

Asset Management

A practical guide to IFRS 8 for real estate entities

January 2010



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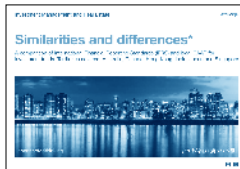
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Introduction

A real estate fund discloses information that enables users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates [IFRS 8.1]. This publication addresses questions that arise when applying IFRS 8 to real estate entities. It should be read only in conjunction with the *A practical guide to IFRS 8 for investment funds* (June 2009), which contains further guidance that may also be relevant.

A practical guide to IFRS 8 for real estate entities, which is based on the requirements of IFRS 8 applicable to financial periods commencing on or after 1 January 2009, is not a substitute for reading the standards and interpretations themselves or for professional judgement as to fairness of presentation. It does not cover all possible disclosures that IFRS 8 requires, nor does it take account of any specific legal framework. Further specific information may be required in order to ensure fair presentation under IFRS. We recommend that readers refer to our publication *IFRS disclosure checklist 2009*. Additional accounting disclosures may be required in order to comply with local laws and stock exchange or other regulations.

Definition and identification of operating segments

An operating segment is a component of an entity [IFRS 5.8]:

- that engages in business activities from which it may earn revenues and incur expenses;
- whose operating results are regularly reviewed by the entity's chief operating decision-maker (CODM) to make decisions about resources to be allocated to the segment and assess its performance; and
- for which discrete financial information is available.

1.1 Can a real estate entity have only one operating segment?

Yes. A real estate entity might have only one operating segment – for example, if the only business activity the entity is engaged in is that of investing in similar real estate properties in a specific geographical area (for example, same type of property in the same area with the same kind of tenants) that are managed together and whose operating results and performance are regularly reviewed by the entity's CODM to make decisions about resources to be allocated to the segment.

Even if the real estate entity does comprise less uniform properties, the CODM might review the results and performance of the portfolio together. The determination of the operating segments is solely based on the 'through the eyes of management' approach and needs to take into account what the CODM does to assess performance and allocate resources.

If the portfolio is composed of significantly divergent properties (for example, office buildings, retail parks, warehouses, hotels, residential housing) or in different locations (for example, Europe, the US, Asia), management should assess whether the CODM is assessing performance and allocating resources on a more disaggregated basis and consider the guidance in IFRS 8.8 in its determination of the operating segments..

However, even if a real estate entity has only one operating segment, the entity needs to present segment information to satisfy the minimum requirements of IFRS 8 [IFRS 8.31].

1.2 Real estate companies often manage their real estate portfolio on a property-by-property basis. Is the real estate entity required to disclose each individual property as an operating segment?

It depends. Each property would be an operating segment if the CODM reviews the results and performance of the properties on a property-by-property basis and makes decisions about resources to be allocated to the properties on the same basis.

However, if only the day-to-day management is performed on a property-by-property basis, but the CODM does not use this information and does not assess performance on a property-by-property basis, the real estate entity determines operating segments on the same basis as the one used by the CODM to assess performance and allocate resources.

Moreover, there is no limit in theory on the number of operating segments (the number of operating segments is a matter of fact) in a real estate or other environment, although IFRS 8 states that an entity with more than 10 reportable segments should consider whether a practical limit of reportable segments has been reached [IFRS 8.19]. Therefore, companies reaching a

conclusion leading to a significant number of reportable segments should consider the aggregation criteria as stated in Q&A 2.1.

It is possible for a single real estate asset to be a separate operating segment. For example (and provided that the other segmental criteria are met):

- A single asset in the US could be an operating segment – for example, if all other real estate assets are located in Europe and information about the asset is reported separately in the reports to the CODM.
- A single logistics asset could be a stand-alone operating segment among office buildings in the real estate entity portfolio – for example, if the other assets in the real estate entity's portfolio are office buildings, and information about the asset is reported separately in the reports provided to the CODM.

1.3 The CODM of a real estate entity might receive information that aggregates the portfolio of property according to different criteria. Such information might distinguish the information by property type or by geographical area. What information should be used to determine the operating segments?

It depends. A real estate entity's CODM may use more than one set of components (business areas of interest). If the CODM uses more than one set of segment information, the real estate entity needs to determine which component constitutes the operating segment. Factors that may be considered include the nature of the business activities of each component, the risk and rewards profile, the existence of managers responsible for them, and information presented to the board of directors [IFRS 8.8].

If the CODM uses overlapping sets of components (for example, it manages the company's activities on a matrix basis), the entity should determine which set of components best constitutes the operating segments by reference to the core principle [IFRS 8.10].

1.4 What kind of criteria may be used by the CODM to determine the real estate entity's segments?

Depending on how a real estate entity is managing its properties, the CODM may receive information on the following basis (not exhaustive):

- Types of the property: office buildings, logistics, retail areas, warehouses, hotels, retail housing, etc;
- Nature of the attached business model: developed properties, properties under development, non-development property;
- Nature of management: individually managed properties, properties managed on a portfolio basis;
- Location of the properties: Europe/US/Asia, town centre/inner suburbs/outer suburbs;
- Types of tenant: retail, corporate, governmental;
- Number of tenants: multiple-tenant property, single-tenant property; and
- Types of investment: direct property investments, indirect property investments.

