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**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. It does not represent an official position of the IFRIC. IFRIC positions are set out in Interpretations.

Note: These notes are based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: July 2006, London

**Project: Revaluation of investment properties under construction
(Agenda paper 10(xi))**

INTRODUCTION

1. In March 2006, the IFRIC received a request for an Interpretation on how IAS 40 and IAS 16 should be applied to investment properties under construction and whether such properties may be carried at a fair value in the balance sheet.
2. Divergent views exist as to whether such property may be revalued and held at fair value or whether it is required to be held at cost.
3. A summary of the issue and an analysis of whether this should be taken onto the IFRIC agenda are set out below.

SUMMARY OF THE ISSUE

4. IAS 40.9 (d) states that IAS 16 applies to “property that is being constructed or developed for future use as an investment property... until construction or development is complete, at which time the property becomes investment property and [IAS 40] applies”.
5. The Basis for Conclusions which accompanies IAS 40 states :

“B17 Some commentators argued that it is difficult to estimate fair value reliably for investment property under construction, because a market may not exist for property under construction. They argued that there may be considerable uncertainty about the cost to complete investment property under construction and about the income that such property will generate. Therefore, they suggested that an entity should not measure investment property at more than cost if the investment property is still under construction.

B18 The Board was persuaded by this argument and concluded that investment property under construction should be excluded from the scope of this standard and should be covered by IAS 16.”

6. IAS 16.15 (dealing with “measurement at recognition”) states that “An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at cost.”
7. IAS 16.29 (dealing with “measurement after recognition”) states that “an entity shall choose either the cost model or revaluation model”.
8. The question raised is whether a company may choose to measure investment property under construction using the revaluation model in IAS 16 or whether it is required to use the cost model.
9. This paper does not consider whether land on which investment property is constructed should be considered as an integral part of an investment property asset, or whether the land and buildings should be considered as separate investment property assets.

View A – the revaluation model is not available for investment properties under construction

10. Supporters of this view note that the Basis for Conclusions accompanying IAS 40, states that the standard excludes investment property under construction because measurement of the fair value of this property is subject to considerable uncertainty. They argue that it would not make sense to exclude this property from IAS 40, on the basis that fair value could not be measured with sufficient reliability, and then allow it to be measured at fair value under IAS 16.

11. This view is supported by paragraph B17 of the Basis for Conclusions of IAS 40 (citing a view with which the Board concurs) which states “an entity should not measure investment property at more than cost if the property is still under construction.”
12. Furthermore, IAS 16.15 states that property, plant and equipment is measured at cost upon initial recognition. This cost includes (paragraph 16b) “costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.”
13. The revaluation model referred to in IAS 16.29 is only available *after* initial recognition at cost. Since the initial cost recognised includes the cost of bringing the asset into a condition where it is ready for use (paragraph 16b), supporters of view A argue that paragraph 29 cannot apply until after the asset is brought into that condition. The revaluation model is therefore not available for assets under construction.

View B – the revaluation model is available for investment properties under construction

14. Opponents of View A argue that the Basis for Conclusions states only that there *may be* considerable uncertainty measuring the fair value. The fact that there may be uncertainty does not imply that there always will be uncertainty. It is a matter of judgement for the preparer based upon the specific facts and circumstances in any given situation as to whether there is sufficient certainty to be able to measure an investment property under construction at fair value in accordance with IAS 16.
15. By bringing the assets within the scope of IAS 16, the Board gave preparers the option of valuing investment property under construction at cost through the construction period and then fair value once completed. If the preparers believe that the fair value can be measured with sufficient reliability whilst a property is still under construction, it does not rule out using the revaluation model in IAS 16.

16. Furthermore, by using the revaluation model under IAS 16, preparers take revaluation gains to equity rather than through the income statement as they would under IAS 40. This more prudent approach reflects the fact that the measurement of the fair value of investment properties under construction is inherently less reliable than the measurement of completed investment properties.
17. Supporters of View B agree that the revaluation model is only available after initial recognition but they do not believe that this requires the asset to be in the location and condition necessary for it to operate in the manner intended by management. They argue that paragraphs 16 - 20 of IAS 16 are intended only to restrict amounts that can be capitalised – not to defer the availability of the revaluation model.
18. Supporters of this view also believe that if the Board had wanted to restrict the use of the cost option in IAS 16 for investment property under construction, it could have explicitly stated this in the standard.

STAFF ANALYSIS

19. The staff notes that the 2003 Bound Volume includes, as an appendix to IAS 40, a decision tree. Whilst this decision tree does not form part of the standards, it states that if a property is “being constructed or developed” it should be accounted for using “IAS 16 (benchmark or allowed alternative) until completion”.
20. This decision tree was deleted as part of the 2003 Improvements project. The cover note accompanying the second pre-ballot draft for IAS 40 from October 2003 states “the decision-tree from the pre-ballot was inadequate and served little purpose not already evident from the text. It has been deleted.”
21. As IAS 16 does not explicitly restrict the availability of the revaluation model to investment property under construction, and the previous version of IAS 40 included an appendix that stated that the revaluation model was available, and the reason for withdrawal of this appendix was that its contents were ‘evident

from the text', the staff concludes that the revaluation model (previously the allowed alternative) is available for investment property under construction.

The staff will ask the IFRIC to confirm that it believes that the revaluation model in IAS 16 is available for investment property under construction.

