Only text in Estonian has legal power

Regulation of the Ministry of Finance on the
"Establishment of the Guidelines of the Accounting Standards Board"
Note 6
In force from: 01.01.2019
Applicable to the accounting periods, starting on 01.01.2018 or later.

ASBG 6 INVESTMENT PROPERTY

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OBJECTIVE AND BASIS FOR PREPARARTION

1. The objective of the Accounting Standards Board's guideline ASBG 6 "*Investment Property*" is to prescribe rules for accounting for investment properties in the financial statements prepared in accordance with the Estonian financial reporting standard (hereinafter also *the financial statement*). Estonian financial reporting standard is a body of financial reporting requirements directed at the public and based on the internationally accepted accounting and reporting principles, which principal requirements are established by the Accounting Act and which is specified by a regulation of the minister responsible for the area established on the basis of subsection 34 (4) of the Accounting Act (hereinafter *guideline of the Standards Board* or for short *ASBG*).

2. ASBG 6 is based on IFRS for SMEs sections 16 "*Investment Property*" and 11 "*Basic Financial Instruments"*) and on concepts defined in section 2 "*Concepts and Pervasive Principles*". The guideline contains references to the specific paragraphs of IFRS for SMEs that the requirements of the guideline are based on. The comparison of ASBG 6 with IFRS for SMEs is presented in clause 33. In areas where ASBG 6 does not specify a particular accounting policy but that are covered by IFRS for SMEs, it is recommended to abide by the accounting policy described in IFRS for SMEs.

SCOPE

3. ***ASBG 6 "Investment Property" shall be used for accounting for investment properties and recognising in the financial statements.***

4. ASBG 6 shall be applied only to recognise investment properties and it shall not be applied to recognise owner-occupied property. The difference between definitions of investment property and owner-occupied property is explained in clauses 5-10.

DEFINITIONS

5. ***The following terms are used in this guideline with the meanings specified:***

<u>Investment property</u> is property (land or a building (or part of a building) or both) held (as an owner or a lessee under finance lease terms) first and foremost to earn rentals or for capital appreciation or both rather than for the use in the production of goods and services, for administrative purposes or sale in the ordinary course of business. (IFRS for SMEs 16.2)

<u>Owner-occupied property</u> is property held by an entity for the production of goods or services or for administrative purposes.

<u>Fair value</u> is the amount for which an asset could be exchanged or a liability settled in a transaction between knowledgeable, willing and independent parties in an arm's length transaction. (IFRS for SMEs 2.34 (b)).

<u>Acquisition cost</u> is the fair value of cash or non-monetary consideration paid to acquire an asset at the time of its acquisition and the fair value of cash or non-monetary consideration received upon assuming a liability. (IFRS for SMEs 2.34 (a)).

<u>Carrying amount</u> is the net amount at which an asset is carried in the balance sheet (taking into consideration accumulated depreciation and any impairment losses).

6. Investment property hereinafter also *investment*) means land or a building (or part of a building) or both held first and foremost to earn rentals or for capital appreciation or both rather than for the use in the production of goods and services, for administrative purposes or sale in the ordinary course of business. A right of superficies may also be considered investment property if it meets the definition of investment property. Contrary to investment property, land and buildings used by an entity in its business activities - such assets are treated as regular items of property, plant and equipment. The below table shows examples of what to consider an investment property and what not. Different guidelines shall be applied, respectively.

Is investment property	Is not investment property
Land held for long-term capital appreciation and not used by an entity itself	Land used by an entity itself but now intended to be sold (recognise as inventories)
A building an entity either owns or leases under finance lease terms and leases out under operating lease terms	A building that an entity owns or leases under finance lease terms and uses in its own business activities (recognise as property, plant and equipment)
A building that an entity plans to lease out but is currently vacant as no tenants have been found	A building being constructed on behalf of a third party (recognise as a long-term construction agreement)
A hotel building whose owner is not involved in the hotel's operating activities that are instead outsourced under a lease or a management agreement	A hotel building if the hotel is operated by its owner even if some services are outsourced (recognise as property, plant and equipment)

7. Investment property has the characteristics of both property, plant and equipment as well those of a financial investment. Although investment property physically resembles property, plant and equipment, its use differs significantly from that of other non-current assets. The cash flows generated by investment property and the fair value of the investment can normally be estimated more precisely and reliably than the cash flows and the fair value of other non-current assets.

