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THE INSTITUTE OF
CHARTERED ACCOUNTANTS OF SRI LANKA

Investment property - LKAS 40

Investment property

ABC Company

Use as its own office premises

XYZ Company

Leased out to third parties

Balance sheets of the companies

PPE

Difference in Characteristics

IP

LKAS 40: Overview

- **Objective**
- **Scope**
- **Definition**
- **Recognition**
- **Measurement at initial recognition**
- **Measurement subsequent initial recognition**
  - Fair value model
  - Cost model
- **Transfers**
- **Disposals and derecognition**
- **Disclosures**

LKAS 40: Objective

Set out the requirements for the accounting treatment and disclosures for investment property (IP)

Scope

Includes:

- Property held for capital appreciation or to earn rentals, where the property is owned by the entity or held by it under a lease
- Property leased out by the entity under an operating lease

Excludes:

- Does not deal with other aspects of leased property dealt with in LKAS 17
- Biological assets (IAS 41)
- Mineral rights and mineral reserves such as oil, natural gas similar non-regenerative assets

Definition

Property (land or 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 for:

(a) Use in the production or supply of goods or services or for administrative purposes; or

(b) Sale in the ordinary course of the business

Definitions

Property held by a lessee under an operating lease

May be as an IP, a lessee under an operating lease, if and only if:

- Rest of the definition of IP is met
- Lessee uses ‘Fair value” (FV) model in LKAS 40
- The asset should be recognized at the lower of the FV of the property and PV of minimum lease payments

Definitions

Example

Star Hotels Company owns a hotel that it leases out under an operating lease to a hotel management group. The hotel is situated on a land leased by the government to the entity under 99 years lease agreement and no transfer of title to the entity at the end of the lease. The hotel building's useful life is expected to be approximately 40 years. There are no provisions in the lease to return the land with the building intact at the end of the 99 year lease.

Land

- Operating lease (LKAS 17)
- Investment property – only if it meets the definition of IP and the entity has chosen the FV model

Building

- Meets the definition of investment property (LKAS 40)

Definitions

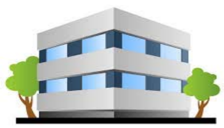
Owner-occupied property

Property held by the owner (or by a lessee under a finance lease) for use in the production of supply of goods or services or for administrative purposes.

Does not generate cash flows independently of the other assets of the entity

Examples of Investment property

- Held for long-term appreciation in value
- Land whose future use has not been determined (assumed for capital appreciation)



- Owned or held under finance lease and leased out under an operating lease
- Vacant building, but held to be leased out

- Being constructed or developed for future use as investment property

What are not investmenr properties?

- **Ordinary course of business ;or**
- **for development and resale**

Third parties

Property occupied by employees

Owner occupied property

Property leased under a finance lease

Investment property

Owner occupied ✚ Held for rental income / capital appreciation

Can be sold out separately / separately leased out under finance lease

LKAS 40

LKAS 16

Investment property

Owner occupied ✚ Held for rental income / capital appreciation

Significant

Cannot be sold out separately / leased out under finance lease

Insignificant

LKAS 16

LKAS 40

Investment property – Group level

Group of companies

One group entity leases property to another group entity

- Investment property at the entity level
- At the consolidation level – PPE (LKAS 16)

From the group's point of view – Owner occupied

Property leased to an associate / JV – IP

Investment property?

Scenario	Yes / No
Property 'Mount' – a block of flats being developed and intended for sale in the ordinary course of business	No
Property 'Soon' – Entity A constructs an office block which will be used as offices by Entity A on completion	No
Property "Green" – an office block owned by an entity within the group and leased to an associated company	Yes
A plot of land held for a currently undetermined future use	Yes
A property acquired for a capital appreciation but used by Entity as its head office	No

Consolidation financial statement

Entities D, E and F are all subsidiaries of 'Duo' group.

Which property should be classified as IP in the consolidated financial statements of Duo Group

Property	Yes / No
An office block owned by Entity F and leased under an operating lease to Entity D who subleases it to an associated company under LKAS 28	**Yes**
An oilfield owned by Entity E and leased to a third party under an operating lease	**No**
A dockyard complex owned by Entity D and leased to a third party under an operating lease. Entity D manages the operation of the offloading and transportation infrastructure within the complex	**No**

Consolidation financial statement

Which item may be classified as IP in the consolidated financial statements of a group?

Property	Yes / No
Land and buildings held under a finance lease and sublet to a subsidiary company which uses it for administrative purposes	**No**
An interest in a holiday complex held under an operating lease that is sublet to and managed by a third party	**Yes**
Land and building held under an operating lease and sublet to an entity within the same group which uses it as its head office	**No**

Recognition

- Recognition principles are similar to those for all other assets
- When it is probable that future economic benefits associated with the property will flow to the entity and the cost of the property to the entity can be reliably measured
- Considering all costs incurred relating to investment property, both costs incurred initially to acquire IP and subsequent costs incurred.
- Subsequent cost : Costs of servicing and maintenance
  - Whether these costs add economic benefits?

