

Query No. 16

Subject: *Revenue Recognition in a Joint Development Arrangement under AS framework.*¹

A. Facts of the Case

1. A Limited Liability Partnership (hereinafter referred to as ‘the LLP’ or ‘the Land Owner’) owns a land which has been contributed for development under a Joint Development Agreement (JDA) with a Real Estate Developer (hereinafter referred to as ‘the Developer’) to construct and sell residential units. LLP was converted from private limited company.

2. The salient features of JDA between the Land Owner (LLP) and the Developer are as under:

- a. *Revenue sharing:* Land Owner (LLP) is entitled to 46% and the Developer is entitled to 54% of the total revenue from the project (as finally agreed).
- b. *Definition of Revenue:* Revenue shall mean and include all the proceeds, including sales, advances/booking amount generated from the sale of the residential units/flats subject to the terms and conditions of the Agreement, together with proportionate percentage of undivided share in common areas and facilities, including all the receipts towards charges for car parking and for usage of the common areas and facilities, but shall not include any amount received as deposits payable for statutory authorities and utility connections.

3. Obligations of the Land Owner:

The Land Owner has irrevocably and exclusively granted, permitted and licensed to the Developer to enter upon the scheduled property for the development of the same as envisaged under the Agreement.

The Land Owner shall continue to be the legal owner of the property till such time as the contract is discharged by performance and the Developer shall have only the right of entry to the scheduled property for the purpose of development.

The Land Owner has also agreed not to disturb or interfere with the construction activities carried out by the Developer and shall co-operate in providing necessary documents as may be required by planning/licensing authorities from time to time.

4. Obligations of the Developer:

- a. The Developer has paid a refundable security deposit as specified in the Agreement.
- b. The Developer hereby agrees to prepare the necessary plans, drawings and designs for the implementation of the project at its cost and submit the same to the concerned Governmental authorities for obtaining licenses, sanctions, consents, permissions, no-objections and other approvals required for implementation of the project. The responsibility for preparing the plans and obtaining the approvals of the project shall be that of the Developer.

¹ Opinion finalised by the Committee on 16.10.2025.

- c. All the costs in relation to developing and implementing the project, including the costs of obtaining the approvals, fees payable to Government authorities, architects, contractors, staff and workmen, the cost of constructions shall exclusively be borne and paid for by the Developer.
- d. The Developer shall secure project completion within the period specified in the Agreement along with a grace period as mentioned therein.
- e. The Developer shall determine the sale price of the residential units subject to the minimum sale price conditions as specified in the Agreement.
- f. All the revenue received from the sale of the residential units shall be deposited into/credited to the joint escrow account opened with the bank by mutual consent till the completion of the sale of all the units in the project.

5. *Power of Attorney:*

The LLP has executed a General Power of Attorney (POA) in favour of the Developer which authorises the Developer to appear before various Government authorities, obtain necessary construction approvals, apply for and obtain plan sanctions, certificates and permissions, secure utility connections, raise funds by creating mortgages on the Developer's revenue share, and execute sale agreements and conveyance documents in favour of purchasers in respect of the Developer's undivided share in the scheduled property.

6. *Nature of Land in Books:*

The subject land is shown as 'Inventory' in the books of account of the LLP.

7. *Revenue Collection Mechanism:*

As per the Agreement, all sale proceeds will be deposited in a joint escrow account and distributed to the Land-Owner (LLP) and Developer in the ratio of 46:54 respectively.

8. *Current Accounting Treatment Dilemma:*

The LLP is uncertain about the appropriate method of accounting for recognition of income under the relevant accounting standards regarding the timing of recognition, measurement of income, the classification of land in books and accounting for consideration received in the form of constructed area, if remain unsold.

9. The LLP seeks opinion of the Expert Advisory Committee on the following specific issues:

- What is the appropriate accounting treatment for recognition of income by the LLP under the JDA arrangement where the LLP receives either cash share or share in constructed area (if remained unsold)?
- At the time of possession to the ultimate customer or at time of execution of sale deed whichever is earlier? or
- As and when the builder receives payment from customers and 46% share becomes due to the LLP? or
- As and when the LLP receives 46% of its share from the builder? or
- Using POCM (Percentage of Completion Method) (which may be most likely be followed by Developer)? or

- Using PCM (Project Completion Method)?

