STAFF PAPER

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Project	**Exposure Draft of proposed amendments to IAS 40 *Investment Property* (ED/2015/9)—Transfers of Investment Property**
Paper topic	Comment letter analysis on the ED

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Introduction

1. The Exposure Draft ED/2015/9 *Transfers of Investment Property* (proposed amendments to IAS 40) (the 'ED') was published in November 2015 to clarify the application of paragraph 57 of IAS 40 *Investment Property*, which specifies the requirements for transfers of property to, or from, investment property.

Objective

2. The objective of this paper is to provide an analysis of the comment letters received on the proposed amendments to IAS 40. The proposals in the ED resulted from discussions of the IFRS Interpretations Committee ('the Interpretations Committee') and the recommendations that it made to the Board. Consequently, this paper is intended to draw on the Interpretations Committee's experience on this issue, and to ask the Committee to make recommendations to the Board.

Structure of the paper

3. This paper:
   (a) provides a description of the issue that led to the proposed amendments;
   (b) analyses the comments received on the ED; and
   (c) asks the Interpretations Committee whether it agrees with the staff recommendation to proceed with the amendments to IAS 40.

Description of the issue

4. The Interpretations Committee received a request to clarify whether a property under construction or development that was previously classified as inventory is transferred to investment property when there is evidence of a change in use. The submitter observed that paragraph 57 of IAS 40 sets outs requirements for transfers to or from investment property, but it did not specifically address transfers of properties under construction or development.
5. The Interpretations Committee observed that the principle in paragraph 57 of IAS 40 for transferring property to or from investment property is based on how an asset is used. It also observed 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, instead of merely being a change in management's intentions.
6. The Interpretations Committee recommended to the Board that it should amend paragraph 57 of IAS 40 through a narrow-scope amendment to reinforce the principle for reclassification to, or from, investment property. The proposed amendment would require transfers of property (including property under construction or development) to, or from, investment property when and only when there is a change in the use of a property, supported by 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. At its meeting in April 2015, the Board agreed with this recommendation to propose amendments to paragraph 57 of IAS 40.

7. In addition, the Board decided to propose to re-characterise the list of circumstances set out in paragraph 57(a)–(d) as a non-exhaustive list of examples of evidence that a change in use has occurred. The Board proposed this change to re-emphasise the application of the principle for transfers to, or from, investment property in paragraph 57 of IAS 40.

8. The Board also proposed to require retrospective application of the proposed amendments.

Comment letter analysis

9. In this section, we discuss and analyse the comments received from respondents to the ED, the comment period for which ended on 18 March 2016.

10. The ED included two questions:

    (a) **Question 1 (reinforce the principle for transfers of investment property)**: The IASB proposes to amend paragraph 57 of IAS 40 to:

        (i) state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change in use occurs when the property meets, or ceases to meet, the definition of investment property.

        (ii) re-characterise the list of circumstances set out in paragraph 57(a)–(d) as a non-exhaustive list of examples of evidence that a change in use has occurred instead of an exhaustive list.

        Do you agree?

    (b) **<u>Question 2</u> (transition)**: The IASB proposes to require retrospective application of the proposed amendment to IAS 40. Do you agree?

11. The Board received 56 comment letters on the ED. From these comment letters:

    (a) many respondents fully agree with the proposals in the ED for the reasons provided in the ED.

(b) some respondents agree with the proposed amendments, but they have further comments or request further clarification of the proposed amendments.

(c) one respondent disagrees with the proposed amendments.

(d) some respondents do not support retrospective application of the proposed amendments.

Analysis of Question 1 (Reinforce the principle for transfers of investment property)

12. The main reasons that many respondents *support* the proposals are because they think that the proposed amendments:

(a) provide a clear explanation of when a change in use occurs as well as of the circumstances that trigger a transfer of property to, or from, investment property; and

(b) reduce the risk of diversity in practice in the accounting for transfers to, or from, investment property.

