

Accounting for Real Estate Transactions

*Unlocking value through
Redevelopment*

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Types of Real Estate Projects

Residential

Commercial

Plotted
Development

Coverage

Revenue Recognition (AS/GN/Ind-AS)

Accounting policies of Real Estate Companies

Borrowing Cost Capitalisation

Operating Cycle of Real Estate Entities

Revenue Recognition (Accounting Standard & Guidance Note)

What is a Project? & Why it is relevant?

Project

Project is 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.

Relevance

Impact Revenue Recognition Computation

Capturing of Cost

Allocation of Land / FSI Cost

AS 9-Revenue Recognition

Revenue should be recognised when following conditions have been fulfilled:

The seller has transferred to the buyer **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

It is not **unreasonable** to expect ultimate collection of revenue from buyers

Methods of Revenue Recognition



Percentage of Completion Method (POCM)

Project Completion Method (PCM)

It is important to note that under IGAAP, Revenue can be recognised only by using Percentage of Completion Method (POCM).

AS 9-Revenue recognition(Guidance Note for Real Estate Transactions)

Percentage of Completion Method (POCM)

Revenue is recognized as per the stage of completion of the project on year-to-year basis during the development of the project.

Objective and Scope

Guidance Note for Real Estate Transactions

Objective

1.1 The objective of this Guidance Note is to recommend the accounting treatment by enterprises dealing in 'Real Estate' as sellers or developers.

The term 'real estate' refers to **land as well as buildings** and rights in relation thereto.

Enterprises who undertake such activity are generally referred to by different terms such as 'real estate developers', 'builders' or 'property developers'.

Scope

1.2 This Guidance Note covers **all forms of transactions** in real estate. An illustrative list of transactions covered:

- (Sale of plots of land (including long term sale type leases) without any development
- (Sale of plots of land with development in the form of common facilities (roads, drainage, water pipelines, electrical lines, sewage, club house, landscaping, etc.)
- (Development and sale of residential and commercial units, row houses, independent houses, with or without an undivided share in land
- (Acquisition, utilisation and transfer of development rights
- (Redevelopment of existing buildings and structures
- (Joint development agreements for any of the above activities

Project Costs:

Guidance Note — Costs to Be Considered at the Time of Revenue Recognition

Project Cost Categories

(a) Cost of Land & Development Rights

Acquisition of land, development rights, rehabilitation costs, registration charges, stamp duty, brokerage & incidental expenses.

(b) Borrowing Costs

As Per AS 16 — costs incurred directly in relation to a project or apportioned to a project.

(c) Construction & Development Costs

Costs directly related to the project and costs attributable to project activity that can be allocated.

Excluded Costs

Not part of construction/development costs if material:

- (General administration costs
- (Selling costs
- (Research and development costs
- (Depreciation of idle plant and equipment
- (Cost of unconsumed/uninstalled material at site
- (Payments to sub-contractors in advance of work performed

Direct Construction & Development Costs

- (Land conversion costs, betterment charges, municipal sanction fee & building permissions
- (Site labour costs, including site supervision
- (Costs of materials used in construction/development
- (Depreciation of plant & equipment used for the project
- (Costs of moving plant, equipment & materials to/from site
- (Costs of hiring plant and equipment
- (Costs of design & technical assistance directly related to the project
- (Estimated costs of rectification & guarantee work, including warranty costs
- (Claims from third parties

Allocable Costs

Attributable to project activity, allocable to specific projects:

- (Insurance
- (Design & technical assistance not directly related to a specific project
- (Construction or development overheads
- (Borrowing costs

Allocated using systematic & rational methods, applied consistently based on normal level of project activity.

Project Revenues:

Guidance Note — Components, Measurement & Uncertainties

Revenue Components

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**
- ✓ Sale of **development rights**

Measurement

Project revenues are measured as the **consideration received or receivable**.

Uncertainties

The measurement of project revenues is affected by a **variety of uncertainties** that depend on the outcome of future events.

Estimates often need **revision** as events occur and uncertainties are resolved.

The amount of project revenue may **increase or decrease** from one reporting period to the next.

