Ewa Rogowska

Investment Property in the Polish Accounting Act and in International Accounting Standards

Olsztyn Economic Journal 6/1, 109-119

2011

OLSZTYN ECONOMIC JOURNAL
Abbrev.: Olszt. Econ. J., 2011, 6(1)

INVESTMENT PROPERTY IN THE POLISH ACCOUNTING ACT AND IN INTERNATIONAL ACCOUNTING STANDARDS

Ewa Rogowska

Kolegium Zarządzania i Finansów
Szkoła Główna Handlowa w Warszawie

Key words: investment property, International Accounting Standards, Accounting Act, initial recognition, measurement after recognition.

Abstract

The article tackles the issue of investment property in International Accounting Standards and in the polish Accounting Act. It describes the importance of applying the IAS in the view of clarity of financial statements. The main part of the article focuses on the definition, initial recognition and subsequent measurement of investment property. The article describes the differences and similarities between the polish Accounting Act and the IAS in the case of investment property. The most important difference is due to the fact that the polish Accounting Act does not allow the use of the revaluation cost model. The Accounting Act does not separate the definition of investment property from investment in general and does not supply solutions for valuation of property acquired for non-monetary assets.

NIERUCHOMOŚCI INWESTYCYJNE W USTAWIE O RACHUNKOWOŚCI I W MIĘDZYNARODOWYCH STANDARDACH RACHUNKOWOŚCI

Ewa Rogowska

Kolegium Zarządzania i Finansów
Szkoła Główna Handlowa w Warszawie

Słowa kluczowe: nieruchomość inwestycyjna, Międzynarodowe Standardy Rachunkowości, ustawa o rachunkowości, wycena.

Abstrakt

W artykule opisano zagadnienie nieruchomości inwestycyjnych w Międzynarodowych Standardach Rachunkowości i w polskiej ustawie o rachunkowości. Wyjaśniono znaczenie stosowania standardów międzynarodowych w kontekście przejrzystości sprawozdań finansowych. Główna część artykułu skupia się na omówieniu definicji, ujęcia początkowego oraz późniejszej wyceny nieruchomości inwestycyjnych. Opisano również różnice i podobieństwa między ustawą o rachunkowości a MSR w kwestii nieruchomości inwestycyjnych. Najważniejsza różnica wynika z braku dopuszczenia przez polską ustawę możliwości wyceny nieruchomości inwestycyjnych za pomocą modelu z przeszacowaniem na kapitał z aktualizacji wyceny w wyborze modelu kosztowego. Ustawa nie wyodrębnia nieruchomości inwestycyjnych z inwestycji ogółem, a także nie podaje rozwiązań dla przypadków szczególnych, jak wycena nieruchomości inwestycyjnej nabytej za pomocą aktywów niepieniężnych.

Introduction

The article focuses on regulations regarding investment property in International Accounting Standards, particularly in IAS 40 "Investment Property" and in the Polish Accounting Act. Since the amendment of the Accounting Act in 2008 these problems were analyzed in a general way, mainly in textbooks intended for researchers and professionals of accounting and financial controlling.

Aim of search and methods of studies

The article aims to present and explain the differences between the IAS and the Accounting Act in the case of investment property. Furthermore, it analyzes the most important discrepancies by the use of an empirical example.

The research method consisted of analyzing the literature of the subject regarding investment property. Relevant paragraphs of the Polish Accounting Act before and after the amendment dated on 18th March 2008 and IAS 40 "Investment Property" were analyzed in the view of their influence on economic entities, the most important differences were presented in a form of an empirical example. Furthermore, in order to clarify the issue of investment property, the relevant regulations were presented in a synthetic tabular form.