13. Respondents also agree with the proposal to re-characterise the list of examples of evidence in paragraph 57(a)–(d) as a non-exhaustive list. This is because it would allow an entity to consider whether circumstances other than those listed provide evidence of a change in use.

14. Respondents who generally *agree* with the principle in the proposed amendments think that the Board should:

(a) clarify if management's 'intended' use of a property provides evidence that is sufficient to support a change in use of property under construction or development (hereafter, **Issue 1**);

(b) add examples of the evidence required to support a change in use of property under construction or development; (hereafter, **Issue 2**);

(c) consider clarifying what provides substantive evidence of a change in use (hereafter, **Issue 3**);

(d) clarify the circumstances in which investment property can be transferred to inventories (hereafter, **Issue 4**); and

(e) clarify whether the requirements in paragraph 57 of IAS 40 also apply to temporary transfers of property (hereafter, **Issue 5**).

15. The respondent who expressed its disagreement urges the Board to redefine the principle for transfers to, or from, investment property. This respondent thinks that the proposed amendment will not reduce diversity in practice. This respondent also thinks that the examples of evidence in paragraph 57(a)–(d) are not aligned with the definition of investment property (hereafter, **Issue 6**).

16. We have analysed each of these issues in the following paragraphs.

Issue 1: clarify if management's 'intended' use of a property provides evidence that is sufficient to support a change in use of property under construction or development

17. Some respondents note that the future use of property under construction or development is often based largely on management's intentions, and that these intentions are often not coupled with observable actions.[1] For example, development may start without a clear plan as to whether the property will be sold, leased or used by the developer.[2]

18. For example, one respondent said:

> As compared to completed investment properties, investment properties under construction are not ready for its intended use (i.e. for rental or capital appreciation, or both), and are therefore subject to change in management's intention in

[1] For example, Malaysian Accounting Standards Board (MASB), Deloitte, PwC, Moore Stephens LLP, European Financial Reporting Advisory Group (EFRAG), BDO, Association of Accounting Technicians (AAT), South African Institute of Chartered Accountants (SAICA), Hong Kong Institute of Certified Public Accountants. The International Organization of Securities Commissions (IOSCO) makes a similar point but for properties in general. IOSCO comments that there could be situations in which an actual change in use of the property may be considered to have occurred before a physical change has occurred (for example, management stops actively marketing a property for sale, but has not yet signed an operating lease agreement with another party). IOSCO thinks that the Board should clarify whether these circumstances trigger a change in use.

[2] Deloitte mentioned this example.

> response to fluctuations in property and capital markets. However, we note that paragraph BC3 of ED/2015/9 states that a change in management's intention alone would not be sufficient evidence for reclassification and would need to be supported by an actual change in use of the property. Accordingly, the proposed amendment as currently written would not be helpful in resolving the current application issue. [Hong Kong Institute of Certified Public Accountants]

19. Accordingly, some respondents request that the Board clarify whether management's 'intended' use of a property provides evidence that is sufficient to support a change in use of a property under construction or development.

20. One respondent recommends rewording the term 'a change in use' to a 'change in an entity's policy for the use of a property' to address those circumstances in which a property is yet to be made available for use.[3]

21. Another respondent suggests amending the principle in paragraph 57 of IAS 40 to allow transfers of property when there is evidence of *an intended change in use'*, rather than only when there is evidence of a change in use.[4]

22. One respondent questions whether paragraphs 57(b) and 58 of IAS 40 should use the phrase 'with a view to sale' because it could be perceived to imply that management's intentions provide evidence that is sufficient to support a change in use. [5]

Staff analysis and recommendation

23. We are of the view that a change in management's intentions, alone, does not provide evidence that is sufficient to support a change in use. For example, we think that management's intentions to develop unused land for sale in the ordinary course of business, alone, should not trigger a transfer from investment property to inventory if the entity has not taken observable actions that support its intention to sell the land. In our view, these observable actions may or may not result in an actual physical change

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[3] Accounting Standards Board of Japan (ASBJ).

