

International Accounting Standard 40**Investment Property**

This version includes amendments resulting from IFRSs issued up to 17 January 2008.

IAS 40 *Investment Property* was issued by the International Accounting Standards Committee in April 2000.

In April 2001 the International Accounting Standards Board (IASB) resolved that all Standards and Interpretations issued under previous Constitutions continued to be applicable unless and until they were amended or withdrawn.

In December 2003 the IASB issued a revised IAS 40. Since then, IAS 40 and its accompanying documents have been amended by the following IFRSs:

- IFRS 2 *Share-based Payment* (issued February 2004)
- IFRS 4 *Insurance Contracts* (issued March 2004)
- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (issued March 2004)
- IAS 1 *Presentation of Financial Statements* (as revised in September 2007).

The following Interpretation refers to IAS 40 (as revised in 2003):

- SIC-21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets* (issued July 2000 and subsequently amended).

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International Accounting Standard 40 *Investment Property* (IAS 40) is set out in paragraphs 1–86. All the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. IAS 40 should be read in the context of its objective and the IASB's Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

- IN1 International Accounting Standard 40 *Investment Property* (IAS 40) replaces IAS 40 *Investment Property* (issued in 2000), and should be applied for annual periods beginning on or after 1 January 2005. Earlier application is encouraged.

Reasons for revising IAS 40

- IN2 The International Accounting Standards Board developed this revised IAS 40 as part of its project on Improvements to International Accounting Standards. The project was undertaken in the light of queries and criticisms raised in relation to the Standards by securities regulators, professional accountants and other interested parties. The objectives of the project were to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements.
- IN3 For IAS 40 the Board's main objective was a limited revision to permit a property interest held by a lessee under an operating lease to qualify as investment property under specified conditions. Those conditions include requirements that the property must otherwise meet the definition of an investment property, and that the lessee must account for the lease as if it were a finance lease and measure the resulting lease asset using the fair value model. The Board did not reconsider the fundamental approach to the accounting for investment property contained in IAS 40.

The main changes

- IN4 The main changes from the previous version of IAS 40 are described below.
- IN5 A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property provided that:
- (a) the rest of the definition of investment property is met;
 - (b) the operating lease is accounted for as if it were a finance lease in accordance with IAS 17 *Leases*; and
 - (c) the lessee uses the fair value model set out in this Standard for the asset recognised.
- IN6 The classification alternative described in paragraph IN5 is available on a property-by-property basis. However, because it is a general requirement of the Standard that all investment property should be consistently accounted for using the fair value or cost model, once this alternative is selected for one such property, all property classified as investment property is to be accounted for consistently on a fair value basis.
- IN7 The Standard requires an entity to disclose:
- (a) whether it applies the fair value model or the cost model; and

- (b) if it applies the fair value model, whether, and in what circumstances, property interests held under operating leases are classified and accounted for as investment property.
- IN8 When a valuation obtained for investment property is adjusted significantly for the purpose of the financial statements, a reconciliation is required between the valuation obtained and the valuation included in the financial statements.
- IN9 The Standard clarifies that if a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property.
- IN10 Comparative information is required for all disclosures.
- IN11 Some significant changes have been incorporated into the Standard as a result of amendments that the Board made to IAS 16 *Property, Plant and Equipment* as part of the Improvements project:
 - (a) to specify what costs are included in the cost of investment property and when replaced items should be derecognised;
 - (b) to specify when exchange transactions (ie transactions in which investment property is acquired in exchange for non-monetary assets, in whole or in part) have commercial substance and how such transactions, with or without commercial substance, are accounted for; and
 - (c) to specify the accounting for compensation from third parties for investment property that was impaired, lost or given up.

Summary of the approach required by the Standard

- IN12 The Standard permits entities to choose either:
 - (a) a fair value model, under which an investment property is measured, after initial measurement, at fair value with changes in fair value recognised in profit or loss; or
 - (b) a cost model. The cost model is specified in IAS 16 and requires an investment property to be measured after initial measurement at depreciated cost (less any accumulated impairment losses). An entity that chooses the cost model discloses the fair value of its investment property.
- IN13 The choice between the cost and fair value models is not available to a lessee accounting for a property interest held under an operating lease that it has elected to classify and account for as investment property. The Standard requires such investment property to be measured using the fair value model.
- IN14 The fair value model differs from the revaluation model that is permitted for some non-financial assets. Under the revaluation model, increases in carrying amount above a cost-based measure are recognised as revaluation surplus. However, under the fair value model, all changes in fair value are recognised in profit or loss.

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- IN15 The Standard requires an entity to apply its chosen model to all of its investment property. However, this does not mean that all eligible operating leases must be classified as investment properties.
- IN16 In exceptional cases, when an entity has adopted the fair value model, there may be clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property following the completion of construction or development, or after a change in use) that its fair value will not be reliably determinable on a continuing basis. In such cases, the Standard requires the entity to measure that investment property using the cost model in IAS 16 until disposal of the investment property. The residual value of the investment property is assumed to be zero.
- IN17 A change from one model to the other is made only if the change results in a more appropriate presentation. The Standard states that this is highly unlikely to be the case for a change from the fair value model to the cost model.
- IN18 IAS 40 depends upon IAS 17 for requirements for the classification of leases, the accounting for finance and operating leases and for some of the disclosures relevant to leased investment properties. When a property interest held under an operating lease is classified and accounted for as an investment property, IAS 40 overrides IAS 17 by requiring that the lease is accounted for as if it were a finance lease. Paragraphs 14–18 of IAS 17 apply to the classification of leases of land and buildings. In particular, paragraph 18 specifies when it is not necessary to measure separately the land and building elements of such a lease.

International Accounting Standard 40

Investment Property

Objective

- 1 The objective of this Standard is to prescribe the accounting treatment for investment property and related disclosure requirements.

Scope

- 2 **This Standard shall be applied in the recognition, measurement and disclosure of investment property.**
- 3 Among other things, this Standard applies to the measurement in a lessee's financial statements of investment property interests held under a lease accounted for as a finance lease and to the measurement in a lessor's financial statements of investment property provided to a lessee under an operating lease. This Standard does not deal with matters covered in IAS 17 *Leases*, including:
- (a) classification of leases as finance leases or operating leases;
 - (b) recognition of lease income from investment property (see also IAS 18 *Revenue*);
 - (c) measurement in a lessee's financial statements of property interests held under a lease accounted for as an operating lease;
 - (d) measurement in a lessor's financial statements of its net investment in a finance lease;
 - (e) accounting for sale and leaseback transactions; and
 - (f) disclosure about finance leases and operating leases.
- 4 This Standard does not apply to:
- (a) biological assets related to agricultural activity (see IAS 41 *Agriculture*); and
 - (b) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

Definitions

- 5 **The following terms are used in this Standard with the meanings specified:**
- Carrying amount*** is the amount at which an asset is recognised in the statement of financial position.
- Cost*** is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, eg IFRS 2 *Share-based Payment*.

Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

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.

- 6 A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, the property would otherwise meet the definition of an investment property and the lessee uses the fair value model set out in paragraphs 33–55 for the asset recognised. This classification alternative is available on a property-by-property basis. However, once this classification alternative is selected for one such property interest held under an operating lease, all property classified as investment property shall be accounted for using the fair value model. When this classification alternative is selected, any interest so classified is included in the disclosures required by paragraphs 74–78.
- 7 Investment property is held to earn rentals or for capital appreciation or both. Therefore, an investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) generates cash flows that are attributable not only to property, but also to other assets used in the production or supply process. IAS 16 *Property, Plant and Equipment* applies to owner-occupied property.
- 8 The following are examples of investment property:
 - (a) land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business.
 - (b) land held for a currently undetermined future use. (If an entity has not determined that it will use the land as owner-occupied property or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation.)
 - (c) a building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases.
 - (d) a building that is vacant but is held to be leased out under one or more operating leases.

- 9 The following are examples of items that are not investment property and are therefore outside the scope of this Standard:
- (a) property intended for sale in the ordinary course of business or in the process of construction or development for such sale (see IAS 2 *Inventories*), for example, property acquired exclusively with a view to subsequent disposal in the near future or for development and resale.
 - (b) property being constructed or developed on behalf of third parties (see IAS 11 *Construction Contracts*).
 - (c) owner-occupied property (see IAS 16), including (among other things) property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal.
 - (d) property that is being constructed or developed for future use as investment property. IAS 16 applies to such property until construction or development is complete, at which time the property becomes investment property and this Standard applies. However, this Standard applies to existing investment property that is being redeveloped for continued future use as investment property (see paragraph 58).
 - (e) property that is leased to another entity under a finance lease.
- 10 Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions could be sold separately (or leased out separately under a finance lease), an entity accounts for the portions separately. If the portions could not be sold separately, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.
- 11 In some cases, an entity provides ancillary services to the occupants of a property it holds. An entity treats such a property as investment property if the services are insignificant to the arrangement as a whole. An example is when the owner of an office building provides security and maintenance services to the lessees who occupy the building.
- 12 In other cases, the services provided are significant. For example, if an entity owns and manages a hotel, services provided to guests are significant to the arrangement as a whole. Therefore, an owner-managed hotel is owner-occupied property, rather than investment property.
- 13 It may be difficult to determine whether ancillary services are so significant that a property does not qualify as investment property. For example, the owner of a hotel sometimes transfers some responsibilities to third parties under a management contract. The terms of such contracts vary widely. At one end of the spectrum, the owner's position may, in substance, be that of a passive investor. At the other end of the spectrum, the owner may simply have outsourced day-to-day functions while retaining significant exposure to variation in the cash flows generated by the operations of the hotel.

