



How are investment properties measured under IAS 40?

Irrespective of the fact that you are an expert or a novice retail real estate investor, you have often heard about IAS 40 when it comes to investment properties. While the expert investors are well-aware of it, the term could be a bit tricky for beginner investors. With that being said, this write-up is solely dedicated to IAS 40, what it is, how it defines investment properties, and also a brief look at its history. So, let's straight into it!

What is IAS 40?

International Accounting Standard 40, aka IAS 40, applies to the accounting for property (land and/or buildings) held to earn rentals or for capital appreciation, or both. Some of the examples that are included as [investment property](#) in IAS 40 are as follows:

- land held for long-term capital appreciation
- land held for a currently undetermined future use
- building leased out under an operating lease
- the vacant building held to be leased out under an operating lease
- property that is being constructed or developed for future use as an investment property

On the other hand, the following are not investment property and, therefore, are outside the scope of IAS 40:

- property held for use in the production or supply of goods or services or for administrative purposes
- property held for sale in the ordinary course of business or in the process of construction or development for such sale (IAS 2 Inventories)
- property being constructed or developed on behalf of third parties (IAS 11 Construction Contracts)
- owner-occupied property (IAS 16 Property, Plant and Equipment), including property held for future use as owner-occupied property, property held for future development and

subsequent use as owner-occupied property, property occupied by employees, and owner-occupied property awaiting disposal

- property leased to another entity under a finance lease

In May 2008, as part of its Annual improvements project, the IASB expanded the scope of IAS 40 to include property under construction or development for future use as an investment property. Earlier such property fell within the scope of IAS 16.

An investment property is first valued at its purchase price. The lower of the fair value of the property interest and the present value of the minimum lease payments is used to calculate the cost of an investment property interest held under a lease in accordance with IAS 17.

For all investment properties, an entity must use the fair value model or the cost model as its accounting policy for subsequent measurement.

- Fair Value Model

IAS 40 states, investment property is remeasured at fair value, which 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. Further IAS 40.35 adds that gains or losses arising from changes in the fair value of investment property must be included in net profit or loss for the period in which it arises.

Meanwhile, IAS 40.55 states that a property, that has previously been measured at fair value, should continue to be measured at fair value until disposal, even if comparable market transactions become less frequent or market prices become less readily available.

- Cost Model

The cost model is covered in IAS 40.56. [Investment property](#) is accounted for in accordance with the cost model as set out in IAS 16 Property, Plant and Equipment – cost less accumulated depreciation and less accumulated impairment losses.

When an entity uses the cost model for an investment property, transfers between categories do not change the carrying amount of the property transferred, and they do not change the

cost of the property for measurement or disclosure purposes.

A brief history of IAS 40

In April 2001 the International Accounting Standards Board (Board) adopted IAS 40 Investment Property. It was originally issued by the International Accounting Standards Committee in April 2000. That Standard had replaced some parts of IAS 25 Accounting for Investments, which had been previously issued in March 1986 and had not already been replaced by IAS 39 Financial Instruments: Recognition and Measurement.

- Later, in December 2003 the Board issued a revised IAS 40 as part of its initial agenda of technical projects.
- Then IFRS 16 Leases made various amendments to IAS 40, including expanding its scope to include both owned investment property and investment property held by a lessee as a right-of-use asset in January 2016.
- In addition, in December 2016, the Board issued Transfers of Investment Property (Amendments to IAS 40) which clarifies when there is a transfer to, or from, investment property.

Comparison with Ind AS 40

- IAS 40 permits both the cost model and fair value model (except in some situations) for the measurement of investment properties after initial recognition, whereas, Ind AS 40 permits only the cost model.
- The transitional provisions given in IAS 40 have not been included in Ind AS 40.
- IAS 40 requires disclosure of fair values of investment property when the cost model is used. Since this requirement is retained in Ind AS 40, paragraphs 53, 53A, 53B, 54, and

55 and certain other paragraphs of IAS 40 have been modified. The modifications include deletion of reference to use of cost model when fair value measurement is unreliable.

- If the criteria of investment property are otherwise met and the fair value model is used, IAS 40 allows for the consideration of a property interest held in an operating lease as an investment property. In these situations, the operational lease would be treated as a financing lease. This procedure is prohibited in Ind AS 40 since the application of the fair value concept is prohibited. As a result, Ind AS 40 has deleted paragraph 6 of IAS 40 (see point 1(i) above). In addition, in Ind AS 40, the phrase "investment property under a finance or operating lease" from paragraph 74 of IAS 40 has been replaced with "investment property under a finance lease."
- As a result of the prohibition of the use of the fair value model in Ind AS 40, there are some modifications needed in the wording of various paragraphs.
- In IAS 40, paragraphs 84B and 85F are added consequently to the issuance of the new standard on leases (IFRS 16, Leases) while Ind AS corresponding to IFRS 16 is under formulation in India. Based on this, these paragraphs will be finalized once Ind AS 116 is finalized.

Before starting your journey as a retail real estate investor, it is important that you understand the importance and objectives of IAS 40. Once that is clear, you can start looking for investment properties. In this tedious task, [PropReturns](#) can provide the investor with helpful information such as rental yield, tenure, location, and much more.