[4] ATT.

[5] Singapore Accounting Standards Council.

to the property. For example, promotional activities with a view to selling a property are, in our view, observable actions that may provide evidence of a change in use, even though those activities may not result in a physical change to the property.

24. We recommend that the amendments to IAS 40 explicitly clarify that a change in management's intentions, alone, does not provide evidence of a change in use. This explanation was included in paragraph BC3 of the ED. We recommend adding to paragraph 58 of IAS 40 that 'A change in management's intentions for the use of a property, in isolation, does not provide evidence of a change in use'. Our recommendation is set out in **Appendix A** to this paper.[6]

25. We further observe that determining the classification of a property under construction or development would entail some degree of judgement about the expected future use of the property. Consequently, we think that the use of the phrase 'with a view to sale' in paragraphs 57(b) and 58 is appropriate when describing examples of evidence of a change in use.

Question 1—Issue 1
Does the Interpretations Committee agree with the staff recommendation to clarify within IAS 40 that a change in management's intentions for the use of a property, in isolation, does not provide evidence of a change in use?

Issue 2: add examples of the evidence required to support a change in use of property under construction or development

26. Some respondents observe that the examples described in paragraph 57(a)–(d) provide evidence only for a change in use of *completed* properties.[7] For this reason they request further explanation, or additional specific examples, of what constitutes

[6] We observe that respondents such as the ASBJ, the Australian Accounting Standards Board (AASB) and the IOSCO recommended that we provide this clarification.

[7] For example, China Accounting Standards Committee, ASBJ, Singapore Accounting Standards Council, Asian-Oceanian Standard-Setters Group (AOSSG), the Institute of CPAs in Israel and Deloitte.

evidence of a change in use of property under construction or development. Some of these respondents suggest the following examples:[8]

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

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

(c) substantial or relevant actions to prove that the change in use has happened such as:

   (i) commencement of leasing activities, lease negotiations with potential tenants or inception of an operating lease;

   (ii) promotional activities to sell the property upon its completion; or

   (iii) modifying the internal structure, layout or construction of the property to make it suitable for a change in use.

27. One respondent suggests that paragraph 57 of IAS 40 should explicitly clarify that the requirements in this paragraph also apply to property under construction or development to avoid any confusion.[9]

28. For example, one respondent states that:

> Further, the circumstances described in paragraph 57 relate primarily to changes in the use of completed properties. In our experience, this issue is much more challenging in the context of properties under construction. Development might often commence without a clear plan of whether each element of a property will be sold upon completion, leased to a third party or used by the developer. As development progresses, or plans are altered in response to changing market conditions, events might occur (for example, marketing of the property to prospective buyers or inception of an operating lease) that

[8] For example, China Accounting Standards Committee, PwC, AOSSG.

[9] MASB.

> could validly be considered evidence of a change in use. Such events occur before the events described in paragraphs 57(a)-(d) –particularly paragraph 57(d), which refers to commencement of a lease (i.e. the date that the property is actually made available to a lessee). Therefore, it is not clear how to apply the proposed paragraph 57 to properties under construction. [Deloitte]

Staff analysis and recommendation

29. We disagree with the view that all of the examples in paragraphs 57(a)–(d) of IAS 40 apply only to completed properties.

30. We observe that the example in paragraph 57(b) of IAS 40 (ie 'commencement of development with a view to sale, for a transfer from investment property to inventories') could apply equally to a property under construction or development as it would to a completed property. For example, the example could apply both when an entity is redeveloping a completed property to be sold, or is developing land or constructing a building to be sold.

31. Nonetheless, we understand the concern expressed by respondents that it would be useful to have more specific examples of a change in the use of a property under construction or development.

32. We are of the view that some of the examples proposed by respondents (for example, the commencement of promotional activities or of leasing activities; or the modifications to the layout of a property under construction) could well be considered to be examples of evidence of a change in use of a property under construction or development. This is because they represent observable actions that may often provide evidence of a change in use of the property. However, others may not be so clear because the conclusion may be very dependent on the particular facts and circumstances.