POCM: Application of Percentage Completion Method

Guidance Note — Paragraphs 5.1 & 5.2

When to Apply POCM

Applied to all real estate transactions where economic substance is similar to **construction contracts**. Key indicators:

- (a) Duration of projects is **beyond 12 months** and commencement & completion dates fall into **different accounting periods**
- (b) Most features are common to construction contracts — **land development, structural engineering, architectural design, construction**
- (c) Individual units contracted to different buyers are **interdependent** upon completion of common activities and/or provision of **common amenities**
- (d) Construction or development activities form a **significant proportion** of the project activity

Conditions for Reliable Estimation

Applied when the outcome can be estimated reliably and **ALL** of 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 **costs to complete** the project and the **stage of completion** at the reporting date can be measured reliably
- (d) Project costs can be **clearly identified and measured reliably** so that actual costs incurred can be compared with prior estimates

When all conditions are met, revenues & costs are recognised applying the percentage of completion method.

Key Principle: Project revenues and project costs should be recognised as revenue and expenses respectively by applying the percentage of completion method (AS 7).

Conditions stated under Guidance note of ICAI for following POCM

- 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.
- The project costs attributable to the project can be clearly identified and measured reliably so that the actual project costs incurred can be compared with prior estimates.

Conditions stated under Guidance note of ICAI for following POCM

All critical approvals obtained.

Reasonable level of development is achieved (25% of **Costs threshold**). Such costs would exclude land costs but include borrowing costs.

25% of Project revenues secured by Agreements

10% of Total revenue are realised in respect of each contract.

Once threshold is achieved then we have to divide Cost incurred till end of reporting period by Estimated Project Cost for determining revenue to be recognised.

Further Conditions for Application of POCM – All four conditions to be satisfied

Rebuttable presumption — Revenue recognised under POCM only when events (a) to (d) are completed

(a) Critical Approvals Obtained

All **critical approvals** necessary for project commencement, including:

- (i) Environmental and other clearances
- (ii) Approval of plans, designs, etc.
- (iii) Title to land or other development/construction rights
- (iv) Change in land use

(b) Reasonable Level of Development

Stage of completion must reach a **reasonable level of development**.

A reasonable level is **NOT achieved** if expenditure on construction and development costs is **less than 25%** of total construction and development costs as defined in Para 2.2(c) read with Paras 2.3 to 2.5.

(c) 25% Saleable Project Area Secured

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

(d) 10% Revenue Realised

At least **10%** of **total revenue** as per agreements of sale or other legally enforceable documents are realised at the reporting date for **each contract**, and it is reasonable to expect parties will comply with payment terms.

E.g., If 10 agreements of sale exist and 10% of gross amount is realised in 8 of them, revenue can be recognised for those 8 agreements.

Accounting for sale of land or plots

Sale of plots of land without any development

- Revenue from sale of plots land without any development should be recognised when all risks and rewards relating to it are transferred.

Sale of developed plots

- Revenue from Sale of developed plots, where the development activity is significant, percentage completion method is used to account for such sales.

Accounting for Tenancy Development Rights (TDR's)

When TDR's are acquired by way of direct purchase or on development or construction of built-up area, the cost of acquisition will be part of the project cost

Accounting for JDA - Developers

Measurement Principles

Area Share:

- Cost of Area Share to be provided for Land/ development rights received under JDA is measured at the fair value of the estimated construction service rendered to the landowner and the same is accounted on launch of the project.

OR

- Total Construction Cost, including Construction Cost of units to be handed over to land owner is to be allocated to Revenue Recognition of units available for sale.

Revenue Share:

Corresponding % of share to be given would be net off from the total revenue of the project.

Two Types of Revenue Share:

- a) Fixed Consideration
- b) Variable Consideration

Accounting for JDA - Landowners

Terms of JDA:

Revenue Share

Area Share

Non-Refundable
Security Deposits

Timing of Revenue
Recognition

What is a Joint Development Project / Private Society Redevelopment Project

A Joint Development Project is a partnership where a landowner provides a vacant or underutilised plot of land, and a developer brings the capital, technical expertise, and marketing to build a new project.

