STAFF PAPER

27 January 2015

IFRS Interpretations Committee Meeting

Project	New items for initial consideration		
Paper topic	IAS 40 *Investment Property*—can a property under construction be transferred from inventory to investment property, when there is an evident change in use?		
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Introduction

1. The IFRS Interpretations Committee (the 'Interpretations Committee') received a submission regarding the application of paragraph 57 of IAS 40 *Investment Property*, which provides guidance on transfers to, or from, investment properties.

2. The issue raised is 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.

3. We performed outreach on this topic with the International Forum of Accounting Standard-Setters (IFASS), securities regulators and the global IFRS technical teams of the international networks of the large accounting firms, in order to find out how widespread the issue raised by the submitter is and to what extent diversity in practice exists. The results of this outreach are included in this paper.

Purpose of the paper

4. The purpose of this paper is to:

   (a) provide background information;

(b) provide a summary of the submission received;

(c) provide a summary of the outreach results on the issue raised;

(d) provide an analysis of the issue raised;

(e) present an assessment of the issue against the Interpretations Committee's agenda criteria;

(f) make a recommendation to the Interpretations Committee to take this issue onto its agenda as part of the Annual Improvements project and amend IAS 40; and

(g) ask the Interpretations Committee whether it agrees with the staff recommendation.

5. The submission is reproduced in full in **Appendix A** to this paper.

Background information

6. The improvements issued in May 2008 include an amendment to IAS 40. 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' (refer to 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.

7. 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 because of their experience with the use of fair value measurement since IAS 40 was issued.

8. The IASB did not make corresponding amendments to the guidance in paragraph 57 of IAS 40 on transfers to, or from, investment properties.

Relevant guidance from the Standard

9. Paragraph 5 of IAS 40 defines *investment property* and *owner-occupied property*, as follows (emphasis added):

> **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**.

10. 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]

Summary of the submission received

11. The submitter observes that paragraph 57 of IAS 40, as drafted, restricts transfers to or from investment property and further notes (emphasis added):

> [Paragraph 57 of IAS 40] 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.

12. The submitter asks whether the lack of an amendment to paragraph 57 when IAS 40 was amended by Improvements to IFRSs in 2008 was an oversight or was intended to prohibit transfers of investment property under construction.

13. To illustrate its views, the submitter provides an example of a property developer who has two properties under construction (ie Property A and Property B). In the examples, the property developer initially plans to sell Property A and rent out Property B. Consequently, the property developer accounts for Property A as inventory at cost and for Property B as investment property at fair value. However, the developer's plans for Property A change and instead of holding Property A for sale, the developer decides to hold this property for rental. The submitter notes that (emphasis added):

> However, **as no lease has commenced, Property A is measured at cost within inventory until the commencement of a lease which will be after completion of construction even though it no longer meets the definition of inventory. The two properties** under construction, although held for the same purpose,

continue to have different classification and measurement basis.

14. To address this issue the submitter suggests that the Interpretations Committee should propose an amendment to paragraph 57 of IAS 40 that would:

(a) clarify that paragraph 57(d) applies to completed properties; and

(b) add examples of the evidence necessary to support a change in classification for a property under construction. The submitter suggests that some examples could be:

(i) the approval from relevant regulatory bodies for a change in the use of the property under construction upon its completion;

(ii) the approval from an appropriate level of management that has been communicated to relevant external parties; or

(iii) relevant actions, such as commencement of leasing activities or promotional activities to sell the property upon its completion (where applicable) or modifying the layout or construction to make it suitable for a change in use.

15. In addition to the submission, the submitter sent us examples of notes to the financial statements that include transfers of property under construction or development. These examples were taken from eight companies in Asia and indicate that the classification of property under construction as investment property is mixed in circumstances in which there has been a change in the use of the property during the construction period. The submitter claims that these examples show that the issue is widespread and that diversity in practice exists.