Importance of applying the IAS

Every process on the international market is linked, which is related to the "shortening of the distance" and "rapprochement" of the actions taken in different, often remote parts of the world (WINIARSKA 2006, p. 9). Economic entities functioning on international markets should present their endeavors in a comparable way, and their financial statements should be subject to uniform rules regardless, of the place where they were prepared. During the times of globalization the significance of the International Financial Reporting Standards (IFRS) grows, because the financial statements prepared according to the rules presented in the IFRS are clear to all participants of the market play around the world (OLSZEWSKA, PODEL 2004, p. 80).

In Poland, the Accounting Act is the basis of accounting regulations. Its provisions specify the framework for keeping and auditing accounting books, preparing financial statements and rendering services in accounting (WALIŃSKA 2009, p. 13).

It is import ant to note, that the Accounting Act is subject to constant evolution in the direction pointed by the International Financial Reporting Standards. These changes resulted in the amendment of the accounting act in the year 2000 and 2008 (WALIŃSKA 2009 p. 212).

Investment property in the IFRS is regulated by IAS 40 which replaced IAS 25 in the scope of measurement of investment property (WALIŃSKA 2007, p. 178). IAS 40 came into force on January 1st 2001 (HELIN 2006, p. 223).

Definition of investment property

Investment property is defined as land, buildings or parts of buildings which are held by the owner (or the lessee under financial lease) who treats them as a source of income from rent or keeps it for appreciation of their value (WALIŃSKA 2007, p. 178).

The International Accounting Standards give a very precise definition of investment property by describing specific examples of what kind of property may be considered as investment property.

In order to verify if a given property may be considered as investment property, the IAS suggest to use the cash flow method or the purpose method.

If cash flow is generated due to ownership of property, it is considered as investment property (IAS 40.7). When the property is owneroccupied, cash flow is generated rather from ordinary business and not from the sole fact of owning the property. Another method is implemented by judging the purpose of the property. The reason for which the property is being used should be clearly distinguished. If it is not used in production nor supply of goods nor services nor for administrative purposes and will not be sold in ordinary course of business it is investment property. The IAS raise the issue of partial use of the property. When a business entity uses part of the property as owner-owned property and a different part as investment property, then for accounting purposes it should treat those parts separately, if they can be separately sold. If these parts cannot be divided, the entity can consider the property as investment property, under the condition that only an insignificant part is used for production purposes (HELIN 2006, p. 225). IAS also underline that judgment is needed to determine whether a property qualifies as investment property and give an example of a passive investor in a hotel and a manager who outsources the day-to-day services retaining the direct management. The entity should elaborate criteria allowing for clear and coherent qualification, in the view of the definition of investment property (HELIN 2006, p. 225).

IAS also tackle the problem when a property is leased to a subsidiary or a parent. In the view of a capital group, the property cannot be treated as investment property, however in the case of the entity leasing out the building it may meet the criteria of investment property.

In Poland, the amendment of the Accounting Act in the year 2008 has changed the definition of investment. Investment is understood as assets held by an entity for economic gain from the appreciation of their value, receiving revenue from interests, dividends, profit shares or other gains also from a business transaction, and particularly financial assets, property, intangible assets which are not used for owner purposes but are held for receiving economic gain (UoR 3.1.17).

The Accounting Act has been adapted to IAS 40 in the case of the definition as the standard does not limit the notion of investment property to acquired property, as it was in the Accounting Act before the amendment (WALIŃSKA 2007, p. 178). This change has widened the definition of investment by changing the term "acquired" into "held". It is very important, as in the view of the amended act, a property which was build by the owner or a property that has changed its purpose may be classified as investment property. Before the amendment only acquired property could have been considered as investment property. Unfortunately, the legislator has not included the full scope of possible parameters of initial recognition of property, as the regulations concentrate on assets acquired by the means of monetary items (HELIN 2009, p. 49).

Initial recognition of investment property

According to International Accounting Standards, the initial recognition is at cost. The cost is not increased by:

– start up costs which are not absolutely necessary to make the property operational

– operational losses incurred after the property becomes operational

– abnormal amounts of wastes, materials, labour or other resources (IAS 40.23).

