TOPIC 8

INDAS – 40 INVESTMENT PROPERTY

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Quote:

Walk a Path that will make you Better and make you Proud !

Many people falsely believe that there's only one standard that deals with long-term tangible assets: INDAS - 16 Property, Plant and Equipment.

Except for INDAS 16, we have a few other standards arranging the long term assets. **INDAS - 40 Investment Property** is one of them.

In this Standard, we'll learn:

- What the investment property is,
- How you should account for it initially and subsequently

Accounting for INDAS - 40 in 40 seconds

Ready? Go...!

The accounting for INDAS 40 Investment Property is identical to that of INDAS 16 (PPE), **EXCEPT**

that INDAS 40 does not follow Revaluation Model for Subsequent Recognition **AND**

Fair Value is determined for Investment Property only for Disclosure Purpose. **DONE!** ☺

Any remaining seconds should be spent on learning the classifications and rules of INDAS 40 Investment Property.

Objective of INDAS 40

INDAS 40 Investment Property prescribes the **accounting treatment and disclosure with respect to investment property**.

But, what is investment property?

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Meaning of Investment Property:

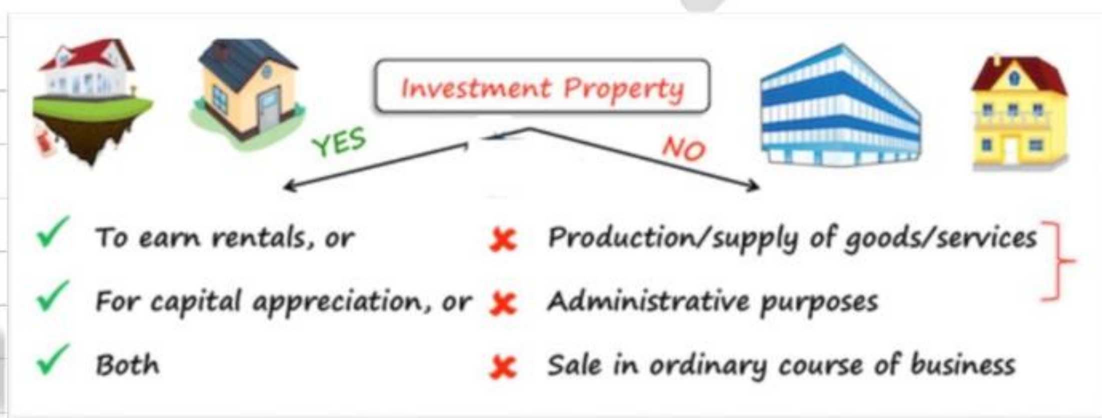
The investment property is a ***land, a building (or a part of it)***, or both, held by Owner or Lessee (under Finance Lease only) for the following specific purposes:

- To earn **rentals**;
- For **capital appreciation**; or
- **Both**.

Here, the strong impact is ***on purpose***. If you hold a building or a land for any of the following purposes, then it ***cannot be classified as investment property***:

- For production or supply of goods or services,
- For administrative purposes, or
- For sale in ordinary course of business.
- Property leased to another entity under a Finance Lease.

If you're using your building or land for the first 2 purposes (Owner Occupied Property), then you should apply INDAS 16; and the standard INDAS 2 Inventories fits when you use them for the sale in ordinary course of business.



Note:

1. **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.

2. This standard also deals with the measurement in the lessee's financial statements of investment property interests held under a lease accounted for as a finance lease and with the measurement in a lessor's financial statements of investment property provided to a lessee under an operating lease.

3. This Standard does not apply to:

- Biological assets related to agricultural activity (see Ind AS 41, Agriculture and Ind AS 16 Property, Plant and Equipment); and
- Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

Examples of Investment Property

- Land held as an investment for **long-term capital appreciation** (rather than short term sale in the ordinary course of business), or ***for future undetermined use*** (i.e. you don't know yet what you'll use it for).
- However, if you buy a land and you intend to build some production hall for your own purposes sometime in the future, then this land is NOT an investment property.
- A building owned by the entity (or held by the entity under finance lease) and leased out under one or more operating leases. This includes a building that is still vacant, but you plan to lease it out.
- Any property that you actually construct or develop for future use as investment property. Be careful here again, because when you construct a building for some third party, this is NOT an investment property, but you should apply INDAS 115 - Revenue from Contracts with Customers.

