

## **Query No. 7**

**Subject: Revenue recognition of real estate units under construction under Ind AS 115.<sup>1</sup>**

### **A. Facts of the Case**

1. A company (hereinafter referred to as ‘the company’) is primarily engaged in business of construction of residential, commercial, IT Park along with renting of immovable properties and providing project management services for managing and developing real estate projects.

2. The following is the revenue recognition policy of the company relating to sale of residential units as per annual report for the year ended 31<sup>st</sup> March 2018:

“Revenue from real estate projects including integrated townships is recognised on the ‘Percentage of Completion Method’ of accounting. Revenue is recognized, in relation to the sold areas only, on the basis of percentage of actual cost incurred thereon including land as against the total estimated cost of the project under execution subject to construction costs being 25% or more of the total estimated cost. The estimates of saleable area and costs are revised periodically by the management. The effect of such changes to estimates is recognised in the period such changes are determined.

In accordance with the Guidance Note on Accounting for Real Estate Transactions (for entities to whom Ind AS is applicable)<sup>2</sup>, issued by the Institute of Chartered Accountants of India (ICAI), revenue is recognised on percentage of completion method if (a) actual construction and development cost (excluding land cost) incurred is 25% or more of the estimated cost, (b) at least 25% of the saleable project area is secured by contracts or agreements with buyers and (c) at least 10% of the total revenue as per sales agreement or any other legally enforceable document are realised as at the reporting date.”

3. The querist has stated that the Ministry of Corporate Affairs (MCA) has notified the new revenue recognition standard, viz., Indian Accounting Standard (Ind AS) 115, ‘Revenue from Contracts with Customers’ on 29<sup>th</sup> March 2018, which would be applicable for accounting periods beginning on or after 1 April 2018. Ind AS 115 replaces all existing Ind AS revenue recognition requirements.

4. The querist has provided the following summary of the sales process of the company:

(a) After obtaining relevant approvals for construction plan and activities, the company launches a project.

(b) Customer selects a residential unit of his/her choice within the project, wherein the price of the residential unit plays a key role in determining the transaction, amongst various other factors. The prices of residential units do not remain constant and are market driven; and also impacted by factors such as floor rise, direction of the flat etc., and customer judgement (highly subjective). Once the residential unit to be purchased is finalized; the customer deposits the booking amount with the company. The booking amount is generally INR 100,000 or less (i.e. less than 5% of the residential unit’s total sale value).

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<sup>1</sup> Opinion finalised by the Committee on 7.8.2019.

<sup>2</sup> This Guidance Note has been withdrawn from the date of Ind AS 115 becoming effective.

- (c) Within the next 30 days, the customer pays 10% of the residential unit's total sale value and enters into an 'Agreement for Sale' with the company, generally much before the residential unit is completed (a copy of the model Agreement to Sell has been provided by the querist for the perusal of the Committee). This Agreement is registered with the property registrar.
  - (d) As per the terms of Agreement between the company and its customers, on achieving construction milestones, the company raises demand on customers and customers are required to make the payment.
  - (e) After the residential unit is ready in all respects, the company raises a demand for last installment. On receiving the final payment, the company hands over possession of residential units to customers.
5. In one of the projects of the company, the extracts of the key terms of Agreement with customers of residential units have been provided by the querist as under:

**“3. Allotment and consideration**

- 3.1 The Promoter shall construct the Building on the Project land in accordance with the Approvals and Plans. Provided that the Promoter shall obtain prior consent in writing of the Allottee in respect of variations or modifications which may adversely affect the Apartment of the Allottee and not otherwise if any alteration or addition is required by any Government Authorities or due to change in the Applicable Law then no consent of the Allottee shall be required to be sought.
- 3.2 Subject to the terms and conditions of this Agreement, the Promoter hereby agrees to sell to the Allottee and the Allottee hereby agree to purchase from the Promoter the Apartment together with the Internal Apartment Specifications at or for the consideration mentioned in Third Schedule hereunder written.”

**“4. Default in payment of consideration**

- 4.1 The Allottee agrees to pay to the Promoter Allottee's Interest, defined above, on all the outstanding amounts which become due but remain unpaid by the Allottee to the Promoter under the terms of this Agreement. The Allottee's Interest shall be payable from the date the concerned payment becomes due and payable by the Allottee till the date of actual payment.
- 4.2 In addition to the liability of the Allottee to pay the Allottee's Interest, the Allottee shall also be liable to pay and reimburse to the Promoter, all the costs, charges and expenses whatsoever, which are borne, paid and/or incurred by the Promoter for the purpose of enforcing payment of and recovering from the Allottee any amount or dues whatsoever payable by the Allottee under this Agreement.
- 4.3 Without prejudice to right of the Promoter to charge interest in terms of this Agreement, on the Allottee committing default in payment on the due dates of any amount that becomes due and payable by the Allottee to the Promoter under this Agreement (including his/her/their proportionate share of taxes levied by concerned Local Authority and other outgoings), the Promoter shall be entitled at his own option, to terminate this Agreement in the event of the Allottee committing three such defaults of payment of instalments. The Promoter shall give notice of 15 (fifteen) days in writing to the Allottee and mail at the email address provided by the Allottee, of his intention to terminate this Agreement and

of the specific breach/breaches of the terms and conditions in respect of which it is intended to terminate the Agreement. If the Allottee fails to rectify the breach/breaches mentioned by the Promoter within the period of notice then at the end of such notice period, the Promoter shall be entitled to terminate this Agreement. Upon termination of this Agreement as aforesaid, Allottee shall execute and register a Deed of Cancellation in favour of the Promoter. The Promoter shall refund to the Allottee within a period of 30 (thirty) days of the execution and registration of the Deed of Cancellation, the instalments of Consideration of the Apartment which may have till then been paid by the Allottee to the Promoter subject to adjustment and recovery of any agreed liquidated damages i.e. deduction of 10% of the total consideration together with any other amount which may be payable to Promoter and subject to the adjustment/deduction related to the Government statutory dues and taxes, bank loan, brokerage if any that have been paid by the Promoter or to be paid by the Promoter.”