Ownership: The landowner usually retains title to the land while granting the developer "development rights" via a registered **Joint Development Agreement (JDA)** and a Power of Attorney (PoA).

Consideration: Instead of an upfront cash payment for the land, the owner typically receives a fixed percentage of the newly constructed area (e.g., specific flats) or a share of the revenue from sales. (Asset light model)

Benefits: The landowner avoids the hassle of construction, while the developer saves on the high upfront cost of land acquisition.

A Private Redevelopment Project specifically involves **demolishing an existing old building** (typically an aging housing society) and replacing it with a modern structure.

Parties Involved: Usually occurs between a **Co-operative Housing Society (CHS)** and a private developer.

Consideration for Owners: Existing residents typically receive:

- 1) A brand-new flat in the same location, often with **additional carpet area**.
- 2) **Rent compensation** during the construction period.
- 3) A "corpus fund" (one time lumpsum cash payment) to the society members.

What happens when Land is not Owned by us ?

Monetary Consideration	Non Monetary Consideration
Payment of revenue share to JDA partner	Constructed premises (New flat in place of existing flat)
Payment of rent, corpus, shifting charges to original members of existing society / slum dwellers	

Accounting of Monetary Consideration

Present Value of all future obligations as per JDA to be accounted on Day 1

Every month thereafter, interest component to be accounted for to true up the Present Value to Future Value

Provision to be reversed when actual cost is incurred

Accounting of Monetary Consideration – Scheme of Entries

Revenue Share to Partner/ Rent to member / Corpus to member

Actuals - Y1	100
Actuals - Y2	150
Actuals - Y3	250
Actuals - Y4	200
Total	700
PV on Day 1 (Y0)	475
Interest	225
Future Value	700

Step 1: Record PV of all future obligations on Day 1 (Year 0)

Inventory A/c	Dr	475
To Provision		-475

Step 2: Record interest component every month to true up PV to FV (Y1 to Y4)

Inventory A/c	Dr	225
To Provision		-225

Step 3: Record Actual Expense (Y1 to Y4)

		<u>Y1</u>	<u>Y2</u>	<u>Y3</u>	<u>Y4</u>	<u>Total</u>
Inventory A/c	Dr	100	150	250	200	700
To Vendor		-100	-150	-250	-200	-700

Step 4: Reverse Provision entry on Actuals (Y1 to Y4)

		<u>Y1</u>	<u>Y2</u>	<u>Y3</u>	<u>Y4</u>	<u>Total</u>
Provsion A/c	Dr	100	150	250	200	700
To Inventory		-100	-150	-250	-200	-700

Accounting of Monetary Consideration

Under **Ind AS 37** (*Provisions, Contingent Liabilities and Contingent Assets*), an entity must recognize a provision only when specific criteria are met:

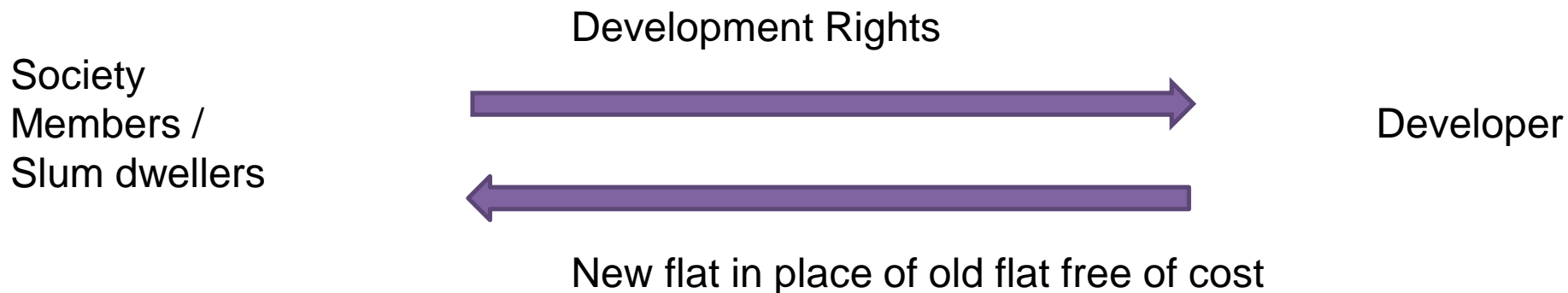
- 1. Present Obligation:** There must be a present obligation (legal or constructive) resulting from a past event.
- 2. Probable Outflow of Resources:** It must be probable (more likely than not) that an outflow of resources will be needed to settle the obligation.
- 3. Reliable Estimate:** A reliable estimate of the obligation's amount must be possible.

