LKAS 40 - Investment Property

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Agenda

• Definition and scope
• Accounting for investment property
• Disclosure
• The closing

Definition

Property that is land or a building (or part of a building) or both

♦ Held for rental, or
♦ Held for capital appreciation

♦ Held for use in production, supply of goods / services or for administration
♦ Held for sale in the ordinary course of business

Classification as investment property is mandatory if the criteria of LKAS 40 are met
Operating lease option

Property held by lessee under operating lease may be classified and accounted for as investment property

Property otherwise meets the definition of investment property

Lessee uses the fair value model

Option available on a property-by-property basis

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Not investment property

Not in the definition

<table>
<thead>
<tr>
<th>Description</th>
<th>Code</th>
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<tbody>
<tr>
<td>Sale in the ordinary course of business</td>
<td>Inventory: LKAS 2</td>
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<tr>
<td>Owner occupied</td>
<td>Property: LKAS 16</td>
</tr>
<tr>
<td>Constructed for third party</td>
<td>Contract: LKAS 11</td>
</tr>
<tr>
<td>Property under finance lease</td>
<td>Lease: LKAS 17</td>
</tr>
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<td>Employee occupied</td>
<td>Property: LKAS 16</td>
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<tr>
<td>Biological assets</td>
<td>LKAS 41</td>
</tr>
<tr>
<td>Mineral rights, exploration / extraction</td>
<td>SLFRS 6</td>
</tr>
</tbody>
</table>
Examples of investment property

- Land held for long-term capital appreciation
- Land held for undetermined future use
- Building owned (or held under a finance lease) and leased out under operating lease
- Property under construction or development for future use as investment property

A question for you: Classification (1)

- Lila-Rent leases a building to Lila-Industrial under an operating lease
- Lila-Rent accounts for the building as investment property in its separate financial statements
- Lila-Industrial uses the building as its Corporate Headquarters

How should the building be classified in the consolidated financial statements of Lila-Tech?
Dual purpose: Able to split

Owner occupied

Rental income

Property, plant and equipment (LKAS 16)

Investment property (LKAS 40)

Dual purpose: Unable to split (1)

** Rental income

Investment property (LKAS 40)

** Owner occupied < 5%
Dual purpose: **Unable to split (2)**

- Owner occupied
- Rental income

Property, plant and equipment (LKAS 16)

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A question for you: **Classification (2)**

- Lila-Build accounts for its investment property at fair value
- Lila-Build constructs a 3-storey building of which it intends to rent out 1 floor
- The floors could be sold separately, but only if the legal status of the property is changed, which would require some formal procedures prescribed by the Lila Planet Council

**How should the building be classified?**
Ancillary services (1)

** Rental income

Investment property (LKAS 40)

Ancillary services (2)

Services Rental income

Property, plant and equipment (LKAS 16)
A question for you: Classification (3)

• Lila-Build acquires an entertainment centre comprising a hotel (including a souvenir shop, some bars and restaurants), a casino, various shops and some more restaurants outside the hotel
• Only the souvenir shop and casino are managed by Lila-Build
• Everything else is managed by a third party

How should the entertainment centre be classified?
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Investment property recognised as an asset when

Probable that future economic benefits will flow to the entity

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Cost can be measured reliably
Initial measurement at cost

- Purchase / self-constructed
  - Purchase price / construction cost
  - Directly attributable expenditure
  - Qualifying borrowing costs unless fair value model

- Operating lease
  - Follow LKAS 17

Includes transaction costs

Subsequent accounting policy choice

- Fair value model
  - Changes in profit or loss
  - Exemption if cannot reliably determine on ongoing basis

- Cost model
  - Same as property, plant and equipment (LKAS 16)
  - Depreciation and impairment testing

Apply choice to all investment property / Change from fair value to cost model very difficult to justify
A question for you: Measurement model (1)

- Lila-Build accounts for its investment property at fair value
- Lila-Build bought several properties in the Inner Sanctum, which it rents out
- One of the properties is located in a poor and neglected area and finding tenants is difficult
- The property has been vacant for over a year now

Can Lila-Build account for this property using the cost model?

