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ACCOUNTING FOR INVESTEMENT PROPERTY UNDER ROMANIAN ACCOUNTING SYSTEM

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Abstract:

Investment property, an important component of the current assets, need special attention both in terms of their impact on accounting and well as in reporting the annual financial statements. Internationally their accounting treatment is presented by the IAS 40 Investment property issued in 2000 and being operative for annual periods beginning on or after 1 January 2001 with a number of subsequent amendments.First step in aligning the Romanian accounting system (RAS) to the international accounting and financial reporting standards has manifested in terms of properties starting with 2012 but only for the listed companies - OMFP 1286 which has brought significant changes in the execution way of the individual financial statements of these companies and in terms of the accounting presentation of the investment properties and fixed assets held for sale. In accordance with this order and the Romanian accounting rules recognize investment properties as being a separate component of the fixed assets, applying the provisions of IAS 40.This paper deals with the next step by presenting the occurred legislative changes related to the accounting treatment of the investment property, changes that are applicable to all the Romanian companies, not just those listed on the stock exchange, starting from the financial year 2015.

Key words: *Investment property, accounting, financial reporting*

In the tangible area starting with the financial year exercise 2015 all the economic agents record and pursue distinctly the investment properties.

Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes; or sale in the ordinary course of business.

Owner-occupied property is property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes.

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

In the category of investment property fall the land held rather in order to increase long-term capital appreciation than in the purpose of selling them in the short term, during the ordinary course of the business; lands held for a currently undetermined future use; buildings owned by the entity (or held by an entity under a finance lease) and leased out under one or more operating leases contracts; free buildings, but which are held in order to be leased out under one or more operating leases contracts; properties that are being constructed or developed for future use as investment properties.

A number of elements of real estate nature will not be treated as investment properties because they do not respect the necessary criteria. This is the case of:

a) properties held for sale during the ordinary development of the business or in the process of construction or development for making such a sale. They represent, in terms of accounting, stock and will be treated as such;

b) properties that are currently under construction or development on behalf of third parties. These represent services in progress for the entity;

c) owner-occupied properties, including (among other things) the properties held for future use as real estate properties used by the owner, properties held for future development and subsequent use as owner-occupied properties, properties used by the employees (whether or not they pay rent at market rates) and real estate properties used by the owner which are going to be transferred.

There are situations where certain properties include a portion that is held for rental or for increasing the capital value and another portion that is held in order to be used in the production or supply of goods or services or for administrative purposes. Their treatment will start from the analysis of the possibility that these parts can be sold separately (or leased out separately under a finance lease). If the parties can be separated, an entity will be accounting them separately. If not, the real estate property represents an investment property only if an insignificant portion is held for use in the production or supplying of goods or services or for administrative purposes.

In some cases, an entity provides ancillary services to the occupants of a real estate property which it holds. An entity treats such a property as an investment property if the services in question are an insignificant part to the whole contract. 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, the services provided represent a significant component. For example, if an entity owns and manages a hotel, the services provided to guests are a significant component of the entire contract. Therefore, an owner-managed hotel is rather a real estate property used by the owner than an investment property.

To determine whether a property qualifies as a real estate investment professional judgement is therefore required. Entities should develop criteria so that they can consistently exercise that judgment in accordance with the definition of the investment property.

The transfers to or from the investment property category shall be made if and only if there is a change in their use. For the transfer from the investment properties in the properties used by the owner, its changing can be evidenced by the user who starts to use the property. For a transfer from investment property category to the inventories it is necessary to start the planning process in anticipation of the sale of the property. The end of owner-occupation involves a transfer from the owner-occupied property category to the investment property category or the commencement of an operating lease with another party which requires a transfer from inventories to the investment property category.

An entity shall transfer a real estate property from the investment property category to inventories when, and only when there is a change in use, evidenced by the commencement of arranging the property for a future sale. During the arrangement period the costs are added, and at the final reception it starts the transfer from stock to investment properties for disposal. If it is decided to dispose of an investment property without any development, the entity continues to treat the property as a real estate investment property until it is removed from the records.

If an entity begins the upgrading process of an existing investment property for future use as an investment property, then the property remains an investment property and is not reclassified as owner-occupied property during the redevelopment.