JDA Obligations: The obligations related to future payments to the landowner / society member (e.g., corpus, rent) are often present obligations arising from a past event (signing the JDA and obtaining rights), which meet the criteria for a **provision** under **Ind AS 37**

Present Value (Paragraph 45 of Ind AS 37) : Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.

Accounting of Non Monetary Consideration

- Existing flat owners transfers development rights to Developer
- Developer provides new flat to existing members free of cost
- Cost of development rights to be recorded at fair value
- Notional revenue from flats given to members free of cost to be recorded as per POCM over the period of time



Accounting of Non Monetary Consideration

Actual P&L

Particulars	Amount	Amount
Revenue from Sale units	2500	
Total Revenue		2500
Actual Cost of sale tower	1500	
Actual Cost of rehab tower	475	
Total Cost		1975
Gross Margin		525
<i>Gross Margin %</i>		21%

IndAS P&L

Particulars	Amount	Amount
Revenue from Sale units	2500	
<i>Notional Revenue from Rehab</i>	500	
Total Revenue		3000
Actual Cost of sale tower	1500	
Actual Cost of rehab tower	475	
<i>Notional Cost of Development Rights</i>	500	
Total Cost		2475
Gross Margin		525
<i>Gross Margin %</i>		18%

Accounting of Non Monetary Consideration – Scheme of Entries

Fair Value of Cost of Development Rights

Cost of Rehab/Redeveloped Building	475
Add: Notional Margin (5%)	25
Cost of Development Rights	500

Step 1: Record Cost of development rights on Day 1 (Year 0)

Inventory A/c	Dr	500
To Deferred Revenue		-500

Step 2: Record rehab revenue as per POCM (Y1 to Y4)

		<u>Y1</u>	<u>Y2</u>	<u>Y3</u>	<u>Y4</u>	<u>Total</u>
Deferred Revenue A/c	Dr	120	75	140	165	500
To Revenue from Rehab		-120	-75	-140	-165	-500

Accounting of Non Monetary Consideration

In redevelopment projects where a developer provides constructed premises in exchange for development rights, this transaction is viewed as a contract with a customer involving **non-cash consideration**.

The mandate to record the value of these development rights (the non-cash consideration) at fair value comes from **Paragraph 66 of Ind AS 115**, which states:

"To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value."

Issues in Accounting for Slum Rehabilitation Authority (SRA)

Hardship Compensation

Vacating the slum dwellers

Construction of Rehabilitation building

Providing alternate accommodation/paying rent for obtaining alternate accommodation

Liasioning Expenses

LOI revisions leading to change in area

Project Estimation and Changes in Project Estimation

Project profitability and revenue recognition depends on various factors including FSI, project cost, estimations of revenue

Estimated Cost should be revised on annual basis, so as to factor the inflationary impact/ revision in project model

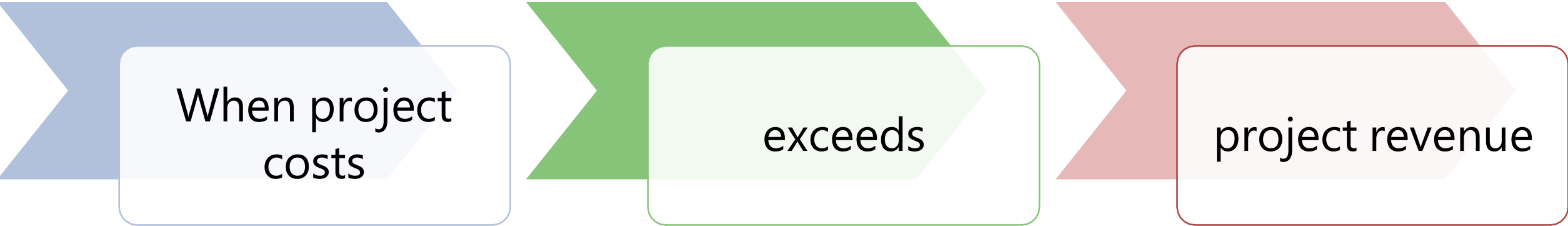
Treatment of Changes in Project Estimation

If revenue is recognised using POCM, the updated estimates must be incorporated for determining Percentage of completion of Project.

