FAR-1 — FINANCIAL ACCOUNTING & REPORTING 1

Topic: INVESTMENT PROPERTY — IAS 40

1 TOPIC OVERVIEW

WHAT IS IT?
IAS 40 governs land/buildings held to earn rentals or for capital appreciation, rather than for own use or sale in the ordinary course of business.

WHY IMPORTANT?
Investment property generates cash flows independently of an entity's other assets — this is why it needs its own classification, measurement and disclosure rules, separate from IAS 16 (PPE) and IAS 2 (inventory).

CORE PRINCIPLE
Choose a policy — fair value model (remeasure every period, gain/loss to P&L, no depreciation) or cost model (per IAS 16) — and apply it consistently to **all** investment property.

2 KEY DEFINITIONS

Investment property: Land or a building (or part of a building), or both, held to earn rentals or for capital appreciation or both — rather than for use in production/supply of goods/services, admin purposes, or sale in the ordinary course of business.

Owner-occupied property: Property held for use in production/supply of goods or services, or for administrative purposes.

3 CLASSIFICATION — IS IT INVESTMENT PROPERTY?

✔ EXAMPLES OF INVESTMENT PROPERTY

- Land held for long-term capital appreciation (not short-term sale)
- Land held for a currently undetermined future use
- A building leased out under one or more operating leases
- A vacant building held to be leased out under an operating lease
- Property being constructed/developed for future use as investment property

✘ NOT INVESTMENT PROPERTY

- Property intended for sale in the ordinary course of business
- Property under construction/development for sale in the ordinary course of business
- Property acquired exclusively for near-term resale, or for development and resale
- Owner-occupied property (current or future use, or awaiting disposal)
- Property occupied by employees (whether or not they pay market rent)

4 PROPERTY PORTIONS HELD FOR DIFFERENT PURPOSES

Situation	Treatment
Separable portions	If portions could be sold separately → account for each portion separately (part IP, part PPE).
Non-separable portions	Whole property is investment property only if the owner-occupied/production portion is **insignificant**.

5 IMPACT OF ANCILLARY SERVICES — DECISION TREE

Services INSIGNIFICANT to the arrangement as a whole	Classification: **Investment Property**. Example: owner of an office building provides security & maintenance to tenants.
Services SIGNIFICANT to the arrangement as a whole	Classification: **Not Investment Property** (owner-managed operation). Example: an entity owns/manages a hotel and provides significant guest services.

Judgement is often needed — an entity must develop and disclose consistent criteria to classify such borderline cases.

RECOGNITION & MEASUREMENT — COST vs FAIR VALUE MODEL

6 RECOGNITION PRINCIPLE [IAS 40:16–19] — SAME AS IAS 16

Owned investment property recognised as an asset when BOTH:

Condition A	Condition B
Probable future economic benefits will flow to the entity	Cost can be measured reliably

Includes costs incurred initially to acquire, and subsequently to add to, replace part of, or service the property. **Day-to-day servicing (repairs & maintenance)** is expensed as incurred. Replaced parts: recognise the new part (if criteria met) and derecognise the replaced part.

7 MEASUREMENT AT RECOGNITION — COST [IAS 40:20–27]

COST OF PURCHASED INVESTMENT PROPERTY

Purchase price + Directly attributable expenditure (legal fees, property transfer taxes, other transaction costs)

✘ COST IS NOT INCREASED BY

- Start-up costs (unless necessary to bring the property to the condition needed to operate as intended)
- Operating losses incurred before the property reaches planned occupancy
- Abnormal waste incurred during construction/development

Exchange of assets → same treatment as IAS 16 (measure at fair value unless the exchange lacks commercial substance or neither FV is reliably measurable).

8 MEASUREMENT AFTER RECOGNITION — TWO MODELS [IAS 40:30,31,32,35,56]

Model	Rule
Fair value model	All investment property remeasured at FV at each period end; **gain/loss → P&L** (not OCI); **NOT depreciated**. Different from IAS 16 revaluation model (which uses OCI/surplus).
Cost model	Applied per IAS 16 requirements — cost less accumulated depreciation less accumulated impairment.

Chosen policy applies to **all** investment property. A voluntary policy change is made only if it gives more reliable/relevant information (applied retrospectively per IAS 8) — a change **from fair value to cost** is unlikely to be appropriate. IAS 40 requires FV to be measured/disclosed regardless of model used; use of an independent valuer is encouraged, not required.

9 WORKED EXAMPLE — COST vs FAIR VALUE MODEL [Example 01]

Building cost Rs.1,000,000 + Rs.10,000 transaction costs; depreciable amount Rs.300,000; useful life 50 yrs. Year-end FV = Rs.1,300,000.

