CHAPTER

5

IND AS 40 – INVESTMENT PROPERTY

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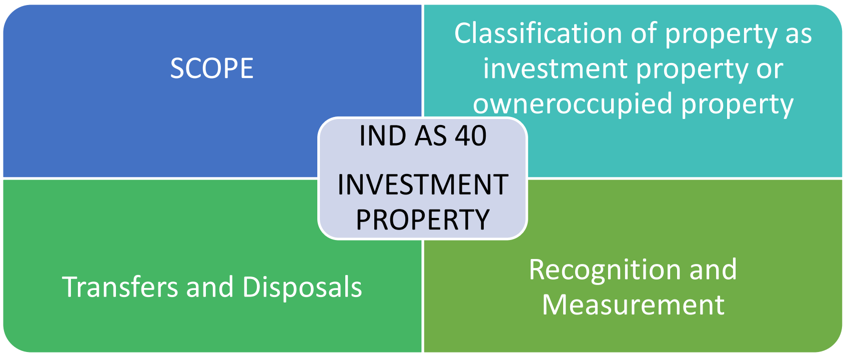
1. OBJECTIVE :

The objective of this standard is to prescribe the accounting treatment for property (land and/or buildings) held to earn rentals or for capital appreciation (or both). Ind AS 40 prescribes the cost model for accounting for investment property.



2. SCOPE :

1) Ind AS 40 should be applied in the recognition, measurement and disclosure of investment property.

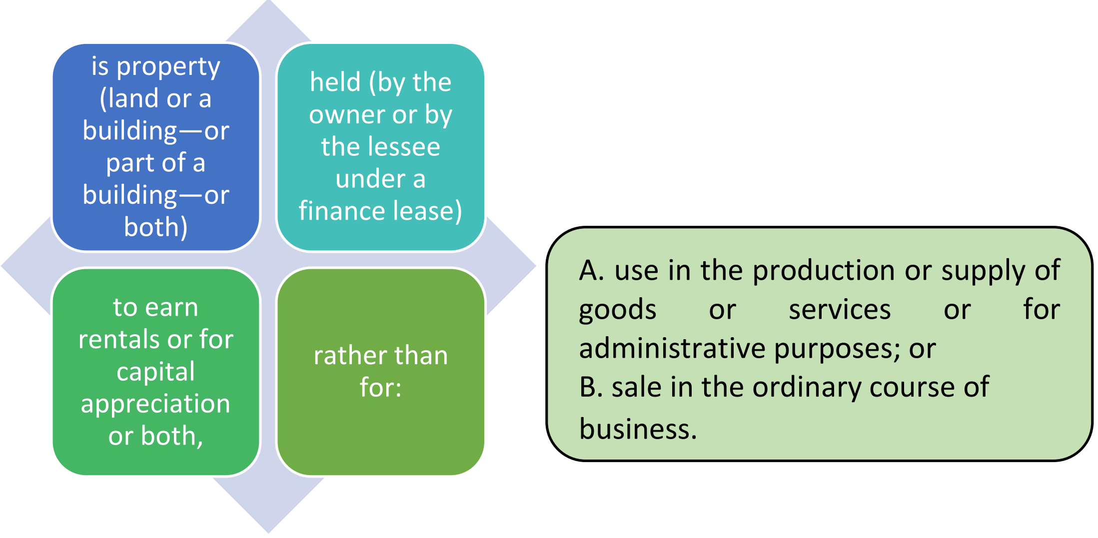
2) This Standard does not apply to:
   a) biological assets related to agricultural activity (see Ind AS 41 '*Agriculture*' and Ind AS 16 '*Property, Plant and Equipment'*); and
   b) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

3. DEFINITIONS :

1. INVESTMENT PROPERTY :

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.



2. **PROPERTY, PLANT AND EQUIPMENT :**

A. are the tangible items that

B. are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

C. are expected to be used during more than one period

3. **OWNER-OCCUPIED PROPERTY :**

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.

4. **FAIR VALUE :**

Fair Value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (IND AS 113)

5. **COST :**

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 Ind ASs, eg Ind AS 102, Share Based Payment.