If there's an expected loss on a project due to cost increases or reduced revenues, a write-down of the project's carrying value may be necessary.

Impact of change in management estimates need to be disclosed in financial statements

Provision for foreseeable loss



When project costs

exceeds

project revenue

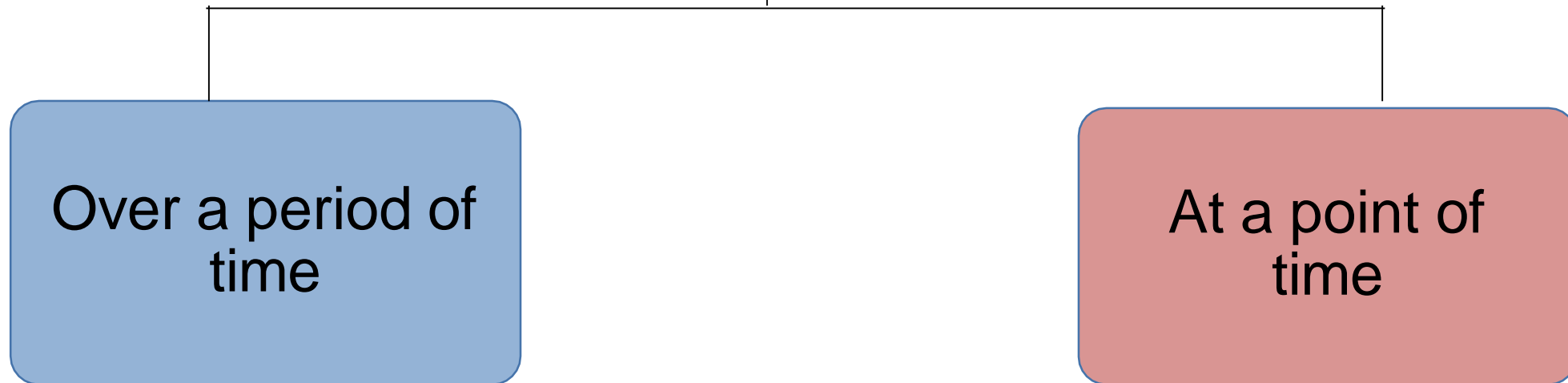
Project losses to be recognised immediately in the statement of profit and loss.

Irrespective of Commencement of Project, Stage of Completion of Project Activity.

Revenue Recognition (Indian Accounting Standard)

