



# **Accounting and Recognition of Revenue for Real Estate Developers**

**CA. Vishal P. Doshi**

- AS 1 – Disclosure of Accounting Policies
- AS 2 – Valuation of Inventories – not applicable to **work in progress arising under construction contracts**
- AS 7 – Construction Contracts
- AS 9 – Revenue Recognition
- Guidance Note on Accounting for Real Estate Transactions (revised 2012)
- Income Computation and Disclosure Standards



# Income Computation and Disclosure Standards

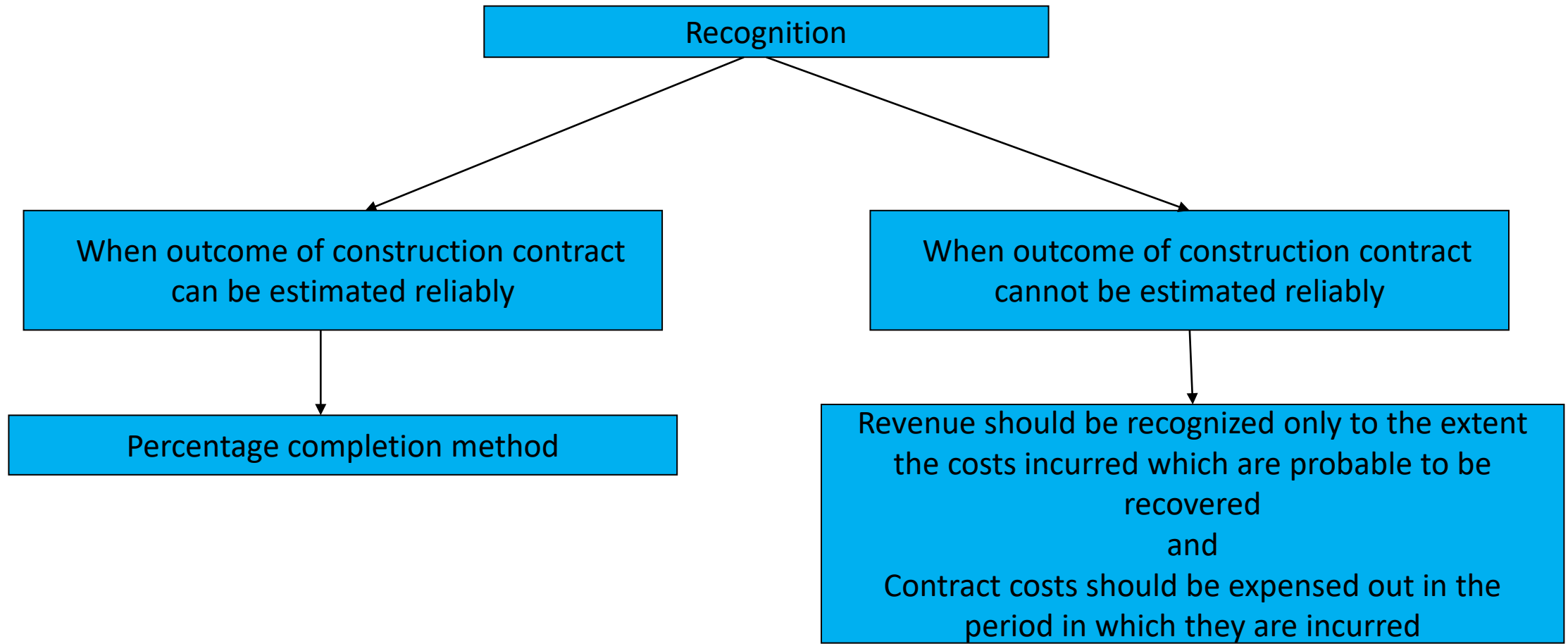
**Clarifications on Income Computation and Disclosure Standards (ICDS) notified under section 145(2) of the Income-tax Act, 1961 dated 23rd March, 2017**

Question 12: Since there is no specific scope exclusion for real estate developers and Build -Operate- Transfer (BOT) projects from ICDS IV on Revenue Recognition, please clarify whether ICDS-III and ICDS-IV should be applied by real estate developers and BOT operators. Also, whether ICDS is applicable for leases.