6. **CARRYING AMOUNT :**

Carrying amount is the amount at which an asset is recognised in the balance sheet.

4. CLASSIFICATION OF PROPERTY AS INVESTMENT PROPERTY & OWNER OCCUPIED PROPERTY :

4.1 NATURE OF INVESTMENT PROPERTY :

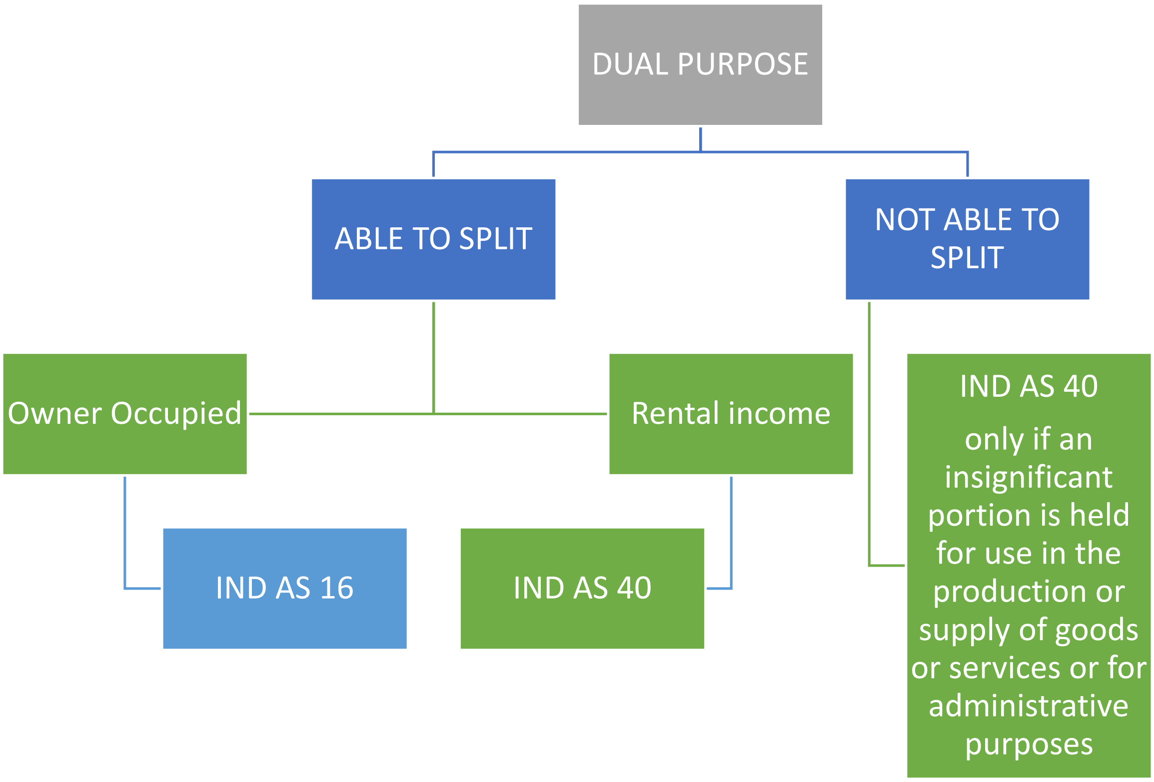
Investment property is held to earn rentals or for capital appreciation or both. Therefore, an investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from owner-occupied property. The production or supply of goods or 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. Ind AS 16 Property, Plant and Equipment applies to owner-occupied property.

