

## STAFF PAPER

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Project	Proposed narrow-scope amendment
Paper topic	IAS 40 <i>Investment Property</i> —can a property under construction be transferred from inventory to investment property when there is an evident change in use?
CONTACT(S)	Denise Durant                      ddurant@ifrs.org                      +44 (0)20 7246 6469

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## Introduction

1. In January 2015 the IFRS Interpretations Committee (the ‘Interpretations Committee’) discussed a request to clarify the application of paragraph 57 of IAS 40 *Investment Property*, which provides guidance on transfers to, or from, investment properties. More specifically, the Interpretations Committee discussed whether a property under construction or development that was previously classified as inventory could be transferred to investment property when there is an evident change in use.
2. The Interpretations Committee recommends that the IASB should address the issue through a narrow-scope amendment to IAS 40 by amending paragraph 57 of IAS 40. This proposed amendment would reinforce the principle for reclassification into, or out of, investment property by specifying that an entity should reclassify investment property (including investment property under construction or development) into, or out of, investment property if, and only if, that a change in the use of such property has occurred, supported by appropriate evidence.

## Purpose of this paper

3. The objective of this paper is to:
  - (a) present background information on the issue;
  - (b) provide a summary of the Interpretations Committee's discussions; and
  - (c) set out the Interpretations Committee's rationale for recommending a narrow-scope amendment to IAS 40.

## Background information

4. IAS 40 was amended through annual improvements in May 2008 by *Improvements to IFRSs*. This amendment revised IAS 40 (and similarly the scope of IAS 16 *Property, Plant and Equipment*) to include within its scope 'property that is being constructed or developed for future use as investment property' (see paragraph 8(e)). Previously, IAS 16 applied to a property that is being constructed or developed for future use as investment property until the construction or development was completed.
5. The IASB decided to include investment property under construction or development within the scope of IAS 40 because it noted that:
  - (a) investment property being redeveloped remained within the scope of IAS 40 and the exclusion of investment property under construction or development gave rise to a perceived inconsistency; and
  - (b) entities were more able to reliably measure the fair value of investment property under construction than when IAS 40 was issued because of their experience with the use of fair value measurement.
6. The IASB did not make corresponding amendments to the guidance in paragraph 57 of IAS 40 on transfers to, or from, investment properties. Paragraph 57 of IAS 40 is reproduced below (emphasis added):

**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;  
or
- (d) commencement of an operating lease to another party, for a transfer from inventories to investment property.
- (e) [deleted]

7. The submitter asked whether the lack of an amendment to paragraph 57 when IAS 40 was amended by *Improvements to IFRSs* in 2008 was an oversight or whether it was intended to prohibit transfers of investment property under construction. In this respect the submitter noted:

IAS 40 para 57, as drafted, restricts transfers to or from investment property. It appears to contemplate **transfers of completed properties only** from inventory to investment property. **It does not seem to provide for a transfer of an incomplete property** from inventory (being constructed for sale) to investment property (being constructed for rental income).

The 2008 Annual Improvement Project extended the application of IAS 40 to investment properties under

construction with no conforming changes made to the guidance on transfers into, or from, investment properties.<sup>1</sup>

### Staff analysis of the issue

8. The following is a summary of the analysis presented to the Interpretations Committee in January 2015. Our full analysis (including the results of the outreach performed on this topic with the International Forum of Accounting Standard-Setters, securities regulators and the global IFRS accounting firms) can be found in [Agenda Paper 12](#) for the January 2015 Interpretations Committee meeting.
9. We observe that two approaches are common in applying the guidance in paragraph 57 of IAS 40.<sup>2</sup> These two approaches are:
- (a) **View A**—IAS 40 is viewed as establishing a principle for transfers to, or from, investment property *when, and only when*, there is a change in use. In addition, paragraph 57(a)–(d) gives examples (that are non-exhaustive) of the evidence that is needed to support the assertion that there has been a change in use. Consequently, a change in classification is supported on the basis of evidence that indicates that there has been a change in use.
  - (b) **View B**—transfers to, or from, investment property occur *when and only when* there has been a change in use that is limited to one of the circumstances described in paragraph 57(a)–(d), including the specific evidence that paragraph describes. Consequently, a change in classification will occur *when and only when* there is a change in use

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<sup>1</sup> Appendix A of [Agenda Paper 12](#) for the January 2015 Interpretations Committee meeting includes the original submission received.

