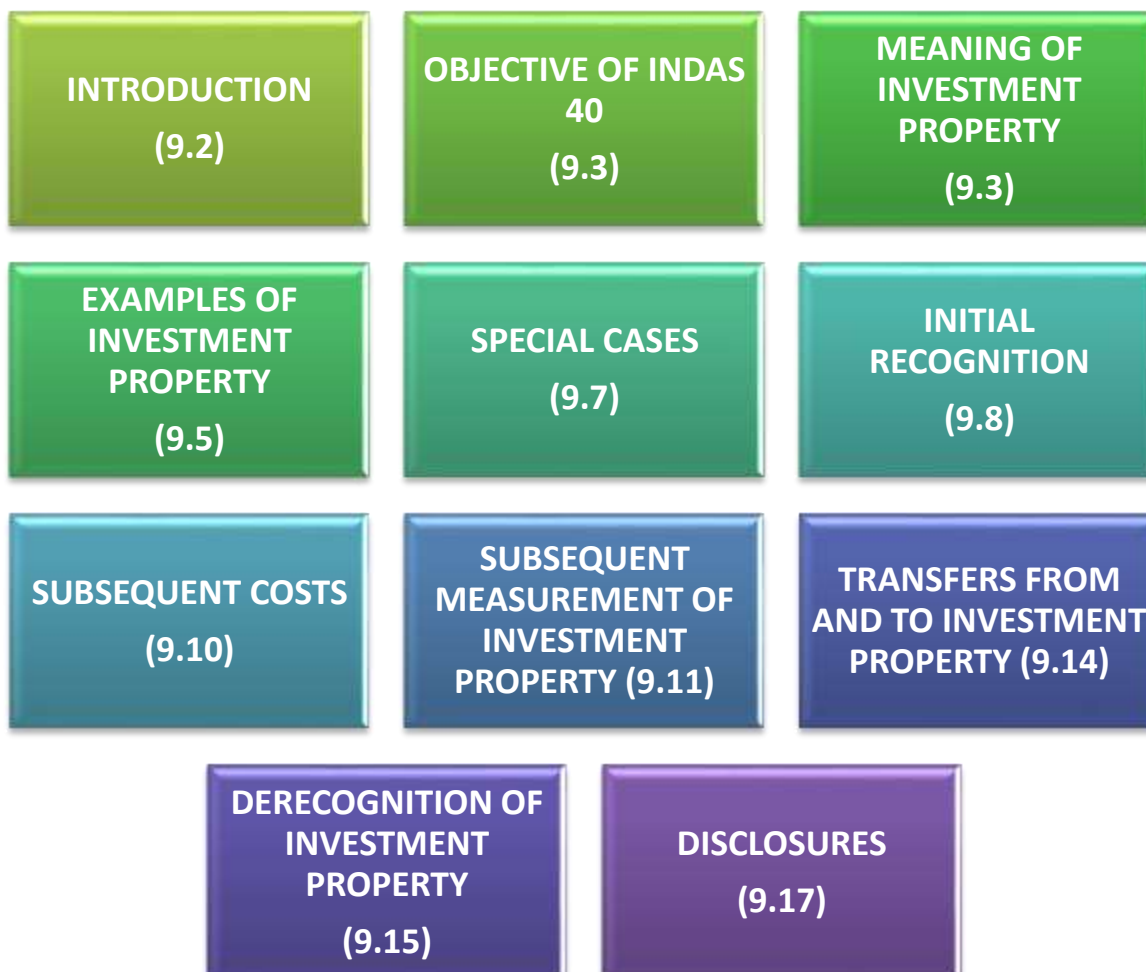


09

# INDAS 40 - INVESTMENT PROPERTY



**Quote:**

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

## 1. INTRODUCTION

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.

**Why there is need to develop separate standard when we already have INDAS 16 PPE?**

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.

