Financial Accounting Standard No. (26)

Investment in Real Estate

Contents

Preface

This standard aims at setting out principles for the recognition, measurement, presentation and disclosure of investment in real estate that is acquired for the purpose of earning periodical income or held for future capital appreciation or both.

Statement of the Standard

1. Scope of the Standard

1/1 This standard shall apply in the recognition, measurement and disclosure of the entity's direct investment in real estate that is acquired for the purpose of earning periodical income or held for future capital appreciation or both.

1/2 This standard does not deal with matters covered under Financial Accounting Standard No. (8): Ijarah and Ijarah Muntahia Bittamleek, including:

a) Measurement of investment in real estate leased on the basis of Ijarah Muntahia Bittamleek.
However, subsequent measurement of investment in real estate held to earn periodical consideration, which is defined in Financial Accounting Standard No. (8) as an operating Ijarah, shall be measured using one of the two methods mentioned in this standard. The institution shall, in future financial periods, consistently apply the method chosen;

b) Recognition of lease income from investment in real estate; and

c) Disclosures about Ijarah and Ijarah Muntahia Bittamleek assets.

1/3 This Standard does not apply to investment in real estate related to agricultural activities and rights and resources related to mining and exploration activities such as oil, natural gas etc.

1/4 Should the requirements of this standard be in conflict with the entity's charter or the laws and regulations of the country in which it operates, a disclosure should be made of the conflict.

2. Definition

The following terms are used in this standard with the meanings specified:

2/1 **Carrying amount:** An amount at which the investment is recognised in the statement of financial position.

2/2 **Cost:** An amount of cash equivalent amount paid or fair value of other consideration given to acquire an asset at the time of its acquisition or construction.

2/3 **Fair value:** An amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

2/4 **Investment in real estate:** A property held to earn periodical income or for capital appreciation or both, rather than for:

a) Use in the production or supply of goods or services or for administrative purposes (owner occupied real estate); or

b) Sale in the ordinary course of business (inventory).

3. Recognition

3/1 For the purpose of this standard, an investment in real estate shall be recognised as an asset when - and only when:

a) It is probable that the future economic benefits that are associated with the investment in real estate will flow to the entity; and

b) The cost of the investment in real estate can be measured reliably.

3/2 An entity evaluates under this recognition principle all its investment in real estate costs at the time they are incurred. These costs include costs incurred initially to acquire an investment in real estate and costs incurred subsequently to add to, replace part of, or service a property.

3/3 Under the recognition principle in para 3/1, an entity does not recognise, in the carrying amount of an investment in real estate, the costs of day-to-day servicing of such a real estate. Rather, these costs are recognised in income statement as incurred. Costs of day-to-day servicing are primarily the cost of labour and consumables, and may include the cost of minor parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the real estate.

4. Measurement

Initial measurement:

4/1 Investment in real estate shall be measured initially at its cost including directly attributable expenditure.

4/2 The cost of a purchased property comprises its purchase price and any directly attributable expenditure. Directly attributable expenditure includes, for example, professional fees for legal services, property transfer taxes and other transaction costs.

4/3 The cost of a constructed or under construction property include any expenditure that is directly attributable to bringing the asset to the location and condition necessary for it to operate in the manner intended by the management.

4/4 For the purpose of initial recognition the cost of an investment in real estate does not include:

a) Start-up costs (unless they are necessary to bring the real estate to the condition necessary for it to be capable of operating in the manner intended by management),
b) Operating losses incurred before the property achieves the planned level of occupancy, or
c) Abnormal amounts of wasted material, labour or other resources incurred in constructing or developing the property.

Subsequent measurement:

4/5 For the purpose of subsequent measurement, an entity shall determine whether the investment in real estate is being held-for-use or held-for-sale.

For held-for-use investments, an entity shall choose as its accounting policy either the fair value model in paragraphs 4/7–4/15 or the cost model in paragraphs 4/16-4/17 and shall apply that policy consistently to all of its investment in real estate.

For held-for-sale investments, an entity shall apply the requirements of paragraphs 4/18-4/20.

4/6 A voluntary change in accounting policy for investment in real estate held-for-use shall be made only if the change results in the financial statements providing reliable and more relevant information. It is highly unlikely that a change from the fair value model to the cost model will result in a more relevant presentation.

Fair value model:

4/7 An entity that chooses the fair value model shall measure all of its investment in real estate at fair value, except in cases described in paragraphs 4/13-4/15.

