Ind AS Impact on Real Estate

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Guidance Note issued by ICAI

- The ICAI issued a Guidance note specifying the application Principles of Ind AS 18, Revenue for the real estate sector.
- The Guidance Note has to be applied by all entities to applying Ind AS.
- The Guidance note specifies transfer of legal title to the buyer as one of conditions for indicating completion of project.

Application of Principles of Ind AS 18 in Respect of Sale of Goods to a Real Estate Project

- The following conditions indicating completion of the project have to be fulfilled to apply the principles of Ind AS 18, Revenue:
- the entity has transferred to the buyer the significant risks and rewards of ownership of the real estate; Where transfer of legal title is a condition precedent to the buyer taking on the significant risks and rewards of ownership and accepting significant completion of the seller's obligation, revenue should not be recognised till such time legal title is validly transferred to the buyer.
- the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the real estate sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the entity; and
- the costs incurred or to be incurred in respect of the transaction can be measured reliably.

For which construction contracts, Percentage of Completion Method(POC) should be applied?

- The POC Method should be applied to transactions where the economic substance is similar to construction contracts, which are indicated as below:
- Duration of the project exceeds 12 months and extends beyond one accounting period
- Features of the project include, land development, structural engineering, architectural design, construction etc,
- While individual units of the project are contracted to be delivered to different buyers these are interdependent upon or interrelated to completion of a number of common activities and/or provision of common amenities.
- The construction or development activities form a significant proportion of the project activity.

When can an entity apply POC?

- The POC can be applied only when the outcome of the real estate project can be estimated reliably when the events given below are completed:
- All critical approvals necessary for commencement of the project have been obtained.These include, wherever applicable: (i) Environmental and other clearances. (ii) Approval of plans, designs, etc. (iii) Title to land or other rights to development/ construction. (iv)Change in land use.
- When the stage of completion of the project reaches a reasonable level of development. A reasonable level of development is not achieved if the expenditure incurred on construction and development costs is less than 25 % of the construction and development costs
- Atleast 25% of the saleable project area is secured by contracts or agreements with buyers.
- Atleast 10 % of the contract consideration as per the agreements of sale or any other legally enforceable documents are realised at the reporting date in respect of each of the contracts and it is reasonable to expect that the parties to such contracts will comply with the payment terms as defined in the contracts.

Example

- Peace Ltd. is a construction company. It has 20 agreements of sale. 25% of the gross amount is recognised for 5 contracts and 10% of the gross amount is recognised for 10 agreements.
- Ind AS Application –
- Revenue can be recognised with respect to the 15 agreements only.
- When the outcome can be reasonably estimated, the project revenues and project costs can be recognized as revenue and expenditure by reference to the stage of completion of the project activity at the reporting date.
- For computation of revenue the stage of completion is arrived at with reference to the entire project costs incurred including land costs, borrowing costs and construction and development costs. Other methods like surveys of work done, technical estimation, etc can be used, however it should not exceed the revenue computed with reference to the 'project costs incurred' method.

How will an entity account for expected losses?

- When it is probable that total project costs will exceed total eligible project revenues, the expected loss should be recognised as an expense immediately.
- The amount of such a loss is determined irrespective of:
  - commencement of project work; or
  - the stage of completion of project activity.

Accounting for Sale of Land or Plots

- Sale of plots of land without any development Revenue from sale of land or plots should be recognised when all the condition of Completion of the project as specified above as fulfilled.
- Sale of plots with development which fulfil conditions of construction, the revenue will be recognized on POC basis on fulfillment of conditions mentioned above.

Transferable Development Rights (TDRs)

- When development rights are acquired by way of direct purchase or on development or construction of built- up area, cost of acquisition would be the cost of purchases or amount spent on development or construction of built-up area, respectively.
- Where development rights are acquired by way of giving up of rights over existing structures or open land, the development rights should be measured in accordance with the principles of exchange of assets enunciated in paragraphs 45 to 47 of Ind AS 38, Intangible Assets.
- When development rights are utilised in a real estate project by an entity, the cost thereof should be added to the project costs.
- When development rights are sold or transferred, revenue should be recognized when the conditions of completion of project as specified above are fulfilled.

Transactions with Multiple Elements

- An entity may contract with a buyer to deliver goods or services in addition to the construction/development of real estate.
- In such cases, the contract consideration should be split into separately identifiable components including one for the construction and delivery of real estate units.
- The consideration received or receivable for the contract should be allocated to each component on the basis of the fair value of each component.