Property held for more than one purpose

In circumstances when property is held partly for capital appreciation and/or rentals, and partly for production or supply of goods or services or for administrative purposes, the two parts are accounted for separately if they could be sold, or leased out separately under a finance lease, separately.

If they could not be sold (or leased out under a finance lease) separately, the property is accounted for as an investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.

Example

An entity owns a hotel, which includes a health and fitness centre, housed in a separate building that is part of the premises of the entire hotel. The owner operates the hotel and other facilities on the hotel with the exception of the health and fitness centre, which can be sold or leased out under a finance lease. The health and fitness centre will be leased to an independent operator.

The entity has no further involvement in the health and fitness centre. In this scenario, management should classify the hotel and other facilities as property, plant and equipment and the health and fitness centre as investment property.

If the health and fitness centre could not be sold or leased out separately on a finance lease, then because the owner-occupied portion is not insignificant, the whole property would be treated as an owner-occupied property.

Ancillary services

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.

Example

The owner of an office building provides security and maintenance services to the lessees who occupy the building. In such a case, since the services provided are insignificant, the property would be treated as an investment property.

If an entity owns and manages a hotel, services provided to guests are significant to the arrangement as a whole. In such case, an owner-managed hotel is owner-occupied property, rather than investment property

Property leased to other group members

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 of Investment Property. Therefore, the lessor treats the property as investment property in its individual financial statements.

Student Notes:-

TABULAR SUMMARISATION

S.No.	Property	Does it meet definition of Inv. Prop?	Which Ind AS is app.?
1	Owned by a company and leased out under an operating lease	YES	Ind AS 40
2	Held under Finance lease and leased out under an Operating Lease	YES	Ind AS 40
3	Held under Finance lease and leased out under an Finance Lease	No	Ind AS 17/ AS 19
4	Property acquired with a view for development or resale	No	Ind AS 2/ AS 2
5	Property developed on behalf of 3rd Party	No	AS 7/Ind AS 115
6	Property partly owner occupied and partly leased out under Operating Lease	YES	Ind AS 16 Ind AS 40
7	Land held for Currently Undetermined use	YES	Ind AS 40
8	Property occupied by Employees paying rent at less than market rate	No	Ind AS 16
9	Investment Property held for Sale	No	Ind AS 105

INITIAL RECOGNITION

The rules for recognition of investment property are essentially the same as stated in INDAS 16 for property, plant and equipment, i.e. you recognize an investment property as an asset only if 2 conditions are met:

1. It is probable that future economic benefits associated with the item will flow to the entity; and
2. The cost of the item can be measured reliably.

SUBSEQUENT COSTS

Do Not Recognise	May Recognise
Cost of Day to Day servicing of a property	Replacement cost incurred for the parts of Investment property if it meets the recognition criteria. In this case, carrying amount of old replaced parts are derecognized.

Q62:

X Limited owns a building which is used to earn rentals. The building has a carrying amount of ₹50,00,000. X Limited recently replaced interior walls of the building and the cost of new interior walls is 5,00,000. The original walls have a carrying amount of 1,00,000. How X Limited should account for the above costs?

Solution

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 and the carrying amount of those parts that are replaced is derecognised.

So, X Limited should add the cost of new walls and remove the carrying amount of old walls. The new carrying amount of the building = ₹ 50,00,000 + ₹ 5,00,000 – ₹ 1,00,000 = 54,00,000.

HOW TO MEASURE INVESTMENT PROPERTY INITIALLY

Investment property shall be initially measured **at cost, including the transaction cost**.

The cost of investment property includes:

- Its **purchase price** and
- Any **directly attributable expenditure**, such as legal fees or professional fees, property taxes, etc.

We **should NOT include**:

- **Start-up expenses** whatsoever.
  However, if these start-up expenses are directly attributable to the item of investment property, then you can include them. But do NOT include any general start-up expenses.
- **Operating losses** that you incur before planned occupancy level is achieved, and
- **Abnormal waste** of material, labor or other resources incurred at construction.

When payment for investment property is **deferred**, then you need to discount it to its present value in order to set the **cash price equivalent**.

Let me just mention that actually, you can classify assets held under finance lease as investment property and in this case, it's initial cost is calculated in line with INDAS 17.

