 - Any other movements
 - ▶ Disclosure of fair value required even in IND AS
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Disclosure requirements

- ▶ Whether, and in what circumstances, property interests held under operating leases are classified as investment property
 - ▶ When a valuation has been adjusted significantly for the purposes of the financial statements, disclose a reconciliation between the valuation obtained and the adjusted valuation
 - ▶ Where an individual property is not valued:
 - A description of the investment property
 - An explanation of why fair value cannot be reliably measured
 - If possible, the range of estimates within which fair value is highly likely to lie
 - On disposal of that property:
 - The fact that it wasn't at a valuation
 - The carrying value at the time of sale
 - The amount of gain or loss recognised
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Disclosure requirements

Where the cost model is used:

- ▶ Movements in investment property in the period:
 - Additions, distinguishing purchases, subsequent expenditure and business combinations
 - Assets classified as held for sale and other disposals
 - Depreciation
 - Impairment losses and their reversal
 - Foreign exchange differences
 - Transfers to and from inventories and owner-occupied property
 - Any other movements
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FIRST TIME ADOPTION

First time adoption matters to be considered

- ▶ Fair value model adopted (not applicable in IND AS)
 - Measure investment property at the date of transition
 - ▶ Fair value as deemed cost option available for PPE and available in original IND AS rules for investment property. This option done away with in IND AS amendment rules 2016 issued in March 2016
 - ▶ Cost model adopted
 - Deemed cost elections available
 - Subsequent depreciation is based on deemed cost
 - Depreciation rates/methods may require adjustment on a prospective basis
 - Component approach required for depreciation
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Thank you