

# Recognition Of Investment Properties: The Case Of Turkey

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## Abstract

Investment properties have come into our literature by the inurement of TAS. Investment properties are the properties that business aims to keep long in its hands because of their profit from increase in long-term value and rental income. The recognition of investment properties, which is under TAS 40, is not included yet in Uniform Chart of Accounts practise. Although it is not in vurrent account plan, investment properties are in the reporting as a seperate item before tangible assets in "Financial Statements and User Guide Samples" in line with Turkey Account Standards. The purpose of the study is to contribute to the literature by recognising with the reference of "Financial Statement Examples and Usage Guide" published by Accounting and Auditing Standards Authority, and providing information about the invesment properties, which are in practise newly, in the framework of TAS 40. It will be easier to adapt the reforms of the Accounting Standards of Turkey and the application unity of users will be achived along with making a number of changes in Uniform Chart of Accounts in the recognition of investment properties which are one of the reforms of Accounting Standards of Turkey.

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**Keywords:** Investment Properties, Public Oversight, Accounting and Auditing Standards Authority, the Uniform Chart of Accounts, TAS 40

## Introduction

Real estates, which are important because of their high value, are classified in detail based on their aim of use by gaining a new dimension in the framework of TAS/TFRS. Recognition of real estates, which are held for the long term profit or rental income, or both, is the subject of this study. These type of real estates are being referred to investment properties and they are under "TAS 40 Investment Properties".

In the study, firstly there is given information about TAS 40 Standard and then recognition of investment properties is explained with examples. The valuation of investment properties are discussed based on fair value

method. The reason for this is that cost method is not included to the examples because it is an ongoing application method, and fair value is considered in exemplary embodiments because it is a concept that came up with TAS. As a result, there are important results indicated in conclusion part, and further suggestions were made for the users related to the subject.

The purpose of the study is to contribute to the literature with the application examples based on the recognition of investment properties which came into practise with Accounting Standards of Turkey.

### **TAS 40 Investment Properties**

Investment properties are the properties which are held for their long term profit or rental income, or both. (TAS 40, art:5)

Some examples of investment properties are listed below (TAS 40, art:8):

- a) Lands held in order to achieve capital gain in the ordinary workflow,
- b) Lands which are not decided how to use in the future,
- c) Business' buildings which are subject to one or more operating leases,
- d) An empty building held for operational leasing,
- e) Real estates which are being constructed to be used as investment properties in the future.

### **Initial Recognition**

At initial recognition, investment properties are measured with acquisition costs included transaction costs (Erer ve Aksoy Hazır, 2014: 21).

The valuation of investment properties at initial recognition is made at cost. Expenses related to the acquisition and construction of an asset are included in its cost (Örten vd, 2014: 586).

As long as there are daily service costs related to investment properties, profit/loss is also recognized. Such expenditures are maintenance and repair expenditures related to real estate (Demir, 2007: 63).

An investment property is recognised only if the following conditions are met (TAS 40, art:16):

- a) It must be probable that the future economic benefits related to property enter the business, and,
- b) The cost of investment property must be measured reliably

Investment property is initially measured at cost. Transaction costs are also included in the initial measurement. The cost of a purchased investment property consists of the purchase price and the expenses directly related to this transaction. Fees paid for legal services, property transfer taxes and other transaction costs can be given as examples of direct expenses (TAS 40, art: 20-21).

A business, which applies this recognition principle, evaluates the investment property costs as soon as they occur. These costs include initial costs which occur during the obtaining process of an investment property, and additions made to an investment property later, changes in it or service costs (TAS 40, art. 17).

A business cannot recognise the daily service costs of a property in the carrying amount of investment property. As these costs occur, profit/loss is also recognised. Although daily service costs primarily consist of labor and consumables, they may include the costs of minor parts too. Such expenditures are usually defined as the “maintenance and repair” expenses related to real estate (TAS 40, art: 18).

### **Valuation After Recognition**

Two methods are used in the valuation of investment properties after purchase. These are,

- a) Fair Value Method and,
- b) Cost Value Method.

Businesses are free to choose what they wish from the two methods and they apply the method they choose to all investment properties (Örten vd, 2014: 587).