Summary of outreach conducted

16. We sent our outreach request to securities regulators, members of IFASS and the global IFRS technical teams of the international networks of the large accounting firms. We asked them the following questions:

Q1. Are you aware of examples of transfers of property under development or construction to, or from investment property?

Q2. If yes to Q1, please would you:

(a) describe the basis on which requirements in paragraph 57 of IAS 40 are applied in your jurisdiction to these transfers?

(b) provide us with examples that illustrate the practices that you observe and the reasons for the practice followed?

Responses received

17. We received 21 responses from the following respondents:

  (a) two regulators;

  (b) thirteen national standard-setters; and

  (c) six global IFRS technical teams of the international networks of the large accounting firms.

18. The views received represent informal opinions and do not reflect the formal views of those organisations.

19. The geographical breakdown for the responses received from national standard-setters is as follows:

Geographical region	**Number of respondents**
Asia	3
Europe	3
Americas	4
Oceania	2
Africa	1
Total respondents	13

20. We summarise the results of the outreach in the following paragraphs.

Summary of outreach responses

Transfers are common

21. Two-thirds of the respondents observed that the transfers of investment property under construction or development are common; a third of the respondents observed that these transfers are very limited or non-existent. Three respondents provided examples of such transfers from public financial statements.

Prevalent approach in applying the guidance in paragraph 57

22. Two-thirds of the respondents think that there is diversity in relation to the application of the guidance in paragraph 57 of IAS 40 and expressed mixed views on the prevalent approach in applying this guidance, as shown below:

    (a) the most common view was that this paragraph includes a principle that is based on the change in use of the property, and identifies paragraphs 57(a)–(d) as a list of events that determine a change in use; however, they think that this list is not exhaustive and other circumstances may support a change in use; and.

    (b) the other respondents think that paragraph 57 allows transfers to or from investment property only if the transfer is evidenced by the circumstances set out in paragraphs 57(a)–(d).

23. About a quarter of respondents explicitly mentioned that they would not object to an amendment to paragraph 57 to clarify the guidance in this paragraph.

Staff analysis

24. We examined the notes to the financial statements of the examples sent by the submitter. We observed that two approaches are common in applying the guidance in paragraph 57 of IAS 40. These two approaches are:

    (a) **View A—**paragraph 57 is viewed as establishing a principle for transfers to, or from, investment property based on a change in use. A change in classification is supported on the basis of evidence that indicates that there has been a change in use.

(b) **View B—**paragraph 57 is not viewed as establishing a principle for transfers to, or from, investment property. A change in use is limited to the circumstances set out in paragraph 57(a)–(d) including the specific evidence that those paragraphs describe.

View A

25. Proponents of this view observe that paragraph 57 requires a transfer in and out of investment property when, and only when, there is a change in use. In addition, paragraphs 57(a)–(d) give examples of the evidence that is needed to support the assertion that there has been a change in use.

26. Proponents of this view further consider that the circumstances set out in paragraphs 57(a)–(d), which evidence a change in use, are not exhaustive.

27. Consequently, in their view, an entity could apply paragraph 57 for transfers of property under construction or development, when there is evidence that a change in use has occurred.

View B

28. Proponents of this view have a more restrictive approach when applying paragraph 57 of IAS 40. They observe that transfers to, or from, investment property occur *when and only when* there has been a change in use that is supported by the evidence set out in one of the circumstances described in paragraph 57(a)–(d). In other words, transfers in other circumstances, or supported by different evidence, are not permitted.

29. Consequently, for example, a property under development or construction that was originally classified as inventory would be transferred to investment property *when and only when* there is a change in use evidenced by the commencement of an operating lease to another party, consistently with paragraph 57(d) of IAS 40.

Our view

Paragraph 57 reflects the general IAS 40 principle and sets out some anti-abuse requirements

30. 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.

31. 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 rather than merely being a change in management's intention.

32. We observe that assessing whether a property continues to qualify as an investment property is in line with paragraph 14 of IAS 40, which states that (emphasis added):

    > **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.