4.2 EXAMPLES :

INVESTMENT PROPERTY	NOT AN INVESTMENT PROPERTY
Land held for long-term capital appreciation	Property intended for sale in the ordinary course of business (IND AS 2)
Land held for a currently undetermined future use.(if the entity is undecided it is assumed that its currently held for capital appreciation)	Property in the process of construction or development for sale in ordinary course of business (IND AS 2)
A building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases.	Owner-occupied property, including property held for future use as owner occupied property. (IND AS 16)

A building that is vacant but is held to be leased out under one or more operating leases.	Property held for future development and subsequent use as owner occupied property (IND AS 16)
Property that is being constructed or developed for future use as investment property.	Property occupied by employees (whether or not the employees pay rent at market rates) (IND AS 16)
	Property leased to another entity under a finance lease (IND AS 17)

4.3 PROPERTY HELD FOR ONE OR MORE PURPOSE :



Question 1 – Sun Ltd.
Sun Ltd. owns a building having 15 floors of which it uses 5 floors for its office; the remaining 10 floors are leased out to tenants under operating leases. According to law company could sell legal title to the 10 floors while retaining legal title to the other 5 floors. Explain how shall the property be classified?

Question 2 – Moon Ltd.
Moon Ltd. uses 35% of the office floor space of the building as its head office. It leases the remaining 65% to tenants, but it is unable to sell the tenant’s space or to enter into finance leases related solely to it. Head office can’t be shifted and is significant to the overall operation of the firm.

Can the above property be classified as Investment Property as per IND AS 40?

Question 3 – An entity

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.

Explain how the above assets can be classified as per IND AS 40.

4.4 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.

If the services provided are significant than the entity should treat the property as owner occupied property and account for it as per IND AS 16

Question 4 – The owner

The owner of an office building provides security and maintenance services to the lessees who occupy the building. Can this be treated as Investment property?

Question 5 –

If an entity owns and manages a hotel, services provided to guests are significant to the arrangement as a whole. Can this be treated as Investment property?

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.

Judgement is needed to determine whether a property qualifies as investment property. Judgement is also required to determine whether the acquisition of Investment Property is the acquisition of an asset or a group of assets or a business combination within the scope of Ind AS 103, Business Combinations.

Question 6 –

No.	Property	Does it meet definition of Investment Property	Which Ind AS is Applicable
1	Owned by a Co and leased out under an Operating Lease		
2	Held Under Finance Lease and Leased out under an Operating Lease		
3	Held under Finance Lease and Leased out under Finance Lease		
4	Property acquired with a view for development and resale		
5	Property partly owner occupied and partly leased out under Operating Lease		
6	Land held for currently undetermined use		
7	Property occupied by Employees paying rent at less than market rate		
8	Investment Property held for sale		
9	Existing Investment Property that is being redeveloped for continued use as Investment Property		

5. RECOGNITION :

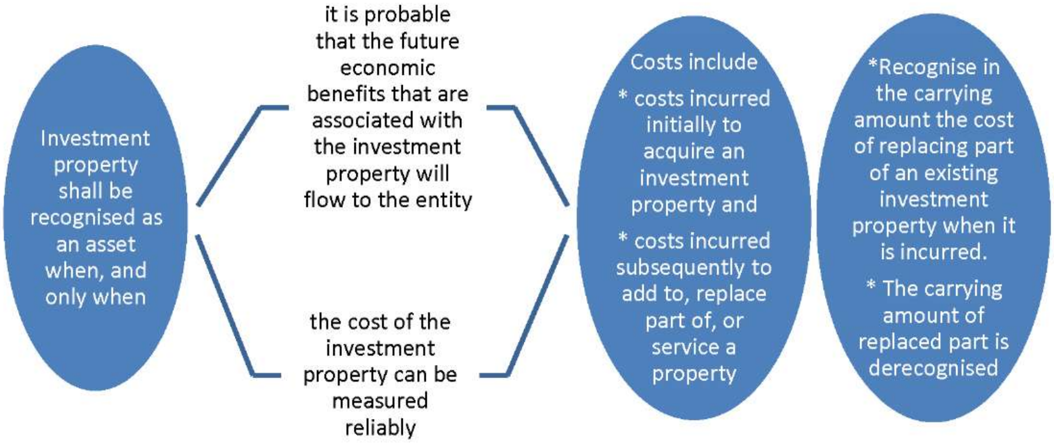
5.1 GENERAL RECOGNITION :

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.

