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SL-25-1 – Advanced Corporate Reporting

Strategic Level (2025 Curriculum)

- LKAS 40 – Investment Properties

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LKAS 40

Investment Properties

An entity may own land or a building as an investment rather than for use in business. The property may therefore generate cash flows that are largely independent of other assets that the entity holds. The treatment of such property is covered by LKAS 40.

Definitions

Investment property	Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) 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. • Sale in the ordinary course of business
Owner-occupied property	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.
Fair value	Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (SLFRS 13)
Cost	the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other SLFRSs .
Carrying amount	Carrying amount is the amount at which an asset is recognised in the statement of financial position.

Application of definition

This understanding is very important to identify whether a property is an investment property or not in an examination situation. The following are **examples** for investment properties.

Land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business.	
Land held for a currently undetermined use.	
A building owned by the reporting entity (or	

a right-of-use asset relating to a building held by the entity) and leased out under one or more operating leases.	
A building that is vacant but is held to be leased out under one or more operating leases.	
Property that is being constructed or developed for future use as investment property.	

Below are **not investment properties**.

Property that is complete or under construction and intended for sale in the ordinary course of business.	
Owner-occupied property, property held or under development for future owner occupation and owner-occupied property awaiting disposal	
Property that is leased to another entity under a finance lease.	

Question 01

Colombo Developments Ltd owns a block of apartments on the outskirts of Colombo. These are let to skilled employees of the company who live overseas but are required to be based in Colombo during the week due to work commitments. A below-market rate of rent is charged to the employees.

Required:

Explain how the property is classified in the financial statements of Colombo.

Special situations with regard to IP (**IMPORTANT**)

1. Partial own use

- Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes.





Able to **sold or leased out separately** and **accounted for separately**

Own Use Proportion

Part to earn rentals or
Capital appreciation
Proportion

PPE (LKAS 16)

IP (LKAS 40)

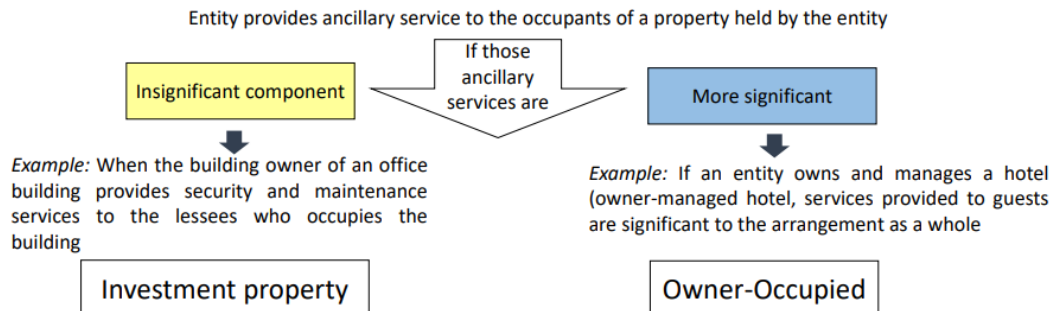


Unable to **sold or leased out separately** and **accounted for separately**

- If significant portion is held for use in the production or supply of goods or services or for administrative purposes – **PPE**
- If significant portion is held to earn rentals - **IP**

2. Ancillary Services

- a. If the ancillary services are a relatively insignificant component of the arrangement as a whole, then the entity may treat the property as IP. Where the ancillary services provided are more significant, the property should be classified as owner-occupied.

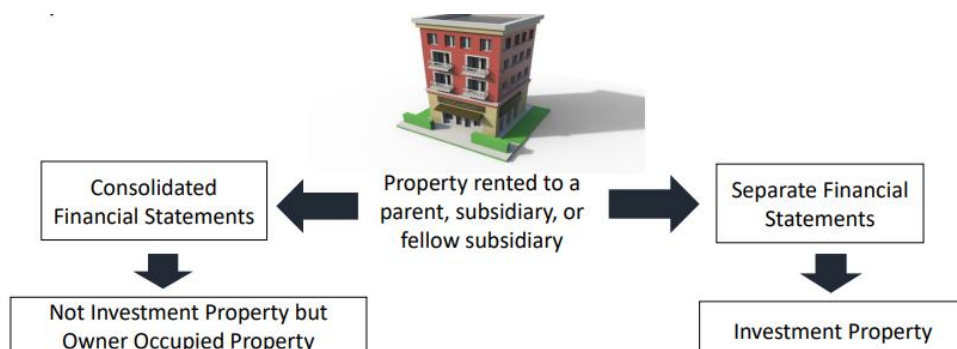


Example – Hotel property as an Investment Property

Situation	Classification
Direct provision of services to hotel guests as services that will generally be considered to be significant by owner of the hotel	
Owner of the hotel transfers some responsibilities to third party under a management contract	
Contract may simply result in the outsourcing of some day to day responsibilities, while the owner retains significant exposure to variations in the cash flows generated by the operations of the hotel	

3. Investment property in a group situation

- a. Property rented to a parent, subsidiary, or fellow subsidiary is not IP as the property is owner occupied from the perspective of the group. However, such property could qualify as investment property in the separate financial statements, if the definition of investment property is otherwise met.



