

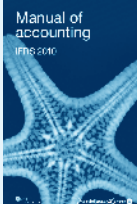
Asset Management

A practical guide to accounting for properties under construction

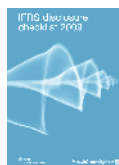
March 2010 update




IFRS technical publications



IFRS manual of accounting 2010
PwC's global IFRS manual provides comprehensive practical guidance on how to prepare financial statements in accordance with IFRS. Includes hundreds of worked examples, extracts from company reports and model financial statements.




IFRS disclosure checklist 2009
Outlines the disclosures required by all IFRSs published up to October 2009.



A practical guide to IFRS 8 for real estate entities
Guidance in question-and-answer format addressing the issues arising for real estate entities when applying IFRS 8, 'Operating segments'.




IFRS pocket guide 2009
Provides a summary of the IFRS recognition and measurement requirements. Including currencies, assets, liabilities, equity, income, expenses, business combinations and interim financial statements.



A practical guide for investment funds to IAS 32 amendments
12-page guide addressing the questions that are arising in applying the amendment IAS 32 and IAS 1, 'Puttable financial instruments and obligations arising in liquidation', with a focus on puttable instruments.




Illustrative IFRS financial statements 2009 – investment funds
Updated financial statements of a fictional investment fund illustrating the disclosure and presentation required by IFRSs applicable to financial years beginning on or after 1 January 2009. The company is an existing preparer of IFRS financial statements; IFRS 1 is not applicable.



A practical guide to new IFRSs for 2010
48-page guidance providing high-level outline of the key requirements of IFRSs effective in 2010, in question and answer format.



Illustrative IFRS financial statements 2009 – private equity
Financial statements of a fictional private equity limited partnership illustrating the disclosure and presentation required by IFRSs applicable to financial years beginning on or after 1 January 2009. The company is an existing preparer of IFRS financial statements; IFRS 1 is not applicable.



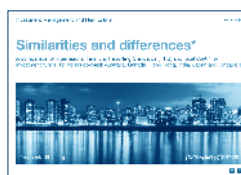
A practical guide to share-based payments
Answers the questions we have been asked by entities and includes practical examples to help management draw similarities between the requirements in the standard and their own share-based payment arrangements. November 2008.



Investment property and accounting for deferred tax under IAS 12
Paper highlighting some of the more frequently encountered issues and suggesting practical solutions relating to investment property and accounting for deferred tax under IAS 12.



Getting to grips with IFRS: making sense of IFRS for the IM industry
Publication highlighting the reporting and business implications of IFRS and the possible solutions for investment management companies.




Similarities and differences - a comparison of local GAAP and IFRS for investment companies
Outline of key similarities and differences between IFRS and local GAAP in Australia, Canada, Hong Kong, India, Japan, and Singapore, available in electronic format only. Visit www.pwc.com/investmentmanagement.



IAS 39 – Achieving hedge accounting in practice
Covers in detail the practical issues in achieving hedge accounting under IAS 39. It provides answers to frequently asked questions and step-by-step illustrations of how to apply common hedging strategies.



Similarities and differences – a comparison of US GAAP and IFRS for investment companies
Outline of key similarities and differences between IFRS and US GAAP applicable to investment companies.



IAS 39 – Derecognition of financial assets in practice
Explains the requirements of IAS 39, providing answers to frequently asked questions and detailed illustrations of how to apply the requirements to traditional and innovative structures.



Understanding financial instruments – A guide to IAS 32, IAS 39 and IFRS 7
Comprehensive guidance on all aspects of the requirements for financial instruments accounting. Detailed explanations illustrated through worked examples and extracts from company reports.

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Introduction

This publication was originally released in August 2009. It was updated in March 2010 with a new section. 'Questions and answers on properties (investment properties or inventories) rented out before sale' (p13).

The IASB's annual improvements project provides a vehicle for making non-urgent but necessary amendments to IFRSs.

The improvements issued in May 2008 include an amendment to IAS 40 (the amended IAS 40 is referred as IAS 40A in this publication). It revises the scope of IAS 40, 'Investment property', (and correspondingly the scope of IAS 16, 'Property, plant and equipment') and introduces new requirements for accounting for properties under construction or development for future use as investment properties. These are now within the scope of IAS 40A. Previously, IAS 16 was applied to all properties under construction up to the point when construction or development was completed (except to those properties recognised as inventory in accordance with IAS 2, 'Inventories'), regardless of the intentions for future use as either own-used property or investment property.