4/8 Any unrealised gains arising from a change in the fair value of investment in real estate shall be recognised directly in equity under "property fair value reserve" for the period in which it arises taking into consideration the split between the portion related to owners' equity and equity of investment accountholders.

4/9 Any unrealised losses resulting from re-measurement at fair value of investment in real estate carried at fair value shall be adjusted in equity against the property fair value reserve, taking into consideration the split between the portion related to owners' equity and equity of investment accountholders, to the extent of the available credit balance of this reserve. In case such losses exceed the available balance, the unrealised losses shall be recognised in the income statement. In case there are unrealised losses relating to investment in real estate that have been recognised in the income statement in a previous financial period, the unrealised gains relating to the current financial period shall be recognised to the extent of crediting back such previous losses in the income statement.

4/10 The realised profits or losses resulting from the sale of any investment in real estate shall be measured as the difference between the book value (or carrying amount) and the net cash or cash equivalent proceeds from the sale for each investment separately. The resulting profit or loss together with the available balance on the property fair value reserve account shall be recognised in the income statement for the current financial period, taking into consideration the split between the portion related to owners' equity and the portion related to investment accountholders.

4/11 Investment in real estate under construction shall be measured at cost until the construction is completed.

4/12 Once the construction is completed and the property is ready for its intended use, it shall measured at its fair value in accordance with paragraphs 4/7-4/10.

Inability to determine fair value reliably:

4/13 There is a rebuttable presumption that an entity can reliably determine the fair value of an investment in real estate on a continuing basis. However, if in exceptional cases, there is clear evidence when an entity first acquires a real estate (or when an existing real estate first becomes investment in real estate after a change in use) that the fair value of the investment in real estate is not reliably determinable on a continuing basis (other than an investment in real estate under construction), the entity shall measure that investment in real estate using the cost model. This arises when, and only when, comparable market transactions are infrequent and alternative reliable estimates of fair value (for example, based on discounted cash flow projections) is not available.

4/14 In the exceptional cases when an entity is compelled, for the reason given in paragraph 4/13, to measure an investment in real estate using the cost model, it measures all its other investment in real estate at fair value (other than an investment in real estate under construction). In these cases, although an entity may use the cost model for one investment in real estate, the entity shall continue to account for each of the remaining properties using the fair value model.

4/15 If an entity has previously measured an investment in real estate at fair value, it shall continue to measure the real estate at fair value until disposal (or until the real estate becomes owner-occupied real estate or the entity begins to develop the real estate for subsequent sale in the ordinary course of business) even if comparable market transactions become less frequent or market prices become less readily available.

Cost model:

4/16 An entity that chooses the cost model shall measure all of its investment in real estate at cost less depreciation and any impairment provisions. Depreciation is the systematic allocation of the cost of an asset over its useful life.

4/17 Major expenditure incurred by the entity related to additions to and improvements in real estate subsequent to its acquisition shall be added to the carrying amount of investment in real estate in the statement of financial position, provided that the entity expects that such expenditure will increase the future economic benefits to the entity from the real estate. However, if such economic benefits are not expected to take place, the entity shall recognise this expenditure in the income statement in the financial period in which it is incurred, taking into consideration the split between the portion related to owners' equity and the portion related to investment accountholders.

Investment in real estate held-for-sale:

4/18 If the entity has made a decision to sell an investment in real estate and expects the sale to occur within twelve months from the end of its reporting period, the investment shall be reclassified in the statement of financial position as 'investment in real estate held-for-sale'.

4/19 Depreciation on investment in real estate carried at cost must be discontinued from the date of such reclassification and the investment shall be carried at lower of its carrying value and expected fair value less costs to sell (net realisable value). Any adjustment shall be recognised in the income statement. Investment in real estate carried at fair value shall continue to be measured at fair value.

4/20 However, if the investment in real estate is not sold within twelve months (except for delays in conclusion of a sale transaction in its normal course is beyond the control of entity) or the plan to sell has been discontinued, the asset is reclassified to its previous classification. For investment in real estate carried at cost, the asset is remeasured to the lower of its recoverable amount and the carrying amount that would have been recognised if the asset would not have been classified as held-for-sale. The resulting adjustment is recognised in the income statement of the period when reclassification is made.

