Sri Lanka Accounting Standard – LKAS 40
Investment Property

By

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Objective

- The objective of this Standard is to prescribe the accounting treatment for investment property and related disclosure requirements.

Scope

- This Standard shall be applied in the recognition, measurement and disclosure of investment property. However, this standard does not apply to:
- biological assets related to agricultural activity (see LKAS 41 Agriculture and LKAS 16 Property, Plant and Equipment); and
- mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

Definitions

- **Carrying amount** is the amount at which an asset is recognised in the statement of financial position.
- **Cost** is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other SLFRSs, eg SLFRS 2 Sharebased Payment.

Definitions

- **Fair value** is 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. (See SLFRS 13 Fair Value Measurement).
- **Investment property** 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:
- use in the production or supply of goods or services or for administrative purposes; or
- sale in the ordinary course of business.

Definitions

- **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.

Classification of property as investment property or owner-occupied property

- Investment property is held to earn rentals or for capital appreciation or both. Therefore, an investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from owner-occupied property.

Practice question 1

- XYZ Co. and its subsidiaries have provided you, their IFRS specialist, with a list of properties they own,
- Land held by XYZ Co. undermined future use.
- A vacant building owned by XYZ Co. and to be leased out under an operating lease.
- Property held by subsidiary of XYZ Co, a real state firm, in the ordinary course of its businesses.
- Property held by XYZ Co. for the use in production
- A hotel owned by ABC Co. a subsidiary of XYZ Co. and for which ABC Co. provides security services for its guests' belongings.
- Required
- Advise XYZ Co. and its subsidiaries as to which of the aforementioned properties qould qualify under LKAS 40 as investment properties. If they do not qualify thus, how should they be treated under IFRS?

Recognition

- An owned investment property shall be recognised as an asset when, and only when:
- it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and
- the cost of the investment property can be measured reliably.
- An investment property held by a lessee as a right-of-use asset shall be recognised in accordance with SLFRS 16.

Measurement at recognition

- An investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement.
- **The cost of a purchased investment property**
- purchase price
- any directly attributable expenditure.
    - Directly attributable expenditure includes, for example, professional fees for legal services, property transfer taxes and other transaction costs.

Not a cost of investment property;

- start-up costs (unless they are necessary to bring the property to the condition necessary for it to be capable of operating in the manner intended by management),
- operating losses incurred before the investment property achieves the planned level of occupancy, or
- abnormal amounts of wasted material, labour or other resources incurred in constructing or developing the property.
- An investment property held by a lessee as a right-of-use asset shall be measured initially at its cost in accordance with SLFRS 16.

Measurement after recognition

- An entity shall choose as its accounting policy either the fair value model or the cost model and shall apply that policy to all of its investment property.

Fair value model

- After initial recognition, an entity that chooses the fair value model shall measure all of its investment property at fair value
- A gain or loss arising from a change in the fair value of investment property shall be recognised in profit or loss for the period in which it arises. No depreciation.

Cost model

- After initial recognition, an entity that chooses the cost model shall measure investment property:
- (a) in accordance with SLFRS 5 Non-current Assets Held for Sale and Discontinued Operations if it meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale);
- (b) in accordance with SLFRS 16 if it is held by a lessee as a right-of-use asset and is not held for sale in accordance with SLFRS 5; and
- (c) in accordance with the requirements in LKAS 16 for the cost model in all other cases.

Practice question 2

- Ara Co., is a listed company in Germany, ventured into the construction of a mega shopping mail in South Asia which is rated as the largest shopping mall in Asia. The company's board of directors after market research decided that inserted of selling the shopping mall to a local investor, who had approached them several times during the construction period with excellent offers, which he progressively increased during the year of construction, the company would hold this property for the purpose of earning rentals by renting out space in the shopping mall to the tenants. For this purpose it used the services of a real estate company to find an anchor tenant (a major international retail chain) that then attracted other important retailers locally to rent space in the mega shopping mall, and within month of the completion of the construction the shopping mall was fully rented out.
- The construction of the shopping mall was completed and the property was placed in service at the end of 20X1. According to the company's engineering department the computed total cost of the construction of the shopping mall was Rs. 100 Mn. An independent valuation expert was used by the company to fair value the shopping mall on an annual basis. According to the fair valuation expert the fair value of the shopping mall at the end of 20X1 and the each subsequent year end and thereafter were:

