INDAS – 40
INVESTMENT PROPERTY

(TOTAL NO. OF QUESTIONS – 7)

INDEX

RTPs QUESTIONS

Q1 (MAY 18)

X Ltd. is engaged in the construction industry and prepares its financial statements up to 31st March each year. On 1st April, 2013, 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, 2017, 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, 2017 and vacated the property on 30th September, 2017. On 30th September, 2017, the fair value of the property was Rs. 2,90,00,000. On 1st October, 2017, X Ltd. immediately began to convert the property into ten separate flats of equal size which X Ltd. intended to sell in the ordinary course of its business. X Ltd. spent a total of Rs. 60,00,000 on this conversion project between 30th September, 2017 to 31st March, 2018. The project was incomplete at 31st March, 2018 and the directors of X Ltd. estimate that they need to spend a further Rs. 40,00,000 to complete the project, after which each flat could be sold for Rs. 50,00,000.
Examine and show how the three events would be reported in the financial statements of X Ltd. for the year ended 31st March, 2018. as per Ind AS

SOLUTION

From 1st April, 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 Rs. 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 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 Rs. 2,00,00,000.

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

The additional costs of Rs. 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 Rs. 2,60,00,000.

The total selling price of the flats is expected to be Rs. 5,00,00,000 (10 x Rs. 50,00,000). Since the further costs to develop the flats total Rs. 40,00,000, their net realizable value is Rs. 4,60,00,000 (Rs. 5,00,00,000 – Rs. 40,00,000), so the flats will be measured at a cost of Rs. 2,60,00,000. (cost or NRV, whichever is lower)

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

Q2 (RTP - Nov. 20 & MTP March 21)

Shaurya Limited owns 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, 2020:

Building A was purchased 5 years ago at the cost of Rs.10 crore and building life is estimated to be 20 years. The company follows a 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, 2019 at the cost of Rs. 2 crore. Expected life of the building is 40 years. As usual, the company follows a straight line method of depreciation.

Further, during the year 2019-2020, the company earned / incurred following direct operating expenditure relating to Building A and Building B:

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

The company does not have any restrictions and contractual obligations against buildings - 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 the 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. 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 crore on 31st March, 2020.

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 the requirement of Ind AS 16 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 31st March, 2020 (Rs. in crore)
Gross Amount:	
Opening balance (A)	10.00
Additions during the year (B)	2.00
Closing balance (C) = (A) + (B)	12.00
Depreciation:	
Opening balance (D) (10 / 20 x 5yrs)	2.50
Depreciation during the year (E) (0.5 + 0.05)*	0.55
Closing balance (F) = (D) + (E)	**3.05**
Net balance (C) - (F)	**8.95**

* depreciation on A + depreciation on B

The changes in the carrying value of investment properties for the year ended 31st March, 2020 are as follows:

Amount recognised in Profit and Loss with respect to Investment Properties

Particulars	Period ending 31st March, 2020 (Rs. in crore)
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 before indirect expenses	**0.32**

Disclosure Note on Investment Properties acquired by the entity

The investment properties consist Property A and Property B. As at 31st March, 2020, the fair value of the properties is Rs.10.50 crore. The valuation is performed by independent valuers, who are specialists in valuing investment properties. A valuation model as recommended by the 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 - Rent growth per annum - Discount rate	- Rs. 50 to Rs. 60 - 10% every 3 years - 12% to 13%

Q3 (May. 21)

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 an office building on it for its 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 Ind AS 40, any land held for currently an 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 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 an office building on it for its own use, the property should be reclassified from investment property to owner occupied as at 31 March 20X2.*

(b) *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 restated.*

(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.*

MTPs QUESTIONS

Q4 (Aug.18 – 10 Marks)

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	1st	2nd	3rd	4th	5th	6th	7th	8th	9th	10th
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 crore x 30% = 4.50 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 ie. 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 crore	(3/50) = 0.06	
Carrying value as on 31st March, 2018	1.75	5.145	2.94	
Impairment loss	**No impairment loss since fair value is more than the cost**			

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.