Following the initial recognition, a business, that has chosen fair value method, measures its investment properties at fair value method. Gains or losses arising from changes in the fair value of investment property is included in profit or loss in the period they occur (TAS 40, art:33-34-35).

There is a legally valid assumption that the fair value of an investment property can always be measured reliably until proven otherwise. However, in some exceptional cases, an evidence is found that it is not possible to measure the fair value always reliable during the acquisition process of an investment property by the business. This situations occurs only when the real estate market is not active and it is not possible to measure the fair value in other kind of reliable ways (TAS 40, art: 53).

In the case of measuring an investment property at fair value by a business, even if comparable market transactions decrease or attainability of market prices become more rare, the aforementioned real estate is continued to be measured at fair value until it is sold (TAS 40, art: 55).

In determining the value of investment properties, measurement can be made based on a valuation by an independent appraisal expert who has the authority on the subject, necessary professional experience, and current information about class and location of the aforementioned investment property. The fair value of investment property can be determined by benefiting from some individuals and organizations such as experts, expertise, real estate experts (Bozdemir, 2014: 97).

A business, which chooses the cost model after the initial recognition, measures all its investment properties with cost method in the framework of provisions specified for that model in TAS 16 except the ones which are classified as held for sale in accordance with "IFRS 5 Held for Sale Assets and Discontinued Operations" (TAS 40, art: 56).

The businesses that choose cost method are required to announce the depreciation method used for that property, the property's useful life, the accumulated depreciation amounts which include the gross carrying amount at the beginning and the end of period and the provisions of accumulated impairment losses, and annual depreciation amounts ( Erer ve Aksoy Hazır, 2014: 23-24).

### **Transfer and Disposal**

It is possible that investment property remains outside of this classification due to the change in intended use. The transfer of a real state to investment property class or transfer from this class is possible only when there is a change in use, and the evidence that such change is taking place is given below (TAS 40, art:57):

- a) In order to transfer the real estate from an investment property to the real estate used by owner, it is started to be used by its owner;
- b) In order to transfer from investment property to stocks for sale, it is started to be developed;
- c) In order to transfer from the real estate used by owner to investment property, it is ended to be used by owner, or
- d) In order to transfer from stocks to investment property, it is started to be leased to another as an operating lease.

In the situations of disposal or end of use of investment property in a continuous manner and no expectations for future economic benefits, investment property is excluded from financial statement table (TAS 40, art: 66).

### **Practises Related to the Recognition of Investment Properties**

Uniform Accounting System General Communiqué was issued in the official newspaper with the date of December 26, 1992 and repeated number of 21447. By beginning of implementation of accounting system communique principles, implementation of different records was ended and businesses began using uniform principle.

The accounts related to the recognition of investment properties, which came into force with TAS/IFRS, are not in the Uniform Chart of Accounts which still in use today. Although there is no different account group in the Uniform Chart of Accounts, the reporting is made according to

Turkey Financial Reporting Standards(TFRS). It is reported in balance sheet and income statement as a separate account.

In all of the studies in the literature, the studies were performed based on Uniform Chart of Accounts. The accounting plan, which has been in practice since 1994, is not qualified to answer to the new TAS/TFRS system. Studies:

Gokcen, Ahmed and Çakıcı (2006) suggested in their study that “Lands and Building Plots” and “Buildings” accounts should be used in the account group of “Tangible Assets”.

On the other hand, Akdogan and Sevilengül (2007) suggested in their study that they can be monitored in an empty account group.

Örten and others (2014) found it appropriate to monitor them in the accounting group of “Other Assets” in their study, but if there is a change made in accounting plan, they claim that empty account group is more appropriate.

In the samples relating to recognition of investment properties, "Financial Statements Example and Usage Guide", which is compatible with Turkey Accounting Standards issued by Public Oversight, Accounting and Auditing Standards Agency, will be the reference and the accounts which have to be reported in accordance with TAS. In the aforementioned guide, there is an item named “Investment Activities” for income and expenses in the income statement.