The Committee may consider the following aspects while formulating its opinion:

- i. AS 9 – Revenue Recognition
- ii. AS 2 – Valuation of Inventories
- iii. Guidance Note on Accounting for Real Estate Transactions (Revised 2012)
- iv. Past EAC Opinion on similar JDA scenario (published as Query No. 34 of Compendium of Opinions, Volume XXXIII)

In spite of the fact that accounting treatment in accordance with the Accounting Standards and provisions of Income-tax Act, 1961 both are different, the querist has drawn attention of the Committee to the fact that in the recent judgment, the Hon'ble High Court of Calcutta in the case of Principal Commissioner of Income-tax vs Emporis Properties (P.) Ltd. (ITAT/59/2023, IA NO. GA/1/2023 dated March 30, 2023), the Court accepted the assessee's contention that profit from stock-in-trade is chargeable to tax under the head 'Profits and Gains of Business' and would arise in the year of actual sale to the prospective buyer.

B. Query

10. In view of the above facts and considering the relevant provisions of applicable Accounting Standards, the querist has sought the opinion of the Expert Advisory Committee on the appropriate accounting treatment for income recognition by the Land Owner (LLP) in the Joint Development Agreement.

C. Points considered by the Committee

11. The Committee notes that the basic issue raised by the querist relates to income recognition by Land Owner (LLP) in the Joint Development Agreement entered into with the Developer. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting for refundable security deposit paid by Developer to LLP, appropriateness of revenue-sharing ratio, measurement of income, accounting for royalty to be paid under JDA, accounting treatment by the Developer, accounting at the time of transition from private limited company to LLP, etc. The Committee has answered the issue only from accounting perspective and not from legal perspective, such as, interpretation of joint development agreement, power of attorney, Income-tax Act, 1961, judgement of the High Court, etc.

12. At the outset, the Committee notes that section 34A inserted by Limited Liability Partnership (Amendment) Act, 2021 provides as follows:

“34A. The Central Government may, in consultation with the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013,

- (a) prescribe the standards of accounting; and
- (b) prescribe the standards of auditing,

as recommended by the Institute of Chartered Accountants of India constituted under section 3 of the Chartered Accountants Act, 1949, for a class or classes of limited liability partnerships.”

Further, in accordance with the LLP Act 2008, the accounts of every LLP are required to be audited in accordance with the LLP Rules 2009, which provides that the Auditor of an LLP is required to conduct the audit and issue the Auditors’ Report in accordance with the Auditing Standards issued by the Auditing and Assurance Standards Board of ICAI.

The Committee further notes that the Accounting Standards for LLPs are yet to be notified by the Central Government. Therefore, in the absence of notified accounting standards, since the LLP in the extant case is carrying on commercial activities, the Committee is of the view that the Accounting Standards issued by the ICAI shall be followed by the LLP, considering the following requirements of the ‘Preface to the Statements of Accounting Standards’, issued by the ICAI:

“3.3 Accounting Standards are designed to apply to the general purpose financial statements and other financial reporting, which are subject to the attest function of the members of the ICAI. Accounting Standards apply in respect of any enterprise (whether organised in corporate, co-operative or other forms) engaged in commercial, industrial or business activities, irrespective of whether it is profit oriented or it is established for charitable or religious purposes. Accounting Standards will not, however, apply to enterprises only carrying on the activities which are not of commercial, industrial or business nature, (e.g., an activity of collecting donations and giving them to flood affected people). Exclusion of an enterprise from the applicability of the Accounting Standards would be permissible only if no part of the activity of such enterprise is commercial, industrial or business in nature. Even if a very small proportion of the activities of an enterprise is considered to be commercial, industrial or business in nature, the Accounting Standards would apply to all its activities including those which are not commercial, industrial or business in nature.”

“6.1 The Accounting Standards will be mandatory from the respective date(s) mentioned in the Accounting Standard(s). The mandatory status of an Accounting Standard implies that while discharging their attest functions, it will be the duty of the members of the Institute to examine whether the Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from the Accounting Standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviation.”

