IFRIC 15 and the Malaysian Property Segment

With another new standard setting its path towards the Malaysian property industry, should Developers brace?

by **Michelle Lim**

Based on current developments, 1st of July 2010 seems set to hold the enforcement of 'International Financial Reporting Interpretation Committee (IFRIC) 15: Agreements for the Construction of Real Estate'. Property developers in the country would see accounting treatment of their revenue subject to recognition upon completion of a development project, rather than the current percentage-of-completion method.

Accounting Treatment

The crust behind this treatment lies within an evaluation of whether control, risks and rewards of ownership of the work in progress (WIP) is transferred to buyers as construction progresses, or at one point of time. If it is determined that a 'continuous transfer' occurs, revenue should therefore be recognised using the percentage-of-completion method. If the transfer of control, risks and rewards of ownership of WIP remains with the developer, revenue should therefore be recognised at the point in time when the development is completed, or delivered. As the former Malaysian Institute of Accountants (MIA) President highlighted in his article on this matter, the fundamental question, is whether property developers are selling products (completed developments), or selling services (construction services as engaged by buyers). Revenue from sales of products are recognised when it is delivered, whereas the performance of services are recognised based on percentage of completion.

Impact

In terms of impact, developers, especially those of multiple-unit developments, would most likely need to comply with IFRIC 15 and recognise revenue upon delivery of a completed property. In terms of tax implication, the impact is somewhat speculative as the Inland Revenue Board (IRB) has yet to clarify on its response to the standard, as its position still stands at Public Ruling 2/2009 which requires recognition of revenue based on the percentage-of-completion method. On this note, observers have commented that with the IFRIC 15 regime, developers would most probably need to keep two sets of accounts. The IRB's view of this matter, when the above Public Ruling was issued, is that cash from buyers would have been received before the property is completed, and hence invokes taxable income. In all, we're looking at reduced profit figures during the transition period of IFRIC 15 adoption, tax liabilities that are incurred before revenue or profit is recognised, and an accounting standard that is applied retrospectively, meaning adjustments on opening balances to be made before the period the standard is effective.

Internationally Speaking

As Malaysia continues toward convergence with International Financial Reporting Standards (IFRS) by 2012, adoption of international accounting standards is set to be faster and naturally impact the Malaysian business community accordingly. While IFRIC 15 has been adopted in various western countries, the standard is undoubtedly for developers in countries where the build-and-sell concept is widely practiced. Still, countries such as France and Belgium have successfully resisted the move to IFRIC 15 regime, while our neighbours, Singapore, Indonesia and Thailand have remained status quo.

Brace?

While the IFRIC 15 regime is not supposed to reduce the overall profitability of a project, the timing of revenue recognition widely strays away from its original form. Then again, how does the matching principle applies to costs associated with revenue that is received through the different accounting periods? Perhaps build and sell all within the same financial year? Your guess is as good as mine.

ABOUT THE AUTHOR

Michelle is the Audit Principal with UHY (Assurance & Business Advisory). She can be reached at *michellelim@uhy-my.com*