### **“13. Termination**

- 13.1 The occurrence, happening or existence of any of following events shall be considered as the **“Allottee’s Event of Default”** –
- (i) Failure on part of the Allottee to make payment of any installments/ outgoings/ payments under this Agreement; or
  - (ii) Failure on part of the Allottee to take possession of the Apartment within the time stipulated and in the manner set out hereinabove; or
  - (iii) Breach by the Allottee of any of the representations, warranties and covenants or failure to perform, comply and observe any of its obligations and responsibilities as set forth in this Agreement; or
  - (iv) Any other acts, deeds or things, which the Allottee may omit or fail to perform in terms of this Agreement, which in the opinion of the Promoter, amounts to an event of default. The Allottee hereby agrees and confirms that the decision of the Promoter in this regard shall be final and binding on the Allottee.
- 13.2 On the occurrence, happening or existence of any of the Allottee’s Event of Default as stated above, the Promoter shall give notice of 15 (fifteen) days by letter in writing through RPAD to the Allottee or by email at the email address (**“Allottee’s Default Notice”**) provided by the Allottee of its intention to terminate this Agreement and of the specific breach or breaches of terms and conditions in respect of which it is intended to terminate the Agreement. Upon failure of the Allottee to rectify/cure the Allottee’s Event of Default within the time period stipulated in the Allottee’s Default Notice, without prejudice to any other right or remedy available to the Promoter under the Applicable Laws or as envisaged in this Agreement. The Promoter shall have the right to terminate this Agreement without any further notice/intimation to the Allottee. The Allottee shall forthwith come forward and execute and register a Deed of Cancellation in favour of the Promoter.
- 13.3 On and from the date of such termination on account of Allottee’s Event of Default as mentioned herein above, the Parties mutually agree that the Promoter shall refund to the Allottee (subject to adjustment and recovery of any agreed liquidated damages i.e. deduction of 10% of the total consideration together with any other amount which may be payable to Promoter and subject to the

adjustment/deduction related to the Government statutory dues and taxes, bank loan, brokerage, if any) within a period of 30 (thirty) days from the date of execution and registration of the Deed of Cancellation, the Consideration or part thereof which may till then have been paid by the Allottee to the Promoter (excluding the amount/s paid by the Promoter to various Authorities as and by way of taxes, duties etc.) but the Promoter shall not be liable to pay to the Allottee any interest on the amount so refunded.

13.4 The Promoter may, at its sole discretion, condone the breach committed by Allottee and may revoke cancellation of the allotment provided that the Apartment has not been re-allotted to another person till such time and Allottee agrees to pay the unearned profits (difference between the Consideration and prevailing sales price) in proportion to total amount outstanding on the date of restoration and subject to such additional conditions/undertaking as may be decided by Promoter. The Promoter may at its sole discretion waive the breach by Allottee for not paying the aforesaid instalments but such waiver shall not mean any waiver in the interest amount and the Allottee will have to pay the full amount of interest due.

13.5 Upon the cancellation/termination, the Promoter shall be entitled to sell or otherwise dispose of the Apartment to any other person/party whomsoever, at such price, in such manner and on such terms and conditions as Promoter may in its sole discretion think fit and proper and the Allottee shall not be entitled to raise any objection or dispute in this regard. However, it is agreed between the Parties that the Promoter shall adjust the amount due from Allottee first towards the interest due then towards taxes and then towards the Consideration (including all outstanding amounts like bank loan, brokerage etc., if any, payable by the Allottee to the Promoter.”

“13.11 The occurrence, happening or existence of any of following events shall be considered as the “**Promoter’s Event of Default**” –

- (i) Failure of the Promoter to give the Intimation to take Possession to the Allottee on or before [Date] (subject to Force Majeure); or
- (ii) Breach by the Promoter of any of the representations, warranties and covenants or failure to perform, comply and observe any of its obligations and responsibilities as set forth in this Agreement.

13.12 Upon the cancellation/termination of this Agreement on account of the Promoter’s Event of Default as mentioned hereinabove, the Allottee shall be entitled to recover all the amounts that have been paid by the Allottee to the Promoter under the terms of this Agreement (excluding taxes etc. that have been paid by the Promoter to the Government/Statutory Bodies/ Authorities and excluding bank loan, brokerage, if any). In such a case as provided under the Act, the Promoter shall refund the aforesaid amounts to the Allottee within a period of 30 (thirty) days or a mutually agreed date from the execution and registration of the Deed of Cancellation by the Allottee in favour of the Promoter.”

### “23. Creation of third party rights

...

23.2 By the allottee:

- (i) The Allottee shall be entitled to transfer his/her/their right under this Agreement to any person or party provided however the Allottee and the new Allottee shall jointly inform the Promoter in respect thereof with a clear covenant on the part of the new Allottee undertaking to adhere to the terms and conditions of this Agreement and also the bye laws of the Organisation. The Allottee shall be entitled to effect such transfer only if the Allottee has till then not defaulted in making any payments payable to the Promoter.
- (ii) However, the Allottee agrees and undertakes to cause the new Allottee to execute/register the deed, document, agreement or writing as may be requested by Promoter to record the transfer as mentioned hereinabove.
- (iii) Stamp duty or other charges as may be applicable on any transfer/addition shall be paid by the transferor/transferee. The Allottee shall indemnify and keep indemnified the Promoter against any action, loss, damage or claim arising against Promoter for non-payment of such stamp duty and requisite charges.
- (iv) The transfer shall be allowed only subject to clearing all the sums that shall be due and payable to the Promoter. The Allottee shall be solely responsible and liable for all legal, monetary or any other consequences that may arise from such nominations/transfer.”