13. The Committee further notes the following clauses from the JDA:

“1.1 Definitions

...

“**Gross Sale Proceeds**” means all receivables, including but not limited to, the transfer or sale proceeds or rentals arising from the transfer, sale, lease, license or proposed transfer, sale, lease, license of the Apartments, to be developed and constructed on the Property and the sale or grant of the right of user of the

parking spaces, or terraces in the Project in favour of the prospective Purchasers,
...

“Project” shall mean the design, development and construction of the Buildings, containing residential Apartments and related infrastructural facilities and amenities on the Property including the Common Areas, and the marketing and sale of these Apartments to prospective Purchasers.

“Revenue Sharing Ratio” shall, subject to any Adjustments mean the ratio of 52:48, in which the Gross Sale Proceeds shall be shared between the Developer and the Owner.”

- “2.1 In consideration of the representations and warranties made by the Developer and the duties and obligations agreed to be performed by the Developer hereinafter and the Owner's Share hereby reserved, the Owner hereby permits the Developer to develop the Property. In consideration of the Developer's Share, the Developer hereby agrees to develop the Property entirely at its cost and expense and in the manner and subject to the terms and conditions set forth herein.”
- “4.1 The Owner hereby permits to the Developer a limited license to enter upon the Property to commence and carry out the preparatory work for the Project until the Commencement Certificate is obtained. On the Commencement Certificate being obtained, this license shall continue in order to permit the Developer to fulfil its obligation of developing the Project as per the terms and conditions contained herein.”
- “5.1 The Developer shall prepare the Draft Plans ...If the Owner suggests any modifications in the Draft Plans, the Developer shall consider such suggestions while finalising the same. ...The Developer shall secure all the requisite Approvals, in the name of the Owner (with Developer being mentioned as the POA holder), for construction and development on the Property for maximum Saleable Area as per prevailing laws. No changes ... which are likely to result in the Saleable Area being shall be made to the Sanctioned Plan, except with the prior written approval of the Owner.”
- “6.4 The Developer shall be entitled to ... engage or remove Persons of the Project Team for execution of the construction work of the Project. ...
- 6.5 The Project Team and all Persons employed are engaged by the Developer in connection with the development and construction of the Project, shall be the Developer’s employees ...”
- “7.2 Except as provided in Clause 7.3 below, the cost of construction of the Residential Complex and generally the development of the Project, including the costs payable to all the authorities for obtaining all Approvals, including licenses, permissions and sanctions, the connection charges and deposits for electricity, water and sewerage and other utilities and fees payable to the Project Team and other Persons involved in the construction and development of the

Project (“**Development Charges**”) shall be borne and paid by the Developer alone.”

“ARTICLE 10: REVENUE SHARING AND REFUNDS

- 10.1 The Gross Sale Proceeds shall be shared between the Parties in the Revenue Sharing Ratio i.e. 52% and 48% for the Developer and the Owner, respectively AFTER PAYING Royalty of 4%.
- 10.2 All the Gross Sale Proceeds shall be received by the Developer or its agents only by way of cheques, demand drafts, wire transfers or RTGS favouring a escrow account...which shall be jointly set up by the Parties with a mutually acceptable reputed bank (“**Escrow Agent**”), and such deposits shall be appropriately accounted for by the Developer. The cheques, wire transfers, RTGS and demand drafts received towards proceeds from the sale of Apartments, including revenues from parking spaces and terraces shall be deposited into the Escrow Account. ... ”
- “10.4 Subject to Clause 10.3 above, on each Monday and Thursday of every calendar week and more frequently, it mutually agreed between the Parties, (“**Release Days**”), the Owner’s Share shall be transferred from the Escrow Account to an account specified by the Owner (“**Owner’s Account**”) and the Developer’s Share shall be transferred from the Escrow Account to an account specified by the Developer (“**Developer’s Account**”).”
- “10.6 If at any time any Purchaser cancels its booking, any amount paid by such Purchaser which becomes repayable on such cancellation shall, on the joint instructions of the Owner and the Developer, be paid out of the amounts deposited in the Escrow Account...If the amounts in the Escrow Account are inadequate for making any refund, the Developer and Owner shall, for the purpose of such refund, deposit in the Escrow Account any amounts required to be repaid to such Purchaser in the ratio of 50:50. ...”
- “11.1 On the Completion of the Project in accordance with the Specifications and the Sanctioned Plan and after the entire Gross Sale Proceeds has been received by the Parties, Owners shall execute a deed of conveyance, (with the Developer as a Confirming Party) or other proper document of transfer of the Property in favour of the ultimate body or association (“**Ultimate Body Corporate**”) formed by the Purchasers of Apartments in the Residential Complex ... The Developer shall as the Promoter be party to any such deed of conveyance or other proper document of transfer for the purpose of conveying the Buildings constructed by it on the Property in favour of the Ultimate Body Corporate. ...
- 11.2 The Sale Agreement, which shall govern the understanding with the Purchasers, shall be in a form mutually agreed upon between the Parties. No deviation shall be made by the Developer to such agreed form without the Owner’s approval, other than any routine administrative deviations. ...”