Recognition

Example

- Mega Ltd develops office buildings for rental.
- Subsequent to completion of a building it incurs expenses such as security, utilities and marketing that must be incurred before the building has secured a reasonable level of occupancy.
- The usual time between the building's completion and securing a reasonable number of tenants is approximately 3 months

How to treat these expenses?

Should be expensed as incurred and relate to maintaining the building and attracting the tenants

Recognition

Example

Bee Ltd acquired a property that required renovation. This was considered in agreeing the price for the property. Subsequently, cost of Rs 10 million was incurred by Bee Ltd for the renovation work

How to recognize renovation expenses?

Should be capitalised

Additional future benefits, can be reliably measured

Measurement at initial recognition

Owned property

- Initially at cost
  - Purchase price
  - Directly attributable expenses
- The following costs cannot be capitalised:
  - Costs relating to market studies undertaken before the purchase of property
  - Internal indirect costs (in-house lawyer's expenses)
  - Start-up costs (unless they are necessary to bring the property to the condition necessary…)
  - Operating losses incurred before the IP achieves its planned level of occupancy
  - Abnormal costs

Measurement at initial recognition

Property held under a lease

- LKAS 40 – sets out the accounting for IP that is held under a finance lease.
- If required criteria are met for an operating lease to be considered as IP – accounted for as if it is a finance lease
- Initial cost – LKAS 17
  - A finance leased asset should be recognised at the asset's fair value or, if lower, at the present value of the minimum lease payments
  - Equivalent amount is recognised as a liability

Questions

Hand-out 1

Questions 1 & 2

Answers

Question 1

Costs	Rs million
Payable on acquisition	52
PV of future payment	48
Directly attributable – refurbishment & redevelopment	50
Borrowing costs	5
Cost to be capitalized as Investment property	**155**

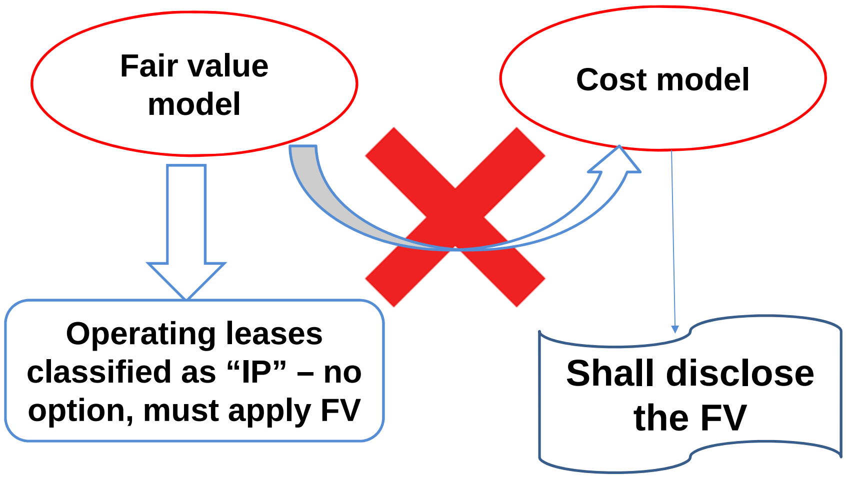
Purchase price and directly attributable costs

Answers

Question 2

Costs	Rs million
Cost of acquisition of property	160
Demolition and site preparation	15
Construction costs (excluding Rs 12 million labour cost)	168
Cost to be capitalized as Investment property	**343**

Subsequent measurement



External valuer – encourages, not required

Fair value model

- FV reflects **rental income** from **current leases** and other assumptions that **market participants** would make about **future rental income** based **on current** condition

- Fair Value – SLFRS 13

" the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date"

- Rebuttable presumption that FV can be measured reliably

Fair value model

- Assets and liabilities that are separately recognised in the balance sheet should not be double-counted (Integral plant and equipment such as lifts or air conditioning)
- Fully furnished office is leased – furniture is included in the FV
- Gains and losses – profit or loss for the period

Fair value model - Exceptions

- Investment properties under construction for which the FV cannot be reliably measured at present, expects to measure at FV later
- Investment properties for which, in exceptional cases and on initial recognition only, the FV cannot be measured reliably on a continuing basis

Use "Cost model"

Cost model

Should show Investment property at:

Cost - accumulated depreciation – accumulated impairment losses

Similar to cost model under **LKAS 16**

Transfers

Should only be made when, and only when, there is a change of use

Investment property

Owner occupied property

If FV – Deemed cost for subsequent accounting

At the commencement of owner occupation - PPE

Transfers

Investment property

To be developed for sale

If FV – Deemed cost (@ the date of transfer) for subsequent accounting

At the date of commencement of development with a view to sale

Transfers

When owner occupation ceases

Owner occupied

Investment property

- If at FV, LKAS 16 up to the date of transfer
- At the date of transfer - FV as per LKAS 16

Transfers

Property held as Inventory → Investment property

If Fair Value to be applied:

