

Construction Industry – Part 2

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Today's Agenda

Borrowing Costs (IAS 23)

Investment Property (IAS 40)

Simple but
Comprehensive

Contentious and
key issues

Real Life Cases
and Examples



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Borrowing Costs (IAS 23)

Amendments to
IAS 23 issued in
March 2007



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1. Objective and Scope

- The objective of IAS 23 is to prescribe the accounting treatment for borrowing costs.
- IAS 23
 - generally requires the immediate expensing of borrowing costs, but
 - permits, as an allowed alternative treatment, the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.
- IAS 23 shall be applied in accounting for borrowing costs, but does not deal with the actual or input cost of equity, including preferred capital not classified as a liability.

Benchmark
– Expenses

Allowed Alternative
– Capitalisation



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2. What Are Borrowing Costs?

- Borrowing costs
 - are interest and other costs incurred by an entity in connection with the borrowing of funds.
 - may include:
 - a) interest on bank overdrafts and short-term and long-term borrowings;
 - b) amortisation of discounts or premiums relating to borrowings;
 - c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;
 - d) finance charges in respect of finance leases recognised in accordance with IAS 17 *Leases*; and
 - e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.



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3. Benchmark Treatment: Expense

Recognition

- Borrowing costs shall be [recognised as an expense](#) in the period in which they are incurred.
- Under the benchmark treatment
 - borrowing costs are recognised as an expense in the period in which they are incurred regardless of how the borrowings are applied.

**Benchmark
– Expenses**

Disclosure

- The financial statements shall disclose
 - [the accounting policy](#) adopted for borrowing costs.



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3. Benchmark Treatment: Expense

Amendments to IAS 23 issued in March 2007

- Converged to the practice in US
- Apply to borrowing costs relating to qualifying assets for which it begins capitalisation on or after 1 January 2009
- Remove the option of immediately recognising the borrowing costs as expenses
- IAS 23 does not apply to borrowing costs directly attributable to the acquisition, construction and production of a qualifying assets measured at fair value, say biological asset

Benchmark
– Expense



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4. Allowed Alternative: Capitalise

Recognition

- Borrowing costs shall be recognised as an expense in the period in which they are incurred,
 - except to the extent that they are **capitalised** in accordance with IAS 23.



Allowed Alternative
– Capitalisation

- What kinds of borrowing costs eligible for capitalisation?
- When does capitalisation commence?
- When does capitalisation suspense?
- When does capitalisation cease?

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4. Allowed Alternative: Capitalise

Recognition → Eligible

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset *shall be capitalised* as part of the cost of that asset.
 - The amount of borrowing costs eligible for capitalisation shall be determined in accordance with IAS 23.



4. Allowed Alternative: Capitalise

Recognition → Eligible

- A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.
- Under the allowed alternative treatment,
 - borrowing costs that are directly attributable to the acquisition, construction or production of an asset are included in the cost of that asset.
- Such borrowing costs are capitalised as part of the cost of the asset when
 - it is probable that they will result in future economic benefits to the entity and
 - the costs can be measured reliably.
- Other borrowing costs are recognised as an expense in the period in which they are incurred.



Other → to be expensed

4. Allowed Alternative: Capitalise

Example

Recognition → Eligible

Qualifying Asset

Examples of qualifying assets:

- Inventories that require a substantial period of time to bring them to a saleable condition
- Manufacturing plants,
- Power generation facilities
- Investment properties

Examples of items cannot be qualifying assets:

- Other investments, and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time
- Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

4. Allowed Alternative: Capitalise

Recognition → Eligible

Qualifying Asset

Attributable borrowing cost

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that
 - would have been avoided if the expenditure on the qualifying asset had not been made.
- When an entity borrows funds specifically for the purpose of obtaining a particular qualifying asset,
 - the borrowing costs that directly relate to that qualifying asset can be readily identified.

4. Allowed Alternative: Capitalise

Recognition → Eligible

- It may be difficult
 - to identify a direct relationship between particular borrowings and a qualifying asset and
 - to determine the borrowings that could otherwise have been avoided. e.g. when the financing activity of an entity is coordinated centrally.
- Difficulties also arise when a group uses a range of debt instruments to borrow funds at varying rates of interest, and lends those funds on various bases to other entities in the group.
- Other complications arise through the use of loans denominated in or linked to foreign currencies, when the group operates in highly inflationary economies, and from fluctuations in exchange rates.
- As a result, the determination of the amount of borrowing costs that are directly attributable to the acquisition of a qualifying asset is difficult and the exercise of judgement is required.

4. Allowed Alternative: Capitalise

Recognition → Eligible

Borrowing costs may be incurred from 2 sources in obtaining a qualifying asset:

1. Borrowed specifically for obtaining a qualifying asset
2. Borrowed generally and used for obtaining a qualifying asset



To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset

- the amount of borrowing costs eligible for capitalisation on that asset shall be determined as the **actual borrowing costs** incurred on that borrowing during the period
- less any investment income on the temporary investment of those borrowings.



4. Allowed Alternative: Capitalise

Recognition → Eligible



- The financing arrangement for a qualifying asset may result in an entity
 - obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditures on the qualifying asset.
- In such circumstances, the funds are often
 - temporarily invested pending their expenditures on the qualifying asset.
- In determining the amount of borrowing costs eligible for capitalisation during a period,
 - any investment income earned on such funds is deducted from the borrowing costs incurred.

4. Allowed Alternative: Capitalise

Case



- Borrowing costs are expensed in the income statement in the period in which they are incurred,
 - except to the extent that they are capitalized as being attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

4. Allowed Alternative: Capitalise

Case



Beijing Enterprises Holdings Ltd.

- Has early adopted all new IFRS in 2004 and stated that:
 - Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e., assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalized as part of the cost of those assets
 - Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs capitalized.

4. Allowed Alternative: Capitalise

Recognition → Eligible

Borrowing costs may be incurred from 2 sources in obtaining a qualifying asset:

1. Borrowed specifically for obtaining a qualifying asset
2. Borrowed generally and used for obtaining a qualifying asset



To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset

- the amount of borrowing costs eligible for capitalisation shall be determined by applying a capitalisation rate to the expenditures on that asset.



4. Allowed Alternative: Capitalise

Recognition → Eligible

Borrowing costs may be incurred from 2 sources in obtaining a qualifying asset:

1. Borrowed specifically for obtaining a qualifying asset
 2. Borrowed generally and used for obtaining a qualifying asset
- The **capitalisation rate** shall be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period,
 - other than borrowings made specifically for the purpose of obtaining a qualifying asset.
 - The amount of borrowing costs capitalised during a period shall not exceed the amount of borrowing costs incurred during that period.



4. Allowed Alternative: Capitalise

Recognition → Eligible

- In some circumstances, it is appropriate to
 - include all borrowings of the parents and its subsidiaries when computing a weighted average of the borrowing costs
- In other circumstances, it is appropriate for
 - each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings.



4. Allowed Alternative: Capitalise

Recognition

Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount

- When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realisable value
 - the carrying amount is written down or written off in accordance with the requirements of other IFRSs.
- In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other IFRSs.



4. Allowed Alternative: Capitalise

Recognition → Commence

- The capitalisation of borrowing costs as part of the cost of a qualifying asset shall commence when:
 - a. expenditures for the asset are being incurred;
 - b. borrowing costs are being incurred; and
 - c. activities that are necessary to prepare the asset for its intended use or sale are in progress.



4. Allowed Alternative: Capitalise

Example

- Entity A constructs a scientific medical equipment for its own use, with a cost of \$50 million and consider it as a qualified asset.
- Borrowing costs capitalised under IAS 23 amounts to \$6 million.
- It also receives a government grant of \$5 million on that asset.
- Can the government grant received be recognised as part of the expenditure on qualified asset?

Expenditures on a qualifying asset

- include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities.
- are reduced by any progress payments received and grants received in connection with the asset (see IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*).

4. Allowed Alternative: Capitalise

Example

- Before the construction of a property in a land, Entity GV has to prepare the construction plan and get the government approval.
- Borrowing costs have been incurred during the above period.
- Are these borrowing costs eligible for capitalisation under IAS 23?

Yes

- The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset.
- They include technical and administrative work prior to the commencement of physical construction,
 - such as the activities associated with obtaining permits prior to the commencement of the physical construction.
- However, such activities exclude
 - the holding of an asset when no production or development that changes the asset's condition is taking place.

4. Allowed Alternative: Capitalise

Recognition → Suspense

- Capitalisation of borrowing costs shall be suspended during extended periods in which active development is interrupted.

Except for the following:

- Not normally suspended during a period when substantial technical and administrative work is being carried out.
- Not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.



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4. Allowed Alternative: Capitalise

Recognition → Cease

- Capitalisation of borrowing costs shall cease
 - when **substantially all** the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- When the construction of a qualifying asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalisation of borrowing costs shall cease
 - when **substantially all** the activities **necessary to prepare that part** for its intended use or sale are completed.