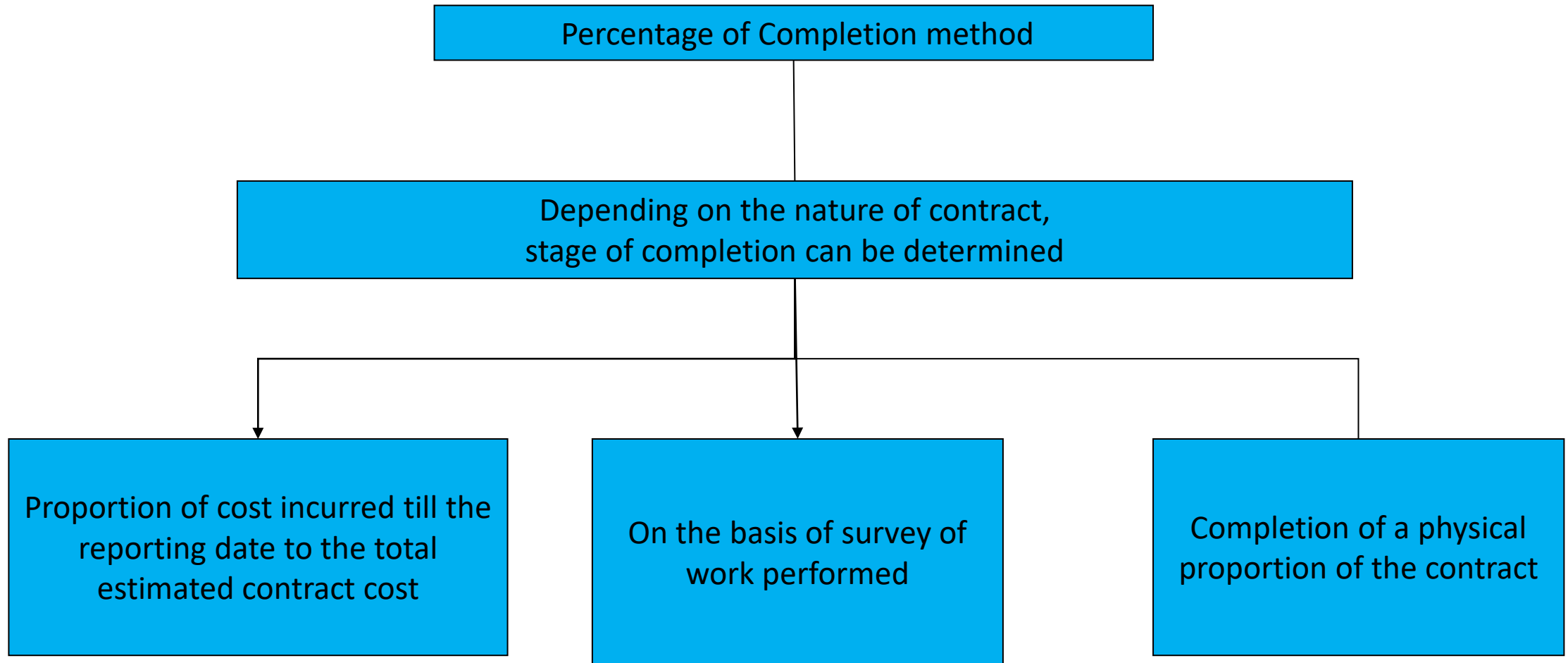
**Answer:** At present there is no specific ICDS notified for real estate developers, BOT projects and leases. Therefore, relevant provisions of the Act and ICDS shall apply to these transactions as may be applicable.