“ARTICLE 13: OWNER’S OBLIGATIONS AND COVENANTS AND LIMITATIONS

13.1 The Owner has simultaneously with the execution of this Agreement, executed a PoA in favour of the Developer and its nominee(s) to enable the Developer to, *inter-alia*, proceed with the obtainment of the Approvals including, license(s), plan(s), consent(s), permission(s) and no objection(s) with regard to the development of the Project, authorising the Developer to represent the Owner before such Government Authority as may be required and for such other incidental purposes as may be required to effectively carry out the intent of this Agreement.

...

13.6 The Owner declares that the Developer has entered into this Agreement expressly on the faith that they have encumbrance free marketable title to the Schedule Property...”

“14.6 The Developer shall be solely responsible for the overall Project design, development, management, construction, marketing, and sales of the Apartments...”

“14.10 All the obligations of the Developer shall be performed by it from out of the Developer’s Share or its own funds. The Developer agrees that the Owner shall not be responsible for or required to provide any funds for the Project.”

“ARTICLE 17: STEP IN RIGHT

17.1 In the event of (1) non Completion of the Project by the Project Completion Date (2) the inability of the Developer to obtain the required Approvals with respect to the development of the Project, ... the Developer shall be entitled to a grace period of six months ... to complete the Project.

17.2 In case if the Developer is unable to complete the Project within the Extended Project Completion Date, the Developer shall be entitled to 12 months from the Extended Project Completion Date (“Compensation Project Completion Period”), subject to ...

17.3 After completion of the Compensation Project Completion Period, the Owner shall have the right to ... step in (“**Step-in-Right**”) the position of the Developer ... and shall be entitled to complete the Project and do all acts, things and deeds in relation to and necessary for the same. The Owner shall, from the date of such exercise of the Step-in Right, be vested with all the rights and interest of the Developer under this Agreement ...

17.4 Upon the Owner exercising Step-in Right as per clause 17.3 above:

(i) As regards the Super built area completed and for which occupation certificate has been obtained ..., the Developer shall be entitled to his share in the Gross Sale Proceeds ...

(ii) As regards the Super built area un-completed and for which occupation certificate has not been obtained ..., the Developer shall be entitled to receive cost of development, construction and other related costs for the completion of the Project ...”

“19.2 All policy decisions regarding sales and pricing of the Apartments shall be made by mutual agreement of the Owner and the Developer. ...”

ARTICLE 21: TERMINATION

“21.1 Except as provided in this Agreement, no Party shall be entitled to terminate this Agreement. However, a Party shall be entitled to terminate this Agreement if the other Party materially breaches any of its representations, warranties, or obligations specified under this Agreement, ...”

“22.1 The ownership of the Property shall at all times during the Term of this Agreement vest absolutely with the Owner, until the said ownership rights in respect of the Property are transferred in favour of the Ultimate Body Corporate or Purchaser of the Apartment...”