Recognition

The recognition criteria of LKAS 40 mirror those of the Conceptual Framework: investment property should be recognised as an asset when two conditions are met:

- (a) It is probable that the future economic benefits that are associated with the investment property will flow to the entity.
- (b) The cost of the investment property can be measured reliably.

Measurement

Initial Measurement	Subsequent Measurement	
	Cost Model	Fair Value Model
At Cost	Cost XXX (-) Accumulated Depreciation (XXX) (-) Accumulated Impairment (XXX) Carrying Amount XXX	FV at year beginning XXX FV at year end (XXX) FV Gain or Loss XXX
		FV gain or loss is recognized in profit or loss for the period.

The **initial cost** of an investment property includes:

- Its purchase price
- Directly attributable expenditure, including professional fees, property transfer taxes and other transaction costs

The **cost** of an investment property shall not include:

- Start-up costs
- Operating losses before the investment property is fully occupied
- Any abnormal costs of wasted material, labour or other resources incurred in the construction or development of the property

An investment property held by a **lessee as a right-of-use asset** shall be measured initially at its cost in accordance with **SLFRS 16**.

Question 02

Kalugala Ltd acquired a property on 1 October 20X5, which it intends to renovate prior to renting out to commercial tenants. The property cost Rs. 6.5m, including Rs. 165,000 legal fees and Rs. 10,000 bank transfer charges. Kalugala intends to spend Rs. 2m on renovations before the property can be rented out. The renovations should take three months; if they extend beyond this time, the cost

in lost income to Kalugala will be Rs. 16,000 per month. When the property is rented out, Kalugala expects to pay Rs. 2,000 per month in maintenance costs.

Required:

State at what cost the property is initially measured. **Explain** how this cost might subsequently change.

Cost of an investment property held under a lease

An investment property that is leased is a right-of-use asset and is initially measured in accordance with SLFRS 16.

Subsequent Measurement

LKAS 40 requires an entity to choose between two models:

- The fair value model
- The cost model

Whatever policy it chooses should be applied to all of its investment property regardless whether it is owned or leased.

Fair value model

After initial recognition, an entity that chooses the fair value model shall measure all of its investment property at fair value, except in the cases described in paragraph 53 (where the FV cannot be reliably measurable).

Where the fair value model is applied, an entity should re-measure all of its investment property to fair value at each reporting date and recognise any gains or losses on re-measurement in profit or loss. If an investment property is self-constructed, any difference between the carrying amount of the property (cost) and the fair value on the date of completion is recognised in profit or loss.

Fair value is established in accordance with SLFRS 13 Fair value measurement, and the fair value should reflect:

- Rental income from current leases
- Other assumptions that market participants would use when pricing investment property under current market conditions

In determining fair value, an entity should not double count assets. For example, elevators or air conditioning are often an integral part of a building and should be included in the investment property, rather than recognised separately.

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. However, in exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property after a change in use) 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** (eg 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**.

- 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 shall measure that investment property under construction at cost until either its fair value becomes reliably measurable or construction is completed (whichever is earlier).
- 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 shall measure that investment property using the cost model in LKAS 16 for owned investment property or in accordance with IFRS 16 for investment property held by a lessee as a right-of-use asset. The residual value of the investment property shall be assumed to be zero. The entity shall continue to apply LKAS 16 or IFRS 16 until disposal of the investment property.

If an entity has previously measured an investment property at fair value, it **shall continue to measure the property at fair value until disposal** (or until the property becomes owner-occupied property or the entity begins to develop the property for subsequent sale in the ordinary course of business) **even if comparable market transactions become less** frequent or market prices become less readily available.

Cost Model

An entity that applies the cost model should measure its investment property as follows:

- In accordance with SLFRS 5 if the property is classified as held for sale

- In accordance with SLFRS 16 if the property is leased and held as a right-of-use asset (but is not held for sale), or
- Using the cost model in LKAS 16, ie at depreciated cost, less any accumulated impairment losses in all other circumstances.

Entities that choose the cost model are required to measure the fair value of investment properties for disclosure purposes, even though this is not the value at which investment property is measured in the financial statements.

Changing Models

An entity should not change from one model to the other unless the change will result in a more appropriate presentation.

LKAS 40 states that it is highly unlikely that a change from the fair value model to the cost model will result in a more appropriate presentation

Question 03 - ACCA

Lavender owns a property, which it rents out to some of its employees. The property was purchased for \$30 million on 1 January 20X2 and had a useful life of 30 years at that date. On 1 January 20X7 it had a market value of \$50 million and its remaining useful life remained unchanged. Management wish to measure properties at fair value where this is allowed by accounting standards.

Required:

How should the property be treated in the financial statements of Lavender for the year ended 31 December 20X7.

Question 04

Moratuwa Properties Ltd acquired a retail park on 1 August 20X5 at a cost of Rs. 9m. The company incurred transaction costs of Rs. 500,000 on the purchase. At 31 December 20X5, the property was determined by an external valuer to have a fair value of Rs. 10.2m. During 20X6, there was a market-wide fall in property prices and the fair value of the retail park at 31 December 20X6 was Rs. 9.9m. Moratuwa Properties Ltd applies the LKAS 40 fair value model.