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Q63.

X Limited purchased a building for ₹30,00,000 in May 1, 20X1.The purchase price was funded by a loan. Property transfer taxes and direct legal costs of ₹1,00,000 and ₹20,000 respectively were incurred in acquiring the building. In 20X1-20X2, X Limited redeveloped the building into retail shops for rent under operating leases to independent third parties. Expenditures on redevelopment were:

2,00,000 planning permission.

7,00,000 construction costs (including ₹40,000 refundable purchases taxes).

The redevelopment was completed and the retail shops were ready for rental on September 2, 20X1. What is the cost of building at initial recognition?

Solution:

The cost of a purchased investment property comprises its purchase price and any direct attributable expenditure.

So, the cost of the building = ₹ (30,00,000 +1,00,000 + 20,000 + 2,00,000 + 7,00,000 - 40,000) = ₹ 39,80,000.

Q64.

X Limited purchased a land worth of ₹1,00,00,000. It has option either to pay full amount at the time of purchases or pay for it over two years for a total cost of ₹1,20,00,000. What should be the cost of the building under both the payments method?

Solution

Using either payment method, the cost will be ₹ 1,00,00,00. If the second payment option is used, 20,00,000 will be treated as interest expenses over the period of credit i.e., 2 years.

Q65.

X Limited (as the lessee) has taken a building under finance lease from the owner. It classifies its interest in the leasehold building as investment property and after initial recognition measures the property interest at fair value. The fair value is ₹50,000. The present value of the minimum lease payment is ₹40,000. At what value, X Limited will recognise its investment property?

Solution.

X Limited shall initially recognise the property interest at ₹ 40,000 i.e., lower of fair value of the property and present value of minimum lease payments. A corresponding lease liability of ₹ 40,000 will be recognised as follows:

Investment Property A/c Dr. ₹ 40,000

To Finance lease obligation ₹ 40,000.

Exchange of Assets – INVESTMENT PROPERTY acquired in Exchange for a Non-monetary Asset or Assets or a combination of Monetary and Non-monetary Assets:

Cost of INVESTMENT PROPERTY is **measured at fair value unless:**

(i) Exchange transaction lacks commercial substance; Or

(ii) Fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.

If the IP acquired is **not** measured at Fair Value, its cost is measured at the **carrying amount of the asset given up.**

EXAMPLE

Sun Ltd acquired a building in exchange of a warehouse whose fair value is ₹ 5,00,000 and payment of cash is ₹2,00,000. The fair value of the building received by the Company is ₹ 8,00,000. The company decided to keep that building for rental purposes.

The Building is acquired with the purpose to earn rentals. Hence, it is a case of Investment Property acquired in exchange for a combination of monetary and non-monetary asset. Therefore,

Journal entry at the time of acquisition is :

Investment Property (Building)..............................Dr	8,00,000
To Cash	2,00,000
To PPE (Property Plant and Equipment) i.e. Warehouse	5,00,000
To Gain on exchange (Profit or Loss)	1,00,000

SUBSEQUENT MEASUREMENT OF INVESTMENT PROPERTY

After initial recognition, we have only one choice for measuring our investment property i.e. at **COST Model**

Here, INDAS 40 does not describe it in details, but refers to the standard **INDAS 16 Property, Plant and Equipment.** It means you need to take the same methodology as in INDAS 16.

(a) Fair value only for disclosure

Entities are required **to measure the fair value of investment property, for the purpose of disclosure** even though they are required to follow the cost model. An entity is encouraged, but not required, to measure the fair value of investment property on the basis of a valuation by an independent value who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued.

Fair Value should reflect the Rental income from current leases and other assumptions that market participants would use when pricing investment property under current market conditions.

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(b) Inability to measure fair value reliably

There is **a rebuttable presumption that an entity can reliably measure the fair value** of an investment property on a continuing basis.

But in exceptional cases, when an entity first acquired (or when an existing property first becomes investment property after a change in use), there may be clear evidence that the fair value of the investment property is not reliably measurable on a continuing basis. This arises when, and only when, the market for comparable properties is inactive (e.g. there are few recent transactions, price quotations are not current or observed transaction prices indicate that the seller was forced to sell) and alternative reliable measurements of fair value (for example, based on discounted cash flow projections) are not available.

