

4.4 Investment Property

10.1.2.62 Authorities will need to review their assets as at 1 April 2009 to identify those assets that meet the definition of an investment property. Assets classified as investment property under the SORP may not meet the definition of an investment property under section 4.4 of the Code and IAS 40. Such assets shall be reclassified as property, plant and equipment and accounted for under section 4.1 of the Code. Property classified as surplus under the SORP that does not meet the definition of held for sale may meet the definition of investment property; this could occur where the property was being held for capital appreciation prior to any sale taking place. The Code (following IFRS 5) does not permit investment property to be reclassified as held for sale. Therefore any assets classified as surplus under the SORP that had been classified as investment property prior to being classified as surplus assets will need to be reclassified as investment property under the Code. It is unlikely that property classified as operational under the SORP would meet the definition of investment property under section 4.4 of the Code.

There are two reasons why investment properties may need to be restated on transition to IFRS. The first reason is that the accounting for investment properties under the Code differs from that under the SORP, and that accounts may need to be restated to reflect – retrospectively – this revised accounting policy. The second reason is that the definition of investment property under the Code is different to that under the SORP, and as a result assets may be classified differently under the Code than under the SORP. Differences in classification are considered below.

Investment property is defined (in paragraph 4.4.2.4 of the Code) as follows:

Investment property is property (land or a building – or part of a building – or both) held solely 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 operations.*

If earning rentals were an outcome of a regeneration policy, for example, the properties concerned would be accounted for as property plant and equipment rather than investment property. Social housing is delivering a service and shall be accounted for as property plant and equipment.

The 2009 SORP defined investment property (in the glossary of terms) as follows:

Interest in land and/or buildings:

- (a) in respect of which construction work and development have been completed, and*
- (b) which is held for its investment potential, with any rental income being negotiated at arm's length.*

*Under the Code, assets have to be held **solely** to earn rentals or for capital appreciation or both if they are to be classified as investment property. The definition under the SORP was less prescriptive, and it is possible that authorities had classified some assets as investment property when they were being held partially for service or policy reasons (industrial estates which were provided to deliver an economic development policy objective as well as to generate income being one example). Authorities will therefore need to review their investment properties and determine whether they are held solely to earn rentals or for capital appreciation or both. Where this is not the case, the assets will need to be*

reclassified as property, plant and equipment. The purpose for which the asset is held is important; industrial estates could be held partly for economic regeneration purposes, and so be classified as property, plant and equipment; or could be held solely to generate rental income and so be classified as investment property. In some cases, the purpose for which the asset was acquired may be different to the purpose for which it is currently being held. It is the purpose for which it is being held at the balance sheet date that needs to be considered in determining whether the asset is an investment property. Further guidance on the classification of investment property can be found in Module 4, Section H of the Code Guidance Notes.

The Code also introduces a new classification of assets – non-current assets held for sale. The strict criteria that need to be satisfied before an asset can be classified as held for sale (see paragraph 4.9.2.13 of the Code) means that some assets that are currently classified as surplus and that the authority intends to sell in due course may not meet the criteria to be classified as held for sale; in the current economic climate, a relatively common example may be that the authority believes the property market will recover in a relatively short period of time, and is therefore retaining the asset until the market has recovered, leading to higher sales proceeds when the asset is eventually sold. Authorities will need to consider whether this approach amounts to holding the asset for capital appreciation, and that the asset should therefore be classified as an investment property. (Where the surplus asset does not meet the criteria to be held for sale, and where the authority concludes it does not meet the definition of an investment property, the asset should be classified as property, plant and equipment.)

Under the Code, investment property that an authority decides to sell is not reclassified as held for sale, but remains investment property until the sale. Authorities may have reclassified investment property as surplus assets under the SORP, and where this is the case, they will need to reclassify the assets as investment property under the Code.