“24.1 The Developer shall not be entitled to obtain any loan facility(ies) from any bank(s),...by creating any Encumbrance of any nature whatsoever on the Property or any part thereof, the Residential Complex or any part of the Project, or any right or interest in the Project Assets, in terms of this Agreement, at any time during or after the Term of this Agreement.”

From the above, the Committee notes the following relevant features of the JDA:

- (a) The Agreement specifies a project involving construction and development of property in which the revenue from sale of such developed property/project will be shared in the agreed manner between the Owner of the land (LLP) and the Developer.
- (b) The duties and obligations of both the parties, Developer and the Owner (LLP) are determined by the Agreement. The Developer is to obtain the permissions and approvals to commence construction, to design, develop and construct the Apartments, to arrange for funds for construction and development and to market or sell the Apartments constructed; whereas the Owner shall contribute the land with clear and marketable title which is free from encumbrances, shall permit to the Developer a limited license to enter upon the Property and shall execute a POA to fulfil its obligations under the Agreement.
- (c) As per Article 10 of the Agreement, all the gross sale proceeds received from the sale of the apartments shall be deposited only into the Joint Escrow Account, which will be transferred by the bank to the Developer’s and the Owners’ accounts at specified frequencies in their respective revenue sharing ratio. Thus, it indicates that none of the party has a sole control on the proceeds collected from sale of apartments. If at any time, any purchaser cancels its booking and any amount paid by such Purchaser becomes repayable, the same is also shared in the specified ratio as per JDA by both the parties.

- (d) Article 11.1 of the Agreement provides that on the completion of the Project and after the entire ‘Gross Sale Proceeds’ has been received by the parties, Owner shall execute a deed of conveyance, (with the Developer as a Confirming Party) or other proper document of transfer of the Property in favour of the ultimate body or association formed by the Purchasers of Apartments. This indicates that the Owner possesses the ownership rights till the sale of the developed Apartments and the Developer does not have full control on the same. Further, Sale Agreement with the Purchasers, shall be in a form mutually agreed upon between the Owner and Developer and no deviation shall be made by the Developer to such agreed form without the Owner’s approval, other than routine administrative deviations. Also, no change in the saleable area is allowed except with the written approval of the Owner. Furthermore, as per Article 19.2, all policy decisions regarding sales and pricing of the Apartments shall be made by mutual agreement of the Owner and the Developer. These indicate that although Developer may be entitled to take operative and administrative decisions throughout the development of the Project, these are to be taken as per the overall policies specified under the JDA and as mutually agreed between both the Owner and Developer.
- (e) As per Article 17 of the Agreement, if the Developer is unable to complete the Project within the Compensation Project Completion Period, the Owner shall have the right to step in (“Step-in- Right”) the position of the Developer. The Owner shall, from the date of such exercise of the Step-in-Right, be vested with all the rights and interests of the Developer under JDA. This indicates that although the Owner may be contributing or providing only land in the beginning, but is continuously involved in the financial and operating decisions of the Project activities till the completion of construction and then the transfer of the ownership of Apartments; and that neither of the Parties, the Owner and Developer, unilaterally control the activities of the Project.

On the basis of the above, the Committee is of the view that in the extant case, there is a contractual arrangement between the Developer and the Owner, where both the parties jointly exercise the control over the activities of the Project (viz., construction, development and sale of the Apartments over the specified land); are performing their respective obligations (with their respective resources and assets); and are also sharing economic benefits arising from the Project in a pre-determined ratio.

14. In this context, the Committee notes the following requirements of Accounting Standard (AS) 27, ‘Financial Reporting of Interests in Joint Ventures’:

“3.1 A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

3.2 Joint control is the contractually agreed sharing of control over an economic activity.

3.3 Control is the power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.”

“4. Joint ventures take many different forms and structures. This Standard identifies three broad types - jointly controlled operations, jointly controlled assets and jointly

controlled entities - which are commonly described as, and meet the definition of, joint ventures. The following characteristics are common to all joint ventures:

- (a) two or more venturers are bound by a contractual arrangement; and
- (b) the contractual arrangement establishes joint control.”