Above exception is available only when the investment property is first recognised as such. If an entity has previously measured the fair value of an investment property, it should continue to measure the fair value of that property 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.

If an entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably measurable on a continuing basis, the entity should make the disclosures as prescribed under IndAS 40.

(c) Investment property in the course of construction

If an entity determines that the fair value of an investment property under construction is not reliably measurable but expects the fair value of the property to be reliably measurable when construction is complete, it should measure the fair value of that investment property either when its fair value becomes reliably measurable or construction is completed (whichever is earlier).

Once construction of that property is complete, it is presumed that fair value can be measured reliably. If this is not the case, the entity should make the disclosures as required by Ind AS 40.

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TRANSFERS FROM AND TO INVESTMENT PROPERTY

When we speak about transfers related to investment property, we mean the change of classification, for example, you classify a building previously held as property, plant and equipment under INDAS 16 to investment property under INDAS 40.

The transfers are possible, but only **when there's a change in use or asset's purpose**, for example:

- You start renting out the property that you previously used as your headquarters (transfer to investment property from owner-occupied property under INDAS 16)
- You stop renting out the building and start using it for yourself
- You held a land for undefined purpose and recently, you decided to construct an apartment house to sell apartments when they are built (transfer from investment property to inventories).
- Commencement of owner-occupation, or of development with a view to owner-occupation, for a transfer from investment property to owner-occupied property;
- Commencement of development with a view to sale, for a transfer from investment property to inventories;
- End of owner-occupation, for a transfer from owner-occupied property to investment property;
- Inception of an operating lease to another party, for a transfer from inventories to investment property.

So what's the accounting treatment in this case.

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

Q66.

Moon Ltd has purchased a building on 1st April 20X1 at a cost of ₹10 million. The building was used as a factory by the Moon Ltd and was measured under cost model. The expected useful life of the building is estimated to be 10years. Due to decline in demand of the product, the Company does not need the factory anymore and has rented out the building to a third party from 1st April 20X5. On this date the fair value of the building is ₹8 million. Moon ltd uses cost model for accounting of its investment property.

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Solution:

	(In Million)
Carrying amount of the building after depreciation of 4 years (10-10/10*4)	6
The company has applied cost model under IndAS 16 till now.	
There is no impairment as the fair value is greater than the carrying amount of building.	
Revaluation Surplus credited to Other Comprehensive Income (not applicable since cost model is used under Ind AS 16)	---
Building initially recognised as Investment Property (Cost model Ind AS 40)	6

DERECOGNITION OF INVESTMENT PROPERTY

The derecognition rules (when you can remove your investment property from your books) in INDAS 40 **are similar to the rules in INDAS 16.**

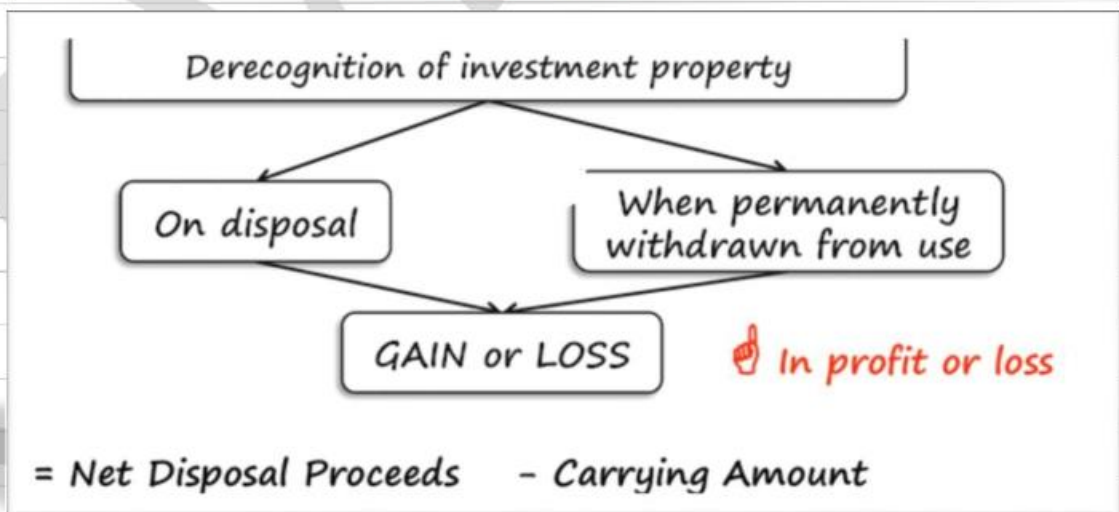
You can derecognize your investment property in two circumstances:

- On disposal, or
- When the investment property is permanently withdrawn from use and no future economic benefits are expected.