8. Investment property may also be an item that the entity does not own but leases under finance lease terms (see ASBG 9 "*Accounting for Leases*").

9. An item under construction or development and intended to be used as investment property in the future shall be recognised as investment property already during construction or development activities in accordance with one of the methods described in clause 14 of this guideline.

10. Under certain circumstances an entity may use a portion of investment property in its own business activities and another portion for earning rentals. These portions shall be accounted for separately. The portion used in own business activities are recognised as property, plant and equipment and the portion leased out, as property investment. (IFRS for SMEs 16.4).

ACCOUNTING POLICIES

Initial Recognition

11. ***An investment property shall be recognised initially in the balance sheet at its cost that also includes the purchase price and the directly attributable expenditure incurred in the acquisition. (IFRS for SMEs 16.5).***

12. Directly attributable expenditure incurred in the acquisition of an investment property includes, for example, notary fees, state fees, fees paid to advisors and other expenditure without which the purchase transaction would not have taken place. (IFRS for SMEs 16.5).

13. If payment for an investment property is deferred beyond normal credit terms, the cost of investment is deemed to be the present value of the consideration payable. The difference between the nominal value and the present value is recognised as an interest expense over the period of credit. (IFRS for SMEs 16.5) Borrowing costs may be capitalised in the cost of a property investment, which after initial recognition are carried at cost pursuant to principles described in clauses 15 and 16 of ASBG 5 "*Property, Plant and Equipment and Intangible Assets*".

Subsequent Measurement

14. ***One of the two following accounting polices shall be used consistently for recognising investment properties (except for micro entities, who shall use the method provided in clause (b)):***

> **(a)** ***Investment property whose fair value can be determined reliably without undue cost or effort shall be accounted for using the fair value method described in clauses 17-25 of this guideline and all the remaining investment properties are measures using the cost method described in clause 26 (IFRS for SMEs 16.7); or***
> **(b)** ***each investment property shall be accounted for using the cost method described in clause 26 of this guideline.***

15. In order to assess whether the fair value can be determined reliably without undue cost or effort, the following aspects should be considered:

> (a) time and cost involved in assessment in relation to the resulting benefit obtained;
> (b) reliability of assessment - the poorer is the credibility of the fair value assessment, the lower is the benefit obtained from this information for the readers of the statement and the less is the cost and effort made for the assessment justified;
> (c) benefit for the reader of the statement - who are the consumers of the statement and what kind of information do they need? For example, if an entity has several owners, part of who do not come in contact with the financial information of the entity on a current basis, then the assessment of fair value is more important. If the

entity has one owner and there are no material external parties who would have a justified need for the information concerning fair value of assets, it is more likely that the cost and effort made to determine the fair value might not be justified.

16. If the entity proceeds from the method described in sub-clause 14 (a) of this guideline, however it is not possible anymore to reliably determine with reasonable cost and effort the fair value of an investment property previously recognised at fair value, the entity will carry this investment at cost, described in clause 26 of this guideline until the fair value can be again reliably determined. The carrying amount of the item at the time of reclassification shall become its cost. (IFRS for SMEs 16.8).

<table>
<tr><td colspan="4"><u>Example 1- Change in accounting policy for investment property</u></td></tr>
<tr><td colspan="4">An entity has on its balance sheet land held for capital appreciation purposes. At 31.12.20X1, the fair value of the land was assessed at 1,000,000 euros based on comparable market transactions.

At the next reporting date at 31.12.20X2, it was not possible to determine the market price under the same method because no comparable market transactions took place. Under alternative methods, the determination of fair value would be time-consuming and costly and according to the entity the fair value range provided by these methods does not form a reliable basis for determining the fair value of the investment property.

At the end of 20X3, comparable market transactions had once again occurred and the fair value of land could be reliably determined (fair value at 31.12.20X3 was 1,200,000 million euros). Which method should the entity use to account for the investment property on its balance sheet?

At 31.12.20X1, fair value was determinable, thus the investment property shall be recorded at fair value in the amount of 1,000,000 euros.