Investment activities are the activities related to acquisition and disposal of other investments which are not in long-term assets and cash equivalents. Profit/loss of investment activities can be found by deducting the income from investment activities and expenses related to it (KGG, Financial Statement Examples and Usage Guide: 51).

### **Investment Properties Acquired by Purchasing**

As stated in article 20 of TAS 40, investment properties are initially recognized at cost. In case of delayed payment for investment property, the cost of the property is equivalent to the amount paid in advance. The difference between this amount and the total payments is recognized as interest expense over the term of the loan (TAS 40, art: 24).

The following gives examples related to the recognition of investment properties acquired by purchasing:

On 01 April 2016, a residence, which has a cash price of TL 2,000,000 for investment and rental income, was purchased for 2,500,000 TL included the value-added tax (VAT) to be paid to seller one month later. On 01 June 2016, it is given monthly rent for TL 500,000.

- Accounting records relating to the purchase of the residence:

01.04.2016	
INVESTMENT PROPERTY	2.000.000
Residence	360.000
OTHER CURRENT ASSETS	140.000
Deductible VAT	
SHORT-TERM LIABILITIES	
Deferred Interest Expense	
TRADE PAYABLES	
Suppliers	2.500.000

- Payment of the debt on the residence to the seller from bank account on 05 Jan 2016

01.05.2016	
TRADE PAYABLES	2.500.000
Suppliers	
CASH AND EQUIVALENT	
Bank	2.500.000

- Residence rental income on 30 June 2016

30.06.2016	
CASH AND EQUIVALENT	500.000
Bank	
INVESTMENT ACTIVITY INCOME	
Investment Property Income	500.000

- Accounting record related to expensing the delay interest by taking it from balance sheet on 30 June 2016

30.06.2016	
FINANCIAL EXPENSE	140.000
SHORT-TERM LIABILITIES	
Deferred Interest Expense	140.000

- In order to determine the fair value of the residence, fair valuation is made by a valuation company and it is determined that the fair value is TL 2,200,000 on 30 June 2016  
 TL 2,200,000 - TL 2,000,000 = TL 200,000

30.06.2016	
INVESTMENT PROPERTY Residence	200.000
INVESTMENT ACTIVITY INCOME Investment Property Fair Value Increased Income	200.000

At the end of the period, the amount in interest expense account is transferred to income statement in order to be included in profit/loss calculation.

### Investment Properties Acquired by Leasing

The initial cost of an investment property interest, which is leased and classified as investment property, is recognized at fair value of the real estate and the lower of minimum lease payments at the present value (TAS 40, art. 25).

If a property interest acquired through leasing is classified as an investment property, item recognized at fair value is not the property itself but the interest on it (TAS 40, art: 26).The classification and recognition of an interest that is related to a real estate held by a lessee in the framework of activity lease is possible only if it is defined as investment property and using the fair value method (TAS 40, art:6).

The following gives examples related to the recognition of investment properties acquired through financial lease:

The fair value of an investment building, which is acquired through financial lease from 01 July 2016 to 31 Dec 2016, is TL 200,000. The present value of the lease payments for the investment property acquired under finance lease is TL 50,000. Liabilities are TL 260,000.

01.07.2016	
INVESTMENT PROPERTY Building	200.000 60.000
SHORT-TERM LIABILITIES Deferred Interest Expense	
OTHER FINANCIAL LIABILITIES Financial Leasing	260.000

- Building rental income on 31 July 2016

31.07.2016	
CASH AND EQUIVALENTS Bank	50.000
INVESTMENT ACTIVITY INCOME Investment Property Rental Income	50.000

- Building rental income on 31 Aug 2016

31.08.2016	
CASH AND EQUIVALENTS Bank	50.000
INVESTMENT ACTIVITY INCOME Investment Property Rental Income	50.000

- Residence rental income on 30 Sep 2016

30.09.2016	
CASH AND EQUIVALENTS Bank	50.000
INVESTMENT ACTIVITY INCOME Investment Property Rental Income	50.000

- Accounting record related to expensing the delay interest (July, Aug, Sep) by taking it from balance sheet on 30 Sep 2016