“8. The contractual arrangement establishes joint control over the joint venture. Such an arrangement ensures that no single venturer is in a position to unilaterally control the activity. The arrangement identifies those decisions in areas essential to the goals of the joint venture which require the consent of all the venturers and those decisions which may require the consent of a specified majority of the venturers.

9. The contractual arrangement may identify one venturer as the operator or manager of the joint venture. The operator does not control the joint venture but acts within the financial and operating policies which have been agreed to by the venturers in accordance with the contractual arrangement and delegated to the operator.

Jointly Controlled Operations

10. The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own fixed assets and carries its own inventories. It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations. The joint venture's activities may be carried out by the venturer's employees alongside the venturer's similar activities. The joint venture agreement usually provides means by which the revenue from the jointly controlled operations and any expenses incurred in common are shared among the venturers.

11. An example of a jointly controlled operation is when two or more venturers combine their operations, resources and expertise in order to manufacture, market and distribute, jointly, a particular product, such as an aircraft. Different parts of the manufacturing process are carried out by each of the venturers. Each venturer bears its own costs and takes a share of the revenue from the sale of the aircraft, such share being determined in accordance with the contractual arrangement.

12. In respect of its interests in jointly controlled operations, a venturer should recognise in its separate financial statements and consequently in its consolidated financial statements:

- (a) the assets that it controls and the liabilities that it incurs; and***
- (b) the expenses that it incurs and its share of the income that it earns from the joint venture.”***

From the above, the Committee notes that a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control is a joint venture. Further joint control is contractually agreed sharing of control over an economic activity and ‘control’ is the power to govern the financial and operating policies of an economic activity so as to obtain economic benefits from it.

Considering these requirements of AS 27 and analysis of various features of the JDA, as discussed in paragraph 13 above, the Committee is of the view that the JDA in the extant case is a joint venture where the Owner and the Developer have entered into a contractual arrangement for undertaking the activities of the Project under the JDA involving inter alia, construction, development and sale of apartments by the Developer on the land contributed by the Owner. Further, considering the above-reproduced requirements of AS 27 (paragraphs 10 and 11), the Committee is of the view that the arrangement in the extant case is in the nature of 'Jointly Controlled Operations' as the JDA (joint venture) involves the use of the assets and other resources of the venturers (Owner and Developer) without the establishment of a separate legal entity; and they also incur their own expenses and liabilities and raise their own finance, which represent their own obligations.

With regard to recognition of revenue from jointly controlled operation, the Committee notes that paragraph 12 of AS 27 states that in respect of its interests in jointly controlled operations, a venturer should recognise in its financial statements share of the income that it earns from the joint venture. The Committee further notes that in the extant case, 'the Project' under the joint venture involves not only construction and development of apartments, but also their sale to the prospective purchasers for which the Developer shall make marketing efforts and incur marketing costs. Therefore, the joint venture shall continue until the sale of all the apartments; and the share of revenue or income for the Owner and Developer shall arise from the sale of apartments to the prospective purchasers (viz., independent third party) and not by sharing the apartments in pre-determined ratio amongst themselves. Accordingly, in respect of its interests in jointly controlled operations, the Land Owner/LLP in the extant case should recognise in its financial statements, share of the income that it earns from the joint venture on account of sale of the output (viz., apartments) to third party.

15. Further, since the Owner's/LLP's share of income or revenue will arise from the sale of developed or under-development apartments to the third party or Purchasers of apartments, the same should be recognised by the Owner/LLP when the conditions of revenue recognition are fulfilled. With regard to revenue recognition and timing thereof, the Committee notes the following requirements of AS 9, 'Revenue Recognition' and the Guidance Note on Accounting for Real Estate Transactions, issued by the ICAI (hereinafter referred to as the 'Guidance Note'):

AS 9

"Main Principles

10. Revenue from sales or service transactions should be recognised when the requirements as to performance set out in paragraphs 11 and 12 are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

Explanation:

...

11. In a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

- (i) *the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and*
- (ii) *no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.”*

Guidance Note

“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) ...
- ...
- (c) Development and sale of residential and commercial units, row houses, independent houses, with or without an undivided share in land.
- ...
- (f) Joint development agreements for any of the above activities.”

“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 ...

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;
- (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. ...”