CBDT issues Draft ICDS on real estate transactions: public comments invited by 26th May, 2017

# Recognition of Revenue (AS 7)



# Percentage of Completion Method (AS 7)



# Percentage of Completion Method (AS 7)

Outcome of **construction contract** =

Contract revenue - contract cost

(with reference to stage of completion)

- Contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expense and profit which can be attributed to the proportion of work completed.
- In case of expected loss, recognize it as expense immediately.
- In case of uncertainty about the collectability of an amount already included in contract revenue which is already recognized in profit and loss statement, is recognized as an expense rather than adjusting it in the contract revenue

- » **Project** is defined as the smallest group of units/plots/saleable spaces which are linked with a common set of amenities in such a manner that unless the common amenities are made available and functional, these units /plots / saleable spaces cannot be put to their intended effective use.
- » A larger venture can be split into smaller projects if the basic conditions as set out above are fulfilled. For example, a project may comprise a cluster of towers or each tower can also be designated as a project. Similarly, a complete township can be a project or it can be broken down into smaller projects.
- » **Project costs** in relation to a project ordinarily comprise
  - a) Cost of land and cost of development rights -All costs related to the acquisition of land, development rights in the land or property including cost of land, cost of development rights, rehabilitation costs, registration charges, stamp duty, brokerage costs and incidental expenses.
  - b) Borrowing Costs – In accordance with Accounting Standard (AS) 16, *Borrowing Costs* which are incurred directly in relation to a project or which are apportioned to a project.
  - c) Construction and development costs – These would include costs that relate directly to the specific project and costs that may be attributable to project activity in general and can be allocated to the project.

# Real Estate Transactions



- » Real estate activities and transactions take diverse forms like sale of land (developed or undeveloped), or construction, development or sale of units that are not complete at the time of entering into agreements.
- » The typical features of most construction/development of commercial and residential units have all features of a construction contract – land development, structural engineering, architectural design and construction are all present. The natures of these activities are such that often the date when the activity is commenced and the date when the activity is completed usually fall into different accounting periods.
- » Real estate sales take place in a variety of ways and may be subject to different terms and conditions as specified in the agreement for sale. Accordingly, the point of time at which all significant risks and rewards of ownership can be considered as transferred, is required to be determined on the basis of the terms and conditions of the agreement for sale.



# Transfer of significant risks and rewards

- » In case of real estate sales, the seller usually enters into an agreement for sale with the buyer at initial stages of construction. This agreement for sale is also considered to have the effect of transferring all significant risks and rewards of ownership to the buyer provided the agreement is legally enforceable and subject to the satisfaction of conditions which signify transferring of significant risks and rewards even though the legal title is not transferred or the possession of the real estate is not given to the buyer.
- » Once the seller has transferred all the significant risks and rewards to the buyer, any acts on the real estate performed by the seller are, in substance, performed on behalf of the buyer in the manner similar to a contractor.
- » Further, where individual contracts are part of a single project, although risks and rewards may have been transferred on signing of a legally enforceable individual contract but significant performance in respect of remaining components of the project is pending, revenue in respect of such an individual contract should not be recognised until the performance on the remaining components is considered to be completed on the basis of the aforesaid principles.

# Percentage completion method



## Some indicators of transactions/activities are:

- a) The period of such projects is in excess of 12 months and the project commencement date and project completion date fall into different accounting periods.
- b) Most features of the project are common to construction-type contracts, viz., land development, structural engineering, architectural design, construction, etc.
- c) 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.
- d) The construction or development activities form a significant proportion of the project activity.

# Percentage completion method



**This method is applied when the outcome of a real estate project can be estimated reliably and when all the following conditions are satisfied:**

- a) total project revenues can be estimated reliably;
- b) it is probable that the economic benefits associated with the project will flow to the enterprise;
- c) the project costs to complete the project and the stage of project completion at the reporting date can be measured reliably; and
- d) the project costs attributable to the project can be clearly identified and measured reliably so that actual project costs incurred can be compared with prior estimates.