The IASB revisited the exclusion of investment property under construction from the scope of IAS 40. It decided that investment property within the scope of IAS 40 being redeveloped at a later stage would remain within the scope of IAS 40; investment property under construction would remain within the scope of IAS 16 until completion of the construction. The exclusion of investment property under construction gave rise to a perceived inconsistency. The IASB also concluded that, with increasing experience regarding the use of fair value as the measurement basis since IAS 40 was issued, entities were more able to reliably measure the fair value of investment property under construction.

The questions and answers on investment properties under construction assume that the financial year is the calendar year and that IAS 40A is not early adopted.

On a separate issue, it is customary in some jurisdictions for a property developer to lease out completed units of a property while development continues on other units, or while the property is being marketed. This is usually done with the intention of attracting potential buyers rather than with the view to earn rental income.

The question arises of whether a property developer should classify a property leased out before completion of the entire site or while waiting for a buyer to be found as inventory within the scope of IAS 2, or as investment property within the scope of IAS 40. This is covered in the questions and answers on properties (investment properties or inventories) rented out before sale.

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Questions and answers on investment properties under construction

1. Scope and transition requirements

1.1 Is the amended IAS 40 applicable to property under construction for which construction started before 1 January 2009?

Yes, IAS 40A para 85B requires prospective application of the amended standard. It permits adoption at an earlier date only if the fair values of the investment properties under construction were determined at that date. IAS 8 para 5 defines prospective application of a standard as applying the new accounting policy to transactions, other events and conditions occurring after the date at which the policy was changed.

The amendment is applicable for all investment properties under construction irrespective of the date at which the construction commenced. All investment properties under construction are therefore measured in accordance with IAS 40A at the first reporting period after the adoption of this standard.

1.2 Is the amendment to IAS 40 a change in accounting policy?

Yes, the requirement to account for investment properties under construction in accordance with IAS 40A is a change in accounting policy [IAS 8.14(a)]. Management is required to account for the change in accounting policy resulting from the initial application of IAS 40A in accordance with the specific transition provisions of IAS 40A [IAS 8 para 19(a); and IAS 40A para 85B] and to provide the disclosures required by IAS 8 para 28.

1.3 Is a property under construction previously classified as inventory transferred to investment properties when the intention to sell changes?

No, a property under construction originally classified as held for sale in the ordinary course of business is transferred to investment property when, and only when there is a change in use evidenced by commencement of an operating lease to another party [IAS 40A.57(d)].

2. Measurement provisions

2.1 Are all investment properties under construction measured at fair value starting from 1 January 2009?

Property under construction that is intended to be used as investment property after construction is completed is accounted for under IAS 40A from 1 January 2009. Management is required to choose between the application of the fair value model and the cost model for the accounting of investment properties. Once the decision is taken, it is applied consistently to all investment properties. There is a requirement to re-measure property under construction at fair value if the fair value model [IAS 40A paras 33-55] is applied.

Fair value measurement is only applied if the fair value is considered to be reliably measurable [IAS 40A para 53]. Excluded from the fair value measurement requirement are investment properties for which:

- The fair value cannot be reliably determined at present, but for which the entity expects the fair value to be reliably determinable when the construction is completed; or
- In exceptional cases, there is clear evidence when an entity first acquires the investment property that the fair value cannot be determined reliably on a continuing basis (or when an existing investment property first becomes investment property after a change in use).

The fair value of the investment property is not reliably determinable on a continuing basis only when comparable market transactions are infrequent and alternative reliable estimates of fair value (that is, based on discounted cash flow projections) are not available [IAS 40A para 53].

It may sometimes be difficult to determine reliably the fair value of the investment property. In order to evaluate whether the fair value of an investment property under construction can be determined reliably, management considers the following factors, among others:

- The provisions of the construction contract.
- The stage of completion.
- Whether the project/property is standard (typical for the market) or non-standard.
- The level of reliable cash inflows after completion.
- The development risk specific to the property and who has the responsibility.
- Past experience with similar constructions.
- Status of construction permits.