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4. Allowed Alternative: Capitalise

Example

Recognition →  Cease

- Example of a qualifying asset for which each part is capable of being usable while construction continues on other parts
 - A business park comprising several buildings, each of which can be used individually
- Example of a qualifying asset that needs to be complete before any part can be used:
 - An industrial plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a steel mill.

4. Allowed Alternative: Capitalise

Example

- Entity A has finished the physical construction of a building for Miss Lee, subject to certain modification according to her specification after her inspection.
- Borrowing costs are incurred during the modification period
- Can these borrowing costs be capitalised?

No

- If minor modifications, such as the decoration of a property to the purchaser's or user's specification, are all that are outstanding, this indicates that substantially all the activities of the property construction are complete.

4. Allowed Alternative: Capitalise

Case



Wharf (Holdings) – Annual Report

- The capitalization of borrowing cost as part of the cost of a qualifying asset
 - commences when expenditure for the asset is incurred, borrowing costs are being incurred and activities to prepare the asset for its intended use or sale are in progress.
- Capitalization of borrowing costs
 - is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or complete.

4. Allowed Alternative: Capitalise

Disclosure

- The financial statements shall disclose:
 - a. the accounting policy adopted for borrowing costs;
 - b. the amount of borrowing costs capitalised during the period; and
 - c. the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

Investment Property (IAS 40)



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Topic to be Covered

- | |
|---|
| 1. Scope |
| 2. Definitions |
| 3. Recognition and Measurement at Recognition |
| 4. Measurement after recognition |
| 5. Transfers |
| 6. Disposals |
| 7. Disclosure |

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1. Scope

- IAS 40 shall be applied in the recognition, measurement and disclosure of investment property.
- However, IAS 40 does not deal with matters covered in IAS 17 *Leases*, including:
 - a) classification of leases as finance leases or operating leases;
 - b) recognition of lease income from investment property (see also IAS 18 Revenue);
 - c) measurement in a lessee's financial statements of property interests held under a lease accounted for as an operating lease;
 - d) measurement in a lessor's financial statements of its net investment in a finance lease;
 - e) accounting for sale and leaseback transactions; and
 - f) disclosure about finance leases and operating leases.



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2. Definitions

- Investment property is property (land or a building – or part of a building – or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:
 - a) use in the production or supply of goods or services or for administrative purposes; or
 - b) sale in the ordinary course of business

Examples of investment property under IAS 40 include:

- Property leased out under operating leases
- Property held for long-term capital appreciation
- Property held for a currently undetermined future use
- Vacant property to be leased out under operating leases

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2. Definitions – Extend to Operating Leases

- A property interest
 - that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if
 - the property would otherwise meet the definition of an investment property and
 - the lessee uses the Fair Value Model
- This classification alternative is available on a property-by-property basis
- However, once this classification alternative is selected for one such property interest held under an operating lease, all properties classified as investment property shall be accounted for using the Fair Value Model

An entity has a choice

Simple?

Let's term this classification as
"Operating Lease IP Alternative"

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2. Definitions – Extend to Operating Leases

Example

- Entity GV has 3 properties as follows:
 - Leasehold property A
 - Leasehold property B
 - Freehold property C
 - All the properties are held to earn rental.
 - What is the implication of IAS 40 on its properties?
- Property C is an investment property under IAS 40 and GV must use IAS 40 to account for it
 - Property A and B are not investment property under IAS 40. However, GV can choose to account for either A or B or both as investment property under IAS 40.
 - If Property A and B are not accounted for under IAS 40, they will be accounted for under IAS 17.
 - Measurement under IAS 40 to be discussed later.

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2. Definitions – Owner-Occupied Property

- Introduce a new term, **owner-occupied property**
 - Defined as a property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes
 - In substance, a property under IAS 16
 - Being one of the examples that is NOT an investment property



2. Definitions – Owner-Occupied Property

Example

- Examples that are NOT investment property include: Which IAS?**
- Owner-occupied property ➤ IAS 16 & 17
 - Property (completed or under development) intended for sale in the ordinary course of business ➤ IAS 2
 - Property being constructed or developed for third parties ➤ IAS 11
 - Property leased out under finance lease ➤ IAS 17
 - Property that is being constructed or developed for future use as investment property ➤ IAS 16 & 17
 - How's the classification for existing investment property being redeveloped for continued future use as investment property?

Still Investment Property



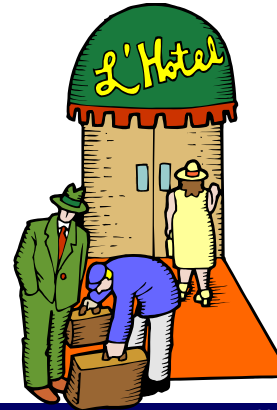
2. Definitions – Owner-Occupied Property

Case



Annual Report 2004 stated that:

- Investment and [hotel properties](#) with an unexpired lease term of more than 20 years are included in the balance sheet [at their open market value](#)
- It is the group's practice [to maintain hotel properties such that the residual values result in depreciation being insignificant.](#)
- The related maintenance expenditure is dealt with in the income statement in the year in which it is incurred.
- Hotel furniture and fixtures is included in other fixed assets and is depreciated.



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2. Definitions – Owner-Occupied Property

Refer back to IAS 16 for definition of property, plant and equipment

- Property, plant and equipment are tangible items that:
 - a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
 - b) are expected to be used during more than one period.

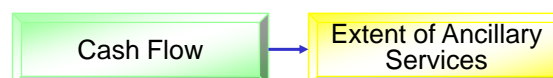
Both for rental, how to distinguish?

For example, how to distinguish:

- A flat leased out for rental
- A hotel

Investment
Property

Owner-occupied
Property



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2. Definitions – Owner-Occupied Property

Cash Flow

- One of the key indicators in determining the classification between investment property and owner-occupied property

Investment Property

- held to earn rentals or for capital appreciation or both
- therefore, generates cash flows largely independently of the other assets held by an entity.

Owner-occupied property

- the production or supply of goods or services (or the use of property for administrative purposes)
- generates cash flows that are attributable not only to property, but also to other assets used in the production or supply process

2. Definitions – Owner-Occupied Property

Cash Flow

Extent of Ancillary Services

- provided by an entity to the occupants of a property it holds is also considered

Ancillary services not significant

→ investment property
owner-occupied property ←
e.g. a owner-managed hotel is not an investment property

Significant ancillary services provided

If owner-managed hotel was classified as investment property before 2005, it should be reclassified as

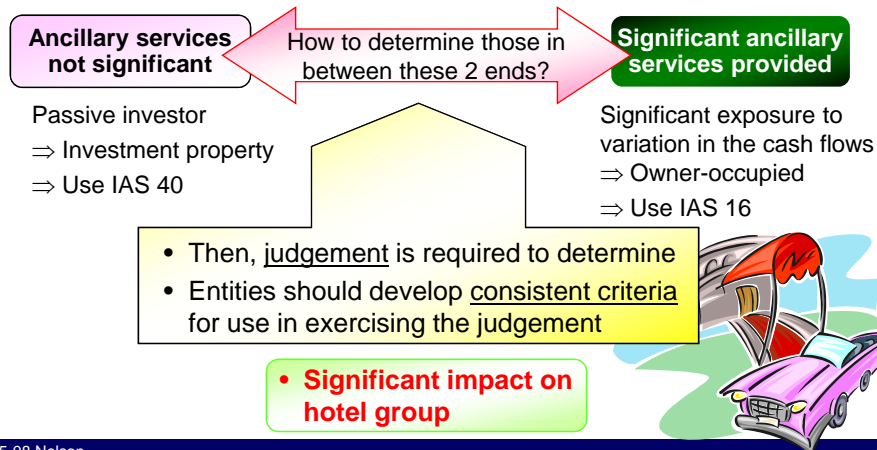
- property, plant and equipment (IAS 16) or
- lease (IAS 17)

• Significant impact on hotel group



2. Definitions – Owner-Occupied Property

- It may be difficult to determine whether ancillary services are so significant that a property does not qualify as investment property
- for example, there may be a spectrum from one end to another:



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2. Definitions – Owner-Occupied Property

Case



Beijing Enterprises Holdings Ltd.

- Has early adopted all new HKFRS in 2004 and stated that:
 - Hotel properties were **previously**
 - **not depreciated** (except where the unexpired term of the lease is 20 years or less)
 - stated at their open market values on the basis of annual professional valuations performed at the end of each financial year
 - **Upon the adoption of HKAS 16 and HKAS 40**, hotel properties would be
 - stated at valuation **less accumulated depreciation** and any accumulated impairment losses
 - As a consequence of this change in accounting policy for hotel properties
 - an aggregate amount of **HK\$6,797,000** was charged to the consolidated profit and loss account for the year ended 31 Dec. 2004

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2. Definitions – Owner-Occupied Property

Case

Shangri-La Asia Ltd.