5. Transfer

5/1 An entity can transfer from investment in real estate to any other classification when, there is a change in use, evidenced by:

a) Commencement of own use, for a transfer from investment in real estate to owner-occupied real estate;

b) Commencement of development with a view to sale, for a transfer from investment in real estate to inventory.

5/2 An entity can transfer to investment in real estate from any other classification when, there is a change in use, evidenced by:

a) End of owner-occupation, for a transfer from owner-occupied real estate to investment in real estate; or

b) Commencement of an operating Ijarah to another party, for a transfer from inventory to investment in real estate.

5/3 Para 5/1 requires an entity to transfer a property from investment in real estate to inventories when, and only when, there is a change in use, evidenced by commencement of development with a view to sale. When an entity decides to dispose of an investment in real estate without development, it continues to treat the real estate as an investment in real estate until it is derecognised (eliminated from the statement of financial position) and does not treat it as inventory. Similarly, if an entity begins to redevelop an existing investment in real estate for continued future use as investment in real estate, the real estate remains an investment in real estate and is not reclassified as owner-occupied real estate during the redevelopment.

5/4 When an entity uses the cost model, transfers between investments in real estate, owner-occupied real estate and inventory do not change the carrying amount of the real estate transferred and they do not change the cost of that real estate for measurement or disclosure purposes.

5/5 For a transfer from investment in real estate carried at fair value to owner-occupied real estate or inventory, the real estate's deemed cost for subsequent accounting shall be its fair value at the date of transfer. The previously recognised property fair value reserve in equity shall be utilised as follows:

a) In case of transfer to owner occupied real estate, the amount equivalent to the depreciation on the previously recognised fair value component of the property shall be transferred to the income statement over the remaining life of the asset; and
b) In case of property transferred to inventory, the property fair value reserve shall be transferred to income statement only on disposal of the property.

5/6 If an owner-occupied real estate becomes an investment in real estate that will be carried at fair value, an entity shall apply cost less depreciation and any impairment provision, up to the date of change in use. The entity treats any difference at that date between the carrying amount of real estate and its fair value as below:

a) Any resulting decrease in the carrying amount of real estate is recognised in income statement. However, in case of owner-occupied real estate that was previously revalued, to the extent that an amount is included in revaluation surplus for that real estate, the decrease is recognised in equity and reduces the revaluation surplus within equity.
b) Any resulting increase in the carrying amount is treated as follows:
    i) To the extent that the increase reverses a previous impairment loss for that real estate, the increase is recognised in income statement. The amount recognised in income statement does not exceed the amount needed to restore the carrying amount

to the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognised.

ii) Any remaining part of the increase is recognised in equity and increases the revaluation surplus on owner occupied real estate within equity. On subsequent disposal of the investment in real estate, the revaluation surplus included in equity may be transferred directly to retained earnings.

5/7 For a transfer from inventory to investment in real estate that will be carried at fair value, any difference between the fair value of the real estate at that date and its previous carrying amount shall be recognised in equity under "property fair value reserve".

6. Derecognition

6/1 An investment in real estate shall be derecognised (eliminated from the statement of financial position) on disposal or when the investment in real estate is permanently withdrawn from use and no future economic benefits are expected from its disposal.

6/2 Gains or losses arising from the retirement or disposal of investment in real estate shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset, and shall be recognised in income statement in the period of the retirement or disposal, taking into consideration the split between the portion related to owner's equity and the portion related to investment accountholders. In case of investment in real estate carried at fair value, for the purpose of computation of the recognised gain or loss in the income statement, the carrying amount shall be considered after adjusting the available balance on the property fair value reserve account attributable to the asset disposed.

7. Presentation Requirements

7/1 At the end of the financial period, investment in real estate shall be presented separately as a line item on the assets side of the statement of financial position.

7/2 Gains/losses from investment in real estate shall be presented separately in the income statement or in the notes under "Gains/

losses from investments in real estate" taking into consideration the split between the portion related to owner's equity and the portion related to investment accountholders.

7/3 Investment in real estate held-for-sale within twelve months shall be presented separately on the face of the statement of financial position. Gain/losses from investment in real estate held-for-sale shall be presented separately on the face of the income statement.

