

**GN(A) 23 (Revised 2012)**

## **Guidance Note on Accounting for Real Estate Transactions**

### **Foreword**

Growth of the real estate sector in the recent past in India, indicates the importance of this sector in Indian economy. Along with fulfilling one of the basic necessities for human existence, i.e., housing, this sector has also been used as a key tool by the Indian Government in achieving an overall socio-economic growth during the last few decades. The development in the real estate market encompasses growth in both commercial and residential spheres. As there are large numbers of entities in this segment, there is intense pressure amongst the entities to stay on top in the investors' choice list.

The Institute of Chartered Accountants of India (ICAI), while realising the role of this sector in fuelling growth of Indian economy and recognising need for guidance on accounting for real estate sales, in 2006, issued *Guidance Note on Recognition of Revenue by Real Estate Developers*.

With the fast growth of this sector, the volume and the number of transactions in this sector have also grown significantly. In the recent past, different practices followed by the various real estate developers in recognising their revenue has also been amongst the favourite headlines in the news across the country. Considering this, ICAI felt that the revision of the Guidance Note is necessary. I appreciate the initiative taken by the Accounting Standards Board in this regard.

I wish to place on record my deep appreciation of CA. Manoj Fadnis, Chairman, Accounting Standards Board, and members of the Accounting Standards Board who have made invaluable contribution in the finalisation of this Guidance Note.

I hope that this revised Guidance Note will be useful – both to our members as well as the others concerned.

New Delhi  
February, 2012

**CA. G. Ramaswamy**  
*President*

## **Preface**

In recent years, with the increase in the demand for real estate, due to factors such as the fast growing population, introduction of various home loan schemes, the growth in the real estate sector has increased manifold. This sector has also emerged as one of the best investing opportunities not only for Indian investors but also for foreign investors. Huge foreign direct investment in the last five years in this sector is witness to this fact. As the premier accounting standards-setting body, the ICAI, due to the distinguished revenue model of this sector, felt that the accounting guidance earlier given by the ICAI in the Guidance Note on *Recognition of Revenue by Real Estate Developers* required revision, so that the diverse practices followed by different players in the market can be harmonised into a single uniform practice, particularly, in the application of Percentage of Completion Method of recognising the revenue. The Guidance Note primarily provides guidance on application of percentage of completion method, where it is appropriate to apply this method, i.e., where 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.

I would like to convey my sincere thanks to our Honourable President CA. G. Ramaswamy and Vice-President CA. Jaydeep N. Shah and CA.S. Santhanakrisnan, Vice- Chairman, ASB for their constant support and co-operation.

I would like to take this opportunity to place on record my deep appreciation of the efforts put in by CA. J. Venkateshwarlu, CA. Vinod Jain, CA. P. R. Ramesh and Shri Chandrasekhar Gokhale, who made immense contribution in the preparation of the basic draft of the revised Guidance Note. I would also like to thank various representatives of the industry, market participants, our members and other individuals for giving their invaluable suggestions on the draft Guidance Note from time to time.

I sincerely compliment Dr. Avinash Chander, Technical Director and CA. Geetanshu Bansal, Senior Executive Officer, for their invaluable contribution and efforts at various stages of finalising of the Guidance Note.

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I am confident that this Guidance Note will be extremely useful to the members of the Institute and others interested in the subject.

New Delhi  
February 11, 2012

**CA. Manoj Fadnis**  
*Chairman*  
*Accounting Standards Board*

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# **Guidance Note on Accounting for Real Estate Transactions**

*(The following is the text of the Guidance Note on Accounting for Real Estate Transactions, issued by the Council of the Institute of Chartered Accountants of India.)*

## **1. Objective and Scope**

### **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 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.

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- (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.

1.3 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.

1.4 Real estate transactions of the nature covered by Accounting Standard (AS) 10, *Accounting for Fixed Assets*, Accounting Standard (AS) 12, *Accounting for Government Grants*, Accounting Standard (AS) 19, *Leases*, and Accounting Standard (AS) 26, *Intangible Assets*, are outside the scope of this Guidance Note.

1.5 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 April 1, 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. This Guidance Note supersedes the Guidance Note on Recognition of Revenue by Real Estate Developers, issued by the Institute of Chartered Accountants of India in 2006, when this Guidance Note is applied as above.

