Project	**Annual Improvements – 2010-2012 Cycle**
Topic	**IAS 40 – Transfers from Investment Property**

Background

1. In September 2008 the Board received notice of an inconsistency in treatment between properties held for sale recognised in accordance with IAS 16 *Property, Plant and Equipment* and properties held for sale recognised in accordance with IAS 40 *Investment Property*.

2. Property, plant and equipment (PPE) were recognised in accordance with IAS 16 until they were in a condition for sale and sale was imminent at which time they were recognised in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

3. Investment properties could be recognised under two alternative standards once the decision to sell had been made, based on the completeness of the development work at the time of transfer from IAS 40:

   (a) either in accordance with IFRS 5 when the property was available for sale in its present condition, or

   (b) in accordance with IAS 2 *Inventories* when the property required further development.

4. This inconsistency led to a general review of transfers from investment properties in 2009. The following was proposed in the 2009 Annual Improvements:

(a) The requirement to transfer investment properties to IAS 2 *Inventories* at the commencement of development with a view to sale should be removed.

(b) Investment properties held for sale should be displayed as a separate category in the statement of financial position.

(c) Investment properties held for sale should be subject to the same disclosures as non-financial assets held for sale in accordance with IFRS 5.

5. However, over the year under which this matter was discussed other IFRSs had been developed and changed. In particular, IAS 16 had been revised in a way which removed much of the original inconsistency.

6. The inclusion of paragraph 68A into IAS 16 as part of the 2008 annual improvements required transfer to IAS 2 of assets, formerly held for rental, when they cease to be rented and become held for sale in the ordinary course of business. The paragraph also stated that IFRS 5 does not apply when assets that are held for sale in the ordinary course of business are transferred to inventories.

7. In March 2010, the comment letter analysis of respondents to the proposed changes highlighted the confusing array of interactions between IAS 40 and other IFRSs and the Committee recommended that the proposed amendment was not finalised. The Board have asked the Committee to look again at the issue.

Structure of the paper

8. Rather than retrace the discussions held over the last two years, the staff have prepared a summary of the diverse views expressed over the time.

9. The paper consists of the following sections:

(a) Recognition of investment properties

(b) Measurement of investment properties

(c) Investment properties held for sale displayed as a separate asset category

10. Each section concludes with a staff summary and recommendation.

Recognition of investment properties

11. Property is initially recognised in accordance with three IFRSs based on the stage of development of the property and its intended use:

    (a) IAS 2 *Inventories*

    (b) IAS 16 *Property, Plant and Equipment*

    (c) IAS 40 *Investment Property*

12. At the May 2010 meeting of the Committee the staff presented a table which showed the ten principal ways in which property can be recognised subsequently in accordance with IFRSs (Appendix 1). The original 2008 query was prompted by the possibility of transferring property between investment properties and other asset categories in the statement of financial position.

Asset categories defined by use

13. Assets are categorised on the statement of financial position by the way in which the resource is employed in the business and the timing and manner in which the entity will receive benefit from the asset. These characteristics are reflected in the definitions of the assets involved:

> **Inventories** are assets held for sale in the ordinary course of business; in the process of production for such sale; or in the form of material or supplies to be consumed in the production process or in the rendering of services.
>
> **Property plant and equipment** are tangible items that are held for use in the production or supply of goods and services, for rental to others, or for administration purposes; and are expected to be used during more than one period.
>
> **Investment property** is property held to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administration purposes or for sale in the ordinary course of business

14. The definition of investment properties excludes both owner-occupied property (IAS 16) and property held for sale in the course of ordinary business (IAS 2). These exclusions are considered consistent with the existing definitions in IAS 16 and IAS 2. At the time of drafting the original IAS 40, the investment property standard sought to define these three different classes of property in such a way as to ensure that all property is covered by one, and only one, standard.

15. The proposed amendment removed the requirement to transfer investment property in the course of development prior to sale to IAS 2. The staff have analysed the effects of this proposal below.

Consistency of assets categorised by use

16. Respondents to the proposed amendment in 2009 believed that when management changes how property is to be used, the accounting should reflect that change. Assets employed in a similar way and assets where the timing of the receipt of benefits have similar characteristics should be classified and presented together.

17. Many felt that properties should be presented solely in accordance with the defined class of asset:

    (a) Inventories for assets to be developed or sold in the ordinary course of business

    (b) Investment properties when held for capital appreciation or rental income

    (c) PPE for assets held for own use.

18. Many respondents consider that prohibiting an entity from transferring a property from investment property to inventory provides a less relevant depiction of the entity’s employment of capital. Many large property groups have two property portfolios – investment and trading. Prohibiting transfer to inventories would mean that the recognition basis of trading properties will

depend on the purpose for which they were *originally* purchased, rather than that for which they are being held at the reporting date.