## 2. OBJECTIVE OF INDAS 40

- A. To prescribe the **accounting treatment and disclosure with respect to investment property**.
- B. To prescribe the **Recognition, Measurement & Disclosure** requirements for Investment Property.
- C. This Standard does not apply to:
- **Biological assets related to agricultural activity (see Ind AS 41, Agriculture and Ind AS16 Property, Plant and Equipment); and**
  - **Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.**

**BUT, WHAT IS INVESTMENT PROPERTY? LET'S UNDERSTAND :-**

## 3. MEANING OF INVESTMENT PROPERTY

The investment property is a **LAND or a BUILDING (or a part of it)**, or both, held by:

- (a) **Owner; or**
- (b) **Lessee as a right of use asset**

for the following specific purposes:

- **To earn Rentals;**
- **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.**

### Author's Note:

Rental should not be the main revenue generating source of activity from that Land & Building.

### Understand the above definition in a simple manner:

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 (i.e. Business Purpose)
- For administrative purposes (i.e. Business Purpose), or
- For sale in ordinary course of business (i.e. Inventory), or
- 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 INDAS2 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 as a right-of-use asset) 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 as Right of Use Asset** (as per INDAS 116) and
- 3) The standard applied to lessor's financial statements of investment property provided to a lessee under an **operating lease**.

## 4. 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.
- Land held **for future undetermined use** (i.e. you don't know yet what you'll use it for. Whether it will be used as owner occupied property or for short-term sale in the ordinary course of business, it is not yet decided.).
- 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 as right of use asset) 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.

Land held as Short Term Investment and Planning to Sale in Near Future within 12 Months, then INDAS 105 will be applicable and not INDAS 40

**Jai Sir has taken Building on Lease for 99 years from Govt. Authorities**

**Apply IndAS 116 First, Jai Sir shall record ROU Asset.**

**Now, if Same Building is being used in Jai's Business -> IndAS 16 will be applied on ROU Asset**

**Now, if Building is not being used in Jai's Business -> Jai has leased it to other Party on:-**

**Finance Lease**  
ROU Asset will be de-recognised

**Operating Lease**  
IndAS 40 will be applicable on ROU Asset

No Question of Applicability of IndAS 40 & 16

**Jai sir took a Building on Lease. Building is not to be Used in Jai Sir Business. Jai Sir has Sub-let the same Building under operating Lease (Sub-letting is not Business Activity of Jai Sir)  
Which IndAS Jai Sir should apply?**

**Jai Sir First will apply IndAS 116  
&  
Record "Right of Use Asset"  
&  
Such ROU Asset is treated as  
Investment Property Under IndAS  
40**

**Important Conclusions:-**

1. Assets owned by Entity but given on Finance Lease - **IndAS 40 shall not apply**
2. Asset taken on Finance Lease by Entity and given on Operating Sub - Lease - **IndAS 40 shall apply.**
3. Asset owned by Entity and given on Operating Lease - **IndAS 40 shall apply.**
4. Asset taken by Entity on Operating Lease (i.e. Short Term Period) - **IndAS 40 may not apply.**

## 5. SPECIAL CASES

### A. PROPERTY HELD FOR MORE THAN ONE PURPOSE (Dual Use Property)

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 the two portions could not be sold separately:

- The property is treated as owner-occupied if a significant portion is held for own use.
- The property is treated as investment property only if an insignificant portion is held for own use.

#### Example 1

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. In the given scenario, the remaining 10 floors should be classified as investment property, since they are able to split the title between the floors.

#### Example 2

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.

Therefore, the company should not classify the property as an investment property as the 35% of the floor space used by the company is significant.

#### Example 3

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.

## B. 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.

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.

## C. 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.

### 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 Right of Use Asset and leased out under an Operating Lease	YES	Ind AS 40
3	Held under Right of Use Asset and leased out under an Finance Lease	No	Ind AS 116
4	Property acquired with a view for development or resale	No	Ind AS 2 & Ind AS 115
5	Property developed on behalf of 3 <sup>rd</sup> Party	No	IndAS 115
6	Property partly owner occupied and partly leased out under Operating Lease	Depends	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
10	Existing Investment Property that is being redeveloped for continued use as Investment Property.	Yes	Ind AS 40

## 6. 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.

An investment property held by a lessee as a right-of-use asset shall be recognised in accordance with Ind AS 116.

