IFRS real estate survey

December 2019

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1. Executive summary and key findings

The 2018 financial statements survey (hereinafter referred to as the 2018 Survey) is the seventh survey published by EY Global IFRS Real Estate Sector Group. In this survey, we provide an analysis of some of the key financial reporting issues of 53 real estate entities reporting under International Financial Reporting Standards (IFRS). Of these 53 entities, we categorised 43 entities as "investment property holding entities" and 10 as "development & construction entities". The distinction between the two categories is important because the entities in each category have different business models and are exposed to different risks and accounting issues.

The economic and regulatory environment has changed significantly over the last few years and the valuation of, and reporting on investment properties, continues to evolve.

In previous surveys, we analysed whether the changing environment impacted the level of disclosures in the financial reports of real estate investment entities, in particular, with respect to the adoption of IFRS 13 *Fair Value Measurement* in 2012 and crisis-related issues such as valuation uncertainty, debt covenants and "going concern" issues.

In this year's survey, we continued to focus on measurement/valuation of investment properties and the related disclosures. In addition, we addressed other areas of financial reporting that have recently attracted attention in the sector:

- We looked at the impact on real estate entities of the new accounting standards IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* that became effective for most entities in 2018.
- We considered the expected impact of accounting standards and interpretations that will become effective for most entities in 2019 and 2020, in particular, IFRS 16 Leases, IFRIC 23 *Uncertainty over Income Tax Treatments* and amendments to IFRS 3: *Definition of a Business*.
- A few real estate entities in the survey have recorded goodwill impairments in the last couple of years. We analysed how significant goodwill continues to be for real estate entities and to what extent goodwill impairments have been recorded.
- Alternative performance measures (APMs), such as funds from operations (FFO) or the measures published by the European Public Real Estate Association (EPRA), may supplement financial reporting for real estate entities and often represent an effective way of communicating important entity-specific developments. We explored the extent to which APMs have been used by real estate entities.
- In January 2015, the International Auditing and Assurance Standards Board (IAASB) issued its new and revised auditor reporting standards, which require auditors to provide more transparent and informative reports on the entities they audit. These standards have been issued in response to demand from users of financial statements, in the wake of the financial crisis, for more relevant information on audits. A particular area of focus within the new standards are the requirements of the new ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*. For audits of listed entities, a new section in the report called Key Audit Matters (KAMs), highlights those issues that, in the auditor's professional judgement, were of most significance in the audit. For most of the financial statements included in this survey, the auditor's reports included KAMs. We have investigated how many KAMs were included in the respective reports and which risks were highlighted.

Our 2018 Survey found that:

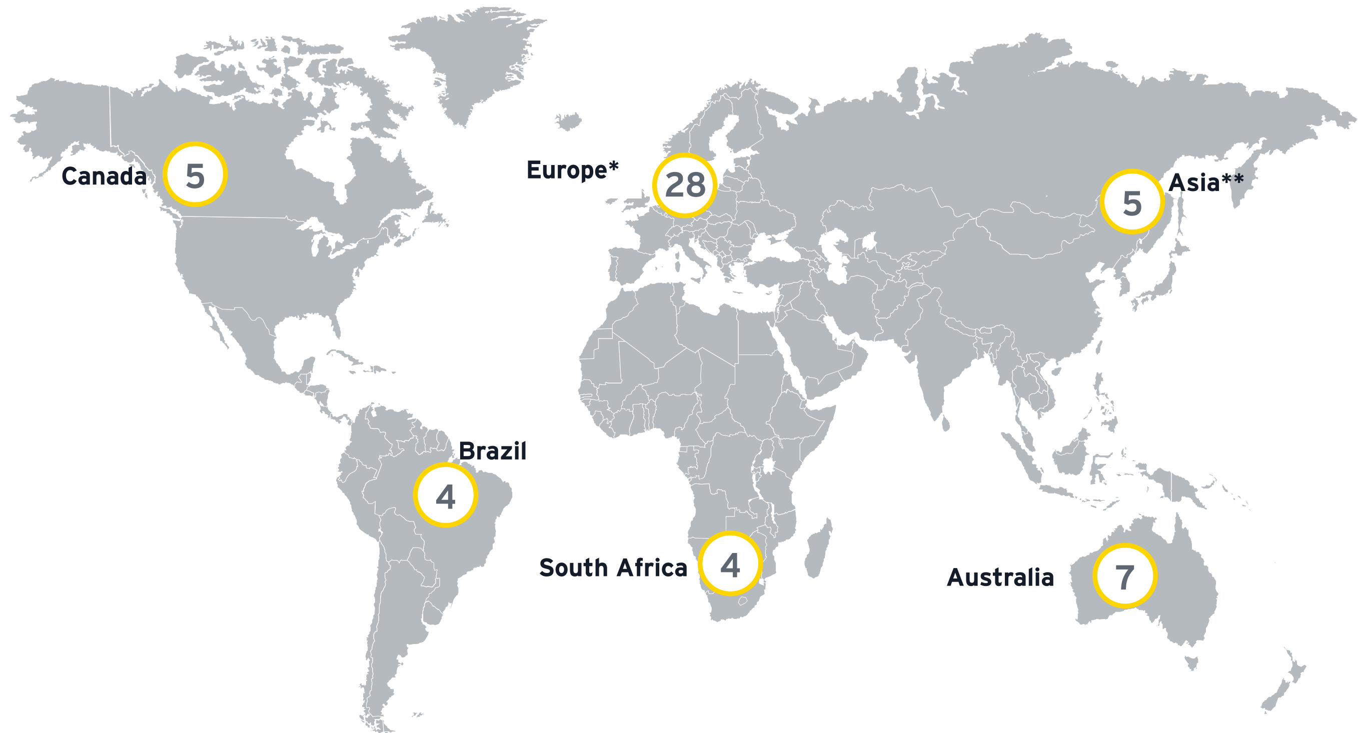
- Nearly unchanged compared to our 2012 survey, almost all surveyed entities belonging to the category "investment property holding entities" measured their investment properties using the fair value model (in contrast to the cost model). The techniques used to measure fair value were either discounted cash flow (DCF) methods or income capitalisation methods, or a mix of both of these valuation methods. Compared to our 2012 survey, we did not find any significant changes.
- Almost three out of four investment property holding entities (74%) assigned external experts to value substantially the whole portfolio of investment property, while only 11% of the entities relied (almost) exclusively on internal valuations.

- Almost all of the surveyed investment property holding entities categorised the fair value measurements of their investment property within Level 3 of the IFRS 13 fair value hierarchy, i.e., fair value measurements for which unobservable inputs are significant to the entire measurement.
- The number of inputs for which quantitative information was disclosed varied across the entities surveyed. However, the majority of investment property holding entities provided between three and seven quantitative inputs.
- The main inputs, for those entities that disclosed quantitative information, were discount rate, followed by net rent per sqm, exit yield, rental income and rental growth.
- While it is clear that for investment property measured at fair value, IFRS 13 requires only narrative information with respect to sensitivity, quantitative information on sensitivity may be useful for the users of financial statements. 74% of the surveyed investment property holding entities provided quantitative information on sensitivity.
- Of the entities in our survey that adopted IFRS 9 in 2018, the vast majority reported no, or only an immaterial, effect on the equity as a result of the adoption of IFRS 9.
- Of 36 surveyed investment property holding entities that have adopted IFRS 15, five entities reported that they have changed their accounting policies with respect to the presentation of service charges.
- For development & construction entities, the changes brought by IFRS 15 were more significant than for investment property holding entities, given that the major revenue stream for a development & construction entity typically comes from contracts with customers that are in the scope of IFRS 15. For two entities that were impacted by IFRS 15, we have included abstracts from their financial statements in which they described the resulting changes.
- With respect to the requirements in paragraph 44A of IAS 7 *Statement of Cash Flows*, 66% of the surveyed entities have disclosed a reconciliation between the opening and closing balances of financing liabilities to disclose changes in liabilities from financing activities.
- Only one entity reported that it has adopted IFRS 16 early. For entities that plan to adopt IFRS 16 in the future, the average increase in assets as a result of adoption is expected to be immaterial.
- With respect to the expected effects from the adoption of the amendments to IFRS 3 and IFRIC 23, none of the surveyed entities indicated that it expects a material impact from either of these standards/amendments.
- The vast majority of surveyed entities did not carry significant amounts of goodwill in their balance sheets. However, 17 of them carried more than an insignificant amount of goodwill in 2017 (i.e., a ratio of more than 1% in carrying amount of goodwill to total assets). Of these 17 entities, 41% recognised a goodwill impairment in 2018.
- There is still a lot of diversity with respect to the use of APMs in the industry. While the use of FFO is prominent in Australia and Canada, in Europe, the EPRA measures are more commonly used. Diversity is also observed in the use of APMs both within and outside the financial statements.
- Almost all of the financial statements in our 2018 Survey (on all of which an unqualified audit opinion was expressed), included KAMs in the auditor's reports. Typically, the KAMs most often addressed in the audit reports were valuation of investment property, revenue recognition and goodwill impairment.