6. The company has obtained two legal opinions from reputed law firms (copies of which have been provided separately for the perusal of the Committee) relating to assessment of the enforceable right to payment under paragraph 35 (c) of Ind AS 115 and as per the applicable legal laws in the State of Maharashtra and in India.

*Management view*

7. Based on the facts, the relevant technical literature and legal opinions, the management of the company is of the view that the revenue from sale of under-construction residential unit would be recognised over a period of time (percentage of completion method) as the condition mentioned in para 35 (c) is met.

*Management Analysis under Ind AS 115*

8. The querist has stated that paragraph 35 of Ind AS 115 is the relevant paragraph and covers revenue recognition from contracts where control of goods and services are transferred to the customer over a period of time. Analysis of paragraph 35 and especially paragraph 35 (c) of Ind AS 115 is as under:

“35 An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

...

- (c) the entity’s performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).”

Applying paragraph 35(c), the company shall be able to recognise revenue over time if:

- (i) the asset created by the entity’s performance does not have an alternative use to the entity; and
- (ii) the entity has an enforceable right to payment for performance completed to date.

9. *Condition 1: The entity's performance does not create an asset with an alternative use to the entity*

Paragraph 36 of Ind AS 115 specifies that the asset created does not have an alternative use to an entity if the entity is restricted contractually from readily directing the asset for another use during the creation of that asset or limited practically from readily directing the asset in its completed state for another use. As stated in the sales process mentioned above, price of residential unit play a key role; and is dependent upon various factors include floor rise; direction /position of the flat, and subjectivity of the customer, and all these particulars are specified in the agreement to sell. Hence, the flats cannot be transferred at the will of the company alone. As per the agreement between the company and its customers, the company does not have a right to sell/ transfer the under construction residential unit to another customer, unless the agreement is terminated.

As per clause 13.5 of the agreement, the company is entitled to sell or otherwise dispose of the under-construction residential unit to any other person/party whomsoever, at such price, in such manner and on such terms and conditions as Promoter may in its sole discretion only at the time of termination of the contract.

10. As per paragraph B6 of Ind AS 115, the possibility of the contract with the customer being terminated is not a relevant consideration in assessing whether the entity would be able to readily direct the asset for another use. Hence, clause 13.5 of the agreement shall be ignored while evaluating the 'alternative use' criteria.

As per Basis for Conclusions (BC) 137 on IFRS 15 'Revenue from Contracts with Customers', the level of customisation is not a determinative factor for assessing alternative use in certain contracts including real estate contracts, where an asset may be standardised but may still not have an alternative use to an entity, as a result of substantive contractual restrictions that preclude the entity from readily directing the asset to another customer. Rather, this indicates that the customer controls the asset as it is created, because the customer has the present ability to restrict the entity from directing that asset to another customer.

According to the querist, as per the *Question 76 of Educational Material on Indian Accounting Standard (Ind AS) 115*, issued by the erstwhile Ind AS Implementation Group of the ICAI, an entity cannot change or substitute the real estate unit specified in the contract with the customer, and thus the customer could enforce its rights to the unit if the entity sought to direct the asset for another use. Accordingly, the contractual restriction is substantive and the real estate unit does not have an alternative use to the entity.

11. Based on the evaluation of the agreement's terms and aforesaid technical guidance, the querist is of the view that there are contractual restrictions and practical limitations on the company's ability to readily direct that asset for another use. Hence, the first condition of paragraph 35 (c) is met.

12. *Condition 2: The entity has an enforceable right to payment for performance completed to date*

As per the clauses 13.1 to 13.6 of the agreement between the company and its customers, customer has the right of termination only on failure of the company to handover timely possession of the apartment, or on account of company's breach of its representations, warranties and covenants, or its failure to perform its obligations and responsibilities as set forth in the agreements. Customers do not have a right to terminate for any other cause/ without cause.

According to the querist, as per the Scenario C to Question 76 of the Educational material on

Indian Accounting Standard (Ind AS) 115, issued by the erstwhile Ind AS Implementation Group of the ICAI, the company has a right to payment for performance completed to date because it could also choose to enforce its rights to proportionate payment under the contract. Consequently, the criterion in paragraph 35(c) of Ind AS 115 is met and the entity has a performance obligation that it satisfies over time. The fact that the company may choose to cancel the contract in the event the customer defaults on its obligations would not affect that assessment, provided that the company's rights to require the customer to continue to perform as required under the contract (i.e., pay the promised consideration) are enforceable.

13. As per Press Release on Implementation of Ind AS 115, 'Revenue from Contract with Customers' for revenue recognition in context of Real Estate Sector, issued by the ICAI, the recognition of revenue as the construction progresses is possible considering the prevalent long established legal system/jurisprudence in India, and facts and circumstances of individual case/contract.

14. The querist has further stated that as per IFRIC Update of March 2018, if there is relevant legal precedent indicating that the entity is not entitled to an amount that at least compensates it for performance completed to date in the event of cancellation for reasons other than the entity's failure to perform as promised, such legal precedent is assumed to be sufficient evidence. Such legal precedent is relevant to the assessment of the entity's enforceable right to payment as described in paragraph 35(c). As per the fact pattern described in the IFRIC Update, in the event of the courts accepting requests to cancel contracts, the entity is entitled only to a termination penalty that does not compensate the entity for performance completed to date.