### 6.1 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.

### 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.

### 6.3 Investment Property acquired through Exchange of another Asset

**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 of Asset Given (1<sup>st</sup> Priority) or Asset Received (2<sup>nd</sup> Priority) 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 PPE acquired is **not** measured at Fair Value, its cost is measured at the **carrying amount of the asset given up**.

#### Example 4

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) (5,00,000 + 2,00,000)	Dr.	7,00,000	
To Cash			2,00,000
To PPE (Property, Plant and Equipment) i.e. Warehouse			5,00,000

**Note:** When the fair value of both the asset given up and acquired is mentioned, it is presumed that both the fair values are equally evident. In such a case, the fair value of the asset given up is considered as the cost of the asset purchased.

However, if the fair value of property acquired is more clearly evident, then the fair value of the asset acquired is considered. In such a situation, the Journal Entry at the time of acquisition (taking information given in the above example) would be

Investment Property (Building)	Dr.	8,00,000	
To Cash A/c			2,00,000
To PPE (Warehouse)			5,00,000
To Gain on Sale of PPE			1,00,000

## 7. SUBSEQUENT COSTS

Do Not Capitalise	Can be Capitalised
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.

## 8. 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 INDAS16.

However,

- Apply Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, if it meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale); or
- Apply Ind AS 116 if it is held by a lessee as a right-of-use asset and is not held for sale in accordance with Ind AS 105;

### (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 valuer 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.

#### Note:

When a lessee measures fair value of an investment property that is held as a right-of-use asset, it shall measure the right-of-asset, and not the underlying property at fair value.

### (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.

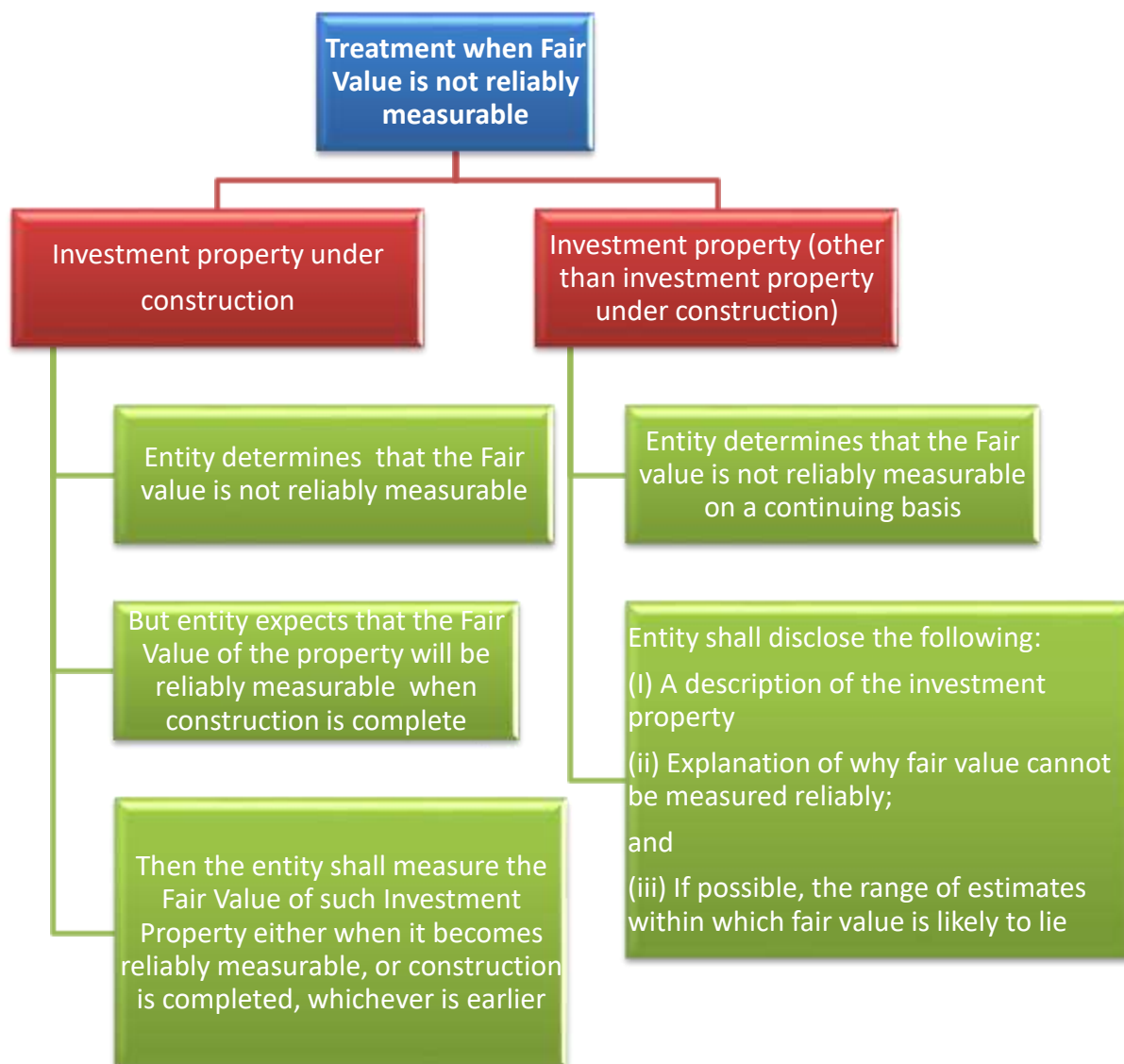
Above exception is available only when the investment property is first recognised as such. If an entity has previously measured the fair value of an investment property, it should continue to measure the fair value of that property until disposal (or until the property becomes owneroccupied property 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 AS40.