(extracted from 2003 Annual Report and Announcement of 17 Dec. 2004)



- Before 2005, its hotel properties are classified as investment properties, which are stated at annual professional valuations at the balance sheet date
- It announced on 17 Dec. 2004 that its hotel properties “will no longer be accounted for as investment properties” from 2005
- It will adopt the following accounting policies retroactively:
 1. The underlying buildings and integral plant and machinery will be stated at cost less accumulated depreciation and impairment
 2. The underlying freehold land will be stated at cost less impairment
 3. The underlying leasehold land will be stated at cost and subject to annual operating lease rental charge (amortization of land cost)

- **Owner-managed hotels cannot be classified as investment property**
- **They can be classified as property, plant and equipment (HKAS 16) and/or leases (HKAS 17)**

2. Definitions – Owner-Occupied Property

Case

Shangri-La Asia Ltd.



- 2004 Final Results Announcement of 31 Mar. 2005 further stated that, from 1 Jan. 2005:

“Adoption of these new accounting policies will have the following significant consequences:

 - a) The net book value of fixed assets, the overall provision for deferred tax liabilities and the net asset value of the Group will be **reduced**
 - b) The annual depreciation and lease rental charges will **increase** and this will **reduce** the profit after tax attributable to the shareholders (“PAT”) and the earnings per share (“EPS”) of the Group.”

- **Owner-managed hotels cannot be classified as investment property**
- **They can be classified as property, plant and equipment (HKAS 16) and/or leases (HKAS 17)**

2. Definitions – Owner-Occupied Property

Case

Shangri-La Asia Ltd.



- Let's do some comparison for 2004 (in US\$'000)

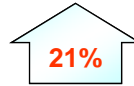
Net assets at 31.12.2004

- as reported in 2004 Annual Report 3,109,000
- as announced on 26 Aug. 2005 2,379,000



Depreciation for the year ended 31.12.2004

- as reported in 2004 Annual Report 39,038
- as announced on 26 Aug. 2005 47,410



2. Definitions - Partially Used Only

- Some properties comprise a portion held as investment property and another portion NOT held as investment property.
- If these portions:

Could be sold separately

or leased out separately under a finance lease
⇒ an entity accounts for the portions separately

Could not be sold separately

⇒ the property is investment property only if an insignificant portion is NOT held as investment property



2. Definitions - Partially Used Only

Case



Accounting policy (2004/05) on buildings:

- The cost of construction of [the Duke of Windsor Social Service Building](#) “the Building” has been written down to a nominal value of HK\$1.
- The Council hires out meeting rooms and auditorium in the Building to third parties and lease out some portion of usable floor area to certain bodies approved by the Government.
- Income derived from hiring meeting rooms and auditorium and leasing out usable floor area have been accounted for in the statement of operations as hiring fees, rental and management fee income.

Point for consideration:

- Fulfil the definition of investment property?
- Generate passive cash flow or owner-occupied?
- Separable under IAS 40? If not, significant portion for rental?

2. Definitions - Partially Used Only

An entity owns property that is leased to, and occupied by, its parent or another subsidiary

⇒ The property does not qualify as investment property in the consolidated financial statements, because the property is owner-occupied from the perspective of the group

Consolidated

⇒ But, from the perspective of the entity that owns it, the property is investment property if it meets the definition of investment property

- The lessor treats the property as investment property in its individual financial statements.

Individual



2. Definitions - Partially Used Only

Example

Can the following freehold properties be classified as investment property in individual level and in consolidation?

	<u>Individual</u>	<u>Consolidation</u>
• Parent A's property leased to Subsidiary B	Yes	No
• Subsidiary C's property leased to Parent D	Yes	No
• Subsidiary E's property leased to Subsidiary F	Yes	No
• Parent G's property leased to Associate H	Yes	Yes

3. Recognition and Measurement

Recognition criteria

Initial Cost

Subsequent Expenditure

- Same as IAS 16 *Property, Plant and Equipment*
- Investment property shall be recognised as an asset when, and only when:
 - a) it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and
 - b) the cost of the investment property can be measured reliably.



3. Recognition and Measurement

Recognition criteria (capitalisation) for

Initial Cost

Subsequent Expenditure

Old IAS 16 Criteria not the same

- Probable that future economic benefit of the asset will flow to the enterprise
- Cost measured reliably

- Probable that future economic benefits in excess of the originally assessed standard of performance of the existing asset will flow to the entity

Now IAS 16 and IAS 40 Same criteria

- Probable that future economic benefit of the asset will flow to the entity
- Cost measured reliably

Same criteria applied to both costs

Expenditure not fulfilling the recognition criteria will be charged to income statement

Clearer approach on so-called
Component Accounting

3. Recognition and Measurement

Measurement at Recognition

- An investment property shall be measured initially at its cost.
- Transaction costs shall be included in the initial measurement.
- The initial cost of a property interest held under a lease and classified as an investment property
 - shall be as prescribed for a finance lease in IAS 17
 - i.e. the asset shall be recognised at the lower of
 - the fair value of the property and
 - the present value of the minimum lease payments.
 - An equivalent amount shall be recognised as a liability in accordance with that same paragraph.
- Introduce the measurement base for investment property acquired from exchange
 - Same as IAS 16 *Property, Plant and Equipment*



3. Recognition and Measurement

Rule on Exchange of Assets Revised

Same amendment in
IAS 16 and
IAS 38

Cost of PPE acquired in exchange is measured at fair value

But not required if: Before IAS 16

- it is an exchange for similar assets

In IAS 16

**Commercial
Substance**

- the exchange transaction lack of Commercial Substance, or

**Fair Value of
Exchanged Asset**

- the Fair Value is not reliably measurable (both asset received and given up)

- If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

4. Measurement after Recognition




Introduce Cost Model and choose either

Fair Value Model

and

Cost Model

- ♦ IAS 40 implicitly implies that the choice can only be elected on the first-time adoption of IAS 40
- ♦ The model chosen should be applied to all investment properties, except for

1. Property held under operating lease classified as investment properties  No choice, only fair value model
2. Investment property backing liabilities that pay a return linked directly to the fair value of, or returns from specific assets including that investment property  Choose a model for all such properties
3. Investment property with a fair value that cannot be reliably determinable on a continuing basis (*i.e. inability to determine fair value reliably*)  No choice, only cost model

4. Measurement after Recognition

Introduce Cost Model and choose either

Fair Value Model

and

Cost Model

- However, even Cost Model is adopted, IAS 40 still requires all entities to determine the fair value of investment property
- For disclosure purpose, the fair value of the investment property has to be disclosed in notes to the financial statement!
- In determining the fair value of investment property for both cost model and fair value model
 - ⇒ an entity is only encouraged, but not required, to rely on a professional valuer's valuation

More Flexible?

4. Measurement after Recognition

After initial recognition, an entity that chooses →

Fair Value Model

- shall measure all of its investment property at fair value, except in the cases that
 1. the fair value cannot be determined reliably, or
 2. the cost model is chosen for the investment property backing liabilities that pay a return linked directly to the fair value of, or returns from specific assets including that investment property
- When a property interest held by a lessee under an operating lease is classified as an investment property
 - ⇒ the fair value model must be applied for all investment properties
- A gain or loss arising from a change in the fair value of investment property shall be recognised in profit or loss for the period in which it arises



Depreciation?
Tax Implication?

4. Measurement after Recognition

Example

- Entity GV has 3 properties, leasehold property A, leasehold property B and freehold property C
- All the properties are held to earn rental.
- What is the implication of IAS 40 if GV chooses to account for A as investment property?

- Then, GV has no choice in accounting for the investment property.
- It must adopt [fair value model](#) in accounting for all investment properties including property A and C (subject to specific exceptions)
- While property A is accounted for at fair value model under IAS 40, property B can still be accounted for under IAS 17.

4. Measurement after Recognition

IAS 40

Fair Value Model

- Uses fair value
 - IAS 40 only encourages, but not requires, a profession valuation on a fair value
- Fair value is defined as the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction
 - Same definition used in other IFRSs and IASs
 - But IAS 40 provides more explanations unique for a fair value of a property

- The fair value of investment property shall reflect [market conditions at the balance sheet date](#)

No depreciation required in IAS 40



Depreciation?
Tax Implication?

Not our concern this time!