At 31.12.20X2, fair value cannot be determined without undue cost or effort, thus the investment should be accounted for at cost until fair value can once again be determined:</td></tr>
<tr><td>C</td><td>Investment property at fair value</td><td>1,000,000</td><td></td></tr>
<tr><td>D</td><td>Investment property at cost</td><td>1,000,000</td><td></td></tr>
<tr><td colspan="4">At 31.12.20X3, fair value is once again reliably determinable, thus the investment should once again be accounted for using the fair value method:</td></tr>
<tr><td>C</td><td>Investment property at cost</td><td>1,000,000</td><td></td></tr>
<tr><td>D</td><td>Investment property at fair value</td><td>1,200,000</td><td></td></tr>
<tr><td>C</td><td>Gain from revaluation of investment property (on the line "other operating income")</td><td>200,000</td><td></td></tr>
<tr><td colspan="4">If the investment property is an asset that is depreciated (e.g. a building), it should be depreciated over the period that fair value cannot be reliably determined (see clause 26).</td></tr>
</table>

Fair Value Method

17. ***Under the fair value method, investment property shall be measured at fair value at each reporting date. Gains/losses arising from a change in the fair value of investment***

property shall be recognised in the income statement of the accounting period. Investment property measured using the fair value method is not depreciated. (IFRS for SMEs 16.7).

18. The best indicator about the fair value of an investment property is its market value. The market value is the best price the seller would receive in an active market for selling the item or the buyer would receive for purchasing it. The price of a transaction taking place under special circumstances, for example, a fire sale, is not considered to be the market value. (IFRS for SMEs 16.7, 11.27 (a))

19. In the absence of an active market, fair value could be measured using another method, for example, by using recent prices for similar transactions (adjusted to reflect any differences) or by using the discounted cash flow model. (IFRS for SMEs 16.7, 11.27 (b), (c), 11.28, 11.29)

20. Fair value shall be determined using the real market information that existed at the reporting date and not on hypothetical market information. In determining fair value, all factors impacting the value of an investment shall be considered, including the location of the property, its physical condition, existing lease agreements, general activity of the market and other factors impacting its value. Fair value shall reflect the general assessment of the market regarding the value of the investment and its determination excludes factors related to a specific seller or buyer that impact the price (e.g. the impact of an unusual financing scheme on the price).

21. The fair value estimate is time-specific as of a given time. If estimation occurs before or after the reporting date, the events between the reporting date and the estimation date that might impact the value of an item shall be taken into consideration in order to account for investment in the balance sheet.

22. In determining fair value of an investment property, the best possible manner of use of the item is taken as basis. The best possible use reflects the use how the market participants would try to maximise the value of the investment property, considering the item-related legal (e.g. possibility to change the detailed plan), physical (e.g. possibility to build extensions) and financial (e.g. possibility to finance change of use) limitations. Generally, it is assumed that the existing use of an item is its best use, unless there are convincing arguments that most of the market participants would use the item otherwise. When determining the fair value of an investment property, the cash flows relating to repair and maintenance of the item are considered and possible cash flows from change in use.

23. In determining the fair value of an investment property, the potential transaction costs relating to the sale of the property shall not be deducted from it.

24. To determine the fair value, the assistance of independent professional external valuers should be used except if an entity employs specialists with appropriate qualifications.

25. In recording investment property at fair value, attention should be paid not to double-count the assets in the balance sheet. In case the fair value of an investment property has been determined inclusive of its furnishings (e.g., utilities, furniture, etc.), such furnishings should be included in the balance sheet in investment property rather than recognised separately as items of property, plant and equipment.

Cost Method

26. ***In applying the cost method, investment property shall be measured similarly to property, plant and equipment, i.e. at cost less accumulated depreciation and any impairment losses (see ASBG 5 "Property, Plant and Equipment and Intangible Assets").***

Improvements, Repairs and Maintenance

27. Costs relating to subsequent improvements shall be added to the cost of investment property only if they meet the definition of investment property and the criteria for recognising assets in the balance sheet (incl. expected participation in the generation of future economic benefits). Costs relating to ongoing maintenance and repair shall be charged to the period's expenses. If a part of an investment property is replaced (e.g., partition walls), the cost of the new part shall be added to the cost of the property and the carrying amount of the replaceable part shall be written off the balance sheet.

28. The capitalisation of improvements or recognition in the period's expenses is of practical importance only if an entity applies the cost method for the recognition of investment property. In applying the fair value method, the value added to the investment property through improvements shall be recognised through revaluations occurring at the reporting date.