# Percentage completion method

**Revenue recognition under the percentage completion method is applied only when all the following conditions are fulfilled:**

- a) All critical approvals necessary for commencement of the project have been obtained. These include:
  - (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
- b) When the stage of completion of each project reaches a reasonable level of development. There is a rebuttable presumption that a reasonable level of development is not achieved if the expenditure incurred on project costs is less than 25% of construction and development costs.
- c) At least 25% of the estimated project revenues are secured by contracts or agreements with buyers.
- d) At least 10% of the total revenue as per agreements of sale or any other legally enforceable documents are realized at reporting date in respect of each contract and it is reasonable to expect that parties to such contracts will comply with payment terms in the contracts.

# Revenue recognition



- » 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.
- » The method of determination of stage of completion with reference to project costs incurred is the preferred method.
- » However, computation of revenue with reference to other methods of determination of stage of completion should not, in any case, exceed the revenue computed with reference to the 'project costs incurred' method.

# Project costs



- » The project costs which are recognised in the statement of profit and loss by reference to the stage of completion of the project activity are matched with the revenues recognised resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed.
- » Costs incurred that relate to future activity on the project and payments made to sub-contractors in advance of work performed under the sub-contract are excluded and matched with revenues when the activity or work is performed.
- » 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:
  - (a) commencement of project work; or
  - (b) the stage of completion of project activity.

# Changes in estimates



- » The percentage of completion method is applied on a cumulative basis in each reporting period to the current estimates of project revenues and project costs.
- » The effect of a change in the estimate of project costs, or the effect of a change in the estimate of the outcome of a project, is accounted for as a change in accounting estimate.
- » The changed estimates are used in determination of the amount of revenue and expenses recognised in the statement of profit and loss in the period in which the change is made and in subsequent periods.
- » The changes to estimates also include changes arising out of cancellation of contracts and cases where the property or part thereof is subsequently earmarked for own use or for rental purposes. In such cases any revenues attributable to such contracts previously recognised should be reversed and the costs in relation thereto shall be carried forward and accounted in accordance with AS 10, *Accounting for Fixed Assets*.

# #ViShare

**#ViShare** #01

## Cut off Procedures

### Purchase of Goods

Goods received after end of year/period  
(Inco-Terms: **EXW, FCA, FAS, FOB, CFR, CIF, CIP, CPT**)

**Recognition in Balance Sheet**

- ✓ 01 Inventory as Raw Material / Traded Goods in Transit
- ✓ 02 Trade Payables / Creditors

**Measurement**

- ✓ 01 Invoice Value (in case of imports: foreign currency translated into INR)  
+ All directly attributable costs from seller's premises / port to location of consignment on cut-off date
- ✓ 02 Lower of Cost or Net Realisable Value (subject to Para 24 of AS -2 and Para 32 of Ind AS 2)

Impact on Profit or Loss will be Nil

**#ViShare** #02

## Cut off Procedures

### Sale of Goods

Bill of Lading / receipt of goods after end of year/period  
(Inco-Terms: **FCA, FAS, FOB, CFR, CIF, CIP, CPT**)

**Recognition in Balance Sheet**

- ✓ 01 Inventory as Finished Goods in Transit
- ✓ 02 Reversal of Trade Receivables / Debtors (if sale has been recognized)

**Measurement**

- ✓ 01 At manufacturing cost similar to other Finished Goods  
+ All directly attributable costs from factory / warehouse to location of goods on cut off date (already debited to Statement of Profit & Loss)
- ✓ 02 Lower of Cost or Net Realisable Value

- If inventory has already been recognized at cost, there will be no impact on Profit or Loss
- If sales has been recognized, then sale and profit / loss thereon will be derecognized



Subscribe to Receive Snippets

Send "Hi" in Whatsapp to

**+91 85118 31981**

To subscribe #ViShare Circulations  
Send "Hi" in Whatsapp to +91 85118 31981

[www.vishaldoshi.in](http://www.vishaldoshi.in) | [vishal.doshi@kcmehta.com](mailto:vishal.doshi@kcmehta.com)



To subscribe #ViShare Circulations  
Send "Hi" in Whatsapp to +91 85118 31981

[www.vishaldoshi.in](http://www.vishaldoshi.in) | [vishal.doshi@kcmehta.com](mailto:vishal.doshi@kcmehta.com)







**www.vishaldoshi.in**