## 9. 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:

1. You start renting out the property that you previously used as your headquarters (transfer to investment property from owner-occupied property under INDAS 16)
2. You stop renting out the building and start using it for yourself
3. 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).
4. Commencement of owner-occupation, or of development with a view to owner-occupation, for a transfer from investment property to owner-occupied property;
5. Commencement of development with a view to sale, for a transfer from investment property to inventories;
6. End of owner-occupation, for a transfer from owner-occupied property to investment property;
7. 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

## 10. DERECOGNITION OF INVESTMENT PROPERTY

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

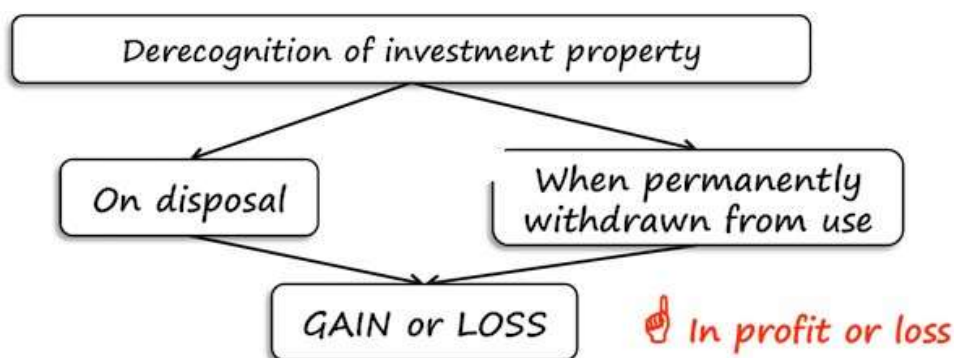
You can derecognize your investment property in two circumstances:

- 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**.



$$= \text{Net Disposal Proceeds} - \text{Carrying Amount}$$

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:

Items	Treatment
Impairments of investment property	Recognised in accordance with Ind AS 36
Retirements or disposals of investment property	Recognised in accordance with Ind AS 40
Compensation from third parties for investment property that was impaired, lost or given up	Recognised in profit or loss when it becomes receivable
The cost of assets restored, purchased or constructed as replacements	Determined in accordance with Ind AS 40

### Example 5:

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

## 11. 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.
- ❖ 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.



Student Notes:-



Student Notes:-

# CHAPTER - 6

## INDAS 40 - INVESTMENT PROPERTY

### **Total No. of Questions: 16**

	<b>TOPIC NAME</b>	<b>PAGE. NO.</b>
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## IDENTIFYING INVESTMENT PROPERTY

