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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**December 2008, London**
Project:	**Annual Improvements**
Subject:	**IAS 40 – Transfers from Investment Property (to inventory or held for sale) (Agenda paper 11C)**

INTRODUCTION

1. The staff has been advised of a potential inconsistency between IAS 40 *Investment Property*, IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 2 *Inventories* when an investment property is now being held for sale. See Appendix 2-4 for relevant excerpts from the three standards.

2. The purpose of this agenda paper is to summarise the staff's analysis of whether the issue may most appropriately be resolved via the annual improvements process.

Issue 1: When investment properties are reclassified in accordance with IAS 40 *Investment Property* because they are held for sale, should the assets be classified as inventory in accordance with IAS 2 *Inventories* or classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*?

Issue 2: If the investment property assets were originally measured using the fair value model as described in paragraph 33 of IAS 40, should they continue to be measured at fair value or should they be accounted for using some other value (original cost, amortized cost, fair value on the date transferred or otherwise) when transferred from investment property?

STAFF RECOMMENDATION

3. The staff recommends that the Board should:

(a) include this issue in the annual improvements project; and

(b) Amend IAS 40 as proposed in Appendix 1 to this paper.

STAFF ANALYSIS

Issue 1 – Whether to account for transfers out of investment property as inventory or held for sale (or otherwise)?

4. Current IFRSs provide guidance on transfers to or from investment property in paragraph 57 of IAS 40. Regarding transfers out of investment property to inventories, paragraph 58 of IAS 40 states:

> 58 Paragraph 57(b) requires an entity to transfer a property from investment property to inventories when, and only when, there is a change in use, evidenced by commencement of development with a view to sale. When an entity decides to dispose of an investment property without development, it continues to treat the property as an investment property until it is derecognised (eliminated from the statement of financial position) and does not treat it as inventory. Similarly, if an entity begins to redevelop an existing investment property for continued future use as investment property, the property remains an investment property and is not reclassified as owner-occupied property during the redevelopment.

5. This guidance appears clear that management's change in intent for the asset does not, in and of itself, cause the asset to be reclassified/ subject to IAS 2. There must also be the 'commencement of development with a view to sale.'

6. When management has changed its intent for an asset originally held as investment property measured using the cost model, but there is no 'commencement of development with a view to sale', paragraph 56 of IAS 40 states:

> 56 After initial recognition, an entity that chooses the cost model shall measure all of its investment property in accordance with IAS 16's requirements for that model, other than those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Investment properties that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall be measured in accordance with IFRS 5.

7. Additionally, when management has changed its intent for an asset originally held as investment property measured using the fair value model, but there is no 'commencement of development with a view to sale', paragraph 5 of IFRS 5 states, in part:

> 5 The measurement provisions of this IFRS do not apply to the following assets, which are covered by the Standards listed, either as individual assets or as part of a disposal group:
> …
> (d) non-current assets that are accounted for in accordance with the fair value model in IAS 40 *Investment Property*.
> ...

8. The guidance in paragraphs 56 and 58 of IAS 40 may cause confusion regarding reclassifications out of investment property when management determines it will sell a non-current asset.

Issue 1 – Staff Rationale and Proposal

9. Management's change in intent (along with the other criteria within IFRS 5) is the primary factor and resulting business goal that should be dislosed. The 'commencement of development with a view to sale' or lack thereof does not

change management's new intent to sell the non-current asset and this should not determine different accounting treatment (in accordance within either IAS 2 or IFRS 5). To avoid potential confusion, the staff recommends a separate line item classification of investment property held for sale plus all disclosures required within IFRS 5.

10. The staff recommends removing paragraph 57(b) and amending paragraph 58 to incorporate a direct reference to IFRS 5 for all situations in which management has determined a non-current asset will be held for sale regardless of whether the cost model or fair value model have previously been used. See Appendix 1 for draft wording of proposed changes to IAS 40.

11. **Does the Board agree with the staff's recommendation on Issue 1? If not, why and what alternative do you propose?**

12. **Does the Board have any drafting comments on Appendix 1?**

Issue 2 – Should subsequent accounting for transfers out of investment property originally measured using the fair value model continue at fair value or some other value (original cost, amortized cost, fair value on the date transferred or otherwise)?

13. IAS 40.30 provides an accounting policy choice to account for investment property using either the fair value model (IAS 40.33) or the cost model (IAS 40.56). Assets subsequently transferred to another classification must follow the "transfers" guidance in IAS 40.57 and subsequent paragraphs.