Reclassifications

29. ***An investment property is reclassified in the balance sheet (e.g. an investment property becomes property, plant and equipment or vice versa) if a change occurs in its purpose of use. From the date when this change occurred, accounting policies of this asset group into which the item has been reclassified shall be applied to the property. (IFRS for SMEs 16.9).***

30. If an entity applies the cost method to valuing an investment property, reclassifications from investment property to property, plant and equipment (and vice versa) do not lead to changes in accounting policies. If an entity applies the fair value method to the measurement of investment property, clauses 31 and 32 shall be used as the basis for reclassification.

31. In reclassifying an investment property that was measured at fair value into an owner-occupied property, its carrying amount at the date of reclassification shall be the deemed cost of the property. From this date, the investment property shall be depreciated similarly to other property, plant and equipment, based on the property's remaining useful life.

32. In reclassifying an owner-occupied property to investment property (measured using the fair value method), the difference between the fair value of the property and its carrying amount at the date of reclassification shall be recognised in the income statement.

<u>Example 2 – Reclassification, revaluation and disposal of investment properties</u>
An entity carries in its balance sheet a building that was used in the entity's business activities, but at 30.06.20X1 the offices were relocated elsewhere and the building was

<table>
<tr><td colspan="3">leased out under an operating lease. As at 30.06.20X1, the carrying amount of the building was 600,000 euros (cost of 800,000 euros and accumulated depreciation of 200,000 euros), but its estimated market value was 1,000,000 euros. How shall the change in the use of the building be measured for accounting purposes if the entity applies the fair value method to account for investment property?</td></tr>
<tr><td colspan="3">In reclassifying the property from an owner-operated property to investment property, the positive difference between the fair value of the property and the carrying amount is recognised as an increase in profit for the accounting period.</td></tr>
<tr><td>D</td><td>Investment property</td><td>1,000,000</td></tr>
<tr><td>D</td><td>Non-current assets (accumulated depreciation)</td><td>200,000</td></tr>
<tr><td>C</td><td>Non-current assets (cost)</td><td>800,000</td></tr>
<tr><td>C</td><td>Gain from revaluation of investment property (on the line "Other income")</td><td>400,000</td></tr>
<tr><td colspan="3">According to the estimate of a real estate agency, as at 31.12.20X1 the market value of the building had decreased to 900,000 euros. How should this change be recognised in the financial statements?</td></tr>
<tr><td colspan="3">All subsequent changes to fair value are recognised as a profit/loss in the income statement of the accounting period:</td></tr>
<tr><td>D</td><td>Loss from revaluation of investment property (on the line "Other expenses")</td><td>100,000</td></tr>
<tr><td>C</td><td>Investment property</td><td>100,000</td></tr>
<tr><td colspan="3">At 31.03.20X2, this investment property was sold for 1,100,000 euros. What are the accounting entries?</td></tr>
<tr><td>D</td><td>Cash</td><td>1,100,000</td></tr>
<tr><td>C</td><td>Investment property</td><td>900,000</td></tr>
<tr><td>C</td><td>Profit from sale of investment property (on the line "Other income")</td><td>200,000</td></tr>
</table>

COMPARISON WITH IFRS FOR SMES

33. The accounting policies prescribed in ASBG 6 for investment properties are in compliance with the accounting policies prescribed in section 16 of IFRS for SMEs except in the following:

(a) According to IFRS for SMEs, all investment properties shall be recognised based on the accounting policy described in sub-clause 14 (a) of this guideline and the cost method, described in sub-clause 14 (b) is not permitted. According to the Board, the cost method is a very common practice among smaller entities and assessing “reasonable cost and effort” would cause extra burden for them, the benefit obtained from which might not be justified. Pursuant to IFRS for SMEs, investment properties whose fair value cannot be reliably determined without undue cost or effort must be accounted for as property, plant and equipment. According to the opinion of the Board, it is more informative and unambiguous if such items are classified as investment property on the face of the balance sheet and the carrying amounts of investment property accounted for at fair value and cost methods are disclosed on the balance sheet or in the notes;

(b) IFRS for SMEs does not address the recognition of gains and losses from asset reclassification from property, plant and equipment to investment property or vice versa. The policies in the section 16 of IFRS for SMEs in similar situations contain the recognition of gains (losses) in the income statement. Based on that, rules have been prescribed in this guideline;

(c) IFRS for SMEs permits in certain cases to account for assets leased under operating leases as investment property. According to the opinion of the Board, it is a very rare situation, thus it was deemed unnecessary to address the topic in this guideline.