<sup>2</sup> We identified these views from examples of notes to the financial statements that include transfers of property under construction or development. The submitter sent us these examples to show that the issue is widespread and that diversity in practice exists. We also looked into the guidance from the accounting manuals of global international accounting firms, which indicated that there are diverse interpretations on the application of paragraph 57 of IAS 40.

evidenced by one of the circumstances described in paragraph 57(a)–(d).

10. We observe that the principle in IAS 40 for classification as investment property is based on how an asset is used. Consequently, if management changes how an asset is used, this change in use triggers a change in the classification of the asset.
11. In our view, a change in use would involve:
  - (a) an assessment of whether a property qualifies as an investment property; supported by
  - (b) evidence that a change in use has occurred instead of merely being a change in management’s intention.
12. In our view, providing evidence that a change in use has occurred prevents:
  - (a) arbitrary changes between categories (property, plant and equipment/inventory to investment property and vice versa); and
  - (b) management of earnings by switching back and forth between categories as property values fluctuate.
13. During our research we found that the set of circumstances in paragraph 57(a)–(d) was added in the year 2000:<sup>3</sup>
  - (a) as an anti-abuse measure to prohibit arbitrary transfers;
  - (b) to make the criteria for transfers tighter; and
  - (c) to require objective evidence of a change in use, hence the use of the words *when and only when* in the introductory line.
14. We are of the view that the list of circumstances set out in paragraphs 57(a)–(d) is not exhaustive. However, we do not think that more examples of circumstances that evidence a change in use should be added to paragraph 57. This is because we think that the focus should be on the principle that transfers to, or from, investment property and should reflect a change in the use of that property that is supported by evidence.

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<sup>3</sup> We consulted Agenda Paper 9 of March 2000 (this paper is not available publicly).

15. Consequently, an entity should reclassify investment property under construction or development into, or out of, investment property if, and only if, there is a change in the use of such property has occurred, supported by appropriate evidence.

### **The Interpretations Committee's view and proposal for a narrow-scope amendment**

16. The Interpretations Committee agreed with the staff analysis. It further observed that the words *when and only when* in paragraph 57 are important to ensure that a reclassification is limited appropriately to reflect changes in use that have taken place.
17. The Interpretations Committee decided to recommend to the IASB that paragraph 57 of IAS 40 should be amended through a narrow-scope amendment to reinforce the principle for reclassification into, or out of, investment property by stating that a change in use would involve:
  - (a) an assessment of whether a property qualifies as an investment property; supported by
  - (b) evidence that a change in use has occurred.
18. The Interpretations Committee also observed that the list of circumstances set out in paragraph 57(a)–(d) should be re-presented as examples of evidence that a change in use has occurred, and not as an exhaustive list.
19. The Interpretations Committee also agreed with our proposed suggestion that for each transfer to, or from, investment property, an entity should describe the evidence used to support the change in use and recommended that this requirement be added to paragraph 75 of IAS 40 (as paragraph 75(i)).

## Agenda criteria assessment

20. The following table sets out the assessment of the proposed amendments against the Interpretations Committee agenda criteria.<sup>4</sup> The conclusion of this assessment is that paragraph 57 of IAS 40 should be amended through a narrow-scope amendment.