The cost of acquisition of assets is understood as the total of monetary items paid on the title of acquisition of the asset at the moment of its acquisition or construction or when a specific amount can be attributed to a given asset when the initial recognition is subject to specific requirements of the IFRS/IAS (HELIN 2006, p. 226).

When an investment property is acquired in exchange for non-monetary assets or a combination of monetary and non monetary assets, the property should be measured at fair value unless it is impossible to determine it in a justifiable way (IAS 40.27).

Measurement after recognition of investment property

The IAS and the Accounting Act allow for a choice of the subsequent measurement between the fair value model and the cost model. However, the IAS suggest to use the fair value model.

The cost model is based on the same rules used to measure fixed assets and intangible assets. This method represents a cautious approach, where the measurement is based on the historical cost, which is depreciated in time, through systematic amortization (WALIŃSKA 2009, p. 212). The Polish Accounting Act does not allow for the appreciation of the value of an investment measured at cost. In special circumstances it may happen through a regulation of the government, but such an eventuality does not have an actual significance. It is important to note, that the measurement, which assumes that the value of the investment may only decrease, seems inadequate with the purpose of the investment, which is generally made for capital appreciation according to the definition given by the legislator in article 3.1.17 of the Accounting Act.

Another aspect that has to be considered, is that generally the IAS does not permit the change of the accounting policy of using the fair value model into the cost model. The IAS states that it would be highly unlikely to change from the fair value model to the cost model in order to present the situation of the entity in a more reliable way (IAS 40.31).

Fair value model

The IAS gives a very exhaustive description of how the fair value is understood in the case of investment property. The standards describes with scrutiny the methodology of estimating the fair value of investment property and regulations regarding the rules and possibilities for transfer between the balance groups and the consequences of such transfers (HELIN 2006, p. 234).

According to the IAS, when estimating the fair value, excessive and underestimated prices due to specific conditions should be excluded. Moreover, transaction costs incurred during the sale or during other forms of disposal of the estimated properly should not be included (HELIN 2006, p. 228).

According to the IAS an entity is encouraged, but not required, to determine the fair value of investment property on the basis of measurement by an independent real estate expert who holds recognized and relevant professional qualifications and has recent experience in the location and category of the investment property being valued (IAS 40.32).

The Accounting Act demands the fair value to be estimated by an expert in real estate at least once every five years. Moreover the measurement at fair value demands evaluating the fair value for every last balance day (WALIŃSKA 2009, p. 213).

Changes in fair value are recognized in loss or profit (IAS 40.35). The Accounting Act states that the changes in fair value should be recognized in other operational loss or profit regardless if it concerns the changes of the value of the investment exceeding the historical cost or are connected with the change of the value lower than at the moment of initial recognition (WALIŃSKA 2009, p. 212–213). The IAS also gives guidance on how to act when there are no similar transactions or the market for similar transactions is limited. In the case of the Polish Accounting Act there are no detailed descriptions, which is connected with the structure of the Accounting Act which does not comment on the articles. A National Accounting Standard regarding investment property has not been elaborated up to the end of 2009. However according to article 10.1.3 of the Accounting Act, in the case of problems which were not tackled by home regulations, entities may use the National Accounting Standards issued by the Accounting Standards Committee and when there is no national standard, the entities may use the IAS (UoR 10.1.3).

Cost model

The IAS suggests that the cost model should only be used when it is impossible to determine the fair value on a continuing basis (IAS 40. 53). The standard, with regard to the cost model, refers to the IAS 16. The Accounting Act and IAS 16 have convergent regulations as to the initial recognition. However IAS 16 allows for two methods of measurement after initial recognition: the historical cost model (depreciation model) and the revaluation model. The Polish Accounting Act allows only for the depreciation model to be used. The act does not present rules for revaluation. According to the Accounting Act, the value of fixed assets may grow only due to other, distinct, regulations issued by the Minister of Finance. The act, emphasizes that, the new, capitalized, value of the non-current assets should not exceed its fair value. The definition of fair value is coherent with the IAS (NIEDZIÓŁKA 2007).