*Finally, it is unlikely that property classified as operational under the SORP would meet the definition of investment property. This is because assets classified as operational under the SORP would have been held to deliver services; this would prevent them satisfying the definition of investment property under the Code as they would not be held **solely** to earn rentals or for capital appreciation or both.*

Step 1 - Restate Opening IFRS Balance Sheet as at 1 April 2009

- 10.1.2.63 The Code (following IFRS 1) requires local authorities to classify and account for investment properties in their opening IFRS balance sheet (1 April 2009) in accordance with section 4.4 of the Code (see also IAS 40 and IPSAS 16). Accounting for investment property at fair value through Surplus or Deficit on provision of services is a change of accounting policy that will require authorities to restate their opening balances in respect of investment property.

Authorities should note that if, when the property was acquired or first became an investment property, there was evidence that the fair value of the investment property was not reliably determinable on a continuing basis, paragraph 4.4.2.13 of the Code requires the investment property to be accounted for using the cost model in section 4.1 of the Code and IAS 16. It is considered unlikely that this situation will occur.

- 10.1.2.64 For existing investment properties, and surplus assets reclassified as investment properties, authorities shall transfer any balances on the Revaluation Reserve in respect of investment property as at 1 April 2009 to the Capital Adjustment Account. Any depreciation charged prior to 1 April 2009 would have been transferred to the Capital Adjustment Account, and therefore no further adjustment is required.

Existing Investment Property

For assets classified as investment property under both the SORP and the Code, it is expected that there will be no material difference between the market value of the asset (as required by the SORP) and the fair value of the asset (as required by the Code); it is therefore unlikely that the carrying amount of the asset will need to be adjusted. Any gains in relation to the asset held in the Revaluation Reserve as at 31 March 2009 under the SORP would, on the retrospective application of the Code, have been credited to the Comprehensive Income and Expenditure Account, and transferred to the Capital Adjustment Account. The following entries are therefore required to restate the opening balance sheet:

<i>Dr Revaluation Reserve</i> <i>Cr Capital Adjustment Account</i>

Any losses on the revaluation of the asset (in excess of the balance on the Revaluation Reserve), and any impairments of the asset would have been charged to the Income and Expenditure Account under the SORP, and transferred to the Capital Adjustment Account. Under the Code, such amounts would have been charged to the Comprehensive Income and Expenditure Statement and transferred to the Capital Adjustment Account. No further transactions are therefore required to restate the opening balance sheet.

Surplus assets reclassified as investment property

Where assets classified as surplus assets under the SORP are reclassified as investment properties under the Code, the balance on the revaluation reserve shall be transferred to the Capital Adjustment Account as follows:

<i>Dr Revaluation Reserve</i> <i>Cr Capital Adjustment Account</i>

The reason for these transactions is the same as for existing investment property. Similarly, there are no transactions required to restate any revaluation losses or impairments charged to the Income and Expenditure Account for the same reason as for existing investment properties.

- 10.1.2.65 As surplus properties were subject to depreciation, authorities shall adjust the carrying amount of surplus properties reclassified as investment properties to fair value where this is materially different to the carrying amount.

Any depreciation charged on a surplus property would have been charged to the Income and Expenditure Account and transferred to the Capital Adjustment Account. As a result, the carrying amount of the surplus property under the SORP may be materially different from the carrying value that should be recognised for the investment property under the Code. If this is the case, the carrying amount of the asset should be restated, with the corresponding credit made to the Capital Adjustment Account, as follows:

<i>Dr Investment property</i> <i>Cr Capital Adjustment Account</i>

- 10.1.2.66 Authorities shall adjust the carrying amount of investment property held under a lease to fair value as at 1 April 2009.

Similarly, an adjustment to the carrying amount of an investment property held under a lease may be required. This is because, under the SORP, such leases were depreciated where they had 20 years or less to run, whereas under the Code, the carrying amount is based on the fair value of the lease interest. It is therefore

possible that the carrying amount previously recognised under the SORP might under- or over-state the carrying amount required to be recognised under the Code. Where this is the case, the authority should restate the carrying amount of the investment property, with the corresponding credit or debit being made to the Capital Adjustment Account:

<i>Dr / Cr Investment property</i> <i>Cr / Dr Capital Adjustment Account</i>

The adjustment is made to the Capital Adjustment Account because, in line with the other adjustments discussed above, all entries required under the Code to be accounted for retrospectively would have been credited or debited to the Comprehensive Income and Expenditure Statement and then transferred to the Capital Adjustment Account.