19. Some believe that the current economic conditions have resulted in developers and holders of investment properties retaining property for longer periods making consistent classification decisions more relevant.

Significance of intent in the recognition of property by asset category

20. Generally, recognition of assets in accordance with the three definitions above works well in practice, but many are troubled by the importance of intent in distinguishing between the three types of asset.

21. This concern was expressed by many when the original proposed investment property standard (IAS 40) was first exposed. Many respondents argued that investment properties should fall within the scope of IAS 16 and there was no need for a separate standard on investment properties as it is not possible to distinguish between both types of property without reference to management intent.

22. Similarly, some respondents to the exposure draft of IAS 40 suggested that property held for sale in the ordinary course of business should be treated as investment property rather than inventories because it is difficult to distinguish property held for sale in the ordinary course of business from that held for capital appreciation.

23. However, the IASC believed that the characteristics of investment property differed significantly from owner-occupied property and inventories and there was a need for a separate standard and a separate asset category with its own separate characteristics.

24. The situation became more complex in later years when IFRS 5 was published as it introduced a fourth asset category. Under this IFRS, assets are recognised in accordance with this standard if :

    (i) The carrying amount of the asset will be recovered principally through a sales transaction

(ii) The asset is available for immediate sale in its present condition

(iii) The sale of the asset is highly probable

25. This standard addresses the issue of intent by containing strictly drawn criteria which must be satisfied – ii and iii above. These criteria are more objective than simply intent or commitment to sell. Intent to sell is not sufficient to warrant recognition as an asset held for sale in accordance with IFRS 5.

26. The staff believe the classification of properties in IFRSs relies predominantly on usage and the manner of obtaining benefit from the asset, ie facts and circumstances. Recognition in accordance with IFRS 5 is subject to strictly drawn criteria before management intent is recognised.

27. The staff do not consider intent is relied on to an excessive degree. The primary criterion for classification is the use of the asset in the business.

Divergence in reporting revenues

28. IAS 40.9 excludes property intended for sale, or in the process of construction for such sale, from investment properties. These properties are recognised in accordance with IAS 2. Similarly, land acquired for development and sale in the ordinary course of business is recognised as inventory. Land for which a use has not yet been identified is recognised as investment property because a subsequent decision about the use of that land would be an investment decision (IAS 40 B67 (b)).

29. Many property companies acquire land, build up 'land banks' and subsequently assess how to use the land (investment property or trading stock) as market circumstances dictate.

30. If transfer to IAS 2 were prohibited, any subsequent development would not go through inventories for sale in the ordinary course of business unless that land had initially been recognised in accordance with IAS 2. Revenue would not be recognised on derecognition of those developments, although revenue would be recognised on the disposal of any developments raised on land initially identified as trading stock.

31. This would create divergence in performance reporting and create inconsistencies both within individual entities and between entities.

Realisation of holding gains

32. Recognising investment properties that are to be sold in their current state in accordance with IFRS 5 presents this transaction relevantly in the statement of comprehensive income. On derecognition of the asset, the entity will recognise a gain (or loss) in the profit and loss account. This gain depicts the realisation of the holding gain on the investment property.

33. This gain will be much smaller for investment properties held at fair value , where the holding gains have been recognised in profit and loss over the reporting periods, than the gain recognised for investment properties held at cost. The gain on the disposal of investment property held at fair value will be only the difference between fair value and the individual transaction sales price. The entire holding gain will be recognised on disposal of those investment properties held at cost.

34. Properties that are developed and sold in the ordinary course of business, on the other hand, will be recognised as inventories (with other property held as trading stock) and gains recognised gross as revenue.

35. This distinction, based on the purpose for which the asset is held, reflects how the asset will be realised and provides useful and consistent information to users.

Consistency with other requirements to transfer to inventories

36. The 2008 improvement to IAS 16, referred to in paragraph 5, requires that PPE sold in the ordinary course of business be recognised in accordance with IAS 2. The removal of the requirement to transfer investment properties undergoing redevelopment for sale in the ordinary course of business to IAS 2 would result in a divergence of reporting. To ensure consistency in the recognition of assets of like-purpose, investment properties in the course of development for sale should also be transferred to IAS 2.

Consistency with transfers of investment properties to other asset categories

37. Respondents to the Annual Improvements ED in 2009 felt that continuing to require all the transfers listed in IAS 40 paragraph 57, but prohibiting the transfer to inventories, was not internally consistent.