2. The survey

The financial statements included in our survey stem from 53 publicly listed real estate entities from all over the world.

Figure 1: Geographical composition of the entire population by number of entities

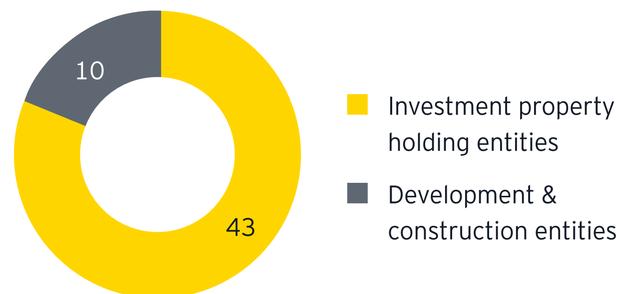


Of these 53 entities, we have categorised 43 as "investment property holding entities" and 10 entities as "development & construction entities".

The distinction between these two categories is important because each group has a different business model and is exposed to different risks and accounting issues.

For the 43 "investment property holding entities" in our survey, the proportion of investment properties in relation to total amount of asset was typically fairly high (i.e., higher than 70% for the vast majority of surveyed entities). The total value of the assets held by these entities in euros is more than EUR 600 billion, with an average total value of EUR 14 billion per entity.

Figure 2: Number of entities by category



* Germany: 4, United Kingdom: 4; France: 4; Spain: 4; Switzerland: 3; Poland: 3; Netherlands: 2; Belgium: 2; Czech Republic: 1, Austria: 1
** Singapore: 4; Japan: 1

For the 10 "development & construction entities" in our survey, investment properties typically did not present a significant portion of the total assets. The total amount of assets of these entities was around EUR 35 billion, with an average total amount of assets of EUR 3.5 billion per entity. This is significantly lower than the respective amount for the investment property holding entities.

While the vast majority of the financial statements included in our survey have 31 December as the fiscal year end date, some have earlier fiscal year end dates (e.g., many entities based in Australia have their fiscal year end dates on 30 June). Accordingly, there were some differences in respect of the date of initial application for certain accounting standards, such as IFRS 15 and IFRS 9. Entities are required to apply these standards for annual reporting periods beginning on or after 1 January 2018. This means that an entity with a fiscal year end date of 31 December would have adopted these standards in their 2018 financial statements, while an entity with a fiscal year end date other than 31 December will only need to adopt these standards for the first time in their 2019 financial statements.

The table below shows all of the entities included in our 2018 Survey, plus the country they are located in and the fiscal year end dates of the financial statements:

Company name	Country	Fiscal year end
General Property Trust	Australia	31 Dec 2018
Stockland Trust	Australia	30 Jun 2018
Scentre Group	Australia	31 Dec 2018
LendLease Group	Australia	30 Jun 2018
Vicinity Centres	Australia	30 Jun 2018
Goodman Group	Australia	30 Jun 2018
Abacus Property Group	Australia	30 Jun 2018
CA Immobilien Anlagen AG	Austria	31 Dec 2018
Befimmo SA	Belgium	31 Dec 2018
Cofinimmo SA	Belgium	31 Dec 2018
MRV Engenharia e Participações S.A	Brazil	31 Dec 2018
Tecnisa S.A.	Brazil	31 Dec 2018
Cyrela Brasil Realty S.A.	Brazil	31 Dec 2018
Gafisa S.A	Brazil	31 Dec 2018
Brookfield Property Partners L.P.	Canada	31 Dec 2018
Riocan REIT	Canada	31 Dec 2018
Dream Office REIT	Canada	31 Dec 2018
First Capital Realty Inc.	Canada	31 Dec 2018
Morguard Corp.	Canada	31 Dec 2018
CPI Property Group S.A.	Czech R.	31 Dec 2018
Gecina S.A.	France	31 Dec 2018
Klépierre SA	France	31 Dec 2018
Icade SIIC	France	31 Dec 2018
Unibail-Rodamco-Westfield SE	France	31 Dec 2018
Vonovia SE	Germany	31 Dec 2018
Deutsche Wohnen SE	Germany	31 Dec 2018
TLG Immobilien AG	Germany	31 Dec 2018

Company name	Country	Fiscal year end
alstria office REIT-AG	Germany	31 Dec 2018
Iida Group Holdings Co., Ltd.	Japan	31 Mar 2019
Wereldhave N.V.	Netherlands	31 Dec 2018
Vastned Retail N.V.	Netherlands	31 Dec 2018
EPP N.V.	Poland	31 Dec 2018
Globe Trade Centre S.A.	Poland	31 Dec 2018
Globalworth Real Estate Invest. Ltd.	Poland and Romania	31 Dec 2018
Ascendas-Singbridge Pte Ltd.	Singapore	31 Mar 2018
City Developments Ltd.	Singapore	31 Dec 2018
MapleTree Investments Pte Ltd	Singapore	31 Mar 2019
CapitaLand Ltd.	Singapore	31 Dec 2018
Growthpoint Properties Ltd.	South Africa	30 Jun 2018
Redefine Properties Ltd.	South Africa	31 Aug 2018
Emira Property Fund Ltd.	South Africa	30 Jun 2018
Accelerate Property Fund Ltd.	South Africa	31 Mar 2019
Merlin Properties SOCIMI S.A.	Spain	31 Dec 2018
Aedas Homes S.A.	Spain	31 Dec 2018
Neinor Homes S.A.	Spain	31 Dec 2018
Inmobiliaria Colonial SOCIMI S.A.	Spain	31 Dec 2018
PSP Swiss Property AG	Switzerland	31 Dec 2018
Mobimo Holding AG	Switzerland	31 Dec 2018
Implenia AG	Switzerland	31 Dec 2018
The British Land Company plc	UK	31 Mar 2019
Hammerson plc	UK	31 Dec 2018
Land Securities Group plc	UK	31 Mar 2019
Derwent London plc	UK	31 Dec 2018

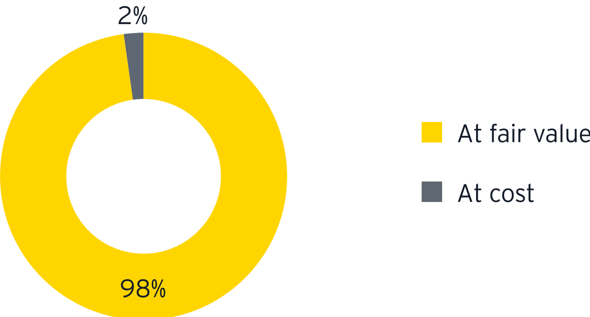
3. Measurement of investment property

3.1 Introduction

In this section, we focus only on the financial statements of the 43 entities in the "investment property holding entities" category, for which the proportion of investment properties in relation to total amount of asset is typically fairly high.