8. Disclosure Requirements

8/1 An entity shall disclose:

a) Whether it applies the fair value model or the cost model.

b) When classification as investment in real estate involves significant judgement, and the criteria it uses to distinguish investment in real estate from owner-occupied real estate and from inventory.

c) The methods and significant assumptions applied in determining the fair value of investment in real estate, including a statement whether the determination of fair value was supported by market evidence or was more heavily based on other factors (which the entity shall disclose) because of the nature of the real estate and the lack of comparable market data.

d) The extent to which the fair value of investment in real estate (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment in real estate being valued. If there has been no such valuation, that fact shall be disclosed.

e) Carrying value of asset under construction and movements during the year.

f) The amounts recognised in income statement for:

   i) Rental income from investment in real estate;

   ii) Direct operating expenses (including repairs and maintenance) arising from investment in real estate that generated rental income during the period; and

iii) Direct operating expenses (including repairs and maintenance) arising from investment in real estate that did not generate rental income during the period.

g) The existence and amounts of restrictions on the realisability of investment in real estate or the remittance of income and proceeds of disposal.
h) The existence of any charge, pledge or restriction on the title of the investment in real estate.
i) Contractual obligations/commitments to purchase, construct or develop investment in real estate or for repairs, maintenance or enhancements.

Fair value model:

8/2 In addition to the disclosures required above, an entity that applies the fair value model shall disclose a reconciliation between the carrying amounts of investment in real estate at the beginning and at the end of the period, showing the following:

a) Additions; disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognised in the carrying amount of an asset;
b) Net gains or losses from fair value adjustments;
c) In case of assets of a foreign operation, the net foreign exchange differences arising on the translation, if any;
d) Transfers to and from inventory and owner-occupied real estate; and
e) Other changes.

8/3 When a valuation obtained for investment in real estate is adjusted significantly for the purpose of the financial statements, the entity shall disclose a reconciliation between the valuation obtained and the significant adjustments included in the financial statements.

8/4 In the exceptional cases referred to in paragraph 4/13, when an entity following the fair value model measures certain investment in real estate using the cost model, the reconciliation required by paragraph 8/2 shall disclose amounts relating to that investment in real estate separately from amounts relating to other investment in real estate.

In addition, an entity shall disclose:

a) A description of the investment in real estate;
b) An explanation of why fair value cannot be determined reliably;
c) If possible, the range of estimates within which fair value is highly likely to lie; and
d) On disposal of investment in real estate not carried at fair value:
   i) The fact that the entity has disposed of investment in real estate not carried at fair value;
   ii) The carrying amount of that investment in real estate at the time of sale; and
   iii) The amount of gain or loss recognised.

Cost model:

8/5 In addition to the disclosures required by para 8/1, an entity that applies the cost model shall disclose:

a) The depreciation methods used;
b) The useful lives or the depreciation rates used;
c) The gross carrying amount and the accumulated depreciation at the beginning and at the end of the period;
d) A reconciliation of the carrying amount of investment in real estate at the beginning and at the end of the period, showing the following:
   i) Additions; disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognised as an asset;
   ii) Depreciation;
   iii) The amount of impairment losses recognised, and the amount of impairment losses reversed, during the period;
   iv) In case of assets of a foreign operation, the net foreign exchange differences arising on the translation, if any;
   v) Transfers to and from inventory and owner-occupied real estate; and
   vi) Other changes.
e) Change in depreciation methods and useful lives or the depreciation rates used (in accordance with the requirements of

Financial Accounting Standard No. (1): General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions); and

f) The fair value of investment in real estate carried at cost and the basis of determination of fair values (i.e., whether fair value is based on a valuation by an independent valuer etc.). In the exceptional cases described in para 4/13, when an entity cannot determine the fair value of the investment in real estate reliably, it shall disclose:

i) A description of the investment in real estate;

ii) An explanation of why fair value cannot be determined reliably; and

iii) If possible, the range of estimates within which fair value is highly likely to lie.

9. Effective Date

9/1 This standard shall be effective for financial periods beginning 1 Muharram 1434 A.H. or 1 January 2013 A.D. Earlier application is permitted. If the standard is applied in an earlier reporting period, the financial statements shall disclose that the standard has been early adopted.

10. Transitional Provisions

10/1 This standard shall be applied retroactively in accordance with the requirements stated in Financial Accounting Standard No. (1): General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions.

10/2 The entity shall disclose the effect of implementing this standard in the financial statements for the financial period in which this standard is applied for the first time.

10/3 The effect of the change in accounting policy on investment in real estate and the effect on income/loss from investments in real estate for the current period and for each prior period presented should be disclosed.