33. Having considered the additional examples proposed by respondents, we are not entirely convinced that we should expand upon the list of examples described in paragraphs 57(a)–(d) of IAS 40. The Board observed in paragraph BC6 of the ED

that the focus of the amendments should be on clarifying the principle for transfers to, or from, investment property, and thus it did not propose to add more examples in the ED. Likewise, we think that adding new examples could potentially raise more questions about the type of evidence that is required to support a change in use. We also think that there is a risk that some could view any new example of evidence as arbitrary, not relevant or always relevant when that might not be the appropriate.

34. In saying that, we think that we could address some of the concerns raised about the list of examples in paragraph 57(a)-(d) by amending one or two of the examples already listed. For example, we think that we could expand upon the number of examples that explicitly refer to property under development by amending the example in paragraph 57(a) to include 'commencement of development with a view to owner-occupation' as an example of a transfer from investment property to owner-occupied property. In addition, we could change the example in paragraph 57(d) to refer to 'inception' of an operating lease, instead of 'commencement' of an operating lease[10]. This is an action that may provide evidence of a change in use before a property is complete, ie when the property is still under construction or development. Our recommendation in this respect is set out in **Appendix A** to this paper.

35. We disagree with the proposal to explicitly clarify that the requirements in paragraph 57 of IAS 40 also apply to property under construction or development, because this clarification is not necessary. In this respect, we observe that investment property includes 'property that is being constructed or developed for future use as investment property' according to paragraph 8(e) of IAS 40. In addition, the changes proposed to the examples in paragraph 57 of IAS 40 make it clear that this paragraph applies to property under construction or development.

Question 2—Issue 2
Does the Interpretations Committee agree with the staff recommendation to amend two of the examples already listed in paragraph 57 of IAS 40 (along the lines of the amendments set out in **Appendix A** to this paper)?

[10] The 'inception date' of a lease is defined in IFRS 16 *Leases* as the 'earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of a lease'. IAS 17 *Leases* includes an almost identical definition of the inception of a lease.

Issue 3: consider clarifying what provides substantive evidence of a change in use

36. Some respondents think that the Board should explain what provides substantive evidence of a change in use. They are of the view that this is a point of debate.[11]

37. For example, one respondent says:

> The IASB should clarify that a change in use has to be supported by evidence that is substantive. To avoid unnecessary subjectivity, the guidance should include indicators that collectively may provide substantive evidence of a change in use, which possibly include obtaining regulatory approvals, undertaking redevelopment activities such as creation of design, construction or floor plans and commencement of major retrofitting works, and marketing property on new use. We note that other existing Standards similarly provide a non-exhaustive list of indicators to guide the assessment of transfers, such as the transfer of control in IFRS 15 *Revenue from Contracts with Customers* and the 'transfer' of financial assets from the 12-month to the lifetime expected credit losses tier in IFRS 9 *Financial Instruments*. The IASB could also consider developing illustrative examples on how different indicators may provide substantive evidence of a change in use based on the facts presented. [Singapore Accounting Standards Council]

Staff analysis and recommendation

38. We do not think that the Board should define what provides substantive evidence of a change in use.

39. We think that in identifying a change in use applying paragraph 57 of IAS 40, an entity should use judgement and assess all relevant facts and circumstances, as it does when initially classifying its property. A particular circumstance or action might provide evidence of a change in use in some situations and not in others. For

[11] For example, ASBJ, AOSSG, Singapore Accounting Standards Council.

example, in its comment letter Deloitte noted the following: '(…) lessees are often sought for properties developed with a view to sale primarily for the purpose of enhancing the sales price (as an investor will typically pay more for a property with an existing 'rent roll').' In such circumstances, there may be no change in use resulting in a transfer from inventory to investment property whereas, in other situations, seeking tenants for a property is likely to provide evidence of a change in use resulting in a transfer to investment property.

