



## Solution 125.1

<b>Component</b>	Investment property industry
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<b>Short title</b>	Revenue recognition by a property developer

**Attention:** This guidance is based on the revised standards and interpretations that are mandatory for accounting periods commencing 1 January 2005. A company may early adopt an individual revised standard, but only in its entirety. Guidance based on the previous version of the standards is included in the “Applying IFRS 2004” guidance.

### Issue

An entity should recognise revenue when [\[IAS18R.14\(a\)-\(e\)\]](#):

- a) the entity has transferred significant risks and rewards of ownership of the goods to the buyer;
- b) the entity does not retain continuing managerial involvement or control over the goods sold;
- c) the amount of revenue can be measured reliably;
- d) it is probable that the economic benefits associated with the transaction will flow to the entity; and
- e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

A construction contract is defined as a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function, or their ultimate purpose or use. A significant feature of a construction contract is that the date of commencement and the date of completion fall into different accounting periods [\[IAS11.3\]](#).

Should a property developer recognise revenue using construction contract accounting [\[IAS11.22\]](#) or when risks and rewards are transferred to the purchaser [\[IAS18R.14\]](#)?

### Background

Entity A, a property developer is the legal owner of a piece of land. Entity A obtains all the necessary building permits and is marketing the construction and sale of 10 houses. During the first 5 months of the construction phase A has successfully advertised and sold 8 of the 10 houses. Contracts were signed with the respective buyers at that time. The agreements include a plot sale and the construction of a house. The contracts do not distinguish between those two elements.



### **Solution**

Entity A should recognise revenue in accordance with IAS 18. The property developer is buying land and building houses on it. This would mean that the construction of houses on its own land is in the scope of IAS 2R (Inventories). The fact that the houses are sold at a certain moment does not change that position.

Entity A enters into a forward sales contract where the buyer agrees to buy before the house is ready. The delivery criteria in IAS 18 would still require that no profit is recognised before the house changes hands.

These agreements do not meet the definition of a construction contract. The contract is not specifically negotiated for the construction of an asset. There is neither a construction contract nor a specific negotiation with the buyer about the building of the houses. The choice given to the buyer to choose from a limited number of options in the final layout of the houses (kitchen, with or without a balcony or an extra room, colour of the tiles etc) does not change this conclusion.