- 10.1.2.67 Where an asset classified as an investment property under the SORP is reclassified as property, plant and equipment under the Code, the asset shall be revalued (as at 1 April 2009) in accordance with section 4.1 of the Code. Any loss on revaluation in excess of the balance for the asset in the Revaluation Reserve shall be transferred to the Capital Adjustment Account.

Where an asset was classified as an investment property under the SORP, but is reclassified as property, plant and equipment under the Code, any balance on the revaluation reserve would remain in place. Because the interpretation of fair value for investment property (effectively market value) is different to that for property, plant and equipment (existing use value), an authority shall revalue such assets as at 1 April 2009. By revaluing the assets at this date, no adjustments will be required for depreciation or impairment losses. If the revaluation reduces the carrying amount of the asset by more than the balance for the asset in the Revaluation Reserve, the difference would (on the retrospective application of the Code) have been charged to the Comprehensive Income and Expenditure Statement, and then transferred to the Capital Adjustment Account. In order to restate the 1 April 2009 balance sheet, the following transactions are therefore required:

<i>Dr / Cr Property, plant and equipment</i> <i>Cr / Dr Revaluation Reserve</i>
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With any revaluation gain, or with any revaluation loss up to the balance on the Revaluation Reserve for the asset

<i>Dr Capital Adjustment Account</i> <i>Cr Property, plant and equipment</i>

With the balance of any revaluation loss over and above the balance on the Revaluation Reserve for the asset

Step 2 - Restate Comparative Figures for 2009/10 (Investment Property acquired prior to 1 April 2009)

- 10.1.2.68 Transactions in relation to investment property during 2009/10 will need to be restated in line with the Code. Where the revaluation of investment property was effected through the Revaluation Reserve, authorities shall restate the 2009/10 position by reversing these transactions and effecting the change to fair value through Surplus or Deficit on provision of services. Any depreciation charged on property that has been reclassified from surplus assets to investment property shall be reversed.

Existing Investment Property

Existing investment property may have been revalued during 2009/10. Amounts credited or debited to the Revaluation Reserve during 2009/10 will need to be taken to the Comprehensive Income and Expenditure Statement, and then transferred to the Capital Adjustment Account, as follows:

*Dr / Cr Revaluation Reserve
Cr / Dr Financing and investment income and expenditure in the Comprehensive Income and Expenditure Statement*

To transfer the amount credited or debited to the revaluation reserve under the SORP to Financing and investment income and expenditure (movement in the fair value of investment property) as required by the Code.

*Dr / Cr General Fund
Cr / Dr Capital Adjustment Account*

To transfer the movement in the fair value of investment property credited or debited to the Financing and investment income and expenditure to the Capital Adjustment Account to comply with the capital financing regime.

Where revaluation losses or impairment losses were charged to the Income and Expenditure Account in 2009/10 under the SORP, these will need to be restated as a movement in the fair value of investment property under the Code.

*Dr Financing and investment income and expenditure (in the Comprehensive Income and Expenditure Statement)
Cr Revaluation loss or Impairment loss (charged to the Income and Expenditure Account)*

Under the SORP, these amounts would have been transferred to the Capital Adjustment Account to comply with the capital financing regime. As this transfer would also be required under the Code, no restatement is required, although the transfer will need to be described as a reversal of the movement in the fair value of investment property in the Movement in Reserves Statement (or the notes to the statement) rather than as the reversal of a revaluation loss or an impairment loss.

Surplus assets reclassified as investment property

Where an asset that was classified as a surplus asset under the SORP is reclassified as investment property under the Code, any revaluation gains or losses shall be reclassified in the same manner as for existing investment property above.

