Accounting for
Real Estate Transactions
- in India

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Trivia?

- Which AS is applicable to Developers?
  - AS 7 Construction Contracts
  - AS 9 Revenue Recognition
  - Something else
- Sale of flats, for the purpose of accounting is
  - Goods
  - Services
  - Partly goods, partly services

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Problem in accounting….

- Real estate transactions are unique
  - It is spread over more than one accounting period
  - Diverse format of transaction structure
- AS 9 does not provide adequate clarity on timing and basis for recognizing revenue for real estate transaction
- Divergent views and accounting treatment / practices
- Other challenges - Need to make accounting estimates - project cost, percentage completed, etc

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Indian accounting norms

- AS 7 – POCM – Not Applicable
- AS 9 – Transfer of risks and rewards – but when!
- Guidance note (May 2006) - Recognition of Revenue by Real Estate Developers
- Guidance note (Rev Feb 2012) - Accounting for Real Estate Transaction

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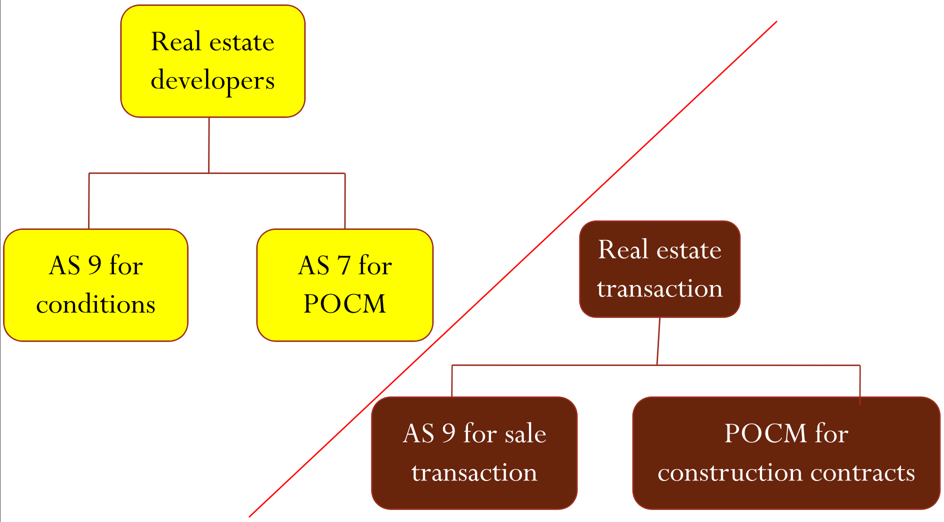
Guidance note



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Old guidance note says….

- SIGNIFICANT Risks are -
  - Price risk is considered to be most significant risk
  - The buyer has legal right to sell or transfer his interest
- Then follow POCM as per AS 7

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Old guidance note did not say.....

- Whether land cost should be included in computing the POCM for threshold limit and for recognizing revenue
- Whether interest / borrowing cost should be included in computing percentage completion
- What should be the minimum threshold for commencing revenue recognition

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Accounting policies of some real estate co.'s

Name	Accounting Policy	Gist
Orbit Corporation Limited	Revenue is recognised under "Percentage Completion Method" i.e. it is based on percentage of actual costs incurred to date to the total estimated costs subject to such actual cost incurred being 25 per cent or more of the total estimated project cost. Land costs are not included in actual costs and estimated costs.	- POCM - 25% threshold - land cost not included for percentage completion
Puravankara Projects Limited	Revenue is being recognized on "Percentage Completion Method" i.e. revenue is based on percentage of actual costs to the total estimated costs, where estimated costs include estimated construction, development, proportionate land cost, and other directly attributable costs under construction. Land Costs are not included for purpose of computing percentage completion.	- POCM - Threshold not defined - land cost not included for percentage completion

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Accounting policies of some real estate co.'s

