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ASPE - IFRS: A Comparison

Investment Property

In this publication we will examine the key differences between Accounting Standards for Private Enterprises (ASPE) and International Financial Reporting Standards (IFRS) related to investment property with a focus on:

- What types of properties are in the scope of IAS 40 - Investment Property; and
- How to measure investment property on and after initial recognition.

References

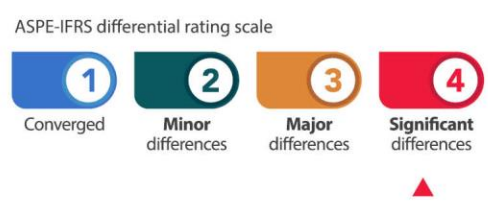
ASPE	IFRS
• Section 3061 - *Property, Plant and Equipment*	• IFRS 13 – *Fair Value Measurement* • IFRS 16 – *Leases* • IAS 16 - *Property, Plant and Equipment* • IAS 17 - *Leases* • IAS 40 - *Investment Property*

Overview of Major Differences

IFRS and ASPE are significantly different in terms of the treatment of investment property. These differences include:

- Under IFRS, investment property is accounted for in accordance with its own standard IAS 40. While under ASPE, investment property does not have a separate standard, but instead is accounted for with property, plant and equipment under Section 3061.

- Under ASPE, investment property is measured at cost on initial and subsequent recognition. While under IFRS an entity has an accounting policy choice to measure investment property at either cost or fair value after initial recognition.



Scope & Classification

Under IFRS investment property is defined as property (land or a building - or part of a building - or both) held (by the owner or by the lessee under a finance lease/as a right-of-use asset[1]) to earn rental income or for capital appreciation (or both), rather than for the entity's own use (in the production or the supply of goods and services or for administrative purposes) or for sale in the ordinary course of business. No definition is provided for investment property under ASPE.

Where an entity looks for guidance on accounting for investment property is very different under IFRS and ASPE. Investment property has is its own standard, IAS 40, under IFRS. However, under ASPE, investment property is not differentiated from property, plant and equipment accounted for under Section 3061.

Under IFRS, determining whether property held is investment property which is within the scope of IAS 40 or is owner-occupied property or something else which is outside the scope of IAS 40 is a key classification decision. Investment property is held to earn rentals or for capital appreciation or both. As a result, an investment property generates cash flows largely independently of the other assets an entity holds. This helps distinguish investment property from owner-occupied property which is held for use in the production or supply of goods or services or for administrative purposes and is accounted for under IAS 16. 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 the property, but also to other assets used in the production or supply process.

The make-up and use of property can vary from one entity to another entity, making it difficult for some entities to determine practically whether IAS 40 is applicable or whether another standard, such as IAS 16 is applicable. For example, in a situation where an entity holds a residential rental property and decides to hold the property until the current tenant moves out and then sell the property, determining whether this is investment property or property held for sale will depend on the circumstances specific to the entity.

To assist entities in understanding whether property held is covered by IAS 40 or another standard, IAS 40 provides some examples of the types of property that are within its scope and should be classified as investment property. These are:

- Land or buildings held for long-term capital appreciation rather than for short-term sale in the ordinary course of business;
- Land held for a currently undetermined future use (if an entity has not determined that it will use the land as owner-occupied property or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation);
- A building owned (or held by the entity under finance lease/a right-of-use asset relating to a building held by the entity) and leased out under operating leases;
- A vacant building that is held to be leased out under operating leases; and
- Property that is being constructed or developed for future use as investment property.

The standard also includes property interests that are held by a lessee under an operating lease under IAS 17, but only if that property would otherwise meet the definition of an investment property and the lessee uses the fair value model for the asset recognized. This type of lease is commonly found in Europe, where land in many cases cannot be purchased freehold. Instead, land is transferred by way of a 100 year land lease. Under ASPE Section 3061, property held by a lessee under an operating lease cannot be recognized as an asset on the balance sheet. Under IFRS 16 there is no concept of operating leases; all leases (with limited exception), are recognized on the balance sheet.