40. We observe that the use of judgement is an aspect that is encouraged in IAS 40; for example, in paragraph 14 of IAS 40:

> 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.

41. We think that that the Board should emphasise the use of judgement in assessing whether a property meets, or has ceased to meet, the definition of investment property and, consequently, whether a change in use has occurred. We think that an explanation in this respect could be included in the basis for conclusions.

Question 3—Issue 3

Does the Interpretations Committee agree with the staff recommendation that the Board should:

(a) not define what provides substantive evidence of a change in use; and

(b) emphasise the use of judgement in assessing whether a property meets, or has ceased to meet, the definition of investment property?

Issue 4: clarify the circumstances in which investment property can be transferred to inventories

42. One respondent asked the Board to clarify the circumstances in which investment property can be transferred to inventories.[12] More specifically, it asked for clarity as to whether the example in paragraph 57(b) (ie 'commencement of development with a view to sale, for a transfer from investment property to inventories') is the only circumstance in which investment property can be transferred to inventories.

43. In this respect this respondent says:

> The ED does not propose any consequential amendments to the guidance in paragraph 58 of IAS 40, which continues to make reference to 'commencement of development with a view to sale' in paragraph 57(b) of IAS 40 as the only circumstance under which IP could be transferred to inventories. The IASB should clarify whether the guidance is intended to be an exception to the proposed principle-based approach to determining transfers and if so, (a) the rationale for such an exception; and (b) whether an entity is precluded from transferring IP under development to inventories if it continues as-is development albeit for subsequent sale in the ordinary course of business. Otherwise, consequential amendments should be made to the guidance to reflect the principles underlying the proposals.
>
> Furthermore, the IASB should avoid using terms such as 'with a view to sale', which could be perceived as being dependent on management's intention and inconsistent with the proposals. [Singapore Accounting Standards Council]

Staff analysis and recommendation

44. We think that 'commencement of development with a view to sale' is not the only circumstance that provides evidence of a transfer from investment property to inventories. As mentioned in the proposed amendment, the list of examples in

[12] Singapore Accounting Standards Council.

paragraphs 57(a)–(d) are not exhaustive—they are simply examples. Accordingly, we think that, depending on the facts and circumstances, a property that is already under development could be transferred from investment property to inventories.

45. Nonetheless, we do not recommend changing the proposals to specifically address this scenario. This is because the proposed amendments already clarify that the examples listed in paragraph 57 of IAS 40 are not exhaustive.

Question 4—Issue 4
Does the Interpretations Committee agree with the staff recommendation that the Board should not further clarify the circumstances in which investment property can be transferred to inventories?

Issue 5: clarify whether the requirements in paragraph 57 of IAS 40 also apply to temporary transfers of property

46. A few respondents asked the Board to clarify whether the principle in paragraph 57 of IAS 40 for transfers to, or from, investment property, would apply to temporary transfers.[13] For example one of these respondents says:

> In respect of Para 57(d) the Institute wishes to seek clarification as to whether it applies to a temporary transfer from inventories to investment property. An example in case: in a soft property market, a property developer may decide to lease out unsold units of properties temporarily with a view to sell when market conditions improve or when a buyer is found since it makes no sense to leave the property empty while awaiting sale. Would this trigger the need to transfer the properties from inventories to investment properties since there is only a temporary change in use? [the Malaysian Institute of Certified Public Accountants (CPA)]

[13] For example, the Malaysian Institute of Certified Public Accountants (CPA) and Naresh J. Patel & Co. Chartered Accountants.

Staff analysis and recommendation

47. We are of the view that an entity would need to assess all relevant facts and circumstances to determine whether a change in use has occurred in the case of a temporary transfer. If evidence indicates that, because of a change in use, a property ceases to meet the definition of investment property (or vice versa), then this should trigger a transfer applying the principle for transfers in paragraph 57 of IAS 40. We do not think that the amendment should explicitly address temporary transfers.