Identification of reportable segments

Management discloses information about each operating segment that:

- has been identified in accordance with IFRS 8.5-10 or results from aggregating two or more of those segments in accordance with IFRS 8.12; and
- exceeds the quantitative thresholds in IFRS 8.13 [IFRS 8.11].

Management may combine information about operating segments that do not meet the quantitative thresholds with information about other operating segments that do not meet the quantitative thresholds to produce a reportable segment only if the operating segments have similar economic characteristics and share a majority of the aggregation criteria in IFRS 8.12 [IFRS 8.14].

2.1 Operating segments that meet the quantitative threshold may be aggregated into a single operating segment if aggregation is consistent with the core principle of IFRS 8, the economic characteristics are similar and segments are similar with regard to all five different areas listed in IFRS 8.12.

However, the characteristics in IFRS 8.12 seem to focus on companies engaged in production and therefore might be less meaningful when applied to a real estate entity. As they need to be fulfilled cumulatively in order to aggregate segments, the aggregation of segments may arguably be inadmissible for funds.

Can a real estate entity that does not fulfil all of the criteria in IFRS 8.12 still aggregate operating segments?

It depends, to the extent that the criteria are not relevant or meaningful when applied to the activities of the fund. Management assesses whether the operating segments have similar economic characteristics and assesses the criteria in IFRS 8.12 only to the extent they are relevant. For example, the factor regarding the nature of the regulatory environment might not be applicable to all companies. In assessing the areas listed in IFRS 8.12 for a real estate entity, management should consider the relevant attributes of the segments, including the nature of the investment properties and how they are managed, the economic environment of the properties' location and the different types of tenant.

2.2 A real estate entity sells all its investment properties that are in one specific location (or have the same specific nature) but plans to buy another property in the same location (or with the same specific nature) in the future. Is it possible to continue to report the respective segment even though the segment currently does not represent any major holdings?

Yes. If the CODM continues to review this segment and expects that the absence of holdings in this segment will be temporary, management may choose to continue to report a segment in the current period even though the segment no longer meets the criteria that requires the segment to be reported separately [IFRS 8.17]. However, if the purchase of the new property takes more than one year, so the segment results for both years are zero, management should assess whether continued reporting of this segment will enable users of its financial statements to evaluate the nature and effects of the business activities in which it engages.

2.3 A real estate entity reclassifies a property from IAS 40, 'Investment property', to IAS 2, 'Inventories', due to the commencement of development with the view to sale. The operating segment 'Developments' did not meet the quantitative thresholds in the past and were not therefore disclosed separately in the segment reporting. After reclassification, the operating segment will meet the quantitative thresholds. The real estate entity claims that no restatement of prior-year numbers is required, as back in the prior year, the property was correctly included in the segment 'Investment properties'. Should the real estate entity restate prior-year segment data?

Yes. IFRS 8.18 requires the restatement of prior-year segment data. The entity is therefore required to disclose the operating segment 'Developments' as a separate segment for the prior year.

However, the real estate entity is not required to reclassify the investment property accounted for as investment property under IAS 40 in the previous year, as the transfer only affects the current period and has not been reflected in the reporting to the CODM in the previous year. The property therefore remains in the segment 'Investment properties' in the comparative amounts but is included in the segment 'Developments' in the current year. The transfer of one property to another segment is not a change in the structure of the internal organisation in a manner that causes the composition of the reportable segments to change [IFRS 8.29]. The prior-year numbers for the segment 'Developments' should therefore only contain the properties allocated to the segment in the previous year.

2.4 Due to the increasing risk related to property investments in the geographical area, real estate entity 'XYZ' changes the way it manages the investments. This requires a change in the reporting to the CODM, which will result in a change of the composition of the reportable segments. Should the real estate entity restate prior year segment data?

Yes. The change in the structure of the internal organisation resulted in a change to the information that the CODM reviews to assess the performance of the operating segments and allocate resources to them. The real estate entity therefore needs to change the composition of its operating segments and its reportable segments. This requires a restatement of prior-year segment data [IFRS 8.29]. The real estate entity can refrain from restating the prior-year segment data only if the information is not available and the cost to develop the information would be excessive. In that case, the entity discloses that fact and presents, in the year in which the change occurs, segment information on both the new and the old basis [IFRS 8.30].

Disclosures

Management discloses information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates [IFRS 8.20].

Entity-wide disclosure requirements apply to all entities subject to IFRS 8, including those entities that have a single reportable segment [IFRS 8.31].

3.1 An entity should report information using the same measure used in the reports regularly provided to the CODM. If the report to the CODM uses tax-based information rather than IFRS-compliant information, is the entity required to use the tax-based information for its segment reporting?

Yes. The amount of each segment item reported should be the measure reported to the CODM for the purpose of making decisions about allocating resources to the segment and assessing its performance [IFRS 8.25].