3.2 Fair value model versus cost model

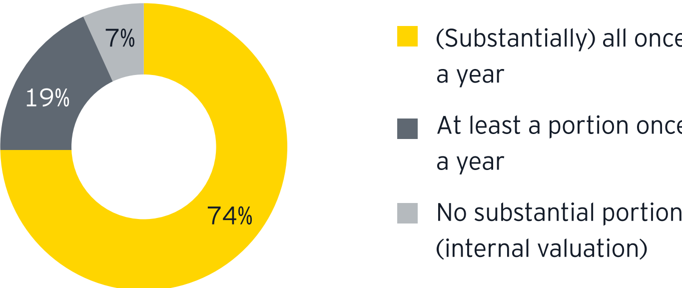
Figure 3: Measurement basis for investment property



IAS 40 *Investment Property* allows entities to choose as its accounting policy either the fair value model or the cost model and to apply that model to all of its investment properties. However, even if the cost model is applied, entities are required to disclose the fair values of their investment property (IAS 40.79 (e)) and, therefore, need to determine the fair value. Almost all of the surveyed entities (98% or 42 out of 43) applied the fair value model, which represents a slight increase in the popularity of the fair value model compared to our last survey in 2012, when 92% of surveyed entities applied that model. Only one entity, Icade, still applies the cost model. However, Icade provides extensive disclosures on the fair value measurement of its investment properties in the notes.

3.3 External or internal valuation

Figure 4: Extent to which portfolio of investment property is valued by external valuers



Entities holding investment property and choosing the fair value model are encouraged, but not required, to measure the fair value of these investment properties 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 property being valued (IAS 40.32). Despite the fact that the involvement of an independent (external) valuer is not mandatory, the vast majority of entities surveyed did involve independent (external) valuers: 74% of the entities surveyed assigned external experts to value substantially the whole portfolio of investment property, while a further 19% assigned external experts to value at least a (substantial) portion of their investment property. Only 7% of the entities surveyed performed (almost) exclusively internal valuations.

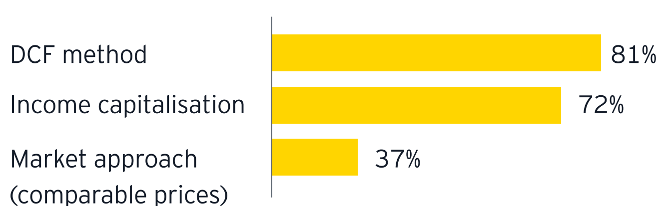
3.4 Valuation methodology

Our previous surveys have shown that investment property holding entities typically apply one or more of the following three valuation techniques to determine the fair value of their investment property:

While the first two methods are most often applied when valuing buildings and land, a market comparison method is often applied when valuing undeveloped land.

The following chart shows the extent to which the different valuation techniques have been applied by the entities in our 2018 Survey (multiple answers were possible):

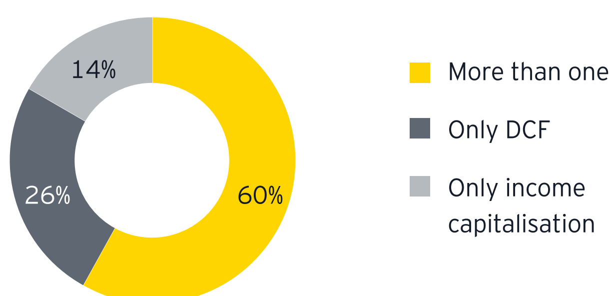
Figure 5: Valuation techniques used



Consistent with our findings in recent surveys, the DCF method is still the method applied by most entities, followed by the income capitalisation method and the direct market comparison method.

However, as the next chart shows, 60% of entities do not rely on the use of a single valuation method to value all of their properties, but rather use different techniques for different properties:

Figure 6: Combinations of valuation techniques used



Exclusive use of a single valuation method was observed by 40% of the entities we surveyed, of which 26% used the DCF method, while the remaining 14% used the income capitalisation method.

3.5 Highest and best use assumption

When determining the fair value of an investment property, an entity has to consider a market participant's ability to generate economic benefits by using the investment property in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use (IFRS 13.27). IFRS 13 defines the highest and best use as "the use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (e.g., a business) within which the asset would be used" (IFRS 13, Appendix A). An entity's current use of a non-financial asset is presumed to be its highest and best use, unless market or other factors suggest that a different use by market participants would maximise the value of the asset (IFRS 13.29). However, there may be situations in which the highest and best use of an investment property differs from its current use. In such a situation, an entity is required to disclose that fact and why the investment property is being used in a manner that differs from its highest and best use.

In our 2018 Survey, only four out of 43 entities valued any of their investment property based on a highest and best use assumption that differs from its current use.

One of these entities, PSP Swiss Property, made the following disclosures on investment property for which the highest and best use was different from its current use:

Extract 1: PSP Swiss Property (2018)

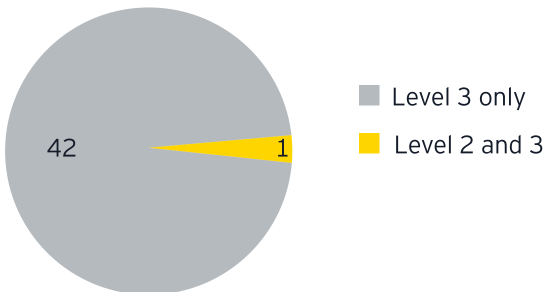
As at 31 December 2018, the independent valuation company identified eleven properties which may have significant optimization potential (2017: twelve Properties). The valuation company assessed these properties in accordance with IFRS 13 on the basis of the Highest and Best Use" concept as at the balance sheet date. At six of these properties in the Zurich region, specific clarifications are being made with regard to the implementation of potential usage optimizations. For three properties the basis for the usage optimization already exist. Likewise the optimizing of the use of one property in Lausanne was continued in dialogue with the city of Lausanne. At the remaining four properties (two in the area Basel and one in Zurich as well as one in Geneva), no concrete measures are planned at the moment.

3.6 Disclosures on assumptions and sensitivity

The disclosure of the assumptions used to measure the fair value of investment properties and the disclosure of the sensitivity of fair value measurements to changes in unobservable inputs continue to be important in light of both the continuing volatility and/or continuing rise of real estate values in many real estate markets, and the demands for transparency from both the users of financial statements and regulators.

The extent of disclosures on fair value measurement required by IFRS 13 depends on the Level (1, 2 or 3) of the fair value hierarchy within which the fair value measurement for a property (as a whole) is categorised. In this survey, we examined how the entities categorised the fair value measurements of their investment property:

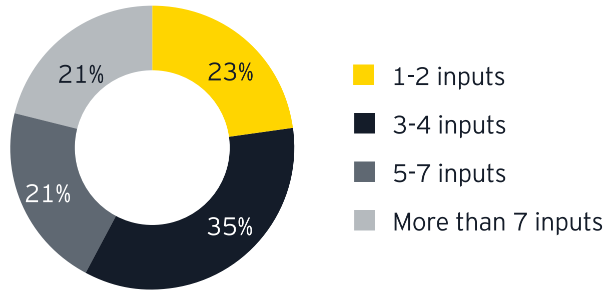
Figure 7: Level of fair value measurement category



While just one entity categorised the fair value measurement of their investment properties within two Levels (2 and 3), all of the other entities in the survey had exclusively categorised the fair value measurement of their investment properties within Level 3.

