

## **Recognition of Investment Property**

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### **Introduction**

ABC is one of the Manufacturing Companies in Sri Lanka and operating as the market leader for roofing sheets in Sri Lanka. XYZ is a fully owned subsidiary of ABC. ABC company acquired a land in 2010 for Rs:50,000,000/= and this land was leased to XYZ on operating lease for 40 years lease term which has annual lease value of Rs. 14,404,200/=. They have entered in to that lease agreement in 2013.

### **Discussion of the Issue**

Land is still treating as PPE according to the LKAS 16 in the books of ABC Ltd (parent company). The land was subsequently re-valued for Rs.60, 000,000 /= and carrying at the re-valued value in the Statement of Financial Position of the ABC Ltd at 2015.3.31. During this year, they have identified that revaluation surplus which was Rs.10mn in their financial statement.

“According to LKAS 16 (paragraph 6), 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 for administrative purposes ; and
- (b) Are expected to be used during more than one period.”

According to the standard cost model or re-evaluation model should be selected for measurement after recognition.

“According to LKAS 17 (paragraph 19), it is possible for a lessee to classify a property interest held under an operating lease as an investment property.”

“According to LKAS 40 (paragraph 75(b), an entity shall disclose: if it applies the fair value model, whether, and in what circumstances, Property interest held under operating lease should classify as investment property.”

“According to the LKAS 40 (paragraph 5), Investment property is property (Land & Building – or part of a building – or both) held (by 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 good or services or for administrative purpose; or Sale in the ordinary course of business.”
- (b) Investment property is initially measured at cost and subsequently measured at fair value.

“According to LKAS 40 (paragraph 61), if an owner - occupied property becomes an investment property that will be carried at fair value, and entity shall apply LKAS 16 up to the date of change in use. The entity shall treat any difference at

that date between the carrying amounts of the property in accordance with LKAS 16 and its fair value in the same way as a revaluation in accordance with LKAS16.”

## **Implication of the Issue**

### Statement of Financial Position

According to this case, there is a classification error. Parent company has classified the land as a Property in the Statement of Financial Position under LKAS 16 (Property Plant & Equipment) and identified a revaluation surplus in the statement of financial position under other components of equity.

### Statement of Comprehensive Income

The company didn't recognize the change in fair value of Investment Property to the Statement of Comprehensive Income. Therefore it has caused to a Fair value impact (Gain or Loss) to the Statement of Comprehensive Income (profit for the year has understated). They have identified a revaluation surplus in their financial statement (Other comprehensive income has overstated).

## **Conclusion and Recommendation**

According to the LKAS 16, they have recognized the Land as PPE in the books of ABC. But that land is leased on operating lease and used to earn rentals. According to LKAS 17(paragraph 19), it is possible for a lessee to classify this land held under an operating lease as an investment property. Therefore it must be classified under LKAS 40 as an investment Property.

Revaluation surplus recognized in the financial statement should be reversed back in the current year. It should be identified as Fair Value gain in the comprehensive income statement (LKAS-40-paragraph 61).