Cost model — SFP/SPL extracts		Fair value model — SFP/SPL extracts	
Cost [1,000,000+10,000]	1,010,000	Investment property [at FV]	1,300,000
Acc. depreciation [300,000/50]	(6,000)	Gain on property valuation [1,300,000−1,010,000]	290,000
Investment property (SFP)	**1,004,000**		
Depreciation (SPL) [300,000/50]	(6,000)		

DISPOSAL, FV RELIABILITY & TRANSFER RULES

10 DISPOSAL [IAS 40:66 & 69]

GAIN / (LOSS) ON DISPOSAL

Net disposal proceeds – Carrying amount

Derecognised on disposal, OR when permanently withdrawn from use and no future economic benefits are expected from its disposal. Gain/loss → **profit or loss** in the period of retirement/disposal.

Worked check [Example 02: sold for Rs.1,550,000, selling costs Rs.50,000; carrying amounts from Example 01]	
Net sale proceeds [1,550,000−50,000]	1,500,000
Carrying amount — Cost model	1,004,000 → Gain 496,000
Carrying amount — Fair value model	1,300,000 → Gain 200,000

11 INABILITY TO MEASURE FAIR VALUE RELIABLY [IAS 40:53 & 55]

There is a rebuttable presumption an entity CAN reliably measure FV on a continuing basis. Exceptions:

IP under construction, FV not yet reliable but expected reliable on completion	Measure at **cost** until FV becomes reliable OR construction completes, whichever is earlier.
IP (not under construction), FV not reliably measurable on a continuing basis	Use the **cost model per IAS 16**; assume **residual value = zero**; continue applying IAS 16 until disposal.
Previously measured at fair value	Must **continue** at fair value until disposal (or transfer to owner-occupied/inventory) — even if the market becomes less active.

12 TRANSFERS — WHEN DOES RECLASSIFICATION HAPPEN? [IAS 40:57–58]

Transfer only when there is a **change in use** — evidenced by the property meeting/ceasing to meet the IP definition. A change in **management's intention alone** is NOT evidence of a change in use.

Evidence of change in use	Transfer from	Transfer to
Commencement of owner-occupation (or development for it)	Investment property	Owner-occupied (IAS 16)
Commencement of development with a view to sale	Investment property	Inventories (IAS 2)
End of owner-occupation	Owner-occupied (IAS 16)	Investment property
Inception of an operating lease to another party	Inventories (IAS 2)	Investment property

If an entity decides to dispose of an IP **without development**, it keeps treating it as investment property until derecognised — it is **never** reclassified to inventory in this case.

13 TRANSFER ACCOUNTING — COST MODEL vs FAIR VALUE MODEL

Cost model for IP [IAS 40:59]: transfers between IP, owner-occupied property and inventories do **not change** the carrying amount or cost of the property for any purpose.

From	To	Treatment
IAS 40 (at FV)	IAS 16	FV at date of change of use becomes **deemed cost** going forward.
IAS 40 (at FV)	IAS 2	FV at date of change of use becomes **deemed cost** going forward.
IAS 16	IAS 40 (at FV)	Apply the **IAS 16 revaluation model** on transfer date (even if cost model was used) — difference per IAS 16 (OCI/surplus, or P&L if reversing a prior deficit).
IAS 2	IAS 40 (at FV)	Measure at FV on transfer date; difference vs previous carrying amount → **profit or loss**.

14 DISCLOSURE [IAS 40:75–79]

GENERAL (BOTH MODELS)

- Fair value or cost model applied; classification criteria used where judgement is needed
- Extent FV is based on an independent valuer's valuation (or that fact if none)
- Restrictions on realisability/remittance; contractual obligations to purchase/construct/repair
- Rental income and direct operating expenses from IP (separately for IP that did/did not generate rental income)

MODEL-SPECIFIC

Fair value model: reconciliation of carrying amount (additions, disposals, net FV gains/losses, transfers, other changes); for FV-unreliable IP — description, reason, estimate range, disposal details.

Cost model: depreciation method, useful lives/rates, gross carrying amount & accumulated depreciation (opening/closing).