Name	Accounting Policy	Gist
DLF	Revenue is recognized on "Percentage Completion Method" i.e. revenue is based on percentage of actual project costs to estimated project costs subject to such actual cost incurred being 30 per cent or more of the total estimated project cost. Estimated project cost includes cost of land/ development rights, borrowing costs, overheads, estimated construction and development cost of such properties. Review of estimates costs are done periodically and effects of changes are recognized and where project cost is estimated to exceed project revenue loss is recognized immediately. Revenue from SEZ projects is recognized on the basis mentioned above and in accordance with Co-developer Agreements / Memorandum of understanding.	–POCM –30% threshold –land cost included
HDIL	Company follows "Project Completion Method" i.e. expense incurred during the year are debited to work-in-progress account and income is accounted when the projects get completed/substantially completed. Revenue is recognized to the extent it is probable and can be reliably measured.	–Project completion method

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New guidance note applies to...

- Transitional provisions:
  - Projects commencing on or after 1st April 2012
  - Projects which have commenced earlier but where revenue is being recognized for the 1st time on or after 1st April 2012
  - Option to apply this GN from an earlier date provided the GN is applied to all transactions after the chosen (earlier) date
- Covers all types of real estate transactions – land, plots with and without development, development agreement, building, TDR, etc.

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POCM

- Cost incurred / Total cost of the project * 100
- Project Cost
  - Cost of land & development rights - including rehabilitation cost, brokerage cost, stamp duty etc
  - Borrowing cost – directly incurred on the project or which are apportioned to the project
  - Construction & development cost relating to project
    - Materials and labour
    - Approval cost
    - Depreciation of plant & machinery
    - Insurance cost
    - Cost like general administration, selling expenses etc should not be included in the cost of construction

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Project means….

- Project is smallest group of unit / plot/ saleable space which are linked with a common set of amenities in such a manner that unless the common amenities are made available and functional, the units / plot / space cannot be put to their intended effective use
- Large developments can be split into smaller projects if the basic conditions are fulfilled
  - For example each tower or a group of tower could be designated as project or a complete township could also be considered as a project
  - The classification would depend on facts and circumstances of each case

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Conditions imposed....

- All critical approvals necessary for the commencement of the project are obtained
  - environmental clearance,
  - approval of plans,
  - designs,
  - title to land or other rights for development,
  - change in land use, etc
- Stage of completion of the project reaches a reasonable level of development
  - i.e. expenditure on Construction & Development (this excludes cost of land and borrowing cost) is not less than 25% of the estimated Construction & Development cost of the project

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Conditions imposed....

- Atleast 25% of the saleable area is secured by contracts or agreement or other legally enforceable documents with buyers
- Atleast 10% of the contracted amount are realized at the reporting date in respect of each of the contracts.
  - The compliance of this clause should be done agreement-wise and not on overall basis.

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A few points to remember….

- Land and borrowing cost to be excluded for calculating threshold limit and while computing the revenue, it should be included
- Onerous contract - When the project cost exceed the eligible project revenue the expected loss should be recognized immediately
- The percentage completion method is applied on a cumulative basis in each reporting period to the current estimate of project revenue and project cost.
  - Change in estimate of project cost & revenue is considered to change in accounting estimate
- Guidance Note does not prohibit methods like survey of work, technical estimation, etc for determining of stage of completion provided the revenue as per other methods is not higher than the revenue on the basis of project cost incurred.

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Disclosures….