Transfers

When transferring a property from investment property into other categories, their actual value kept in the books should be used as the new initial recognition value (HELIN 2006, p. 230). If the property was owner-owned and measured according to IAS 16 and will be measured according to its fair value, than the differences will be recognized in the revaluation reserve. If the property was considered as supplies, the differences are recognized in loss or profit of the given period (HELIN 2006, p. 230).

According to article 3.32.c of the Accounting Act in the case of transfers of investment property into fixed assets, which were measured at fair value, the differences will be recognized in other operational loss or profit.

Empirical example

TransGlobal enterprise has acquired a small office block for the amount of 1 000 000 PLN intended for rental. The building has been recognized in long-term investment. According to an independent real estate expert the value of the investment grew during the balance year by 20 000 PLN.

Case 1: The accounting policy of the business unit states that the investment will be measured at cost according to the rules presented in the Polish Accounting Act. Regular amortization will be performed over the period of 40 years in the amount of 25 000 PLN per year and eventual impairments will be written off if necessary.

The balance value of the investment at the end of the first year is 975 000 PLN (1 000 000 PLN – 25 000 PLN = 975 000 PLN). The operational costs due to amortization amount to 25 000 PLN.

Case 2: The accounting policy states that the investment will be measured according to the revaluated cost model consistent with IAS 16.

The balance value of the investment at the end of the first year is 994 500 PLN (1 000 000 PLN + 20 000 PLN – (1 020 000 PLN/40 years) = (1 020 000 PLN – 25 500 PLN = 994 500 PLN).

The growth of the value of the investment is recognized in the revaluation capital. The operational costs due to amortization amount to 25 500 PLN.

Case 3: The accounting policy states that the investment will be measured according to the fair value model.

The balance value of the investment at the end of the first year is 1 020 000 PLN (1 000 000 PLN + 20 000 PLN = 1 020 000 PLN). Other operational profit is 20 000 PLN.

The balance value of the same investment may amount at the end of the balance year to 975 000 PLN, 994 500 PLN and 1 020 000 PLN according to the chosen accounting policy. The financial result may be reduced by 25 000 PLN (case 1), 25 500 PLN (case 2). In case 3 the financial result has been increased by 20 000 PLN.

According to the above, the choice of a given accounting policy may influence the value of investment property and the financial result. The lack of the possibility to use the revaluation cost model in the Polish Accounting Act may create significant differences in the balance sheet and the profit and loss account of the entities that prepare their statements according to the Polish regulations and those that use the IAS.

Comparison of Polish regulations and the IAS for investment property

Table 1

Comparison of Polish regulations and the IAS for investment property

Accounting Act	International Accounting Standards
1	2
Fixed assets with the exception of 3.1.17 are understood as assets and equal to assets of an expected economical usage longer than a year, complete, usable and designated for own-usage including – land, rights of perpetual usufruct, buildings, premises, titles to cooperative flats, titles to cooperative premises (UoR 3.1.15).	The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production (IAS, Framework for the Preparation and Presentation of Financial Statements 53). Tangible items are understood as that which: (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) are expected to be used during more than one period. (IAS 16.5).
Investment is understood as assets held by an entity for economic gain from the appreciation of their value, receiving revenue from interests, dividends, profit shares or other gains also from a business transaction, and particularly financial assets, property, intangible assets which are not used for owner purposes but are held for receiving economic gain (UoR 3.1.17).	Investment property is held to earn rentals or for capital appreciation or both (IAS 40. 7).