10/4 The effect of the change in accounting policy on investment accounts and the effect on their share of income/loss from investments for the current period and for each prior period presented, should be disclosed.

Adoption of the Standard

The Standard of Investments in Real Estate was adopted by the Accounting and Auditing Standards Board in its meeting No. (40) on 21 June 2012 A.D.

Members of the Board

1. Mr. Muhammad Said Abdulwahab	Chairman
2. Mr. Hamad Abdulla Eqab	Deputy Chairman
3. Sheikh Dr. Abdul Sattar Abu-Ghuddah	
4. Sheikh Essam Mohammed Ishaq	
5. Mr. Fawad Laique	
6. Mr. Jamil A Darras	
7. Dr. Nordin Mohd Zain / Mr. Aly El Azhary	
8. Mr. Firas S Hamdan	
9. Mr. Simon Gray	
10. Dr. Hussein Said Saifan	
11. Mr. M Faiz Azmi / Mr. Madhukar Shenoy	
12. Mr. Prakash Pathmanathan	
13. Mr. Oliver Agha	
14. Mr. Jalil Al-Aali	
15. Dr. Khaled Al Fakih	Member/ Secretary General/ Rapporteur

Appendix (A)
Brief History of the Preparation of the Standard

In its meeting No. (36) held in Manama, Kingdom of Bahrain on 27 Dhul-Qa'dah 1430 A.H., corresponding to 16 October 2009 A.D., the Accounting and Auditing Standard Board decided to develop a new Standard on Investment in Sukuk, Shares, and Similar Instruments.

Subsequently, a consultant was commissioned to prepare a preliminary study and exposure draft of the Standard on Investment in Sukuk, Shares, and Similar Instruments. Preparation of the preliminary study and exposure draft was overseen by the Accounting and Auditing Standards Board.

The preliminary study and exposure draft were discussed by the Accounting and Auditing Standards Board through a series of meetings and telephone conference calls.

The preliminary study and exposure draft were deliberated by Accounting and Auditing Standard Board in its meeting No. (37) held on 10 Sha'ban 1431 A.H., corresponding to 22 July 2010 A.D., and (38) held on 10 Sha'ban 1431 A.H., corresponding to 2 December 2011 A.D. Subsequent exposure draft was also deliberated by Accounting and Auditing Standard Board in its meeting No. (39) held on 21 Rajab 1432 A.H., corresponding to 23 June 2011 A.D.

Listening session of the exposure draft was convened in Manama, Kingdom of Bahrain on 29 Rabi' II, 1433 A.H., corresponding to 22 March 2012 A.D., to gather comments from the Islamic finance industry as well as accounting and auditing professions.

The exposure draft was revised in light of the comments made in Accounting and Auditing Standards Board meeting No. (39) and the listening session.

The Accounting and Auditing Standards Board adopted the Standard on Investments in Associates at its meeting No. (40) held on 1 Sha'ban 1433 A.H., corresponding to 21 June 2012 A.D.

Appendix (B)
Reasons for the Standard

The previous Financial Accounting Standard No. (17) on Investments first issued in 2002 A.D. previously dealt with all forms of investments including investment in real estate and laid the initial foundation for accounting and reporting of investments in real estate. Given the significant diversity in the accounting requirements of investment in financial instruments and real estate, there was a need for separation of the accounting standards for these investments. Also the real estate investments now form a substantial part of the financial statements and activities of Islamic Financial Institutions. It was concluded that accounting for investment in real estate shall be addressed through a separate and more detailed accounting standard. Further, over the years, complex accounting issues have evolved in line with the expansion of the real estate sector and the current standards were seen to be very basic to address the needs and requirements of the various users and preparers of financial statements. There was a need for providing additional guidance regarding issues surrounding the classification of investment in real estate, treatment for under construction assets and jointly financed assets etc., and enhance the disclosure requirements for exposure to investments in real estate.

Appendix (C)
Basis for Conclusions

Scope

The scope of the standard intends to cover direct investment in real estate rather than investment in shares and other financial instruments providing indirect exposure to investment in real estate. Accounting for such investments is covered under other standards within AAOIFI. The accounting guidance in this standard applies to each level of the financial statements separately; i.e., both consolidated and individual financial statements of an entity. For example, if a subsidiary holds investment in real estate, on consolidation on a line-by-line basis, the guidance of this standard shall apply to investments in real estate in preparation of the consolidated financial statements. However, the investment in the subsidiary in separate financial statements shall be accounted for in accordance with FAS No. (23) on Consolidation.