- 14 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.
- 15 In some cases, an entity owns property that is leased to, and occupied by, its parent or another subsidiary. The property does not qualify as investment property in the consolidated financial statements, because the property is owner-occupied from the perspective of the group. However, from the perspective of the entity that owns it, the property is investment property if it meets the definition in paragraph 5. Therefore, the lessor treats the property as investment property in its individual financial statements.

Recognition

- 16 **Investment property shall be recognised as an asset when, and only when:**
- (a) **it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and**
 - (b) **the cost of the investment property can be measured reliably.**
- 17 An entity evaluates under this recognition principle all its investment property costs at the time they are incurred. These costs include costs incurred initially to acquire an investment property and costs incurred subsequently to add to, replace part of, or service a property.
- 18 Under the recognition principle in paragraph 16, an entity does not recognise in the carrying amount of an investment property the costs of the day-to-day servicing of such a property. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the cost of labour and consumables, and may include the cost of minor parts. The purpose of these expenditures is often described as for the ‘repairs and maintenance’ of the property.
- 19 Parts of investment properties may have been acquired through replacement. For example, the interior walls may be replacements of original walls. Under the recognition principle, an entity recognises in the carrying amount of an investment property the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard.

Measurement at recognition

- 20 **An investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement.**

- 21 The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure. Directly attributable expenditure includes, for example, professional fees for legal services, property transfer taxes and other transaction costs.
- 22 The cost of a self-constructed investment property is its cost at the date when the construction or development is complete. Until that date, an entity applies IAS 16. At that date, the property becomes investment property and this Standard applies (see paragraphs 57(e) and 65).
- 23 The cost of an investment property is not increased by:
- (a) start-up costs (unless they are necessary to bring the property to the condition necessary for it to be capable of operating in the manner intended by management),
 - (b) operating losses incurred before the investment property achieves the planned level of occupancy, or
 - (c) abnormal amounts of wasted material, labour or other resources incurred in constructing or developing the property.
- 24 If payment for an investment property is deferred, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit.
- 25 **The initial cost of a property interest held under a lease and classified as an investment property shall be as prescribed for a finance lease by paragraph 20 of IAS 17, ie the asset shall be recognised at the lower of the fair value of the property and the present value of the minimum lease payments. An equivalent amount shall be recognised as a liability in accordance with that same paragraph.**
- 26 Any premium paid for a lease is treated as part of the minimum lease payments for this purpose, and is therefore included in the cost of the asset, but is excluded from the liability. If a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property. Guidance on determining the fair value of a property interest is set out for the fair value model in paragraphs 33–52. That guidance is also relevant to the determination of fair value when that value is used as cost for initial recognition purposes.
- 27 One or more investment properties may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an investment property is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

- 28 An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:
- (a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred, or
 - (b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange, and
 - (c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.
- For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations.
- 29 The fair value of an asset for which comparable market transactions do not exist is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. If the entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

Measurement after recognition

Accounting policy

- 30 **With the exceptions noted in paragraphs 32A and 34, an entity shall choose as its accounting policy either the fair value model in paragraphs 33–55 or the cost model in paragraph 56 and shall apply that policy to all of its investment property.**
- 31 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that a voluntary change in accounting policy shall be made only if the change will result in a more appropriate presentation of transactions, other events or conditions in the entity's financial statements. It is highly unlikely that a change from the fair value model to the cost model will result in a more appropriate presentation.
- 32 This Standard requires all entities to determine the fair value of investment property, for the purpose of either measurement (if the entity uses the fair value model) or disclosure (if it uses the cost model). An entity is encouraged, but not required, to determine the fair value of investment property on the basis of a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued.

- 32A An entity may:**
- (a) choose either the fair value model or the cost model for all investment property backing liabilities that pay a return linked directly to the fair value of, or returns from, specified assets including that investment property; and**
 - (b) choose either the fair value model or the cost model for all other investment property, regardless of the choice made in (a).**
- 32B** Some insurers and other entities operate an internal property fund that issues notional units, with some units held by investors in linked contracts and others held by the entity. Paragraph 32A does not permit an entity to measure the property held by the fund partly at cost and partly at fair value.
- 32C** If an entity chooses different models for the two categories described in paragraph 32A, sales of investment property between pools of assets measured using different models shall be recognised at fair value and the cumulative change in fair value shall be recognised in profit or loss. Accordingly, if an investment property is sold from a pool in which the fair value model is used into a pool in which the cost model is used, the property's fair value at the date of the sale becomes its deemed cost.

Fair value model

- 33 After initial recognition, an entity that chooses the fair value model shall measure all of its investment property at fair value, except in the cases described in paragraph 53.**
- 34 When a property interest held by a lessee under an operating lease is classified as an investment property under paragraph 6, paragraph 30 is not elective; the fair value model shall be applied.**
- 35 A gain or loss arising from a change in the fair value of investment property shall be recognised in profit or loss for the period in which it arises.**
- 36** The fair value of investment property is the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction (see paragraph 5). Fair value specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, special considerations or concessions granted by anyone associated with the sale.
- 37** An entity determines fair value without any deduction for transaction costs it may incur on sale or other disposal.
- 38 The fair value of investment property shall reflect market conditions at the end of the reporting period.**
- 39** Fair value is time-specific as of a given date. Because market conditions may change, the amount reported as fair value may be incorrect or inappropriate if estimated as of another time. The definition of fair value also assumes simultaneous exchange and completion of the contract for sale without any variation in price that might be made in an arm's length transaction between knowledgeable, willing parties if exchange and completion are not simultaneous.

- 40 The fair value of investment property reflects, among other things, rental income from current leases and reasonable and supportable assumptions that represent what knowledgeable, willing parties would assume about rental income from future leases in the light of current conditions. It also reflects, on a similar basis, any cash outflows (including rental payments and other outflows) that could be expected in respect of the property. Some of those outflows are reflected in the liability whereas others relate to outflows that are not recognised in the financial statements until a later date (eg periodic payments such as contingent rents).
- 41 Paragraph 25 specifies the basis for initial recognition of the cost of an interest in a leased property. Paragraph 33 requires the interest in the leased property to be remeasured, if necessary, to fair value. In a lease negotiated at market rates, the fair value of an interest in a leased property at acquisition, net of all expected lease payments (including those relating to recognised liabilities), should be zero. This fair value does not change regardless of whether, for accounting purposes, a leased asset and liability are recognised at fair value or at the present value of minimum lease payments, in accordance with paragraph 20 of IAS 17. Thus, remeasuring a leased asset from cost in accordance with paragraph 25 to fair value in accordance with paragraph 33 should not give rise to any initial gain or loss, unless fair value is measured at different times. This could occur when an election to apply the fair value model is made after initial recognition.
- 42 The definition of fair value refers to 'knowledgeable, willing parties'. In this context, 'knowledgeable' means that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the investment property, its actual and potential uses, and market conditions at the end of the reporting period. A willing buyer is motivated, but not compelled, to buy. This buyer is neither over-eager nor determined to buy at any price. The assumed buyer would not pay a higher price than a market comprising knowledgeable, willing buyers and sellers would require.
- 43 A willing seller is neither an over-eager nor a forced seller, prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in current market conditions. The willing seller is motivated to sell the investment property at market terms for the best price obtainable. The factual circumstances of the actual investment property owner are not a part of this consideration because the willing seller is a hypothetical owner (eg a willing seller would not take into account the particular tax circumstances of the actual investment property owner).
- 44 The definition of fair value refers to an arm's length transaction. An arm's length transaction is one between parties that do not have a particular or special relationship that makes prices of transactions uncharacteristic of market conditions. The transaction is presumed to be between unrelated parties, each acting independently.
- 45 The best evidence of fair value is given by current prices in an active market for similar property in the same location and condition and subject to similar lease and other contracts. An entity takes care to identify any differences in the nature, location or condition of the property, or in the contractual terms of the leases and other contracts relating to the property.

- 46 In the absence of current prices in an active market of the kind described in paragraph 45, an entity considers information from a variety of sources, including:
- (a) current prices in an active market for properties of different nature, condition or location (or subject to different lease or other contracts), adjusted to reflect those differences;
 - (b) recent prices of similar properties on less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices; and
 - (c) discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts and (when possible) by external evidence such as current market rents for similar properties in the same location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows.
- 47 In some cases, the various sources listed in the previous paragraph may suggest different conclusions about the fair value of an investment property. An entity considers the reasons for those differences, in order to arrive at the most reliable estimate of fair value within a range of reasonable fair value estimates.
- 48 In exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property following the completion of construction or development, or after a change in use) that the variability in the range of reasonable fair value estimates will be so great, and the probabilities of the various outcomes so difficult to assess, that the usefulness of a single estimate of fair value is negated. This may indicate that the fair value of the property will not be reliably determinable on a continuing basis (see paragraph 53).
- 49 Fair value differs from value in use, as defined in IAS 36 *Impairment of Assets*. Fair value reflects the knowledge and estimates of knowledgeable, willing buyers and sellers. In contrast, value in use reflects the entity's estimates, including the effects of factors that may be specific to the entity and not applicable to entities in general. For example, fair value does not reflect any of the following factors to the extent that they would not be generally available to knowledgeable, willing buyers and sellers:
- (a) additional value derived from the creation of a portfolio of properties in different locations;
 - (b) synergies between investment property and other assets;
 - (c) legal rights or legal restrictions that are specific only to the current owner; and
 - (d) tax benefits or tax burdens that are specific to the current owner.