### **Q.INDAS40.SM.101:**

*Dodd's Ltd acquired a property by way of a 20 year lease on 1 August 20X3. The company split the property into 30 units and immediately began to market each separate floor to small businesses as available to let on short-term leases. By the end of November just six units had been sublet and as an incentive to attract more tenants, Dodd's offered to provide certain services to its tenants. These services included security, maintenance, a central reception function and a secretarial function. These services were extended to the existing tenants. This is a departure from the normal business model of Dodd's Ltd and required the company to recruit a number of staff to work at the property and occupy two of the empty units. By the year-end of 31 December 20X3, a further 10 units had been sublet.*



*Discuss whether the property is an investment property.*

### **SOLUTION**

- An investment property is property which is held to earn rentals or for capital appreciation or both rather than for use in the production or supply of goods or services or for administrative purposes or for sale in the ordinary course of business.
- The property is held as a right-of-use asset under a lease in accordance with IndAS 116; this is not relevant to its possible classification as an investment property as IndAS 40 does not require an investment property to be owned.
- The property is available to let under short-term (operating) leases, and therefore meets the basic definition of an investment property.
- From 1 August 20X3 to the end of November the 30 individual units are either let or available to let without the provision of any ancillary services. Therefore for this time the property is classified as investment property.
- From the end of November to 31 December 20X3, ancillary services are provided to all existing and prospective tenants. The question is whether these ancillary services are significant to the arrangement as a whole. If they are, then the property is classified as owner-occupied; if they are not then the property is classified as investment property.
- Based on the information, the services provided appear to be significant. Dodd's Ltd is required to recruit a number of additional staff and certain services provided are core to the operation of tenants' businesses.
- Therefore it should be concluded that the property is owner-occupied from the end of November and it should be accounted for in accordance with IndAS 16 *Property, Plant and Equipment*.

### **Q.INDAS40.OM.102: (Singapore CA)**

- (a) *Geylang Electrical owns a piece of land. The directors have not yet decided whether to build a factory on it for use in its business or to keep it and sell it when its value has risen.*
- (b) *Somerset Trading owns a building which is currently vacant. The company intends to lease each floor of the building out under a separate operating lease.*
- (c) *Somerset Trading also owns a building which it leases to its subsidiary company, Devon Lighting.*



*Would these be classified as investment properties under INDAS 40?*

### **SOLUTION**

- (a) Yes. If an entity has not determined that it will use land either as an owner-occupied property or for short-term sale in the ordinary course of business, the land is considered to be held for capital appreciation.
- (b) Yes. A building which is vacant but is held to be leased out under one or more operating leases is investment property.
- (c) The building is an investment property in Somerset Trading's separate financial statements, however in the Somerset Trading consolidated financial statements this is owner-occupied property.

**Q.INDAS40.RMP.103: (RTP Nov 22)**

*An entity owns a two-storey building. Floor 1 is rented out to independent third parties under operating leases. Floor 2 is occupied by the entity's administration and maintenance staff. The entity can measure reliably the fair value of each floor of the building without undue cost or effort. How the same will be classified / presented in the balance sheet as per relevant Ind AS. What will be the accounting treatment as per relevant Ind AS on initial and subsequent date?*

**SOLUTION**

Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) 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 Property mentioned in (a) above would be covered under Ind AS 16 'Property, Plant and Equipment'.

On applying the above provisions, Floor 1 of the building is classified as an item of investment property by the entity (lessor) because it is held to earn rentals. Ind AS 40 is applicable in this case. An investment property should be measured initially at its cost. After initial recognition, an entity shall measure all of its investment properties in accordance with Ind AS 16's requirements for cost model. However, 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.

Floor 2 of the building will be classified as property, plant and equipment because it is held by administrative staff i.e., it is held for use for administrative purposes. Ind AS 16 is applicable in this case. An item of property, plant and equipment that qualifies for recognition as an asset should be initially measured at its cost. After recognition, an entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment.

## COST & CARRYING AMOUNT OF INVESTMENT PROPERTY

### **Q.INDAS40.SM.201:**

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:**

As per Ind AS 40, 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).