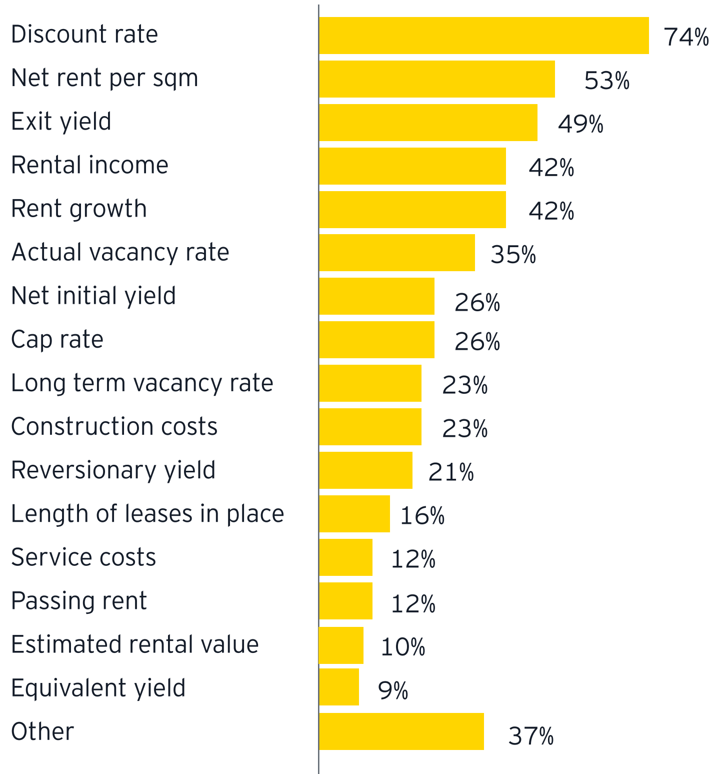
For Level 2 and Level 3 measurements, IFRS 13 requires the disclosure of the inputs used in the fair value measurement. Figure 8 shows the number of different inputs that the entities in the survey disclosed.

Figure 8: Total number of inputs used in fair value measurement that have been disclosed



The following table shows the percentage of entities that have provided disclosures on each of the inputs:

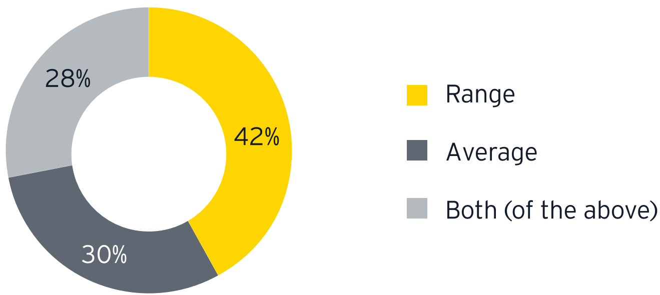
Figure 9: Types of inputs disclosed



IFRS 13 does not prescribe precisely how the quantitative disclosures of inputs used in the fair value measurement should be made. Illustrative example 17 (valuation techniques and inputs) accompanying IFRS 13 suggests that such disclosures could be made by providing a range of values, as well as a weighted average value for each input.

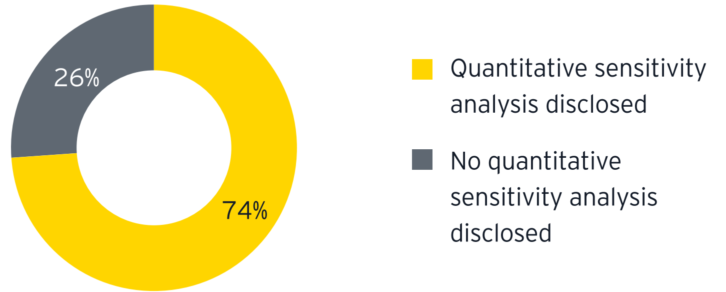
The following chart shows how the surveyed entities have provided the quantitative disclosures on inputs used in the fair value measurement, i.e., by presenting a range of values, by presenting an average value, or by presenting both:

Figure 10: Disclosure approaches for input value parameters



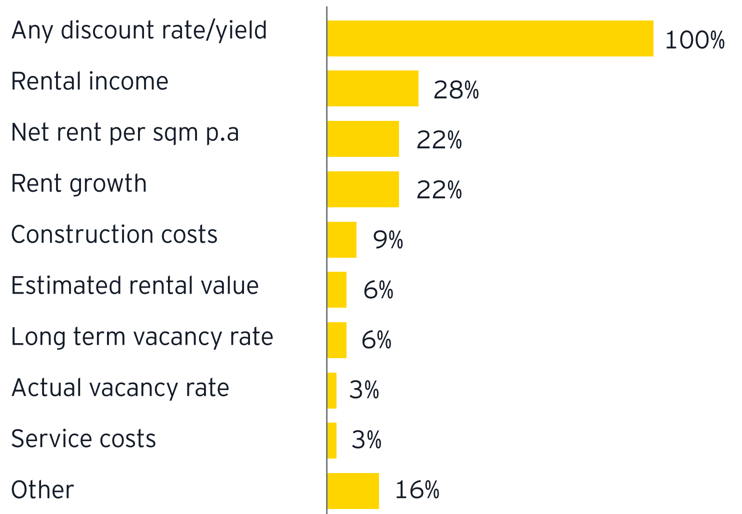
For Level 3 measurements, IFRS 13 requires a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs might result in a significantly different amount and, if applicable, a description of interrelationships between those inputs and other unobservable inputs and of how they might magnify or mitigate the effect of changes in the unobservable inputs. While it is clear that IFRS 13 requires only narrative information with respect to sensitivities, quantitative information on sensitivities may be useful for the users of financial statements. The following chart shows that the vast majority of entities surveyed (74%) have voluntarily provided quantitative information on sensitivities:

Figure 11: Disclosure of quantitative sensitivity analysis



For those entities that disclosed quantitative sensitivity information, we analysed the inputs for which the sensitivity information was provided. The chart below shows that all of these entities disclosed sensitivity information for at least discount rate or yield. However, we also observed that many entities provided additional sensitivity information for other inputs, such as rental income, net rent per sqm, rent growth or construction costs:

Figure 12: Sensitivity analysis by input



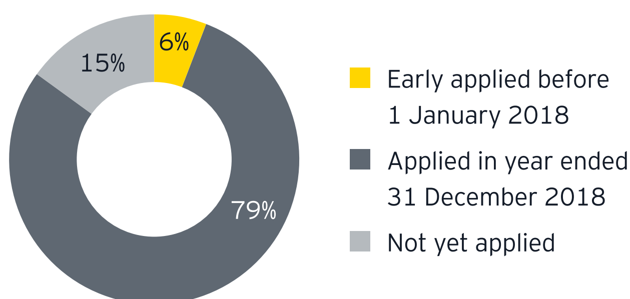
4. First-time application of new standards and amendments

4.1 Impact of application of IFRS 9

IFRS 9 was issued in 2014, bringing together the classification and measurement, impairment and hedge accounting sections of the International Accounting Standards Board's (IASB) project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. The standard became effective for annual periods beginning on or after 1 January 2018, while early application was permitted.

The following chart shows the number of entities surveyed that have early applied IFRS 9, applied IFRS 9 at its effective date or that have not yet applied IFRS 9, given that those entities had a fiscal year beginning before 1 January 2018:

Figure 13: Date of application of IFRS 9



For those entities that applied IFRS 9 in 2018, the majority experienced no, or only an immaterial, impact on equity as a result of the application of IFRS 9. In particular, none of the entities reported a significant impact from applying the new impairment loss model under IFRS 9.

However, as an exception, one entity, City Development Ltd. reported a material effect from the adoption of IFRS 9 in respect of unquoted equity instruments that had previously been measured at cost (under IAS 39) and now had to be measured at fair value (under IFRS 9). City Development Ltd. disclosed the following:

Extract 2: City Development Ltd (2018)

These equity investments represent investments that the Group and the Company intend to hold for the long term for strategic purposes. As permitted by SFRS(I) 9, the Group and the Company have designated these investments at the date of initial application as measured at FVOCI. Unlike FRS 39, the accumulated fair value reserve related to these investments will never be reclassified to profit or loss.