- 50 In determining the fair value of investment property, an entity does not double-count assets or liabilities that are recognised as separate assets or liabilities. For example:
- (a) equipment such as lifts or air-conditioning is often an integral part of a building and is generally included in the fair value of the investment property, rather than recognised separately as property, plant and equipment.
 - (b) if an office is leased on a furnished basis, the fair value of the office generally includes the fair value of the furniture, because the rental income relates to the furnished office. When furniture is included in the fair value of investment property, an entity does not recognise that furniture as a separate asset.
 - (c) the fair value of investment property excludes prepaid or accrued operating lease income, because the entity recognises it as a separate liability or asset.
 - (d) the fair value of investment property held under a lease reflects expected cash flows (including contingent rent that is expected to become payable). Accordingly, if a valuation obtained for a property is net of all payments expected to be made, it will be necessary to add back any recognised lease liability, to arrive at the fair value of the investment property for accounting purposes.
- 51 The fair value of investment property does not reflect future capital expenditure that will improve or enhance the property and does not reflect the related future benefits from this future expenditure.
- 52 In some cases, an entity expects that the present value of its payments relating to an investment property (other than payments relating to recognised liabilities) will exceed the present value of the related cash receipts. An entity applies IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to determine whether to recognise a liability and, if so, how to measure it.

Inability to determine fair value reliably

- 53 **There is a rebuttable presumption that an entity can reliably determine the fair value of an investment property on a continuing basis. However, in exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property following the completion of construction or development, or after a change in use) that the fair value of the investment property is not reliably determinable on a continuing basis. This arises when, and only when, comparable market transactions are infrequent and alternative reliable estimates of fair value (for example, based on discounted cash flow projections) are not available. In such cases, an entity shall measure that investment property using the cost model in IAS 16. The residual value of the investment property shall be assumed to be zero. The entity shall apply IAS 16 until disposal of the investment property.**

- 54 In the exceptional cases when an entity is compelled, for the reason given in the previous paragraph, to measure an investment property using the cost model in accordance with IAS 16, it measures all its other investment property at fair value. In these cases, although an entity may use the cost model for one investment property, the entity shall continue to account for each of the remaining properties using the fair value model.
- 55 **If an entity has previously measured an investment property at fair value, it shall continue to measure the property at fair value until disposal (or until the property becomes owner-occupied property or the entity begins to develop the property for subsequent sale in the ordinary course of business) even if comparable market transactions become less frequent or market prices become less readily available.**

Cost model

- 56 After initial recognition, an entity that chooses the cost model shall measure all of its investment property in accordance with IAS 16's requirements for that model, other than those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Investment properties that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall be measured in accordance with IFRS 5.

Transfers

- 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;
 - (d) commencement of an operating lease to another party, for a transfer from inventories to investment property; or
 - (e) end of construction or development, for a transfer from property in the course of construction or development (covered by IAS 16) to investment property.
- 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.

- 59 Paragraphs 60–65 apply to recognition and measurement issues that arise when an entity uses the fair value model for investment property. When an entity uses the cost model, transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes.
- 60 **For a transfer from investment property carried at fair value to owner-occupied property or inventories, the property's deemed cost for subsequent accounting in accordance with IAS 16 or IAS 2 shall be its fair value at the date of change in use.**
- 61 **If an owner-occupied property becomes an investment property that will be carried at fair value, an entity shall apply IAS 16 up to the date of change in use. The entity shall treat any difference at that date between the carrying amount of the property in accordance with IAS 16 and its fair value in the same way as a revaluation in accordance with IAS 16.**
- 62 Up to the date when an owner-occupied property becomes an investment property carried at fair value, an entity depreciates the property and recognises any impairment losses that have occurred. The entity treats any difference at that date between the carrying amount of the property in accordance with IAS 16 and its fair value in the same way as a revaluation in accordance with IAS 16. In other words:
- (a) any resulting decrease in the carrying amount of the property is recognised in profit or loss. However, to the extent that an amount is included in revaluation surplus for that property, the decrease is recognised in other comprehensive income and reduces the revaluation surplus within equity.
 - (b) any resulting increase in the carrying amount is treated as follows:
 - (i) to the extent that the increase reverses a previous impairment loss for that property, the increase is recognised in profit or loss. The amount recognised in profit or loss does not exceed the amount needed to restore the carrying amount to the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognised.
 - (ii) any remaining part of the increase is recognised in other comprehensive income and increases the revaluation surplus within equity. On subsequent disposal of the investment property, the revaluation surplus included in equity may be transferred to retained earnings. The transfer from revaluation surplus to retained earnings is not made through profit or loss.
- 63 **For a transfer from inventories to investment property that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount shall be recognised in profit or loss.**

- 64 The treatment of transfers from inventories to investment property that will be carried at fair value is consistent with the treatment of sales of inventories.
- 65 **When an entity completes the construction or development of a self-constructed investment property that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount shall be recognised in profit or loss.**

Disposals

- 66 **An investment property shall be derecognised (eliminated from the statement of financial position) on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.**
- 67 The disposal of an investment property may be achieved by sale or by entering into a finance lease. In determining the date of disposal for investment property, an entity applies the criteria in IAS 18 for recognising revenue from the sale of goods and considers the related guidance in the Appendix to IAS 18. IAS 17 applies to a disposal effected by entering into a finance lease and to a sale and leaseback.
- 68 If, in accordance with the recognition principle in paragraph 16, an entity recognises in the carrying amount of an asset the cost of a replacement for part of an investment property, it derecognises the carrying amount of the replaced part. For investment property accounted for using the cost model, a replaced part may not be a part that was depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed. Under the fair value model, the fair value of the investment property may already reflect that the part to be replaced has lost its value. In other cases it may be difficult to discern how much fair value should be reduced for the part being replaced. An alternative to reducing fair value for the replaced part, when it is not practical to do so, is to include the cost of the replacement in the carrying amount of the asset and then to reassess the fair value, as would be required for additions not involving replacement.
- 69 **Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset and shall be recognised in profit or loss (unless IAS 17 requires otherwise on a sale and leaseback) in the period of the retirement or disposal.**
- 70 The consideration receivable on disposal of an investment property is recognised initially at fair value. In particular, if payment for an investment property is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue in accordance with IAS 18 using the effective interest method.
- 71 An entity applies IAS 37 or other Standards, as appropriate, to any liabilities that it retains after disposal of an investment property.

- 72 Compensation from third parties for investment property that was impaired, lost or given up shall be recognised in profit or loss when the compensation becomes receivable.**
- 73** Impairments or losses of investment property, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:
- (a) impairments of investment property are recognised in accordance with IAS 36;
 - (b) retirements or disposals of investment property are recognised in accordance with paragraphs 66–71 of this Standard;
 - (c) compensation from third parties for investment property that was impaired, lost or given up is recognised in profit or loss when it becomes receivable; and
 - (d) the cost of assets restored, purchased or constructed as replacements is determined in accordance with paragraphs 20–29 of this Standard.

Disclosure

Fair value model and cost model

- 74** The disclosures below apply in addition to those in IAS 17. In accordance with IAS 17, the owner of an investment property provides lessors' disclosures about leases into which it has entered. An entity that holds an investment property under a finance or operating lease provides lessees' disclosures for finance leases and lessors' disclosures for any operating leases into which it has entered.
- 75 An entity shall disclose:**
- (a) **whether it applies the fair value model or the cost model.**
 - (b) **if it applies the fair value model, whether, and in what circumstances, property interests held under operating leases are classified and accounted for as investment property.**
 - (c) **when classification is difficult (see paragraph 14), the criteria it uses to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business.**
 - (d) **the methods and significant assumptions applied in determining the fair value of investment property, including a statement whether the determination of fair value was supported by market evidence or was more heavily based on other factors (which the entity shall disclose) because of the nature of the property and lack of comparable market data.**
 - (e) **the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued. If there has been no such valuation, that fact shall be disclosed.**

- (f) the amounts recognised in profit or loss for:
 - (i) rental income from investment property;
 - (ii) direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the period; and
 - (iii) direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period.
 - (iv) the cumulative change in fair value recognised in profit or loss on a sale of investment property from a pool of assets in which the cost model is used into a pool in which the fair value model is used (see paragraph 32C).
- (g) the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal.
- (h) contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.

Fair value model

- 76 In addition to the disclosures required by paragraph 75, an entity that applies the fair value model in paragraphs 33–55 shall disclose a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing the following:
- (a) additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognised in the carrying amount of an asset;
 - (b) additions resulting from acquisitions through business combinations;
 - (c) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;
 - (d) net gains or losses from fair value adjustments;
 - (e) the net exchange differences arising on the translation of the financial statements into a different presentation currency, and on translation of a foreign operation into the presentation currency of the reporting entity;
 - (f) transfers to and from inventories and owner-occupied property; and
 - (g) other changes.
- 77 When a valuation obtained for investment property is adjusted significantly for the purpose of the financial statements, for example to avoid double-counting of assets or liabilities that are recognised as separate assets and liabilities as described in paragraph 50, the entity shall disclose a reconciliation between the valuation obtained and the adjusted valuation included in the financial statements, showing separately the aggregate amount of any recognised lease obligations that have been added back, and any other significant adjustments.