33. We observe that providing evidence prevents:

    (a) arbitrary changes between categories (property, plant and equipment/inventory to investment property and vice versa); and

    (b) earnings management by switching back and forth between categories as property values fluctuate.

34. In other words, we observe that paragraph 57 is an anti-abuse paragraph[1], hence the use of the words 'when and only when' in the introductory line. Similarly, we observe that paragraph 58 of IAS 40 re-emphasises that a reclassification in or out of investment property can only be made when a change in use occurs.

35. Paragraph 58 of IAS 40 is reproduced below (emphasis added):

> **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.**

36. Consequently, we think that an entity should transfer investment property under construction or development into, or out of, investment property if there is evidence that a change in the use of such property has occurred. For example, if an entity has:

    (a) started to occupy a property that was previously an investment property, this action would trigger a transfer from investment property to property, plant and equipment; or

    (b) started to earn rentals from a property that was originally planned for sale in the ordinary course of business, this action would trigger a transfer from inventory to investment property.

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[1] During our research we found that the set of circumstances in paragraph 57(a)–(d) was added in the year 2000: (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. We consulted Agenda Paper 9 of March 2000.

The list of circumstances in paragraphs 57(a)–(d) is not exhaustive

37. We think 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 should reflect a change in the use of that property that is supported by evidence.

38. We note that the submitter had provided some additional examples to include in paragraph 57. As noted above, we think that additional examples are not needed if the principle in paragraph 57 is reinforced.

Should paragraph 57 be amended?

39. We are of the view that the principle in paragraph 57 of IAS 40 should be reinforced to:

    (a) avoid different interpretations of the meaning of the words: 'when, and only when' and 'evidenced by' in the introductory line of this paragraph;

    (b) avoid misinterpretations that a 'change in use' of property is only evidenced by the list of circumstances set out in paragraphs 57(a)–(d) and correct the mistaken belief that this list is exhaustive; and

    (c) address the submitter's concerns that transfers of properties under construction or development seem to be excluded from paragraph 57 of IAS 40.

40. We think that we could reinforce the principle in this paragraph by stating that:

    (a) an entity should assess whether a property continues to qualify as an investment property (based on the guidance in IAS 40); and

    (b) a change in use needs to be supported by evidence indicating that a change in use has occurred, rather than being merely a change in intention.

41. We also think that, for each transfer to, or from, investment property, an entity should describe the evidence used to support the change in use. We think that this requirement could be added to paragraph 75 of IAS 40 (as paragraph 75(i)).

42. We think that by reinforcing the principle in paragraph 57 we will be able to address the concerns raised by submitter, because management will be able to use this principle to determine whether a change in use has occurred for properties that are under construction or development.

Proposed amendment

43. On the basis of our discussion above, we propose the following amendment to paragraph 57 as follows:

> 57 An entity shall t~~T~~ransfer~~s~~ a property to, or from, investment property ~~shall be made when, and~~ only when there is a change in use of a property but only if there is evidence that a change in use has occurred. A change in use occurs when the property meets or ceases to meet the definition of investment property. ~~evidenced by:~~ Examples of evidence that support a change in use that would lead to a reclassification to, or from investment property include, among others: ~~evidenced by:~~
>
> (a) 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]

44. We also propose adding paragraph 75(i) as follows:

> 75 An entity shall disclose:

(a)…

<u>(i) for each transfer to, or from, investment property, a description of the evidence used to support the change in use.</u>

Agenda criteria assessment

45. The staff's assessment of the Interpretations Committee's agenda criteria is as follows:[2]

Agenda criteria

We should address issues (5.16):	
that have widespread effect and have, or are expected to have, a material effect on those affected.	<u>Met.</u> We observe that there is a diversity in practice on the application of the guidance in paragraph 57 of IAS 40 on the basis of: (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; (b) the outreach results received; and (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. We have included the guidance from these accounting manuals in **Appendix B** of this paper.
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 IFRSs and the *Conceptual Framework for Financial Reporting*.	<u>Met.</u> We observe that the principle in IAS 40 for classification as investment property is how an asset is used. We, think, however, that the principle in paragraph 57 of IAS 40 should be reinforced to: (a) avoid different interpretations of the meaning of the words: 'when, and only when' and 'evidenced by' in the introductory line of this paragraph; (b) avoid misinterpretations that a 'change in use' of property is only evidenced by the list of circumstances set out in paragraphs 57(a)–(d) and the mistaken belief that this list is exhaustive; and (c) address the submitter's concerns that transfers of properties under construction or

[2] These criteria can be found in the *IFRS Foundation Due Process Handbook* .