## **2. Definitions**

**2.1 *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. For example, a project may comprise a cluster of towers

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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.

**2.2 Project Costs** – 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.

**2.3 Construction costs and development costs that relate directly to a specific project include:**

- (a) land conversion costs, betterment charges, municipal sanction fee and other charges for obtaining building permissions;
- (b) site labour costs, including site supervision;
- (c) costs of materials used in construction or development of property;
- (d) depreciation of plant and equipment used for the project ;
- (e) costs of moving plant, equipment and materials to and from the project site;
- (f) costs of hiring plant and equipment;
- (g) costs of design and technical assistance that is directly related to the project;

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- (h) estimated costs of rectification and guarantee work, including expected warranty costs; and
- (i) claims from third parties.

2.4 The following costs should not be considered part of construction costs and development costs if they are material:

- (a) General administration costs;
- (b) selling costs;
- (c) research and development costs;
- (d) depreciation of idle plant and equipment;
- (e) cost of unconsumed or uninstalled material delivered at site; and
- (f) payments made to sub-contractors in advance of work performed.

2.5 Costs that may be attributable to project activity in general and can be allocated to specific projects include:

- (a) insurance;
- (b) costs of design and technical assistance that is not directly related to a specific project; and
- (c) construction or development overheads; and
- (d) borrowing costs.

Such costs are allocated using methods that are systematic and rational and are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of project activity. Construction overheads include costs such as the preparation and processing of construction personnel payroll.

2.6 **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.

### **3. Accounting for Real Estate Transactions**

3.1 Real estate activities and transactions take diverse forms. While some are for sale of land (developed or undeveloped), others are for construction, development or sale of units that are not complete at the time of entering into agreements for construction, development or sale.

3.2 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. It is not unusual for such activities to spread over two or more accounting periods.

3.3 For recognition of revenue in case of real estate sales, it is necessary that all the conditions specified in paragraphs 10 and 11 of Accounting Standard (AS) 9, Revenue Recognition, are satisfied. As stated above, 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. 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. Accordingly, revenue in such cases is recognised by applying the percentage of completion method on the basis of the methodology explained in AS 7, *Construction Contracts*.

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. This Guidance Note, thus, provides guidance in the application of:

- Principles of AS 9 in respect of sale of goods for recognising revenue, costs and profits from transactions of real estate which are in substance similar to delivery of goods where the revenues, costs and profits are recognised when the revenue recognition process is completed; and
- Percentage completion method for recognising revenue, costs and profits from transactions and activities of real estate which have the same economic substance as construction contracts.

3.4 The application of the methods described in paragraph 3.3 above requires a careful analysis of the elements of the transaction, agreement, understanding and conduct of the parties to the transaction to determine the economic substance of the transaction. The economic substance of the transaction is not influenced or affected by the structure and/or legal form of the transaction or agreement.

## **4. Application of Principles of AS 9 in Respect of Sale of Goods to a Real Estate Project**

4.1 The application of principles of AS 9 in respect of sale of goods requires recognition of revenues on completion of the transaction/activity when the revenue recognition process in respect of a real estate project is completed as explained in paragraph 4.2 below.

4.2 The completion of the revenue recognition process is usually identified when the following conditions are satisfied:

- (a) 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;

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- (b) The seller has effectively handed over possession of the real estate unit to the buyer forming part of the transaction;
- (c) No significant uncertainty exists regarding the amount of consideration that will be derived from the real estate sales; and
- (d) It is not unreasonable to expect ultimate collection of revenue from buyers.

4.3 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.

## **5. Application of Percentage Completion Method**

5.1 The percentage completion method should be applied in the accounting of all real estate transactions/activities in the situations described in paragraph 3.3 above, i.e., where the economic substance is similar to construction contracts. Some further indicators of such transactions/activities are:

- (a) The duration of such projects is beyond 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 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.

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

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- (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.

When the outcome of a project can be estimated reliably, project revenues and project costs associated with the project should be recognised as revenue and expenses respectively applying the percentage of completion method in the manner detailed in paragraphs 5.3 to 5.8 below.

5.3 Further to the conditions in paragraph 5.2 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 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.
- (b) 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 as defined in paragraph 2.2 (c) read with paragraphs 2.3 to 2.5.