This general principle is used to consider whether capitalisation is appropriate both in respect of the cost incurred initially to acquire or construct an investment property and costs incurred subsequently to add to, replace part of, or service a property



5.2 SUBSEQUENT COSTS :

Under the recognition principle set out above, 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 and costs incurred to replace parts of the original property being recognised in the investment property if they meet the recognition criteria.

When the cost of replacement parts are capitalised, the carrying amounts of the replaced parts are derecognised.

Question 7 – X Limited

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

6. MEASUREMENT :

6.1 MEASUREMENT AT RECOGNITION – GENERAL :

An investment property should be measured initially at its cost. Transaction costs are included in the initial measurement.

The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure (e.g. professional fees for legal services, property transfer taxes and other transaction costs). 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.

Question 8 – Netravati Ltd.

Netravati Ltd. purchased a commercial office space as an Investment Property, in the Global Trade Centre Commercial Complex, for Rs. 5 crores. However, for purchasing the same, the Company had to obtain membership of the Global Trade Centre Commercial Complex Association by paying Rs. 6,25,000 as a one-time joining fee. Netravati Ltd. wants to write off the one-time joining fees paid as an expense under Membership and Subscription Charges and value the investment property at Rs. 5 crores. Advise.

Would you answer change if the office space was purchased with the intention of using it as an administrative centre of the company?

Question 9 – X Limited

X Limited purchased a building for Rs. 30,00,000 on 1st May, 20X1 with an intention to earn rentals. The purchase price was funded by a loan, interest on which is payable @ 5%. Property transfer taxes and direct legal costs of Rs. 1,00,000 and Rs. 20,000 respectively were incurred in acquiring the building. X Limited redeveloped the building into retail shops for rent under operating leases to independent third parties. Expenditures on redevelopment were:

(a) Rs. 2,00,000 planning permission.

(b) Rs. 7,00,000 construction costs (including Rs. 40,000 refundable purchase taxes)

What is the cost of the Building as per Ind AS 40?

6.2 DEFERRED PAYMENTS :

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.

Question 10 – X Limited

X Limited purchased a land worth of Rs. 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 Rs. 1,20,00,000. What should be the cost of the building under both the payment methods?

6.3 EXCHANGE OF ASSETS :

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.

Question 11 – Sun Ltd.

Sun Ltd. acquired a building in exchange of a warehouse whose fair value is Rs.5,00,000 and payment of cash is Rs.2,00,000. The fair value of the building received by the

Company is Rs.8,00,000. The company decided to keep that building for rental purposes. Pass the journal Entry for the above transaction

Question 12 – Y Limited

Y Limited purchased a building for Rs.30,00,000 in May 1, 2011.The purchase price was funded by a loan. Property transfer taxes and direct legal costs of Rs.1,00,000 and Rs.20,000 respectively were incurred in acquiring the building. In 2011-2012, Y Limited redeveloped the building into retail shops for rent under operating leases to independent third parties. Expenditures on redevelopment were:
Rs.2,00,000 planning permission.
Rs.7,00,000 construction costs (including Rs.40,000 refundable purchases taxes).
The redevelopment was completed and the retail shops were ready for rental on September 2, 2011. What is the cost of building at initial recognition?

Question 13 – Z Limited

Z Limited purchased a land worth of Rs.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 Rs.1,20,00,000. What should be the cost of the building under both the payment methods?

Question 14 – S Limited

S 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 Rs.50,000. The present value of the minimum lease payment is Rs.40,000. At what value, S Limited will recognise its investment property?

7. MEASUREMENT AFTER RECOGNITION :

ACCOUNTING POLICY :

a. After initial recognition, an entity is required to measures all of its investment property in accordance with Ind AS 16's requirement for cost model

b. If it meets 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 Ind AS 105

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.

8. TRANSFERS :

An entity shall transfer a property to, or from, investment property when, and only when, there is a change in use.

a) commencement of owner-occupation, or of development with a view to owner-occupation, for a transfer from investment property to owner-occupied property;

Ind AS 40 → Ind AS 16

b) commencement of development with a view to sale, for a transfer from investment property to inventories;

Ind AS 40 → Ind AS 2

c) end of owner-occupation, for a transfer from owner-occupied property to investment property; or

Ind AS 16 → Ind AS 40

d) inception of an operating lease to another party, for a transfer from inventories to investment property.