Where depreciation was charged on the asset in 2009/10 under the SORP, this will need to be reversed. The required entries in the restated 2009/10 accounts are:

*Dr Investment property
Cr Depreciation (charged to the Income and Expenditure Account)*

To reverse the depreciation charged under the SORP

*Dr General Fund
Cr Capital Adjustment Account*

To reverse the transfer of the depreciation to the Capital Adjustment Account that would have been made under the SORP

- 10.1.2.69 Depreciation charged on investment property held under a lease shall be reversed. The carrying amount of the lease shall be adjusted to fair value if required.

Where depreciation was charged on an investment property held under a lease in 2009/10 under the SORP, this will need to be reversed. The required entries in the restated 2009/10 accounts are:

*Dr Investment property
Cr Depreciation (charged to the Income and Expenditure Account)*

To reverse the depreciation charged under the SORP

*Dr General Fund
Cr Capital Adjustment Account*

To reverse the transfer of the depreciation to the Capital Adjustment Account that would have been made under the SORP

As discussed above under Step 1, the accounting treatment of investment property held under a lease required by the Code is different to that required by the SORP. As a result, there may be a need to adjust the carrying amount of the lease interest where the carrying amount under the SORP (allowing for any adjustments made under Step 1 and the reversal of depreciation above) would be materially different from that required under the Code. Such adjustments should be shown in the restated 2009/10 accounts as a movement in the fair value of investment property, and then transferred to the capital adjustment account. The entries required are as follows:

*Dr / Cr Investment Property
Cr / Dr Financing and investment income and expenditure in the Comprehensive Income and Expenditure Statement*

To adjust the carrying of the investment property held under a lease to the amount required by the Code.

*Dr / Cr General Fund
Cr / Dr Capital Adjustment Account*

To transfer the movement in the fair value of investment property credited or debited to the Financing and investment income and expenditure to the Capital Adjustment Account to comply with the capital financing regime.

- 10.1.2.70 Depreciation shall be charged in Surplus or Deficit on assets reclassified from investment property to property, plant and equipment. The depreciation shall be reversed to the Capital Adjustment Account and reported in the Movement in Reserves Statement.

Where an asset was classified as an investment property under the SORP, but is reclassified as property, plant and equipment under the Code, the asset would have been revalued under Step 1 above. The restatement of the 2009/10 accounts will need to include depreciation on this asset that would not have been charged under the SORP; the depreciation would then need to be transferred to the Capital Adjustment Account. The transactions required to restate the accounts are as follows:

*Dr Depreciation (in the Comprehensive Income and Expenditure Statement)
Cr Property, plant and equipment*

To charge the depreciation required under the Code

*Dr Capital Adjustment Account
Cr General Fund*

To transfer the depreciation charge to the Capital Adjustment Account to comply with the capital financing regime

Step 3 - Restate Comparative Figures for 2009/10 (Investment Property acquired during 2009/10)

- 10.1.2.71 Where an authority has acquired investment property during 2009/10, any revaluations or depreciation charged on investment property held under a lease shall be reversed in line with Step 2. In addition, an authority shall consider whether any investment property acquired during 2009/10 requires its carrying amount to be adjusted to fair value, and whether any investment property under construction requires its carrying amount to be adjusted to fair value.

Where authorities have acquired investment property in the year, there will be no transactions required to restate the acquisition of the investment property. Where the newly acquired investment property was revalued in the year, the transactions shall be restated in line with the requirements of Step 2. Similarly, any depreciation charged in respect of an investment property held under a lease should be restated in line with the requirements of Step 2.

The Code requires investment property under construction to be carried at fair value once an authority is able to measure reliably the fair value of the investment property; and at cost before that date. Under the SORP, such properties would always have been carried at cost. Authorities will therefore need to consider if they are able to measure reliably the fair value of the investment property under construction. Where this is the case, the carrying amount of the investment property will need to be restated; the transactions required to restate the 2009/10 accounts are as follows:

*Dr / Cr Investment Property
Cr / Dr Financing and investment income and expenditure in the Comprehensive Income and Expenditure Statement*

To adjust the carrying of the investment property under construction to the amount required by the Code.