14. If an asset classified as investment property is measured using the fair value model, IAS 40.60 states:

> 60 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 IAS 16 or IAS 2 shall be its fair value at the date of change in use.

15. Based on current IFRSs (and dependant upon the conclusion reached within Issue 1 of this paper), after the asset is transferred and becomes subject to other

literature (i.e. IAS 16 or IAS 2), the recognition and measurement provisions of the other standard become applicable. For example, if investment property is transferred to the owner-occupied classification, the ‘measurement after recognition’ provisions of IAS 16.29 apply. Likewise, if investment property is transferred to inventory as a result of management’s ‘commencement of development with a view to sale’, the ‘measurement of inventories’ provisions of IAS 2 apply.

16. Currently, when an asset is transferred from investment property at fair value to another classification that also allows fair value measurement, for instance when transferring to the owner-occupied classification and using the revaluation model permitted by IAS 16, there would be little change in the measurement models.

17. This concept also holds true for “transfers” from investment property at fair value to classification as ‘held for sale’ in accordance with IFRS 5. This is because assets “transferred” in these circumstances need to comply with all of the disclosure provisions of IFRS 5, but paragraph 5(d) of IFRS 5 excludes ‘non-current assets that are accounted for in accordance with the fair value model in IAS 40 *Investment Property*’ from the measurement provisions of IFRS 5. Therefore the measurement provisions of IAS 40 continue to apply.

18. Currently, when an asset is transferred from investment property using the fair value model to IAS 2, which does not allow for remeasurement, the deemed cost at the date of transfer is explicitly stated within IAS 40.60 to be ‘its fair value at the date of change in use’. Subsequent accounting treatment is, however, not as clear.

19. The question arises as to whether long-lived assets previously accounted for using the fair value model should subsequently change to the cost model using fair value at the date of reclassification as deemed cost.

20. The Basis for Conclusions to IAS 40 (2000), paragraphs B32 and B33 state, in part, that “With the passage of time, cost-based measurements become

increasingly irrelevant." If investment property is being transferred to another classification that allows or requires the use of the cost model, such as IAS 2, the asset must be held with an intent to sell and the potential for divergence between fair value and cost (as prescribed in IAS 40.60) will likely be minimised (in comparison to the likely difference between the cost model and fair value model if the asset is held with a long-term view of use). This first view maintains the current general application of IAS 2 and the cost model once an asset is transferred out of investment property. This first view reaffirms paragraph 60 of IAS 40 that deemed cost on the date of transfer is the fair value on the date of transfer and all subsequent measurements will follow the newly applicable literature (in this case the cost model in IAS 2).

21. A second view is to apply the disclosure provisions of IAS 2 upon a transfer from investment property at fair value to inventory, but to maintain the measurement provisions of 'fair value' initially chosen within paragraph 33 of IAS 40. Given an entity's prior ability to obtain and measure fair value, continued measurement at fair value provides comparability over multiple reporting periods. It also (substantially) eliminates divergence in measurement between assets that are transferred out of investment property into inventory due to the entity's 'commencement of development with a view to sale' (per IAS 40.58) and assets that are not transferred out of investment property, but that meet the criteria as held for sale in accordance with IFRS 5 (that will continue to be measured at fair value given the scope exclusion in paragraph 5 of IFRS 5).

22. Additionally, the disclosure provisions of IFRS 5 could be required when an asset being measured at fair value is transferred out of investment property and into inventory. This would provide disclosures deemed necessary for other non-current assets that are held for sale and would ensure the concept of 'commencement of development with a view to sale' is not misapplied.

23. These disclosure provisions would also be consistent with the 'Proposed amendment to IFRS 5 *Non-current Assets Held for Sale and Discontinued*

Operations' included in the August 2008 Exposure Draft of Proposed *Improvements to IFRSs*. The ED's proposed amendments to IFRS 5 are included here for reference:

> **Proposed amendment to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations***
>
> **Scope**
>
> 5A This IFRS specifies the disclosures required in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Disclosures in other IFRSs do not apply to such assets (or disposal groups) unless those IFRSs specifically require disclosures in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Additional disclosures about such assets (or disposal groups) may be necessary to comply with the general requirements of IAS 1.
>
> **Effective date**
>
> 44D Paragraph 5A was added by *Improvements to IFRSs* issued in [date]. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 January 2010. Earlier application is permitted.