4. Measurement after Recognition

Case



Interim Report 2005 clearly stated that:

- The directors consider it inappropriate for the company to adopt two particular aspects of the new/revised HKFRSs as these would result in the financial statements, in the view of the directors, either:
 - not reflecting the commercial substance of the business or
 - being subject to significant potential short-term volatility, as explained below



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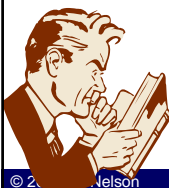
4. Measurement after Recognition

Case



Interim Report 2005 clearly stated that:

- HKAS 40 "Investment property" requires an assessment of the fair value of investment properties.
- The group intends to follow the same accounting treatment as adopted in 2004, which is to value such investment properties on an annual basis.
- Accordingly, the investment properties were not revalued at 30 June 2005, since the directors consider that such change of practice could introduce a significant element of short-term volatility into the income statement in respect of assets which are being held on a long-term basis by the group
- It is not practicable to estimate the financial effect of this non-compliance as no interim valuation of the properties has been conducted.



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4. Measurement after Recognition

Case

However, 2006 Interim Report stated that



- With effect from 1 January 2006, in order to comply with the HKAS 40 “Investment Property”,
 - the group states its investment properties at fair value, based on independent third party valuation, at both the interim and year-end balance sheet dates.
- This has resulted in an increase in the fair value of investment properties and a related deferred tax charge in the consolidated income statement for the six months ended 30 June 2006, amounting to HK\$546 million and HK\$89 million respectively

4. Measurement after Recognition

Fair Value Model

Under IAS 40

Fair value has the following attributes:

- No deduction for transaction costs it may incur on sale or other disposal
- Time-specific as of a given date
- Reflects rental income from current leases and from future leases in light of current conditions (with reasonable and supportable assumption)
- Refers to knowledgeable, willing parties
- Refers to an arm's length transaction



What are the differences between fair value and value in use?

4. Measurement after Recognition

Fair Value Model

- Value in use consists of the following attributes which are not found in fair value:
 - a) additional value derived from creation of a portfolio of properties;
 - b) synergies between investment property and other assets;
 - c) legal rights or restrictions that are specific only to the current owner; and
 - d) tax benefits or tax burdens that are specific to the current owner.



What are the differences between fair value and value in use?

4. Measurement after Recognition

Fair Value Model

- The best evidence of fair value is given by current prices in an active market
 - For similar property in the same location and condition and
 - Subject to similar lease and other contracts.
- An entity takes care to identify any differences
 - in the nature, location or condition of the property, or
 - in the contractual terms of the leases and other contracts relating to the property

4. Measurement after Recognition

Fair Value Model

- If **NO** current prices in an active market, an entity considers the information from a variety of sources, including
 - a) current prices in an active market for properties of different nature, condition or location (or subject to different lease or other contracts), adjusted to reflect those differences;
 - b) recent prices of similar properties on less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices; and
 - c) discounted cash flow projections (based on reliable estimates of future cash flows, and using discount rate with appropriate adjustments and assumptions)
- Considers difference conclusions to arrive reliable estimate of fair value within a range of reasonable fair value estimates

4. Measurement after Recognition

Fair Value Model

- There is a rebuttable presumption that an entity can reliably determine the fair value of an investment property on a continuing basis.
- However, in exceptional cases and in initial recognition of investment property, there is clear evidence that the fair value of the investment property is not reliably determinable on a continuing basis.
 - This arises when, and only when,
 - comparable market transactions are infrequent and
 - alternative reliable estimates of fair value (for example, based on discounted cash flow projections) are not available.
- In such cases, an entity shall measure that investment property (alone) using the cost model in IAS 16
 - residual value shall be assumed to be zero
 - apply IAS 16 until disposal of the investment property
 - shall continue to account for other investment properties using the fair value model

4. Measurement after Recognition

Fair Value Model

- If an entity has previously measured an investment property at fair value
 - it shall continue to measure the property at fair value until disposal or cessation to be investment property, even if
 - comparable market transactions become less frequent or
 - market prices become less readily available.

Once you chose **Fair Value Model**, you cannot fall back to **Cost Model**

4. Measurement after Recognition

Fair Value Model

After initial recognition, an entity that chooses →

Cost Model

- shall measure all of its investment properties in accordance with the requirements of IAS 16 for that cost model other than
 - those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*
 - then, those investment properties shall be measured in accordance with IFRS 5

Once you chose **Fair Value Model**, you cannot fall back to **Cost Model**

4. Measurement after Recognition

Case

Hang Seng Bank (2004 Annual Report)

- Hang Seng Bank has NOT early adopted HKAS 40 but stated that:
 - “By adoption of HKAS 40, investment properties are carried at fair value with the changes in fair value reported directly in the profit and loss account.”
 - “The Group will continue to adopt the fair value model for investment properties.”
 - “The change in fair value of investment properties will cause volatility in the profit and loss account.”

Once you chose **Fair Value Model**, you cannot fall back to **Cost Model**



4. Measurement after Recognition

Case

See a latest and actual case



For the 6-month 30.6.2005	2005 HK\$'M	2004 HK\$'M
Turnover	613	562
Profit before tax	3,234	407
<i>After crediting:</i> Fair value changes on investment properties	2,799	-

↑ 695%

Once you chose **Fair Value Model**, you cannot fall back to **Cost Model**

Profit is even higher than the revenue

4. Measurement after Recognition

Case

Interim Report 2005 stated that:



Great Eagle Holdings Limited

Six months ended 30 June (HK\$'000) 2005 2004

Revenue	1,563,020	1,280,895
Profit before tax	2,783,792	176,357

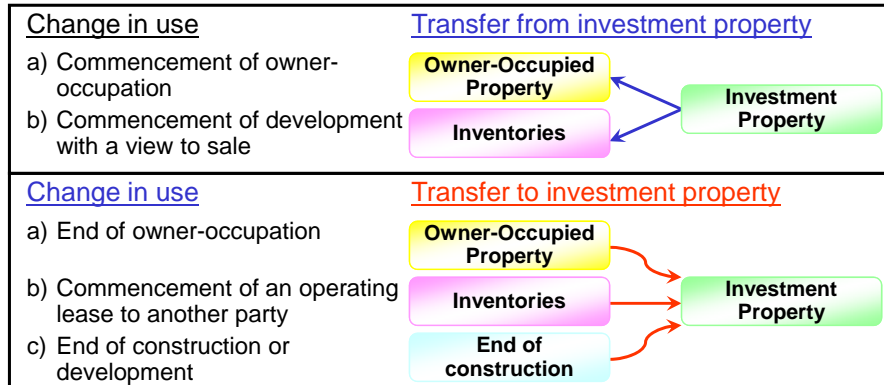
1,478%

Once again, profit is even higher than the revenue

Fair value changes on investment properties	2,500,169	-
Profit before tax without HKAS 40 (by estimate)	283,623	176,357

5. Transfer

- Introduce transfer section (but is similar to those in SSAP 17 before)
- Transfers to, or from, investment property shall be made when, and only when, there is a **change in use**, evidenced by:



Measurement at transfer?

Depend on the model the entity is using

5. Transfer

- When an entity uses → **Cost Model**
 - transfers DO NOT change the carrying amount of the property transferred and
 - they DO NOT change the cost of that property for measurement or disclosure purposes.

Measurement at transfer?

5. Transfer

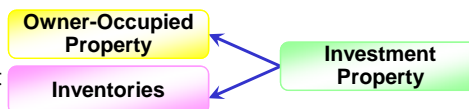
- For a transfer from investment property (i.e. the following cases) carried at fair value

Fair Value Model

Change in use

- Commencement of owner-occupation
- Commencement of development with a view to sale

Transfer from investment property



- the property's deemed cost for subsequent accounting in accordance with IAS 16 or IAS 2 shall be its fair value at the date of change in use.

Measurement at transfer?

5. Transfer

Example

- GV has adopted IAS 40 and stated its investment properties at fair value even the properties are held under operating leases.
 - On 1 Jan. 2005, GV's investment property A held under operating lease was stated at fair value of \$1,000. Its original cost was \$800.
 - On 10 Feb. 2005, the lease of property A expired and GV decided and began to hold it as its office.
 - What is the accounting implication on the decision?
- Property A would no longer be investment property and would be reclassified as owner-occupied property.
 - Even property A is held under operating lease, such operating lease interest would still be accounted for as a finance lease continuously in accordance with IAS 17 and classified and measured as property, plant and equipment in accordance with IAS 16.
 - The fair value at the date of change in use, i.e. 10 Feb. 2005 will be regarded as the deemed cost in property, plant and equipment.

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5. Transfer

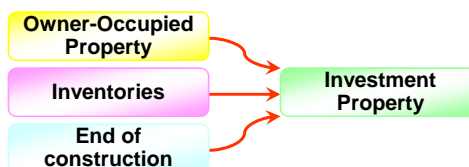
- For a [transfer to investment property](#) (i.e. the following cases) and that investment property will be carried at fair value

Fair Value Model

Change in use

- End of owner-occupation
- Commencement of an operating lease to another party
- End of construction or development

Transfer to investment property



Measurement at transfer?