*Dr / Cr General Fund
Cr / Dr Capital Adjustment Account*

To transfer the movement in the fair value of investment property credited or debited to the Financing and investment income and expenditure to the Capital Adjustment Account to comply with the capital financing regime.

- 10.1.2.72 IAS 40 states that, where an asset is transferred from operational assets to investment property, the asset is revalued to fair value on transfer and the gain or loss is recognised in the Revaluation Reserve (up to the balance on the reserve; thereafter the loss is recognised in the surplus or deficit on provision of services). These requirements also cover assets transferred from operational assets to surplus assets under the SORP, where the surplus assets are reclassified as investment properties under the Code. This balance is retained in the Revaluation Reserve until the investment property is derecognised. This requirement shall apply prospectively from 1 April 2009, and shall not be applied to transfers prior to 1 April 2009. This arises due to the difficulties in establishing the balance that would be required on the Revaluation Reserve due to the reserve being constituted with a nil balance at 1 April 2007.

Because this requirement is applied prospectively from 1 April 2009, it will not apply to any surplus property reclassified as investment property prior to 1 April 2009. Where, during 2009/10 property was transferred to investment property, or transferred to surplus assets under the SORP, but subsequently reclassified as investment property, the property would have been revalued. No entries are required to restate this revaluation, as in accordance with paragraph 10.1.2.72 above, such amounts are retained on the Revaluation Reserve until the investment property is derecognised. If the property classified as a surplus asset under the SORP was depreciated during 2009/10, that depreciation would need to be reversed to restate the 2009/10 accounts. The transactions required are as follows:

*Dr Investment property
Cr Depreciation (charged to the Income and Expenditure Account)*

To reverse the depreciation charged under the SORP

*Dr General Fund
Cr Capital Adjustment Account*

To reverse the transfer of the depreciation to the Capital Adjustment Account that would have been made under the SORP

- 10.1.2.73 Where an authority acquired a property as investment property under the SORP that is reclassified as property, plant and equipment under the Code, the authority shall consider whether any depreciation needs to be charged and whether the property needs to be revalued.

If a property was acquired during 2009/10 as an investment property under the SORP, but under the Code is reclassified as property, plant and equipment because it is held partially for the purpose of delivering a policy objective, it is likely that the asset will need to be revalued, as property, plant and equipment is measured at existing use value. No balance is expected to exist on the Revaluation Reserve, as the asset will be newly acquired. Any revaluation losses will therefore be charged to the Comprehensive Income and Expenditure Statement. The transactions required to restate the asset in the 2009/10 accounts are as follows:

It is considered that a revaluation loss is more likely than a revaluation gain, and the following transactions are therefore expected to be relevant:

*Dr Financing and investment income and expenditure in the Comprehensive Income and Expenditure Statement
Cr Property, plant and equipment*

With any revaluation loss

*Dr Capital Adjustment Account
Cr General Fund*

To reverse any revaluation loss charged to the Financing and investment income and expenditure in the Comprehensive Income and Expenditure Statement to comply with the capital financing regime.

Where, unusually, a revaluation gain occurs, the following transactions will be required:

*Dr Property, plant and equipment
Cr Revaluation Reserve*

With any revaluation gain

Depending on the depreciation policy of the authority, a depreciation charge in respect of the asset reclassified as property, plant and equipment may be required. In these cases, the transactions required to restate the 2009/10 accounts are as follows:

*Dr Depreciation (in the Comprehensive Income and Expenditure Statement)
Cr Property, plant and equipment*

To charge the depreciation required under the Code

*Dr Capital Adjustment Account
Cr General Fund*

To transfer the depreciation charge to the Capital Adjustment Account to comply with the capital financing regime