Agenda criteria

	development seem to be excluded from paragraph 57 of IAS 40. 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 should reflect a change in the use of that property that is supported by evidence. We think 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. We think that this requirement could be added to paragraph 75 of IAS 40 (as paragraph 75(i)).
In addition: Can the Interpretations Committee address this issue in an efficient manner (5.17)	Met. We propose that the Interpretations Committee should amend paragraph 57 of IAS 40 as part of the 2014-2016 Annual Improvements project.
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.	Met. The proposed amendment will be effective for a reasonable time period. As we have explained above, the proposed improvement is justified.

Additional criteria for annual improvements

In addition to the implementation and maintenance criteria, an annual improvement should (6.11, 6.12):	
• Replace unclear wording; • Provide missing guidance; or • Correct minor unintended consequences, oversights or conflict.	Met. We are of the view that the principle in paragraph 57 of IAS 40 could be reinforced by stating that: (a) an entity should assess whether a property qualifies as an investment property (based on the guidance in IAS 40); and (b) a change in use needs to be supported by evidence indicating that a change in use has occurred, rather than being merely a change in management's intention. We think that an entity should disclose the evidence on what the change in use was identified for each transfer to, or from, investment property. We think that this requirement could be added to paragraph 75 of IAS 40 (as paragraph 75(i)). We think that our proposals will address the concerns raised by the submitter.

Additional criteria for annual improvements

Not change an existing principle or propose a new principle	Met. We think that the proposed amendment is not changing an existing principle or proposing a new principle.
Not be so fundamental that the IASB will have to meet several times to conclude (6.14)	Met. We think that the proposed amendment is not so fundamental that the IASB will have to meet several times to conclude upon it.

Staff recommendation

46. On the basis of the outreach results received and our assessment of the Interpretations Committee's agenda criteria, we think that our proposed amendment to paragraph 57 of IAS 40 and the proposal to add paragraph 75(i) to IAS 40 meets the criteria for inclusion in the Annual Improvements project (2014–2016 cycle).

47. Consequently, we recommend that the Interpretations Committee should recommend that the IASB makes the amendment through annual improvements, so that the principle for transfers to, or from, investment property in paragraph 57 is reinforced.

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree to reinforce the principle in paragraph 57 of IAS 40 by stating that the principle in paragraph 57 of IAS 40 could be reinforced by stating that:

   (a) an entity should assess whether a property continues to qualify as an investment property (based on the guidance in IAS 40); and

   (b) a change in use needs to be supported by evidence indicating that a change in use has occurred rather than being merely a change in intention?.

2. Does the Interpretations Committee agree with the staff's recommendation to add paragraph 75(i) 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 Interpretations Committee agree with the staff's recommendation that the Interpretation Committee should recommend that the IASB make the amendment through annual improvements?

Appendix A—Submission received

A1. We reproduce below the submission that we received. We have deleted details that would identify the submitter of this request.

Submission received

We have a request for the IFRS Interpretations Committee to consider.

Investment properties under construction were brought into the scope of IAS 40 in 2008. The amendment extended the scope of the standard but seems to have at least one unintended consequence. The guidance in IAS 40.57 does not seem to allow a property under construction to be transferred from inventory to investment property even when there is an evident planned change in use. Measurement guidance is provided for this eventuality. We wonder if the lack of modifications to paragraph 57 was an oversight rather than an intention to prohibit transfers of investment property under construction.