2.2 How should investment properties under construction be measured if the fair value cannot be reliably determined?

IAS 40A requires an investment property for which the fair value cannot be reliably determined to be accounted for at cost [IAS 40A para 53]. However, there is no reference to the cost model in IAS 16, 'Property, plant and equipment', in that regard. IAS 40A para 3 differentiates between:

- Investment property under construction for which the fair value cannot be reliably measured at present but for which in future the fair value would be reliably determinable; and
- Investment property that cannot be reliably measured at fair value on a continuing basis.

In the latter case, IAS 40A refers to the application of the cost model in accordance with IAS 16; however, if this is the case, the residual value of the property should be assumed to be zero.

2.3 Is it admissible to choose the fair value model to account for investment property under construction even though the cost model is used to account for completed investment property?

No, management is required to choose between the application of the fair value model and the cost model when accounting for investment properties. Once the decision is taken, it is applied consistently to all investment properties including investment property under construction. It is not admissible to account for an investment property under construction under the fair value model while opting to account for other investment properties under the cost model.

However, in the exceptional case explained above – where an entity chooses to apply the fair value model, but one of its investment properties is one for which the fair value cannot be determined reliably on a continuing basis – management applies the cost model in accordance with IAS 16 for that property [IAS 40A para 53]. In this situation, management accounts for the investment property under construction at fair value if the fair value can be determined reliably irrespective of the application of the cost model for the other property [IAS 40A para 54].

2.4 Is it admissible to measure an investment property under construction at cost in future periods if the fair value was determined reliably in the past?

No, management continues to measure the property at fair value until disposal or change in use (for example, the property becomes owner-occupied), even if comparable market transactions become less frequent or market prices become less readily available [IAS 40A para 55]. In this case, management uses alternative valuation methods such as discounted cash flow projections [IAS 40A para 46(c)].

In addition, it is generally prohibited to change from the fair value model to the cost model [IAS 40A para 31 and IAS 8 para 14(b)]. This also applies to completed investment properties for which the fair value model was chosen and the fair value of which could be determined reliably in the past.

With respect to investment property under construction, the general presumption that the fair value can be determined reliably can only be rebutted on initial recognition [IAS 40A para 53B]. Once a reliable fair value has been determined for an investment property under construction, management is required to measure the property at fair value if the fair value model is applied to investment property [IAS 40A para 53A] and subsequently the entity can no longer conclude that the fair value of the property cannot be determined reliably [IAS 40A para 53B].

2.5 How does management account for a property under construction that is transferred from investment property to owner-occupied property at commencement of owner occupation.

IAS 40A para 60 requires the investment property's fair value at the date of transfer to be deemed its cost for subsequent accounting under IAS 16. If the fair value cannot be determined reliably at the date of transfer (that is, it was also not available in the past), the cost of the construction less impairment is used to account for the property under construction.

Management allocates the amount recognised at the date of transfer in respect of the building under construction to its significant parts [IAS 16 para 44]. IAS 16 does not state which method should be used to allocate the cost.

2.6 Are future capital expenditures for development of a property and the related future benefits from these future expenditures considered when determining the fair value of the investment property under construction?

Yes, because such expenditure is not considered to improve or enhance the property; it is part of the strategic construction plan.

The issue arises because IAS 40A para 51 prohibits consideration of future capital expenditures that will improve or enhance the property as well as the related benefits arising from those future capital expenditures when determining the fair value of an investment property.

This should not be interpreted as referring to expenditures/benefits that a knowledgeable, willing buyer would consider when calculating the purchase price of an investment property under construction. Fair value reflects open market conditions and the knowledge and estimates of value of those knowledgeable willing buyers and sellers who participate in that market as well as general economic factors that affect the market. The market value of an investment property is determined on the basis of the highest value considering any use that is financially feasible, justifiable and reasonably probable.

In addition, any future capital expenditure that would be undertaken by the average market participant to get the investment property to its highest and best use is reflected in the property's fair value. However, if the planned development would be undertaken by the existing owner only, those capital expenditures and related benefits are not reflected in the property's fair value.

3. Recognition of fair value gains and losses

3.1 Where is gain or loss from initial measurement of investment properties under construction recognised on adoption of the new standard?