QUESTIONS FROM PAST EXAM PAPERS

Q5 (Jan 21 – 5 Marks) (Mixed of IndAS 16 & IndAS 40)

On 1st April 2019, an entity purchased a building for Rs. 50,00,000 and paid a non-refundable property transfer tax and direct legal cost of Rs. 2,50,000 and Rs. 50,000 respectively while acquiring the building.

During 2019, the entity redeveloped the building into a two-storey building. Expenditures on re-development were:

- *Rs. 1,00,000 Building plan approval;*
- *Rs. 10,00,000 construction costs (including Rs. 60,000 refundable purchase taxes); and*
- *Rs. 40,000 due to abnormal wastage of material and labour.*

When the re-development of the building was completed on 1st October 2019, the entity rented out Ground Floor of the building to its subsidiary under an operating lease in return for rental payment. The subsidiary uses the building as a retail outlet for its products. The entity kept the first floor for its own administration and maintenance staff usage. Equal value can be attributed to each floor.

How will the entity account for all the above-mentioned expenses in the books of account?

Also, discuss how the above building will be shown in the Consolidated financial statement of the entity as a group and in its separate financial statements as per relevant Ind AS.

SOLUTION

In accordance with Ind AS 16, all costs required to bring an asset to its present location and condition for its intended use should be capitalised. Therefore, the initial purchase price of the building would be:

Particulars	Amount Rs.
Purchase amount	50,00,000
Non-refundable property tax	2,50,000
Direct legal cost	50,000
	53,00,000
Expenditures on redevelopment:	
Building plan approval	1,00,000
Construction costs (10,00,000 – 60,000)	9,40,000
Total amount to be capitalised at 1st October 2019	**63,40,000**

Treatment of abnormal wastage of material and labour:

As per Ind AS 16, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset.

It will be charged to Profit and Loss in the year it is incurred.

Hence, abnormal wastage of Rs. 40,000 will be expensed off in Profit & Loss in the financial year 2019-2020.

Accounting of property- Building

When the property is used as an administrative centre, it is not an investment property, rather it is an 'owner occupied property'. Hence, Ind AS 16 will be applicable.

When the property (land and/or buildings) is held to earn rentals or for capital appreciation (or both), it is an Investment property. Ind AS 40 prescribes the cost model for accounting of such investment property.

Since equal value can be attributed to each floor, Ground Floor of the building will be considered as Investment Property and accounted as per Ind AS 40 and First Floor would be considered as Property, Plant and Equipment and accounted as per Ind AS 16.

Cost of each floor = Rs.63,40,000 / 2 =Rs. 31,70,000

As on 1st October 2019, the carrying value of building vis-à-vis its classification would be as follows:

(i) In Separate Financial Statements: The Ground Floor of the building will be classified as investment property for Rs. 31,70,000, as it is property held to earn rentals. The First Floor of the building will be classified as an item of property, plant and equipment for Rs. 31,70,000.

(ii) In Consolidated Financial Statements: The consolidated financial statements present the parent and its subsidiary as a single entity. The consolidated entity uses the building for the supply of goods. Therefore, the leased-out property to a subsidiary does not qualify as investment property in the consolidated financial statements. Hence, the whole building will be classified as an item of Property, Plant and Equipment for Rs. 63,40,000.

Q6 (May 18 & July 21 – 8 Marks)

Special Limited is a multinational entity that owns 3 properties. All 3 properties were purchased on 1st April, 2020. The following details were furnished:

Particulars	Property 1	Property 2	Property 3
Purchase Price	Rs. 7,50,000	Rs. 10,50,000	Rs. 12,00,000
Estimated life	10 years	15 years	15 years
Fair value as on 31st March, 2021	**Rs. 8,00,000**	**Rs. 9,50,000**	**Rs. 13,00,000**

The Company uses Property 1 and Property 2 for its business purposes. The Company is exploring the opportunity to sell Property 3 if it gets reasonable consideration. Until the time it is not sold, the Company has rented the property.