We think that a further narrow scope amendment to paragraph 57 could address this issue.

We appreciate your attention to this matter.

The issue

IAS 40

Para 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.

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. We believe that this is an oversight with unintended consequences as illustrated below.

A property developer has two properties under construction. The original plan was to have Property A for sale (as inventory at cost) and Property B for rental (as investment property at fair value). The property developer changes their plan during construction to keep Property A for earning rentals rather than selling it and obtains approval from the Land Officer for the change in use. It undertakes initial leasing activities to attract tenants. Both properties will be held for rental upon completion. However, as no lease has commenced, Property A is measured at cost within inventory until the commencement of a lease which will be after completion of construction even though it no longer meets the definition of inventory. The two properties under construction, although held for the same purpose, continue to have different classification and measurement basis.

	Property A under construction	**Property B under construction**
Original plan	**For sale**	**For rental**
Classification and measurement	Inventory measured at cost	Investment property measured at fair value
After change of plan	For rental From the definition's perspective, it no longer meets the definition of inventories which are assets in the production for such sale but meets the definition of investment properties which are properties held to earn rentals or for capital appreciation.	For rental
Classification and measurement during construction under IAS 40.57	Continued to be measured at cost within inventory because there is no commencement of an operating lease to another party.	Investment property measured at fair value

We believe that a narrow-scope amendment to IAS 40 para 57 could address this issue by revising IAS 40.57 (d) to clarify that it applies to completed properties and adding an additional example of the evidence necessary to support a change in classification for a property under construction. The examples of evidence for the transfer into, or from, investment properties during the construction stage, might include:

- approval from relevant regulatory bodies for a change in the use of the property under construction upon its completion;
- approval from an appropriate level of management which has been communicated to relevant external parties; or
- relevant actions, such as commencement of leasing activities or promotional activities to sell the property upon its completion (where applicable) or modifying the layout or construction to make it suitable to a change in use.

Appendix B – Extracts from accounting manuals of global accounting firms [emphasis added]

B1. Deloitte iGAAP 2014 – A guide to IFRS reporting

6 Transfers
Transfers to, or from, investment property are made when, and only when, there is a change in use evidenced by one of the following:

[IAS 40:57]

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

These circumstances are discussed more fully below.

Paragraphs 60 to 65 of IAS 40 apply to recognition and measurement issues that arise when the fair value model is used for investment property and transfers are made to or from investment property (see 6.1 to 6.4 below). When the cost model is used, transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred. They do not, therefore, change the cost of the property for measurement or disclosure purposes. [IAS 40:59]

6.1 Transfer from investment property to owner-occupied property
The Standard requires an investment property to be transferred to owner-occupied property only when there is a change of use evidenced by commencement of owner-occupation. [IAS 40:57(a)]

When an investment property carried at fair value is transferred to owner-occupied property, the property's deemed cost for subsequent accounting in accordance with IAS 16 *Property, Plant and Equipment* is its fair value at the date of change in use. [IAS 40:60]

6.2 Transfer from investment property to inventories
The Standard requires an investment property to be transferred to inventories only when there is a change of use evidenced by commencement of development with a view to sale. [IAS 40:57(b)]

When an investment property carried at fair value is transferred to inventories, the property's deemed cost for subsequent accounting in accordance with IAS 2 *Inventories* is its fair value at the date of change in use. [IAS 40:60]

6.3 Transfer from owner-occupied property to investment property
End of owner-occupation signals a potential transfer to investment property. If an owner-occupied property becomes an investment property that will be carried at fair value, IAS 16 is applied up to the date of change of use. Any difference at that date between the carrying amount of the property in accordance with IAS 16 and its fair value is treated in the same way as a revaluation in accordance with IAS 16. [IAS 40:61]

This means that any decrease in the carrying amount of the property is recognised in profit or loss, unless the decrease is the reversal of a previous revaluation surplus, in which case the decrease is recognised in other comprehensive income and reduces that revaluation surplus within equity. [IAS 40:62]