Entities applying the fair value model are required to account for investment properties under construction at fair value with fair value changes recognised in profit or loss, unless the fair value is not reliably determinable, from the date of adoption of IAS 40A.

Previously, such properties were generally accounted for at cost under IAS 16 until completion. Upon completion, the difference between fair value and cost was recognised in profit or loss.

The transition provisions of the amended IAS 40A provide for prospective application of the amended standard [IAS 40A para 85B]; the fair values at previous dates are not therefore required.

For entities with existing investment property under construction at the date of adoption, the previously unrecognised fair value gains or losses (if the losses have not already been recognised through impairment) are recognised in the income statement as fair value gain or loss in the financial statements for the first period after the date of adoption. Appropriate disclosures are made in the notes to the financial statements, including the disclosures required for newly adopted standards under IAS 8 (see section 5).

Example

Entity A started construction of investment property X in 2007 and investment property Y in 2008. X was completed in the first quarter of 2009; Y is expected to be completed in 2010.

The cost of construction as of 31 December 2008 amounts to C10 million for X and C5 million for Y.

During 2009, A incurred additional C1 million costs for the completion of X during the first quarter and C6 million for Y.

As part of the 2008 year-end procedures, A performed a valuation of the investment property under construction. This revealed that the fair value of the properties at 31 December 2008 amount to C14 million for X and C8 million for Y.

At 31 December 2009, the fair value of X is C16 million, and the fair value of Y is C14 million.

Entity A measures its investment properties at fair value and does not early adopt IAS 40A.

How does A account for the investment property?

A accounts for the investment properties in its financial statements at 31 December 2008 at cost in accordance with IAS 16. In 2009, the investment properties are fair valued.

The fair value gain of C5 million (fair value of C16 million less cost of C10 million up to 31 December 2008 and C1 million in 2009) on X relates to gains in the period since commencement of construction. It is recognised in profit or loss for 2009.

The fair value gain of C3 million (fair value of C14 million less cost of C5 million in 2008 and C6 million 2009) on Y relates to gains in the period since commencement of construction. It is recognised in profit or loss for 2009.

It is not appropriate to recognise the C7 million (fair value of C22 million at 31 December 2009 less fair value of C15 million at 31 December 2008) relating to construction in prior periods as an adjustment to retained earnings in the opening balances on 1 January 2009.

3.2 Are changes in fair values of investment property under construction for which construction commenced in 2008 or earlier determined as at 1 January 2009?

No, there is no requirement to determine the fair values of investment properties under construction at the date of adopting the revised standard.

The transition from accounting under IAS 16 to accounting under IAS 40A is a change in accounting policy due to a change in a standard, according to IAS 8 para 14(a). IAS 8 para 28(f) only requires disclosures regarding the effects of the initial application of new accounting policies; there is therefore no requirement to disclose the valuation effects relating to previous periods separately from the effects relating to 2009. Fair value would only be required on the first reporting date (for example at 31 March; 30 June; December 2009).

3.3 How are additional construction costs accounted for if the investment property under construction is measured at fair value?

Costs incurred in the course of the ongoing construction are capitalised and added to the previously recognised construction costs, provided they meet the definition of cost in IAS 40A para 5. After the new cost basis has been determined, the profit or loss from re-measuring the investment property under construction at fair value is calculated. It is not appropriate to recognise actual construction costs as an expense and recognise a corresponding adjustment to the fair value change. That would result in presentation of higher valuation profit (or lower valuation loss), with the difference being construction cost recognised as expense. Based on the example above, entity A recognises the additionally incurred costs of C1 million for X and C6 million for Y as part of the cost of construction and not as expense.

4. Impairment of investment properties and provisions for onerous contracts

4.1 Is an impairment test performed for investment property under construction accounted for at cost in accordance with IAS 40A?

Yes, when there is an indication (triggering event) that investment property is impaired. At each reporting date, management assesses whether there is a triggering event that an investment property under construction measured at cost may be impaired, irrespective of whether the cost accounting relates to management's decision to account for the investment property under the cost model or to the fact that the fair value cannot be determined reliably in accordance with IAS 40A para 53.

If there are indications (triggering events) that an investment property is impaired, impairment testing is performed at the end of the reporting period [IAS 36 para 9]. Excluded from this requirement and therefore not subject to an impairment test are investment properties that are measured at fair value [IAS 36 para 2(f)].