cont. table 1

1	2
The value at recognition is the price of acquisition or the costs incurred to create the fixed asset, including the costs incurred to make improvements, extensions, rebuilding, modernization or reconstruction resulting in a greater value of the fixed asset in comparison to the state before the improvements, extension, rebuilding, modernization or reconstruction (UoR 32.1-5).	The cost of an investment property is not increased by: (a) 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), (b) operating losses incurred before the investment 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. IAS (40. 23). 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 (IAS 40.17).
	One or more investment properties may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an investment property is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognize the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up (IAS 40.27).
Assets and liabilities are measured at least once every balance sheet day: property and intangible assets regarded as investment according to the rules presented for fixed assets and intangible assets in 31, 32.1-5, 33 or according to the fair value (UoR 28. 1).	With the exceptions noted in paragraphs 32A and 34, an entity shall choose as its accounting policy either the fair value model in paragraphs 33–55 or the cost model in paragraph 56 and shall apply that policy to all of its investment property (IAS 40.30).
The fair value should be measured at least once every 5 years by a real estate expert. If it is not possible to determine the fair value of investment other than property, then their price is at the cost of acquisition or the costs incurred during the process of construction. The fair value of financial investment made abroad is determined according to the rules of the host country (UoR 28.1.9).	An entity is encouraged, but not required, to determine the fair value of investment property on the basis of a measurement by an independent who holds a recognized and relevant professional qualification and has recent experience in the location and category of the investment property being valued (IAS 42.32).

cont. table 1

1	2
Other operational loss or income is understood as loss or income connected indirectly with the business operations of the entity and particularly costs or losses connected with maintaining property, intangible assets considered as investment and the actualization of the value of the investment, also connected with the transfer of the investment to fixed assets or intangible assets if they were measured at fair value (UoR 3.1.32).	The changes of fair value are recognized in loss or profit (IAS40.35).
Other operational loss or income include the actualization of the value of the investment connected with the transfer of the investment to fixed assets or intangible assets if they were measured at fair value (UoR 3.1.32).	For a transfer from investment property carried at fair value to owner-occupied property or inventories, the property's deemed cost for subsequent accounting in accordance with IAS 16 or IAS 2 shall be its fair value at the date of change in use. If an owner-occupied property becomes an investment property that will be carried at fair value, an entity shall apply IAS 16 up to the date of change in use. The entity shall treat any difference at that date between the carrying amount of the property in accordance with IAS 16 and its fair value in the same way as a revaluation in accordance with IAS 16 (IAS 60–61). For a transfer from inventories to investment property that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount shall be recognized in profit or loss (IAS 40.63).

Source: IAS – Framework for the Preparation and Presentation of Financial Statements, IAS 16, IAS 40, Accounting Act.

Conclusion

Different countries use a variety of legal regulations and a wide array of practical solutions to describe given economic occurrences in the language of accounting. It is important to note, that common and uniform principles in IFRS/IAS significantly increase the clarity of financial statements.

Polish regulations in the amended in 2008 Accounting Act in the case of investment property do not differ greatly from the rules presented in the International Accounting Standards. However, the lack of the possibility to use the revaluation model when investment property is measured at cost, may generate important differences between a financial statement prepared according to the Accounting Act and the IAS, especially when the real estate prices have a soaring tendency. Another issue is that the Accounting Act does not tackle the problem of assets acquired through non-monetary items. International regulations contain very clear indications regarding actual solutions, which are lacking in the Polish Accounting Act. Moreover, the Accounting Act does not separate investment property from investment in general. The definition of investment property in the Accounting Act should be clearly divided from the definition of investment, because the economic reality indicates that the issue of investment creates a lot of problems. It is necessary to elaborate a National Accounting Standard regarding investment property in order to limit arising doubts in practical implementation.

Translated by authors

Accepted for print 1.10.2010

References

CEBROWSKA T. 2007. *Rachunkowość finansowa i podatkowa*. PWN, Warsaw.

Framework for the preparation and presentation of financial statements. 1989. IASB, London.