15. As per section 19 (6) of The Real Estate (Regulation and Development) Act, 2016 (RERA), "Every allottee, who has entered into an agreement for sale to take an apartment, plot or building as the case may be, under section 13, shall be responsible to make necessary payments in the manner and within the time as specified in the said agreement for sale and shall pay at the proper time and place, the share of the registration charges, municipal taxes, water and electricity charges, maintenance charges, ground rent, and other charges, if any." It should be noted that the RERA does not just stipulate/mandate the allottee (customer) to make necessary payments; rather it also stipulates that the payment needs to be made in the manner and time as specified in the agreement to sell. In other words, the aforesaid section 19 (6) entitles the company to claim compensation from prospective buyers for their failure to pay the instalments due; whether on account of delay or on account of invalid termination of the Agreement to sell by buyers, in accordance with the provisions of RERA.

16. Also, as per the querist, paragraph BC 142 to IFRS 15 states that there is a link between the factors of no alternative use and right to payment since the asset which entity is creating has no alternative use to the entity, as the entity is effectively constructing at the direction of the customer. Consequently, the entity will want to be protected from the risk of the customer terminating the contract and leaving the entity with no asset or an asset that has little value to the entity. This is established by requiring that if the contract is terminated, the customer must pay for the entity's performance completed to date. Consequently, the fact that the customer is obliged to pay for the entity's performance suggests that the customer has obtained the benefits from the entity's performance.

17. Based on the analysis of the agreement, technical guidance and the legal opinions, the company is of the view that it has an enforceable right to payment for performance completed to date. Hence, the second condition of paragraph 35 (c) is met. Further to the above evaluation, the company has also sought and obtained legal opinions from reputed law firms in regard to legal precedents currently supporting the company's view in recognizing the

revenue in accordance with paragraph 35 (c) of Ind AS 115 and relevant provisions of RERA as referred above; and has received a view from the firms that there are no legal precedents currently in India which express or lay down a position of law which is contrary to company's proposed position. The legal opinions have also further confirmed a position, which is line with the company's conclusion. Hence, in the view of the company, both the conditions of paragraph 35 (c) of Ind AS 115 are met and the company must account for the sale of under-construction residential units as per percentage of completion method (POCM).

18. The querist has also provided separately as *Annexure A*, extracts from the following technical literature which have been referred to while arriving at a view on this query:

- Ind AS 115, 'Revenue from Contracts with Customers'
- Basis for Conclusions on IFRS 15
- IFRIC Update March 2018
- ICAI Press Release on Implementation of Ind AS 115, Revenue from Contracts with Customers in context of Real Estate Sector
- Educational Material on Indian Accounting Standard (Ind AS) 115, Revenue from Contracts with Customers
- The Real Estate (Regulation and Development) Act, 2016

## **B. Query**

19. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee as to how should the company recognise revenue for such contracts under Ind AS 115 while the residential units sold is still under construction?

## **C. Points considered by the Committee**

20. The Committee notes that the basic issue raised in the query relates to the revenue recognition in case of real estate unit (apartment) under construction under Ind AS 115. The Committee has, therefore, considered only this issue and not examined any other issue that may arise from the Facts of the Case, such as, measurement of revenue, other aspects of Ind AS 115, including, whether there are multiple distinct performance obligations, variable consideration, measure of progress, accounting for the cost of obtaining the contracts, etc. Further, the Committee has restricted its opinion from accounting perspective and has not examined from legal perspective, such as, legal interpretation under the provisions of RERA, the Maharashtra Ownership Flats (Regulation of the Promotion of Construction, Sale, Management and Transfer) Act, 1963, Indian Contract Act and other laws. The Committee further wishes to point out that it has considered only the issue of fulfillment of the criteria laid down in paragraph 35 of Ind AS 115 and, since in the extant case, the querist has referred to only the criterion under paragraph 35 (c) of Ind AS 115 for recognizing revenue over time, the Committee has expressed the opinion only in that context and has not examined the other two criteria, viz., under paragraph 35(a) and 35(b) as the same have not been specifically raised by the querist. At the outset, the Committee also wishes to mention that the facts and circumstances of each real estate contract may vary and the regulatory framework and legal precedence in each jurisdiction/state may be different. Therefore, the facts and circumstances of each case should be appropriately examined under Ind AS 115 and this opinion should not be generalized for other real estate transactions.

21. The Committee notes that paragraph 35 of Ind AS 115 specifies that an entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if any one (or more) of the three criteria in paragraph 35 is met.

Further, paragraph 32 of Ind AS 115 states that if an entity does not satisfy a performance obligation over time, it satisfies the performance obligation at a point in time. Accordingly, the Committee notes that at contract inception for each performance obligation, an entity applies the criteria in paragraph 35 to determine whether it recognises revenue over time.

22. The Committee notes that while applying paragraph 35(c), an entity recognises revenue over time if:

- (i) the asset created by the entity's performance does not have an alternative use to the entity; and
- (ii) the entity has an enforceable right to payment for performance completed to date.