78 In the exceptional cases referred to in paragraph 53, when an entity measures investment property using the cost model in IAS 16, the reconciliation required by paragraph 76 shall disclose amounts relating to that investment property separately from amounts relating to other investment property. In addition, an entity shall disclose:

- (a) a description of the investment property;
- (b) an explanation of why fair value cannot be determined reliably;
- (c) if possible, the range of estimates within which fair value is highly likely to lie; and
- (d) on disposal of investment property not carried at fair value:
 - (i) the fact that the entity has disposed of investment property not carried at fair value;
 - (ii) the carrying amount of that investment property at the time of sale; and
 - (iii) the amount of gain or loss recognised.

Cost model

79 In addition to the disclosures required by paragraph 75, an entity that applies the cost model in paragraph 56 shall disclose:

- (a) the depreciation methods used;
- (b) the useful lives or the depreciation rates used;
- (c) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period;
- (d) a reconciliation of the carrying amount of investment property at the beginning and end of the period, showing the following:
 - (i) additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognised as an asset;
 - (ii) additions resulting from acquisitions through business combinations;
 - (iii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;
 - (iv) depreciation;
 - (v) the amount of impairment losses recognised, and the amount of impairment losses reversed, during the period in accordance with IAS 36;
 - (vi) the net exchange differences arising on the translation of the financial statements into a different presentation currency, and on

translation of a foreign operation into the presentation currency of the reporting entity;

- (vii) transfers to and from inventories and owner-occupied property; and
- (viii) other changes; and

- (e) the fair value of investment property. In the exceptional cases described in paragraph 53, when an entity cannot determine the fair value of the investment property reliably, it shall disclose:
 - (i) a description of the investment property;
 - (ii) an explanation of why fair value cannot be determined reliably; and
 - (iii) if possible, the range of estimates within which fair value is highly likely to lie.

Transitional provisions

Fair value model

- 80 An entity that has previously applied IAS 40 (2000) and elects for the first time to classify and account for some or all eligible property interests held under operating leases as investment property shall recognise the effect of that election as an adjustment to the opening balance of retained earnings for the period in which the election is first made. In addition:
- (a) if the entity has previously disclosed publicly (in financial statements or otherwise) the fair value of those property interests in earlier periods (determined on a basis that satisfies the definition of fair value in paragraph 5 and the guidance in paragraphs 36–52), the entity is encouraged, but not required:
 - (i) to adjust the opening balance of retained earnings for the earliest period presented for which such fair value was disclosed publicly; and
 - (ii) to restate comparative information for those periods; and
 - (b) if the entity has not previously disclosed publicly the information described in (a), it shall not restate comparative information and shall disclose that fact.
- 81 This Standard requires a treatment different from that required by IAS 8. IAS 8 requires comparative information to be restated unless such restatement is impracticable.
- 82 When an entity first applies this Standard, the adjustment to the opening balance of retained earnings includes the reclassification of any amount held in revaluation surplus for investment property.

Cost model

- 83 IAS 8 applies to any change in accounting policies that is made when an entity first applies this Standard and chooses to use the cost model. The effect of the change in accounting policies includes the reclassification of any amount held in revaluation surplus for investment property.
- 84 **The requirements of paragraphs 27–29 regarding the initial measurement of an investment property acquired in an exchange of assets transaction shall be applied prospectively only to future transactions.**

Effective date

- 85 An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.
- 85A IAS 1 *Presentation of Financial Statements* (as revised in 2007) amended the terminology used throughout IFRSs. In addition it amended paragraph 62. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies IAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

Withdrawal of IAS 40 (2000)

- 86 This Standard supersedes IAS 40 *Investment Property* (issued in 2000).

Approval of IAS 40 by the Board

International Accounting Standard 40 *Investment Property* was approved for issue by the fourteen members of the International Accounting Standards Board.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Hans-Georg Bruns	
Anthony T Cope	
Robert P Garnett	
Gilbert Gélard	
James J Leisenring	
Warren J McGregor	
Patricia L O'Malley	
Harry K Schmid	
John T Smith	
Geoffrey Whittington	
Tatsumi Yamada	

Basis for Conclusions on IAS 40 *Investment Property*

This Basis for Conclusions accompanies, but is not part of, IAS 40.

Introduction

- BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 40 *Investment Property* in 2003. Individual Board members gave greater weight to some factors than to others.
- BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 40. The project was undertaken in the light of queries and criticisms raised in relation to the Standards by securities regulators, professional accountants and other interested parties. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts within Standards, to deal with some convergence issues and to make other improvements. In May 2002 the Board published its proposals in an Exposure Draft of *Improvements to International Accounting Standards*, with a comment deadline of 16 September 2002. The Board received over 160 comment letters on the Exposure Draft.
- BC3 Because the Board's intention was not to reconsider the fundamental approach to the accounting for investment property established by IAS 40, this Basis for Conclusions does not discuss requirements in IAS 40 that the Board has not reconsidered. The IASC Basis for Conclusions on IAS 40 (2000) follows this Basis.

Scope

Property interests held under an operating lease

- BC4 Paragraph 14 of IAS 17 *Leases* requires a lease of land with an indefinite economic life to be classified as an operating lease, unless title is expected to pass to the lessee by the end of the lease term. Without the provisions of IAS 40 as amended, this operating lease classification would prevent a lessee from classifying its interest in the leased asset as an investment property in accordance with IAS 40. As a result, the lessee could not remeasure its interest in the leased asset to fair value and recognise any change in fair value in profit or loss. However, in some countries, interests in property (including land) are commonly—or exclusively—held under long-term operating leases. The effect of some of these leases differs little from buying a property outright. As a result, some contended that such leases should be accounted for as finance leases or investment property, or as both.

- BC5 The Board discussed possible solutions to this issue. In particular, it considered deleting paragraph 14 of IAS 17, so that a long-term lease of land would be classified as a finance lease (and hence could qualify as an investment property) when the conditions for finance lease classification in paragraphs 4–13 of IAS 17 are met. However, the Board noted that this would not resolve all cases encountered in practice. Some leasehold interests held for investment would remain classified as operating leases (eg leases with significant contingent rents), and hence could not be investment property in accordance with IAS 40.
- BC6 In the light of this, the Board decided to state separately in paragraph 6 (rather than amend IAS 40's definition of investment property) that a lessee's interest in property that arises under an operating lease could qualify as investment property. The Board decided to limit this amendment to entities that use the fair value model in IAS 40, because the objective of the amendment is to permit use of the fair value model for similar property interests held under finance and operating leases. Put another way, a lessee that uses the cost model for a property would not be permitted to recognise operating leases as assets. The Board also decided to make the change optional, ie a lessee that has an interest in property under an operating lease is allowed, but not required, to classify that property interest as investment property (provided the rest of the definition of investment property is met). The Board confirmed that this classification alternative is available on a property-by-property basis.
- BC7 When a lessee's interest in property held under an operating lease is accounted for as an investment property, the Board decided that the initial carrying amounts of that interest and the related liability are to be accounted for as if the lease were a finance lease. This decision places such leases in the same position as investment properties held under finance leases in accordance with the previous version of IAS 40.
- BC8 In doing so, the Board acknowledged that this results in different measurement bases for the lease asset and the lease liability. This is also true for owned investment properties and debt that finances them. However, in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*, as revised in 2003, an entity can elect to measure such debt at fair value, but lease liabilities cannot be remeasured in accordance with IAS 17.
- BC9 The Board considered changing the scope of IAS 39, but concluded that this would lead to a fundamental review of lease accounting, especially in relation to contingent rentals. The Board decided that this was beyond the limited revisions to IAS 40 to facilitate application of the fair value model to some operating leases classified as investment properties. The Board did, however, indicate that it wished to revisit this issue in a later project on lease accounting. The Board also noted that this was the view of the Board of the former IASC as expressed in its Basis for Conclusions, in paragraphs 25 and 26.*

* These paragraphs in the IASC Basis are shown as struck through because they may be misleading when read in isolation from IAS 39 (as revised in 2003), which permits liabilities within its scope to be marked to market, with changes in fair value recognised in profit or loss in the period in which the changes occur.

- BC10 Finally, the Board noted that the methodology described in paragraphs 40 and 50(d) of IAS 40, whereby a fair valuation of the property that takes all lease obligations into account is adjusted by adding back any liability that is recognised for these obligations, would, in practice, enable entities to ensure that net assets in respect of the leased interest are not affected by the use of different measurement bases.

The choice between the cost model and the fair value model

- BC11 The Board also discussed whether to remove the choice in IAS 40 of accounting for investment property using a fair value model or a cost model.
- BC12 The Board noted that IASC had included a choice for two main reasons. The first was to give preparers and users time to gain experience with using a fair value model. The second was to allow time for countries with less-developed property markets and valuation professions to mature. The Board decided that more time is needed for these events to take place (IAS 40 became mandatory only for periods beginning on or after 1 January 2001). The Board also noted that requiring the fair value model would not converge with the treatment required by most of its liaison standard-setters. For these reasons, the Board decided not to eliminate the choice as part of the Improvements project, but rather to keep the matter under review with a view to reconsidering the option to use the cost model at a later date.
- BC13 The Board did not reconsider IAS 40 in relation to the accounting by lessors. The definition of investment property requires that such a property is held by the owner or a lessee under a finance lease. As indicated above, the Board agreed to allow a lessee under an operating lease, in specified circumstances, also to be a 'holder'. However, a lessor that has provided a property to a lessee under a finance lease cannot be a 'holder'. Such a lessor has a lease receivable, not an investment property.
- BC14 The Board did not change the requirements for a lessor that leases property under an operating lease that is classified and accounted for by the lessee as investment property. The Board acknowledged that this would mean that two parties could both account as if they 'hold' interests in the property. This could occur at various levels of lessees who become lessors in a manner consistent with the definition of an investment property and the election provided for operating leases. Lessees who use the property in the production or supply of goods or services or for administrative purposes would not be able to classify that property as an investment property.