Any increase in the carrying amount is recognised in other comprehensive income and increases the revaluation surplus within equity, unless the increase reverses a previous impairment loss on that property in which case the increase is recognised in profit or loss. The amount recognised in profit or loss should not exceed the amount needed to restore the carrying amount to the amount that would have been determined (net of depreciation) had no impairment loss been recognised. [IAS 40:62]

On subsequent disposal of such a property, the revaluation surplus may be transferred to retained earnings, but not through profit or loss. [IAS 40:62]

6.4 Transfer from inventories to investment property

A transfer from inventories to investment property should be made when, and only when, there is a change in use, evidenced by the commencement of an operating lease to another party. For a transfer to investment property, if the property will be carried at fair value, any difference between the fair value and the carrying amount of the property at the date of transfer is recognised in profit or loss. [IAS 40:63] This is consistent with the treatment of sales of inventories. [IAS 40:64]

B2. Ernst &Young International GAAP 2015

9 TRANSFER OF ASSETS INTO OR FROM INVESTMENT PROPERTY

The standard specifies the circumstances in which a property becomes, or ceases to be, an investment property. There must be a change in use, evidenced by:

(a) the commencement or end of owner-occupation;

(b) the commencement of development with a view to sale, at which point an investment property would be transferred to inventory;

(c) commencement of an operating lease to another party, for a transfer from inventory to investment property (but see 2.3 above). [IAS 40.57].

(…)

9.1 Transfers from inventory

Some interpret the instances of change set out in IAS 40.57 as exhaustive, given the reference to 'evidenced by' in that paragraph, and, therefore, apply this guidance in practice in a very narrow sense. [IAS 40.57]. However, in our view, the standard establishes a guiding principle regarding transfers to investment property based on whether there is a change in use and provides a list of examples of evidence. It would seem inconsistent, for example, to prevent a transfer to investment property of a property that meets the relevant definition.

Importantly though, a mere change in management's intention to change the use cannot be considered as evidence of a change in use and, therefore, will – on its own – not be sufficient for a transfer (for example, see the decision of the United Kingdom's regulator on this point below).

Actions toward affecting a change in use must have been taken by the entity during the reporting period to support that such a change has occurred. The assessment of whether a change in use has occurred is based on an assessment of all the facts and circumstances.

We illustrate the application of this principle with an example below:

Example 19.5: Transfers from inventory

In 2014, an entity purchased land with the intent to construct an apartment building on the land and sell the apartments to private customers. Accordingly, the land was classified as inventory. During 2014, the prices for residential properties decreased and at the beginning of 2015 the entity decided to change its original business plans. Instead of constructing an apartment building and selling the apartments, the entity decided to construct an office building that it would lease out to tenants. The entity holds and manages other investment property as well.

During the first half of 2015, the entity obtained permission from the relevant authorities to commence the construction and hired an architect to design the office building. The physical construction of the office building began in August 2015. No operating leases had been agreed, nor commenced, with other parties for the lease of office space. However, negotiations had been held with potential tenants.

We would generally conclude that there is sufficient evidence for a change in use from inventory to investment property if the following criteria are met:

- The entity has prepared a business plan that reflects the future rental income generated by the property and this is supported with evidence that there is demand for rental space.
- The entity can demonstrate that it has the resources, including the necessary financing or capital, to hold and manage an investment property.
- The change in use is legally permissible. That is, the entity has obtained permission from relevant authorities for the change in use. In cases where the approval of the change in use is merely perfunctory, the entity's request for permission may be sufficient evidence.

· If the property must be further developed for the change in use, development has commenced.

For the scenario described in the fact pattern, the entity met the above criteria at the point in time when it obtained permission from the relevant authorities to change the use of the property and commenced development of the property by hiring an architect. At that time, the land would be transferred from inventory to investment property.