Definition

The definition of investment in real estate has been largely retained from the previous FAS No. (17). The new standard clarifies the definition further and has added extensive application guidance to assist in determination of classification of investment in real estate under this standard and reduce inconsistency in practice. Determination of which assets are scoped out within this standard is based on management intention and involves judgement and hence additional disclosure requirements have been added to assist users in obtaining more information and understanding management's basis of classification of investment in real estate.

In line with the previous FAS No. (17), measurement of Ijarah Muntahia Bittamleek assets have been scoped out from this standard. However, this has been made explicit in the drafting of the revised standard. As assets under Ijarah Muntahia Bittamleek contracts are eventually transferred to the lessee, it was considered in appropriate to provide fair value option for such assets to the lessor.

Jointly Financed Investment

The previous standard required separate classification requirements for the portion of investment jointly financed by the investment accountholders. The Accounting and Auditing Standards Board noted that this conceptually created diversity in accounting for investment in real estate. The Board also noted that the accounting for the funding provided by the investment accountholders is governed by the previous Financial Accounting Standard No. (6): Equity of investment accountholders and their equivalent and this standard should only focus on providing a single basis of recognition and measurement for each investment irrespective of its mix of funding. Hence, it was concluded that this standard shall not provide different classification or measurement criteria for investments based on its source of funding. However, the Board noted that, consistent with the requirements of Financial Accounting Standard No. (1): General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions, each entity should provide the disclosures of the sources of funding of its assets. Further, it was noted that distribution of profits to investment accountholders was governed by contractual terms and based on the distribution principles approved by the Shari'a supervisory board of each entity and hence divergent account policies purely based on sources of funding of the asset was not considered appropriate.

Subsequent Measurement

The subsequent measurement rules are in line with the previous FAS No. (17); i.e., at cost and at fair value. The Board discussed whether the two measurement choices should be retained. As this standard is focussed on investments, the Board fully supported the fair value model as it provides a relevant measure of the value of the entity's assets and would support a business model that holds assets for capital appreciation. However, the Board also noted that the cost model is required where the ability to derive a reliable and consistent measure of fair value was in doubt and where there was a need for property markets to develop and mature. Also, entities focussed on periodic return on assets may have preferences for the cost model to reflect operational efficiencies.

Where the investments in real estate are measured at fair value, the previous FAS No. (17) also required that the fair value gains be reported in the statement of financial position in a separate fair value reserve. This requirement addressed Shari'a concerns on distribution of profits on the basis of unrealised fair value gains arising from investment in real estate. Accordingly, this requirement has been retained in the revised standard. The requirements are similar to the accounting for financial investments in 'available-for-sale' investments in the previous FAS No. (17) and 'equity investments at fair value through equity' under FAS No. (25). Although the standard retains the fair value option for entities to provide alternative reliable and relevant measurement of investment in real estate (financial position perspective), the standard implicitly requires that any gains should be considered as part of profit or loss only on realisation.

Further, it was clarified that the requirements to assess impairment for investment in real estate carried at cost and recognition of fair value decline in the income statement for investment in real estate carried at fair value should be performed on an asset-by-asset basis and a portfolio based assessment was not appropriate.

Investment in Real Estate Under Construction

This standard does not allow under construction assets to be measured at fair value until the construction is completed. The Board discussed this matter at length and noted that largely the property markets remain less developed for such assets and the experience and maturity of the valuation profession in most markets to develop a reliable measure of fair value of under construction assets that meet the definition of the framework was yet to be tested satisfactorily. Hence, to ensure relevance, reliability and understandability of measurement for financial reporting purposes, it was decided that under construction assets would be measured at cost until completion of construction.

Investment in Real Estate Held-for-Sale

The Board also noted that investment in real estate (cost model) held for sale within twelve months should be measured at lower of its carrying value and fair value less cost to sell to reflect the intention of the management to realise the value of the asset through sale rather than its continuing use (i.e., discontinuation of depreciation). Investment in real estate carried at fair value would only need separate presentation in the statement of financial position to reflect management intent; however, as the measurement is using a fair value basis there would be no requirement to follow separate measurement guidance for such assets.