Question 5—Issue 5
Does the Interpretations Committee agree with the staff recommendation that the amendment should not explicitly address temporary transfers?

Issue 6: redefine the principle for transfers to, or from, investment property

48. One respondent thinks that the proposed amendment is unlikely to remove or reduce diversity in practice. This respondent suggests that the Board should redefine the principle for transfers to, or from, investment property if there is a change in use, and provide specific requirements to support such a decision. Likewise, this respondent thinks that the examples of evidence in paragraph 57 of IAS 40 are not aligned with the definition of investment property, and could potentially mislead or confuse preparers of the financial statements[14].

Staff analysis and recommendation

49. We do not recommend that the Board redefine the principle for transfers to, or from, investment property.

50. We observe that the principle in paragraph 57 for transfers to, or from, investment property is consistent with the requirements in relevant IFRS Standards. It requires an entity to make an assessment of the different ways in which property can be used according to those Standards (ie IAS 2 *Inventories*: as assets held for sale in the ordinary course of business; IAS 16 *Property, Plant and Equipment*: as owner-

[14] The Japanese Institute of Certified Public Accountants (JICPA).

occupied property; IAS 40: as property held to earn rentals or for capital appreciation). On the basis of this assessment, an entity is then required to determine whether the property meets, or ceases to meet, the definition of investment property.

Question 6—Issue 6
Does the Interpretations Committee agree with the staff recommendation that the Board should not redefine the principle for transfers to, or from, investment property?

Analysis of Question 2 (Transition)

51. The Board proposed retrospective application of the proposed amendments. This was on the basis that a transfer to, or from, investment property would often result in a change in the property's measurement basis. A change in the measurement basis is a change in an accounting policy applying paragraph 35 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

52. With reference to the respondents who replied to Question 2:

    (a) many respondents fully *agree* with the proposed transition; and

    (b) some respondents *agree in principle* or *disagree* with the proposed transition.

53. Respondents who *agree* with the proposed transition did so for the reasons provided in the ED and also because they think that retrospective application:

    (a) will permit the appropriate measurement in the statement of financial position for investment properties where there has been a change in use;

    (b) allows for greater comparability; and

    (c) enhances the quality of financial information presented in the financial statements.

54. Some respondents who *agree in principle* or *disagree* with the proposed amendment think that it may not be possible to apply the proposed amendments

retrospectively without the use of hindsight. Some others think that retrospective application would become too burdensome (hereafter, **Issue 7**).

Issue 7: it may not be possible to apply the amendments retrospectively without the use of hindsight and/or retrospective application may become too burdensome

55. Respondents had mixed views about the requirement to apply the proposed amendments retrospectively:

(a) Some respondents agree with the proposed transition provisions but think that, in some cases, it will not always be possible to apply a full retrospective approach without the use of hindsight.[15]

(b) Some other respondents think that the Board should change the transition provisions because retrospective application will be too complex to apply. In this respect they commented that:[16]

(i) retrospective application will invariably involve the use of hindsight; for example, in evaluating assets for which no active market exists, or in determining the exact point in time at which there was evidence of a change in use; and

(ii) it will be too onerous to apply a new accounting policy to a large number of properties as if that policy has always been applied because it would involve obtaining fair values at the new or revised transfer dates; and/or obtaining evidence to support transfers of properties that previously did not qualify for a transfer.

56. For example, one respondent says:

> Full retrospective adoption of the amendment would require an entity that held investment property under the fair value model to: (a) reconsider whether and, if so, when, any of its investment properties should have been transferred to owner-

[15] For example, Deloitte, KASB, Repsol.