From the above, the Committee notes that recognition of revenue depends upon whether and at what point of time, significant risks and rewards of ownership have been transferred, which requires a careful evaluation of the facts and circumstances including elements of the transaction, agreement, understanding and conduct of the parties (venturers and the purchasers of apartments) to the transaction. Further, as per the requirements of AS 9 and the Guidance Note, in case of real estate transactions akin to sale of goods, revenue can be recognised when, inter alia, 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.

Further, the Committee notes that since the LLP in the extant case is the owner of the land and its share of performance of obligations in the joint venture is, primarily, the transfer of land (rather than construction services), its share of revenue in the joint venture should be recognised on transfer of significant risks and rewards related to ownership of such land as per the requirements of AS 9 and Guidance Note (as reproduced above).

In this regard, the Committee notes that clause 11.1 of the Joint Development Agreement provides that on the completion of the Project and after the entire Gross Sale Proceeds have been received by the Parties, Owner shall execute a deed of conveyance or other proper document of transfer of the Property in favour of the ultimate body or association formed by the Purchasers of apartments in the Residential Complex. From this, it appears that transfer of property or legal title in the apartments shall take place after the completion of project and when the entire sale proceeds from the sale of apartments have been received, which seems to imply that from the perspective of Owner (LLP), significant risks and rewards of ownership of land have not been transferred and it retains control of or property in the land till the completion of the project (including sale of apartments) and receipt of entire sale proceeds. Accordingly, the Committee is of the view that revenue in the extant case should be recognised by LLP only after completion of the project, receipt of entire sale proceeds in respect of the apartments and execution of a deed of conveyance; and when other conditions as per AS 9 and the Guidance Note are fulfilled.

16. With regard to the issue raised by the querist relating to classification of land as 'inventory', the Committee notes that till the time significant risks and rewards are not transferred to the buyer, as aforementioned, since land is being held by the LLP for sale or transfer to the buyer of apartments, the land meets the definition of 'inventory' as per the requirements of AS 2, 'Valuation of Inventories' and should be classified as such in the financial statements of the LLP. Further, any sale proceeds realised by the LLP from the sale of apartments till recognition of revenue should be considered as 'advance'.

With regard to the issue raised relating to accounting for the share in constructed area or apartments received, if remained unsold, the Committee notes that the Joint Development Agreement does not specify about sharing of unsold apartments and as discussed in paragraph 14 above, the joint venture shall continue until the sale of all the apartments; and the share of revenue or income for the Owner and Developer shall arise from the sale of apartments to the prospective purchasers (viz., independent third party) and not by sharing the apartments in pre-determined ratio amongst themselves. Further, as discussed in paragraph 15 above, since the LLP in the extant case is the owner of the land and its share of performance of obligations in the joint venture is, primarily, the transfer of land (rather than construction services), its share of revenue in the joint venture should be recognised on transfer of significant risks and rewards

related to ownership of such land to the buyers of apartments. Therefore, the question of accounting for unsold apartments in the books of LLP shall not arise.

D. Opinion

17. On the basis of the above, the Committee is of the opinion that in respect of its interests in jointly controlled operations, a venturer (land owner/LLP in the extant case) should recognise in its financial statements share of the income that it earns from the joint venture on account of sale of its output (viz. apartments) to third party, as discussed in paragraph 14 above. Further, in respect of sale to third parties, recognition of revenue depends upon whether and at what point of time, significant risks and rewards of ownership have been transferred, which requires a careful evaluation of the facts and circumstances including elements of the transaction, agreement, understanding and conduct of the parties (venturers and the purchasers of apartments) to the transaction. As discussed in paragraph 15 above, in the extant case, considering clause 11.1 of the Joint Development Agreement, it appears that from the perspective of Owner (LLP), significant risks and rewards of ownership of land will not be transferred and it retains control of or property in the land till the completion of the project (including sale of apartments) and receipt of entire sale proceeds. Accordingly, revenue in the extant case, should be recognised by LLP only after completion of the project, receipt of entire sale proceeds in respect of the apartments and execution of a deed of conveyance; and when other conditions as per AS 9 and the Guidance Note are fulfilled.