A question for you: Measurement model (2)

- Lila-Build accounts for its investment property at fair value
- Lila-Build bought 3 properties in the Outer Regions that it intends to rent out in the future
- At the date of acquisition there was no active market in this area
- According to management it is therefore not possible to measure the fair value of the properties reliably

Can Lila-Build account for these properties using the cost model?
Property under construction or development

Can fair value be determined reliably?

Yes

Fair value

Use cost until earlier of fair value determinable or construction complete

No

Cost model

Same as property, plant and equipment (LKAS 16)

Considerations for measurement of fair value

Actual current market rates for similar properties in similar locations

Rental income from leases and market expectations regarding future lease terms

Hypothetical knowledgeable and willing buyers and sellers

Investor expectations
### Measurement of fair value, if no active market

<table>
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<tr>
<th>Include</th>
<th>Exclude</th>
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<tbody>
<tr>
<td>Current market conditions for properties of different nature, condition or location adjusted to reflect those differences</td>
<td>Estimates based on atypical arrangements</td>
</tr>
<tr>
<td>Recent prices of similar properties on less active markets</td>
<td>Transaction costs of sale</td>
</tr>
<tr>
<td>Discounted cash flow projections</td>
<td>Double-count of assets and liabilities</td>
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<tr>
<td></td>
<td>Expected cash outflows for improvements</td>
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<tr>
<td></td>
<td>Expected cash inflows after improvements</td>
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</tbody>
</table>

### Transfer to investment property (fair value)

- **Owner occupied (LKAS 16)**
- **Inventory (LKAS 2)**
- **Investment property at fair value**
- **Revaluation in OCI**
- **Revaluation in profit or loss**

OCI = other comprehensive income
A question for you: Reclassification

• Lila-Build accounts for its investment property at fair value
• Lila-Build has been using one of its properties as a warehouse for storing robot parts prior to production
• Lila-Build plans to move storage to a purpose-built warehouse, and will rent out the warehouse to a third party

Should Lila-Build reclassify the warehouse to investment property?

Transfer from investment property (fair value)

Investment property at fair value

Owner occupied (LKAS 16)  
Inventory (LKAS 2)

Fair value becomes new cost basis
Derecognise when

- Permanently withdrawn from use and no future benefits expected through disposal
- Disposed of

Gain / loss recognised in profit or loss

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Key disclosures – Both models

• Criteria to distinguish between investment property and owner-occupied property and inventory
• Methods, significant assumptions to determine fair value
• Extent to which independent valuer involved and any adjustments to the valuation obtained
• Rental Income
• Direct operating expenses
  • From investment property generating rental income
  • From vacant investment property
• Material contractual obligations, including repairs, maintenance
Key disclosures

**Fair value model**
- Reconciliation
- Information on property for which fair value cannot be determined
- Whether properties held under operating leases have been classified as investment property

**Cost model**
- Reconciliation
- Fair value, or
- Information on property for which fair value cannot be determined

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Which statements are true?

- Owner-occupied property is investment property
- Property constructed for a third party is investment property
- Employee-occupied property is investment property
- Property held for rental or capital appreciation is investment property
Which statements are true?

- LKAS 40 requires investment property to be accounted for using the fair value model
- LKAS 40 allows an accounting policy election for investment property between the fair value model and the cost model
- If property is dual purpose, then LKAS 40 requires the cost model to be used
- LKAS 40 requires investment property to be accounted for using the cost model

Which statements are true?

- Under the fair value model for investment property, changes in fair value are recorded in profit or loss
- Under the fair value model for investment property, changes in fair value are recorded in OCI
- Under the fair value model for investment property, changes in fair value are recorded as an increase to the asset with an offset to a liability
- Under the fair value model for investment property, changes in fair value are not reflected; rather the asset is depreciated and reviewed for impairment as necessary
1) Investment property is property held for rentals or capital appreciation
2) Initial measurement is at cost
3) Accounting policy election for subsequent measurement using the fair value model or the cost model
4) Under the fair value model, changes in fair value go in profit or loss
5) Under the cost model, investment property treated like property, plant and equipment

THANK YOU
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The contents of this presentation have been predominantly sourced from KPMG Material.