

Discussion on the Revenue Recognition of Chinese Real Estate Enterprises under the New Revenue Criterion

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ABSTRACT: *In July 2017, the Ministry of Finance of China revised and issued the new revenue standard "China Accounting Standards No. 14th-revenue", and the new revenue criteria has undergone a great change compared with the old one. This paper selects real estate industry in china, which is more controversial in recent years, to analyse the influence of the new income criterion on the income recognition. This paper finds that: (1) The new income criterion changes the period of time or point of time of income recognition of real estate enterprises, and the progress of income recognition may be accelerated; (2) The distinction requirement of individual performance obligation under the new income criterion makes the income and cost confirmation of complex sales of real estate enterprises more in line with the principle of matching; (3) The new income criterion regulates the measurement of transaction price of real estate enterprises, and clearly stipulates the confirmation of transaction price under different influencing factors.*

KEY WORD: *New Revenue Criterion; Real Estate Industry; Revenue Recognition*

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I. INTRODUCTION

In recent years, the real estate industry has flourished and is an important part of China's socialist market economy. Compared with manufacturing and industrial enterprises, real estate enterprises have the characteristics of long production cycle, large amount of capital investment, fast turnover speed and general pre-sale financing (Ye Jianfang, Bo Yun, 2012). The real estate companies often finance through bank loan, and high bank loan finance and low own funds results in high risk. Therefore, though the real estate industry usually appears to be high profits, stable operation, the real estate companies are also characterized by non-ideal financial indicators, such as high debt ratio and large income fluctuation. In July 2017, the Ministry of Finance of China revised and issued the new revenue standard "China Accounting Standards No. 14th-revenue (the abbreviation CAS)". The promulgation of the new revenue criterion provides new guidelines for the recognition and measurement of revenue in the real estate industry. In order to provide guidance and suggestions for the practical operation of real estate enterprises, this paper hopes to discuss the income recognition of real estate enterprises under the new income criterion in the light of the "Enterprise Accounting Standards No. 14th-income".

II. THE INFLUENCE ON INCOME RECOGNITION ON REAL ESTATE COMPANIES

2.1 Changes Time of Income Recognition and Accelerate the Progress of Revenue Recognition

The time of confirmation of real estate sales revenue is the key and difficult point of career judgment (Yi Pingliang, 2014). According to regulation fourth of the old CAS 14, the income of sale of goods must meet the following conditions at the same time before it can be confirmed: firstly, the enterprise has transferred the main risks and rewards in the ownership of the goods to the purchaser; secondly, the enterprise has neither retained the continuing management rights normally associated with ownership nor implemented effective control over the goods sold; thirdly, the amount of income can be measured reliably; fourthly, the relevant economic benefits are likely to flow into the enterprise; and finally the associated costs that have occurred or will occur can be measured reliably. As a result of this, the real estate enterprises usually enter an income in an account while the customers pay according to the sales contract and get the property payment certificate (usually received the initial sales and confirmed the remaining payment arrangements). In the actual accounting practice, it is not strictly that revenue is required to be recognized during the month in which the property is delivered. And the revenue is always recognized in the year in which the property is delivered. This way of confirming revenue causes real estate enterprises to be unable to accurately reflect the real business performance. For the housing sales, while the housing is not yet completed and the enterprise has not handed over the goods to the customer, the revenue can not be confirmed because the main risks and rewards in the ownership of the goods to the purchaser haven't transferred to the customer. As a result, the customer's prepayment can not be recognized

as income, but recognized as a liability (prepaid accounts), resulting in the actual operating situation will occur time deviation.

Regulation fourth of new CAS 14 stipulates that an enterprise shall fulfill its obligation to perform in the contract, that is, to confirm revenue when the customer obtains control of the relevant commodity. At the same time, regulation 11th stipulates that, on the commencement date of the contract, the enterprise shall evaluate the contract, identify the individual performance obligations contained in the contract, and determine whether the individual performance obligations are performed within a certain period of time, or at a certain point in time, and recognize the income separately in the performance of each individual performance obligation. If one of the following conditions is met, the performance obligation shall be fulfilled within a certain period of time; otherwise, it shall meet the performance obligation at a certain point in time: (1) The client obtains and consumes the economic benefits arising from the performance of the enterprise while the enterprise performs; (2) the customer is able to control the goods under construction in the process of contract fulfillment; (3) the goods produced in the course of the contract fulfillment of the enterprise are irreplaceable and the enterprise has the right to collect money for the cumulative portion of the performance that has been completed to date throughout the contract period. According to the new revenue criteria, although the sale of commercial housing has not been delivered and customers can not control the goods under construction in the process of contract fulfillment of the enterprise, but the signing and filing of the sales contract so that the housing price fluctuations occurred by the customer enjoy, no longer related to the enterprise (Liu Shaojun, 2018). In fact, this meets the accounting judgment "The client obtains and consumes the economic benefits arising from the performance of the enterprise while the enterprise performs".

At the same time, the sales contract will generally clarify the building number and room number, with relative irreplaceable, real estate enterprises also enjoy the legal protection of the collection rights, and meet the regulation of " the goods which produced by enterprise during the performance of the contract have an irreplaceable use." In view of this, the sale of commercial housing is an enterprise activity performed within a certain period of time, and the enterprise shall recognize the income within the agreed period of time (Zhong Wencheng, 2018). In other words, real estate companies do not have to confirm revenue until the end of the delivery time, and can confirm revenue according to the progress after the pre-sale. Compared with the old income criterion, some sales income of real estate enterprises can be confirmed in advance under the new income criterion.