38. In paragraph 57, investment properties are required to be transferred to or from other asset categories when their intended use changes. Consequently, both transfers to inventories and PPE and transfers from inventories and PPE are *required* to reflect the change in use of the asset employed. It seems inconsistent to many to prevent a transfer *to* inventories while requiring transfer to and from PPE and still requiring transfers *from* inventories.

Staff recommendation - recognition

39. The staff recommend that the transfer to inventories required by IAS 40 is retained and that recognition of investment properties in accordance with different IFRSs, depending on intended use and stage of development, should continue as at present:

    (a) The existing guidance is clear.

    (b) Assets are recognised in accordance with the definition of particular classes of assets. Investment properties are recognised on a basis consistent with the facts of their use and characteristics at the reporting date and not in accordance with historical intent at the date of acquisition.

    (c) All assets held for the same purpose, and utilised in the same way, are recognised together as one category (inventories; PPE; investment properties; or non-current assets held for sale) on the statement of financial position.

    (d) The performance of an entity is depicted in a relevant way in the statement of comprehensive income. On derecognition of the asset revenue is recognised on the sale of inventory and a gain is recognised on the disposal of investment properties.

(e) Retention of the requirement to transfer investment properties to IAS 2 *Inventories* at the commencement of development with a view to sale is consistent with the requirement to transfer properties from IAS 16 to IAS 2 when sold in the ordinary course of business and with the other transfer requirements detailed in IAS 40.57.

Staff recommendation 1
The staff recommend that property assets continue to be recognised in the statement of financial position as different classes of assets based on their use and manner of employment by the entity, in accordance with the existing asset categories and definitions. Does the Committee agree with this recommendation?

Measurement of investment properties

40. IAS 40 introduced fair value as a measurement basis for investment property. Fair value was considered by many to be more relevant than cost because of the extended time frame of ‘holding’ investment properties for capital appreciation. The fair value measurement basis of IAS 40 assumes that the property will continue to be owned by the entity and, therefore, excludes costs of sales.

41. Many considered fair value the more relevant basis when IAS 40 was issued, but fair value measurement was not made a requirement due to the practical difficulties of measuring fair value in some geographies.

Measurement of investment properties and inventories

42. The original concern referred to the IFRIC in 2008, concerning how investment properties were *recognised* once the decision was made to sell, evolved into a greater concern about how such properties would be *measured*. Many feared that investment properties held at a more relevant measurement basis (in accordance with IAS 40) would be measured at a less relevant basis after transfer to inventories and it was proposed that transfer to IAS 2 be prohibited.

43. Similarly, some respondents when IAS 40 was originally proposed were also concerned about measuring investment property held for sale in the ordinary

course of business at a less relevant measurement basis in accordance with IAS 2. They suggested that all property should be treated as investment property because they considered it illogical to allow a fair value basis for some properties (those held for long-term appreciation), but cost for other properties (ie those held for short term sales).

44. The IASC disagreed with this view because:

    (a) Using fair value for property held for sale in the ordinary course of business would raise wider questions about inventory accounting that went beyond the scope of IAS 40.

    (b) It is more important to use fair value for property held for several years (investment property) than it is for those properties held for a relatively short time (inventories).

45. The typical time scale of holding investment properties is much longer than it is for assets being developed for resale. While it is accepted that many developments can take a few years to complete, assets held for capital appreciation or rental often are held for decades. Over this time scale, fair value is obviously more relevant. By taking deemed cost to be fair value at the date of transfer to inventories, the holding gains or losses to date of transfer are reflected in the carrying amount in inventory.

46. In the development of IAS 40, the IASC restated the principle that assets should be categorised based on their use to the business and that measurement of assets within each category should be identical.

Measurement of assets under development

47. At the time of drafting IAS 40 it was accepted by the IASC that when an investment property is redeveloped for sale it is no longer possible in all cases to measure that part-developed asset at fair value. Hence, continuing to recognise such properties at fair value in accordance with IAS 40 is not always possible once development begins. Therefore, properties in the course of development for sale are recognised in accordance with IAS 2 at their IAS 40 fair value measure,

as deemed cost, and subsequent development is recognised in accordance with IAS 2 at cost.

48. As recently as February 2010, the International Valuation Standards Council have issued guidance on the valuation of investment property under construction. In spite of this, the valuation of part-developed properties is still considered to be difficult in practice.

Consistent measurement bases within individual IFRSs

49. The staff believe financial statements are most useful if assets recognised in accordance with an individual IFRS are all measured on the same basis. A review of the measurement bases used when investment property (held at cost) and investment property (held at fair value) are transferred to other asset categories shows a single anomaly.