Basis for Conclusions on IAS 40 (2000)

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Basis for Conclusions on IAS 40 (2000) *Investment Property*

This Basis for Conclusions accompanies, but is not part of, IAS 40. It was issued by the Board of the former International Accounting Standards Committee (IASC) in 2000. Apart from the deletion of paragraphs B10–B15, B25 and B26, this Basis has not been revised by the IASB—those paragraphs are no longer relevant and have been deleted to avoid the risk that they might be read out of context. However, cross-references to paragraphs in IAS 40 as issued in 2000 have been marked to show the corresponding paragraphs in IAS 40 as revised by the IASB in 2003 (superseded references are struck through and new references are underlined). Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ. In addition, the text has been annotated where references to material in other standards are no longer valid, following the revision of those standards. Reference should be made to the IASB's Basis for Conclusions on the amendments made in 2003.

Background

- B1 The IASC Board (the “Board”) approved IAS 25 *Accounting for Investments* in 1986. In 1994, the Board approved a reformatted version of IAS 25 presented in the revised format adopted for International Accounting Standards from 1991. Certain terminology was also changed at that time to bring it into line with then current IASC practice. No substantive changes were made to the original approved text.
- B2 IAS 25 was one of the standards that the Board identified for possible revision in E32 *Comparability of Financial Statements*. Following comments on the proposals in E32, the Board decided to defer consideration of IAS 25, pending further work on Financial Instruments. In 1998, the Board approved IAS 38 *Intangible Assets* and IAS 39 *Financial Instruments: Recognition and Measurement*, leaving IAS 25 to cover investments in real estate, commodities and tangible assets such as vintage cars and other collectors’ items.
- B3 In July 1999, the Board approved E64 *Investment Property*, with a comment deadline of 31 October 1999. The Board received 121 comment letters on E64. Comment letters came from various international organisations, as well as from 28 individual countries. The Board approved IAS 40 *Investment Property* in March 2000. Paragraph B67 below summarises the changes that the Board made to E64 in finalising IAS 40.
- B4 IAS 40 permits entities to choose between a fair value model and a cost model. As explained in paragraphs B47–B48 below, the Board believes that it is impracticable, at this stage, to require a fair value model for all investment property. At the same time, the Board believes that it is desirable to permit a fair value model. This evolutionary step forward will allow preparers and users to gain greater experience working with a fair value model and will allow time for certain property markets to achieve greater maturity.

Need for a Separate Standard

- B5 Some commentators argued that investment property should fall within the scope of IAS 16 *Property, Plant and Equipment*, and that there is no reason to have a separate standard on investment property. They believe that:

- (a) it is not possible to distinguish investment property rigorously from owner-occupied property covered by IAS 16 and without reference to management intent. Thus, a distinction between investment property and owner-occupied property will lead to a free choice of different accounting treatments in some cases; and
 - (b) the fair value accounting model proposed in E64 is not appropriate, on the grounds that fair value is not relevant and, in some cases, not reliable in the case of investment property. The accounting treatments in IAS 16 are appropriate not only for owner-occupied property, but also for investment property.
- B6 Having reviewed the comment letters, the Board still believes that the characteristics of investment property differ sufficiently from the characteristics of owner-occupied property that there is a need for a separate Standard on investment property. In particular, the Board believes that information about the fair value of investment property, and about changes in its fair value, is highly relevant to users of financial statements. The Board believes that it is important to permit a fair value model for investment property, so that entities can report fair value information prominently. The Board tried to maintain consistency with IAS 16, except for differences dictated by the choice of a different accounting model.

Scope

Investment Property Entities

- B7 Some commentators argued that the Standard should cover only investment property held by entities that specialise in owning such property (and, perhaps, also other investments) and not cover investment property held by other entities. The Board rejected this view because the Board could find no conceptual and practical way to distinguish rigorously any class of entities for which the fair value model would be less or more appropriate.

Investment Property Reportable Segments

- B8 Some commentators suggested that the Board should limit the scope of the Standard to entities that have a reportable segment whose main activity is investment property. These commentators argued that an approach linked to reportable segments would require an entity to adopt the fair value model when the entity considers investment property activities to be an important element of its financial performance and would allow an entity to adopt IAS 16 in other cases.
- B9 An approach linked to reportable segments would lead to lack of comparability between investment property held in investment property segments and investment property held in other segments. For this reason, the Board rejected such an approach.

Long Operating Leases

- B10 As proposed in E64, the Standard does not permit a lessee to treat its interest in property held under an operating lease as investment property, even if the lessee acquired its interest in exchange for a large up front payment or the lease has a very long term. Instead, IAS 17, Leases, requires the lessee to recognise the lease payments as an expense on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.
- B11 In some countries, such as Hong Kong and the United Kingdom, enterprises commonly make a large up front payment to acquire a long-term interest in property (sometimes known as a leasehold interest). Some lessees consider that a leasehold interest is, in economic substance, virtually indistinguishable from rights acquired on buying a property. Indeed, some commentators noted that outright ownership of land or buildings is impossible in some markets, such as Hong Kong, and that property "ownership" in these markets is invariably transferred by selling rights under operating leases. Some commentators, particularly from these countries, felt that lessees should be permitted to use the fair value model to account for such interests.
- B12 Some commentators suggested amending paragraph 11 of IAS 17, Leases, so that such leases could be classified as finance leases. This paragraph states that a lessee of land does not receive substantially all of the risks and rewards incident to ownership if title is not expected to pass to the lessee by the end of the lease term.
- B13 The Board found no conceptual basis for distinguishing one class of operating leases for which a fair value model might be appropriate from another class of operating leases where it might be more appropriate to continue the existing cost-based accounting model under IAS 17. In particular, the Board concluded that an up-front payment does not change the economic substance of a lease sufficiently to justify an accounting treatment that differs from the treatment used for otherwise similar leases with no up-front payment. A distinction based on the presence or absence of an up-front payment is difficult to reconcile with the accrual basis of accounting.
- B14 The Board concluded that the Standard on investment property should not deal with property held under an operating lease and that IAS 17, Leases, should continue to deal with all operating leases. The Board also concluded that no other solution is practicable without a fundamental review of lease accounting.
- B15 Some commentators urged IASC to begin a fundamental review of lease accounting as soon as possible. The G4+1 group of standard setters is currently undertaking such a review and published a paper on this subject in December 1999. The Board is monitoring progress on this project with interest. However, the Board does not currently have such a review on its own work plan.

Investment Property under Construction

- B16 E64 proposed that investment property under construction should be measured at fair value. E64 argued that fair value is the most relevant measure and that fair value of investment property under construction is not necessarily more difficult to measure than completed investment property. For example, where an investment property under construction is largely pre-leased, there may be less uncertainty about future cash inflows than for a completed investment property that is largely vacant.
- B17 Some commentators argued that it is difficult to estimate fair value reliably for investment property under construction, because a market may not exist for property under construction. They argued that there may be considerable uncertainty about the cost to complete investment property under construction and about the income that such property will generate. Therefore, they suggested that an entity should not measure investment property at more than cost if the investment property is still under construction.
- B18 The Board was persuaded by this argument and concluded that investment property under construction should be excluded from the scope of this Standard and should be covered by IAS 16.
- B19 Paragraph ~~52~~ 58 of the Standard addresses cases where an entity begins to redevelop an existing investment property for continued future use as investment property. One approach would be to require a temporary transfer out of investment property into property under development (subject to IAS 16) for the duration of the redevelopment. However, the Board felt that such temporary transfers would be confusing and would be of little or no benefit to users of financial statements. This approach would also need arbitrary rules to distinguish major redevelopments that would result in such a temporary transfer from less significant works that would not lead to such a transfer. Accordingly, paragraph ~~52~~ 58 states that the property remains an investment property and is not reclassified as owner-occupied property during the redevelopment.
- B20 When an entity completes the construction or development of a self-constructed investment property that will be carried at fair value, there is likely to be a difference between the fair value of the property at that date and its previous carrying amount. The Board considered two approaches to accounting for such differences under the fair value model.
- (a) Under the first approach, the difference would be transferred to revaluation surplus. This approach would be consistent with the Standard's approach to transfers from owner-occupied property to investment property.
 - (b) Under the second approach, the difference would be recognised in profit or loss for the period. The Board concluded that this second approach gives a more meaningful picture of performance (see paragraph ~~59~~ 65).