Country Garden disclosed its 2017 interim results report adjusted to the new revenue guidelines in August 2017 and became the first China's "crab-eating" company in the real estate industry. The direct effect of the new income criterion on the income recognition of some real estate is that the time of income recognition of real estate projects could be confirmed within a certain period of time instead of at a certain point in time. According to its disclosed interim balance sheets, country garden's real estate development revenue reached 74.47 billion yuan, of which 14.75 billion yuan (19.8%), was confirmed over a period of time in the first half of 2017. In accordance with the new guidelines, the financial statements of Country garden increase the initial retained earnings of RMB 3.15 billion, increase revenue of the current period of 14.75 billion yuan, and increase the net profit of the current period of 3.33 billion yuan. It can be seen that the new income criterion has a significant impact on the income recognition model of real estate enterprises.

However, some scholars believe that the practice of country garden is debatable. Because when the contract is terminated due to customer reasons, the real estate company will only charge a certain percentage of the total housing amount as punitive liquidated damages, and does not have the compulsory right to collect fees for the completed performance part. Therefore, recognizing income in advance is not conducive to reflecting the real operation situation of the enterprise (Zheng Jun etc., 2018), and makes enterprises not respond to business risks in a timely manner. Early recognition of income into the account may not be applicable to the business of taking out a loan to buy a house, because the debt risk of the mortgage will affect the transfer of control. In conclusion, only when the proportion of high-end customers or customers who can buy the house at full price of real estate enterprises is large, the impact of the new revenue criteria is also significant.

2.2 More in Line with the Principle of Matching

In order to increase the selling of housing and attract consumers, the sales contracts of real estate enterprises are often accompanied by the construction of various infrastructure, such as planning roads, ancillary facilities or off-site costs (such as parking spaces, fire stations, communication signals, etc.). Regulation fourth and ninth of new CAS 14 provide that: on the date of the commencement of the contract, the enterprise shall evaluate the contract and identify each individual performance obligation contained in the contract. The term "performance obligation" refers to the commitment of an enterprise to transfer clearly distinguishable commodities to customers in a contract. If the goods promised by the enterprise to the customer meet the following conditions at the same time, they shall act as a clear distinction between goods: firstly, the customer is able to benefit from the goods or from the use of the goods in conjunction with other readily available resources;

secondly, the commitment of the enterprise to transfer the commodity to the customer may be distinguished separately. The guidelines provide clear guidance for real estate companies about complex sales involving multiple transaction arrangements.

Although the contracted infrastructure is a useful resource readily available to the customer, whether this commitment can be distinguished from other commitments in the contract requires a reasonable assessment by the financial staff of the enterprise. If the above definition that can clearly distinguish the goods and the recognition conditions of the separate performance of obligations are met, revenue is recognized separately. In this case, the recognition of revenue cost can be more consistent with the matching principle.

2.3 Standardize the Confirmation of Transaction Prices under Different Influencing Factors

(1) Standardize accounting treatment of material financing elements in real estate transaction contracts.

Article 17 of new CAS14 stipulates: if there is a significant financing element in the contract, the enterprise shall determine the transaction price based on the amount payable in cash when the customer obtains the commodity control right. The difference between the transaction price and the contract consideration shall be amortized by the effective interest rate method during the contract period. In other words, when there is a significant financing component in the sales contract signed by real estate enterprises and customers, the financing cost should be separated from the income and accounting treatment should be carried out separately. At this point, the difference between the sales revenue and the amount actually received shall be recognized as the interest income or interest expense of the enterprise. Different from what is handled under the old CAS14 criterion, on the contract start date, if the enterprise expects that the interval between the customer's acquisition of commodity control and the customer's payment of price is no more than one year, it can ignore the significant financing elements existing in the contract (Zhang Junmin, 2017).

(2) Standardize accounting treatment when the real estate transaction price involves variable consideration.

Article 16 of new CAS14 stipulates: if there is variable consideration in the contract, the enterprise shall determine the best estimate of the variable consideration according to the expected value or the most likely amount, but the transaction price including the variable consideration shall not exceed the amount that the accumulated confirmed income will most likely not have a significant reversal when the relevant uncertainty is eliminated. For real estate enterprises, the variable of value includes sales discounts or discounts when signing sales contracts with customers, real estate enterprises should take into account customers' willingness to pay and ability to pay at the same time (Gao Yuyu, Gao Yunbin, 2018), comprehensively evaluate whether there is a high probability that the accumulated confirmed income will not have a major reversal, and confirm a certain minimum amount of income when the control right is transferred, rather than wait until the uncertainty is eliminated. This makes the real estate enterprises will be greatly affected by the new criterion, because the real estate enterprises under the old CAS14 criterion need to delay the recognition of income because the transaction price cannot be estimated reliably.

III. CONCLUSION

The new income criterion has a significant impact on accounting measurement of the income recognition of the real estate industry. This paper holds the view that the core influence of the new income criterion on real estate enterprises is to change the period or point of time of income recognition and speed up their income recognition. At present, the real estate enterprises' asset-liability ratio is generally abnormally high, so the adoption of new income criteria can soothe the debt ratio of real estate enterprises to a certain extent, help enterprises get lower financing costs, and ensure the rapid and stable growth of enterprises. At the same time, the new revenue standard regulates the processing of complex sales business of real estate enterprises and the confirmation of transaction price under different influencing factors, enhances the maneuverability of the standards, makes the revenue recognition more fair, which is conducive to providing reliable financial information, and also more in line with the requirements of the matching principle.

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