24. Paragraph 8 of IAS 2 states, in part, that 'Inventories encompass goods purchased and held for resale including…land and other property held for resale…' IAS 2 clearly includes disclosures related to assets that are held 'with a view to sale' and IAS 2 includes non-current assets in its scope.

25. A <u>third view</u> is that the deemed cost on the date of transfer from investment property to inventory should be consistent with other applicable literature allowing for fair value measurements less 'costs to sell'.

26. This third view is evidenced by the measurement of agricultural produce as set out in paragraph 13 of IAS 41 *Agriculture*:

> 13 Agricultural produce harvested from an entity's biological assets shall be measured at its fair value less estimated point-of-sale costs at the point of harvest. Such measurement is the cost at that date when applying IAS 2 *Inventories* or another applicable Standard.

27. This third view is also evidenced by the continued measurement of certain inventories at 'net realisable value in accordance with well-established practices in those industries' or 'fair value less costs to sell' as clarified in paragraph 3(a) and 3(b) of IAS 2, respectively. Further, IAS 2.3 states, in part, 'When such inventories are measured at net realisable value [or as applicable 'fair value less

costs to sell’], changes in that value are recognized in profit or loss in the period of change.’

28. A <u>fourth view</u> is that an asset is not allowed to be transferred from investment property in circumstances when management has an intent to sell, regardless of whether ‘commencement of development with a view to sale’ has occurred or not. Thus the potential for abuse of the determination of ‘commencement’ is avoided. This fourth view creates comparability in measurement models from period to period for the same asset. Additionally, the provisions of IFRS 5 should be applied to ensure proper disclosure of management’s intent to sell.

29. This view preserves the benefits of the second view of comparability plus the disclosure provisions of IFRS 5. This view is also consistent with the proposed amendment to IFRS 5 as included in the August 2008 exposure draft of Improvements to IFRSs.

Issue 2 – Staff Rationale and Proposal

30. The staff believes that continuing to measure an asset using the measurement model previously selected provides the most relevant information about the progress of development activities and that providing IFRS 5 disclosures give comparable information about the sale of investment property whether or not further development is required before the asset is sold. This treatment also provides consistency between accounting periods as well as avoiding the potential for manipulation of the concept of ‘commencement of development with a view to sale’.

31. The staff recommends the fourth view (continuing to measure the asset at the measurement model originally selected in IAS 40). The staff recommends the following amendments to IFRSs:

    (a) Amending paragraph 60 of IAS 40 to exclude the reference to ‘inventories’ and ‘IAS 2’, and

(b) Amending paragraph 58 to remove the reference to paragraph 57(b) and incorporate the concept that management's intent to sell an asset should refer to IFRS 5 for additional considerations.

32. **Does the Board agree with the staff's recommendation? If not, why and what alternative do you propose**?

33. **Does the Board have any drafting comments on Appendix 1?**

Appendix 1 – DRAFTING

The changes proposed by the staff are underlined (additions) or ~~struck-through~~ (deletions).

Amendments to IAS 40: *Investment Property* (as revised in 2003)

57 Transfers to, or from, investment property shall be made when, and only when, there is a change in use, evidenced by:

…

~~(b) commencement of development with a view to sale, for the transfer from investment property to inventories;~~

…

58 ~~Paragraph 57(b) requires an entity to transfer a property from investment property to inventories when, and only when, there is a change in use, evidenced by commencement of development with a view to sale.~~ When an entity decides to dispose of an investment property~~ without development~~, it continues to treat the property as an investment property until it is derecognised (eliminated from the statement of financial position)~~, and does not treat it as inventory~~. Investment properties that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall apply the provisions of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, as applicable. Similarly, if an entity begins to redevelop an existing investment property for continued future use as investment property, the property remains an investment property and is not reclassified as owner-occupied property during the redevelopment.

…

60 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 IAS 16~~ or IAS 2~~ shall be its fair value at the date of change in use.

Amendments to the Basis for Conclusions on IAS 40 *Investment Property* (as revised in 2003)

Transfers

B66A The Board identified potentially inconsistent guidance regarding the classification of an investment property when management intends to sell the asset. Some read the guidance in paragraph 58 as requiring classification within inventories in accordance with IAS 2 *Inventories* while the guidance in paragraph 56 requires classification in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

B66B The Board concluded that continuing to measure the property using the measurement model previously selected provided the most relevant information about the progress of development activities and that providing IFRS 5 disclosures gave comparable information about the sale of investment property whether or not further development was required before sale.

