Accounting for Investment Properties under the Public Benefit Entity ("PBE") Standards

With the advent of the new Public Benefit Entity ("PBE") financial reporting standards as issued by the External Reporting Board ("XRB"), there are some key changes in the way that entities are required to account for certain transactions and balances. One such change is in the way that entities are now required to account for their investment properties.

In this article I outline the key recognition and measurement requirements outlined in PBE IPSAS 16 Investment Property. I also highlight some of the key differences with the previous generally accepted accounting practice (GAAP) and some important first time adoption choices. Please note that this standard only applies to Tier 1 and Tier 2 PBEs.

Definitions and scope

→ An investment property is defined as land or a building (or part of a building) held to earn rentals or for capital appreciation or both, rather than for (i) use in the production or supply of goods or services or for administrative purposes; or (ii) sale in the ordinary course of operations. Such land or buildings can be held by the owner or under a finance lease.

→ Land or buildings used for administrative purposes or in the production or supply of goods or services are not included as part of investment properties and these include:

- Owner occupied property, including property occupied by employees (whether or not the employees pay rent at market rates);
- Property that is being constructed or developed for future use as owner occupied property;
- Property held to provide a social service and which also generates cash flows (e.g. housing stock for low income families at below market rentals);
- Property leased to another entity under a finance lease;
- Property held for sale in the ordinary course of business; or
- Property held for strategic services

The above property types would therefore not meet the definition of an investment property. This also includes any owner-managed hotels or hostels.

→ Careful consideration may also be required for group entities that have a property management entity to manage office buildings. Property leased to, and occupied by, a controlling entity or another controlled entity does not qualify as an investment property in the consolidated financial statements, because it is deemed as owner-occupied from the perspective of the economic entity. However, such a property would meet the definition of an investment property in the separate financial statements of the property management entity i.e. the entity that owns the property. As an example, where a parent entity has leased property to controlled entities, the property would be classified as an investment property in the parent numbers with the classification changing to property, plant and equipment in the consolidated numbers.

Recognition and initial measurement

An entity can recognise investment properties in their statement of financial position when, and only when, it meets the following two conditions:

→ It is probable that the future economic benefits or service potential that are associated with the investment property will flow to the entity; and

→ The cost or fair value of the investment property can be measured reliably.

Once the above conditions are met, investment properties are then measured initially at their cost (which is the amount expended to acquire an asset at the time of acquisition or construction). Any transaction costs are also captured and capitalised at this stage. However, when an investment property has been acquired through a non-exchange transaction at no cost, or for a nominal charge, the cost in such instances is measured at the fair value of the property as at the date of acquisition.

Subsequent measurement

After the initial recognition described above, the next step would be for an entity to choose its accounting policy. There are two options available for PBEs applying PBE IPSAS 16 as follows:

→ ***Fair value model –*** under this model, an investment property is subsequently measured at fair value at each reporting date, and any changes in fair value are recognised in surplus or deficit for the period in which they arise.

→ The fair value model is now optional for both Tier 1 and Tier 2 PBEs whereas under old GAAP, this was mandatory for entities that did not qualify for differential reporting. Such non-qualifying entities had the option of recognising the fair value changes either in equity or in surplus or deficit. Such an option has now been removed with all fair value changes being recognised in surplus or deficit. Consequently, for entities that used to recognise fair value movements in equity, this change will result in more volatility in their reported surplus or deficit.

→ ***Cost model –*** under this model, an investment property is measured at depreciated cost, less any accumulated impairment losses. Entities adopting this model apply the cost model used for property, plant and equipment.

→ Under old GAAP, the cost model was only available to entities qualifying for differential reporting. This model has now been made available to both Tier 1 and Tier 2 entities. A point to note is that entities applying this model are now required to disclose in their notes the fair value of the investment property. However, in an effort to reduce compliance costs, entities applying the cost model, that are eligible to use Tier 2 PBE Standards, are exempted from disclosing the fair value of their investment properties.

The model that an entity chooses from the above options is then required to be applied to all of its investment properties. However, the requirement above is softened in an instance where fair value cannot be readily determined. If an entity applies the fair value model but, when a particular property is acquired, there is clear evidence that the entity will not be able to determine fair value on a continuing basis, the cost model is used for such a property. In such an instance, the cost model will continue to be applied for such a property until it is disposed of. Additionally, the residual value of the property is assumed to be zero. This scenario is likely to be rare in New Zealand given our active market for property.

The intention is that entities will not swap between models. Any subsequent changes from one model to the other are only made if the change will result in a more appropriate presentation. However, it may be difficult for entities applying the fair value model to demonstrate that a change to the cost model will result in a more appropriate presentation. Accordingly, the initial choice is very important i.e. entities need to ensure the fair value model is more appropriate for them in the long term before opting for that model.

The other condition that is apparent from the standard is that transfers to or from investment property are made only when there is a change of use.

PBEs that hold property interests may need to assess whether such interests meet the definition of an investment property as outlined above. A property interest held by a lessee under an operating lease can be classified and accounted for as an investment property provided the lessee uses the fair value model. However, the lessee is expected to account for the lease as if it were a finance lease.

Disclosures

The standard has a number of disclosure requirements depending on the whether an entity is applying the cost model or the fair value model. We encourage entities to use a disclosure checklist to ensure the applicable disclosure requirements are adequately met.

How RSM can help

As experts in this sector RSM is currently assisting many PBEs navigate their transition to the new PBE standards. If you have investment properties and would like to ensure all bases are covered, we have a dedicated technical team that can provide you with the assistance you require. If you would like to discuss how we can help please contact us.

About the Author

Mwauluka Mubano CA, FCCA is an Audit Manager at RSM. Mwauluka has had significant auditing and accounting experience in both Zambia and New Zealand working with large companies in the manufacturing, mining, mining related and forestry industries

Contact Mwauluka on:

E: mwauluka.mubano@rsmnz.co.nz
W: www.rsmnz.co.nz