Property Occupied by Another Entity in the Same Group

- B21 In some cases, an entity owns property that is leased to, and occupied by, another entity in the same group. The property does not qualify as investment property in consolidated financial statements that include both entities, because the property is owner-occupied from the perspective of the group as a whole. However, from the perspective of the individual entity that owns it, the property is investment property if it meets the definition set out in the Standard.
- B22 Some commentators believe that the definition of investment property should exclude properties that are occupied by another entity in the same group. Alternatively, they suggest that the Standard should not require investment property accounting in individual financial statements for properties that do not qualify as investment property in consolidated financial statements. They believe that:
- (a) it could be argued (at least in some such cases) that the property does not meet the definition of investment property from the perspective of a subsidiary whose property is occupied by another entity in the same group—the subsidiary's motive for holding the property is to comply with a directive from its parent and not necessarily to earn rentals or to benefit from capital appreciation. Indeed, the intragroup lease may not be priced on an arm's length basis;
 - (b) this requirement would lead to additional valuation costs that would not be justified by the limited benefits to users. For groups with subsidiaries that are required to prepare individual financial statements, the cost could be extensive as entities may create a separate subsidiary to hold each property;
 - (c) some users may be confused if the same property is classified as investment property in the individual financial statements of a subsidiary and as owner-occupied property in the consolidated financial statements of the parent; and
 - (d) there is a precedent for a similar exemption (relating to disclosure, rather than measurement) in paragraph 4(c) of IAS 24 *Related Party Disclosures*, which does not require disclosures in a wholly-owned subsidiary's financial statements if its parent is incorporated in the same country and provides consolidated financial statements in that country.*
- B23 Some commentators believe that the definition of investment property should exclude property occupied by any related party. They argue that related parties often do not pay rent on an arm's length basis, that it is often difficult to establish whether the rent is consistent with pricing on an arm's length basis and that rental rates may be subject to arbitrary change. They suggest that fair values are less relevant where property is subject to leases that are not priced on an arm's length basis.

* IAS 24 *Related Party Disclosures* as revised by the IASB in 2003 no longer provides the exemption mentioned in paragraph B22(d).

- B24 The Board could find no justification for treating property leased to another entity in the same group (or to another related party) differently from property leased to other parties. Therefore, the Board decided that an entity should use the same accounting treatment, regardless of the identity of the lessee.

Liabilities Related to Investment Property

- B25 ~~Some commentators suggested that the Standard should address the measurement of liabilities incurred to acquire investment property. Under IAS 39, Financial Instruments: Recognition and Measurement, such liabilities are, in many cases, measured on an amortised cost basis. These commentators believe that there will be a mismatch if the property is measured at fair value.~~
- B26 ~~The Board concluded that it should not, at this stage, permit or require a fair value model for liabilities incurred to acquire investment properties. The Board also decided not to modify the fair value model for investment property to adjust for mismatches caused by using an amortised cost basis for related financial liabilities. Under IAS 39, the possibility already exists of a similar mismatch between those financial assets measured at fair value and financial liabilities. The Board is participating in an international Joint Working Group on financial instruments, which is pursuing the possibility of measuring all financial assets and financial liabilities at fair value.~~

Government Grants

- B27 IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* permits two methods of presenting grants relating to assets—either setting up a grant as deferred income and amortising the income over the useful life of the asset or deducting the grant in arriving at the carrying amount of the asset. Some believe that both of those methods reflect a historical cost model and are inconsistent with the fair value model set out in this Standard. Indeed, Exposure Draft E65 *Agriculture*, which proposes a fair value model for biological assets, addresses certain aspects of government grants, as these are a significant factor in accounting for agriculture in some countries.
- B28 Some commentators urged IASC to change the accounting treatment of government grants related to investment property. However, most commentators agreed that IASC should not deal with this aspect of government grants now. The Board decided not to revise this aspect of IAS 20 in the project on Investment Property.
- B29 Some commentators suggested that IASC should begin a wider review of IAS 20 as a matter of urgency. In early 2000, the G4+1 group of standard setters published a Discussion Paper *Accounting by Recipients for Non-Reciprocal Transfers, Excluding Contributions by Owners: Their Definition, Recognition and Measurement*. The Board's work plan does not currently include a project on the accounting for government grants or other forms of non-reciprocal transfer.

Definition of Investment Property

- B30 The definition of investment property excludes:
- (a) owner-occupied property—covered by IAS 16 *Property, Plant and Equipment*. Under IAS 16, such property is carried at either depreciated cost or revalued amount less subsequent depreciation. In addition, such property is subject to an impairment test; and
 - (b) property held for sale in the ordinary course of business—covered by IAS 2 *Inventories*. IAS 2 requires an entity to carry such property at the lower of cost and net realisable value.
- B31 These exclusions are consistent with the existing definitions of property, plant and equipment in IAS 16 and inventories in IAS 2. This ensures that all property is covered by one, and only one, of the three Standards.
- B32 Some commentators suggested that property held for sale in the ordinary course of business should be treated as investment property rather than as inventories (covered by IAS 2). They argued that:
- (a) it is difficult to distinguish property held for sale in the ordinary course of business from property held for capital appreciation; and
 - (b) it is illogical to require a fair value model for land and buildings held for long-term capital appreciation (investment property) when a cost model is still used for land and buildings held for short-term sale in the ordinary course of business (inventories).
- B33 The Board rejected this suggestion because:
- (a) if fair value accounting is used for property held for sale in the ordinary course of business, this would raise wider questions about inventory accounting that go beyond the scope of this project; and
 - (b) it is arguably more important to use fair value accounting for property that may have been acquired over a long period and held for several years (investment property) than for property that was acquired over a shorter period and held for a relatively short time (inventories). With the passage of time, cost-based measurements become increasingly irrelevant. Also, an aggregation of costs incurred over a long period is of questionable relevance.
- B34 Some commentators suggested requiring (or at least permitting) entities, particularly financial institutions such as insurance companies, to use the fair value model for their owner-occupied property. They argued that some financial institutions regard their owner-occupied property as an integral part of their investment portfolio and treat it for management purposes in the same way as property leased to others. In the case of insurance companies, the property may be held to back policyholder liabilities. The Board believes that property used for similar purposes should be subject to the same accounting treatment. Accordingly, the Board concluded that no class of entities should use the fair value model for their owner-occupied property.

- B35 Some commentators suggested that the definition of investment property should exclude property held for rentals, but not for capital appreciation. In their view, a fair value model may be appropriate for dealing activities, but is inappropriate where an entity has historically held rental property for many years and has no intention of selling it in the foreseeable future. They consider that holding property for long-term rental is a service activity and the assets used in that activity should be treated in the same way as assets used to support other service activities. In their view, holding an investment in property in such cases is similar to holding “held-to-maturity investments”, which are measured at amortised cost under IAS 39.
- B36 In the Board’s view, the fair value model provides useful information about property held for rental, even if there is no immediate intention to sell the property. The economic performance of a property can be regarded as being made up of both rental income earned during the period (net of expenses) and changes in the value of future net rental income. The fair value of an investment property can be regarded as a market-based representation of the value of the future net rental income, regardless of whether the entity is likely to sell the property in the near future. Also, the Standard notes that fair value is determined without deducting costs of disposal—in other words, the use of the fair value model is not intended as a representation that a sale could, or should, be made in the near future.
- B37 The classification of hotels and similar property was controversial throughout the project and commentators on E64 had mixed views on this subject. Some see hotels essentially as investments, while others see them essentially as operating properties. Some requested a detailed rule to specify whether hotels (and, perhaps, other categories of property, such as restaurants, bars and nursing homes) should be classified as investment property or as owner-occupied property.
- B38 The Board concluded that it is preferable to distinguish investment property from owner-occupied property on the basis of general principles, rather than have arbitrary rules for specific classes of property. Also, it would inevitably be difficult to establish rigorous definitions of specific classes of property to be covered by such rules. Paragraphs ~~9–11~~ 11–13 of the Standard discuss cases such as hotels in the context of the general principles that apply when an entity provides ancillary services.
- B39 Some commentators requested quantitative guidance (such as a percentage) to clarify whether an “insignificant portion” is owner-occupied (paragraph ~~8~~ 10) and whether ancillary services are “significant” (paragraphs ~~9–11~~ 11–13 of the Standard). As for similar cases in other Standards, the Board concluded that quantitative guidance would create arbitrary distinctions.

Subsequent Expenditure

- B40 Some believe that there is no need to capitalise subsequent expenditure in a fair value model and that all subsequent expenditure should be recognised as an expense. However, others believe—and the Board agreed—that the failure to capitalise subsequent expenditure would lead to a distortion of the reported components of financial performance. Therefore, the Standard requires that an entity should determine whether subsequent expenditure should be capitalised using a test similar to the test used for owner-occupied property in IAS 16.

- B41 Some commentators suggested that the test for capitalising subsequent expenditure should not refer to the originally assessed standard of performance. They felt that it is impractical and irrelevant to judge against the originally assessed standard of performance, which may relate to many years in the past. Instead, they suggested that subsequent expenditure should be capitalised if it enhances the previously assessed standard of performance—for example, if it increases the current market value of the property or is intended to maintain its competitiveness in the market. The Board saw some merit in this suggestion.
- B42 Nevertheless, the Board believes that a reference to the previously assessed standard of performance would require substantial additional guidance, might not change the way the Standard is applied in practice and might cause confusion. The Board also concluded that it was important to retain the existing reference to the originally assessed standard of performance* to be consistent with IAS 16 and IAS 38.