With regard to first condition relating to whether the asset has an alternative use to the entity, the Committee notes paragraphs 36, B6 and B7 of Ind AS 115 as follows:

- “36. An asset created by an entity's performance does not have an alternative use to an entity if the entity is either restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset or limited practically from readily directing the asset in its completed state for another use. The assessment of whether an asset has an alternative use to the entity is made at contract inception. After contract inception, an entity shall not update the assessment of the alternative use of an asset unless the parties to the contract approve a contract modification that substantively changes the performance obligation. ...”
- “B6 In assessing whether an asset has an alternative use to an entity in accordance with paragraph 36, an entity shall consider the effects of contractual restrictions and practical limitations on the entity's ability to readily direct that asset for another use, such as selling it to a different customer. The possibility of the contract with the customer being terminated is not a relevant consideration in assessing whether the entity would be able to readily direct the asset for another use.
- B7 A contractual restriction on an entity's ability to direct an asset for another use must be substantive for the asset not to have an alternative use to the entity. A contractual restriction is substantive if a customer could enforce its rights to the promised asset if the entity sought to direct the asset for another use. In contrast, a contractual restriction is not substantive if, for example, an asset is largely interchangeable with other assets that the entity could transfer to another customer without breaching the contract and without incurring significant costs that otherwise would not have been incurred in relation to that contract.”

The Committee notes that in the extant case, based on the legal precedents submitted, the company has taken a view that the asset, viz., real estate unit under construction, does not have an alternative use to the company since it is restricted contractually from readily directing the asset for another use during the creation of that asset. Based on the facts provided by the querist, the Committee notes that the real estate apartment/unit is clearly specified in the Agreement to Sale with the customer with regard to its location (floor, etc.) and the company cannot change or substitute the real estate unit specified in the contract with the customer, and thus the customer could enforce its rights to the unit if the entity sought to direct the asset for another use. Accordingly, the contractual restriction is substantive and the real estate unit does not have an alternative use to the entity as described in paragraph 35(c).

23. As regards the second condition relating to whether the entity has an enforceable right

to payment for performance completed to date, the Committee notes paragraphs 37, B9, B10, B11, B12 and B13 of Ind AS 115 as follows:

- “37 An entity shall consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for performance completed to date in accordance with paragraph 35(c). The right to payment for performance completed to date does not need to be for a fixed amount. However, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity’s failure to perform as promised. ...”
- “B9 In accordance with paragraph 37, an entity has a right to payment for performance completed to date if the entity would be entitled to an amount that at least compensates the entity for its performance completed to date in the event that the customer or another party terminates the contract for reasons other than the entity’s failure to perform as promised. An amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date (for example, recovery of the costs incurred by an entity in satisfying the performance obligation plus a reasonable profit margin) rather than compensation for only the entity’s potential loss of profit if the contract were to be terminated. Compensation for a reasonable profit margin need not equal the profit margin expected if the contract was fulfilled as promised, but an entity should be entitled to compensation for either of the following amounts:
- (a) a proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity’s performance under the contract before termination by the customer (or another party); or
  - (b) a reasonable return on the entity’s cost of capital for similar contracts (or the entity’s typical operating margin for similar contracts) if the contract-specific margin is higher than the return the entity usually generates from similar contracts.
- B10 An entity’s right to payment for performance completed to date need not be a present unconditional right to payment. In many cases, an entity will have an unconditional right to payment only at an agreed-upon milestone or upon complete satisfaction of the performance obligation. In assessing whether it has a right to payment for performance completed to date, an entity shall consider whether it would have an enforceable right to demand or retain payment for performance completed to date if the contract were to be terminated before completion for reasons other than the entity’s failure to perform as promised.
- B11 In some contracts, a customer may have a right to terminate the contract only at specified times during the life of the contract or the customer might not have any right to terminate the contract. *If a customer acts to terminate a contract without having the right to terminate the contract at that time (including when a customer fails to perform its obligations as promised), the contract (or other laws) might entitle the entity to continue to transfer to the customer the goods or services promised in the contract and require the customer to pay the consideration promised in exchange for those goods or services. In those circumstances, an entity has a right to payment for performance completed to date because the entity has a right to continue to perform its obligations in accordance with the contract*

*and to require the customer to perform its obligations (which include paying the promised consideration).* (Emphasis supplied by the Committee.)

- B12 In assessing the existence and enforceability of a right to payment for performance completed to date, an entity shall consider the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms. This would include an assessment of whether:
- (a) legislation, administrative practice or legal precedent confers upon the entity a right to payment for performance to date even though that right is not specified in the contract with the customer;
  - (b) relevant legal precedent indicates that similar rights to payment for performance completed to date in similar contracts have no binding legal effect; or
  - (c) an entity's customary business practices of choosing not to enforce a right to payment has resulted in the right being rendered unenforceable in that legal environment. However, notwithstanding that an entity may choose to waive its right to payment in similar contracts, an entity would continue to have a right to payment to date if, in the contract with the customer, its right to payment for performance to date remains enforceable.
- B13 The payment schedule specified in a contract does not necessarily indicate whether an entity has an enforceable right to payment for performance completed to date. Although the payment schedule in a contract specifies the timing and amount of consideration that is payable by a customer, the payment schedule might not necessarily provide evidence of the entity's right to payment for performance completed to date. This is because, for example, the contract could specify that the consideration received from the customer is refundable for reasons other than the entity failing to perform as promised in the contract."

