

Query No. 8

Subject: Classification of the Project as Inventory or Investment Property under Ind AS framework.¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the Company’) is a public sector undertaking (PSU) under the aegis of Ministry of Housing & Urban Affairs, Government of India established in the year 1960 as a construction arm of Government of India. The Company has achieved Navratna status in the year 2014. The Company as a group has four operational subsidiaries and several Joint ventures under its umbrella. The Company operates into three business segments (a) Project Management Consultancy (PMC), (b) Real Estate, and (c) Engineering, Project and Construction (EPC).

Under PMC segment, the Company executes cost plus contracts obtained on either nomination basis or through competitive bidding. The projects are executed by contractors appointed by the Company through transparent tendering process.

Under Real Estate segment, the Company works as a developer, procures land, gets the works executed by entering into contractual engagements with contractors and the project is sold in pre-construction and post-construction stages. Marketing is done by the Company only.

Under EPC segment, the Company takes contract at fixed prices and the work is executed through sub-contractors.

2. Indian Accounting Standards (Ind AS) were introduced on the Company w.e.f. 01.04.2016. The accounts of the financial year (F.Y.) 2016-17 were prepared in accordance with Ind AS with comparatives of F.Y. 2015-16 and opening balance sheet of 01.04.2015.

3. The Company is in the business of development of real estate property for sale in the ordinary course of business. ‘A’ Municipal Corporation (AMC) and the Company has developed a joint real estate property at J place with the Company’s share at 76.98% and AMC’s share at 23.02% (hereinafter referred to as ‘the Project’). The Company executed the real estate project at J place in the year 2010 under joint operations with AMC.

4. The agreement between the Company and AMC was executed for sale of property after development. (A copy of Office Memorandum of Understanding (MoU) has been separately supplied by the querist for the perusal of the Committee.) As per the said agreement, the Company’s share is 76.98% and AMC’s share is 23.02%. There was no intention of either the Company or AMC to lease out the property after development as per the said MoU.

5. Upon completion of the Project, the Company tried to sell the property. The Company appointed a property consultant M/s J vide Letter of Intent (LoI) dated 18.08.2008 for the purpose.

¹ Opinion finalised by the Committee on 24.4.2024.

1st Attempt: The Company called Expression of Interest (EOI) through advertisement in August 2009. Additionally, letters were also sent to 37 hotel agencies but no response was received.

2nd Attempt: In December 2009, letters were sent to 15 hotel agencies and an open advertisement was published in the leading newspaper for sale of property but nothing could be materialised.

3rd Attempt: The Company again tried to sell the property in January, 2011 by an open offer on website and advertisement in various newspapers, but no offer was received.

4th Attempt: Finally, the Company tried to sell the space to Joint Operator, M/s AMC in January, 2014 but the same could also not materialised.

6. It is further submitted that a proposal for opening of the sale was also initiated and the same was submitted to the Board of Directors (BoD) and advertisement was published for sale, but could not be sold out due to non-availability of Completion/Occupancy Certificate from the concerned Authority and since the Project could not complete Real Estate Regulatory Authority (RERA) formalities also.

7. Since the property has already been completed and habitable, substantial portion of the Project has been utilised to generate income till the sale of the properties after receipt of the Occupancy Certificate and completion of RERA formalities. The space has been let out to some government authorities. The intention of the management towards the developed properties is to sell them in the market and not for let out and accordingly, rent agreement with the tenant is always entered for a short period of 1-2 years and with a vacation clause.

8. The Company has always tried to sell the property to recover its cost. Till date, the Company and AMC hold this property jointly. The temporary rental income earned from the property is shared in the profit sharing ratio. The Company has recently received the Occupancy Certificate of the Project on 09.01.2024. Sale of the Project will be launched at the earliest after completing RERA and other statutory requirements.

B. Query

9. In view of the above, the opinion is sought from the Expert Advisory Committee of the ICAI as to whether the Company may continue to present share of assets in J place Property as 'Real Estate Inventory' or should transfer the same as 'Investment Property' or any other suitable treatment is required as per applicable Ind AS?

C. Points considered by the Committee

10. The Committee notes that the basic issue raised in the query relates to classification of the Company's share of assets in J place Property (the Project) as 'Inventory' or 'Investment Property'. The Committee has, therefore, considered only this issue and has not considered any other issues that may arise from the Facts of the Case, such as, accounting and reporting for different business segments of the Company, i.e., project management consultancy (PMC), real estate and EPC, accounting for rental income earned from property, whether the property can be leased out before obtaining Occupancy Certificate, accounting for project cost, accounting for project management fee (if any) charged by the Company for

implementation of the Project, accounting for any portion of the property self-occupied by the Company, etc. Further, the Committee has answered the issue only from accounting perspective and not from legal perspective, such as, legal interpretation and compliances of the lease agreement with the tenants, MoU between the two parties, etc. The Committee has based its analysis on the information provided by the querist. Furthermore, the Standards referred to hereinafter are Indian Accounting Standards (Ind ASs) notified under the Companies (Indian Accounting Standards) Rules, 2015, and applicable as on 31st March, 2024. At the outset, the Committee notes that the querist has stated in the Facts of the Case that the arrangement is in the nature of joint operations; therefore, the Committee has proceeded on this premise and has not examined whether the joint arrangement in the extant case is in the nature of ‘joint operation’ or ‘joint venture’.