You need to calculate **gain or loss on disposal** as a difference between:

- Net disposal proceeds, and
- Asset's carrying amount.

Gain or loss on disposal is recognized **in profit or loss.**



Example: Sun Ltd, an aeronautics company is having a building which is given on an operating lease. The book value of such building in the books is ₹ 2,00,000.

Case -A

Pluto Ltd. offers to buy the building at ₹ 4,00,000.

Bank	Dr	4,00,000
To Investment Property		2,00,000
To Gain on disposal		2,00,000

Case- B

Pluto Ltd. Offers to take the building on finance lease for 10 years at a lease rental of ₹ 80,000 p.a. The present value of minimum lease payments is ₹ 3,20,000.

Lease Receivable	Dr	3,20,000
To Investment Property		2,00,000
To Gain on Disposal		1,20,000

Disclosures

An entity should disclose:

- Its accounting policy for measurement of investment property.
- the criteria it uses to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business.
- the extent to which the fair value of investment property (as measured for 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.
- the amounts recognised in profit or loss for:
  - rental income from investment property;
  - direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the period; and
  - direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period.
- the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal.
- contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.

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- In addition to the general disclosures required above, an entity is required to disclose:
    - the depreciation methods used;
    - the useful lives or the depreciation rates used;
    - the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period;
- An entity is also required to provide a reconciliation of the carrying amount of investment property at the beginning and end of the period, showing the following:
    - additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognised as an asset;
    - additions resulting from acquisitions through business combinations;
    - assets classified as held for sale or included in a disposal group classified as held for sale in accordance with Ind AS 105 and other disposals;
    - depreciation;
    - the amount of impairment losses recognised, and the amount of impairment losses reversed, during the period in accordance with Ind AS 36;
    - 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;
    - transfers to and from inventories and owner-occupied property; and
    - other changes.

An entity is also required to disclose the fair value of investment property. In the exceptional cases when an entity cannot measure the fair value of the investment property reliably, it should disclose:

- a description of the investment property;
- an explanation of why fair value cannot be measured reliably; and
- if possible, the range of estimates within which fair value is highly likely to lie.

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Additional Questions

Q67.

On April 1, 20X1 an entity acquired an investment property (building) for ₹ 40,00,000. Management estimates the useful life of the building as 20 years measured from the date of acquisition. The residual value of the building is ₹ 2,00,000. Management believes that the straight-line depreciation method reflects the pattern in which it expects to consume the building's future economic benefits. What is the carrying amount of the building on March 31, 20X2?

Solution

Cost of the asset is ₹ 40,00,000.

Depreciable amount = Cost less Residual value = ₹ (40,00,000 - 2,00,000) = ₹ 38,00,000

Depreciation for the year = Depreciable amount/useful life

= ₹ 38,00,000/20 = ₹ 1,90,000.

Carrying amount = Cost less accumulated depreciation

= ₹ (40,00,000 - 1,90,000) = ₹ 38,10,000.

Q68.

X Limited has an investment property (building) which is carried in Balance Sheet on March 31, 20X1 at ₹ 15,00,000. During the year X Limited has stopped letting out the building and used it as its office premise. On March 31, 20X1, management estimates the recoverable amount of the building as ₹ 10,00,000 and its remaining useful life as 20 years and residual value is nil. How should X Limited account for the above investment property as on March 31, 20X1?

Solution:

At March 31, 20X1, X Limited must transfer the property from investment property to property, plant and equipment since there is a change in use of the said building. The transfer should be made at its carrying amount i.e., Rs 15,00,000. Since recoverable amount of the property as on March 31, 20X1 is Rs 10,00,000, impairment loss Rs 5,00,000 should be recognised in the Statement of Profit and Loss.

The entity must disclose the reclassification.

From April, 20X1, X Limited will depreciate the building over its remaining useful life of 20 years.

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Q69.