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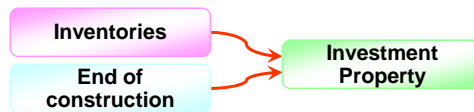
5. Transfer

- For a transfer to investment property (i.e. the following cases) and that investment property will be carried at fair value

Fair Value Model



- apply IAS 16 up to the date of change in use. ⇒ Revaluation reserve is
 - frozen and
 - accounted for in accordance with IAS 16 subsequently
- treat any difference at that date between its
 - carrying amount under IAS 16, and
 - its fair value
 in the same way as a revaluation under IAS 16



- any difference between
 - the fair value of the property at that date and
 - its previous carrying amount shall be recognised in profit/loss

Measurement at transfer?

5. Transfer

Example

- GV has adopted IAS 40 and stated its investment properties at fair value even the properties are held under operating leases.
- On 1 Mar. 2005, freehold property B stated at revalued amount of \$1,000 (originally used as its own office) has been leased out to derive rental income. Revaluation surplus recognised for B was \$300 while B's fair value at that date should be \$1,200.
- What is the accounting implication on the decision?

- Property B would be reclassified as investment property.
- In accordance with IAS 40, GV should apply IAS 16 on B up to the date of change in use and treat any difference at that date between its carrying amount under IAS 16, and its fair value in the same way as a revaluation under IAS 16.
 - Thus, a revaluation surplus of \$200 would be further recognised.
 - Total revaluation reserves would become \$500 (\$200 + \$300)
- The revaluation reserves of \$500 would be frozen and accounted for in accordance with IAS 16 subsequently.

6. Derecognition (or Disposals)

- An investment property shall be derecognised (eliminated from the balance sheet):
 1. on disposal or
 2. when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal
- Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between
 1. the net disposal proceeds and
 2. the carrying amount of the asset,and shall be recognised in profit or loss (unless IAS 17 requires otherwise on a sale and leaseback) in the period of the retirement or disposal

7. Disclosure

a) Disclosure for both Fair Value Model and Cost Model

- whether the fair value model or the cost model is adopted
- if fair value model is applied, whether property interests held under operating leases are accounted for as investment property
- if classification is difficult, the criteria to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business
- the methods and significant assumptions applied in determining the fair value of investment property
- whether (and the extent to which) the fair value of investment property is based on a valuation by a qualified independent valuer
- the amounts recognised in profit or loss, say for rental income from investment property, and direct operating expenses (including repairs and maintenance) arising from investment property
- the existence and amount of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal
- contractual obligations to purchase, construct, or develop investment property or for repairs, maintenance or enhancements

7. Disclosure

b) Additional Disclosure for Fair Value Model

- A reconciliation between the carrying amounts of investment property at the beginning and end of the period similar to that of property, plant and equipment
- When a valuation obtained for investment property is adjusted significantly for the purpose of the financial statements, the entity shall disclose a reconciliation between the valuation obtained and the adjusted valuation included in the financial statements
- In the exceptional cases when there is inability to determine fair value reliably and cost model is applied to a particular investment property, additional disclosures are required

7. Disclosure

c) Additional Disclosure for Cost Model

- the depreciation methods used;
- the useful lives or the depreciation rates used;
- the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period;
- a reconciliation of the carrying amount of investment property at the beginning and end of the period, similar to that of property, plant and equipment
- the fair value of investment property
- In the exceptional cases when there is inability to determine fair value reliably, additional disclosures are required

That's all



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That's all

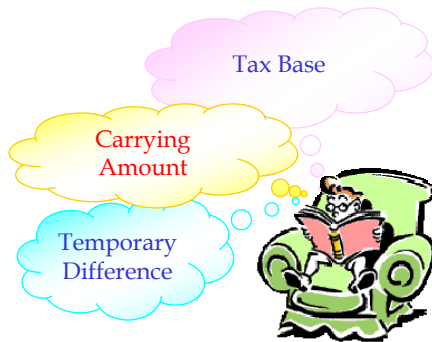
- SIC Interpretation 21
- Practical application of IAS 40



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SIC Interpretation 21



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Income Tax – Recovery of Revalued Non-Depreciable Assets

1. Issue
2. Basis for Conclusions
3. Conclusions
4. Implication to Property in HK and Macao



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1. Issue

- Under IAS 12.51, the measurement of deferred tax liabilities and assets should reflect
 - the tax consequences that would follow from the manner in which
 - the entity expects, at the balance sheet date, to recover or settle the carrying amount of those assets and liabilities that give rise to temporary differences.



1. Issue

- IAS 12.20 notes that
 - the revaluation of an asset does not always affect taxable profit (tax loss) in the period of the revaluation and
 - that the tax base of the asset may not be adjusted as a result of the revaluation.
- If the future recovery of the carrying amount will be taxable
 - any difference between
 - the carrying amount of the revalued asset and
 - its tax baseis a temporary difference and gives rise to a deferred tax liability or asset.

1. Issue

- The issue is how to interpret the term “recovery” in relation to an asset that
 - is not depreciated (non-depreciable asset) and
 - is revalued under the revaluation model of IAS 16 (IAS 16.31).
- **SIC Interpretation 21**
“also applies to investment properties which
 - are carried at revalued amounts under IAS 40.33
 - but would be considered non-depreciable if IAS 16 were to be applied.”

Implied that

- an investment property if under IAS 16 would be depreciable, like land in HK,
- the conclusion in SIC Interpretation 21 is not applicable to that property

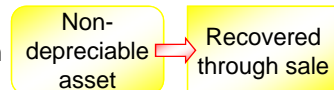
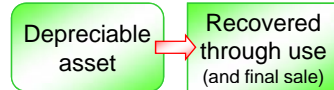
2. Basis for Conclusions

- The Framework indicates that an entity recognises an asset if it is probable that the future economic benefits associated with the asset will flow to the entity.
- Generally, those future economic benefits will be derived (and therefore the carrying amount of an asset will be recovered)
 - through sale,
 - through use, or
 - through use and subsequent sale.



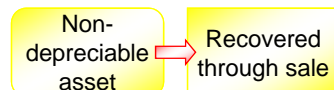
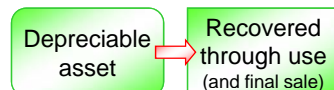
2. Basis for Conclusions

- Recognition of depreciation implies that
 - the carrying amount of a depreciable asset is expected to be recovered
 - through use to the extent of its depreciable amount, and
 - through sale at its residual value.
- Consistent with this, the carrying amount of a non-depreciable asset, such as land having an unlimited life, will be
 - recovered only through sale.
- That is, because the asset is not depreciated,
 - no part of its carrying amount is expected to be recovered (that is, consumed) through use.
- Deferred taxes associated with the non-depreciable asset reflect the tax consequences of selling the asset.



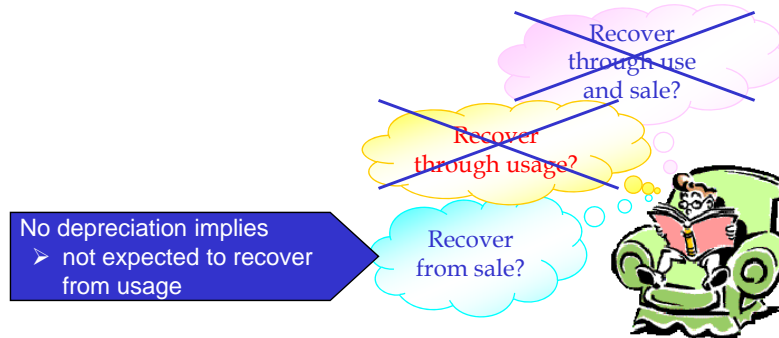
2. Basis for Conclusions

- The expected manner of recovery is not predicated on the basis of measuring the carrying amount of the asset.
 - For example, if the carrying amount of a non-depreciable asset is measured at its value in use,
 - the basis of measurement does not imply that the carrying amount of the asset is expected to be recovered through use, but through its residual value upon ultimate disposal.



3. Conclusions

- The deferred tax liability or asset that arises from the revaluation of a non-depreciable asset under the revaluation model of IAS 16 (IAS 16.31) should be measured
 - on the basis of the tax consequences that would follow from recovery of the carrying amount of that asset through sale,
 - regardless of the basis of measuring the carrying amount of that asset.



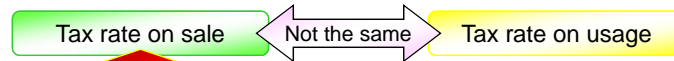
3. Conclusions



What's the implication on land in HK and Macao?

- Accordingly, if the tax law specifies
 - a tax rate applicable to the taxable amount derived from the sale of an asset
 - that differs from the tax rate applicable to the taxable amount derived from using an asset
 - the former rate is applied in measuring the deferred tax liability or asset related to a non-depreciable asset.