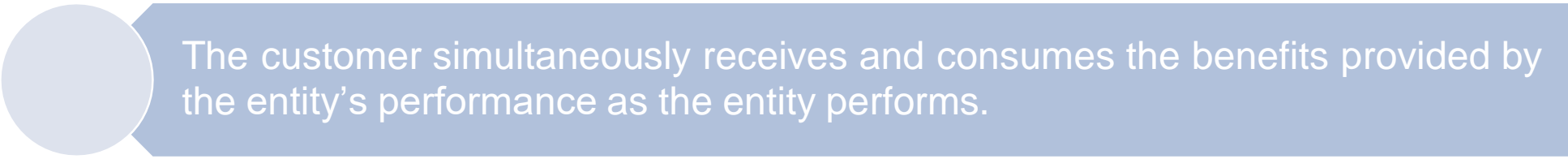
Ind AS 115- Revenue Recognition

Ind AS 115 states that revenue can be recognised in the following ways

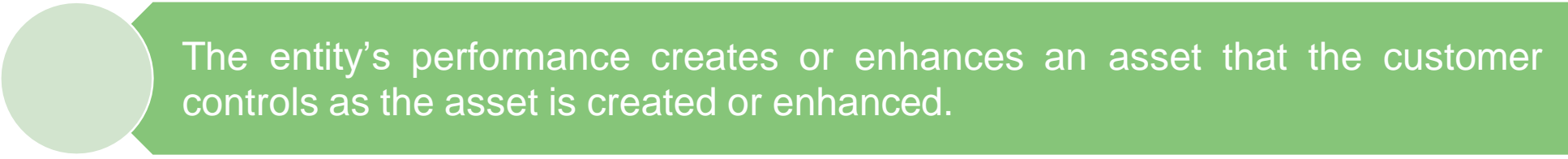


Ind AS 115- Revenue Recognition

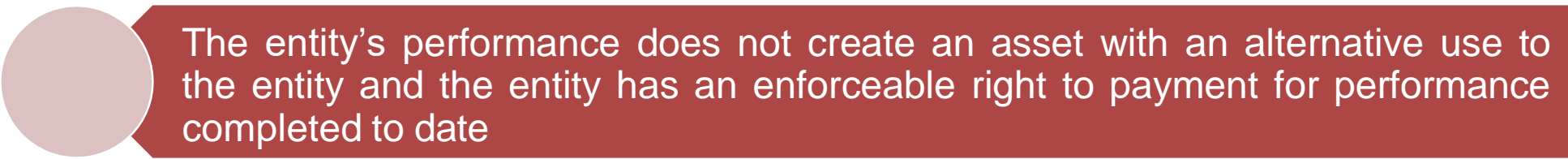
Revenue should be recognized over a period of time if one of the following criteria is met:



The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.



The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.



The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date

In case none of the above criteria is met revenue should be recognised at a point of time.

Case Study on Revenue Recognition

Case (POCM or PCM)

P Ltd. is developing a multi-unit residential complex. A customer enters into a binding sales contract with P Ltd. for a specified unit that is under construction. Each unit has a similar floor plan and is of a similar size, but other attributes of the units are different (for example, the location of the unit within the complex).

The customer pays a deposit (10%) upon entering into the contract and promises to make progress payments during construction of the unit. The deposit is refundable, only if, the entity fails to complete construction of the unit in accordance with the contract.

- P Ltd. retains legal title to the real estate unit construction is complete.
- The customer can resell or pledge the right as the real estate unit is being constructed.
- P Ltd. cannot direct the unit to another customer as per terms of the contract.
- In addition, the customer does not have the right to terminate the contract unless P Ltd. fails to perform as promised.

How revenue should be recognised for such a contract under Ind AS 115 in the following scenarios:

Case Study on Revenue Recognition

Scenario A: If the customer defaults on its obligations by failing to make the promised progress payments as and when they are due, the entity would have a right to all of the consideration promised in the contract, if it completes the construction of the unit.

Answer:

As per Ind AS 115, an entity recognises revenue when it satisfies a performance obligation by transferring a promised property to a customer. An entity 'transfers' a property to a customer when the customer obtains control of that asset. Control may be transferred either at a point in time or over time.

Revenue is recognised over time if one of the three criteria stated in Ind AS 115 are met or at a point in time if it does not meet any of the criteria.

In the given case P has a right to payment for performance completed to date. This is because if the customer were to default on its obligations, P would have an enforceable right to all of the consideration promised under the contract if it continues to perform as promised.

P has a performance obligation that it **satisfies over time**. To recognise revenue for that performance obligation satisfied over time, P should measure its progress toward **complete satisfaction of its performance obligation**.

Case Study on Revenue Recognition

Scenario B: If the customer defaults on the contract before completion of the unit, P Ltd. only has the right to retain the deposit.

Answer:

As per the criteria mentioned in Ind AS-115 the entity applies it to determine whether its promise to construct and transfer the unit to the customer is a performance obligation satisfied over time. The real estate unit does not have an alternative use to P. However, P does not have an enforceable right to payment for performance completed to date - until construction of the unit is complete, P only has a right to the deposit paid by the customer. Because P does not have a right to payment for work completed to date, P's performance obligation is not a performance obligation satisfied over time. Instead, P accounts for the sale of the unit as a performance obligation satisfied **at a point in time**.