11. In this context, the Committee notes the following extracts from Ind AS 40, ‘Investment Property’ and Ind AS 2, ‘Inventories’:

Ind AS 40

“Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both, rather than for:

- (a) use in the production or supply of goods or services or for administrative purposes; or**
- (b) sale in the ordinary course of business.”**

“8 The following are examples of investment property:

- (a) land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business.
- (b) land held for a currently undetermined future use. (If an entity has not determined that it will use the land as owner-occupied property or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation.)
- (c) a building owned by the entity (or a right-of-use asset relating to a building held by the entity) and leased out under one or more operating leases.
- (d) a building that is vacant but is held to be leased out under one or more operating leases.
- (e) property that is being constructed or developed for future use as investment property.

9 The following are examples of items that are not investment property and are therefore outside the scope of this Standard:

- (a) property intended for sale in the ordinary course of business or in the process of construction or development for such sale (see Ind AS 2

Inventories), for example, property acquired exclusively with a view to subsequent disposal in the near future or for development and resale.

- (b) Omitted
- (c) owner-occupied property (see Ind AS 16 and Ind AS 116), including (among other things) property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal.
- (d) [Refer Appendix 1]
- (e) property that is leased to another entity under a finance lease.”

“14 Judgement is needed to determine whether a property qualifies as investment property. An entity develops criteria so that it can exercise that judgement consistently in accordance with the definition of investment property and with the related guidance in paragraphs 7–13. Paragraph 75(c) requires an entity to disclose these criteria when classification is difficult.”

“75 An entity shall disclose:

- (a) its accounting policy for measurement of investment property.**
- ...
- (c) when classification is difficult (see paragraph 14), the criteria it uses to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business.**
- ...”

Ind AS 2

“*Inventories* are assets:

- (a) held for sale in the ordinary course of business;**
- (b) in the process of production for such sale; or**
- (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.”**

The Committee notes from the above-reproduced requirements that inventories are assets that are *held for sale* in the ordinary course of business; whereas a property (land or a building—or part of a building—or both) *held to earn rentals* or for capital appreciation or both, rather than for sale in the ordinary course of business, is classified as Investment property. The Committee also notes that paragraph 9 of Ind AS 40 states examples of items that are not investment property and are therefore outside the scope of this Standard; and it includes property *intended for sale* in the ordinary course of business or in the process of construction or development for such sale. Thus, the classification of an asset as ‘investment’ or

'inventories' depends on its intended primary use for an entity. If an asset is essentially held for sale in the ordinary course of business, the same cannot be classified as investment property.

The Committee further notes that Ind AS 40 states that judgement is required to determine the appropriate classification of the property based on the specific facts and circumstances, i.e., whether it should be classified as investment property or not. It requires an entity to develop criteria so that it can exercise that judgement consistently in accordance with the definition of investment property and with the related guidance in paragraphs 7–13. Paragraph 75(c) requires an entity to disclose, when classification is difficult, the criteria it uses to distinguish investment property from the property held for sale in the ordinary course of business.

12. In this context, the Committee notes that the Company is in the business of development of real estate property for sale in the ordinary course of business. An agreement (MoU) between the Company and AMC was executed in the year 2005 for sale of property after development, salient features of which are reproduced below:

“WHEREAS ‘AMC’ intends to develop its land/PROPERTIES at J place, having commercial potential as real estate ventures.

WHEREAS the Company, A Government of India Enterprise, under Ministry of Urban Development & Poverty Alleviation has all resources, capabilities and expertise for taking up development of Commercial/residential complexes and or buildings as Real Estate Ventures as per the mutual requirements and in order to generate maximum revenue.

WHEREAS both ‘AMC and the Company’ by pooling their resources & expertise shall take up these projects to their mutual advantage.”

“10. *For sale of the property* a professional marketing agency will be appointed. The marketing expenses/brokerage would be borne by the Company and ‘AMC’ for their respective areas.

11. In order to work out the profit element the equity of both the partners shall be deducted from the total *sale proceeds*. The profits generated from the project or alternately the built up space, after working out the weighted percentage based on the report of the ‘Agency’ would be shared between the Company and ‘AMC’ in the ratio of their equity.

12. Up keep and maintenance of the property after completion of construction in respect to sale/leasing of the accommodation shall be done jointly by AMC and the Company/respective owners with mutual understanding.”

The Committee notes from the above terms of MoU and the other facts supplied by the querist that the Company along with AMC appointed a professional marketing agency for sale of the property. The Committee also notes from the Facts of the Case that the Company has made various attempts to sell the property, viz. appointment of property consultant, giving advertisement in leading newspapers, attempt to sell it to the joint operator etc. However, the property could not be sold due to non-availability of Completion/Occupancy Certificate and pending RERA formalities. Therefore, as stated by the querist, in order to generate temporary rental income, the property has been let out to some government authorities for short period.

Further, it is also mentioned by the querist that the Company has recently received the Occupancy Certificate of the Project and sale of the Project will be launched at the earliest after completing RERA and other statutory requirements. Thus, the intention of the management of the Company towards the developed properties, as demonstrated from the actions taken, has always been to sell them in the market and not for letting out. Therefore, the Committee is of the view that in the extant case, the Company's share in the property or project in the extant case is in the nature of 'Inventory' and not 'Investment Property'.

D. Opinion

13. On the basis of the above, the Committee is of the opinion that in the extant case, the Company's share in the property or project is in the nature of 'Inventory' and not 'Investment Property', as discussed in paragraphs 11 and 12 above.