Disclosures

Enhanced disclosure requirements have been added to the standard to improve the extent of information available to the users of the financial statements in relation to an entity's exposure to investments in real estate. In case of use of the fair value model, in addition to other enhanced disclosures, requirements have been added to disclose adjustments made to valuations obtained for financial statement purposes. It was noted that some valuation reports reflect the fair value of the wider/composite property and adjustments are required to be made to valuations to reflect values to be recognised in the financial statements. Examples include allocation between own-use and investment in real estate of a combined asset, adjustments made to avoid double-counting (e.g., when valuation includes value attributable to furniture, equipment etc., which are or may be required to be recognised separately, adjustment for liabilities etc.).

Transition Provisions

As the standard retains the primary classification categories and the required information is expected to be available under the previous requirements of FAS No. (17), it was decided that the amendments should be applied retroactively in accordance with the principles of Financial Accounting Standard No. (1): General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions.

Appendix (D)
Application Guidance*

Definition of Investment in Real Estate

Investment in real estate comprise property (land or a building -or part of a building- or both) held to earn periodical income or for capital appreciation or both. Therefore, an investment in real estate generates cash flows largely independently of the other assets held by an entity. This distinguishes investment in real estate from owner-occupied real estate. The production or supply of goods or services (or the use of real estate for administrative purposes) generates cash flows that are attributable not only to the real estate, but also to other assets used in the production or supply process.

The following are examples of investment in real estate that are covered within the scope of this standard:

a) Land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business.
b) Land held for a currently undetermined future use, (If an entity has not determined that it will use the land as owner-occupied real estate or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation).
c) A building owned by the entity and leased out under one or more operating Ijarah contracts.
d) A building that is vacant but is held to be leased out under one or more operating Ijarah contracts.
e) Property that is being constructed or developed for future use as investment in real estate.

(*) The application guidance is an intergral part of this standard.

The following are examples of items that are not investment in real estate and are therefore outside the scope of this standard:

a) Real estate intended for sale in the ordinary course of business or in the process of construction or development for such sale, for example, real estate acquired exclusively with a view to subsequent disposal in the near future or for development and resale (inventories).

b) Owner-occupied real estate, including (among other things) real estate held for future use as owner-occupied real estate, real estate held for future development and subsequent use as owner-occupied real estate, real estate occupied by employees and owner-occupied real estate awaiting disposal.

c) Real estate being constructed or developed on behalf of third parties (construction contracts).

d) Investment in real estate leased on the basis of Ijarah Muntahia Bittamleek.

Some real estate comprise a portion that is held to earn rentals or for capital appreciation and another portion that is owner occupied. If these portions could be sold separately, an entity accounts for the portions separately. If the portions could not be sold separately, the property is classified as investment in real estate only if an insignificant portion is owner occupied.

In some cases, an entity provides ancillary services to the occupants of a property it holds. Such property is accounted for as investment in real estate if the services are insignificant to the arrangement as a whole. An example is when the owner of an office building provides security and maintenance services to the lessees who occupy the building.

In other cases, if the services provided are significant the property shall be treated as owner-occupied real estate, rather than investment in real estate. For example, if an entity owns and manages a hotel, services provided to guests are significant to the arrangement as a whole and hence the hotel property would not be treated as investment in real estate.

It may be difficult to determine whether ancillary services are so significant that a real estate does not qualify as investment in real estate. For example, the owner of a hotel sometimes transfers some responsibilities to third parties under a management contract. The terms of such contracts vary widely. At one end of the spectrum, the owner's position may, in substance, be that of a passive investor. At the other end of the spectrum, the owner may simply have outsourced day-to-day functions while retaining significant exposure to variation in the cash flows generated by the operations of the hotel.

Judgment is needed to determine whether a real estate qualifies as investment in real estate. An entity develops criteria so that it can exercise that judgment consistently in accordance with the definition of investment in real estate.

Consolidated Financial Statements

In some cases, an entity owns real estate that is leased to, and occupied by, its parent or another subsidiary. The real estate does not qualify as investment in real estate in the consolidated financial statements, because the real estate is owner-occupied from the perspective of the group. However, from the perspective of the entity that owns it, the real estate is investment in real estate if it meets the definition in paragraph (8). Therefore, the lessor treats the real estate as investment in real estate in its individual financial statements.

Explanation of the Definition of Fair Value

The fair value of investment in real estate is the price at which the real estate could be exchanged between knowledgeable, willing parties in an arm's length transaction. Fair value specifically excludes an estimated price inflated or deflated by special terms or circumstances such as a typical financing sale and leaseback arrangement, special considerations or concessions granted by anyone associated with the sale.

