Accounting for Public Infrastructure Costs and Affordable Housing Losses associated with Property Development in accordance with *MFRS 15 Revenue from Contracts with Customers* ("MFRS 15")

With the coming into effect of MFRS 15, the accounting for public infrastructure costs and affordable housing losses associated with property development has become one of the key discussion topics in the property development industry.

Background

Property developers in Malaysia are required to apply to local government authorities ("LGAs") for planning permission to build premium housing development projects. The permission to build might be granted by the LGAs with certain conditions. Those conditions often include a commitment by the developer to construct, either:

(a) '**public infrastructure**', such as interchanges, schools, places of worship, and other public amenities to be transferred to the LGAs for no consideration; and/or

(b) '**affordable housing**', to be sold to LGA-approved customers for amounts less than the costs of construction.

Issues have arisen about the accounting for the public infrastructure costs and affordable housing losses associated with property development upon the:

1) adoption of **MFRS 15** for financial periods beginning on or after 1 January 2018;
2) issuance of an Addendum in Circular by Malaysian Institute of Accountants dated 7 March 2018 to inform that an entity shall not apply the principles in FRSIC Consensus 17 *Development of Affordable Housing* on adoption of MFRS 15; and
3) publication of an article by Malaysian Accounting Standards Board ("MASB") on 25 January 2019 on the topic of "Costing property development inventories", as well as a Q&A on accounting for public infrastructure costs and affordable housing on 30 January 2019 **(*"Collectively known as the Papers")***.

Accounting for Public Infrastructure Costs

Public infrastructure is not inventory as property developers do not "sell" the public infrastructure. Instead, the costs should be included in the inventories of premium houses by applying paragraph 10 of MFRS 102 *Inventories* as "other costs" **incurred** in bringing the inventories (i.e. premium houses) to their present location and condition.

The timing of when the cash is paid to meet the costs is not relevant to the recognition of the public infrastructure costs in premium houses inventories.

Development permission might be granted on the basis that the property developer agrees to construct public infrastructure:

(a) before it constructs premium housing;
(b) at the same time that it constructs premium housing; or
(c) after it constructs premium housing.

For public infrastructure constructed before the construction of premium housing, the accounting is simple as costs would be included in the inventories of premium housing **as soon as they are incurred**.

For public infrastructure constructed after the construction of premium housing, the expected public infrastructure costs would be **accrued over time as construction of premium houses progresses**. These accrued costs would be allocated as costs incurred that are attributable to premium housing inventories as those inventories **are constructed**.

Accounting for Affordable Housing Losses

Affordable housing meets the definition of inventories in accordance with MFRS 102 *Inventories* as the property developer will 'sell' the affordable houses to customers. The fact that the property developer is projected to make losses on selling affordable housing does not affect the fact that affordable houses under construction are inventories of the property developer.

Applying paragraph 9 of MFRS 102 *Inventories*, affordable housing under construction is measured at the lower of cost and net realisable value, which is the estimated selling price less the estimated costs of completion and estimated costs necessary to make the sale.

The costs of constructing the affordable housing are recognised as inventories by the property developer to the extent that they are recoverable.

The excess costs (i.e. the costs incurred that exceed the net realisable value of the affordable houses) relate to the cost of constructing the premium housing inventories and hence, shall **be included in the measurement of those inventories.**

The excess costs for the affordable houses are treated as "other costs" that are necessarily incurred in bringing the inventories (i.e. premium houses) to their present location and condition and be allocated under paragraph 12 of MFRS 102 *Inventories*.

The property developer may construct affordable houses:
(a) before it constructs premium housing;
(b) at the same time that it constructs premium housing; or
(c) after it constructs premium housing.

For affordable housing constructed before the construction of premium housing, the excess costs would be included in the inventories of premium housing **as soon as they are incurred**.

For affordable housing constructed after the construction of premium housing, the expected excess costs would be **accrued** over time as construction of the premium houses progresses. These accrued costs would be allocated as costs incurred that are attributable to premium housing inventories as those inventories are constructed.

How does this affect real estate industry?

The adoption of MFRS 15 may result in the change in property developers' existing practices in accounting for public infrastructure costs and affordable housing losses and therefore, in the change in accounting policy and retrospective application may be required.

Property developers are therefore advised to assess the implication of these new accounting treatments on their financial statements.

Disclaimer

This article was contributed by Quality Assurance and Technical team of Baker Tilly Malaysia. The views expressed represent our perspectives as of May 2019, based on the interpretation on the accounting standards and the Papers as published in the MASB website.

This article is not comprehensive and was prepared based on information available generally and is not intended to be relied upon as professional advice. We may identify additional issues as we analyse the standard and the entities, and our views may evolve during that process.

When applying the individual accounting frameworks, entities should refer to all accounting standards in its entirety. We will not accept liability for any loss or damage suffered by any person directly or indirectly through reliance upon the information contained in this article.

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