Given the present economic crisis, there might be a triggering event for investment property under construction (or any advance payments relating thereto), irrespective of whether the entity as a whole is profitable.

4.2 How is the impairment test performed?

The entity estimates the recoverable amount (that is, the higher of (i) the fair value of the asset less costs to sell and (ii) its value in use) of the investment property under construction carried at cost [IAS 36 para 9]. If the recoverable amount of the investment property under construction is less than its carrying amount, the carrying amount of the investment property under construction is reduced to its recoverable amount (impairment loss) [IAS 36 para 59].

If the recoverable amount cannot be estimated reliably for the individual property, management determines the recoverable amount of the cash-generating unit (CGU) to which the investment property belongs. A CGU is defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets [IAS 36 para 6]. Management needs to define the CGU at an appropriate level, which may also be the individual investment property under construction or any other level below the operating segment level.

Note: the definition of the CGU is independent from the decision about the level that any existing goodwill would be tested for impairment in accordance with IAS 36 para 80 (that is, operating segment level).

4.3 Is there an obligation to recognise a provision, if an entity entered into a construction contract, for which at the balance sheet date it can be foreseen that the market value of the property after it is completed will not cover its construction costs (onerous contract)?

A provision for onerous contracts is recognised if the unavoidable costs of meeting the obligations under the contract or existing from it exceed the economic benefits expected to be received under it [IAS 37 paras 66-69]. This would be the case, for example, if an entity enters into a binding forward purchase agreement to purchase a completed property after the construction has been completed, and this contract requires the entity to pay a fixed purchase price with a net present value of C100 million at the reporting date, and the estimated economic benefits of the completed investment property at the reporting date is below that (say, C80 million). The loss of C20 million is recognised immediately in the income statement. The resulting provision is recognised on the balance sheet.

If there is an onerous contract as defined above (that is, the future economic benefits cannot cover the fixed purchase price), an impairment test is performed on any asset dedicated to the contract (for example, prepayments made in relation to the purchase). Such assets relating to an onerous contract are written down to the recoverable amount, if this is less than the carrying amount [IAS 37 para 69]. A provision is recognised only after such asset is reduced to zero.

Regardless of the assessment as to whether or not there is an onerous contract, IAS 40A para 75(h) requires disclosure of contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements).

5. Disclosure and other issues

5.1 Following the change in accounting policies, what disclosures are required?

IAS 8 para 28 requires disclosures about the initial application of a new or amended standard. Those disclosures include, among others, disclosures on the nature of the change in accounting policy as well as the amount of the adjustments made for each financial statement line item affected. The disclosure includes all effects of adopting the amended standard, regardless of which period they should be attributed to economically.

For investment property that was under construction at the date of adoption of the amended IAS 40A and that remains under construction at the next reporting date, disclosure is required of the effect of measuring the property at fair value, with valuation adjustments recorded in the income statement. Management therefore discloses, as a minimum, the fair value gains or losses recognised during the period that have been recognised because of the adoption of the revised standard [IAS 8 para 28(f)]. Management separately discloses the fair value gains or losses recognised in the period on all properties under construction at the reporting date, as these gains/losses would not have been recognised if the new accounting policy had not been adopted.

Based on the example in Q&A 3.1, entity A separately discloses the gain of C3 million arising on property Y that is still under construction at year end; there is no need to disclose C5 million arising on property X, as the gain would have anyway be recognised in the income statement based on its previous accounting policy.

There is no requirement to disclose the fair value changes from investment properties under construction separately from the other gains and losses from fair value adjustments in the reconciliation between the carrying amounts of investment property at the beginning and the end of the year [IAS 40A para 76].

5.2 Is it admissible to separately disclose the valuation effect from 1 January 2009?

There is no requirement to disclose the valuation effect as of 1 January 2009 relating to investment properties under construction held at that date. However, management may wish to disclose the fair value gains or losses recognised at the date of adoption, if different from the amount disclosed under IAS 8 para 28(f), as a result of the initial application of the amended IAS 40A on existing investment properties under construction at the date of adoption. The users of the financial statements might find such a disclosure useful, as it improves the users' ability to analyse and compare information given in financial statements.