- **Difference between FV and the previous carrying value at the date of transfer - P&L (sale of inventory)**

Transfers

Transfer of investment property at cost model

- Will not change the carrying amount of property transferred
- No revaluation gains / losses
- No changes to the cost of the property for measurement and disclosure purposes

Transfers

Transfers do not take place

- Investment property sold without development
- Investment property developed for continuing future use as investment property
- Property being developed for future use as an investment property

Disposals and derecognition

Derecognise

- When disposed
- Permanently withdrawn from use

Gain / loss on disposal = Net disposal proceeds - carrying amount

Gain / losses to be recognized in profit or loss

Demolition cost

Example
- A Ltd purchased a land with a building that is unusable for total consideration of Rs 200 million.
- The building is demolished after purchase and a new building will be constructed instead.
- The total cost paid to a 3rd party to demolish – Rs 10 million.
- Both the land and the new building meet the definition of IP and A Ltd uses the cost model under LKAS 40.
- It is determined that any other market participant acquiring the land would demolish the current building

- Building does not meet the definition of an asset (no economic benefits)
- The economic rationale behind the purchase was to acquire land rather than land and building
- All consideration paid (Rs 200 million) should be allocated to the land
- Demolishing cost – site preparation cost and would be capitalised

Disclosure

- Extensive disclosure requirements (in additional to IAS 1, for leased properties)
- FV model – disclosure requirements of SLFRS 13 and LKAS 40
- Cost model – fair value disclosure,

Questions

Hand-out 1

Questions 3, 4 & 5

Answers

Question 3

Property A	**Cost Model**
Property B	**FV Model**
Property C	**FV Model**

Answers

Question4

Property	FV – Y/E 31/12/2015	Explanation
A	40	(140 – 100) Change in fair value
B	(9)	Loss from the date of transfer
C	-	Sold
D	(6)	Loss on FV
Total	**25**	

Answers

Question5

Property	Balance (Rs million)	Income / (expense)- Rs million
At 1/1/2015	258	
Old furnishing derecognized	(23)	(23)
Cost of new furnishing	62	
Sub total	297	
Fair value income (balance)	42	42
As at 31/12/2015	339	
Net income reported within Profit / loss		**19**

Question 1

Jasmin (Pvt) Ltd acquired an interest in land and building for Rs 52 million payable on acquisition. Further Rs 60 million to be paid after 5 years. The present value of this is to be considered as Rs 48 million. Jasmin (Pvt) Ltd redeveloped the site into apartments for rental under operating leases and wishes to classify in its balance sheet as investment property.

The following costs have been incurred:

- Directly attributed cost of refurbishment and redevelopment – Rs 50 million
- Labour cost paid during the site strike – Rs 3 million
- Rs 5 million interest on money borrowed to finance the redevelopment accruing over the construction period
- Costs of Rs 2 million incurred in the 3 months prior to the development becoming fully tenanted.

What is the total cost to be recognized initially as investment property in the balance sheet of Jasmin (Pvt) Ltd?

Question 2

Mount View (Pvt) Ltd acquired land and building at a cost of Rs 160 million (including Rs 10 million legal and other acquisition costs). It redeveloped the site into apartments for rental under operating leases and wishes to classify the development in its balance sheet as investment property.

The following costs have been incurred:

- Demolition and site preparation – Rs 15 million
- Construction costs – Rs 180 million (including Rs 12 million for labour costs arising from a labour strike).

Additionally, Rs 5 million was received as income for a short period prior to construction when the site was used as a car park.

What is the amount should be recognized initially as investment property in the balance sheet of Mount View (Pvt) Ltd?

Question 3

See View Ltd has interests in three investment properties:

- Property A– was constructed by See View Ltd – the fair value of this property is not reliably determinable on a continuing basis
- Property B – It is held by See View Ltd under a finance lease; and
- Property C is held by Sea View Ltd under an operating lease

Assuming all three properties have been properly classified as investment property, which model should be used for the measurement of them after initial recognition

Question 4

During the year ended 31 December 2015, an entity held interest in four investment properties at fair value.

Relevant financial information is set out below:

Property	FV @ 1/1/2015	FV at transfer	Proceeds of sale	FV @ 31/12/2015
A	100	n/a	n/a	140
B	98	89	n/a	80
C	210	n/a	218	n/a
D	118	n/a	n/a	112

During the year:

- Property B became an owner occupied and was transferred to property, plant and equipment
- Property C was sold

What amount should be included in profit or loss as the fair value change of investment properties for the year ended 31 December 2015?

Question 5

Regent Ltd owns an investment property which leases on a furnished basis and account for it using the FV model.

At 1 January 2015 the property had a carrying value of Rs 258million including Rs 23 million relating to furnishings. During 2015 Regent Ltd replaced the furnishings at a cost of Rs 62 million. At 31 December 2015 the fair value of the furnished property was Rs 339 million.

What amount should be replaced within profit or loss for the year ended 31 December 2015 for this property?