Accordingly, cost of the Building is arrived at as under:

Particulars	Amount in Rs.	Total Rs.
Purchase price		30,00,000
Add: Property transfer taxes		1,00,000
Direct legal costs		20,000
Purchase price		2,00,000
Construction costs	7,00,000	
Less: Refundable purchase taxes	40,000	6,60,000
<b>Cost of the Building as per Ind AS 40</b>		<b>39,80,000</b>

### **Q.INDAS40.SM.202:**

Netravati Ltd. purchased a commercial office space as an Investment Property, in the Global Trade Centre Commercial Complex, for ₹ 5 crores. However, for purchasing the same, the Company had to obtain membership of the Global Trade Centre Commercial Complex Association by paying ₹ 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 ₹ 5 crores. Advice. Would you answer change if the office space was purchased with the intention of using it as an administrative centre of the company?



### **SOLUTION**

#### **Cost of Investment Property**

As per Ind AS 40, 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). Accordingly, on initial recognition, the one-time joining fee of ₹ 6,25,000 should be added to the purchase price. Therefore, the investment property should be measured at ₹ 5,06,25,000 (i.e. cost of the commercial office space + one-time joining fee). Writing off the amount of ₹ 6,25,000 to the P&L is not appropriate.

#### **Use as Administrative Office**

If the property is used as an administrative center, it is not an investment property, but rather an 'owner occupied property'. Hence, Ind AS 16 will be applicable. Even under Ind AS 16, all direct costs relating to the acquisition of the asset should be added to the purchase price. Hence, cost of the asset under Ind AS 16 would be ₹ 5,06,25,000.

### **Q.INDAS40.SM.203:**

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.

**Q.INDAS40.SM.204:**

Sun Ltd acquired a building in exchange of a warehouse. The Carrying amount of warehouse as well as Fair Value is 3,50,000 & ₹ 5,00,000 respectively. Sun Ltd. made a 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.

**SOLUTION:**

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) A/c	Dr.	7,00,000	
To Cash A/c			2,00,000
To PPE (Warehouse) A/c			3,50,000
To Gain on Exchange (P&L) A/c			1,50,000

**Q.INDAS40.SM.205:**

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.

**Q.INDAS40.SM.206:**

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.

**Q.INDAS40.SM.207:**

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 × 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.

### **Q.INDAS40.SM.208: (SIMILAR TO RTP - Nov 20 & MTP March 21)**

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 purchased 5 years ago at the cost of ₹ 10 crores and building life is estimated to be 20 years. 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 ₹ 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	= ₹ 75 lakhs
Rental income from Building B	= ₹ 25 lakhs
Sales promotion expenses	= ₹ 5 lakhs
Fees & Taxes	= ₹ 1 lakhs
Ground rent	= ₹ 2.5 lakhs
Repairs & Maintenance	= ₹ 1.5 lakhs
Legal & Professional	= ₹ 2 lakhs
Commission and brokerage	= ₹ 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 ₹ 50 - ₹ 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 ₹ 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.

**SOLUTION:**

Investment property is held to earn rentals or for capital appreciation or both. Ind AS 40 shall be applied in the recognition, measurement and disclosure of investment property. An investment property shall be measured initially at its cost. After initial recognition, an entity shall measure all of its investment properties in accordance with Ind AS 16's requirements for cost model.

The measurement and disclosure of Investment property as per Ind AS 40 in the balance sheet would be depicted as follows:

**Investment Properties:**

Particulars	Period ended 31 <sup>st</sup> March 20X2 (Rs. in crores)
Gross Amount	
Opening Balance (A)	10
Additions during the year (B)	2
Closing balance (C) = (A) + (B)	12
Depreciation	
Opening Balance (D)	2.50
Depreciation during the year € (0.5 + 0.5)	0.55
Closing balance (F) = (D) + (E)	3.05

The changes in the carrying value of investment properties for the year ended 31<sup>st</sup> March, 20X2 are as follows:

**Amount recognised in Profit and Loss with respect to Investment Properties**

Particulars	Period ended 31 <sup>st</sup> March 20X2 (Rs. in crores)
Rental income from investment properties (0.75 + 0.25)	1.00
Less: Direct operating expenses generating rental income (5+1+2.5+1.5+2+1)	-0.13
Profit from investment properties before depreciation and indirect expenses	0.87
Less: depreciation	-0.55
Profit from earnings from investment properties	0.32

**Disclosure Note on Investment Properties acquired by the entity**

The investment properties consist Property A and Property B. As at March 31, 20X2, the fair value of the properties is ₹ 10.50 crores. The valuation is performed by independent valuers, who are specialists in valuing investment properties. A valuation model as recommended by International Valuation Standards Committee has been applied. The Company considers factors like management intention, terms of rental agreements, area leased out, life of the assets etc. to determine classification of assets as investment properties.

The Company has no restrictions on the realisability of its investment properties and no contractual obligations to purchase, construct or develop investment properties or for repairs, maintenance and enhancements.

Description of valuation techniques used and key inputs to valuation on investment properties:

Valuation technique	Significant unobservable inputs	Range (Weighted average)
Discounted cash flow (DCF) method	Estimated rental value per sq. ft. per month	Rs. 50 to Rs. 60
	- Rent growth per annum	- 10% every 3 Years
	- Discount rate	- 12% to 13%

## RECLASSIFICATION

### **Q.INDAS40.SM.301:**

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.

### **SOLUTION:**

	<b>(In Million)</b>
Carrying amount of the building after depreciation of 4 years (10-10/10*4)	<b>6</b>
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)	<b>6</b>

### **Q.INDAS40.SM.302:**

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.

### **Q.INDAS40.SM.303: (SIMILAR TO RTP MAY 18)**

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 ₹ 2,00,00,000 and immediately began to lease the property to Y Ltd. on an operating lease. Annual rentals were ₹ 20,00,000. On 31st March, 20X5, the fair value of the property was ₹ 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 ₹ 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 ₹ 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 ₹ 40,00,000 to complete the project, after which each flat could be sold for ₹ 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.



**SOLUTION:**

From 1st April, 20X1, 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 ₹ 2,00,00,000 at each year end.

On 30th September, 20X5, the property ceases to be an investment property. X Ltd. begins to develop it for sale as flats.

As per para 59 of 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. Hence, the carrying value of the reclassified property will be ₹ 2,00,00,000.

Since the lease of the property is an operating lease, rental income of ₹ 10,00,000 ( $₹ 20,00,000 \times 6/12$ ) would be recognised in P/L for the year ended 31st March, 20X6.

The additional costs of ₹ 60,00,000 for developing the flats which were incurred up to and including 31st March, 20X6 would be added to the 'cost' of inventory to give a closing cost of ₹ 2,60,00,000.

The total selling price of the flats is expected to be ₹ 5,00,00,000 ( $10 \times ₹ 50,00,000$ ). Since the further costs to develop the flats total ₹ 40,00,000, their net realisable value is ₹ 4,60,00,000 ( $₹ 5,00,00,000 - ₹ 40,00,000$ ), so the flats will be measured at a cost of ₹ 2,60,00,000.

The flats will be shown in inventory as a current asset.

**MIXED & MISC. CATEGORY****Q.INDAS40.SM.401: (SIMILAR TO RTP May21 & EXAM MAY22 & MTP****May23)**

*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?*

**SOLUTION:**

As per paragraph 8(b) of Ind AS 40, any land held for currently undetermined future use, should be classified as an investment property. Hence, in this case, the land would be regarded as held for capital appreciation. Hence the land property should be classified by X Ltd as investment property in the financial statements as at 31 March 20X1.

As per Para 57 of the Standard, an entity can change the classification of any property to, and from, an investment property when and only when evidenced by a change in use. A change occurs when the property meets or ceases to meet the definition of investment property and there is evidence of the change in use. Mere management's intention for use of the property does not provide evidence of a change in use.