4.2 Impact of application of IFRS 15

IFRS 15 was issued in 2014 and became effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. IFRS 15 allows both full retrospective application, in which IFRS 15 must be applied for all periods presented in the financial statements (with some limited relief provided), or modified retrospective application, in which IFRS 15 is only applied in the current period presented in the financial statements (i.e., the initial period of application), with the cumulative effect of initially applying IFRS 15 recorded as an adjustment to the opening balance of retained earnings in the current period.

The following chart shows the number of entities surveyed that have applied IFRS 15 using: the full retrospective method; the modified retrospective method; entities that have not yet applied IFRS 15 (given that those entities had a fiscal year end before 31 December 2018)*:

Figure 14: Transition method applied under IFRS 15

4.2.1 Investment property holding entities

The major revenue stream for an investment property holding entity is typically rental income generated from its tenants. The accounting for rental income is scoped out of IFRS 15, as it falls within the scope of IAS 17 *Leases* or IFRS 16. However, services included in lease contracts (e.g., common area maintenance) give rise to revenue from non-lease components that need to be split out and accounted for separately in accordance with IFRS 15. When more than one party is involved in providing goods or services to a customer, IFRS 15 requires an entity to determine whether it is a principal or an agent in these transactions by evaluating

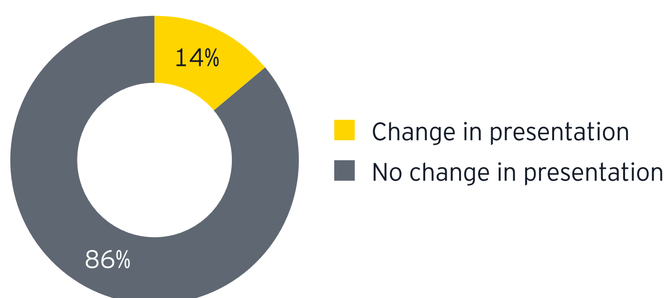
the nature of its promise to the customer. An entity is a principal (and, therefore, records revenue on a gross basis) if it controls a promised good or service before transferring that good or service to the customer. An entity is an agent

* In Brazil, real estate development entities, registered with the Brazilian Securities and Exchange Commission (CVM), have to prepare consolidated financial statements in accordance with Accounting Practices Adopted in Brazil and with International Financial Reporting Standards (IFRS), applicable to real estate development entities, in accordance with the guidance contained in CVM/SNC/SEP Circular Letter No. 02/2018, dated 12 December 2018, which provides guidance for the accounting procedures related to the recognition, measurement and disclosure of certain types of transactions arising from contracts for the purchase and sale of real estate units under construction. They have been excluded from this graph.

(and, therefore, records revenue at the net amount that it retains for its agency services) if its role is to arrange for another entity to provide the goods or services. The application guidance contained within IFRS 15 to determine whether an entity is acting as a principal or as an agent has changed compared to legacy revenue requirements in IAS 18. Hence, we have investigated whether, under IFRS 15, entities reached different conclusions on transition than they did previously. In this respect, we focused only on those entities in the investment property holding entities category in this survey.

The following chart shows the number of investment property holding entities surveyed that applied IFRS 15 in 2018 that changed their presentation of service charges in connection with the application of IFRS 15 because they reached a different conclusion about whether they are a principal or an agent:

Figure 15: Change in presentation of service charges



Of those entities that changed the presentation, we only observed one entity that changed the presentation for some elements of service charge income and expense from a gross to a net basis, while for all other entities, the change was from a net to a gross basis. One of the entities that changed its presentation is CPI Property Group S.A. which described this change in their 2018 financial statements, as follows:

Extract 3: CPI Property Group S.A. (2018)

Net versus gross revenue recognition

Before the adoption of IFRS 15, the Group analysed principal versus agent criteria stipulated by IAS 18 and concluded that it does not have an exposure to the significant risks and rewards associated with service charges and accounted for these transactions as if it was an agent. Under IFRS 15, control of the specified goods or services is the overarching principle to consider in determination whether an entity acts as a principal or an agent. The Group evaluated individual service charge arrangements and determined that it does control the services before they are transferred to tenants and therefore that the Group rather acts as a principal in the arrangements. Consequently, the Group changed, in respect of service charges, revenue recognition from net to gross, before deduction of costs of services.

Management also concluded that service revenue should no longer be presented separately from other service charges, because combined presentation of the service charges provides more relevant information about the business. More detail on service charge and other income is provided in note 2.2.

There is no impact of the IFRS 15 adoption on the statement of financial position as at 1 January 2017 and 31 December 2017. The presentation of the statement of profit or loss for the year ended 31 December 2017 was adjusted due to changes in accounting policy as follows:

	31.12.2017	Effect of IFRS 15 adoption	31.12.2017 adjusted
Gross rental income	262.1	-	262.1
Service revenue	10.8	(10.8)	-
Net service charge income	14.7	(14.7)	-
Service charge and other income	-	102.6	102.6
Cost of service and other charges	-	(77.1)	(77.1)
Property operating expense	(55.9)	-	(55.9)
Net rental income	231.7	-	231.7
Total revenues	438.2	77.1	515.4
Total direct business operating expenses	(166.4)	(77.1)	(243.6)
Net business income	271.8	-	271.8

Another entity that has changed its presentation with respect to service charges is alstria office REIT AG, which described this change in their 2018 financial statements, as follows:

Extract 4: alstria office REIT (2018)

The Group mainly generates revenues from the long-term leasing of real estate space. The accounting of these revenues is based on IAS 17 or, in the future, on IFRS 16 and is not subject to the requirements of IFRS 15. In addition, revenues are generated from the Group's own provision of real estate management services, which, however, are of subordinate importance in relation to the Group's total revenues. Proceeds from the sale of real estate assets are not reported under sales but in a separate line item, Net result from the disposal of investment property" and are also subject to the regulations of IFRS 15.

As part of the conclusion — also taking emerging industry best practices into consideration — it emerged that alstria assumes a principal position with regard to the service charge costs of letting and that these ancillary costs charged to the tenants are to be presented as revenues. The costs incurred relating to the provision of services in this context are presented as real estate operating expenses. This does not result in a change in net rental income. The following table shows how revenues and the corresponding expenses from property management increased in the 2017 and 2018 financial years compared to the balance sheet to be applied up to December 31, 2017.

EUR k	2018	2017
Revenue in accordance with IAS 18	193,193	193,680
Revenue in accordance with IFRS 15	232,353	231,067
Increase in revenue as result of application of IFRS 15	39,160	37,387
Expenses from property operating expenses due to presentation in accordance with IAS 18	(24,125)	(20,769)
Expenses from property operating expenses due to presentation in accordance with IFRS 15	(63,285)	(58,156)
Increase in operating expenses due to presentation in accordance with IFRS 15	(39,160)	(37,387)

Since alstria applies the retrospective approach with regard to the first-time application of IFRS 15, the comparative information in the consolidated financial statements 2018 has been adjusted for the corresponding periods of the 2017 financial year. Expenses and income from service charges in accordance with IFRS 15 are now presented gross, but their amount does not change. Therefore, the first-time application of IFRS 15 has no impact on the earnings position of the Group.

4.2.2 Development & construction entities

The changes brought by IFRS 15 were more significant for development & construction entities, than for investment property holding entities. This is because the major revenue stream for a development & construction entity typically results from contracts with customers that are in the scope of IFRS 15, while for investment property holdings entities, the major revenue stream is typically rental income, which is accounted for under IAS 17 or IFRS 16.