50. The measurement bases applied to transferred investment property are:

Investment property held at cost

Transferred and recognised as	Measurement basis
IAS 2 Inventories	IAS 16 cost
IAS 16 Property, Plant and Equipment	IAS 16 cost
IFRS 5 Non-current Assets Held for Sale and Discontinued Operations	Lower of carrying amount and fair value less costs to sell (IAS 40 para 56)

Investment property held at fair value

Transferred and recognised as	Measurement basis
IAS 2 Inventories	Deemed cost is fair value at date of transfer (IAS 40 Para 60)
IAS 16 Property, Plant and Equipment	Deemed cost is fair value at date of transfer (IAS 40 Para 60)
IFRS 5 Non-current Assets Held for Sale and Discontinued Operations	IAS 40 basis (IFRS 5 Para 5 (d)) (Fair value)

51. For investment properties held at fair value, fair value at the date of transfer is deemed to be cost if the property is transferred to inventories or PPE. Subsequently the asset is measured at cost for both former investment properties held at cost and former investment properties held at fair value.

52. The exception to measuring assets, recognised in accordance with the same asset category, on the same measurement basis is IFRS 5. In accordance with this IFRS, former investment properties held at cost are measured subsequently at the IFRS 5 measurement basis of the lower of its carrying amount and fair value less costs of sale. This measurement basis is used for most non –current assets held for sale – including former investment properties held at cost and properties previously recognised in accordance with IAS 16. Investment properties held at fair value, however, continue to be measured in accordance with IAS 40 after recognition as non-current assets held for sale ie at fair value excluding costs of sale.

53. IFRS 5 excludes three classes of assets held at fair value with gains or losses through profit and loss from the IFRS 5 measurement basis:

    (a) Financial assets

    (b) Investment properties held at fair value

    (c) Agricultural assets held at fair value less costs to sell

54. The basis for conclusion to IFRS 5 confirms the principle behind the recognition of assets in accordance with IFRS 5 ie that the carrying amount of the assets will be recovered principally through sale.

55. The staff see no reason why investment properties, formerly held at fair value, should not be measured at the lower of carrying amount and fair value less costs of sale. Unlike financial assets, the sale costs of investment properties can be significant and these costs of sales should be reflected in the measurement of the asset when the more stringent 'held for sale' criteria of IFRS 5 are met.

Staff recommendation 2
The staff recommend that the exemption in IFRS 5. 5 (d) should be removed and that investment properties held at fair value recognised as non-current assets held for sale in accordance with IFRS 5 should be measured at the lower of carrying amount and fair value less costs of sale. Does the Committee agree with this recommendation?

Investment properties held for sale displayed as a separate asset category

56. The proposed Annual Improvement recommended that investment properties held for sale, but not able to satisfy the strict criteria for recognition in accordance with IFRS 5, should be displayed as a separate category of asset on the statement of financial position and should be subject to the disclosure requirements of IFRS 5.

57. The staff do not agree with this proposal for the reasons noted above:

    (a) Assets should be recognised in accordance with existing IFRS definitions and based on their usage within the business.

    (b) The classification and definition of different types of asset is clear and mutually exclusive.

    (c) Any distinction between investment properties displayed as held for sale that do not satisfy the strict criteria of IFRS 5, and other investment properties would be based solely on management intent.

(d) The introduction of a new asset category would increase complexity in financial reporting.

Staff recommendation 3
The staff recommend that the proposal to display investment properties held for sale that do not satisfy the criteria of IFRS 5 as a separate asset category be rejected. Does the Committee agree with this recommendation?

Staff recommendation 4
The staff propose that the draft amendments required to IAS 40 be brought to the Committee at their next meeting, based on the discussions above.

Recognition of property — Appendix 1

58. Properties can be recognised as different categories of asset, in accordance with a number of IFRSs, depending on their stage of completion and intended use.

Sold in course of business	*IAS 2 Inventories*
Developed or constructed for sale or lease	*IAS 2 Inventories*
Owner-occupied or being developed for owner occupation	*IAS 16 Property, Plant and Equipment*
Under construction for future use as investment property	*IAS 16 Property, Plant and Equipment*
Leased, but level of services provided deems it owner-occupied	*IAS 16 Property, Plant and Equipment*
Owned or leased property held to earn rentals or for capital appreciation or both	*IAS 40 Investment Property*
Existing investment property being developed for continued future use as an investment property	*IAS 40 Investment Property*
Property provided by lessor under operating lease (lessor accounting)	*IAS 40 Investment Property*
Property held for disposal without development, sale not highly probable	*IAS 40 Investment Property*
Fully developed property held for sale - highly probable to be sold	*IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*