Appendix 2 – EXTRACTS from IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

Scope

2 The classification and presentation requirements of this IFRS apply to all recognised *non-current assets*[1] and to all *disposal groups* of an entity. The measurement requirements of this IFRS apply to all recognised non-current assets and disposal groups (as set out in paragraph 4), except for those assets listed in paragraph 5 which shall continue to be measured in accordance with the Standard noted.

[1] For assets classified according to a liquidity presentation, non-current assets are assets that include amounts expected to be recovered more than twelve months after the reporting period. Paragraph 3 applies to the classification of such assets.

3 Assets classified as non-current in accordance with IAS 1 *Presentation of Financial Statements* shall not be reclassified as *current assets* until they meet the criteria to be classified as held for sale in accordance with this IFRS. Assets of a class that an entity would normally regard as non-current that are acquired exclusively with a view to resale shall not be classified as current unless they meet the criteria to be classified as held for sale in accordance with this IFRS.

4 Sometimes an entity disposes of a group of assets, possibly with some directly associated liabilities, together in a single transaction. Such a disposal group may be a group of *cash-generating units*, a single cash-generating unit, or part of a cash-generating unit.[2] The group may include any assets and any liabilities of the entity, including current assets, current liabilities and assets excluded by paragraph 5 from the measurement requirements of this IFRS. If a non-current asset within the scope of the measurement requirements of this IFRS is part of a disposal group, the measurement requirements of this IFRS apply to the group as a whole, so that the group is measured at the lower of its carrying amount and fair value less costs to sell. The requirements for measuring the individual assets and liabilities within the disposal group are set out in paragraphs 18, 19 and 23.

[2] However, once the cash flows from an asset or group of assets are expected to arise principally from sale rather than continuing use, they become less dependent on cash flows arising from other assets, and a disposal group that was part of a cash-generating unit becomes a separate cash-generating unit.

5 The measurement provisions of this IFRS[3] do not apply to the following assets, which are covered by the Standards listed, either as individual assets or as part of a disposal group:

[3] Other than paragraphs 18 and 19, which require the assets in question to be measured in accordance with other applicable IFRSs.

(a) deferred tax assets (IAS 12 *Income Taxes*) .

(b) assets arising from employee benefits (IAS 19 *Employee Benefits*).

(c) financial assets within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*.

(d) non-current assets that are accounted for in accordance with the fair value model in IAS 40 *Investment Property*.

(e) non-current assets that are measured at fair value less estimated point-of-sale costs in accordance with IAS 41 *Agriculture*.

(f) contractual rights under insurance contracts as defined in IFRS 4 *Insurance Contracts*.

…

Presentation and disclosure

30 An entity shall present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).

…

Gains or losses relating to continuing operations

37 Any gain or loss on the remeasurement of a non-current asset (or disposal group) classified as held for sale that does not meet the definition of a discontinued operation shall be included in profit or loss from continuing operations.

Presentation of a non-current asset or disposal group classified as held for sale

38 An entity shall present a non-current asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the statement of financial position. The liabilities of a disposal group classified as held for sale shall be presented separately from other liabilities in the statement of financial position. Those assets and liabilities shall not be offset and presented as a single amount. The major classes of assets and liabilities classified as held for sale shall be separately disclosed either in the statement of financial position or in the notes, except as permitted by paragraph 39. An entity shall present separately any cumulative income or expense recognised in other comprehensive income relating to a non-current asset (or disposal group) classified as held for sale.

39 If the disposal group is a newly acquired subsidiary that meets the criteria to be classified as held for sale on acquisition (see paragraph 11), disclosure of the major classes of assets and liabilities is not required.

40 An entity shall not reclassify or re-present amounts presented for non-current assets or for the assets and liabilities of disposal groups classified as held for sale in the balance sheets for prior periods to reflect the classification in the statement of financial position for the latest period presented.

Additional disclosures

41 An entity shall disclose the following information in the notes in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:

(a) a description of the non-current asset (or disposal group);

(b) a description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal;

(c) the gain or loss recognised in accordance with paragraphs 20–22 and, if not separately presented in the statement of comprehensive income, the caption in the statement of comprehensive income that includes that gain or loss;

(d) if applicable, the reportable segment in which the non-current asset (or disposal group) is presented in accordance with IFRS 8 *Operating Segments*.