30.09.2016	
FINANCIAL EXPENSE	30.000
SHORT-TERM LIABILITIES Deferred Interest Expense	30.000

- In order to determine the fair value of the building, fair valuation is made by a valuation company and it is determined that the fair value is TL 210,000 on 30 Sep 2016. The increase in the value of the investment property,

$$TL\ 210,000 - TL\ 200,000 = TL\ 10,000$$

30.09.2016	
INVESTMENT PROPERTY Building	10.000
INVESTMENT ACTIVITY INCOME Investment Property Fair Value Increase	10.000

- Accounting record related to expensing the delay interest (Oct, Nov, Dec) by taking it from balance sheet on 31 Dec 2016

30.12.2016	
FINANCIAL EXPENSE	30.000
SHORT-TERM LIABILITIES Deferred Interest Expense	30.000

- Accounting records relating to the payment of debts to leasing company on 31 Dec 2016

31.12.2016	
OTHER FINANCIAL LIABILITIES Financial Leasing	260.000
CASH AND EQUIVALENTS Bank	260.000

- In order to determine the fair value of the building, fair valuation is made by a valuation company and it is determined that the fair value is TL 240,000 on 31DEC 2016. The increase in the value of the investment property,

$$TL\ 240,000 - TL\ 210,000 = TL\ 30,000$$

31.12.2016	
INVESTMENT PROPERTY Building	30.000
INVESTMENT ACTIVITY INCOME Investment Property Fair Value Increase	30.000

Loans, bank loans which is measured at amortised cost calculated by effective interest method after the initial recognition, issued bonds, bonds

and notes, principal payments and interest of long-term ones, debt made from the financial markets such as liabilities from financial leases are shown in this item. Financial debts that meets the specifications relating to short term liabilities are classified as short term, and the others are classified as long term (KGGK, Finansal Tablo Örnekleri: 42).

### **Investment Properties Acquired by Bartering**

It is possible to acquire one or more investment property in exchange for a combination of monetary and non-monetary assets. The cost of this kind of investment property is measured at fair value in these conditions: a) If there is no lack of commercial substance of the barter transaction, b) Unless there is reliable measurement of fair value of bartering assets. In the situation of failure in measuring the fair value of acquired asset, the cost is measured as carrying amount of the asset given (TAS 40, art: 27).

It is decided whether the bartering transaction has a commercial substance or not by evaluating whether there will be any changes in the future cash flow given the result of the transaction. In the following cases, it is considered that there is a commercial substance in bartering transaction (TAS 40, art: 28):

- a) In the case of difference between the qualification of the asset received with the qualification of the asset given, or
- b) Change in the value of activity segment specific to business, which is affected from bartering transaction, as a result of bartering process, and
- c) When the difference in the fair value of the assets bartered is significant.

The following gives examples related to recognition of investment properties acquired by bartering:

An investment building is purchased in order to gain appreciation income by selling it in the future for TL 100,000 (18% VAT excluded), which is included a TL 60,000 valued building with an accumulated depreciation of TL 24,000 and cash rest on 15 July 2016.

- Purchase of investment property;

15.07.2016			
INVESTMENT PROPERTY		100.000	
Building		24.000	
TANGIBLE ASSETS		11.800	
Accumulated Depreciation			
OTHER CURRENT ASSETS			
Discount VAT			
TANGIBLE ASSETS			60.000
Building			
CASH AND EQUIVALENTS			75.800
Cash			

- The fair value of the building increased by TL 20,000 on 30 Sep 2016.

30.09.2016			
INVESTMENT PROPERTY		30.000	
Building			
INVESTMENT ACTIVITY INCOME			30.000
Investment Property			
Fair Value Increase			

### **Properties Acquired by Constructing**

When it is not possible to measure the fair value of an investment property, which is in construction, reliably but the business predicts that it can be measured reliably after the construction, the investment property is measured at cost until the fair value can be measured reliably or the construction is completed. When the business determines that it is not always possible to measure the fair value of the investment property (except the investment property which is in construction) reliably, the business measures the investment property with cost method determined in TAS 16. The residual value of investment property is considered to be zero. The business applies TAS 16 until the disposal of investment property (TAS 40, art: 53).

