GUIDANCE NOTE ON ACCOUNTING FOR REAL ESTATE TRANSACTIONS

1. Objective

The objective of this Guidance Note is to recommend accounting treatment for entities dealing in Real Estate as Sellers or Developers. The term 'real estate' refers to land as well as buildings and rights in relation thereto. Entities who undertake such activity are generally referred to by different terms such as 'real estate developers', 'builders' or' property developers'.

2. Scope

The Guidance Note covers all forms of transactions in real estate.

An illustrative list of transactions which are covered by this Guidance Note is as under

(a) Sale of plots of land (including long term sale type leases) without any development.

(b) Sale of plots of land (including long term sale type leases) with development in the form of common facilities like laying of roads, drainage lines and water pipelines, electrical lines, sewage tanks, water storage tanks, sports facilities ,gymnasium, club house, landscaping etc.

(c) Development and sale of residential and commercial units, row houses, independent houses, with or without an undivided share in land.

(d) Acquisition, utilisation and transfer of development rights

(e) Redevelopment of existing buildings and structures.

(f) Joint development agreements for any of the above activities

3. AS 7 or AS 9

The Guidance Note primarily provides guidance on application of percentage of completion method where it is appropriate to apply this method as explained in subsequent paragraphs as such transactions and activities of real estate have the same economic substance as construction contracts. For this purpose, the Guidance Note draws upon the principles enunciated in Accounting Standard (AS) 7, Construction Contracts. In respect of transactions of real estate which are in substance similar to delivery of goods principles enunciated in Accounting Standard (AS) 9, Revenue Recognition, are applied.

4. Date of Applicability

This Guidance Note should be applied to all projects in real estate which are commenced on or after April 1, 2012 and also to projects which have already commenced but where revenue is being recognised for the first time on or after April1, 2012. An enterprise may choose to apply this Guidance Note from an earlier date provided it applies this Guidance Note to all transactions which commenced or were entered into on or after such earlier date.

5. Project Costs

Project costs in relation to a project ordinarily comprise:

(i) Cost of land and cost of development rights: All the cost of acquisition of land, Development of land i.e. rehabilitation costs, registration charges, stamp duty, brokerage costs and incidental expenses.

(ii) Borrowing Cost*:* In accordance with AS 16, Borrowing Costs, which are incurred directly in relation to a project or which are apportioned to a project

(iii) 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.

The below cost are incurred on specific or general basis to the project. These are allocated to the project on rational and consistent basis.

(a) Insurance;

(b) Costs of design and technical assistance that is not directly related to a specific project;

(c) Construction or development overheads; and

(d) Borrowing cost

6. Project Revenues

Project revenues include revenue on sale of plots, undivided share in land, sale of finished and semi-finished structures, consideration for construction, consideration for amenities and interiors, consideration for parking spaces and sale of development rights.

Project revenues are measured as the consideration received or receivable. The measurement of project revenues is affected by a variety of uncertainties that depend on the outcome of future events. The estimates often need revision as events occur and uncertainties are resolved. Therefore, the amount of project revenue may increase or decrease from one reporting period to the next.

7. Contract for sale of Land and Real Estate Assets

Revenue and cost are to be recognised once the sale transaction is complete.

All the conditions of AS 9 Revenue are to be satisfied:

- all significant risks and rewards of ownership and the seller retains no effective control of the real estate to a degree usually associated with ownership
- The seller has effectively handed over possession of the real estate unit to the buyer forming part of the transaction
- No significant uncertainty exists regarding the amount of consideration that will be derived from the real estate sales; and
- It is not unreasonable to expect ultimate collection of revenue from buyers

8. Construction Contract

Application of 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:

- total project revenues can be estimated reliably;
- it is probable that the economic benefits associated with the project will flow to the entity;
- the project costs to complete the project and the stage of project completion at the reporting date can be measured reliably; and
- 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.

Under Percentage completion Method there is a rebuttable presumption that the outcome of a real estate project can be estimated reliably and that revenue should be recognised under the percentage completion method only when the events in(a) to (d) below are completed.

(a) All the critical approvals necessary for commencement of the project have been obtained

(b) If the expenditure incurred on the construction and development costs is less than 25%, nothing is recognised as in the profit and loss A/C of the contract.

(c) At least 25% of the saleable project area is secured by contracts or agreements with buyers.

(d) At least 10 % of the contract consideration as per the agreements of sale are realised at the reporting date in respect of each of the contracts.

9. 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:

(a) Commencement of project work; or

(b) The stage of completion of project activity.

10. Transferable Development Rights

(i) 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 recorded either at fair market value or at the net book value of the portion of the asset given up whichever is less. For this purpose, fair market value may be determined by reference either to the asset or portion thereof given up or to the fair market value of the rights acquired whichever is more clearly evident.

(ii) When development rights are sold or transferred, revenue should be recognised when both the following conditions are fulfilled:

(a) Title to the development rights is transferred to the buyer; and

(b) It is not unreasonable to expect ultimate realisation of revenue.

11. Transactions with Multiple Elements:

- An enterprise may contract with a buyer to deliver goods or services in addition to the construction/development of real estate [e.g. property management services, sale of decorative fittings (excluding fittings which are an integral part of the unit to be delivered), rental in lieu of unoccupied premises, etc.]. 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 market value of each component.
- The accounting of each of the components should be in accordance with AS 9Revenue Recognition or AS 7 Construction Contracts.

12. Disclosure

An entity should disclose:

(a) The amount of project revenue recognised as revenue in the reporting period;

(b) The methods used to determine the project revenue recognised in the reporting period; and

(c) The method used to determine the stage of completion of the project.

An entity should also disclose each of the following for projects in progress at the end of the reporting period:

a) the aggregate amount of costs incurred and profits recognised (less recognised losses) to date;

b) the amount of advances received;

c) the amount of work in progress and the value of inventories; and

d) Excess of revenue recognised over actual bills raised (unbilled revenue)