42 If either paragraph 26 or paragraph 29 applies, an entity shall disclose, in the period of the decision to change the plan to sell the non-current asset (or disposal group), a description of the facts and circumstances leading to the decision and the effect of the decision on the results of operations for the period and any prior periods presented.

…

Appendix 3 – EXTRACTS from IAS 2 *Inventories*

Scope

2 **This Standard applies to all inventories, except:**

(a) work in progress arising under construction contracts, including directly related service contracts (see IAS 11 *Construction Contracts*);

(b) financial instruments (see IAS 32 *Financial Instruments: Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*); and

(c) biological assets related to agricultural activity and agricultural produce at the point of harvest (see IAS 41 *Agriculture*).

3 **This Standard does not apply to the measurement of inventories held by:**

(a) producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realisable value in accordance with well-established practices in those industries. When such inventories are measured at net realisable value, changes in that value are recognised in profit or loss in the period of the change.

(b) commodity broker-traders who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognised in profit or loss in the period of the change.

4 The inventories referred to in paragraph 3(a) are measured at net realisable value at certain stages of production. This occurs, for example, when agricultural crops have been harvested or minerals have been extracted and sale is assured under a forward contract or a government guarantee, or when an active market exists and there is a negligible risk of failure to sell. These inventories are excluded from only the measurement requirements of this Standard.

5 Broker-traders are those who buy or sell commodities for others or on their own account. The inventories referred to in paragraph 3(b) are principally acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-traders' margin. When these inventories are measured at fair value less costs to sell, they are excluded from only the measurement requirements of this Standard.

Definitions

6 **The following terms are used in this Standard with the meanings specified:**

***Inventories* are assets:**

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

***Net realisable value* is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.**

***Fair value* is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.**

7 Net realisable value refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business. Fair value reflects the amount for which the same inventory could be exchanged between knowledgeable and willing buyers and sellers in the marketplace. The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell.

8 Inventories encompass goods purchased and held for resale including, for example, merchandise purchased by a retailer and held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the entity and include materials and supplies awaiting use in the production process. In the case of a service provider, inventories include the costs of the service, as described in paragraph 19, for which the entity has not yet recognised the related revenue (see IAS 18 *Revenue*).

…

Disclosure

36 The financial statements shall disclose:

(a) the accounting policies adopted in measuring inventories, including the cost formula used;

(b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;

(c) the carrying amount of inventories carried at fair value less costs to sell;

(d) the amount of inventories recognised as an expense during the period;

(e) the amount of any write-down of inventories recognised as an expense in the period in accordance with paragraph 34;

(f) the amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as expense in the period in accordance with paragraph 34;

(g) the circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph 34; and

(h) the carrying amount of inventories pledged as security for liabilities.

37 Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are merchandise, production supplies, materials, work in progress and finished goods. The inventories of a service provider may be described as work in progress.

38 The amount of inventories recognised as an expense during the period, which is often referred to as cost of sales, consists of those costs previously included in the measurement of inventory that has now been sold and unallocated production overheads and abnormal

amounts of production costs of inventories. The circumstances of the entity may also warrant the inclusion of other amounts, such as distribution costs.

39 Some entities adopt a format for profit or loss that results in amounts being disclosed other than the cost of inventories recognised as an expense during the period. Under this format, an entity presents an analysis of expenses using a classification based on the nature of expenses. In this case, the entity discloses the costs recognised as an expense for raw materials and consumables, labour costs and other costs together with the amount of the net change in inventories for the period.

…

Appendix 4 – EXTRACTS from IAS 40 *Investment Property*

Definitions

5 **The following terms are used in this Standard with the meanings specified:**

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 IFRSs, eg IFRS 2** ***Share-based Payment*****.**

Fair value **is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.**

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:**

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

(b) 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.**

6 **A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, the property would otherwise meet the definition of an investment property and the lessee uses the fair value model set out in paragraphs 33–55 for the asset recognised. This classification alternative is available on a property-by-property basis. However, once this classification alternative is selected for one such property interest held under an operating lease, all property classified as investment property shall be accounted for using the fair value model. When this classification alternative is selected, any interest so classified is included in the disclosures required by paragraphs 74–78.**

7 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. The production or supply of goods or services (or the use of property for administrative purposes) generates cash flows that are attributable not only to property, but also to other assets used in the production or supply process. IAS 16 *Property, Plant and Equipment* applies to owner-occupied property.

