

## **Q&A on accounting for public infrastructure costs and affordable housing losses associated with property development**

### **Q1 – What are the questions?**

#### **A1**

Property developers in Malaysia must apply to their local government authorities (LGAs) for planning permission to build, for example, premium housing development projects. Permission to build might be granted by the LGA subject to conditions. Those conditions often include a commitment by the developer to construct:

- (a) 'public infrastructure' the developer is required to construct and transfer for no consideration to the LGA such as interchanges, schools, places of worship, and other public amenities; and/or
- (b) 'affordable housing' to be sold to LGA-approved customers for amounts less than the costs of construction.

Questions have arisen about the accounting for the costs of constructing public infrastructure and the estimated losses on affordable housing.

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### **Q2 – Is public infrastructure inventory of a property developer?**

#### **A2**

In the circumstances outlined in Q1, we do not consider the public infrastructure to be inventory. IAS 2 *Inventories*, states 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 [IAS 2.6].

Property developers do not 'sell' the public infrastructure, it is transferred to the LGA for no consideration. Public infrastructure would only be inventories for entities engaged in the business of profiting from the construction and sale of public infrastructure to LGA that are the entity's customers.

### **Q3 – Is affordable housing inventory of a property developer?**

#### **A3**

Yes, they meet the IAS 2 definition. The developer will 'sell' the affordable houses to customers. The fact that the 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.

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#### **Q4 – How should the costs of constructing public infrastructure be accounted for?**

##### **A4**

The costs of constructing public infrastructure are incurred in order to construct and sell the premium houses. Therefore, the costs are allocated to the inventories for the premium houses, applying IAS 2.10. That is, from the perspective of costing the premium housing inventory, the costs of constructing the public infrastructure are incurred solely for the purpose of constructing and selling the premium houses. The costs incurred in construction of the public infrastructure could be likened to formwork that is built to facilitate the construction of the foundations for premium housing. The formwork itself is not an end product for the developer and will be dismantled at the relevant stage of construction but is a cost that needs to be incurred and should be allocated to premium housing construction.

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#### **Q5 – How are the costs to construct affordable housing accounted for?**

##### **A5**

Applying IAS 2, affordable housing under construction is measured at the lower of cost and net realisable value [IAS 2.9]. The developer estimates the net realisable value of the affordable housing, which is the estimated selling price less the estimated costs of completion and estimated costs necessary to make the sale. [IAS 2.6].

The costs of constructing the affordable housing are recognised as inventories by the developer to the extent they are recoverable. The excess costs (ie the costs incurred that exceed the net realisable value of the affordable houses) relate to the cost of constructing the premium housing inventories and be included in the measurement of those inventories.

Losses are recognised if the developer estimates that net realisable value is lower than cost for the development (where the development is the unit of account).

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#### **Q6 – Is the accounting affected by whether public infrastructure is constructed before or after the premium housing?**

##### **A6**

No - the timing of when cash is paid to meet costs is not relevant to the recognition of inventories. Relevant costs are attributed to inventories as those inventories are constructed – the timing of when cash is paid to meet those costs is not relevant.

The nature of the estimates required to be made by property developer differ depending on whether public infrastructure is constructed before or after the premium housing;

- If, for example, the public infrastructure is constructed **before** the premium housing, the public infrastructure construction costs would be recognised (accumulated) as costs attributable to premium housing inventories as soon as they are incurred.
- If the public infrastructure is constructed **after** the premium housing, the expected public infrastructure construction costs would be accrued. These accrued costs would be allocated as costs incurred that are attributable to premium housing inventories as those inventories are constructed. When the public infrastructure is subsequently constructed, the actual costs would be set against the accrued costs.

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**Q7 – When are revenues and profits recognised?****A7**

An entity applies IFRS 15 *Revenue from Contracts with Customers* to determine when to recognise revenue. Applying IFRS 15 an entity recognises revenue when it transfers a promised good or service to a customer. The entity transfers a good or service when (or as) the customer obtains control of it. A customer may obtain control of the good or service over time (e.g. during construction) or at a point in time (e.g. when construction is complete).

In either case, the costs of the relevant inventories are recognised as assets and carried forward until the related revenues are recognised [IAS 2.1].

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**Q8 – Are there any unresolved issues about which further guidance is needed?****A8**

No. The existing accounting standards are sufficient to address issues arising when, as a condition of obtaining development permission, a developer is required to construct public infrastructure and/or affordable housing. These standards include IAS 2 and IFRS 15.

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