- (a) Since X Ltd has commenced construction of office building on it for own use, the property should be reclassified from investment property to owner occupied as at 31 March 20X2.
- (b) As per Para 59, transfers between investment property, owner occupied and inventories do not change the carrying amount of the property transferred and they do not change the cost of the property for measurement or disclosure purposes.
- (c) No. The change in classification to, or from, investment properties is due to change in use of the property. No retrospective application is required and prior period's financial statements need not be re-stated.
- (d) Mere management intentions for use of the property do not evidence change in use. Since X Ltd has no plans to commence construction of the office building during 20X1-20X2, the property should continue to be classified as an investment property by X Ltd. in its financial statements as at 31 March 20X2.

**Note: The answer to the above is as per ICAI Module. However, Different opinion exist and the property can be reclassified as PPE.**

**Q.INDAS40.RMP.402: (MTP Aug18)**

*UK Ltd. has purchased a new head office property for Rs. 10 crores. The new office building has 10 floors and the organization structure of UK Ltd. is as follows:*



Floor	1 <sup>st</sup>	2 <sup>nd</sup>	3 <sup>rd</sup>	4 <sup>th</sup>	5 <sup>th</sup>	6 <sup>th</sup>	7 <sup>th</sup>	8 <sup>th</sup>	9 <sup>th</sup>	10 <sup>th</sup>
Use	Waiting Area	Admin	HR	Accounts	Inspection	MD Office	Canteen	Vacant		

*Since UK Ltd. did not need the floors 8, 9 and 10 for its business needs, it has leased out the same to a restaurant on a long-term lease basis. The terms of the lease agreement are as follows:*

- *Tenure of Lease Agreement - 5 Years*
- *Non-Cancellable Period - 3 years*
- *Lease Rent - annual lease rent receivable from these floors are Rs. 10,00,000 per floor with an escalation of 5% every year.*

Based on the certificate from its architect, UK Ltd. has estimated the cost of the 3 top floors as approximately Rs. 3 crores. The remaining cost of Rs. 7 crores can be allocated as 25% towards Land and 75% towards Building.

As on 31st March, 2018, UK Ltd. obtained a valuation report from an independent valuer who has estimated the fair value of the property at Rs. 15 crores. UK Ltd. wishes to use the cost model for measuring Property, Plant & Equipment and the fair value model for measuring the Investment Property. UK Ltd. depreciates the building over an estimated useful life of 50 years, with no estimated residual value.

Advise UK Ltd. on the accounting and disclosures for the above as per the applicable Ind AS.

### SOLUTION

- (a) Ind AS 16 'Property, Plant and Equipment' states that property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.
- (b) As per Ind AS 40 'Investment property', investment property is a property held to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes or sale in the ordinary course of business.
- (c) Further, as per Ind AS 40, the building owned by the entity and leased out under one or more operating leases will be classified as investment property. Here the top three floors have been leased out for 5 years with a non-cancellable period of 3 years. The useful life of the building is 50 years. The lease period is far less than the useful life of the building leased out. Further, the lease rentals of three years altogether do not recover the fair value of the floors leased i.e.  $15 \text{ crore} \times 30\% = 4.50 \text{ crore}$ . Hence the lease is an operating lease. Therefore, the 3 floors leased out as operating lease will be classified as investment property in the books of lessor i.e. UK Ltd.
- (d) However, for investment property, Ind AS 40 states that an entity shall adopt as its accounting policy the cost model to all of its investment property. Ind AS 40 also requires that an entity shall disclose the fair value of such investment property (ies).

(In crore)

	PPE (70%)		Investment property (30%)	Total
	Land (25%)	Building (75%)		
Cost	1.75	5.25	3	10
FV	2.625	7.875	4.5	15
Valuation model followed	Cost	Cost	Cost	
Value recognized in the books	1.75	5.25	3	
Less: Depreciation	Nil	$(5.25/50) = 0.105 \text{ crore}$	$(3/50) = 0.06$	
Carrying value as on 31st March, 2018	1.75	5.145	2.94	
<b>Impairment loss</b>	<b>No impairment loss since fair value is more than the cost</b>			

**Note-** Do not get confused over here.

Ind AS 40 will classify an asset. Ind AS 116 will do the recognition and accounting for that asset after it is classified as a leasehold property according to Ind AS 40.



**Student Notes:-**