IAS 40 also provides guidance on the types of property that are outside its scope and are to be accounted for in accordance with another IFRS. These types of property include:

[1] At the time of the writing of this publication IAS 17 – *Leases* is still in effect and its impact on IAS 40 has been reflected in this publication. This publication also explains the impact of IFRS 16 – *Leases,* that will be effective for annual reporting periods beginning on or after January 1, 2019 and is available for early adoption, on IAS 40

- Property intended for sale in the ordinary course of business or in the process of construction / development for such sale. For example, property acquired exclusively with a view to subsequent resale or development should be accounted for in accordance with IAS 2 - Inventories (e.g. at the lower of cost or net realizable value). Under ASPE such property would be accounted for under Section 3031 - Inventories;
- Owner-occupied property, including property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees (whether or not the employees pay market rent) and owner-occupied property awaiting disposal should be accounted for in accordance with IAS 16 (e.g. at amortized cost or revalued amount). Under ASPE such property would be accounted for Under Section 3061; and
- Property leased to another party under a finance lease.

Dual Use Properties

Another example of where the uncertainly mentioned above can arise under IFRS is illustrated when looking at properties that have dual use. For a property that has a part held for rental income or capital appreciation and another part that is held for the entities own use (for example, multiple floors of a building), is this property accounted for in accordance with IAS 40 or IAS 16, or both?

When accounting for investment property, where the parts held could be sold separately (or leased out separately under a finance lease) the entity is required to separate the property into an investment property part and another asset part (e.g. property, plant and equipment). When an entity cannot meet the separate sale requirement the entity may still be required to record and apply IAS 40 to the property, rather than account for it under IAS 16, if the part held for its own use is only an insignificant part of the total property. The standard does not provide guidance on what would be deemed an insignificant part, however, five percent of the total property is typically used as a practical guide.

Under ASPE the entire property would be accounted for under Section 3061.

Ancillary Services

Another example of where the uncertainty above may arise is for entities that provide services to occupants of a property. IAS 40 terms these services as ‘ancillary services’ and requires the property to be treated as an investment property in accordance with the standard, only if the services are insignificant to the arrangement as a whole. Again, the standard does not define what constitutes insignificant, however, it does provide two extreme examples for guidance: i) an owner managed hotel and ii) an office building for which security and maintenance services are provided. In the first example, the hotel is not classified as an investment property because the services provided are a significant component of the arrangement. In the second example, the office building is an investment property because these ancillary services are an insignificant component of the arrangement.

Under ASPE the property is accounted for under Section 3061 regardless of the services provided.

Recognition

At Recognition

Similar to how a property of this type would be recorded under ASPE Section 3061, investment property under IAS 40 is initially recognized at cost, which is comprised of the purchase price and directly attributable expenses, including transaction costs.

Under IAS 40, the initial cost of an investment property interest held by a lessee is the same as required for a finance lease under IAS 17 / a right-of-use asset under IFRS 16.

Under IAS 40 and under ASPE when an investment property is acquired in exchange for a non-monetary asset the cost of the investment property is measured at the fair value of the asset given up unless the fair value of the asset received is more clearly evident.

After Recognition

How the property is accounted for subsequent to initial recognition may be very different between IFRS and ASPE.

Under ASPE Section 3061 this type of property would continue to be measured at cost, less accumulated depreciation and any accumulated impairment losses. However, under IFRS subsequent to initial recognition IAS 40 requires an entity to make an accounting policy choice on how to account for the investment property. The investment property may be recorded at either:

a) Cost, less accumulated depreciation and any accumulated impairment losses, as prescribed by IAS 16 or for property held by a lessee as a right-of-use asset in accordance with IFRS 16; or
b) Fair value at each reporting date, with any gain or loss arising from the change in fair value recognized in profit and loss in the period it arises.

Generally an entity is required to consistently apply the chosen measurement model to all investment property held. There are a limited number of very specific exceptions to this rule. One such exception is that a property interest held by a lessee under an operating lease in accordance with IAS 17 that is classified as investment property must be measured at fair value.

Cost Method

While an entity has an option to use the cost method, using this method might still result in a different accounting treatment as to how the property is accounted for under ASPE, since the IFRS property, plant and equipment requirements and lease requirements are not exactly the same as those under ASPE. Please refer to our IFRS-ASPE Comparison Series publications on Property, Plant and Equipment and Leases which covers the specific differences in detail.