Case Study on Determination of transaction price

Case

A real estate developer has launched a 20:80 scheme for the sale of units to the customers, i.e., 20 percent of the total consideration is to be paid upfront by the customer and the balance 80 percent is to be paid on possession. Presuming that the contract qualifies for the recognition of revenue over a period of time as per Ind AS 115, how should the transaction price be measured?

Answer

Ind AS 115, Paragraph 60, states:

"In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing."

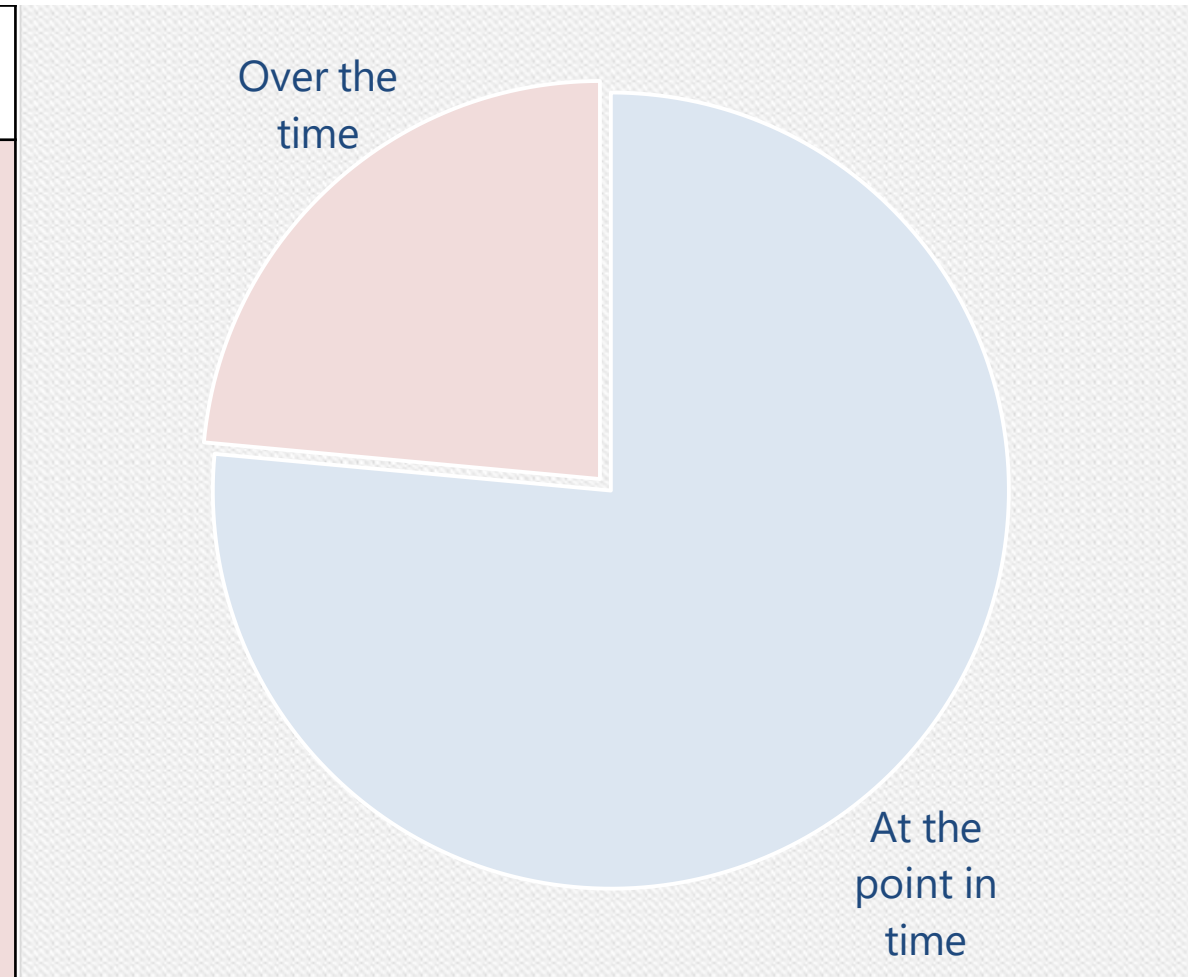
In schemes with disproportionate payments (like 20:80), the developer must separate the significant financing component from the consideration to determine the transaction price. The effects of financing must be presented separately in the statement of profit and loss. Interest revenue or expense is recognized based on the contract asset (or receivable) or contract liability recognized in accounting for the contract with the customer.