Ind AS 2 → Ind AS 40

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.

Question 15 – Moon Ltd.

Moon Ltd. has purchased a building on 1st April, 2011 at a cost of Rs.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 10 years. 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, 2015. On this date the fair value of the building is Rs.8 million. Moon ltd uses cost model for accounting of its investment property.

9. DISPOSALS :

1) An investment property should be derecognised (eliminated from the balance sheet)
   a. on disposal or
   b. when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.
2) The disposal of an investment property may be achieved by:
   a. sale or
   b. entering into a finance lease.
3) Gains or losses arising from the retirement or disposal of investment property should be calculated as the difference between the net disposal proceeds and the carrying amount of the asset and is recognised in profit or loss (unless Ind AS 17 requires otherwise on a sale and leaseback) in the period of the retirement or disposal.

Question 16 – Sun Ltd.

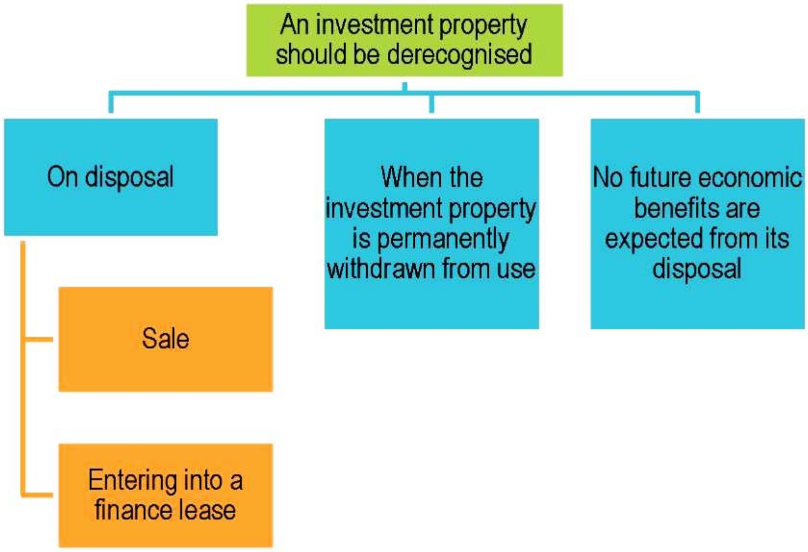
Sun Ltd., an aeronautics company is having a building which is given on an operating lease. The book value of such building in the books is Rs.2,00,000.

Case -A

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

Case – B

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



10. DISCLOSURE :

An entity should disclose:

1) its accounting policy for measurement of investment property.
2) the criteria it uses to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business.
3) 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.
4) the amounts recognised in profit or loss for:
   a) rental income from investment property;
   b) direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the period; and
   c) direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period.
5) the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal.
6) contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.
7) In addition to the general disclosures required above, an entity is required to 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;

8) 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) a description of the investment property;

b) an explanation of why fair value cannot be measured reliably; and

c) if possible, the range of estimates within which fair value is highly likely to lie.

11. SELF PRACTICE QUESTIONS :

Question 17 – On April 1, 2011

On April 1, 2011 an entity acquired an investment property (building) for Rs.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 Rs.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, 2012?

Question 18 – T Limited

T Limited has an investment property (building) which is carried in Balance Sheet on March 31, 2011 at Rs.15,00,000. During the year T Limited has stopped letting out the building and used it as its office premise. On March 31, 2011, management estimates the recoverable amount of the building as Rs.10,00,000 and its remaining useful life as 20 years and residual value is nil. How should T Limited account for the above investment property as on March 31, 2011?

Question 19 – X Limited

In financial year 2011-2012, 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, 2011 - Purchase cost of the property Rs.1,80,00,000.

On April 1, 2011 – Non-refundable transfer taxes Rs.20,00,000 (not included in the purchase cost).

On April 2, 2011- Legal cost related to property acquisition Rs.5,00,000.