5.3 Is there a separate sensitivity analysis required for investment properties under construction?

In addition to disclosures on sources of estimation uncertainty relevant for existing investment properties, under IAS 1 paras 125 and 129(b), there may be some parameters for investment property under construction carried at fair value that might become subject to a sensitivity analysis (such as the effect on the valuation of the potential prolongation of the construction or letting periods). When applying parameters used for existing investment properties to property under construction, sensitivity analysis for valuation of investment properties under construction should take into account the uncertainty relating to the parameters used for valuation. These may be significantly higher than those for completed investment properties.

5.4 Can a property under construction be classified as property held for sale?

The classification of property under construction as property held for sale requires the criteria set out in IFRS 5 paras 6-12 to be met and the property under construction not to be accounted for under IAS 2 (for example, the property under construction was originally intended to be used as investment property but is now part of a portfolio of investment properties the entity intends to dispose of). Among other things, property under construction is required to be available for immediate sale in its present condition. In addition, that sale should be highly probable and should occur under normal market conditions.

For property under construction, the criterion of marketability should be particularly scrutinised. Classification under IFRS 5 is not permitted if the property cannot be sold as property under construction but only following completion (that is, it requires significant further development before a sale can be achieved). In this case, the investment property is not available for immediate sale in its present condition, because completion (further development) is required to reach marketability.

If there is – in exceptional cases – a possibility to dispose of the property before the construction is completed, meaning the property should be transferable ‘as it is’, ‘rather today than tomorrow’, the presentation as held for sale is required, provided that all other conditions are met.

The question will then arise of how to account for the construction costs incurred after the classification of the property as an asset held for sale. In order to measure the investment property under construction classified as held for sale, the additional construction costs are capitalised (including borrowing costs meeting the criteria for capitalisation) irrespective of whether the investment property is scoped in or out of the measurement provisions of IFRS 5. Management does not directly expense construction costs.

5.5 Is there an obligation to determine fair values for investment property under construction even though the cost model is used to account for investment property?

The disclosure of the fair value of investment property accounted for under the cost model. This disclosure is not required for those properties where the fair value cannot be determined reliably. In this case, some further disclosures are required. Apart from the description of the investment property, management explains why the fair value cannot be determined reliably and, if possible, the range of estimates within which the fair value is highly likely to lie [IAS 40 para 78(a) to (c)].

5.6 Are there specific disclosures required with respect to the change in accounting policies?

Yes, the amendment to IAS 40 is a change in accounting policy required by a standard in accordance with IAS 8 para 14(a). Management is required to provide the disclosures required in IAS 8 para 28. This requires management to disclose, among other things:

- The title of the IFRS and the nature of the change in accounting policy.
- A description of the transition provision, whether the change in accounting policy has been made in accordance with the transition provisions and whether the transition provisions might have an effect on future periods.
- For the current period and each period presented, the amount of the adjustment for each line item affected.

Questions and answers on properties (investment properties or inventories) rented out before sale

1 What is inventory?

Inventories are assets [IAS 2 para 6]:

- Held for sale in the ordinary course of business;
- In the process of production for such sale; or
- In the form of materials or supplies to be consumed in the production process or in the rendering of services.

Inventories therefore encompass land and other property held for resale [IAS 2 para 8].

2 What is investment property?

Investment property is 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 [IAS 40 para 5].

Property intended for sale in the ordinary course of business or in the process of construction or development for such a sale is not an investment property [IAS 40 para 9(a)].

Transfers to or from investment property should be made only when there is a change in use, evidenced by the commencement of an operating lease to another party, for a transfer from inventories to investment property [IAS 40 para 57(d)]. A lease commences at the date from which the lessee is entitled to exercise its right to use the leased asset [IAS 17 para 4].

The classification of a property rented out before sale depends on the facts and circumstances. The commencement of a lease in itself does not automatically require the transfer from inventory to investment property, although it may be indicative of a change in management's intention. Careful consideration is therefore required to assess whether the property is held for sale or to earn rentals and for capital appreciation.