The following table shows some examples of real estate acquisitions and their accounting treatment applicable:

	Examples purchasing real estates	**Accounting treatment**
1.	Acquiring a building at 300,000 lei cost in order to be sold in the normal course of business.	The building acquired in order to be sold in the normal course of business represents **a stock**
2.	Acquiring a building at 400,000 lei cost in order to be used by the Company as administrative headquarters.	The building acquired in order to be used by the company as administrative headquarters is **a tangible asset.**
3.	Acquiring a building at 380,000 lei cost. Initially it is not used by the owner, requiring facilities and improvements, such as: building extension 100.000 lei, repairs and maintenance 20.000 lei. On completion of the facilities the building will be used as the company's administrative headquarters.	The building cannot be considered a real estate investment property. Pending the buildings and establishments it represents a **tangible asset in progress.** On completion of facilities it will be passed to tangible assets.
4.	Acquiring a building at cost 400,000 lei, used as the company's administrative headquarters, about 6% of the space. The rest of the building is leased under an operating lease. The company provides security services to tenants.	The building will be considered an **investment property** because the owner-occupied space is insignificant.
5.	Acquiring a building at cost 500,000 lei. The building is leased to third parties under a finance lease.	The building **cannot be considered an investment property**. Initially it will be recognized as tangible asset property and subsequently at the end of the lease it will be subjected to the financial lease provisions.
6.	Acquiring a building at cost 500,000 lei, in another locality where employees are frequently sent on mission, in order to be used by them to reduce hotel costs.	The building **cannot be considered an investment property.** It meets the criteria for recognition as tangible asset.
7.	Acquiring a building at cost 400,000 lei. Currently the building is free, the entity intending to rent it to third parties under an operating lease; to date he has not yet found a tenant.	The building is considered a **real estate investment property.**
8.	Acquiring a building that is not finished, at cost 550,000 lei. The entity is going to arrange it on behalf of another company; for this purpose it is signed a contract for	The building **cannot be considered a real estate investment property.** The service contract signed with another company is recognized as a construction contract.

	services that directly relates to the construction of the building in question, the percentage of profit is 30%.	
9.	In 2015 a number of 5 lands were purchased at the price of 200,000 lei each field. On one of the lands the company intends to build a building that will serve as administrative headquarters. As the land prices in the area increased the company intends to keep other land without building anything on them.	**The land on which the construction is made** is recognized in the **account 2111** Lands. For the other 4 lands **there is the intention to increase the value of the long-term capital** and the amount of 800,000 lei will be recognized **as investment property.**
10.	In 2015 it is purchased a land. Since prices are very low in the area the company does not intend to sell the land soon or build a building for office.	**The land is classified as investment property** because the company intends to use it in the future in a still undetermined way.

Investment property 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 property will flow to the entity; and
(b) the cost of the investment property can be measured reliably.

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

An investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement. The cost of a purchased investment 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.

The cost of an investment property is not increased by: start-up costs (unless they are necessary to bring the property to the condition necessary for it to be capable of operating in the manner intended by management), operating losses incurred before the investment property achieves the planned level of occupancy, or abnormal amounts of wasted material, labour or other resources incurred in constructing or developing the property.

Under the recognition principle an entity does not recognize in the carrying amount of an investment property the costs of the day-to-day servicing of such a property. Rather, these costs are recognized in profit or loss as incurred. Costs of day-to-day servicing are primarily the cost of labor 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 property.

For **subsequent measurement**, an entity may choose either the **fair value model** or the **cost model** for all other investment property. Under de fair value model investment properties are measured at fair value with changes in fair value recognized in profit or loss. Using the cost model, investment properties are carried at cost less accumulated depreciation and impairment in terms of IAS 16. Fair value must also be disclosed.

Case 1: An entity intends to buy a building in order to be leased to third parties under an operating lease. In order to search for a seller it calls to the services of a real estate agency that will charge a fee of 2% of the acquisition cost. The building was purchased at the price of 800,000 lei.

On acquisition, the entity has paid the notary the following charges:

- Requesting the land book extract for authentication - 200 lei for emergency release;
- tabulation tax - 4,500 lei
- notary fees - 18,000 lei

The building is amortized in 10 years. The company opted to use the cost model.

Purchase price	800.000 lei
+ Real estate agency comision: 800.000 lei x 2 %	16.000 lei
+Notary fees: 200 lei + 4.500 lei + 18.000 lei	22.700 lei
= INVESTMENT PROPERTY COST	**838.700 lei**

(a)Initial recognition:

838.700 lei	215 Investment properties	=	404 Suppliers of non-current assets	838.700 lei

(b)Annual depreciation:

83.870 lei	6811 Depreciation of non-current assets	=	2815 Depreciation of investment properties	83.870 lei

Companies that at the entry into force of the 1802 OMPF (01.01.2015) owned in heritage real estates must determine, based on accounting policies and the professional judgment which that of the property held qualify to be classified in investment properties. Then they will proceed to the restatement of the property investments as real estate investments in the accounting system including the related depreciation and adjustments made for impairment losses if necessary.