8 The following are examples of investment property:

(a) land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business.

(b) 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.)

(c) a building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases.

(d) a building that is vacant but is held to be leased out under one or more operating leases.

9 The following are examples of items that are not investment property and are therefore outside the scope of this Standard:

(a) 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.

(b) property being constructed or developed on behalf of third parties (see IAS 11 *Construction Contracts*).

(c) 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.

(d) property that is being constructed or developed for future use as investment property. IAS 16 applies to such property until construction or development is complete, at which time the property becomes investment property and this Standard applies. However, this Standard applies to existing investment property that is being redeveloped for continued future use as investment property (see paragraph 58).

(e) property that is leased to another entity under a finance lease.

10 Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions could be sold separately (or leased out separately under a finance lease), an entity accounts for the portions separately. If the portions could not be sold separately, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.

11 In some cases, an entity provides ancillary services to the occupants of a property it holds. An entity treats such a property as investment property if the services are insignificant to the arrangement as a whole. An example is when the owner of an office building provides security and maintenance services to the lessees who occupy the building.

12 In other cases, the services provided are significant. For example, if an entity owns and manages a hotel, services provided to guests are significant to the arrangement as a whole. Therefore, an owner-managed hotel is owner-occupied property, rather than investment property.

13 It may be difficult to determine whether ancillary services are so significant that a property does not qualify as investment property. For example, the owner of a hotel sometimes transfers some responsibilities to third parties under a management contract.

The terms of such contracts vary widely. At one end of the spectrum, the owner's position may, in substance, be that of a passive investor. At the other end of the spectrum, the owner may simply have outsourced day-to-day functions while retaining significant exposure to variation in the cash flows generated by the operations of the hotel.

14 Judgement is needed to determine whether a property qualifies as investment property. An entity develops criteria so that it can exercise that judgement consistently in accordance with the definition of investment property and with the related guidance in paragraphs 7–13. Paragraph 75(c) requires an entity to disclose these criteria when classification is difficult.

15 In some cases, an entity owns property that is leased to, and occupied by, its parent or another subsidiary. The property does not qualify as investment property in the consolidated financial statements, because the property is owner-occupied from the perspective of the group. However, from the perspective of the entity that owns it, the property is investment property if it meets the definition in paragraph 5. Therefore, the lessor treats the property as investment property in its individual financial statements.

…

Measurement after recognition

Fair value model

33 After initial recognition, an entity that chooses the fair value model shall measure all of its investment property at fair value, except in the cases described in paragraph 53.

…

Cost model

56 After initial recognition, an entity that chooses the cost model shall measure all of its investment property in accordance with IAS 16's requirements for that model, other than those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Investment properties that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall be measured in accordance with IFRS 5.

Transfers

57 Transfers to, or from, investment property shall be made when, and only when, there is a change in use, evidenced by:

(a) commencement of owner-occupation, for a transfer from investment property to owner-occupied property;

(b) commencement of development with a view to sale, for a transfer from investment property to inventories;

(c) end of owner-occupation, for a transfer from owner-occupied property to investment property;

(d) **commencement of an operating lease to another party, for a transfer from inventories to investment property; or**

(e) **end of construction or development, for a transfer from property in the course of construction or development (covered by IAS 16) to investment property.**

58 Paragraph 57(b) requires an entity to transfer a property from investment property to inventories when, and only when, there is a change in use, evidenced by commencement of development with a view to sale. When an entity decides to dispose of an investment property without development, it continues to treat the property as an investment property until it is derecognised (eliminated from the statement of financial position) and does not treat it as inventory. Similarly, if an entity begins to redevelop an existing investment property for continued future use as investment property, the property remains an investment property and is not reclassified as owner-occupied property during the redevelopment.

59 Paragraphs 60–65 apply to recognition and measurement issues that arise when an entity uses the fair value model for investment property. When an entity uses the cost model, 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.

60 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 IAS 16 or IAS 2 shall be its fair value at the date of change in use.

…

63 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.

64 The treatment of transfers from inventories to investment property that will be carried at fair value is consistent with the treatment of sales of inventories.