Subsequent Measurement

Accounting Model

- B43 Under IAS 25, an entity was permitted to choose from among a variety of accounting treatments for investment property (depreciated cost under the benchmark treatment in IAS 16 *Property, Plant and Equipment*, revaluation with depreciation under the allowed alternative treatment in IAS 16, cost less impairment under IAS 25 or revaluation under IAS 25).†
- B44 E64 proposed that all investment property should be measured at fair value. Supporters of the fair value model believe that fair values give users of financial statements more useful information than other measures, such as depreciated cost. In their view, rental income and changes in fair value are inextricably linked as integral components of the financial performance of an investment property and measurement at fair value is necessary if that financial performance is to be reported in a meaningful way.
- B45 Supporters of the fair value model also note that an investment property generates cash flows largely independently of the other assets held by an entity. In their view, the generation of independent cash flows through rental or capital appreciation distinguishes investment property from owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) generates cash flows that are attributable not merely to property, but also to other assets used in the production or supply process. Proponents of the fair value model for investment property argue that this distinction makes a fair value model more appropriate for investment property than for owner-occupied property.

* IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 requires all subsequent costs to be covered by its general recognition principle and eliminated the requirement to reference the originally assessed standard of performance. IAS 40 was amended as a consequence of the change to IAS 16.

† IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments. They are replaced with cost model and revaluation model.

- B46 Those who oppose measurement of investment property at fair value argue that:
- (a) there is often no active market for investment property (unlike for many financial instruments). Real estate transactions are not frequent and not homogeneous. Each investment property is unique and each sale is subject to significant negotiations. As a result, fair value measurement will not enhance comparability because fair values are not determinable on a reliable basis, especially in countries where the valuation profession is less well established. A depreciated cost measurement provides a more consistent, less volatile, and less subjective measurement;
 - (b) IAS 39 does not require fair value measurement for all financial assets, even some that are realised more easily than investment property. It would be premature to consider extending the fair value model until the Joint Working Group on financial instruments has completed its work;
 - (c) a cost basis is used for “shorter term” assets (such as inventories) for which fair value is, arguably, more relevant than for “held for investment” assets; and
 - (d) measurement at fair value is too costly in relation to the benefits to users.
- B47 This is the first time that the Board has proposed requiring a fair value accounting model for non-financial assets. The comment letters on E64 showed that although many support this step, many others still have significant conceptual and practical reservations about extending a fair value model to non-financial assets, particularly (but not exclusively) for entities whose main activity is not to hold property for capital appreciation. Also, some entities feel that certain property markets are not yet sufficiently mature for a fair value model to work satisfactorily. Furthermore, some believe that it is impossible to create a rigorous definition of investment property and that this makes it impracticable to require a fair value model at present.
- B48 For those reasons, the Board believes that it is impracticable, at this stage, to require a fair value model for investment property. At the same time, the Board believes that it is desirable to permit a fair value model. This evolutionary step forward will allow preparers and users to gain greater experience working with a fair value model and will allow time for certain property markets to achieve greater maturity.
- B49 IAS 40 permits entities to choose between a fair value model and a cost model. An entity should apply the model chosen to all its investment property. [This choice is not available to a lessee accounting for an investment property under an operating lease as if it were a finance lease—refer to the IASB’s Basis for Conclusions on the amendments made in 2003.] The fair value model is the model proposed in E64: investment property should be measured at fair value and changes in fair value should be recognised in the income statement. The cost

model is the benchmark treatment* in IAS 16 *Property, Plant and Equipment*: investment property should be measured at depreciated cost (less any accumulated impairment losses). An entity that chooses the cost model should disclose the fair value of its investment property.

- B50 Under IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*,† a change in accounting policies from one model to the other model should be made only if the change will result in a more appropriate presentation of events or transactions. The Board concluded that this is highly unlikely to be the case for a change from the fair value model to the cost model and paragraph ~~25~~ 31 of the Standard reflects this conclusion.
- B51 The Board believes that it is undesirable to permit three different accounting treatments for investment property. Accordingly, if an entity does not adopt the fair value model, the Standard requires the entity to use the benchmark treatment in IAS 16 and does not permit the use of the allowed alternative treatment. However, an entity may still use the allowed alternative for other properties covered by IAS 16.*

Guidance on Fair Value

- B52 The valuation profession will have an important role in implementing the Standard. Accordingly, in developing its guidance on the fair value of investment property, the Board considered not only similar guidance in other IASC literature, but also International Valuation Standards (IVS) issued by the International Valuation Standards Committee (IVSC). The Board understands that IVSC intends to review, and perhaps revise, its Standards in the near future.
- B53 The Board believes that IASC's concept of fair value is similar to the IVSC concept of market value. IVSC defines market value as "the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion." The Board believes that the guidance in paragraphs ~~29-30~~ 36, 37 and ~~32-38~~ 39-44 of the Standard is, in substance (and largely in wording as well), identical with guidance in IVS 1.
- B54 Paragraphs ~~34~~ 38 and ~~39-46~~ 45-52 have no direct counterpart in the IVSC literature. The Board developed much of this material in response to commentators on E64, who asked for more detailed guidance on determining the fair value of investment property. In developing this material, the Board considered guidance on fair value in other IASC Standards and Exposure Drafts, particularly those on financial instruments (IAS 32 and IAS 39), intangible assets (IAS 38) and agriculture (E65).

* IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments.

† revised by the IASB in 2003 as IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Independent Valuation

- B55 Some commentators believe that fair values should be determined on the basis of an independent valuation, to enhance the reliability of the fair values reported. Others believe, on cost-benefit grounds, that IASC should not require (and perhaps not even encourage) an independent valuation. They believe that it is for preparers to decide, in consultation with auditors, whether an entity has sufficient internal resources to determine reliable fair values. Some also believe that independent valuers with appropriate expertise are not available in some markets.
- B56 The Board concluded that an independent valuation is not always necessary. Therefore, as proposed in E64, the Standard encourages, but does not require, an entity to determine the fair value of all investment property on the basis of a valuation by an independent valuer who holds a recognised and relevant professional qualification and who has recent experience in the location and category of the investment property being valued. This approach is consistent with the approach to actuarial valuations in IAS 19 *Employee Benefits* (see IAS 19, paragraph 57).

Inability to Measure Fair Value Reliably

- B57 E64 included a rebuttable presumption that an entity will be able to determine reliably the fair value of property held to earn rentals or for capital appreciation. E64 also proposed a reliability exception: IAS 16 should be applied if evidence indicates clearly, when an entity acquires or constructs a property, that fair value will not be determinable reliably on a continuing basis.
- B58 Some commentators opposed various aspects of this proposal, on one or more of the following grounds:
- (a) the rebuttable presumption underestimates the difficulties of determining fair value reliably. This will often be impossible, particularly where markets are thin or where there is not a well-established valuation profession;
 - (b) the accounting model under IAS 16 includes an impairment test under IAS 36. However, it is illogical to rely on an impairment test when fair value cannot be determined using cash flow projections, because an impairment test under IAS 36 is also difficult in such cases;
 - (c) where fair value cannot be determined reliably, this fact does not justify charging depreciation. Instead, the property in question should be measured at cost less impairment losses; and
 - (d) to avoid the danger of manipulation, all efforts should be made to determine fair values, even in a relatively inactive market. Even without an active market, a range of projected cash flows is available. If there are problems in determining fair value, an entity should measure the property at the best estimate of fair value and disclose limitations on the reliability of the estimate. If it is completely impossible to determine fair value, fair value should be deemed to be zero.

- B59 The Board concluded that the rebuttable presumption and the reliability exception should be retained, but decided to implement them in a different way. In E64, they were implemented by excluding a property from the definition of investment property if the rebuttable presumption was overcome. Some commentators felt that it was confusing to include such a reliability exception in a definition. Accordingly, the Board moved the reliability exception from the definition to the section on subsequent measurement (paragraphs ~~47–49~~ 53–55).
- B60 Under E64, an entity should not stop using the fair value model if comparable market transactions become less frequent or market prices become less readily available. Some commentators disagreed with this proposal. They argued that there may be cases when reliable estimates are no longer available and that it would be misleading to continue fair value accounting in such cases. The Board decided that it is important to keep the E64 approach, because otherwise entities might use a reliability exception as an excuse to discontinue fair value accounting in a falling market.
- B61 In cases where the reliability exception applies, E64 proposed that an entity should continue to apply IAS 16 until disposal of the property. Some commentators proposed that an entity should start applying the fair value model once the fair value becomes measurable reliably. The Board rejected this proposal because it would inevitably be a subjective decision to determine when fair value has become measurable reliably and this subjectivity could lead to inconsistent application.
- B62 E64 proposed no specific disclosure where the reliability exception applies. Some commentators felt that disclosure would be important in such cases. The Board agreed and decided to include disclosures consistent with paragraph 170(b) of IAS 39* (see paragraphs ~~68 and 69(e)~~ 78 and 79(e) of IAS 40). Paragraph 170(b) of IAS 39 requires disclosures for financial assets whose fair value cannot be reliably measured.