### Agenda criteria

<p>We should address issues (5.16):</p> <p>that have widespread effect and have, or are expected to have, a material effect on those affected.</p> <p>where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and that can be resolved efficiently within the confines of existing Standards and the <i>Conceptual Framework for Financial Reporting</i>.</p>	<p><b>Met.</b> The Interpretations Committee observed that there is a diversity in practice on the application of the guidance in paragraph 57 of IAS 40 on the basis of:</p> <ul style="list-style-type: none"> <li>(a) the notes to the financial statements of the examples sent by the submitter. We observed that two different approaches are common in applying the guidance in paragraph 57 of IAS 40.</li> <li>(b) the outreach results received.</li> <li>(c) the guidance from the accounting manuals of global international accounting firms, which indicates that there are diverse interpretations on the application of paragraph 57.<sup>5</sup></li> </ul> <p><b>Met.</b> The Interpretations Committee observed that the principle in IAS 40 for classification as investment property is how an asset is used. Nevertheless, the Interpretations Committee recommends the IASB to reinforce the principle in paragraph 57 of IAS 40 to:</p> <ul style="list-style-type: none"> <li>(a) avoid different interpretations of the meaning of the words: ‘when, and only when’ and ‘evidenced by’ in the introductory line of this paragraph;</li> <li>(b) avoid misinterpretations that a ‘change in use’ of property is only evidenced by the list of circumstances set out in paragraph 57(a)–(d) and the mistaken belief that this list is exhaustive; and</li> <li>(c) address the submitter’s concerns that transfers of properties under construction or development seem to be excluded from paragraph 57 of IAS 40.</li> </ul> <p>The Interpretations Committee did not recommend that more examples of circumstances that</p>
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<sup>4</sup> These criteria can be found in the [IFRS Foundation Due Process Handbook](#).

<sup>5</sup> Appendix B of [Agenda Paper 12](#) for the January 2015 Interpretations Committee meeting includes the the guidance from these accounting manuals.

**Agenda criteria**

	<p>evidence a change in use are added to paragraph 57. This is because the focus should be on the principle that transfers to, or from, investment property and should reflect a change in the use of that property that is supported by evidence.</p> <p>The Interpretations Committee recommended that for each transfer to, or from, investment property, an entity should disclose a description of the evidence used to support the change in use. This requirement should be added to paragraph 75 of IAS 40 (as paragraph 75(i)).</p>
<p>In addition: can the Interpretations Committee address this issue in an efficient manner (5.17)?</p>	<p><u>Met.</u> The Interpretations Committee recommends the IASB to amend paragraph 57 of IAS 40 through a narrow-scope amendment.</p>
<p>Will it be effective for a reasonable time period (5.21)? Only take on the topic of a forthcoming Standard if short-term improvements are justified.</p>	<p><u>Met.</u> The Interpretations Committee thinks that the proposed amendment will be effective for a reasonable time period and is justified.</p>

**Interpretations Committee recommendation to the IASB**

21. On the basis of the outreach results received and the analysis of the Interpretations Committee’s agenda criteria, the Interpretations Committee proposes the IASB to amend paragraphs 57 and 75 of IAS 40 through a narrow-scope amendment.

***Transition provisions and effective date***

22. We propose that the narrow-scope amendment to IAS 40 is applied retrospectively because a change of reclassification into, or out of, investment property would result in a change in the measurement basis. A change in the measurement basis is a change in an accounting policy, in accordance with paragraph 35 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application should be permitted.

***First-time adopters***

23. We think that a first-time adopter should apply the amendment to IAS 40 at the date of transition to IFRS. In this respect, we have considered but concluded that



a clarifying amendment to IFRS 1 *First-time adoption of International Financial Reporting Standards* is not necessary.

### **Consequential amendments**

24. We have not identified any consequential amendments to other Standards that may have been triggered by this proposed amendment.

#### **Questions for the IASB**

1. Does the IASB agree with the Interpretations Committee's recommendation to reinforce the principle in paragraph 57 of IAS 40 by stating that the principle in paragraph 57 could be reinforced?
2. Does the IASB agree with the Interpretations Committee's recommendation to amend paragraph 75 of IAS 40 to require an entity to disclose, for each transfer to, or from, investment property, a description of the evidence used to support the change in use?
3. Does the IASB agree with the Interpretations Committee's recommendation to amend IAS 40 through a narrow-scope amendment?