Practice question 2

- 20X1: Rs. 100 Mn
- 20X2: Rs. 120 Mn
- 20X3: Rs. 125 Mn
- 20X4: Rs. 115 Mn
- The independent valuation expert was on the opinion that the useful life of the shopping mall was ten years and its residual value was Rs. 10 Mn.
- Required
- What would be the impact on the profit and loss account of the company if it decides to treat the shopping mall as an investment property under LKAS 40.
- Using fair value model
- Using cost model

Transfers

- An entity shall transfer a property to, or from, investment property when, and only when, there is a change in use.
- 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. In isolation, a change in management's intentions for the use of a property does not provide evidence of a change in use.

Examples of evidence of a change in use include:

- commencement of owner-occupation, or of development with a view to owner-occupation, **for a transfer from investment property to owner-occupied property;**
- commencement of development with a view to sale, **for a transfer from investment property to inventories;**
- end of owner-occupation, **for a transfer from owner-occupied property to investment property**; and
- inception of an operating lease to another party, **for a transfer from inventories to investment property.**

Transfers – Cost model

- When an entity uses the cost model for investment property, transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes.

Transfers – FV model

- **Transfer from investment property carried at fair value to owner-occupied property or inventories**
- For a transfer from investment property carried at fair value to owner-occupied property or inventories, **the property's deemed cost** for subsequent accounting in accordance with LKAS 16 or LKAS 2 shall be its fair value at the date of change in use.

Transfer from owner-occupied property to investment property

- If an owner-occupied property becomes an investment property that will be carried at fair value, an entity shall apply LKAS 16 for owned property and SLFRS 16 for property held by a lessee as a right-of-use asset up to the date of change in use. The entity shall treat any difference at that date between the carrying amount of the property in accordance with LKAS 16 or SLFRS 16 and its fair value in the same way as a revaluation in accordance with LKAS 16.

Transfer from inventories to investment property

- For a transfer from inventories to investment property that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount shall be recognised in profit or loss.

Practice question 3

- ABC Co. owns a property that it is using as its head office. At 1st of January 2015, its carrying value was Rs. 20 Mn and its remaining useful life was 20 years. On 1st of July 2015, the business was reorganized, a cheaper premise was found for use as the head office. It was therefore, decided to lease the property under an operating lease. The property was valued by a qualified professional, who assessed the property's value as Rs. 21 Mn on 1st July and Rs. 21.6 Mn on 31st December 2015.

Required

- Explain the accounting treatment of the property in the financial statement for the year ended 31 December 2015.

Disposals

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

Disclosure

- An entity shall disclose:
- whether it applies the fair value model or the cost model.
- when classification is difficult (see paragraph 14), the criteria it uses to distinguish investment property from owner occupied property and from property held for sale in the ordinary course of business.
- the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognized and relevant professional qualification and has recent experience in the location and category of the investment property being valued. If there has been no such valuation, that fact shall be disclosed.
- the amounts recognised in profit or loss

MCQ 1

- A gain arising from a change in fair value of an investment property for which an entity has opted to use the fair value model is recognized in
  - Net profit or loss for the year
  - General reserve in the shareholder's equity
  - Valuation reserve in the shareholders' equity
  - None of the above

MCQ 2

- An investment property should be measured at initially at;
  - Cost
  - Cost less accumulated impairment losses
  - Depreciable cost less accumulated impairment losses
  - Fair value less accumulated impairment losses

MCQ 3

- The applicable SLFRS/ LKAS for property being constructed or developed for future use as investment property is
  - LKAS 2, inventories until construction is completed and then it is accounted for under LKAS 40, investment property
  - LKAS 40, investment property
  - SLFRS 15, revenue from contracts with customers
  - LKAS 16, property plant and equipment, until construction is completed and then it is accounted for under LKAS 40, investment property

MCQ 4

- The transfers from investment property to property plan and equipment are appropriate
  - When there is change of use
  - Based on the company's discretion
  - Only when the company adopts the fair value model under LKAS 38
  - The entity can never transfer property into another classification on the financial position statement once it is classified as investment property.

MCQ 5

- An investment property is derecognized when,
  - It is disposed to a third party
  - It is permanently withdrawn from use
  - No future economic benefits are expected from its disposal
  - In all of the above cases

- Thank you