It has adopted a revaluation model for subsequent measurement of these properties. The depreciation is charged on a straight line method. However, the Company has not charged any depreciation on Property 1 and Property 3 for the current year since the fair value of properties exceeds their carrying amount. The difference between their fair value and carrying amount has been recognized in the statement of profit and loss. The properties are shown under the head property, plant and equipment in the Balance Sheet.

Analyze whether the accounting policies adopted by the Company in relation to the given properties are in accordance with Ind AS. If not, advise the correct treatment and present an extract of the Balance Sheet for the year ended 31st March 2021.

SOLUTION

1. Property '1' and '2'

As per Ind AS 16, Property plant and equipment are tangible items that:

(a) are held for use in the production or supply of goods or services or for administrative purposes; and

(b) are expected to be used during more than one period.

Hence, property 1 and 2 are held for use in the business, therefore Ind AS 16 shall apply in respect of these two properties.

Accounting Principles:

- If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

  If an asset's carrying amount is decreased as a result of revaluation, the decrease shall be recognised in the profit and loss statement.

2. **Property '3'**

As per Ind AS 40, Investment property is property held to earn rentals or for capital appreciation or both, rather than for:

- Use in the production of goods or services or for administrative purposes; or
- Sale in the ordinary course of business.

Therefore, property 3 is an investment property and the company shall follow a cost model for its subsequent measurement.

Accounting Principles:

- An entity shall adopt as its accounting policy the cost model to all of its investment property; and
- requires that an entity shall disclose the fair value of investment property.

Further, Ind AS 1 'Presentation of Financial Statements' requires that as a minimum, the balance sheet shall include line items that present the following amounts:

a. Property, Plant and Equipment
b. Investment Property.

Analysis:

As per the facts given in the question, Special Ltd. has

a. Presented all three properties in balance sheet as 'property, plant and equipment';
b. Not charged depreciation to Property '1' and '3';
c. Upward revaluation is recognised in the statement of profit and loss as profit; and
d. Applied revaluation model to Property '3' being classified as Investment Property.

With respect to the accounting principles, the accounting treatment by Special Ltd. is not correct. Accordingly, Special Ltd. shall depreciate Property 1 irrespective of the fact that their fair value exceeds the carrying amount.

- The revaluation gain shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus.
- There is no alternative of revaluation model in respect to property '3' being classified as Investment Property and only cost model is permitted for subsequent measurement.
- However, Special Ltd. is required to disclose the fair value of the property in the Notes to Accounts.
- Further, Property '3' shall be presented as a separate line item as Investment Property and depreciation should be charged on it as well.

Therefore, as per the provisions of Ind AS 1, Ind AS 16 and Ind AS 40, the presentation of these three properties in the balance sheet will be as follows:

Balance Sheet (extracts) as at 31st March, 2021

Assets	Rs.
Non-Current Assets	
Property, Plant and Equipment	
Property '1' 8,00,000	
Property '2' 9,50,000	17,50,000
Investment Properties	
Property '3' (1,200,000 – 80,000)	11,20,000
Equity and Liabilities	
Other Equity	
Revaluation Reserve	
Property '1' [8,00,000 – (7,50,000 – 75,000)]	1,25,000

The revaluation reserve should be routed through Other Comprehensive Income (subsequently not reclassified to Profit and Loss) and shown in a separate column under Statement of Changes in Equity.

Working Notes:

Particulars	Property 1	Property 2	Property 3
Purchase Price	Rs. 7,50,000	Rs. 10,50,000	Rs. 12,00,000
Estimated Life	10 years	15 years	15 years
Depreciation for the year	Rs. 75,000	Rs. 70,000	Rs. 80,000
Carrying Value as on 31st March, 2021	Rs. 6,75,000	Rs. 9,80,000	Rs. 11,20,000
Fair Value as on 31st March, 2021	Rs. 8,00,000	Rs. 9,50,000	Rs. 13,00,000
Subsequently Measurement at	Fair Value	Fair Value	Cost
Revaluation Surplus / (Deficit)	Rs. 1,25,000	(Rs. 30,000)	-

NEWLY ADDED QUESTIONS FROM ICAI MODULE

Q7 (ICAI MODULE) - Same as Q.3

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.