3 **Entity A, a property developer with a history of developing properties for sale immediately after completion, constructs a residential property for sale. To increase the possibility of selling the entire property after completion, the entity decides to lease out individual apartments when completed. The tenants move in before the property in its entirety is completed and sold. How should A account for the property?**

Entity A should continue to classify the property as inventory, as this is consistent with the entity's principal activities and its strategy for the property even after the commencement of leases. The leases are intended to increase the possibility to sell the property rather than to earn rental income on a continuing basis, and the property is not held for capital appreciation.

The entity's intention to sell the property immediately after completion has not changed, as the property continues to be held exclusively with the view to subsequent disposal in the ordinary course of business; it does not therefore meet the definition of investment property [IAS 40 para 9(a)].

4 Entity B, a property developer with a history of developing properties for sale immediately after completion, constructs a residential property for sale. However, as property prices are at a multi-year low and there are few buyers/transactions in the market, Entity B decides to rent out the property until market activity improves. Entity B believes it will be better able to find a buyer for the property at that time. How should B account for the property?

Entity B needs to carefully assess whether the property should continue to be classified as inventory or be transferred to investment properties in accordance with IAS 40 para 57(d).

The property should continue to be classified as inventory if this is consistent with B's strategy for this property. However, it should be transferred to investment property if there is a change in management's intention to hold the property for future rentals or for capital appreciation (for example, until market prices recover).

Determining the correct classification of such a property requires judgement. The inception of a lease with third parties in itself does not automatically require the reclassification as investment property, although it may be indicative of a change in management's intention.

The property may therefore continue to be classified as inventory to the extent it is available for immediate sale in its present condition, at a current market price, in the ordinary course of business. Factors to consider include:

- Is the property actively marketed for sale?
- Is the property available for sale at a price that is reasonable relative to its current market value?
- Does a market exist for properties with sitting tenants, with longer lease terms, such that the property is in a condition to be sold immediately?
- Where there is no market for properties with sitting tenants, are the terms of any leases less than the length of the period that other similar properties take to be sold in the ordinary course of business under current market conditions?

If the entity is unwilling to sell the property at the current, depressed market price, it is likely that the intended use of the property has changed to meet the definition of an investment property – held to earn rental income and for capital appreciation. Factors to consider are, inter alia:

- Has the board decided to postpone the sale of the property until the market price recovers?
- Is there a change in the business plan that takes into account the rental income earned and the necessary future maintenance expenses?
- Is the property no longer actively marketed for sale?
- Is there still a(n) (active) market for similar properties?
- Is the property available for sale only at a price that is not reasonable relative to its current market value?

- 5 Entity C, a property developer with a history of developing properties for sale immediately after completion, constructs a residential property for sale. However, as property prices are at a multi-year low, Entity C decides to no longer pursue the plan to sell the property after completion and to reconsider the decision to sell at a later stage when the market improves. The intended change in use is evidenced by a formal decision of the board and a change in Entity C's business plan. Entity C intends to rent the property out to third parties on longer lease terms. However, at year end, no lease contract has been signed. How should C account for the property?**

Entity C should continue to classify the property as inventory. IAS 40 para 57 precludes the transfer of such a property to investment property until there is an actual change in use; this is evidenced by the commencement of an operating lease with a tenant [IAS 40 para 75(c)]. The intention to rent out the building after completion – with no lease contract yet in place – may indicate a change in the intended use but is, in itself, not sufficient to qualify for a change in classification.

- 6 Entity D is engaged in two lines of business: property development for sale; and investment property held for rental purposes. Two of the properties currently classified as investment property are to be sold in the near future. Property X is going to be redeveloped prior to sale. The redevelopment will significantly improve and enhance the property. Property Y will also be sold, but significant redevelopment is not necessary (although some basic repairs will be undertaken).**

Entity D wishes to transfer both properties from investment property to inventory at the date the developments commence in accordance with IAS 40 para 57(b). How should D account for the properties?

Entity D should transfer property X to inventories at the commencement of the redevelopment; property Y should continue to be classified as investment property until the criteria in IFRS 5 are met, at which point the property should be classified as held for sale.

IAS 40 para 57(b) requires an investment property to be transferred to inventories only when the property is being developed with a view to sale. Developments in this context should substantially modify or otherwise enhance the property; basic repairs typically would not qualify as a substantial modification.

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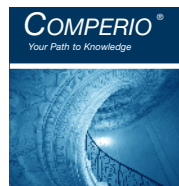
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