B3. KPMG Insights into IFRS 2013/14 – KPMG's practical guide to International Financial Reporting Standards

3.4.190 TRANSFERS TO OR FROM INVESTMENT PROPERTY

3.4.200 Timing of transfers

3.4.200.10. Although an entity's business model plays a key role in the initial classification of property (see 3.4.60.30), the subsequent reclassification of property is based on an actual change in use rather than on changes in an entity's intentions [IAS 40.57–58].

(...)

3.4.200.30 To reclassify inventories to investment property, a change in use is required. This will generally be evidenced by the commencement of an operating lease to another party. In some cases, a property (or a part of a property) classified as inventory (se chapter 3.8) is leased out temporarily while the entity searches for a buyer. In our view, the commencement of such an operating lease, solely by itself, does not require the entity to transfer the property to investment property provided that the property continues to be held for sale in the ordinary course of business. Any rental income is incidental to such sale (see 3.2.120.10). [IAS 40.57]

3.4.200.40 An entity may no longer have the intention or the ability to develop property classified as inventory for sale in the ordinary course of business as originally planned due to fluctuations in property and capital markets. Depending on the facts and circumstances of the situation, it may be appropriate to reclassify a property originally classified as inventory to investment property if there is a change in the business model of the entity or a change in the use of the property. Examples of such situations include the following.

- Property development of land has completely ceased and it is being rented in its current condition (not on a temporary basis).
- Property development has completely ceased and all of the development plans for resale have been indefinitely deferred, and the entity continues to hold the property awaiting improvement in the property market; the essence seems to be that the property or land is now being held for rental and/or capital appreciation.

3.4.200.45 A change in management's intention alone would not be sufficient evidence for reclassification and would need to be supported, for example, by an actual change in the use of the property and/or cessation of further development as originally planned.

3.4.200.50 A reclassification of an investment property to inventory or property, plant and equipment is performed only when an entity's use of the property has changed. In our view, the commencement of construction for sale or own use would usually mean that the property is no longer available for rent to third parties. Therefore, a change in use occurs on commencement of redevelopment and reclassification is appropriate at that point. [IAS 40.57].

B4. PwC Manual of accounting IFRS 2014

Transfers

17.123 IAS 40 deals in detail with transfers to or from investment property. Transfers should be made when, and only when, there is a change of use and the detailed rules are as follows:

■ *Investment property becomes owner-occupied property*

A transfer should be made from investment property to owner-occupied property at the commencement of owner-occupation. [IAS 40 para 57(a)]. Where the investment property has been carried at fair value, the fair value at the date of transfer becomes the deemed cost for subsequent accounting under IAS 16. [IAS 40 para 60].

■ *Investment property is to be developed for sale*

A transfer should be made from investment property to inventory at the date of commencement of development with a view to sale. [IAS 40 para 57(b)]. Where the investment property has been carried at fair value, the fair value at the date of transfer becomes the deemed cost for subsequent accounting under IAS 2. [IAS 40 para 60].

- *Owner-occupied property becomes investment property*

A transfer should be made from owner-occupied property to investment property when owner-occupation ceases. [IAS 40 para 57(c)]. If the investment property is to be carried at fair value, IAS 16 is applied up to the date of transfer. The property is fair valued at the date of transfer and any revaluation gain or loss, being the difference between fair value and the previous carrying amount, is accounted for as a revaluation surplus or deficit in equity in accordance with IAS 16. Increases are recognised directly in equity, unless there was an impairment loss recognised for the same property in prior years and a portion of the increase is recognised in profit or loss to the extent of that impairment loss. Decreases are recognised in profit or loss for any decrease in excess of the amount included in the revaluation surplus for that property. The treatment of revaluation gains and losses under IAS 16 is discussed further in chapter 16. [IAS 40 paras 61, 62].

- *Property held as inventory becomes investment property*

When an operating lease is granted to a third party on a property held as inventory and upon the commencement of the lease, the property should be transferred to investment property. [IAS 40 para 57(d)]. If the investment property is to be held at fair value, any difference between the fair value and the previous carrying amount at the date of transfer is recognised in profit or loss. This is consistent with the treatment of sales of inventory. [IAS 40 paras 63, 64]