The fair value of investment in real estate shall reflect market conditions at the end of the reporting period. Fair value is time-specific as of a given date. Because market conditions may change, the amount reported as fair value may be incorrect or inappropriate if estimated as of another time. The definition of fair value also assumes simultaneous exchange and completion of the contract for sale without any variation in price that might be made in an arm's length transaction between knowledgeable, willing parties if exchange and completion are not simultaneous.

The fair value of investment in real estate held for earning periodic income reflects, among other things, rental income from current leases and reasonable and supportable assumptions that represent what knowledgeable, willing parties would assume about rental income from future leases in the light of current conditions. It also reflects, on a similar basis, any cash outflows (including rental payments and other outflows) that could be expected in respect of the real estate. Some of those outflows are reflected in the liability whereas others relate to outflows that are not recognised in the financial statements until a later date (e.g., periodic payments such as contingent rents).

The definition of fair value refers to 'knowledgeable, willing parties'. In this context, 'knowledgeable' means that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the investment in real estate, its actual and potential uses, and market conditions at the end of the reporting period. A willing buyer is motivated, but not compelled, to buy. This buyer is neither over-eager nor determined to buy at any price. The assumed buyer would not pay a higher price than a market comprising knowledgeable, willing buyers and sellers would require.

A willing seller is neither an over-eager nor a forced seller, prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in current market conditions. The willing seller is motivated to sell the investment in real estate at market terms for the best price obtainable. The factual circumstances of the actual investment in real estate owner are not a part of this consideration because the willing seller is a hypothetical owner (e.g., a willing seller would not take into account the particular tax circumstances of the actual investment in real estate owner).

The definition of fair value refers to an arm's length transaction. An arm's length transaction is one between parties that do not have a particular or special relationship that makes prices of transactions uncharacteristic of market conditions. The transaction is presumed to be between unrelated parties, each acting independently.

The best evidence of fair value is given by current prices in an active market for similar real estate in the same location and condition and subject to similar lease and other contracts. An entity takes care to identify any differences in the nature, location or condition of the property, or in the contractual terms of the leases and other contracts relating to the property.

In the absence of current prices in an active market, an entity considers information from a variety of sources, including:

a) Current prices in an active market for properties of different nature, condition or location (or subject to different lease or other contracts), adjusted to reflect those differences;
b) Recent prices of similar properties on less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices; and
c) Discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts and (when possible) by external evidence such as current market rents for similar properties in the same location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows.

In some cases, the various sources listed in the previous paragraph may suggest different conclusions about the fair value of an investment in real estate. An entity considers the reasons for those differences in order to arrive at the most reliable estimate of fair value within a range of reasonable fair value estimates.

In determining the carrying amount of investment in real estate under the fair value model, an entity does not double-count assets or liabilities that are recognised as separate assets or liabilities. For example:

a) Equipment such as lifts or air-conditioning is often an integral part of a building and is generally included in the fair value of the investment in real estate, rather than recognised separately as fixed asset.
b) If an office is leased on a furnished basis, the fair value of the office generally includes the fair value of the furniture, because the rental income relates to the furnished office. When furniture is included in the fair value of investment in real estate, an entity does not recognise that furniture as a separate asset.
c) The fair value of investment in real estate excludes prepaid or accrued operating lease income, because the entity recognises it as a separate liability or asset.
d) The fair value of investment in real estate held under a lease reflects expected cash flows (including contingent rent that is expected to become payable).

Accordingly, if a valuation obtained for a real estate is net of all payments expected to be made, it will be necessary to add back any recognised lease liability to arrive at the carrying amount of the investment in real estate using the fair value model.

The fair value of investment in real estate does not reflect future capital expenditure that will improve or enhance the real estate and does not reflect the related future benefits from this future expenditure.

An entity is encouraged, but not required, to determine the fair value of investment in real estate on the basis of a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment in real estate being valued.

Finance Cost on Assets Under Construction

Directly attributable expenditure for assets under construction shall also include finance costs incurred on a time proportion basis during the construction period. Only financing costs of contracts that are specific to the construction of the underlying asset should be considered to qualify for capitalization. Other financing costs shall be charged to the income statement.

Impairment

The Board was of the view that the international guidance available on determination and measurement of impairment for investment in real estate was adequate, and separate guidance was not required under the revised standard.