From the above, the Committee notes that paragraph 37 states that, to have an enforceable right to payment, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised. Further, paragraph B10 states that in assessing whether an entity has right to payment for performance completed to date, it shall consider whether it would have an *enforceable right to demand or retain payment* for performance completed to date if the contract were to be terminated before completion for reasons other than the entity's failure to perform as promised. In this context, paragraph B12 states that in assessing the existence and enforceability of a right to payment, the entity shall consider the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms. This would include an assessment of whether legislation, administrative practice or legal precedent confers upon the entity a right to payment for performance to date even though that right is not specified in the contract with the customer. The Committee observes that the assessment of enforceable rights as described in paragraph 35(c) is focused on the existence of the right and its enforceability. The Committee also notes that an entity does not have an enforceable right to payment for performance completed to date as described in paragraph 35(c), if, based on contractual terms or relevant legal precedence, the entity is not entitled to an amount that at least compensates it for performance completed to date in the event of cancellation for reasons other than the entity's failure to perform as promised. This would be the case where, in the event of the courts accepting requests from the customers to cancel contracts, the entity is entitled only to a termination penalty that does not compensate

the entity for performance completed to date.

24. Accordingly, the Committee is of the view that the assessment of enforceable right to payment requires an assessment of the particular facts and circumstances of the contract/Agreement taking into consideration the legal environment within which the contract is enforceable. In this context, the Committee notes that the Agreement to Sale in the extant case, provides the right to the customer to terminate the Agreement only on failure of the company to perform its obligations under the agreement as promised to the customer, such as, to give timely possession to the customer (allottee), or on breach by the company of any of the representations, warranties and covenants, etc. and not due to any other reason. Thus, the terms of Agreement are enforceable both on the company as well as the customer. Moreover, on the Allottee committing three defaults in payment of installments on the due dates, the promoter has the *option* to terminate the agreement. Thus, if the Promoter does not opt to terminate Agreement, the customer, by himself, apparently cannot terminate the Agreement and in that case, as per the Agreement, the Promoter may have the right to enforce the payment from the customer, which, although in view of the Committee, would again depend upon the legal enforceability of the same considering the legal position/precedents etc. The Committee further notes that as per clause 4.3 of the Agreement to Sale submitted by the querist, in the case of default in payment by the customer on the due dates, and if the company (promoter) opts to terminate the agreement with the customer, the company shall refund to the customer the instalments of consideration of the apartment/unit which may have till then been paid by the customer to the company subject to adjustment and recovery of any agreed liquidated damages, i.e., deduction of 10% of the total consideration, together with any other amount which may be payable to the company and subject to the adjustment/deduction related to the Government statutory dues and taxes, bank loan, brokerage if any that have been paid by the company. The Committee is of the view that this contractual clause restricts the company's right to recover only 10% of the consideration in case it opts to terminate the agreement on default by the customer. However, the querist has mentioned that the contractual rights under the Agreement are without prejudice to other remedies available to the company under other law, notwithstanding the contractual terms to the contrary. Further, as per the requirements of Ind AS 115, entities are required to consider any laws, legislation or legal precedent that could supplement or override contractual terms in addition to contractual terms.

From the above, the Committee is of the view that since the Agreement with the customer is silent with regard to the promoter's (company's ) right to require the customer to pay the consideration, the relevant law (s) and legal precedents, etc. have to be relied upon. As far as law is concerned in the context of real estate transaction, the Committee notes that the Real Estate (Regulation and Development) Act, 2016 (RERA) is the central and overriding law. Therefore, in this context, the Committee notes sections 19(6) and 19(7) of the Real Estate (Regulation and Development) Act, 2016, which states as follows:

“Rights and Duties of Allottees

**19.**

...

(6) Every allottee, who has entered into an agreement for sale to take an apartment, plot or building as the case may be, under section 13, shall be responsible to make necessary payments in the manner and within the time as specified in the said agreement for sale and shall pay at the proper time and place, the share of the registration charges, municipal taxes, water and electricity charges, maintenance charges, ground rent, and other charges, if any.

(7)The allottee shall be liable to pay interest, at such rate as may be prescribed, for any delay in payment towards any amount or charges to be paid under sub-section (6).”

From the above, the Committee notes that the Act prescribes the allottee to make necessary payments in the manner and within the time as specified in the Agreement for sale and also prescribes interest for any delay in payments. Further, reading of paragraph B 12 of Ind AS 115 indicates high significance of legal environment and underlying legal jurisprudence in the country. The Committee also notes that the querist has also relied upon the legal opinion and judgement to derive on the point that till the contract is not terminated, it continues to be enforceable and on this basis, the company contends that it has complied with the condition under paragraph 35(c) of Ind AS 115. However, the Committee wishes to point out that considering its terms of reference, as a matter of policy, it does not enter into legal interpretation of various enactments and legal issues involved and expresses opinions on accounting and auditing aspects. Since in the extant case, the impugned matter is substantially based on legal interpretation; under these circumstances, the Committee is of the opinion that based on legal interpretation, if the company is able to demonstrate compliance with the conditions under paragraph 35(c) of Ind AS 115, there is no adversity in recognising revenue over time on the basis of facts and circumstances submitted to it.

#### **D. Opinion**

25. In view of terms of reference, as a matter of policy, the Committee does not enter into legal interpretational issues and expresses opinions on accounting and auditing aspects. Accordingly, on the basis of the above, without evaluating the legal interpretation of various enactments and the issues involved, which, in the extant case, are substantially based on legal interpretation; under these circumstances, the Committee is of the opinion that based on legal interpretation, if the company is able to demonstrate compliance with the conditions under paragraph 35(c) of Ind AS 115, then the Committee does not find any adversity in recognising revenue over time on the basis of facts and circumstances submitted to it, as discussed in paragraphs 22 to 24 above.