While many of the principles in IFRS 15 are similar to the legacy revenue requirements under IAS 11 *Construction Contracts*, IAS 18, and related Interpretations (including IFRIC 15 *Agreements for the Construction of Real Estate*) which were all replaced by IFRS 15, for some entities the pattern of revenue recognition for some or all of their arrangements has changed. Under IFRS 15, some development & construction entities were required to make additional judgements that they did not have to make under legacy revenue requirements. IFRS 15 also specifies the accounting treatment for certain items not typically thought of as revenue, such as certain costs associated with obtaining and fulfilling a contract and the disposal of certain non-financial assets (including investment property). Key issues for development & construction entities include:

- Identifying performance obligations
- Recognition of revenue at a point in time or over time. Refer to extract 5 where Implenia describes its accounting policy including the criteria for determining at which point in time revenue is recognised
- Accounting for contract modifications and the constraint on variable consideration. Refer to extract 5 where Implenia explains that it has changed its accounting policy due to IFRS 15.
- Evaluating significant financing components
- Measuring progress over time toward satisfaction of a performance obligation
- Recognising contract cost assets (including costs of obtaining a contract). Refer to extract 6 where City Developments explains that sales commissions are no longer expensed as incurred, but capitalised as costs to obtain a contract
- Presentation of contract assets and liabilities. Refer to extract 6 where City Development Ltd. explains the changes it made to the presentation of contract assets and liabilities due to IFRS 15
- Addressing disclosure requirements

It is also worth noting that under IAS 11, entities had to record assets for unbilled accounts receivable when revenue was recognised, but not billed. Once the invoice was submitted to the customer, the unbilled receivable was reclassified as a billed accounts receivable. Similarly, billings in excess of costs were generally recognised as liabilities. In contrast to this, IFRS 15 is based on the notion that a contract asset or a contract liability is generated when either party to a contract performs. In addition, an entity does not recognise a receivable until it has an unconditional right to receive consideration from the customer. Entities are required to present contract assets or contract liabilities in the statement of financial position or disclose them in the notes to the financial statements.

Further information on IFRS 15 can be found in our publication Applying IFRS, A closer look at IFRS 15, the revenue recognition standard (updated September 2019).

Extract 5: Implenia AG (2018)

IFRS 15 Revenue from Contracts with Customers

IFRS 15 Revenue from Contracts with Customers" replaces the standards IAS 11 Construction Contracts" and IAS 18 Revenue" as well as associated interpretations and are to be applied to revenue streams from contracts with customers. The provisions envisage a five-step model for recognizing revenue, which is applicable to all contracts with customers. Revenue for services supplied is to be recognized in the amount of the expected consideration. The point in time or period for recognizing revenue is based on the transfer of control to the customer.

In General Contracting, in Construction Works and for services, contractually agreed revenue is recognized over time. Sales of real estate are recognized at the moment in which control is transferred, i.e. at the time title is transferred, which is normally upon entry in the official land register. No material conversion effects resulted from this.

IFRS 15 contains more stringent guidelines regarding accounting for contract modifications. According to IFRS 15, revenue is only to be recognized if it is highly probable that significant amounts of revenue will not be reversed at a later date. Claims were previously capitalized if approval from the customer was probable. The reassessment of claims previously recognized as assets led to a reduction in equity of CHF 14.2 million after tax as at 1 January 2018. The balance sheet item trade receivables decreased by CHF 11.2 million as a result, work in progress by CHF 7.5 million and deferred tax liabilities by CHF 4.5 million.

Guarantee retentions are now reported under work in progress, since there is no unconditional right to consideration on such receivables. As a result, trade receivables were reduced by CHF 66.8 million as at 1 January 2018, while work in progress increased accordingly.

The balance sheet item for trade receivables was reduced by a total of CHF 78.1 million for the above mentioned reasons and the balance sheet item for work in progress increased by a total of CHF 59.3 million. These adjustments resulted in a reduction in deferred tax liabilities of CHF 4.5 million. Non-controlling interests decreased by CHF 0.4 million as a result.

A further deviation emerges from the reporting of claims that have not yet been approved. These will no longer be reported as value-adjusted receivables, as there is no unconditional right to consideration. Trade receivables only contain unconditional rights to consideration. The allowance for expected credit losses on trade receivables only contains allowances for unconditional receivables. The corresponding receivables and allowances associated therewith of CHF 78.0 million each were offset as at 1 January 2018. The balance sheet item for trade receivables did not change as a result.

Implenia applies the modified retrospective method for the conversion to IFRS 15. If Implenia had applied the replaced standards in the reporting period, group revenue and consequently profit before tax would have been around CHF 20 million higher. Consolidated profit and equity would have risen by around CHF 15 million.

Extract 6: City Developments Ltd (2018)

1. Success-based sales commissions

The Group and the Company pay sales commissions to both external and internal property sales agents for securing property sales contracts for the Group on a success basis. The Group and the Company previously recognized sales commissions as an expense when incurred, but now capitalizes such costs as costs of obtaining a contract under SFRS(I) 15 i.e. contract costs as they are incremental and are expected to be recovered. The capitalized costs are amortized consistently with the pattern of revenue recognized for the related contract.

2. Amortization of development costs

The Group and the Company previously recognized cost of sales on the sold units in its development projects by applying the percentage of completion on the relevant projects' total estimated construction costs. On adoption of SFRS(I) 15, the Group and the Company recognize such costs in profit or loss when incurred to the extent of units sold in a development project.

3. Borrowing costs

Arising from the tentative agenda decision issued by the IFRS Interpretation Committee (IFRIC) relating to the capitalization of borrowing costs for the construction of a residential multi-unit estate development where revenue is recognized over time, the Group has ceased capitalization of borrowing costs on its development properties.

4. Presentation of contract assets and liabilities

On adopting SFRS(I) 15, the Group and the Company have also changed the presentation of the following amounts:

- Contract assets in respect of the property development business which relate primarily to the Group's and the Company's right to consideration for work completed but have not been billed at the reporting date.

  Group: As at 31 December 2017, $139.5 million and $168.9 million (1 January 2017: $223.8 million and $371.2 million) which were presented as trade receivables" and development properties" respectively, under FRS have been reclassified to contract assets.

  Company: As at 31 December 2017, $8.8 million and $168.9 million (1 January 2017: $9.2 million and $272.1 million) which were presented as trade receivables" and development properties" respectively under FRS have been reclassified to contract assets.

- Contract liabilities in respect of the property development business which relate mainly to advance consideration received from customers and progress billings in excess of the Group's right to the consideration.

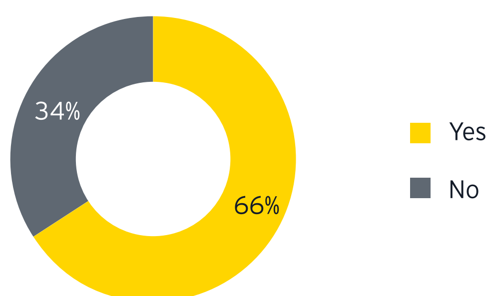
  Group: As at 31 December 2017, $356.3 million (1 January 2017: $403.2 million) which was presented as trade and other payables" under FRS has been reclassified to contract liabilities."

4.3 Impact of application of amendment of IAS 7

In January 2016, the IASB published amendments to IAS 7. The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The amendments were applicable for annual periods beginning on or after 1 January 2017. Under IAS 7, one way to fulfil these disclosure requirements is by providing a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities.

As real estate entities typically have significant liabilities from financing activities, we looked at how these new disclosure requirements have been implemented, i.e., whether or not the information provided by the entities was in the form of a reconciliation between the opening and closing balances of these liabilities. The outcome is shown in the chart below:

Figure 16: Use of a reconciliation to provide information on changes in financing liabilities



Yes

No

5. IFRS issued but not yet effective

5.1 Expected impact of application of IFRS 16

Real estate entities will need to change certain lease accounting practices when implementing the new leases standard, IFRS 16, issued by the IASB in 2016, which becomes effective for annual periods beginning on or after 1 January 2019.