Depending on the model used at cost or at fair value, the restatement is shown in the following examples.

If a company uses the cost model, restating the initial application involves the following entries:

a) Recognition of the investment properties which qualify for the recognition conditions:

215 Investment properties = 212 Buildings

b) Switching the amortization recorded associated with the construction to the amortization of the real estate investments:

2812 Depreciation of buildings = 2815 Depreciation of investment properties

c) The impairment loss adjustments, if any:

2912 Impairment of buildings = 2915 Impairment of investment properties

If the entity uses the fair value model, the records regarding the restatement of the initial application are the following:

Case 2: ALFA acquires at 31.12.2012 a building at a cost of 380,000 lei in order to be used as the administrative headquarters. The amortization period is 10 years. In January 2015 ALFA has rented the building to a third party operating leases. At 31.12.2015 the building is re-evaluated at the fair value of 450,000 lei. At 10.01.2016, ALFA decides to use again the building as central administrative headquarters.

Solution:

(a) Buying the building at 31.12.2012:

380.000 lei	212 Buildings	=	404 Suppliers of non-current assets	380.000 lei

(b) The amortization of the year 2013:

38.000 lei	6811 Depreciation of non-current assets	=	2812 Depreciation of buildings	38.000 lei

(c) The amortization of the year 2014:

38.000 lei	6811 Depreciation of non-current assets	=	2812 Depreciation of buildings	38.000 lei

(d) On January 1, 2015 the building is transferred to investment property

380.000 lei	215 Investment properties	=	212 Buildings	380.000 lei

And for the accumulated amortization of 70,000 lei

76.000 lei	2812 Depreciation of buildings	=	2815 Depreciation of investment properties	76.000 lei

(e) Amortization of the investment property for 2015:

38.000 lei	6811 Depreciation of non-current assets	=	2815 Depreciation of investment properties	38.0 i

(f) Revaluation of investment property 31.12.2015:

(f1) Elimination of accumulated amortization of the gross value 38.000 lei x 3 years = 114.000 lei

114.000 lei	2815 Depreciation of investment properties	=	215 Investment properties	114.000 lei

(f2) Recording the added value:
Remaining value = 380.000 lei – 114.000 lei = 266.000 lei
Added value = 450.000 lei – 266.000 lei = 184.000 lei

184.000 lei	215 Investment properties	=	105 Revaluation reserve	184.000 lei

(g) Amortization of investment property revaluation during 01.01.2016-01.10.2016:
Annual amortization = 450.000 lei/7 ani = 64.285 lei/year
Monthly amortization: 64.285 lei/year/12 months = 5.357 lei/month
Period amortization = 9 months x 5.357 lei/month = 48.213 lei

48.213 lei	6811 Depreciation of non-current assets	=	2815 Depreciation of investment properties	48.213 lei

(h)Transferul investiției imobiliare la imobilizări corporale:

48.213 lei	2815 Depreciation of investment properties	=	2812 Depreciation of buildings	48.213 lei

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450.000 lei	212 Buildings	=	215 Investment properties	450.000 lei

(h3) Transfer from revaluation reserve:

184.000 lei	105 Revaluation reserve	=	1175 Retained earnings representing the revaluation reserve surplus	184.000 lei

i)The amorization of the building during the period 01.10.2016-31.12.2016:
The amortization of the period = 3 months x 5.357 lei/month = 16.071 lei

16.071 lei	6811 Depreciation of non current assets	=	2812 Depreciation of buildings	16.071 lei

Case 3: ALFA has purchased on 31.12.N a building at the cost of 700,000 lei, amortized linearly over 10 years. Since March N + 2 ALFA decided to rent the whole building to the BETA company under operational leasing.

Solution:

Purchase at 31.12.N:

700.000 lei	212 Buildings	=	404 Suppliers of non-current assets	700.000 lei

b)Amortization of the year N+1: 700.000 lei/10 years = 70.000 lei

70.000 lei	6811 Depreciation of non-current assets	=	2812 Depreciation of buildings	70.000 lei

c)Amortization of the period January-February N+2: 70.000 lei x 2 luni/12 months = 1.167 lei:

1.167 lei	6811 Depreciation of non-current assets	=	2812 Depreciation of buildings	1.167 lei

d) The transfer of the building to investment properties:

700.000 lei	215 Investment properties	=	212 Buildings	700.000 lei

And for the accumulated amortization 70.000 lei + 1.167 lei = 71.167 lei

71.167 lei	2812 Depreciation of buildings	=	2815 Depreciation of investment properties	71.167 lei

e) Amortization of investment property for the remaining period:

Number of months remaining for amortization = 10 years x 12 months – 12 months – 2 months = 106 months

Remaining value = 700.000 lei – 71.167 lei = 628.833 lei

Monthly amortization = 628.833 lei / 106 months = 5.932 lei/month

Amortization March 2015 – December 2015 = 10 months x 5.932 lei/month = 59.932 lei

59.932 lei	6811 Depreciation of non-current assets	=	2815 Depreciation of investment properties	59.932 lei

Case 4: A company has as activity objected the acquisition and sale of buildings. On 07.04.2015 she purchased a building at the cost of 900,000 lei. At 31.12.2015 the net realizable value of the building was 800,000 lei.