#### **Annexure A**

##### ***Technical literature guidance:***

##### ***Guidance for revenue recognition under Ind AS 115***

1. As per paragraph 31 to 33 and 35 to 37 of Ind AS 115 provides the following guidance with respect to satisfaction of the performance obligations:

**“31 An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.**

32 For each performance obligation identified in accordance with paragraphs 22–30, an entity shall determine at contract inception whether it satisfies the performance obligation over time (in accordance with paragraphs 35–37) or satisfies the performance obligation at a point in time (in accordance with paragraph 38). If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

33 Goods and services are assets, even if only momentarily, when they are received

and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

- (a) using the asset to produce goods or provide services (including public services);
- (b) using the asset to enhance the value of other assets;
- (c) using the asset to settle liabilities or reduce expenses;
- (d) selling or exchanging the asset;
- (e) pledging the asset to secure a loan; and
- (f) holding the asset.”

“35 An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs (see paragraphs B3-B4);
- (b) the entity’s performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or
- (c) the entity’s performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).

36 An asset created by an entity’s performance does not have an alternative use to an entity if the entity is either restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset or limited practically from readily directing the asset in its completed state for another use. The assessment of whether an asset has an alternative use to the entity is made at contract inception. After contract inception, an entity shall not update the assessment of the alternative use of an asset unless the parties to the contract approve a contract modification that substantively changes the performance obligation...

37 An entity shall consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for performance completed to date in accordance with paragraph 35(c). The right to payment for performance completed to date does not need to be for a fixed amount. However, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity’s failure to perform as promised...”

### ***Guidance for alternative use under Basis for Conclusions on IFRS 15***

“BC137 Although the level of customisation might be a helpful factor to consider when assessing whether an asset has an alternative use, the boards decided that it should not be a determinative factor. This is because in some cases (for example, some real estate contracts), an asset may be standardised but may still not have an alternative use to an entity, as a result of substantive contractual restrictions that

preclude the entity from readily directing the asset to another customer. If a contract precludes an entity from transferring an asset to another customer and that restriction is substantive, the entity does not have an alternative use for that asset because it is legally obliged to direct the asset to the customer. Consequently, this indicates that the customer controls the asset as it is created, because the customer has the present ability to restrict the entity from directing that asset to another customer (an entity would also need to consider whether a right to payment exists to conclude that control of the asset transfers over time as it is created, see paragraphs BC142–BC148). The boards observed that contractual restrictions are often relevant in real estate contracts, but might also be relevant in other types of contracts.”

BC138 The boards also noted that contractual restrictions that provide a protective right to the customer would not be sufficient to establish that an asset has no alternative use to the entity. The boards observed that a protective right typically results in the entity having the practical ability to physically substitute or redirect the asset without the customer being aware of or objecting to the change. For example, a contract might state that an entity cannot transfer a good because a customer has legal title to the goods in the contract. However, the customer’s legal title to the goods is intended to protect the customer in the event of the entity’s liquidation and the entity can physically substitute and redirect the goods to another customer for little cost. In this example, the contractual restriction is merely a protective right and does not indicate that control of the goods have transferred to the customer.”

#### ***Guidance for right to payment under Basis for Conclusions on IFRS 15***

“BC142 The boards decided that there is a link between the assessment of control and the factors of no alternative use and a ‘right to payment’. This is because if an asset that an entity is creating has no alternative use to the entity, the entity is effectively constructing an asset at the direction of the customer. Consequently, the entity will want to be economically protected from the risk of the customer terminating the contract and leaving the entity with no asset or an asset that has little value to the entity. That protection will be established by requiring that if the contract is terminated, the customer must pay for the entity’s performance completed to date. This is consistent with other exchange contracts in which a customer would typically be obliged to pay only if it has received control of goods or services in the exchange. Consequently, the fact that the customer is obliged to pay for the entity’s performance (or, in other words, is unable to avoid paying for that performance) suggests that the customer has obtained the benefits from the entity’s performance.”

“BC144 The boards noted that the compensation to which the entity would be entitled upon termination by the customer might not always be the contract margin, because the value transferred to a customer in a prematurely terminated contract may not be proportional to the value if the contract was completed. However, the boards decided that to demonstrate compensation for performance completed to date, the compensation should be based on a reasonable proportion of the entity’s expected profit margin or be a reasonable return on the entity’s cost of capital. Furthermore, the boards noted that the focus should be on the amount to which the entity would be entitled upon termination rather than the amount to which the entity might ultimately be willing to settle for in a negotiation. Consequently, the

boards clarified their intention about what a ‘reasonable profit margin’ is intended to represent in paragraph B9 of IFRS 15.

BC145 In addition, the boards clarified that an entity need not have a present unconditional right to payment but, instead, it must have an enforceable right to demand and/or retain payment for performance completed to date if the customer were to terminate the contract without cause before completion...”

***Guidance for right to payment in IFRIC Agenda Paper 2C March 2018***

“...The assessment of whether an entity has an enforceable right to payment for performance completed to date requires an entity to consider the rights and obligations created by the contract, taking into account the legal environment within which the contract is enforceable. Accordingly, the Committee observed that the outcome of an entity’s assessment depends on the particular facts and circumstances of the contract...”

...The Committee observed that the principle in paragraph 31 of IFRS 15 for the recognition of revenue requires the customer to have obtained control of a promised good or service. Accordingly and as noted above, the underlying objective of the criterion in paragraph 35 (c) is to determine whether the entity is transferring control of goods or services to the customer as an asset is being created for that customer. In line with this objective, it is the payment the entity is entitled to receive under the existing contract with the customer relating to performance under that contract that is relevant in determining whether the entity has an enforceable right to payment for performance completed to date. The consideration received by the entity from the third party in the resale contract is consideration relating to that resale contract—it is not payment for performance under the existing contract with the customer

In the fact pattern described in the request, the payment to which the entity has a right under the existing contract with the customer is a payment for the difference between the resale price of the unit, if any, and its original purchase price (plus selling costs). That payment does not at all times throughout the duration of the contract entitle the entity to an amount that at least approximates the selling price of the part-constructed real estate unit and, thus, it does not compensate the entity for performance completed to date. Accordingly, the entity does not have an enforceable right to payment for performance completed to date as described in paragraph 35(c) of IFRS 15...”