15 FINANCIAL STATEMENT IMPACT

STATEMENT OF PROFIT OR LOSS

- Fair value gain/loss (FV model only) — never OCI
- Depreciation expense (cost model only)
- Gain/loss on disposal; gains/losses on transfer (IP ↔ Inventory)
- Rental income; direct operating expenses

STATEMENT OF FINANCIAL POSITION

- Investment property — separate non-current asset line (at FV or cost−dep.)
- Revaluation surplus (equity/OCI) — only from an IAS 16→IAS 40 transfer

TRANSFER JOURNAL ENTRIES & QUICK RECAP

16 WORKED TRANSFER JOURNAL ENTRIES [Examples 04–07]

① IP (FV) → Owner-occupied, then cost model [Ex.04: FV Rs.1,000,000→Rs.1,200,000 on transfer date; 9.5 yrs left]		
Investment property (FV gain to transfer date)	200,000	
Investment income/gain (P&L)		200,000
Property, plant & equipment [deemed cost = FV]	1,200,000	
Investment property		1,200,000
Depreciation [1,200,000/9.5 × 6/12]	63,158	
Accumulated depreciation		63,158
② IP (FV) → Inventory (development for sale) [Ex.05: FV Rs.1,000,000→Rs.1,200,000]		
Investment property (FV gain to transfer date)	200,000	
Investment income/gain (P&L)		200,000
Inventories [deemed cost = FV]	1,200,000	
Investment property		1,200,000
③ Owner-occupied (cost model) → IP (FV) [Ex.06: CA Rs.1,000,000; FV on transfer Rs.1,200,000; year-end FV Rs.1,300,000]		
Depreciation to transfer date [1,000,000/10×6/12]	50,000	
Accumulated depreciation (PPE)		50,000
PPE [revalue to FV: 1,200,000−(1,000,000−50,000)]	250,000	
Gain on revaluation (OCI/surplus — IAS 16 rules apply)		250,000
Investment property [at FV on transfer date]	1,200,000	
Property, plant & equipment		1,200,000
Investment property [year-end FV gain: 1,300,000−1,200,000]	100,000	
Investment income/gain (P&L)		100,000
④ Inventory → IP (FV) [Ex.07: CA Rs.1,000,000; FV on transfer Rs.1,200,000; year-end FV Rs.1,300,000]		
Investment property [at FV on transfer date]	1,200,000	
Inventory [previous carrying amount]		1,000,000
Profit or loss [difference]		200,000
Investment property [year-end FV gain: 1,300,000−1,200,000]	100,000	
Investment income/gain (P&L)		100,000

Revaluation surplus arising on an owner-occupied→IP transfer (scenario ③) may be transferred to retained earnings on subsequent disposal of the investment property (transfer normally made at the time of disposal). **Completion of self-constructed IP** [IAS 40:65]: any difference between FV at completion and previous carrying amount → profit or loss.

! ⚠ EXAM TRAPS — COMMON MISTAKES

- **Depreciating** investment property under the fair value model — it is never depreciated under FV; only under the cost model.
- Recognising a fair value gain/loss in **OCI** instead of P&L — unlike IAS 16 revaluation, IAS 40 FV gains/losses always go through profit or loss.
- Reclassifying based on **management's intention alone** — a change in use needs actual evidence (start of occupation, development, or a lease).
- Treating a decision to sell an IP **without development** as a transfer to inventory — it stays investment property until derecognised.
- Applying the **wrong transfer rule** — cost model transfers never change carrying amount; FV-model transfers use FV as deemed cost or run the difference through OCI/P&L depending on direction.
- Forgetting to apply the **IAS 16 revaluation model** (not just fair value) when transferring owner-occupied property to investment property — including catch-up depreciation to the transfer date first.
- Assuming FV must always be used — forgetting the **rebuttable exception** for IP under construction or where FV genuinely cannot be measured reliably (cost model, nil residual value).
- Confusing **mixed-use property**: significant owner-occupied portion (non-separable) means the WHOLE property fails IP classification, not just part of it.
- Assuming ancillary services never affect classification — **significant** services (e.g. hotel operations) take the property outside IAS 40 entirely.
- Forgetting that gains on disposal are based on **net** proceeds (after selling costs), not gross proceeds.

17 QUICK DECISION TREE — ANSWERING ANY IAS 40 QUESTION

1. Question given → 2. IP, PPE, or inventory? Any change in use? → 3. Which model — cost or FV? → 4. Calculate (FV gain/loss, depreciation, or transfer amount) → 5. Journal entry → ✔ FS effect / final answer

IAS 40 — INVESTMENT PROPERTY IN 60 SECONDS

IP = land/building held for rentals or capital appreciation, not own use or ordinary-course sale.

Recognise if: probable future benefit + cost reliably measurable.

Fair value model: remeasure every period, gain/loss → P&L, never depreciate.

Cost model: per IAS 16 — cost − acc. dep. − acc. impairment.

Disposal gain/loss = net proceeds − carrying amount → P&L.

Transfer needs a real change in use — not just changed intention.

Cost-model transfers: no change in carrying amount.

FV-model transfers: IP→IAS16/IAS2 = FV becomes deemed cost; IAS16→IP = apply revaluation model first; IAS2→IP = difference to P&L.

FV not reliable: use cost model, nil residual value, until disposal.