4. Implication to Property



Used for non-depreciable asset

What's the implication on land in HK and Macao?

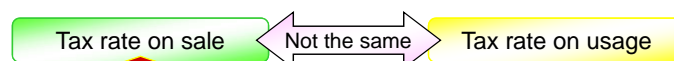
- Remember the scope identified in issue before

- SIC Interpretation 21
"also applies to investment properties which
 - are carried at revalued amounts under IAS 40.33
 - but would be considered non-depreciable if IAS 16 were to be applied."

Implied that

- an investment property if under IAS 16 would be depreciable, like land in HK,
- the conclusion in SIC Interpretation 21 is not applicable to that property

4. Implication to Property



Used for non-depreciable asset

What's the implication on land in HK?

- It implies that
 - the management cannot rely on SIC Interpretation 21 to assume the tax consequences being recovered from sale
 - It has to consider which tax consequences that would follow from the manner in which the entity expects to recover the carrying amount of the investment property
- As an investment property is generally held to earn rentals
 - the profits tax rate would best reflect the tax consequences of an investment property in HK
 - unless the management has a definite intention to dispose of the investment property in future

Different from the past in most cases

4. Implication to Property

Case

- The early adoption of HKAS-INT 21 has resulted in a change in accounting policy relating to deferred taxation of the Group's investment property.
- Prior to this, deferred tax arising from the revaluation of investment property was calculated on the basis that the property was held for sale.
- In accordance with the provisions of HKAS-INT 21, the deferred tax arising from the revaluation of the property should be recalculated as if the investment property is held through use and charged to the profit and loss account.

2004 Annual Report, HKEX



4. Implication to Property

Case

Interim Report 2005 clearly stated that:



- The directors consider it inappropriate for the company to adopt two particular aspects of the new/revised HKFRSs as these would result in the financial statements, in the view of the directors, either:
 - not reflecting the commercial substance of the business or
 - being subject to significant potential short-term volatility, as explained below

4. Implication to Property

Case

However, **2005 Final Results Announcement** disclosed that provision for deferred tax was finally made with regard to revaluation of the HK investment properties (total HK\$2.2 billion) at 2005 year-end.

Interim Report 2005 clearly stated that:

- HKAS 12 "Income Taxes", together with HKAS-INT 21 "Income Taxes – Recovery of Revalued Non-Depreciable Assets", requires deferred taxation to be recognised on any revaluation movements on investment properties.
- It is further provided that any such deferred tax liability should be calculated at the profits tax rate in the case of assets which the management has no definite intention to sell.
- The company has not made such provision in respect of its HK investment properties since the directors consider that such provision would result in the financial statements not reflecting the commercial substance of the business *since, should any such sale eventuate, any gain would be regarded as capital in nature and would not be subject to any tax in HK.*
- Should this aspect of HKAS 12 have been adopted, deferred tax liabilities amounting to HK\$2,008 million on the revaluation surpluses arising from revaluation of HK investment properties would have been provided.
(estimate - over 12% of the net assets at 30 June 2005)

4. Implication to Property

Case

2006 Annual Report stated that:



- In prior years, the group was required to apply the tax rate that would be applicable to the sale of investment properties to determine whether any amounts of deferred tax should be recognised on the revaluation of investment properties.
 - Consequently, deferred tax was only provided to the extent that tax allowances already given would be clawed back if the properties were disposed of at their carrying value, as there would be no additional tax payable on disposal.
- As from 1 January 2005, in accordance with HK(SIC) Interpretation 21, the group recognises deferred tax on movements in the value of an investment property using tax rates that are applicable to the property's use, if the group has no intention to sell it and the property would have been depreciable had the group not adopted the fair value model

4. Implication to Property

Case



Great Eagle Holdings Limited

2005 Interim Report stated the following for deferred taxes related to investment properties

- In previous periods, deferred tax consequences in respect of revalued investment properties were assessed on the basis of the tax consequence that would follow from recovery of the carrying amount of the properties through sale in accordance with the predecessor interpretation (SSAP-Interpretation 20).
- In the current period, the Group has applied HKAS Interpretation 21 (“INT-21”) “Income Taxes - Recovery of Revalued Non-Depreciable Assets” which
 - **removes the presumption that the carrying amount of investment properties are to be recovered through sale.**

4. Implication to Property

Case



Great Eagle Holdings Limited

2005 Interim Report stated the following for deferred taxes related to investment properties

- Therefore, the deferred tax consequences of the investment properties are now assessed on the basis that reflect the tax consequences that would follow from the manner in which the Group expects to recover the property at each balance sheet date.
- In the absence of any specific transitional provisions in HKAS INT-21, this change in accounting policy has been applied retrospectively. Comparative figures for 2004 have been restated
- Out of deferred taxation of HK\$2,490 million, approximately HK\$1,913 million was provided in respect of the revaluation surplus of the Group’s Hong Kong investment properties.
- Notwithstanding this provision, it is considered that profit on the disposal of such properties should not be taxable as there is currently no capital gains tax in Hong Kong.

Application of IAS 40

Fair Value Model

Cost Model



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Application of IAS 40

- As stated before, when a property interest held by a lessee under an operating lease is classified as an investment property

- ⇒ the fair value model must be applied for all investment properties
- ⇒ a gain or loss arising from a change in the fair value of investment property shall be recognised in profit or loss for the period in which it arises

Fair Value Model

Cost Model

Since the land element of a property in HK and Macao can only be held under "operating leases" (per IAS 17), does it imply that:

- There is no choice for all investment properties in HK and Macao?
- All such properties shall use **Fair Value Model**? With all resulting gain or loss recognised in profit or loss?
- Alternatively, they can only be accounted for as operating leases in accordance with IAS 17?

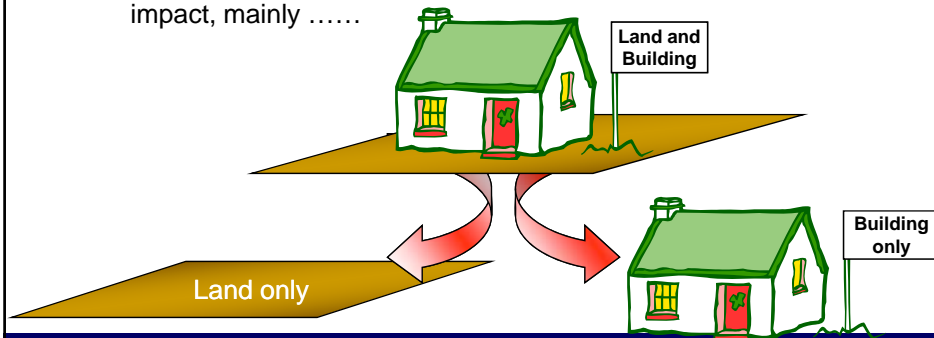
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Recap on IAS 17

1. Deleting one sentence
2. Introducing several new paragraphs
 - New requirements with significant impact, mainly

Separate measurement
(of the land and buildings elements)

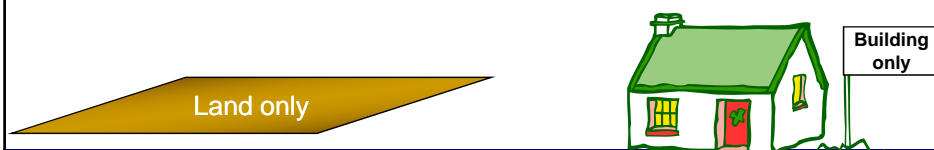


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Recap on IAS 17

- As before, lease classification is made
 - at the inception of the lease
 - leases of land and buildings are classified as operating or finance leases
 - in the same way as leases of other assets



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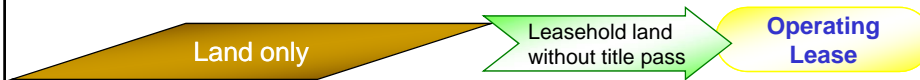
Recap on IAS 17

Lease of land

- Land normally has an indefinite economic life
- If title of leasehold land is not expected to pass to the lessee
 - ⇒ Lessee normally does not receive substantially all of the risks and rewards incidental to the ownership
 - ⇒ In which case the lease of land will be an **operating lease**
 - payment acquiring such leasehold represents **prepaid lease payments**
 - amortised over the lease term in accordance with the pattern of benefits provided

Examples:

- Land purchased in HK and Macao
- Land use right acquired in PRC



Recap on IAS 17

Lease of land

Lease of land and buildings

If a lease contains land and buildings elements

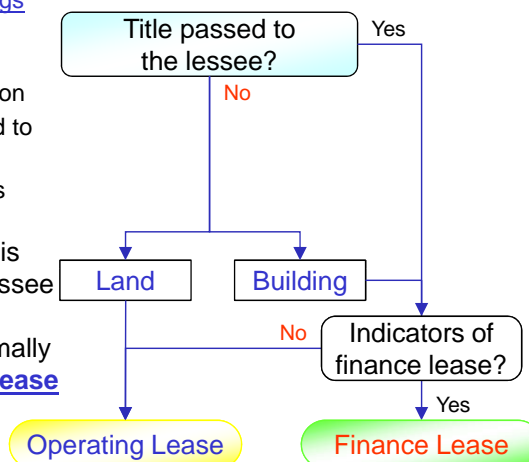
- 2 elements are considered separately for lease classification