***Press Release for Revenue Recognition in context of real estate sector issued by ICAI***

As per the Press Release on Implementation of Ind AS 115, Revenue from Contracts with Customers in context of Real Estate Sector issued by the Institute of Chartered Accountants of India (“ICAI”):

“...the ICAI would like to clarify that the Ind AS 115 does allow recognition of revenue using Percentage of Completion Method (POCM) and has explicit and specific requirements to recognise revenue, where performance obligation is satisfied over a period of time. It may be noted that paragraphs 35-37 of Ind AS 115 explicitly permit recognition of revenue using POCM, where the performance obligation is satisfied over time.

...

It may be noted that Paragraph 35(b) & (c) of Ind AS 115 are intended to address situations of real estate sector. In view of the above, recognition of revenue as the construction progresses is possible considering the prevalent long established legal system/jurisprudence in India, and facts and circumstances of individual case/contract”

### ***Educational Material on Indian Accounting Standard (Ind AS 115)***

As per the Educational Material on Ind AS 115, issued by the Ind AS Implementation Group of the ICAI, the revenue from real estate contracts would be recognised for the following scenarios:

**“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. The courts have previously upheld similar rights that entitle developers to require the customer to perform, subject to the entity meeting its obligations under the contract.

**Response to Scenario A:** ... P cannot change or substitute the real estate unit specified in the contract with the customer, and thus the customer could enforce its rights to the unit if the entity sought to direct the asset for another use. Accordingly, the contractual restriction is substantive and the real estate unit does not have an alternative use to P.

P also has a right to payment for performance completed to date in accordance with paragraphs 37 and B9-B15. 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. Therefore, the terms of the contract and the legal precedent indicate that there is a right to payment for performance completed to date.

Consequently, the criteria in paragraph 35(c) are met, and 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 in accordance with paragraphs 39-45 and paragraph B14-B19.

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

**Response to Scenario B:** As discussed above, the entity applies paragraph 35(c) 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 in accordance with paragraph 35(c). Instead, P accounts for the sale of the unit as a performance obligation satisfied at a point in time in accordance with paragraph 38.

**Scenario C:** In the event of a default by the customer, P Ltd. shall serve the customer with a notice period to perform/pay. Either P Ltd. can require the customer to perform as required under the contract or the entity can cancel the contract in exchange for the asset under construction and be entitled to a penalty of a proportion of the contract price. In case of such cancellation, the P Ltd. shall be entitled to sell the unit to any other person if the customer does not fulfil his obligation within the notice period given by P Ltd.

**Response to Scenario C:** Notwithstanding that P Ltd. could cancel the contract (in which case the customer's obligation to P Ltd. would be limited to transferring control of the partially completed asset to it and paying the penalty prescribed), P Ltd. has a right to payment for performance completed to date because it could also choose to enforce its rights to proportionate payment under the contract. Consequently, the criterion in paragraph 35(c) of Ind AS 115 is met and the entity has a performance obligation that it satisfies over time. The fact that P Ltd. may choose to cancel the contract in the event the customer defaults on its

obligations would not affect that assessment, provided that P Ltd.'s rights to require the customer to continue to perform as required under the contract (i.e., pay the promised consideration) are enforceable.

...”

***The Real Estate (Regulation and Development) Act, 2016***

As per section 18 of The Real Estate (Regulation and Development) Act, 2016

“18. (1) If the promoter fails to complete or is unable to give possession of an apartment, plot or building,—

(a) in accordance with the terms of the agreement for sale or, as the case may be, duly completed by the date specified therein; or

(b) due to discontinuance of his business as a developer on account of suspension or revocation of the registration under this Act or for any other reason,

he shall be liable on demand to the allottees, in case the allottee wishes to withdraw from the project, without prejudice to any other remedy available, to return the amount received by him in respect of that apartment, plot, building, as the case may be, with interest at such rate as may be prescribed in this behalf including compensation in the manner as provided under this Act:

Provided that where an allottee does not intend to withdraw from the project, he shall be paid, by the promoter, interest for every month of delay, till the handing over of the possession, at such rate as may be prescribed.

(2) The promoter shall compensate the allottees in case of any loss caused to him due to defective title of the land, on which the project is being developed or has been developed, in the manner as provided under this Act, and the claim for compensation under this subsection shall not be barred by limitation provided under any law for the time being in force

(3) If the promoter fails to discharge any other obligations imposed on him under this Act or the rules or regulations made thereunder or in accordance with the terms and conditions of the agreement for sale, he shall be liable to pay such compensation to the allottees, in the manner as provided under this Act.”

As per sub section (6) and (7) of section 19 of The Real Estate (Regulation and Development) Act, 2016

“(6) Every allottee, who has entered into an agreement for sale to take an apartment, plot or building as the case may be, under section 13, shall be responsible to make necessary payments in the manner and within the time as specified in the said agreement for sale and shall pay at the proper time and place, the share of the registration charges, municipal taxes, water and electricity charges, maintenance charges, ground rent, and other charges, if any.

(7) The allottee shall be liable to pay interest, at such rate as may be prescribed, for any delay in payment towards any amount or charges to be paid under sub-section (6).”