22. Despite being available for investment property under construction, the staff considers that there may be practical problems with applying the revaluation model to this kind of property.
23. IAS16.20, which deals with “measurement at recognition,” states that “recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management”. IAS16.31, which deals with “measurement after recognition,” states that when an entity uses the revaluation model, “after recognition as an asset, an item of property plant and equipment whose fair value can be measured reliably shall be carried at revalued amount...”
24. The staff is aware that some entities currently revalue property under construction which has not reached the location and condition necessary for it to be capable of operating in the manner intended by management. These entities argue that as soon as some costs have been recognised “in the carrying amount of an item of property plant and equipment”, the entity has recognised an asset. The IAS16.31 revaluation model is available after recognition of an asset. Therefore, as soon as an entity has recognised some costs in the carrying amount of an item, that asset may be revalued.
25. On the other hand, the staff notes that IAS26.20 states that “recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management”. Since recognition ceases when an item is in that location and condition, recognition must be ongoing until that point.

26. As the IAS16.31 revaluation model is only available after recognition, and recognition does not cease until the item is in the location and condition necessary for it to be capable of operating in the manner intended by management, the staff believes that the revaluation model is only available to assets which have reached that location and condition.
27. The staff considers that this view is consistent with the IAS16 model which includes a cost collection model for “measurement at recognition” (paragraphs 15-28) followed by a subsequent measurement model for “measurement after recognition” in paragraphs 29-49.
28. Additionally the staff notes that IAS16.55 requires that an asset be depreciated when it is “available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.”
29. The staff therefore considers that, while the revaluation model is available for investment property under construction, it is only available for items which are in the location and condition necessary for them to be capable of operating in the manner intended by management, and that once assets are in that location and condition, they must be depreciated.

If the IFRIC concludes that the issue should not be taken onto the agenda, the staff will ask it to state whether it believes that IAS 16 is clear in this respect and whether this should be reflected in any rejection wording developed.

30. IAS 16.9 states that “the standard does not prescribe a unit of measure for recognition, ie what constitutes an item of property plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity’s specific circumstances.”
31. In the case of investment property under construction, if the unit of account, ie ‘the item’, is defined as the whole investment property, then there can not be any completed items which qualify for the revaluation model under IAS 16 until such time as the entire property is completed. As soon as the entire

property is completed, it is accounted for under IAS 40. The revaluation model under IAS 16 does not therefore apply unless the investment property comprises more than one item.

32. The staff believes that applying the revaluation model to investment property under construction therefore requires an entity to identify the items within that property which are complete and in the location and condition necessary for them to be capable of operating in the manner intended by management, and to value those items individually. The completed items within the investment property under construction should then be depreciated.

Consideration of whether the issue should be taken onto the IFRIC agenda

Existence of significantly divergent interpretations

33. The original request received by the IFRIC stated that “it seems like most large property developers in the United Kingdom measure investment property under construction at fair value whereas property developers outside the United Kingdom tend to measure these at cost. Although this might be considered as merely a choice of measurement model under IAS 16.29, we have reason to believe many property developers would consider measurement of investment property at revalued amount as not available under IAS 16.”

34. [Paragraph omitted from observer notes]

35. [Paragraph omitted from observer notes]

36. In the light of the above and of the experience of certain IFRIC members of practice in other countries, the staff believes that divergence does exist in practice.

37. [Paragraph omitted from observer notes]

Relation to a Board project

38. The issue is unlikely to be covered by an existing Board project.

Timeliness of a consensus view of the IFRIC

39. There is no reason in principle why the IFRIC should not be able to reach a consensus on this issue on a timely basis.

Potential courses for IFRIC

40. The staff considers that there are a number of potential approaches available to IFRIC to deal with this issue. In particular, the staff has considered the following options :
- a. issuing a rejection wording
 - b. taking the project onto the agenda and proposing an Interpretation
 - c. referring the issue to the Board
41. Whilst it appears that there is divergence in this area, the staff considers that, if that divergence is not significant or does not have practical or widespread relevance, then a rejection wording should be published. In evaluating the relevance of the issue, the staff has considered:
- a. that the issue is specific to one type of industry
 - b. that the issue is only relevant to a relatively small subset of the assets of that industry (ie investment properties that are under construction at period ends and for which fair value is different from cost)
 - c. that the fair value of property under construction may be similar to its cost (particularly if the construction period is short)
 - d. that in the (small sample of) financial statements reviewed, where a revaluation had occurred, the revaluation of investment properties under construction did not appear to be a quantitatively material amount.
42. On the basis of the above, the staff considers that the divergence is not significant and does not have widespread and practical relevance. They therefore propose that a rejection wording be issued.
43. The staff believes that if no rejection wording is issued, the IFRIC could either take on a project to issue an Interpretation in this area or it could ask the Board to amend the standard. One approach to amending the standard might be to

alter either IAS 16 or IAS 40 to clarify which models are available. For example, IAS 16.5 could be amended to read :

“An entity shall apply either the cost model or the revaluation model within this standard to property that is being constructed or developed for future use as an investment property but does not yet satisfy the definition of ‘investment property’ in IAS 40 *Investment Property*.

44. Another alternative might be to ask the Board to consider amending IAS 40 and IAS 16 to state that investment property under construction is accounted for using IAS 40 rather than IAS 16.
45. [Paragraph omitted from observer notes]
46. [Paragraph omitted from observer notes]

The staff ask the IFRIC to state :

- a. whether it agrees with the staff analysis that the revaluation model within IAS 16 is available for investment property under construction.***
- b. whether it agrees with the staff view that this issue should not be taken on to the IFRIC agenda.***
- c. whether it agrees that it is clear that the revaluation model is only available once an item is in the location and condition necessary for it to be capable of operating in the manner intended by management.***
- d. whether it agrees with the issuance of rejection wording in the form above.***