If title of both elements is expected to pass to the lessee

- Both elements are classified as **finance lease**

If title of land or both elements is NOT expected to pass to the lessee

- The land element alone (as having indefinite life) is normally classified as an **operating lease**
- The building element is considered separately



Recap on IAS 17

Lease of land and buildings

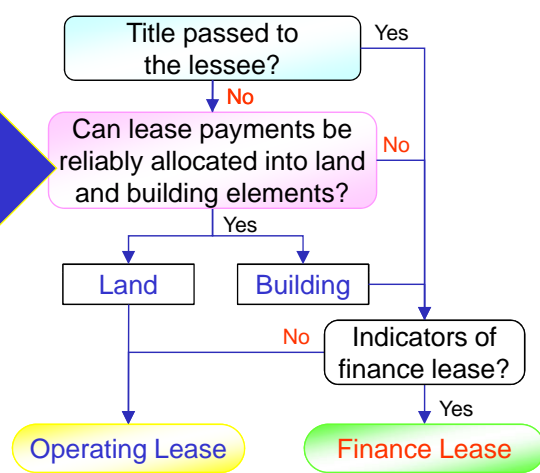
- To classify and account for a lease of land and buildings
 - the minimum lease payments (including any lump-sum upfront payments) are allocated between the land and the buildings elements
 - in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception of the lease
- If the lease payments cannot be allocated reliably between the 2 elements
 - the entire lease is classified as a **finance lease**
 - unless it is clear that both elements are operating leases, in which case the entire lease is classified as an **operating lease**
- For a lease of land and building if the land is immaterial
 - The lease may be treated as a single unit and classified as finance or operating leases



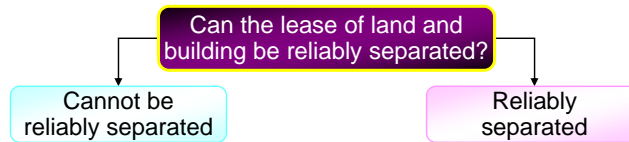
Recap on IAS 17

Lease of land and buildings

Minimum lease payment allocated in proportion to the **relative fair values** of land and building elements



Application of IAS 40

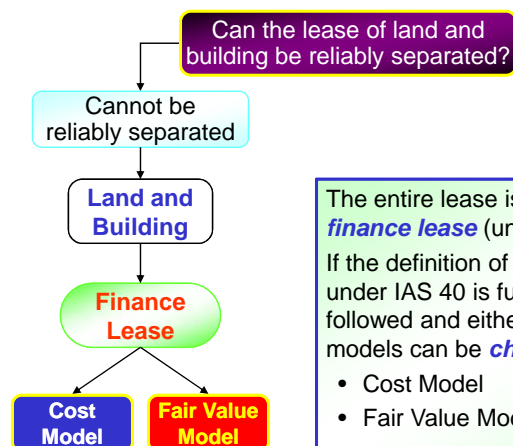


Complicated by IAS 17 since land is only held under operating lease

Since the land element of a property in HK and Macao can only be held under “operating leases” (per IAS 17), does it imply that:

- There is no choice for all investment properties in HK and Macao?
- All such properties shall use **Fair Value Model**? With all resulting gain or loss recognised in profit or loss?
- Alternatively, they can only be accounted for as operating leases in accordance with IAS 17?

Application of IAS 40

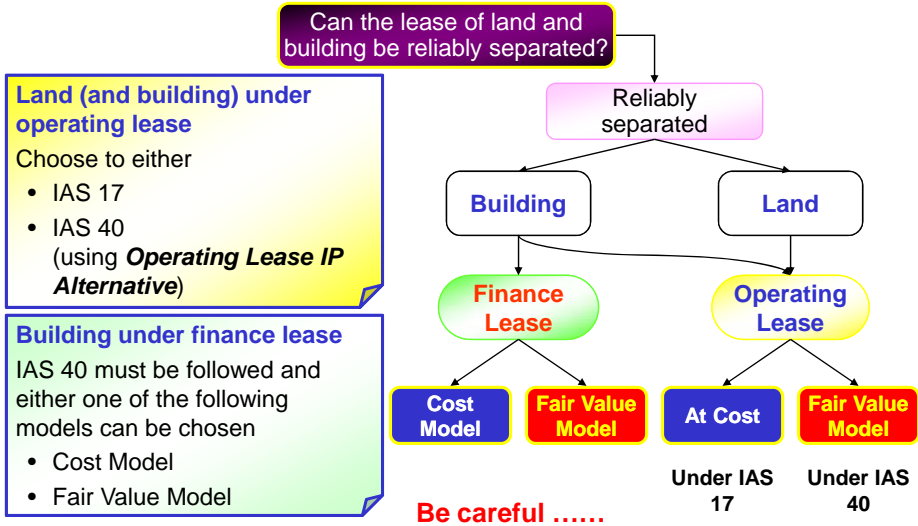


The entire lease is accounted for as a **finance lease** (under IAS 17)
 If the definition of investment property under IAS 40 is fulfilled, IAS 40 must be followed and either one of the following models can be **chosen**

- Cost Model
- Fair Value Model

Simple!

Application of IAS 40



Land (and building) under operating lease

Choose to either

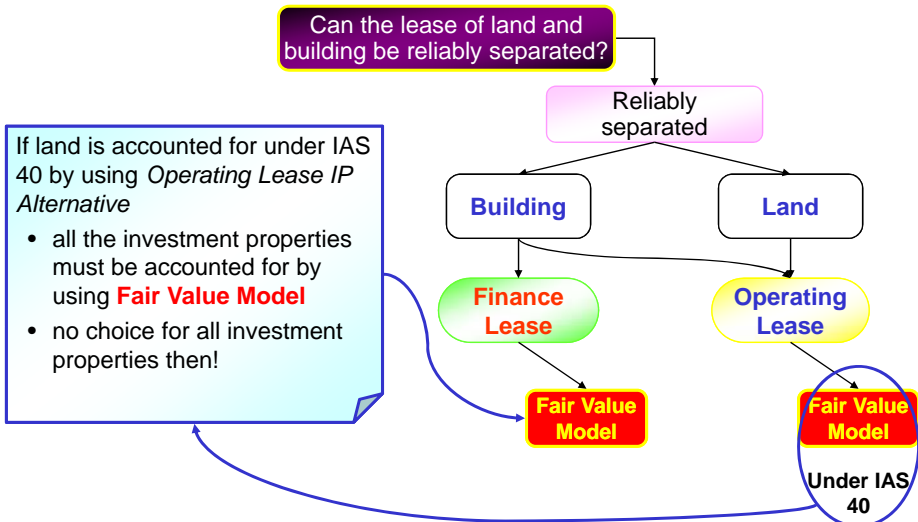
- IAS 17
- IAS 40 (using **Operating Lease IP Alternative**)

Building under finance lease

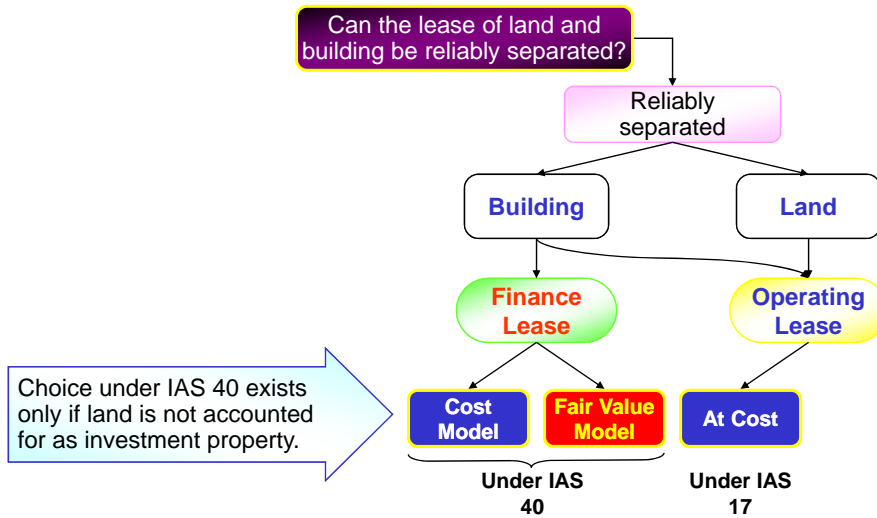
IAS 40 must be followed and either one of the following models can be chosen