[16] For example, Israel Accounting Standards Board, the Norwegian Accounting Standards Board, PwC, the Lithuanian Accountants and Auditors Association (LAAA), KPMG.

occupied property; (b) obtain the fair value of the investment property at the new or revised transfer date, in order to determine the deemed cost of the property under IAS 16 *Property, Plant and Equipment*; (c) recalculate depreciation, and reconsider impairment testing, from that date to the present. As an alternative, we recommend that entities be permitted to apply the amendments to changes in use that take place after the date of initial application of the amendments. [KPMG]

57. Respondents who *generally agree* or *disagree* with requiring retrospective application think that the Board should *either* require:

(a) prospective application;[17] or

(b) retrospective application but with some practical expedients (ie allow a limited form of retrospective application).

Staff analysis and recommendation

58. In considering the comments received on the proposed transition requirements, we first assessed what differences might arise in the amounts recognised on the date of transition between a retrospective approach (ie applying the amendments as if they had always been in place) and a prospective approach (ie applying the amendments only to changes in use that occur after the transition date).

59. The following are relevant to this assessment:

(a) Our previous analysis of the issue, as well as responses in comment letters, indicate that many entities already apply the requirements in paragraph 57 of IAS 40 in line with the proposed amendments to that paragraph. For those entities, the amendments are not expected to change their existing accounting and, thus, there would be no difference between a retrospective approach and a prospective approach.

[17] A couple of respondents observed that the amendment to IAS 40 in May 2008 required prospective application. Consequently they think that the Board should follow the same transition approach for the amendments to IAS 40.

(b) For some transfers, the amounts recognised are unaffected by the transition approach. For example,

(i) previous transfers to investment property that are measured at fair value.

(ii) for investment property measured at cost, previous transfers between investment property and owner-occupied property.

(iii) previous transfers to inventories for which the property is sold before the transition date.

(c) Previous transfers that could be affected include transfers from investment property to owner-occupied property (for investment property measured at fair value); and a change in use for property previously held as inventory that is now held for capital appreciation (and thus meets the definition of investment property). Nonetheless, for transfers from investment property to owner-occupied property, any difference may not be material because it might arise only from a small difference in timing. For example, applying the amendments retrospective might result in a previous transfer from investment property to owner-occupied property occurring, say, in April in a particular year (at the time that evidence of the change in use was available). An entity may not have reflected the transfer to owner-occupied property until commencement of owner-occupation (paragraph 57(a) of IAS 40) in, say, September of that year. Accordingly, in this scenario, there could be a difference because the deemed cost of the owner-occupied property would have been established as its fair value in September rather than April. However, that difference might be significant only if property valuations changed significantly between April and September in that particular year.

(d) Even if, often, any difference arising on previous transfers from investment property to inventory might not be material, we agree with the points raised in paragraph 56 of this paper that the steps that an entity would be required to take to apply the amendments retrospectively could be onerous.

60. Having considered these factors and, in particular that there will often be little difference in the amounts recognised on the date of transition between a retrospective and a prospective approach, we recommend that an entity be permitted to apply the amendments prospectively to changes in use that occur after the transition date. We think that this has the potential to reduce costs significantly for a narrow set of transactions but would not be expected to have a significant effect on the information provided.

61. In saying that, we do not recommend that an entity is *required* to apply the amendments prospectively. This is because prospective application would prevent an entity from appropriately reclassifying some properties to reflect their current use. For example, assume an entity had applied paragraph 57 of IAS 40 so that a change in use occurred only in the four situations described in bullets (a)-(d) of that paragraph. In that case, the entity would have transferred a property from inventory to investment property only on commencement of an operating lease. If the entity had previously changed the use of the property so that it was no longer held for sale but is now held for capital appreciation (without a lease), on transition the entity may still classify the property as inventory, even though the property meets the definition of investment property. Permitting the entity to apply the amendments retrospectively would solve this issue.

62. We have not suggested permitting or requiring a retrospective transition approach with some practical expedients as was suggested by some respondents. This is because such an approach would provide less useful information than a full retrospective approach and, yet, it would not resolve the concerns raised about transition in paragraphs 55-56 of this paper.