Accounting policies of real estate companies

Accounting policies of real estate companies


Based on Sample Selected of 16 Listed Companies operating in real estate business, it is observed that most of the Companies are following PCM.

At the point in time (PCM)	Over the time (POCM)
<ol style="list-style-type: none">1. Sobha2. Godrej Properties3. Brigade4. Lodha (Up to FY 2022-23)5. Rustomjee6. DLF7. Prestige8. Mahindra Lifespaces9. Puravankara10. NBCC India Limited11. Phoenix12. Ansal Properties and Infrastructure13. Omaxe	<ol style="list-style-type: none">1. Oberoi2. Sunteck3. Marathon4. Lodha (from FY 2023-24)



Indian Accounting Standards Ind AS 115, a real estate company can use Percentage of Completion Method (POCM)

POCM (revenue over time) is allowed if Para 35 criteria of Ind AS 115 are satisfied.



Most relevant condition for real estate: Para 35(c).

Para 35(c) Conditions

POCM (revenue over time) is allowed if Para 35 criteria of Ind AS 115 are satisfied.

Most relevant condition for real estate: Para 35(c).

1. Asset has no alternative use to developer

2. Developer has enforceable right to payment for work completed till date

If both conditions are met → Revenue can be recognized over time (POCM).

Typical Indicators Supporting POCM


Customer-specific unit allocation




Cancellation penalties



Legally enforceable recovery rights



Continuous transfer of control



Non-refundable consideration

POCM under Guidance Note vs Ind AS 115

POCM under Guidance Note vs Ind AS 115

The POCM as per the Guidance Note and Ind AS 115 are dissimilar. Key difference is given below.

Point of difference	IGAAP/ Guidance Note	Ind AS-115
Threshold for revenue recognition under POCM	<ul style="list-style-type: none">• All critical approvals obtained• Construction and development costs = 25%• Saleable project area is secured by contracts = 25%• Realised contract consideration = 10%	<ul style="list-style-type: none">• Revenue to be recognised straight-away and there is no condition for achieving any threshold.• However, contract enforceability criterion is required to be met for recognizing revenue.• If the entity is unable to reasonably estimate progress (early stages of contracts), an entity should recognise revenue upto cost incurred to date, unless the contract is onerous.• Methods to determine POCM<ul style="list-style-type: none">-Input Method-Output Method

Operating Cycle in case of real estate operations

Operating Cycle in Case of Real Estate Operations

The operating cycle in case of real estate operations varies from project to project depending on the size of the project, type of development, project complexities and related approvals. Accordingly, project related assets and liabilities are classified into current and non-current based on the operating cycle of the project.

Operating Cycle of some of the entities are:

Name of the Entity	Tenure of Operating Cycle	Tenure of assets and liabilities related to operating cycle	Tenure of Other assets and liabilities
Prestige Estate Projects Limited	Operating cycle of the Company is 5 years.	Assets and liabilities related to project are classified as current and non-current depending upon operating cycle.	12 months for all other assets and liabilities.
Godrej Properties Limited	Operating cycle of the Company ranges from 3 to 7 years.		
Macrotech Developers Limited	Operating cycle of the Company varies from project to project		

Borrowing Cost Capitalisation

Borrowing Cost Capitalisation

If the borrowed funds are temporarily parked in MF's/FD's, such income needs to be adjusted against the Project Cost.

Interest Cost when to capitalise in a running project ?

- (a) General Borrowing Cost
(Weighted average borrowing Cost)
- (b) Specific Borrowing Cost

Under Ind AS:

Borrowing costs is not allowed to be inventorised post launch of the project where revenue is recognised on POCM basis.

Questions ?

Thank You

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