Gains and Losses on Remeasurement to Fair Value

- B63 Some commentators argued that there should be either a requirement or an option to recognise changes in the fair value of investment property in equity, on the grounds that:
- (a) the market for property is not liquid enough and market values are uncertain and variable. Investment property is not as liquid as financial instruments and IAS 39 allows an option for available-for-sale investments;
 - (b) until performance reporting issues are resolved more generally, it is premature to require recognition of fair value changes in the income statement;
 - (c) recognition of unrealised gains and losses in the income statement increases volatility and does not enhance transparency, because revaluation changes will blur the assessment of an entity's operating performance. It may also cause a presumption that the unrealised gains are available for distribution as dividends;

* In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

- (d) recognition in equity is more consistent with the historical cost and modified historical cost conventions that are a basis for much of today's accounting. For example, it is consistent with IASC's treatment of revaluations of property, plant and equipment under IAS 16 and with the option available for certain financial instruments under IAS 39;
 - (e) for properties financed by debt, changes in the fair value of the properties resulting from interest rate changes should not be recognised in the income statement, since the corresponding changes in the fair value of the debt are not recognised under IAS 39;
 - (f) under paragraphs 92 and 93 of the *Framework*, income should be recognised only when it can be measured with sufficient certainty. For example, IAS 11 *Construction Contracts* requires certain conditions before an entity can use the percentage-of-completion method. These conditions are not normally met for investment property; and
 - (g) results from operations should be distinguished from changes in values. For example, under IAS 21, unrealised exchange differences on a foreign entity* are recognised in equity.
- B64 Some commentators suggested that increases should be recognised in equity and decreases should be recognised in profit or loss. This is similar to the revaluation model that forms the allowed alternative treatment† in IAS 16 (except for the lack of depreciation).
- B65 As proposed in E64, the Board concluded that, in a fair value model, changes in the fair value of investment property should be recognised in the income statement as part of profit or loss for the period. The arguments for this approach include the following:
- (a) the conceptual case for the fair value model is built largely on the view that this provides the most relevant and transparent view of the financial performance of investment property. Given this, it would be inconsistent to permit or require recognition in equity;
 - (b) recognition of fair value changes in equity would create a mismatch because net rental income would be recognised in the income statement, whereas the related consumption of the service potential (recognised as depreciation under IAS 16) would be recognised in equity. Similarly, maintenance expenditure would be recognised as an expense while related increases in fair value would be recognised in equity;

* In IAS 21 *The Effects of Changes in Foreign Exchange Rates*, as revised by the IASB in 2003, the term 'foreign entity' was replaced by 'foreign operation'.

† IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments.

- (c) using this approach, there is no need to resolve some difficult and controversial issues that would arise if changes in the fair value of investment property were recognised in equity. These issues include the following:
 - (i) should fair value changes previously recognised in equity be transferred (“recycled”) to profit or loss on disposal of investment property; and
 - (ii) should fair value changes previously recognised in equity be transferred (“recycled”) to profit or loss when investment property is impaired? If so, how should such impairment be identified and measured; and
- (d) given the difficulty in defining investment property rigorously, entities will sometimes have the option of applying the investment property standard or either of the two treatments in IAS 16. It would be undesirable to include two choices in the investment property standard, as this would give entities a choice (at least occasionally) between four different treatments.

Transfers

- B66 When an owner-occupied property carried under the benchmark treatment under IAS 16 becomes an investment property, the measurement basis for the property changes from depreciated cost to fair value. The Board concluded that the effect of this change in measurement basis should be treated as a revaluation under IAS 16 at the date of change in use. The result is that:
- (a) the income statement excludes cumulative net increases in fair value that arose before the property became investment property. The portion of this change that arose before the beginning of the current period does not represent financial performance of the current period; and
 - (b) this treatment creates comparability between entities that had previously revalued the property under the allowed alternative treatment in IAS 16 and those entities that had previously used the IAS 16 benchmark treatment.*

Summary of Changes to E64

- B67 The most important change between E64 and the final Standard was the introduction of the cost model as an alternative to the fair value model. The other main changes are listed below.
- (a) The guidance on determining fair value was expanded, to clarify the following:
 - (i) the fair value of investment property is not reduced by transaction costs that may be incurred on sale or other disposal (paragraph ~~30~~ 37 of the Standard). This is consistent with the measurement of

* IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to ‘benchmark’ treatment and ‘allowed alternative’ treatments.

financial assets under paragraph 69 of IAS 39.* E64 was silent on the treatment of such costs;

- (ii) measurement is based on valuation at the balance sheet date (paragraph ~~37~~ 38);
 - (iii) the best evidence of fair value is normally given by current prices on an active market for similar property in the same location and condition and subject to similar lease and other contracts (paragraph ~~39~~ 45). In the absence of such evidence, fair value reflects information from a variety of sources and an entity needs to investigate reasons for any differences between the information from different sources (paragraphs ~~40–41~~ 46 and 47);
 - (iv) market value differs from value in use as defined in IAS 36 *Impairment of Assets* (paragraph ~~43~~ 49);
 - (v) there is a need to avoid double counting of investment property and separately recognised assets and liabilities. Integral equipment (such as elevators or air-conditioning) is generally included in the investment property, rather than recognised separately (paragraph 44 50);
 - (vi) the fair value of investment property does not reflect future capital expenditure that will improve or enhance the asset and does not reflect the related future benefits from this future expenditure (paragraph ~~45~~ 51);
 - (vii) an entity uses IAS 37 to account for any provisions associated with investment property (paragraph ~~46~~ 52); and
 - (viii) in the exceptional cases when fair value cannot be determined reliably, measurement is under the IAS 16 benchmark treatment[†] only (in such cases, revaluation under IAS 16 would also not be reliable) and residual value is assumed to be zero (given that fair value cannot be determined reliably) (paragraphs ~~47–48~~ 53 and 54).
- (b) In relation to the scope of the Standard and the definition of investment property:
- (i) paragraph ~~3~~ 4 now clarifies that the Standard does not apply to forests and similar regenerative natural resources and to mineral rights, the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources. This wording is consistent with a similar scope exclusion in IAS 16 *Property, Plant and Equipment*. The Board did not wish to prejudge its decision on the treatment of such items in the current projects on Agriculture and the Extractive Industries;

* Paragraph 69 was replaced by paragraph 46 when the IASB revised IAS 39 in 2003.

† IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003 eliminated all references to 'benchmark' treatment and 'allowed alternative' treatments.

- (ii) land held for a currently undetermined future use is a further example of investment property (paragraph ~~6(b)~~ 8(b)), on the grounds that a subsequent decision to use such land as inventory or for development as owner-occupied property would be an investment decision;
 - (iii) new examples of items that are not investment property are: property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal (paragraph ~~7(e)~~ 9(c));
 - (iv) property that is being constructed or developed for future use as investment property is now covered by IAS 16 and measured at cost, less impairment losses, if any (paragraph ~~7(d)~~ 9(d)). E64 proposed that investment property under construction should be measured at fair value; and
 - (v) the reference to reliable measurement of fair value (and the related requirements in paragraphs 14–15 of E64) was moved from the definition of investment property into the section on subsequent measurement (paragraphs ~~47–49~~ 53–55).
- (c) New paragraph ~~20~~ 23 deals with start up costs, initial operating losses and abnormal wastage (based on paragraphs 17 and 18 of IAS 16^{*}). The Board considered adding guidance on the treatment of incidental revenue earned during the construction of investment property. However, the Board concluded that this raised an issue in the context of IAS 16 and decided that it was beyond the scope of this project to deal with this.
- (d) There is an explicit requirement on determining gains or losses on disposal (paragraph ~~62~~ 69). This is consistent with IAS 16, paragraph 56.[†] There are also new cross-references to:
- (i) IAS 17 *Leases* and IAS 18 *Revenue*, as guidance for determining the date of disposal (paragraph ~~64~~ 67); and
 - (ii) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, for liabilities retained after disposal (paragraph ~~64~~ 71).
- (e) The Standard states explicitly that an entity should transfer an investment property to inventories when the entity begins to develop the property for subsequent sale in the ordinary course of business (paragraphs ~~51(b) and 52~~ 57(b) and 58). E64 proposed that all transfers from investment properties to inventories should be prohibited. The Standard also deals more explicitly than E64 with certain other aspects of transfers.

* In IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003, paragraphs 17 and 18 were replaced by paragraphs 19–22.

† In IAS 16 *Property, Plant and Equipment* as revised by the IASB in 2003, paragraph 56 was replaced by paragraphs 68 and 71.

- (f) New disclosure requirements include:
- (i) extension of the required disclosure on methods and significant assumptions, which are now to include disclosure of whether fair value was supported by market evidence, or whether the estimate is based on other data (which the entity should disclose) because of the nature of the property and the lack of comparable market data (paragraph ~~66(b)~~ 75(d));
 - (ii) disclosures of rental income and direct operating expenses (paragraph ~~66(4)~~ 75(f)); and
 - (iii) disclosures in the exceptional cases when fair value is not reliably determinable (paragraphs ~~68 and 69(e)~~ 78 and 79(e)).
- (g) E64 proposed a requirement to disclose the carrying amount of unlet or vacant investment property. Some commentators argued that this disclosure was impracticable, particularly for property that is partly vacant. Some also felt that this is a matter for disclosure in a financial review by management, rather than in the financial statements. The Board deleted this disclosure requirement. It should be noted that some indication of vacancy levels may be available from the required disclosure of rental income and from the IAS 17 requirement to disclose cash flows from non-cancellable operating leases (split into less than one year, one to five years and more than five years).
- (h) E64 included no specific transitional provisions, which means that IAS 8 would apply. There is a risk that restatement of prior periods might allow entities to manipulate their reported profit or loss for the period by selective use of hindsight in determining fair values in prior periods. Accordingly, the Board decided to prohibit restatement in the fair value model, except where an entity has already publicly disclosed fair values for prior periods (paragraph ~~70~~ 80).