GABRUSEWICZ W., SAMELAK J. 2006. *Rachunkowość finansowa, obszary problemowe.* Wydawnictwo Akademii Ekonomicznej w Poznaniu, Poznań.

HELIN A. 2006. *Sprawozdanie finansowe według MSSF, zasady sporządzania i prezentacji.* C.H. Beck, Warszawa.

JARUGA A. 2002. *Międzynarodowe regulacje rachunkowości. Wpływ na rozwiązana krajowe*, C.H. Beck, Warsaw.

JARUGA A. 2004. *Międzynarodowe Standardy Rachunkowości a ustawa o rachunkowości – podobieństwa i różnice.* Stowarzyszenie Księgowych w Polsce. C.H.Beck, Warszawa.

KOWALICZYK-PRYCZKOWSKA A. 2005. *MSR i MSSF, praktyczny przewodnik po Międzynarodowych Standardach Rachunkowości i Sprawozdawczości Finansowej.* Dr Josef Rabbe Spółka Wydawnicza, Warszawa.

MSR 16. 2009. IASB, London.

MSR 40. 2008. IASB, London.

NIEDZIÓŁKA A. 2007. *Międzynarodowy Standard Rachunkowości nr 16 – „Rzeczowe aktywa trwałe" a polska ustawa o rachunkowości.* ECDDP, Kraków.

OLCHOWICZ I., TŁACZAŁA A. 2004. *Sprawozdawczość finansowa.* Difin, Warszawa.

OLSZEWSKA M., PODEL W. 2004. *Nowe prawo upadłościowe.* Difin, Warszawa.

SOBAŃSKA I., NOWAK W.A. 2006. *Międzynarodowe i krajowe regulacje rachunkowości i ich implementacja: wyzwania i bariery*. Wydawnictwo Uniwersytetu Łódzkiego, Łódź.

TURYNA J. 2003. *Standardy rachunkowości, MSR – US GAAP – Polskie ustawodawstwo*, Difin, Warszawa.

Ustawa z dnia 29 września 1994 r. o rachunkowości. Dz.U. nr 21, poz. 591 z późn. zm.

WALIŃSKA E. 2007. *Międzynarodowe Standardy Rachunkowości, ogólne zasady pomiaru i prezentacji pozycji bilansu i rachunku wyników.* Oficyna Wolters Kluwer Business, Warszawa.

WALIŃSKA E. 2008. *Polska praktyka rachunkowości w kontekście procesu harmonizacji międzynarodowej sprawozdawczości finansowej*. Oficyna Wolters Kluwer Business, Warszawa.

WALIŃSKA E. 2009. *Ustawa o rachunkowości. Komentarz.* LEX Wolters Kluwer Business, Warszawa.

WALIŃSKA E. 2006. *Międzynarodowe standardy rachunkowości. Ogólne zasady pomiaru i prezentacji pozycji bilansu i rachunku wyników*. Wolters Kluwer Polska, Warszawa.

WIĘCŁAW W. 2006. *Różnice kursowe w świetle ustawy o rachunkowości, wybranych rozwiązań międzynarodowych i przepisów ustawy o podatku dochodowym od osób prawnych : wybrane zagadnienia.* MAC, Warszawa.

WINIARSKA K. 2006. *Rachunkowość zaawansowana.* Oficyna Ekonomiczna, Kraków.

WINIARSKA K. 2006. *Podstawy rachunkowości.* Wolters Kluwer Polska, Warsaw.

WYRZYKOWSKI W. 2006. *Wynik bilansowy a dochód podatkowy w okresie transformacji systemowej.* Scientific Publishing Group, Gdańsk.

ZIENKIEWICZ E. 2009. *Co zrobić, gdy wzrośnie wartość inwestycji w nieruchomości.* Rzeczpospolita, http://www.rp.pl/artykul/6,311515.html (access on 28.05.2010).