On April 6, 2011- Advertisement campaign to attract tenants Rs.3,00,000.

On April 8, 2011 - Opening ceremony function for starting business Rs.1,50,000.

Throughout 2011-2012, incurred Rs.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?

Question 20 – X Ltd

X Ltd. is engaged in the construction industry and prepares its financial statements up to 31st March each year. On 1st April, 20X1, X Ltd. purchased a large property (consisting of land) for Rs. 2,00,00,000 and immediately began to lease the property to Y Ltd. on an operating lease. Annual rentals were Rs. 20,00,000. On 31st March, 20X5, the fair value of the property was Rs. 2,60,00,000. 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, 20X5 and vacated the property on 30th September, 20X5. On 30th September, 20X5, the fair value of the property was Rs. 2,90,00,000. On 1st October, 20X5, 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, 20X5 to 31st March, 20X6. The project was incomplete at 31st March, 20X6 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, 20X6 as per Ind AS.

Question 21 – Shaurya Limited

Shaurya Limited owns a Building A which is specifically used for the purpose of earning rentals. The Company has not been using the building A or any of its facilities for its own use for a long time. The company is also exploring the opportunities to sell the building if it gets the reasonable amount in consideration.
Following information is relevant for Building A for the year ending 31st March, 20X2:
Building A was initially purchased at the cost of Rs. 10 crores. At that time, the useful life of the building was estimated to be 20 years; out of which 5 years have been expired as on 1st April, 20X1. The company follows straight line method for depreciation.
During the year, the company has invested in another Building B with the purpose to hold it for capital appreciation. The property was purchased on 1st April, 20X1 at the cost of Rs. 2 crores. Expected life of the building is 40 years. As usual, the company follows straight line method of depreciation.
Further, during the year 20X1-20X2 the company earned/incurred following direct operating expenditure relating to Building A and Building B:

Rental income from Building A	= Rs. 75 lakhs
Rental income from Building B	= Rs. 25 lakhs
Sales promotion expenses	= Rs. 5 lakhs
Fees & Taxes	= Rs. 1 lakhs
Ground rent	= Rs. 2.5 lakhs
Repairs & Maintenance	= Rs. 1.5 lakhs
Legal & Professional	= Rs. 2 lakhs

Commission and brokerage = Rs. 1 lakhs

The company does not have any restrictions and contractual obligations against Property - A and B. For complying with the requirements of Ind AS, the management sought an independent report from the specialists so as to ascertain the fair value of buildings A and B. The independent valuer has valued the fair value of property as per the valuation model recommended by International valuation standards committee. Fair value has been computed by the method by streamlining present value of future cash flows namely, discounted cash flow method.

The other key inputs for valuation are as follows:

The estimated rent per month per square feet for the period is expected to be in the range of Rs. 50 - Rs. 60. And it is further expected to grow at the rate of 10 percent per annum for each of 3 years. The weighted discount rate used is 12% to 13%.

Assume that the fair value of properties based on discounted cash flow method is measured at Rs. 10.50 crores. The treatment of fair value of properties is to be given in the financials as per the requirements of Indian accounting standards.

What would be the treatment of Building A and Building B in the balance sheet of Shaurya Limited? Provide detailed disclosures and computations in line with relevant Indian accounting standards. Treat it as if you are preparing a separate note or schedule, of the given assets in the balance sheet.

Question 22 – X Ltd.

X Ltd owned a land property whose future use was not determined as at 31 March 20X1. How should the property be classified in the books of X Ltd as at 31 March 20X1? During June 20X1, X Ltd commenced construction of office building on it for own use. Presuming that the construction of the office building will still be in progress as at 31 March 20X2

(a) How should the land property be classified by X Ltd in its financial statements as at 31 March 20X2?

(b) Will there be a change in the carrying amount of the property resulting from any change in use of the investment property?

(c) Whether the change in classification to, or from, investment properties is a change in accounting policy to be accounted for in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors?

(d) Would your answer to (a) above be different if there were to be a management intention to commence construction of an office building for own use; however, no construction activity was planned by 31 March 20X2?

Thanks ....