…

Basis for Conclusions on IAS 40 (2000) *Investment Property*

This Basis for Conclusions accompanies, but is not part of, IAS 40. It was issued by the Board of the former International Accounting Standards Committee (IASC) in 2000. Apart from the deletion of paragraphs B10–B15, B25 and B26, this Basis has not been revised by the IASB—those paragraphs are no longer relevant and have been deleted to avoid the risk that they might be read out of context. However, cross-references to paragraphs in IAS 40 as issued in 2000 have been marked to show the corresponding paragraphs in IAS 40 as revised by the IASB in 2003 (superseded references are struck through and new references are underlined). Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ. In addition, the text has been annotated where references to material in other standards are no longer valid, following the revision of those standards. Reference should be made to the IASB's Basis for Conclusions on the amendments made in 2003.

Definition of Investment Property

B30 The definition of investment property excludes:

(a) owner-occupied property—covered by IAS 16 *Property, Plant and Equipment*. Under IAS 16, such property is carried at either depreciated cost or revalued amount less subsequent depreciation. In addition, such property is subject to an impairment test; and

(b) property held for sale in the ordinary course of business—covered by IAS 2 *Inventories*. IAS 2 requires an entity to carry such property at the lower of cost and net realisable value.

B31 These exclusions are consistent with the existing definitions of property, plant and equipment in IAS 16 and inventories in IAS 2. This ensures that all property is covered by one, and only one, of the three Standards.

B32 Some commentators suggested that property held for sale in the ordinary course of business should be treated as investment property rather than as inventories (covered by IAS 2). They argued that:

(a) it is difficult to distinguish property held for sale in the ordinary course of business from property held for capital appreciation; and

(b) it is illogical to require a fair value model for land and buildings held for long-term capital appreciation (investment property) when a cost model is still used for land and buildings held for short-term sale in the ordinary course of business (inventories).

B33 The Board rejected this suggestion because:

(a) if fair value accounting is used for property held for sale in the ordinary course of business, this would raise wider questions about inventory accounting that go beyond the scope of this project; and

(b) it is arguably more important to use fair value accounting for property that may have been acquired over a long period and held for several years (investment property) than for property that was acquired over a shorter period and held for a relatively short time (inventories). With the passage of time, cost-based measurements become increasingly irrelevant. Also, an aggregation of costs incurred over a long period is of questionable relevance.

B34 Some commentators suggested requiring (or at least permitting) entities, particularly financial institutions such as insurance companies, to use the fair value model for their owner-occupied property. They argued that some financial institutions regard their owner-occupied property as an integral part of their investment portfolio and treat it for management purposes in the same way as property leased to others. In the case of insurance companies, the property may be held to back policyholder liabilities. The Board believes that property used for similar purposes should be subject to the same accounting treatment. Accordingly, the Board concluded that no class of entities should use the fair value model for their owner-occupied property.

B35 Some commentators suggested that the definition of investment property should exclude property held for rentals, but not for capital appreciation. In their view, a fair value model may be appropriate for dealing activities, but is inappropriate where an entity has historically held rental property for many years and has no intention of selling it in the foreseeable future. They consider that holding property for long-term rental is a service activity and the assets used in that activity should be treated in the same way as assets used to support other service activities. In their view, holding an investment in property in such cases is similar to holding "held-to-maturity investments", which are measured at amortised cost under IAS 39.

B36 In the Board's view, the fair value model provides useful information about property held for rental, even if there is no immediate intention to sell the property. The economic performance of a property can be regarded as being made up of both rental income earned during the period (net of expenses) and changes in the value of future net rental income. The fair value of an investment property can be regarded as a market-based representation of the value of the future net rental income, regardless of whether the entity is likely to sell the property in the near future. Also, the Standard notes that fair value is determined without deducting costs of disposal—in other words, the use of the fair value model is not intended as a representation that a sale could, or should, be made in the near future.

…

Transfers

B66 When an owner-occupied property carried under the benchmark treatment under IAS 16 becomes an investment property, the measurement basis for the property changes from depreciated cost to fair value. The Board concluded that the effect of this change in measurement basis should be treated as a revaluation under IAS 16 at the date of change in use. The result is that:

(a) the income statement excludes cumulative net increases in fair value that arose before the property became investment property. The portion of this change that arose before the beginning of the current period does not represent financial performance of the current period; and

(b) this treatment creates comparability between entities that had previously revalued the property under the allowed alternative treatment in IAS 16 and those entities that had previously used the IAS 16 benchmark treatment.[10]

[10] IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments.

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