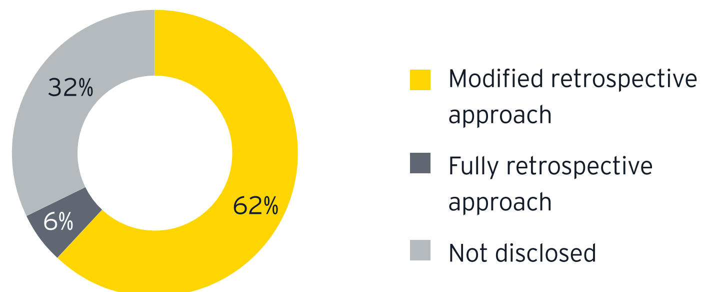
While IFRS 16 significantly changes the accounting for lessees that are real estate tenants, requiring them to recognise most leases (i.e., rental contracts) on their balance sheets as lease liabilities with corresponding right-of-use-assets, landlord/lessor accounting is substantially unchanged from current accounting. As with IAS 17, IFRS 16 requires landlords to classify their rental contracts into two types: finance leases and operating leases. Lease classification determines how and when a landlord recognises lease revenue and what assets a landlord records. In most circumstances, the profit or loss recognition pattern for landlords is not expected to change.

Under IFRS 16, an intermediate landlord accounts for the head lease by recognising lease liabilities with a corresponding right-of-use-asset and for the subleases similar to leases over owned assets. However, an intermediate landlord considers the lease classification criteria with reference to the remaining right-of-use asset rather than the underlying asset (e.g., a building subject to a lease) arising from the head lease when classifying a sublease as finance or operating. If a leased property meets the definition of investment property, the sublease is classified as an operating lease and the intermediate landlord elects the fair value model in IAS 40 as an accounting policy, IFRS 16 requires the intermediate landlord to measure right-of-use assets arising from leased property in accordance with IAS 40. This represents a change from the current scope of IAS 40. Under existing requirements, this is an election that is available on a property-by-property basis.

IFRS 16's transition provisions permit lessees to use either the full retrospective or the modified retrospective approach for leases existing at the date of initial application of the standard (i.e., the beginning of the annual reporting period in which an entity first applies the standard), with options to use certain transition reliefs. Only one of the entities surveyed has adopted IFRS 16 early.

In respect of disclosure of the different transition approaches the entities intend to apply when adopting IFRS 16, the majority of entities surveyed (62%) intend to apply the modified retrospective approach, while only a small proportion of the entities surveyed (6%) intend to apply the full retrospective approach. Approximately a third of the entities did not provide the related disclosure, presumably for reasons of materiality.

Figure 17: Transition method to be applied under IFRS 16



The vast majority of entities surveyed (49 of 53) made qualitative or quantitative disclosures on the expected effects that the adoption of IFRS 16 would have on their balance sheets and/or their equity. However, we found very few disclosures of the potential effects of IFRS 16 on the

income statement or the statement of cash flows. Under the assumption that for those entities which stated that the adoption of IFRS 16 would not have a material effect on their balance sheet and/or their equity, the respective effect is nil, we have calculated the unweighted average effects from adopting IFRS 16, as follows:

- An average expected increase in total assets by 0.7%
- An average expected increase in total liabilities by 1.2%
- The average expected impact on total equity was only marginal

Accordingly, on average the footprint of IFRS 16 in financial statements of entities in the real estate sector will not be as significant as can be observed in other sectors such as retail, utilities, telecommunication and airlines.

The entity in our 2018 Survey that expected the highest relative increase in assets and liabilities from the application of IFRS 16 was Implenia AG, a development and construction entity from Switzerland (i.e., not an investment property holding entity). Implenia AG provided the following disclosures on the expected impact of IFRS 16 in its 2018 financial statements:

Extract 7: Implenia AG (2018)

IFRS 16 Leases

The new standard concerning leases will be applied from 1 January 2019 and replaces IAS 17 Leases" as well as interpretations associated therewith.

Under IFRS 16, all assets and liabilities arising from leases must be recognized in the balance sheet unless the lease term is not more than twelve months or the asset is of minor value. The capitalization of leased assets and the recognition of lease obligations as liabilities will expand the balance sheet.

Implenia has material leases for real estate, large-scale equipment, vehicles and small machinery as well as site equipment. Leases for small machinery and site equipment often have a term of less than one year and are therefore not posted on the balance sheet under the new standard either.

Rights of use and lease liabilities of around CHF 160 million would have to be recognized at the reporting date. Recognition of rights of use would mainly relate to real estate and large-scale equipment. As a result of this balance sheet expansion, the equity ratio would decrease by approximately 1.1% at the reporting date while equity would remain virtually unchanged. Operating income before depreciation and amortization would have improved by CHF 68 million. Operating income in the reporting period would have been marginally higher. Conversion will lead to a reduction in rental expense. In contrast, depreciation and interest expense will be higher. The impact on profit before tax would be immaterial in the reporting period. Cash flow from operating activities would increase by CHF 65 million in the reporting period and cash flow from financing activities would decrease accordingly.

The extent of the balance sheet expansion depends on the number of pieces of large-scale equipment leased as at the reporting date, the company-specific interest rate and the assessment regarding the exercise of possible extension, purchase or cancellation options.

Implenia will apply the modified retrospective method for IFRS 16.

5.2 Expected impact of the amendments to IFRIC 23 and IFRS 3

5.2.1 IFRIC 23 Uncertainty over Income Tax Treatments

In June 2017, the IASB issued IFRIC 23. IFRIC 23 clarifies the accounting for uncertainties in income taxes. The interpretation has to be applied to determine the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12 *Income Taxes*. IFRIC 23 is effective for annual reporting periods beginning on or after 1 January 2019.

Our survey looked at the surveyed entities' disclosure of the possible impact that application of IFRIC 23 will have on their financial statements in the period of initial application. None of the entities surveyed indicated that they expect a material impact from this new interpretation. One entity was not in a position to finally assess impact effects as it had not finished its analysis.

5.2.2 Amendments to IFRS 3 *Definition of a Business*

In the real estate sector, the question whether the acquisition of real estate constitutes a business combination or the acquisition of a group of assets has been discussed for a long time. One of our earlier surveys highlighted significant differences in how entities in the real estate sector determine whether an acquisition qualifies as a business combination, which reinforces the view that the determination was subject to judgement.

In October 2018, the IASB issued amendments to IFRS 3 aimed at resolving some of the difficulties that arise when an entity determines whether it has acquired a business or a group of assets. The amendments are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020.

Our survey looked at the surveyed entities' disclosure of the possible impact that application of the amendments to IFRS 3 will have on their financial statements in the period of initial application. None of the entities surveyed indicated that it expects a material impact from applying IFRS 3. One entity was not in a position to assess the effects of any impact as it had not completed its analysis.

6. Goodwill and impairment

Goodwill in the real estate sector typically arises on the acquisition of a business as a result of the following factors:

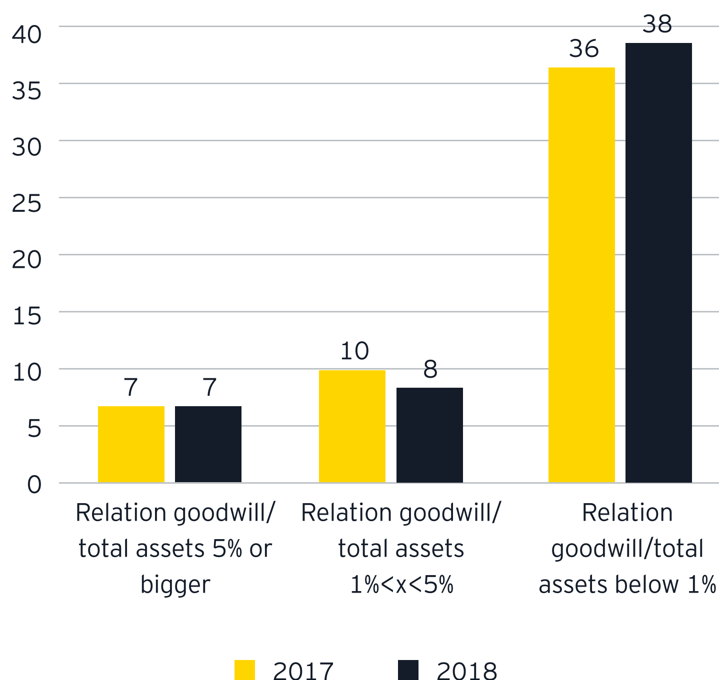
- Synergies of the acquired portfolio and synergies of combining portfolios (e.g., anticipated abilities of the acquired management/development team to outperform the market or achieve economies of scale)
- The requirement to measure identifiable items using a measurement basis other than fair value – typically deferred taxes measured at nominal value
- Overpayments

