Workshop on IND AS – Investment Property

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BACKGROUND

Background

- Applicable from January 1, 2005. Replaced the earlier standard issued in 2000
- 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

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

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?

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.)

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?

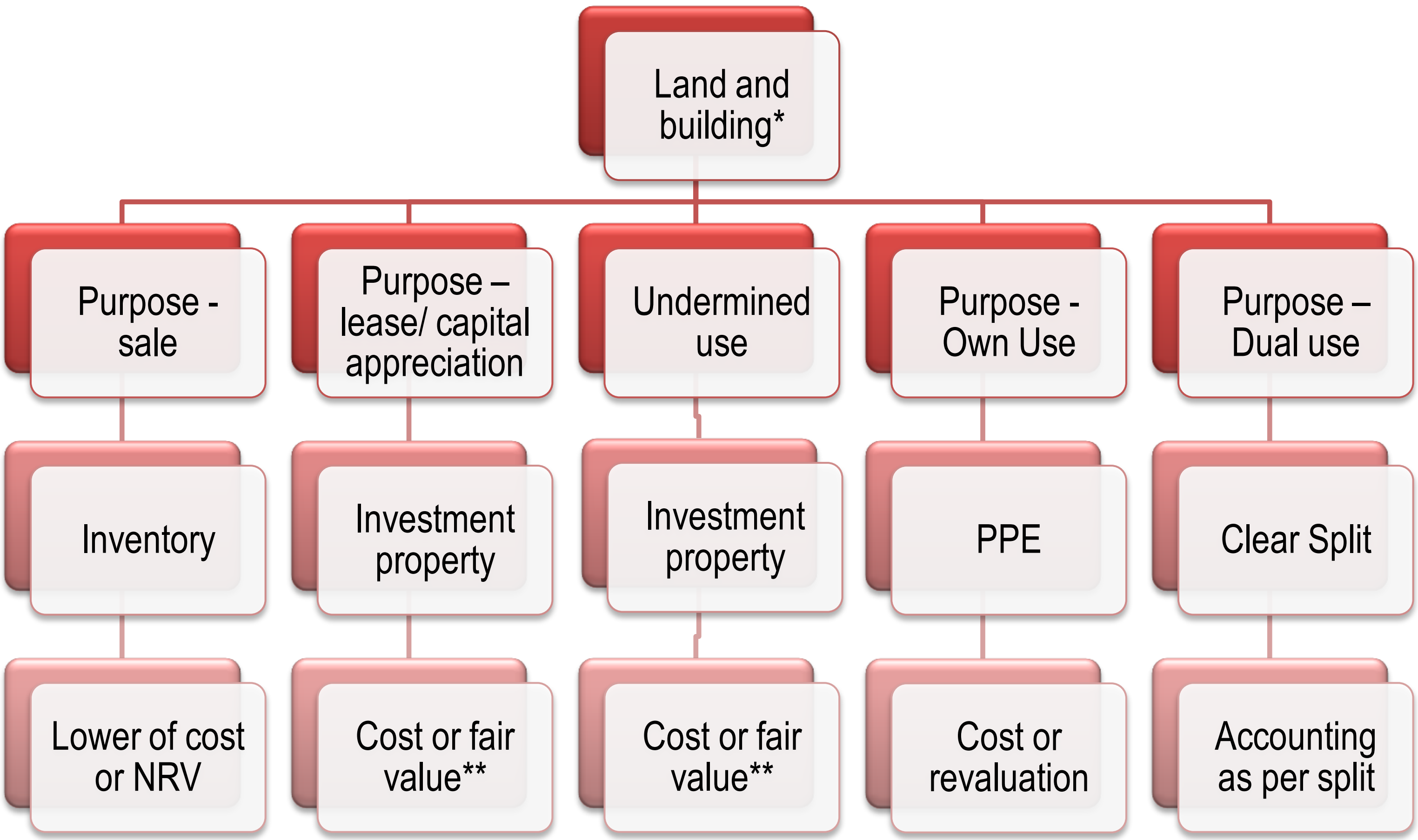
Definition – some practical aspects

- 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

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

Land and building – classification in inventory and investment property



* 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

Recognition

Initial measurement at cost including transaction costs

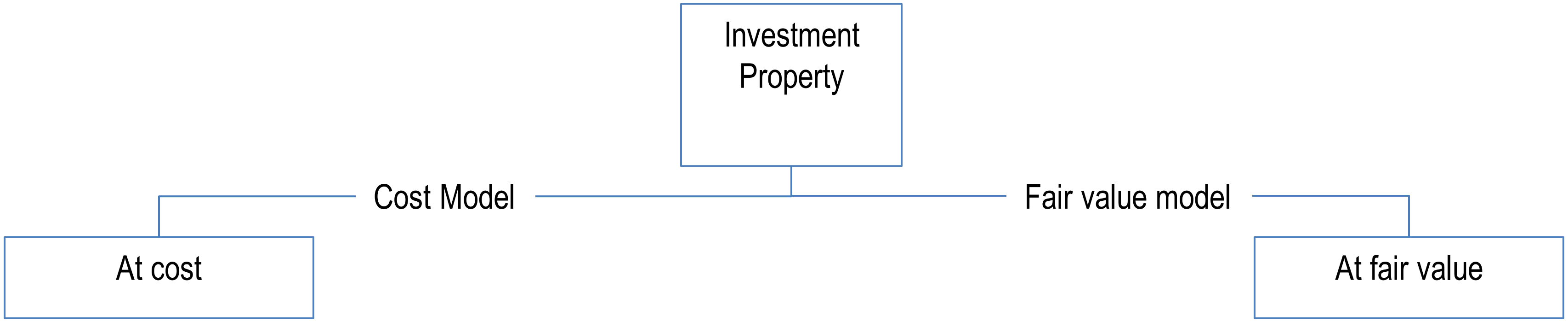
Situation		Initial cost
Purchased investment property	►	Purchase price and any directly attributable expenditure
Self-constructed investment property	►	Cost at the date when the construction or development is complete
Property interest held under a lease and classified as an investment property	►	As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

Recognition

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

- 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

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

Measurement after recognition

	IND AS (Rs.)	IFRS (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

Transfers

Transfer from	Transfer to	Date of transfer & value
Investment property under the fair value model	Owner occupied property	► 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	► As above, except change in value taken to equity (revaluation surplus) ► Depreciation charged upto date of transfer
Investment property	Inventory	► 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	► 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'red 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?

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

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

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

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

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

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
- 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

Thank you