# Report Writing

Title:

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For:

By:

## Introduction

As the chief financial consultant, I have to determine the most appropriate use for the buildings of Conglomerate plc. To do this I have to begin by classifying the category in which the office buildings fall and how it would then be treated in the income statement. To start with, the office buildings can be categorized as an investment property because the company had not yet determined what use they will put the offices. The company was further contemplating the use of the office buildings as rentals and this would mean that the office buildings are an investment property. However, where Conglomerate plc used the office buildings for the company's own use then this would be the case of an 'owner-occupier' and thus the buildings would be classified as plant, property and equipment (PPE). This classification is important because the accounting treatment of investment property is governed by IAS 40 while that of PPE is governed by IAS 16.

### a. Accounting treatment of office buildings if they are rented to a third party

The office buildings should be recorded at their fair market value or even at their cost. The office buildings will fall under the category of investment property since Conglomerate plc will use them as rentals (Dobruna 2013, p. 101). According to IAS 40 such investment property will be valued using the fair value model. The fair value model is the price at which Conglomerate plc would sell the office buildings to a third party at arm's length. The office buildings are further categorized as investment property since Conglomerate plc may be holding the buildings for capital appreciation given that the prices of the office buildings are likely to rise sharply in the subsequent years.

Given that it is clear that the office buildings owned by Conglomerate plc is an investment property, it will initially be recognized in the accounts as an asset. This means that in December 31st 2013 when it is initially recorded in the accounts it will be recorded at its purchase price plus the costs that are directly attributable to the building. According to Greuning and Koen (2001, p. 156 ) the costs that are directly attributable to the office buildings include things like the professional fees, the initial handling and the delivery costs, costs of preparing the site and the assembly and installation costs. However, according to IAS 40 things like the abnormal costs and the initial operating losses will not be included amongst the directly attributable costs (Greuning & Terblanche 2011, p. 123). In the case of the office buildings owned by Conglomerate plc the initial cost will be 35m pounds. This is the cost of constructing the office building plus the cost of purchasing the land.

In the subsequent years, the reporting entity can record the office buildings at the cost or fair value model. For instance, in our case we will opt for the fair value model but if an entity decides to use the cost basis it will mean that the office buildings would be valued at its cost less any cumulative impairment losses and less the cumulative depreciation. Even so, the entity will have to give the fair value in line with the requirements of IAS 40.When recording the office buildings in the subsequent years the changes in the fair value of the office building will be recognized in the period in which such a change arises (Hussey 2010, p. 258). The IAS is not particular on where such a change should be recorded but it should be disclosed separately from the rental income and the direct operating expenses. In this case, Conglomerate plc is likely to realize an increase in the price of the office buildings and thus the profit should be recorded in the financial year it was realized.

**b. Accouting treatment if the office buildings are used by Conglomerate plc for its own accommodation**

If Conglomerate plc decides to occupy the office building then it can record the asset using either the cost basis or the fair value model (Alexander & Jorissen 2007, p. 266). In this case, the office buildings will be governed by IAS 16 for property, plant equipment because they are ‘owner-occupied’. To begin with the office building will have to be recognized in the financial statements because IAS 16 requires that property, plant and equipment needs to be recognized if the asset’s cost can be reliably measured and the entity will enjoy the economic benefits of the asset in future. In this case, the cost of the office buildings can be measured reliably and Conglomerate plc stands to benefit economically from the office buildings. The cost incurred in constructing the office building and bringing it to its present state will be included when recognizing the asset (CIMA 2005, P. 273). This cost will include such things as site preparation and the fees paid to professionals such as engineers and the architects.

So in the financial year of 31st December 2013 the office buildings will be recognized as an asset at its initial price and will thereby be recorded at its cost. Conglomerate plc will record the initial cost of the office buildings at 35m pounds . According to Alexander and Archer (2008, p. 50) once the asset has been recognized, it can be recorded at its revalued amount in the subsequent years. Baltazar (2011, p. 78) is of the view that when an asset is revalued it’s value can either increase or decrease and this revaluation can should be carried out annually. Since the office buildings are likely to experience a rise in prices the revaluation of the assets will lead to a rise in the value of the building. Therefore, in the subsequent years it will be credited under the comprehensive income in the income statement. This will be recorded beneath the accumulated equity as a revaluation surplus.

**c. Accounting treatment for a fall in property prices both for IAS 40 and for IAS 16**

According to IAS 16 when there is a loss in the value of property prices during a certain accounting period then it means that such a property will realize a decrease on revaluation. In this case, the loss in the value of the property will be treated as an expense in the income statement (Epstein & Jermakowicz 2010, p. 404). With regards to IAS 40 the lost in the value of property will be recorded in the income statement. The losses incurred in the accounting period due to the fall in the prices of property would be included in the calculation of the net loss. The similarity in the treatment of losses due to a fall in property prices for IAS 16 and IAS 40 is that they are both recorded in the income statement (Everingham, Kleynhans, & Posthumus, 2007, p. 220). However, the treatment contrasts because IAS 16 records this loss as an expense while IAS 40 includes it to form part of the net loss.

**d. Accounting treatment for office buildings on disposal under IAS 16 and IAS 40**

When Conglomerate plc sells the office buildings come 2020 they will treat is as a derecognition because they will be disposing the asset as they will no longer derive any benefits. The profits derived from the sale of the office buildings are not recorded in the income statement of Conglomerate plc as revenue. The decommissioning or the liability of the asset will be treated depending on the model used by the reporting institution (Mirza, Holt & Orrell 2006, p. 299). In the case of the revaluation model the increase in liability will be debited to the revaluation surplus.

On the other hand, IAS 40 will derecognize the asset and the gain or loss realized on selling the asset will be recorded in the income statement as either an income or an expense (Mackenzie et al 2012, p. 90). The difference between the carrying amount of the office building and the proceeds after sale will be used to determine whether the business has realized a loss or a gain. Therefore, in IAS 40 the compensation to be received from third parties on the sale of the office buildings belonging to Conglomerate plc will be recognized in the accounts of Conglomerate when it is receivable (Mirza 2010, p. 118). Since Conglomerate has made a substantial profit from the sale of the office building, in accordance to IAS 40 the profit will be treated as an income in Conglomerate's income statement.

## Conclusion

When the office buildings are used as an investment property its initial value will be recognized in the financial statements at the end of the accounting period in 2013. The subsequent value of the building in the subsequent years will be recorded at the fair value and the profit realized will be recorded in the year it arises. When the office building is treated as a PPE its initial value will be recognized in 2013 and in the subsequent years, it will be recorded in the financial statements at the revalued price. In addition to this, when there is a decline in the fair value of the office buildings the IAS 40 requires that it will be part of the net loss while the IAS 16 will treat this loss as an expense. Unlike IAS 16, the IAS 40 treats profit realized on disposal of an asset as revenue. Therefore, the use in which Conglomerate plc will put the office buildings will determine the accounting treatment they will use for this asset.

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