We looked at the extent to which goodwill was recognised in the entities' financial statements at year end 2018 and for the comparative period by determining the percentage of the carrying amount of goodwill in relation to total assets. We then categorised the entities, as follows:

- Entities with goodwill amounting to 5% of total assets or more
- Entities with goodwill amounting to more than 1% but less than 5% of total assets
- Entities with goodwill amounting to less than 1% of total assets

The following chart shows the outcome of this analysis for 2017 and 2018, which demonstrates that the majority of surveyed entities do not carry significant amounts of goodwill on their balance sheets:

Figure 18: Relative significance of goodwill



For those entities surveyed that, as of year-end 2017, had goodwill amounting to 1% or more of total assets (17 entities in total) we investigated:

- Whether any goodwill impairment was recorded in the subsequent year of 2018. And, if so
- How large the impairment was relative to the carrying amount of goodwill at the preceding year end in 2017

We found that 41% of those entities incurred goodwill impairment charges in 2018, and the average (unweighted) impairment charge amounted to 27% of the carrying amount of goodwill at the preceding year end. Some entities explained that the increase in real estate values was a cause for goodwill impairment.

7. Alternative performance measures

Alternative performance measures (APMs), such as FFO, or the measures published by EPRA, often supplement GAAP-reporting for real estate entities and represent an effective way of communicating important entity specific developments and make them comparable with peers.

The EPRA is a non-profit organisation based in Brussels and represents the interests of listed European real estate entities. EPRA's purpose is in broadening the understanding of investment opportunities in listed real estate entities in Europe as an alternative to traditional assets. In order to improve the comparability of real estate entities and to present property-specific issues, EPRA has created a framework for standard reporting beyond IFRS requirements.

We analysed the extent to which APMs have been used by the 43 entities that we categorised as "investment property holding entities", for which the proportion of investment properties in relation to total amount of asset is typically fairly high.

We found the following:

- All of the surveyed entities used some kind of APMs, even though not necessarily FFO or one of the EPRA measures
- FFO was presented by 40% of the surveyed entities, primarily by entities located in Australia, Canada and Germany. Most of these entities presented FFO in the Management Discussion and Analysis (MD&A)/ management commentary and other sections of the annual report outside the financial statements. Interestingly, some entities in Australia also presented FFO within the financial statements as part of their segment reporting disclosures.
- The EPRA measures were presented by 50% of surveyed entities, in particular, by European real estate entities.
- Typically, EPRA measures were presented outside the financial statements. However, a few entities also presented EPRA measures within the financial statements, one of those entities being Derwent London plc (see below).
- Approximately 30% of the entities surveyed used a separate section in their annual report to present EPRA measures.
- Some of the entities located in South Africa did not use EPRA measures, but, instead, used other similar measures.

As pointed out above, Derwent London plc was one of the entities that included EPRA measures in their notes to financial statements. An extract of this note showing the summary table of EPRA measures is presented below:

Extract 8: Derwent London plc (2018)

38 EPRA Performance measures

Summary table

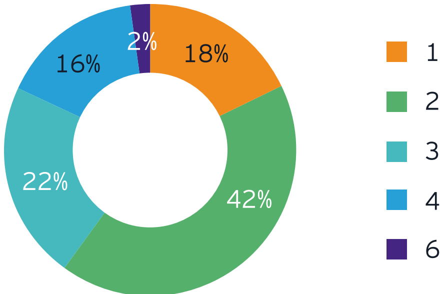
	2018		2017	
		Pence per share p		Pence per share p
EPRA earnings	£126.1m	113.07	£105.0m	94.23
EPRA net asset value	£4,220.8m	3,776	£4,153.1m	3,716
EPRA triple net asset value	£4,131.1m	3,696	£4,042.8m	3,617
EPRA vacancy rate	1.8%		1.3%	
EPRA cost ratio (including direct vacancy costs)	23.3%		20.8%	
EPRA net initial yield	3.4%		3.4%	
EPRA topped-up" net initial yield	4.6%		4.4%	

8. Key audit matters (KAMs)

In January 2015, the International Auditing and Assurance Standards Board issued its new and revised auditor reporting standards, which require auditors to provide more transparent and informative reports on the entities they audit. These standards have been issued in response to demand from users of financial statements, in the wake of the financial crisis, for more relevant information on audits. A particular area of focus within the new standards is the requirements of the new ISA 701. For audits of listed entities, a new section in the report, Key Audit Matters, highlights those issues that, in the auditor's professional judgement, were of most significance in the audit. These are areas where there might be a higher risk of material misstatement or where significant management or auditor judgements are involved. ISA 701 includes a judgement-based decision-making framework to help auditors decide which issues from the audit would constitute KAMs.

In almost all of the financial statements in our survey (on all of which an unqualified audit opinion was expressed), the auditor's report included KAMs. We analysed how many KAMs were included in the respective reports. The chart below shows that most audit reports included two or three KAMs:

Figure 19: Number of KAMs that have been addressed in the audit reports



The chart below shows the three topics that were most often addressed as KAMs in the audit reports:

Figure 20: Areas for which KAMs have been prepared

Not surprisingly, for those entities that we categorised as "investment property holding entities" the percentage of audit reports in which a KAM" valuation of investment property was included was almost 100%.

A similar observation was made with respect to audit reports of entities in our survey categorised as "development & construction entities" for which the relative frequency of the KAM "Revenue recognition" was significantly higher than that for those entities categorised as "investment property holding entities": For development & construction entities", seven of nine (78%) audit reports that included KAM included a KAM on "Revenue Recognition", while for investment property holding entities the corresponding number was only 18%.

The relative frequency of the KAM "Goodwill impairment" is quite significant, considering that the carrying amount of goodwill typically makes up only a minor portion of a real estate entities' total assets. However, this is consistent with our observation in section 6 above that, for the entities surveyed that carried more than an insignificant amount of goodwill in 2017, there was a high likelihood of a significant goodwill impairment in 2018.

9. Looking ahead

Our survey shows that, while in some areas of financial reporting of real estate entities, a high degree of global consistency has already been achieved (especially in respect of the increased use of the fair value model compared with the cost model) and there is greater consistency in related disclosures, significant diversity in disclosures remains in many areas which makes it difficult for investors to directly compare entities.

The major new accounting standards that have been issued in the recent years — IFRS 9, IFRS 15 and IFRS 16 — will likely not leave a significant footprint in the financial statements of investment property holding entities, while in particular, in respect of IFRS 15, the impact for development & construction entities may be more significant. It remains to be seen to what extent these new standards will impact the degree of consistency or diversity in financial reporting of real estate entities.

Real estate entities should closely monitor the IASB's Primary Financial Statements projects, which is part of the IASB's plan to promote "Better Communication in Financial Reporting". The objective of this project is to improve the primary financial statements with a focus on the statements of financial performance. The IASB is also proposing a reduction in the number of presentation choices for items in the statement of financial performance and statement of cash flows to make it easier for investors to compare entities' performances and evaluate their future prospects. A number of illustrative examples of statements of financial performance are expected to be included in an exposure draft in order to illustrate the IASB's proposal. The IASB expects to publish an exposure draft at the end of 2019. This project may have far reaching consequences for real estate entities.

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Notes

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