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- (c) At least 25% of the saleable project area is secured by contracts or agreements with buyers.
- (d) At least 10 % of the total revenue 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. To illustrate - If there are 10 Agreements of sale and 10 % of gross amount is realised in case of 8 agreements, revenue can be recognised with respect to these 8 agreements.

5.4 When the outcome of a real estate project can be estimated reliably and the conditions stipulated in paragraphs 5.2 and 5.3 are satisfied, project revenue and project costs associated with the real estate project should be recognised as revenue and expenses 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 as defined in paragraph 2.2. Whilst the method of determination of stage of completion with reference to project costs incurred is the preferred method, this Guidance Note does not prohibit other methods of determination of stage of completion, e.g., surveys of work done, technical estimation, etc. 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. Illustration appended to this Guidance Note clarifies the method of computation of revenue.

5.5 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. This method provides useful information to the extent of contract activity and performance during a period.

5.6 The recognition of project revenue by reference to the stage of completion of the project activity should not at any point exceed the estimated total revenues

from 'eligible contracts'/other legally enforceable agreements for sale. 'Eligible contracts' means contracts/ agreements specified in paragraph 5.3 where at least 10% of the contracted amounts have been realised and there are no outstanding defaults of the payment terms in such contracts.

5.7 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.

5.8 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. Therefore, 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.

5.9 The changes to estimates referred to in paragraph 5.8 above 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*.

## **6. Accounting for Sale of Land or Plots**

### **A. Sale of plots of land without any development**

Revenue from sale of land or plots should be recognised when all the conditions in paragraph 4.2 above are met.

### **B. Sale of developed plots**

Where the development activity is significant and if the projects meet the criteria specified in paragraphs 3.3 and 5.1 above, the percentage completion method is used to account for such sales.

## **7. Transferable Development Rights**

7.1 Transferable Development Rights (TDRs) are generally acquired in different ways as mentioned hereunder:

- (a) Direct purchase.
- (b) Development and construction of built-up area.
- (c) Giving up of rights over existing structures or open land.

7.2 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.

7.3 When development rights are utilised in a real estate project by an enterprise, the cost of acquisition should be added to the project costs.

7.4 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.

## **8. Transactions with Multiple Elements**

8.1 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.

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8.2 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.

8.3 The accounting of each of the components should be in accordance with paragraph 3.3 above.

## **9. Disclosure**

9.1 An enterprise 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.

9.2 An enterprise 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; and
- (b) the amount of advances received;
- (c) the amount of work in progress and the value of inventories;
- (d) Excess of revenue recognised over actual bills raised (unbilled revenue).

### **Illustration on application of percentage completion method**

Total saleable area	20,000 Sq. ft.
Estimated Project Costs( This comprises land cost of Rs. 300 Lakhs and construction costs of Rs. 300 Lakhs)	Rs. 600 lakhs

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Cost incurred till end of reporting period (This includes land cost of Rs. 300 lakhs and construction cost of Rs. 60 Lakhs)	Rs. 360 Lakhs
Total Area Sold till the date of reporting period	5,000 Sq. ft.
Total Sale Consideration as per Agreements of Sale executed	Rs. 200 Lakhs
Amount realised till the end of the reporting period	Rs.50 Lakhs
Percentage of completion of work	60% of total project cost including land cost <b>or</b> 20% of total construction cost

At the end of the reporting period the enterprise will not be able to recognise any revenue as reasonable level of construction, which is 25% of the total construction cost, has not been achieved, though 10% of the agreement amount has been realised.

### **Continuing the illustration**

If the work completed till end of reporting period is (This includes land cost of Rs 300 Lakhs and construction cost of Rs 90 lakhs)	Rs. 390 Lakhs
Percentage of completion of work would be	65% of total project cost including land cost <b>or</b> 30% of construction cost

The enterprise would be able to recognise revenues at the end of the accounting period. The revenue recognition and profits would be as under:

Revenue recognised (65 % of Rs 200 lakhs as per Agreement of Sale)	Rs. 130 Lakhs
Proportionate cost (5000 sft./20,000 sft.) X 390	Rs. 97.50 Lakhs
Income from the project	Rs. 32.50 Lakhs
Work in progress to be carried forward	Rs. 292.50 Lakhs