When the investment property in construction, which was already measured at cost, comes in the situation that the fair value of it can be measured reliably, it is measured at fair value. The property is considered to be measured at fair value reliably, when the construction is completed. Otherwise, the property is measured by using the cost method in TAS 16 (TAS 40, art.53A).

A business, which measured an item related to investment property in construction at fair value, cannot reach a result that the fair value of this

property could not be measured reliably after the construction ( TAS 40, art: 53B).

When the business completes the construction or development process of the investment property which is constructed or developed by its own to be pursued on the basis of fair value, the difference between the fair value on completion date and book value shown earlier is recognized as profit or loss (TAS 40, art: 65).The following gives examples related to the recognition of investment properties acquired by constructing:

TL 50,000 for labor, TL 60,000 for raw materials and TL 20,000 for other expenses were spent to begin construction of a building to gain rental income on 30 May 2016. When the construction was completed on 30 June 2016, the fair value of the property was determined as TL 170,000.

- Accounting record of the investment property in construction on 30 May 2016

TL 50,000 (Labor) + TL 60,000 (Raw Materials) + TL 20,000 (Other Expenses) = TL 130,000

30.05.2016	
INVESTMENT PROPERTY Building in Construction	130.000
CASH AND EQUIVALENTS Cash	130.000

- Accounting record of the investment property in construction on 30 June 2016

30.06.2016	
INVESTMENT PROPERTY Building	170.000
INVESTMENT PROPERTY Building in Construction	130.000
INVESTMENT ACTIVITY INCAOME Investment Property Fair Value Increase	40.000

### Transfer of Investment Properties

The transfer of a property to investment property class or from this class is possible when there is a change in use. The evidence that these changes are taking place are given below (TAS 40, art: 57).

a) Transfer from investment property to property used by owner,

- b) Transfer from investment property to stocks,
- c) Transfer from property used by owner to investment property,
- d) Transfer from stocks to investment property.

It is stated that it is possible to transfer a business’ investment property to stocks only if there is a change in use. The evidence of the use of the aforementioned changes is the start of development activities in order to sell after making improvements. If a business decides to dispose its investment property without making any development, it continues to classify the property as investment property until removing it from financial statement and does not consider it as stock. Likewise, when a business makes redevelopment of its investment property in order to use it as investment property also in the future, this property remains as investment property and it is not classified as property used by owner during the redevelopment process (TAS 40, art: 58). The example of the transfer of investment property to property used by owner is given below:

The fair value of an investment building, which is valued at fair value, is TL 200,000 on 30 June 2016. This building is decided to be used as labaratuvar for research and development. When changes occur in the use of property, the fair value of it is determined as TL 180,000 on 30 Sep 2016.

30.09.2016	
TANGIBLE ASSETS	180.000
Building	
INVESTMENT ACTIVITY EXPENSE	20.000
Fair Value Decrease	
INVESTMENT PROPERTY	
Building	200.000

### Conclusion

By the enactment of “TAS 40 Investment Properties” standards, for businesses properties are recognized in tangible assets, and in the recognition and reporting of investment properties many new applications were enacted.

Investment properties are located in no. 25 “Assets” in Unifor Chart Accounts systematic during the recognition according to Tax Procedural Code (TPC). However, they should be recognized in a seperate account by enacting of TAS/TFRS. Additionally, all properties were recognized at cost before the implementation of Turkey Accounting Standards, but after that “fair value” concept has come into question. In the study, properties held for rental income and appreciation are grouped seperately from the other properties, and this kind of properties are stated as investment properties and they are recognized in the framework of TAS 40 standards.

The purpose of the study is to address the differences between investment properties, which came into force with Turkey Accounting Standards, and their implementation, and to contribute to literature by recognizing possible application examples. Uniform System of Accounts is inadequate in recognition of investment properties. It will be easier to adapt to the innovations introduced by Turkey Accounting Standards and application union between users will be provided by making a number of changes in the Uniform Chart of Accounts in practise.

The differences arising from fair valuation of investment properties affects the profit or loss. Independant companies which has been athorized in this regard are needed for the determination of fair value of investment properties. In the expertise reports related to fair value of investment properties, non-objective evolution should be avoided.

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