- Project revenue recognized & method used
- Method of determination of stage of completion
- Aggregate amount of cost incurred and profit recognized,
- Amount of advances received, work in progress, inventory
- Unbilled revenue i.e. excess of revenue over actual bills raised

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Illustration 1

Total Saleable Area	20,000 sq ft
Land cost	Rs. 300 lacs
Estimated construction & development cost	Rs. 300 lacs
Total area sold	5,000 sq ft
Total sale agreement value	Rs. 200 lacs
Amount realized	Rs. 50 lacs
Cost incurred till date (incl. land)	Rs. 360 lacs

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Illustration 2

Total Saleable Area	20,000 sq ft
Land cost	Rs. 300 lacs
Estimated construction & development cost	Rs. 300 lacs
Total area sold	5,000 sq ft
Total sale agreement value	Rs. 200 lacs
Amount realized	Rs. 50 lacs
Cost incurred till date (incl. land)	Rs. 390 lacs

- Final answer –
  - Revenue to be recognized at 65 % of Rs 200 lacs i.e. Rs 130 lacs
  - Cost [5000/20,000*390] Rs 97.50 lacs
  - Work in progress – Rs 292.50 lacs
  - Profit – Rs 32.50 lacs

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Old vs. New

Particulars	Old Guidance Note	Revised Guidance Note
Objective	▪ Recommended principles of revenue recognition for real estate transactions	▪ More broader – also provides the basis in which principles of AS 7 and AS 9 to be applied, more detailed principles for recognizing revenue, etc.
Definition of term real estate	▪ Referred to land as well as building	▪ Refers to land as well as buildings and rights in relation thereto
Scope	▪ No specific scope but only covered principles of revenue recognition	▪ Covers all forms of real estate transactions like sale of plots of land with or without development , development and sale of residential and commercial premises , Acquisition, utilization and transfer of TDR, Joint Development, Redevelopment etc

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Old vs. New

Particulars	Old Guidance Note	Revised Guidance Note
Definitions	▪ No definitions provided	▪ Definition of various terms used in the guidance note are provided [example –project, project cost etc]
Revenue Recognition	▪ If conditions specified by AS-9 for revenue recognition satisfied than revenue to be recognized using principles of AS-7	▪ If economic substance of transactions is like construction contract revenue should be recognized using principles of AS-7 ▪ If the economic substance is similar to sale of goods than principles of AS-9 should be used
Application of POCM	▪ No guidance provided	▪ Detailed guidance note provided . Also additional conditions like threshold limit, collection, minimum sales etc defined

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Old vs. New

Particulars	Old Guidance Note	Revised Guidance Note
Calculation of threshold limit of 25%	▪ No guidance provided ▪ AS-7 was required to referred to for guidance	▪ Guidance provided as to what items should be considered for calculation of threshold limit of 25%
Acquisition, Utilization and sale of TDR	▪ Not covered	▪ Covered
Disclosure requirements	▪ No disclosure requirements prescribed other than disclosure of accounting policy	▪ Additional disclosure requirements have been prescribed

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Old vs. New Impact analysis

All conditions specified in 5.3 of GN satisfied				Revised GN	Old GN (land cost was excluded)
Total saleable area	20000	sft	Total estimated cost	600.00	300.00
Land cost	300.00	lacs	Actual cost incurred	390.00	90.00
Estimated construction and development cost	300.00	lacs	stage of completion	65%	30%
Total area sold	5000	sft	Revenue to be recognised	130.00	60.00
Total sale agreement value	200.00	lacs	cost allocated		
Amount realized	50.00	lacs	Land	48.75	22.50
cost incurred including land cost	390.00	lacs	cost of construction	48.75	22.50
			Total	97.50	45.00
			Profit for the period	32.50	15.00

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IFRIC 15 - Agreement for Construction of Real Estate

- *Sale of flats = IAS 18 Revenue (Goods/ Service) or IAS 11 Construction Contract*
- *IAS 11 – Developer is "Contractor"*
  - *buyer is able to specify major structural elements or the design or changes therein*
  - *Revenue recognized based on stage of completion*
- *IAS 18 – Sale of goods*
  - *limited ability to influence the design of the real estate (right to choose from limited options)*
  - *Revenue recognized when possession is transferred*

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IFRIC 15 - Agreement for Construction of Real Estate

- *IAS 18 – Rendering of Services*
  - *Customer supplies construction materials*
  - *Revenue recognized based on stage of completion*

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Thank you

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