Looking at the two accounting policy choices discussed above, an entity following IFRS may believe that adopting the cost method would require less work. However, this may not actually be the case. Under the disclosure requirements of IAS 40, an entity that adopts the cost method is still required to disclose the fair value of the investment property, or in the very limited circumstances set out in the standard where the fair value cannot be reliably determined, a description of the investment property, an explanation of why the fair value cannot be reliably determined and an estimate (if possible) of the range in which the fair value is likely to be. So an entity that chooses the cost method is still required to gather fair value information. No such disclosure is required under ASPE Section 3061.

Fair Value Method

IAS 40 defines the fair value as “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”. The requirements on how to determine and account for investment property using the fair value method are set out in the standard.

When measuring the fair value of investment property in accordance with IFRS 13, an entity ensures that the fair value reflects the rental income from current leases and other assumptions that market participants would use when pricing investment property under current market conditions.

IAS 40 provides a rebuttable presumption that an entity can reliably determine fair value. However, in exceptional cases where the market for comparable properties is inactive (for example, 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 estimates of fair value (for example, based on discounted cash flow projections) are not available, the entity shall measure that investment property using the cost model in IAS 16 for owned investment property or in accordance with IFRS 16 for investment property held by a lessee as a right-of-use asset until disposal of the investment property. Note that this determination must be made at the time the investment property is initially recognized. The exemption is unable to be used in the future, even where comparable market transactions become less frequent or market prices become less readily available.

When determining fair value, another key consideration is ensuring that assets and liabilities are not double counted. The standard provides some examples to help illustrate this issue. In one example, equipment that is an integral part of the building, such as elevators or air-conditioning are generally included in the fair value of the investment property, rather than separately recorded as property, plant and equipment. Another example relates to the lease of a property on a furnished basis. In this situation, the value of the furniture will usually be included in the fair value determination of the property, as the rental income relates to the furnished property.

One of the major impacts of choosing the fair value method is the volatility of reported earnings. Under this method any gains or losses arising from the change in fair value of the investment property must be recognized in profit and loss in the period that the gain or loss arises. In addition, no depreciation is recognized. In contrast under the cost method, assuming a property is not sold in a reporting period, an entity records the property at cost, with amortization of the property value over its useful life being the impact on earnings in each period.

Transfers

Under IFRS, transfers into or out of the investment property category are only made when there is a change in use that is evidenced by one of the following:

- Commencement of 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; or
- Commencement of an operating lease to another party, for a transfer from inventories to investment property.

Paragraphs IAS 40.59-.65 provide further guidance on recognition and measurement issues that occur in the above situations when using the cost or fair value methods.

Under ASPE, since investment property is accounted for as property, plant and equipment there are no transfers into or out an investment property category. However, if there is a change in use of the property (for example deciding to sell the asset), determining whether it would still be accounted for under Section 3061 or would be accounted for under another Section would depend on the specific facts and circumstances of the entity’s situation.

Disposals

Under IAS 40, an investment property is derecognized when it is disposed of or when it is permanently withdrawn from use and no future economic benefits are expected from its disposal. Any gain or loss, calculated as the difference between the net disposal proceeds and the carrying amount of the investment property, is recognized in profit or loss at the time of the retirement or disposal of the property. Any compensation from third parties for investment property that was impaired, lost or given up is recognized in profit or loss when the compensation becomes receivable.

Similarly, a gain or loss incurred on disposal of such a property would be calculated and treated the same way under ASPE Section 3061.

Conclusion

As can be seen from the discussion above, significant differences exist in the way investment property is accounted for under ASPE and IFRS. The most notable difference being that under IFRS a separate standard exists which provides specific guidance on accounting for investment property. If you require further guidance on accounting for investment properties under ASPE or IFRS please contact your local BDO Canada LLP office. If you are considering the adoption of a new standard, learn how our BDO Integrated Advisory Services Team can help you with the transition.

To learn more about the differences between standards, view our ASPE-IFRS: A Comparison Series.

The information in this publication is current as of April 15th, 2016.