IFRS 8 adopts the management approach to segment reporting, and the guidance in IFRS 8.25 is consistent with this approach. Therefore, if the CODM uses only one measure to allocate resources and assess performance and this single measure is based on local GAAP numbers, they should be used for the purpose of segment reporting. In this case, the explanations of the measurements used as required by IFRS 8.27 gain additional significance, and a reconciliation of the segments' financial information to the consolidated IFRS financial statements will be necessary [IFRS 8.28].

3.2 Would the answer in Q&A 3.1 change if the CODM uses both tax-based information and IFRS-compliant information?

Yes. If the CODM uses more than one measure, the reported measures should be those that are determined in accordance with the principles most consistent with those used in measuring the corresponding amounts in the entity's financial statements [IFRS 8.26]. This means that if the CODM uses both IFRS and tax-based information, the IFRS numbers have to be reported, as they are consistent with the measures used in the entity's financial statement.

3.3 What material items of income and expenses or other non-cash items are reported in a real estate environment?

A real estate entity should disclose several different financial measures if they are reviewed by the CODM when measuring the performance of the segment. The following are examples of typical financial information that a real estate entity might disclose [IFRS 8.23]:

- Rental income from external customers;
- Interest income;
- Interest expenses;
- Depreciation and amortisation;
- Net gains or losses from fair value adjustment;
- Income tax;
- Property operating expenses; and
- Ground rents paid (linked with concession).

3.4 How should an entity disclose ‘revenue’ if the amount disclosed in the statement of comprehensive income is presented net of rental expenses but the CODM reviews the rental income and expenses on a gross basis?

The real estate entity should disclose the fact that the amounts are regularly provided to the CODM on a gross basis. It should present the amounts of revenue gross and then reconcile those to the consolidated IFRS revenue.

3.5 IFRS 8.32 requires the disclosure of revenues from external customers for each product or service or each group of similar products and services. Would this require a real estate entity to disclose revenue on a property-by-property basis if the entity has only one operating segment?

No. IFRS 8.32 does not require information to be given on a property-by-property basis. However, the disclosure should be given for by group of similar products and services. An entity may therefore break down the rental income received by type of property – for example, as follows:

| | in €000 |
|----------------------|----------------|
| Rental income: | |
| – Warehouse property | 6,917 |
| – Office property | 14,285 |
| – Retail property | 18,942 |
| Total rental income | 40,144 |
| Service charges | 2,112 |
| Total revenue | 42,354 |

3.6 IFRS 8.33 requires an entity to disclose geographical information. Would this requirement be met if a real estate entity domiciled in Germany discloses revenue from external customers and non-current assets such as investment properties by continent (for example, Europe, Asia/Pacific, Americas)?

No. The entity discloses separately the revenue from external customers as well as the non-current assets – such as investment properties attributed to the entity's country of domicile – to an individual foreign country if material, and to all remaining foreign countries in total from which the entity derives revenue. The entity may break down the rental income and the non-current assets received by location as follows:

| In €000 | Revenues | Non-current assets |
|-----------------------|-----------------|---------------------------|
| Germany | 1.343 | 26.860 |
| France | 17.634 | 352.680 |
| The Netherlands | 10.589 | 211.780 |
| Rest of Europe | 3.750 | 75.000 |
| Europe (total) | 33.316 | 666.320 |
| United States | 6.547 | 130.940 |
| Rest of America | 1.533 | 30.660 |
| Americas (total) | 8.080 | 161.600 |
| Asia/Pacific (total) | 958 | 19.160 |
| Total revenue | 42,354 | 847.080 |

3.7 A real estate entity enters into swap agreements to economically hedge the interest rate cash flow risk of the variable interest borrowings that are used to finance the property investments. The information reviewed by the CODM only presents the interest received from the swap, as the entity presents the interest payments on the borrowings and the interest received and paid from the swap net. Should the real estate entity present the interest income and the interest expense grossed up?

No. Even though the standard requires an entity to report interest income separately from interest expense for each reportable segment, in the above scenario the interest expense should be presented net. This is because the CODM relies primarily on the net interest expense to assess the interest rate cash flow risk. As such, the real estate entity may report that segment's interest expense net of its interest income, disclose that it has done so and reconcile it to the figures presented in the primary financial statements.

3.8 IFRS 8.34 requires disclosure of the extent an entity relies on its major customers. Does this require a real estate entity to disclose its major tenants?

Yes. If the revenue of the real estate entity is driven by a single tenant (10% or more of revenue), the real estate entity is required to disclose that fact and state the total amount of revenue from that tenant. However, the standard does not require disclosure of the name of the tenant nor the property it relates to.

If the revenue is driven by a large number of tenants and no single tenant or group under common control contributes more than 10% of the entity's revenue, the real estate entity does not need to give this disclosure. However, the entity should state that fact.

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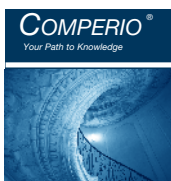


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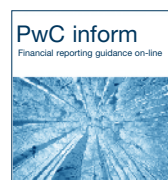
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