63. We do not recommend permitting first-time adopters to apply a prospective transition approach. This is consistent with the fact that IFRS 1 *First-time Adoption of International Financial Reporting Standards* does not include an exception to, or exemption from, retrospective application of the requirements in IAS 40. In addition, we note that our recommendation to permit entities to apply a prospective transition approach is based on the fact that those entities already apply IFRS Standards.

Question 7—Issue 7
Does the Interpretations Committee agree with the staff recommendation: (a) to permit an entity to apply the amendments either (i) retrospectively applying IAS 8, or (ii) prospectively to changes in use that occur after the transition date? (b) not to permit any transition relief for first-time adopters?

Summary of staff recommendations

64. On the basis of the analysis in the previous section of the paper, we think that the Interpretations Committee should recommend to the Board that it proceed with the proposed amendments to IAS 40.

65. We also propose to the Interpretations Committee that it should recommend to the Board that it make some changes to clarify the proposed amendments to IAS 40.

66. Our initial thoughts on the wording of the amendments to IAS 40 are set out in **Appendix A** to this paper. These amendments are summarised as follows:

   (a) **Issue 1:** clarify that a change in management's intentions, in isolation, does not provide evidence of a change in use. In this respect, we propose to move the explanation in paragraph BC3 of the ED to paragraph 58 of IAS 40.

   (b) **Issue 2:** amend two of the examples in paragraph 57 of IAS 40 so that they could relate to property under construction or development as well as completed property.

   (c) **Issue 3:** in the basis for conclusions, emphasise the use of judgement in assessing whether a property meets, or has ceased to meet, the definition of investment property.

   (d) **Issue 4:** no further action is proposed.

   (e) **Issue 5:** no further action is proposed.

   (f) **Issue 6:** no further action is proposed.

(g) **Issue 7:** permit an entity to apply the amendments either retrospectively or prospectively to changes in use that occur after the transition date.

Question 8
Does the Interpretations Committee agree with the staff recommendation to recommend to the Board that it proceed with the amendments to IAS 40?

Appendix A—Draft amendments

This appendix includes the staff's initial thoughts on the wording of the amendments to IAS 40, incorporating the staff recommendations in this paper—this drafting is subject to change. The amendments to the proposals in the ED are shown in red and *italics*.

~~[Draft]~~ Amendment to IAS 40 *Investment Property*

Paragraph<u>*s*</u> 57*<u>–58</u>* ~~is~~ *<u>are</u>* amended and paragraph 85F is added. Deleted text is struck through and new text is underlined.

Transfers

57 **~~Transfers~~ <u>An entity shall transfer a property</u> to, or from, investment property ~~shall be made~~ when, and only when, there is *~~<u>evidence of</u>~~* a change in use~~, evidenced by~~<u>. A change in use occurs when the property meets, or ceases to meet, the definition of investment property</u> *<u>and there is evidence of the change in use</u>*<u>. Examples of evidence that</u> *<u>may</u>* <u>support a change in use that would lead to a transfer to, or from, investment property include, among others</u>:**

(a) commencement of owner-occupation, *<u>or of development with a view to owner-occupation,</u>* 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~~ <u>and</u>

(d) *~~<u>commencement</u>~~* *<u>inception</u>* of an operating lease to another party, for a transfer from inventories to investment property.

(e) [deleted]

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~~* *<u>such as on</u>* 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. *<u>A change in management's intentions for the use of a property, in isolation, does not provide evidence of a change in use.</u>*

…

Effective date

…

85G ~~[Draft]~~ *Transfers of Investment Property* (Amendment to IAS 40), issued in [date], amended paragraphs 57 and 58. An entity shall apply that amendment *either*:

(a) *retrospectively to each prior period presented applying IAS 8* Accounting Policies, Changes in Accounting Estimates and Errors*; or*

(b) *prospectively to changes in use of property that occur on or after the beginning of the reporting period in which an entity first applies the amendment to paragraph 57 of IAS 40.*