Required:

Prepare relevant extracts from the financial statements of Moratuwa Properties Ltd for the years ended 31 December 20X5 and 20X6.

Transfers

LKAS 40 provides guidance on the value at which property should be **transferred in and out** of the investment property category.

Transfers to or from investment property should only be made when there is a change in use. In order for there to be a change of use:

- (a) The property must **meet** or **cease** to meet the **definition** of investment property, **and**
- (b) There must be **evidence** to support a change in use

LKAS 40 provides the following examples

- (a) Owner occupation commences: the investment property is transferred to property, plant and equipment (LKAS 16)
- (b) Owner occupation ceases: the property is transferred to investment property (LKAS 40)
- (c) Development of an investment property with a view to sale commences: the investment property is transferred inventories (LKAS 2)
- (d) An operating lease to another party commences: the property is transferred to investment property (LKAS 40)



Transfers where the cost model is applied

Where a property is transferred to or from the investment property category and the cost model is applied, the carrying amount of the property does not change on the transfer.

Transfers where the fair value model is applied

Where a property is transferred to or from the investment property category and the fair value model is applied, the following rules regarding measurement apply.

- (a) For a transfer from investment property to owner-occupied property or inventories, the **deemed cost** for subsequent accounting **is the fair value at the date of change in use.**

- (b) For a transfer from owner-occupied property to investment property, any difference between the previous carrying amount of the property and its fair value is accounted for as an LKAS 16 **revaluation at the point of transfer**.
- (c) For a transfer from inventories to investment property, any difference between the previous carrying amount of the property and fair value at the date of transfer is **recognised in profit or loss**.

Question 05

A business owns a building that it has been using as a head office. In order to reduce the costs, 30th June 2015 it moved its head office functions one of its production centers and is now letting out its head office. Company policy is to use the fair value model for their investment properties.

The building had an original cost on 1st January 2005 of Rs.250,000 and was being depreciated over 50 years. Fair value measurement revealed following balances,

30th June 2015 ----- Rs. 350,000

31st December 2015 ---- Rs. 380,000

Required:

Explain how this will appear in the F/S at 31 December 2015.

Disposals

An investment property is derecognised on disposal or when it is permanently withdrawn from use and no future economic benefits are expected from its disposal. Disposal may be achieved by a sale or by entering into a finance lease.

Any gain or loss on disposal is the difference between the net disposal proceeds and the carrying amount of the asset; it is recognised in profit or loss.

Compensation from third parties for investment property that was impaired, lost or given up is recognised in profit or loss when the compensation becomes receivable.

Disclosures

LKAS 40 requires a number of general disclosures together with additional disclosures, depending on whether the fair value model or cost model is applied.

General disclosures

An entity with investment properties must disclose the following.

- (a) Whether it applies the fair value or the cost model
- (a) The criteria used to distinguish between investment property, owner occupied property and inventory where classification is difficult
- (b) The extent that the fair value of investment property (as measured or disclosed in the financial statements) is based on valuation by an independent, qualified and experienced valuer
- (c) Amounts recognised in profit or loss in respect of:
 - Rental income from investment property
 - Direct operating expenses of investment property which did and did not generate rental income in the period
- (d) Details of restrictions on the realisability of investment property or the remittance of income or the proceeds of disposal
- (e) Contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements

Fair value model disclosures

Where the fair value model is applied, the following must be disclosed in addition to the general disclosures listed above.

- (a) Whether, and in what circumstances, property interests held under operating leases are classified as investment property
- (b) A reconciliation between the carrying amounts of investment property at the start and end of the period which details:
 - Additions (from acquisitions, subsequent expenditure and business combinations)
 - Assets classified as held-for-sale
 - Net gains or losses from fair value adjustments
 - Net exchange differences arising on translation of financial statements into a presentation currency
 - Transfers to and from inventories and owner-occupied property
 - Other changes

Where the fair value model is applied but an investment property is measured using the cost model because its fair value cannot be measured reliably, a description of the property must be provided, together with an explanation of why

the fair value cannot be measured reliably and, if possible, a range of estimates within which the fair value is highly likely to lie.

Cost Model Disclosures

- (a) Where the cost model is applied, the following must be disclosed in addition to the general disclosures listed above.
- (b) The depreciation methods used and useful lives or depreciation rates
- (c) The gross carrying amount and the accumulated depreciation at the beginning and end of the period
- (d) A reconciliation between the carrying amounts of investment property at the start and end of the period which details:
 - (e) Additions
 - (f) Assets classified as held-for-sale
 - (g) Depreciation
 - (h) Impairment losses recognised and reversed
 - (i) Net exchange differences arising on translation of financial statements into a presentation currency
 - (j) Transfers to and from inventories and owner-occupied property
- (k) The fair value of the investment property, or if this cannot be reliably measured, a description of the property, an explanation of why the fair value cannot be measured reliably and, if possible, a range of estimates within which the fair value is highly likely to lie.

Please note that the disclosure requirements are continuously changing and updating. Therefore, referring to the standard is important for disclosures.