In financial year 20X1-20X2, X Limited incurred the following expenditure in acquiring property consisting of 6 identical houses each with separate legal title including the land on which it is built.

The expenditure incurred on various dates is given below:

On April 1, 20X1 - Purchase cost of the property ₹ 1,80,00,000.

On April 1, 20X1 – Non-refundable transfer taxes ₹ 20,00,000 (not included in the purchase cost).

On April 2, 20X1- Legal cost related to property acquisition ₹ 5,00,000.

On April 6, 20X1- Advertisement campaign to attract tenants ₹ 3,00,000.

On April 8, 20X1 - Opening ceremony function for starting business ₹ 1,50,000.

Throughout 20X1-20X2, incurred ₹ 1,00,000 towards day-to-day repair maintenance and other administrative expenses.

X Limited uses one of the six houses for office and accommodation of its few staffs. The other five houses are rented to various independent third parties.

How X Limited will account for all the above mentioned expenses in the books of account?

Solution

The cost of the property = ₹ (1,80,00,000 + 20,00,000 + 5,00,000) = ₹ 2,05,00,000.

Since five houses out of six are being rented, so 5/6th of the property cost will be accounted for as an investment property and 1/6th of the property cost will be accounted for as owner occupied property.

Cost of the investment property = ₹ 2,05,00,000 x 5/6 = ₹ 1,70,83,333

Cost of the owner occupied property = ₹ (2,05,00,000 - 1,70,83,333) = ₹ 34,16,667. All other costs, i.e., Advertisement expenses, ceremony expenses and repair maintenance expenses will be expensed off as and when incurred.

Q70.

X Ltd. is engaged in the construction industry and prepares its financial statements up to 31stMarch each year. On 1stApril, 2013, X Ltd. purchased a large property (consisting of land) for Rs2,00,00,000 and immediately began to lease the property to Y Ltd. on an operating lease. Annual rentals were Rs 20,00,000. On 31stMarch, 2017, the fair value of the property was Rs2,60,00,000. Under the terms of the lease, Y Ltd. was able to cancel the lease by giving six months' notice in writing to X Ltd. Y Ltd. gave this notice on 31st March, 2017 and vacated the property on 30th September, 2017. On 30th September, 2017, the fair value of the

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property was Rs 2,90,00,000. On 1st October, 2017, X Ltd. immediately began to convert the property into ten separate flats of equal size which X Ltd. intended to sell in the ordinary course of its business. X Ltd. spent a total of Rs 60,00,000 on this conversion project between 30th September, 2017 to 31st March, 2018. The project was incomplete at 31st March, 2018 and the directors of X Ltd. estimate that they need to spend a further Rs 40,00,000 to complete the project, after which each flat could be sold for Rs 50,00,000.

Examine and show how the three events would be reported in the financial statements of X Ltd. for the year ended 31st March, 2018. as per Ind AS.

Solution:

From 1st April, 2013, the property would be regarded as an investment property since it is being held for its investment potential rather than being owner occupied or developed for sale.

The property would be measured under the cost model. This means it will be measured at Rs 2,00,00,000 at each year end.

On 30th September, 2017, the property ceases to be an investment property. X Ltd. begins to develop it for sale as flats. The increase in the fair value of the property from 31st March, 2017 to 30th September, 2017 of Rs30,00,000 (Rs29,00,000 – Rs26,00,000) would be recognised in P/L for the year ended 31st March, 2018.

Since the lease of the property is an operating lease, rental income of Rs 10,00,000 (Rs20,00,000 x 6/12) would be recognised in P/L for the year ended 31st March, 2018.

When the property ceases to be an investment property, it is transferred into inventory at its then fair value of Rs 2,90,00,000. This becomes the initial 'cost' of the inventory.

The additional costs of Rs 60,00,000 for developing the flats which were incurred up to and including 31st March, 2018 would be added to the 'cost' of inventory to give a closing cost of Rs 3,50,00,000.

The total selling price of the flats is expected to be Rs 5,00,00,000 (10 x Rs 50,00,000). Since the further costs to develop the flats total Rs40,00,000, their net realisable value is Rs 4,60,00,000 (Rs 5,00,00,000 – Rs 40,00,000), so the flats will be measured at a cost of Rs 3,50,00,000.

The flats will be shown in inventory as a current asset

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