On 05.08.2016 the management decided that this building which was acquired for sale should be leased to third parties. Amortization period = 10 years

Solution:

(a) Recognition of transactions until the date the property intented for sale becomes an real estate investment:

(a1) Acquisition on 07.04.2015:

900.000 lei	371 Goods purchased for resale	=	401 Suppliers	900.000 lei

(a2) The recognition of the depreciation at 31.12.2015:

Acquisition cost at 07.04.N	900.000 lei
Net realizable value at 31.12.N	800.000 lei
Depreciation loss: 900.000 lei – 800.000 lei	100.000 lei

100.000 lei	6814 Impairment of current assets	=	397 Write-down of goods purchased for	100.000 lei

			resale	

(b) Transfer of the building to real estate investments at 5.08.2016:

900.000 lei	215 Investment properties	=	371 Goods purchased for resale	900.000 lei

And adjustments:

100.000 lei	397 Write-down of goods purchased for resale	=	2915 Impairment of investment properties	100.000 lei

(c) Amortization of the real estate investition: 900.000 lei/10 years x 3 months/12 months = 22.500 lei

22.500 lei	6811 Depreciation of non-current assets	=	2815 Depreciation of investment properties	22.500 lei

Case 5: ALFA has 2 buildings A and B and are used to obtain rental income and recognized as investment property.

For building A improvement and reconstruction works are being executed for sale, the value of the works is 200,000 lei. On the commencement date of the works for building A we know:

Account 215 Investment properties - initial value = 460.000 lei

Account 2815 Depreciation of investment properties = 100.000 lei

Account 105 Revaluation reserve = 50.000 lei

On building B no additional work is performed but it is intended to be used as administrative space as leases expire.

For building B we know:

Account 215 Investment properties initial value = 900.000 lei

Account 2815 Depreciation of investment properties = 200.000 lei

Account 2915 Impairment of investment properties = 30.000 lei

Solution:

a) The value of the investment property increases with landscaping expenses incurred

200.000 lei	235 Investment properties in progress	=	404 Suppliers of non-current assets	200.000 lei

b) Reception of the work:

200.000 lei	215 Investment properties	=	235 Investment properties in progress	200.000 lei

c) Stock transfer:

560.000 lei	345 Finished goods	=	215 Investment properties	660.000 (200.000 + 460.000)
100.000 lei	2815 Depreciation of investment properties			

d) Transfer of the revaluation difference:

50.000 lei	105 Revaluation reserve	=	1175 Retained earnings representing the revaluation reserve surplus	50.000 lei

e) Building B when it starts to be used by the owner it is transferred to the category of real estate properties:

900.000 lei	212 Buildings	=	215 Investment properties	900.000 lei
200.000 lei	2815 Depreciation of investment properties	=	2812 Depreciation of buildings	200.000 lei
30.000 lei	2915 Impairment of investment properties	=	2912 Impairment of buildings	30.000 lei

Conclusion

As the rate of globalisation is rapidly increasing, all the countries are taking the necessary measures to ensure the correct presentation of data about the financial position and performance results of the company. Property, in general terms, may be held or developed for several reasons. First, it may be held or developed as an integral part of the reporting entity's production, manufacturing, administration or trading activities, and performance of the reporting entity may largely depend on the results of these activities. Secondly, the property may be held or developed primarily as an investment for capital growth or rental or similar income, such that an assessment of performance requires consideration of changes in value. Thirdly, the property may be held or developed with the intention of sale in either the short or long term, in which case the performance of the reporting entity depends on realisation of the property.

The main objective of the present paper is to analyse the particular case of accounting for investment property under OMFP 1802/2014. When companies first apply these regulations, they establish based on their accounting policies and their professional judgment, which of the owned real estates qualify to be classified in real estate investments. For their reflection in the accounting system it is used the account 215 Investment properties. According to the International Financial Reporting Standards and Romanian Accounting Standards, investment property is valued using the cost or fair value method at one's choice.

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IAS 40 – Investment Property

IAS 16 - Property, Plant and Equipment

IAS 2 – Inventories

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