Distinctive Financial Reporting

FAC3702

Study unit 2
Investment property

Study unit 2 - Overview

- Recognition
- Measurement
  - @ Recognition
  - Subsequently
    - Cost model
    - Fair value model
- Transfers
- Derecognition
- Disclosure
- Tax

Definitions

- Carrying amount
  - Amount at which asset is recognised in SFP
- Property
  - Land and/or building or part thereof
- Investment property
  - Property held by owner (or lessee under finance lease)
  - To earn rentals and/or capital appreciation
  - OTHER than
    - Use in production/supply of goods/services
    - Use for administrative purposes
    - Sale in the ordinary course of business
- Owner-occupied property
  - Property held by owner (or lessee under finance lease)
  - For use in production/supply of goods/services or admin purposes
- Other – same definition as PPE
  - 'Cost' and 'Fair value

Investment *v* owner-occupied property

- Investment property
  - Rentals & capital appreciation
  - Cash flows largely independent from other assets held by entity.
  - Insignificant ancillary services
  - IAS 40
- Owner-occupied property
  - Integrated part of entity's business
  - IAS 16 – PPE
- Partly investment & partly owner-occupied
  - Can units be sold separately?
    - Yes – account for portions separately
    - No – Is insignificant portion used for production/admin?
      - Yes → Recognise as investment property

- Group – property leased to parent or subsidiary company:
  - Individual company → investment property
  - Consolidation → owner-occupied property

Recognition

- Probable
    - Future economic benefits associated with item will flow to entity
- Cost can be measured reliably
    - Initial cost to acquire investment property
    - Subsequent costs to add to, replace or service property
    - NOT day to day servicing of property (e.g. repairs)

Apply criteria at time cost is incurred

Measurement @ recognition

- Cost – acquired property
  - Purchase price
  - Directly attributable expenditure, incl. transaction costs
  - NB: VAT/Transfer duty if not recoverable
- Cost – self-constructed investment property
  - Cost @ date construction/development completed
- Do not include:
  - Start-up cost (unless necessary to bring property in operation)
  - Operating losses before planned level of occupancy is achieved
  - Abnormal amounts of wasted material, labour & other resources in constructing/developing the property

Measurement @ recognition (2)

- Abnormal credit terms
  - Asset: Recognise cash value (Present value of selling price)
  - Excess = interest (Selling price – Cash value)
- Exchanging/swapping investment properties
  - Cost: fair value of asset given up unless:
    - Fair value of neither acquired/disposed asset reliably measured
      - Carrying value of asset given up
    - Exchange transaction lacks commercial substance
      - Carrying value of asset given up

    - “Commercial substance”
      - Consider extent → future cash flows expected to change as result of transaction.
        - Cash flows differ from previous cash flows of asset given up; or
        - Entity-specific portion of operation affected by transaction changes; AND
        - Difference is significant relative to fair value of exchanged assets.

Subsequent recognition

- Entity may choose:
  - Fair value model
  - Cost model

  Apply to ALL investment properties

- Determine fair value, irrespective of which model used.
  - Measurement if fair value model is used, or
  - Disclosure if cost model is used

Fair Value Model

- Fair value
  - Price at which property could be exchanged
  - Between knowledgeable, willing partners
  - In arm's length transaction.
  - Ignore: transaction costs
  - Reflect market conditions at end of reporting period
    - Current prices for similar property in same location & condition
    - Prices for different properties – adjust
    - Discounted cash flow projections
  - Exclude separately recognised assets/liabilities
    - E.g. lifts, air conditioners, prepaid rental income etc.
- Fair value measurement through profit/loss
- No depreciation

Cost model

- Fair value not reliably determinable
  - Property under construction
  - If compelled to use cost model for this reason, may use fair value model for other investment properties
- Depreciation
- Over useful life of investment property

Transfers – Change in use

- When?
  - Commencement of owner-occupation
    - Investment property →owner-occupied property
  - End of owner-occupation
    - Owner-occupied property→ investment property
  - Commencement of development with view to sell
    - Investment property → inventory
  - Commencement of operating lease to another person
    - Inventory → investment property

Transfers - Value

- Cost model: no change to carrying amount or cost of transferred property
- Fair value model
  - Investment property →owner-occupied property/inventory
    - Fair value @ date of transfer
  - Owner-occupied property→ investment property
    - Carrying amount @ transfer date
      - Calculate depreciation/impairments until date of transfer
    - Difference between fair value & carrying amount → revaluation [IAS16]
  - Inventory → investment property
    - Fair value – carrying amount = profit/loss
  - Investment property → inventory
    - Completes development
    - Fair value – carrying amount = profit/loss (NOT as revaluation)

Derecognition

- When?
  - Disposal
    - Sale or finance lease
  - Permanently withdrawn from use & no future economic benefits expected from disposal
  - ‘Replaced’ parts of investment properties
    - Cost model
      - Carrying value of replaced part or
      - Cost of replacement
    - Fair value model
      - Fair value may have already been adjusted for replaced part
      - Include cost of replacement in carrying value & reassess fair value

Gains or losses on disposal

- Calculation
  - Net disposal proceeds
    - Adjust for deferred payment terms – cash equivalent & interest
  - Less: Asset's carrying amount

- Recognise as profit/loss

3rd Party compensation

- Compensation from 3rd parties
    - E.g. insurance indemnity payments
- Investment property impaired, lost or given up
- Recognise as profit/loss
- Separately account for:
    - Impairment of investment property [IAS 36 & SU 3]
    - Retirement/disposal of investment property
    - Compensation received from 3rd party
    - Cost to restore, construct or purchase assets

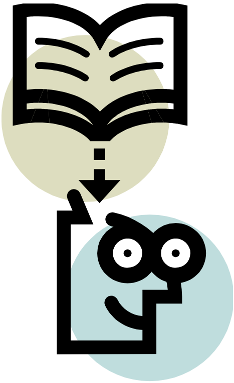
CGT

- Capital gain/loss
  - Disposal of asset
    - Sale, donation, loss or destruction
  - Proceeds less base cost
- Base cost
  - Incl: acquisition cost, improvements & costs incurred directly in the acquisition, creation or disposal of the asset
  - Excl: holding costs (interest, repairs & maintenance), recoverable expenses (deductible for income tax) adjustments for inflation.
- Framework – page 38 of Study Guide
  - Inclusion rate for companies – 66%

Deferred tax [FAC3701]

- Cost model → same as PPE
- Fair value
  - Assume carrying value recovered through sale
  - No depreciation
  - Capital allowance
    - SARS does not distinguish between investment & owner-occupied property. Tax treatment depends on use
    - Capital allowances
      - Manufacturing buildings
      - Hotels, commercial buildings, buildings let to employees
      - None on land and general residential buildings
  - Deferred tax on fair value adjustments
    - Fair value adjustment x CGT inclusion rate (66.6%) x tax rate (28%)
  - Presumption rebutted → depreciate property
    - Deferred tax = Fair value adjustment x tax rate (28%)

Disclosure - NB!!!!



STUDY

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