Project	**Annual Improvements – 2009–2011 cycle**
Topic	**IAS 40 Transfers from Investment Property**

Background

1. As part of the 2009 *Annual Improvements* the transfer of investment properties in the course of development to other asset categories was reviewed. In the course of this review, concerns were raised about the changes in measurement bases that result when investment properties are transferred from one asset category to another. These measurement bases are summarised in Appendix 1.

2. In particular, some Board members were concerned about the change in measurement basis when the decision is taken to redevelop investment properties with a view to resale. Paragraph 57 of IAS 40 *Investment Property* requires that these properties should be recognised in accordance with IAS 2 *Inventories* and measured subsequently at cost. Several Board members were concerned that, where the investment properties had previously been measured at fair value in accordance with IAS 40, a less relevant measurement basis would be applied after transfer to inventories.

3. To remedy this, the following was proposed in the 2009 *Annual Improvements*:

   (a) The requirement to transfer investment properties to IAS 2 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.

Purpose of the paper

4. In March 2010, the Annual Improvements comment letter analysis highlighted the confusing array of interactions between IAS 40 and other IFRSs. As a result, the Interpretations Committee recommended that the proposed amendments should not be finalised. At the May meeting, the Board asked the Interpretations Committee to look again at the issue.

5. The Interpretations Committee have since reviewed the accounting for investment properties in some detail, and confirm their earlier recommendation that no changes should be made in relation to IAS 40 as part of the annual improvements process. The purpose of this paper is to report these views to the Board. No action is requested of the Board.

6. The Interpretations Committee's reasons for this recommendation are recorded under three subject headings:

- Recognition of investment properties
- Measurement of investment properties
- Investment properties held for sale displayed as a separate asset category

Recognition of investment properties

Asset categories defined by use

7. 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. Property is initially recognised in accordance with three IFRSs:

> IAS 2, *Inventories*: **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.
>
> IAS 16, *Property, Plant and Equipment*: **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.
>
> IAS 40, *Investment Property*: **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

8. At the time that it was drafted, 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.

Consistency of assets categorised by use

9. Respondents to the proposed amendment in 2009 believe 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.

10. 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.

11. Furthermore, 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.

Divergence in reporting revenues

12. 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)).

13. 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.

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

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

Recognition of property disposals in profit or loss

16. Investment properties that are to be sold in their current state are recognised in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. On sale 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.

17. 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 will be recognised gross as revenue.

18. This distinction provides useful and consistent information to users.

Consistency with other requirements to transfer to inventories

19. IAS 16 requires that PPE (property, plant and equipment) that is sold in the ordinary course of business should 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 with an identical 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

20. 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. At present, transfers to inventories and PPE and transfers from inventories and PPE are *required* in order 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.

Interpretations Committee recommendation - recognition

21. The Interpretations Committee recommend that the transfer to inventories required by IAS 40 should be 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 their use at the end of the reporting period, and not in accordance with historical intent or with the initial classification of related land.

    (c) All assets held for the same purpose, and used in the same way, are recognised as one category on the statement of financial position.

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

(e) The requirement to transfer investment properties developed for sale to IAS 2 is consistent with the requirement to transfer properties from IAS 16 to IAS 2 and with the other transfer requirements detailed in IAS 40.

Measurement of investment properties

22. 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. Fair value measurement was not made a requirement, however, because of the practical difficulties of measuring fair value in some geographical regions.

Measurement of investment properties and inventories

23. The typical time scale for 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 are often 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.

Measurement of assets under development

24. 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. Consequently, 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.

25. 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.

Measurement of some components of inventories at fair value

26. One solution to concerns about the measurement basis used for investment properties might be to continue to measure these assets at fair value after their transfer to inventories.

27. This proposal is not considered satisfactory:

    (a) Such properties could be difficult to fair value.

    (b) Measuring inventories on different bases, depending upon their initial asset categorisation, would not provide useful information.

    (c) Deeper concerns about the mixed measurement bases currently applied in the statement of financial position are outside the scope of the annual improvement process.

28. 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. The Interpretations Committee supports these principles.

Interpretations Committee recommendation - measurement

29. The Interpretations Committee recommend that the measurement of investment properties in accordance with different IFRSs, depending upon intended use and stage of development, should continue as at present:

    (a) The existing guidance is clear.

(b) All assets are measured in accordance with their recognition as a particular class of asset as at the end of the reporting period.

(c) All assets held for the same purpose, and used in the same way, are measured together on a consistent basis on the statement of financial position. Diversity of measurement within individual categories of assets will not be increased.

(d) Investment properties for which the quality of relevance is most important will continue to be measured at fair value.

(e) It is not appropriate to address wider concerns about the mixed measurement model through the annual improvement process.

Investment properties held for sale displayed as a separate asset category

30. The proposed Annual Improvement recommended that investment properties held for sale 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.

31. The Interpretations Committee 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 use 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, but which 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.

32. Consequently, the staff do not recommend that the Board should take any further action relating to this issue.

Question for the Board
Does the Board agree with the Interpretation Committee's recommendation that the Board should not make an amendment to IFRSs to address this issue? If not, what does the Board propose?

Recognition of property — Appendix 1

33. Properties can be recognised as different categories of asset, in accordance with a number of IFRSs, depending upon 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 makes it deemed to be 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 that it will be sold	*IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*