- Cost Model
- Fair Value Model

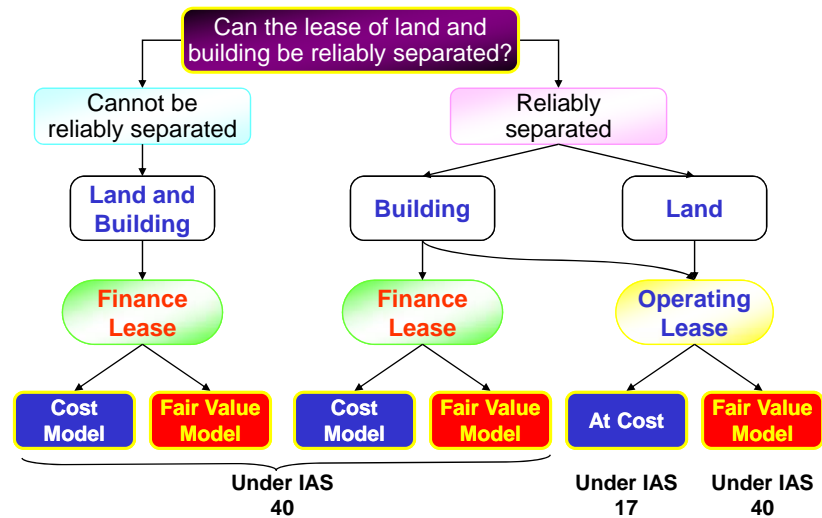
Application of IAS 40



Application of IAS 40



Application of IAS 40



Application of IAS 40

Case



Jardine Group (2005 Annual Report)

“Investment properties are properties held for long-term rental yields.”

⇒ definition (and/or for capital appreciation)

“Investment properties are carried at fair value, representing open market value determined annually by independent qualified valuers.”

⇒ adopt Fair Value Model (Recognised) with independent revaluation

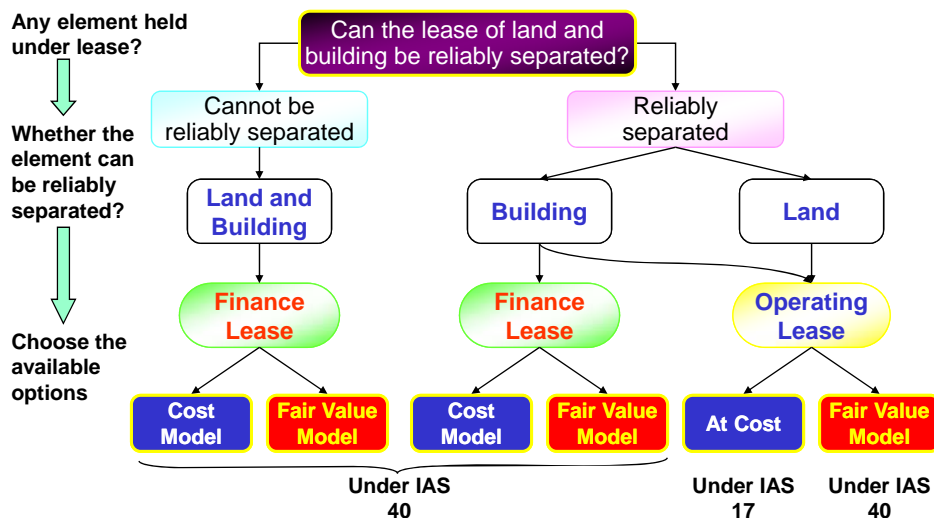
“Changes in fair values are recorded in the consolidated profit and loss account.”

⇒ changes in fair value recognised in P/L

“In accordance with IAS 40 (revised), leasehold properties held for long-term rental yields are classified as investment properties and carried at fair value.”

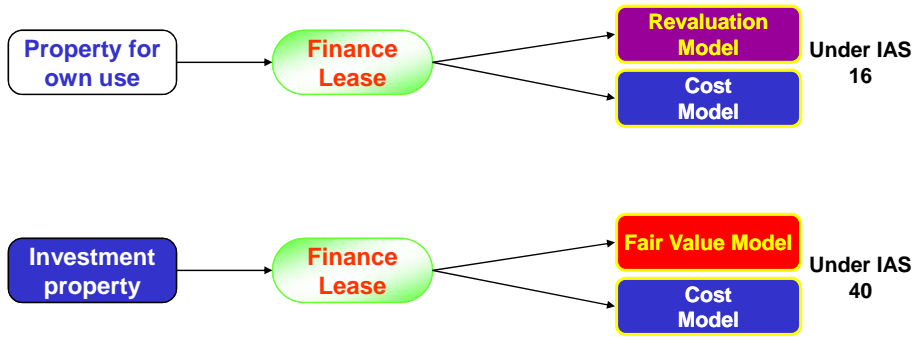
⇒ same as the requirement in IAS 40.75(b)

Application of IAS 40



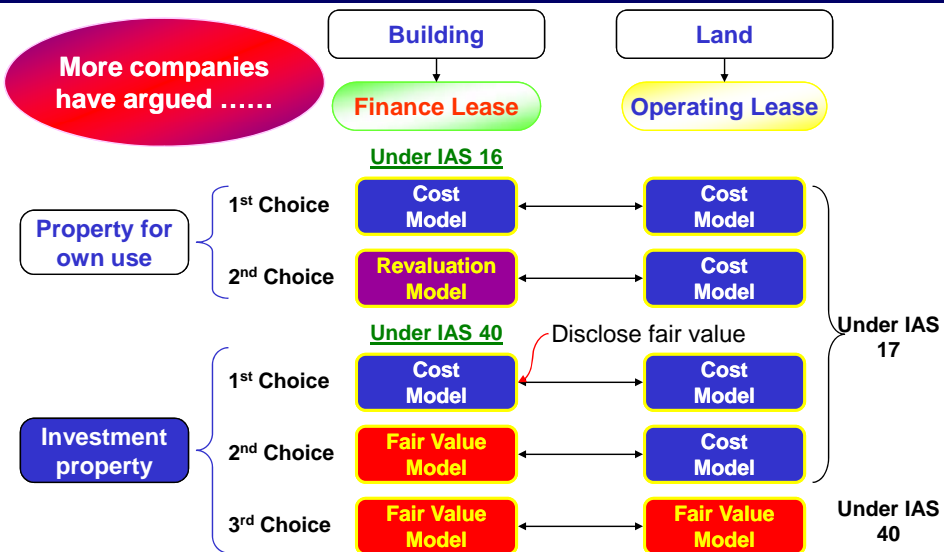
Summary

Land and building cannot be reliably separated



Summary

Land and building can be reliably separated



Summary

Case



Annual Report 2005

- In the opinion of the directors, the lease payments of the Group cannot be allocated reliably between the land and building elements, therefore, the entire lease payments are included in the cost of land and building and are amortised over the shorter of the lease terms and useful lives.



Annual Report 2005

- As the Group's lease payments cannot be allocated reliably between the land and buildings elements, the entire lease payments are included in the cost of the land and buildings as a finance lease in property, plant and equipment.
- The adoption of HKAS 17 has not resulted in any change in the measurement of the Group's land and buildings.

Summary

Example

- Can PPE or Investment Property in HK or Macao be carried at cost model after the adoption of IAS 17 and IAS 40?

- PPE can be carried at cost model if either:
 - The lease of land and building cannot be reliably allocated between land and building element
 - The whole lease will be
 - classified as finance lease (other than exception case) and
 - then accounted for at cost model under IAS 16; or
 - The lease of land and building can be reliably allocated between land and building
 - The land is carried at amortised cost under IAS 17
 - The building is carried at cost model under IAS 16

Summary

Example

- Can PPE or Investment Property in HK or Macao be carried at cost model after the adoption of IAS 17 and IAS 40?
 - Investment Property can be carried at cost model if either:
 - The lease of land and building cannot be reliably allocated between land and building element
 - The whole lease will be
 - classified as finance lease (other than exception case) and
 - then accounted for at cost model under IAS 40; or
 - The lease of land and building can be reliably allocated between land and building
 - The land is carried at amortised cost under IAS 17
 - The building is carried at cost model under IAS 40

Summary

Case

BeLLE 百丽 百丽国际 BELLE INTERNATIONAL
控股有限公司 HOLDINGS LIMITED

Annual Report 2007

- Property that is held for long-term rental yields or for capital appreciation or both, and that is not occupied by the companies in the Group, is classified as investment property.
- Investment property is carried at cost, including related transaction costs, less accumulated depreciation and accumulated impairment losses, if any.
- Depreciation is provided using the straight-line method to write off the cost of the investment properties over their estimated useful lives of 35 to 40 years. Where the carrying amount of an investment property is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

Construction Industry – Part 2

21 June 2008

Full set of slides in PDF may be found in
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