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IFRIC INTERPRETATION X

Agreements for the Construction of Real Estate

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References

- IAS 1 *Presentation of Financial Statements* (as revised in 2007)
- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- IAS 11 *Construction Contracts*
- IAS 18 *Revenue*
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- IFRIC 12 *Service Concession Arrangements*
- IFRIC 13 *Customer Loyalty Programmes*

Background

- 1 In the real estate industry, entities that undertake the construction of real estate, directly or through subcontractors, may enter into agreements with one or more buyers before construction is complete. Such agreements take diverse forms.
- 2 For example, entities that undertake the construction of residential real estate may start to market individual units (apartments or houses) 'off plan', ie while construction is still in progress, or even before it has begun. Each buyer enters into an agreement with the entity to acquire a specified unit when it is ready for occupation. Typically, the buyer pays a deposit to the entity that is refundable only if the entity fails to deliver the completed unit in accordance with the contracted terms. The balance of the purchase price is generally paid to the entity only on contractual completion, when the buyer obtains possession of the unit.
- 3 Entities that undertake the construction of commercial or industrial real estate may enter into an agreement with a single buyer. The buyer may be required to make progress payments between the time of the initial agreement and contractual completion. Construction may take place on land the buyer owns or leases before construction begins.

Scope

- 4 This Interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors.
- 5 Agreements in the scope of this Interpretation are agreements for the construction of real estate. In addition to the construction of real estate, such agreements may include the delivery of other goods or services.

Issues

- 6 The Interpretation addresses two issues:
- (a) Is the agreement within the scope of IAS 11 or IAS 18?
 - (b) When should revenue from the construction of real estate be recognised?

Consensus

- 7 The following discussion assumes that the entity has previously analysed the agreement for the construction of real estate and any related agreements and concluded that it will retain neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the constructed real estate to an extent that would preclude recognition of some or all of the consideration as revenue. If recognition of some of the consideration as revenue is precluded, the following discussion applies only to the part of the agreement for which revenue will be recognised.
- 8 Within a single agreement, an entity may contract to deliver goods or services in addition to the construction of real estate (eg a sale of land or provision of property management services). In accordance with paragraph 13 of IAS 18, such an agreement may need to be split into separately identifiable components including one for the construction of real estate. The fair value of the total consideration received or receivable for the agreement shall be allocated to each component. If separate components are identified, the entity applies paragraphs 10-12 of this Interpretation to the component for the construction of real estate in order to determine whether that component is within the scope of IAS 11 or IAS 18. The segmenting criteria of IAS 11 then apply to any component of the agreement that is determined to be a construction contract.
- 9 The following discussion refers to an agreement for the construction of real estate but it also applies to a component for the construction of real estate identified within an agreement that includes other components.

Determining whether the agreement is within the scope of IAS 11 or IAS 18

- 10 Determining whether an agreement for the construction of real estate is within the scope of IAS 11 or IAS 18 depends on the terms of the agreement and all the surrounding facts and circumstances. Such a determination requires judgement with respect to each agreement.
- 11 IAS 11 applies when the agreement meets the definition of a construction contract set out in paragraph 3 of IAS 11: ‘a contract specifically negotiated for the construction of an asset or a combination of assets ...’ An agreement for the construction of real estate meets the definition of a construction contract when the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether it exercises that ability or not). When IAS 11 applies, the construction contract also includes any contracts or

components for the rendering of services that are directly related to the construction of the real estate in accordance with paragraph 5(a) of IAS 11 and paragraph 4 of IAS 18.

- 12 In contrast, an agreement for the construction of real estate in which construction could take place independently of the agreement and buyers have only limited ability to influence the design of the real estate, eg to select a design from a range of options specified by the entity, or to specify only minor variations to the basic design, is an agreement for the sale of goods within the scope of IAS 18.

Accounting for revenue from the construction of real estate

The agreement is a construction contract

- 13 When the agreement is within the scope of IAS 11 and its outcome can be estimated reliably, the entity shall recognise revenue by reference to the stage of completion of the contract activity in accordance with IAS 11.
- 14 The agreement may not meet the definition of a construction contract and therefore be within the scope of IAS 18. In this case, the entity shall determine whether the agreement is for the rendering of services or for the sale of goods.

The agreement is an agreement for the rendering of services

- 15 If the entity is not required to acquire and supply construction materials, the agreement may be only an agreement for the rendering of services in accordance with IAS 18. In this case, if the criteria in paragraph 20 of IAS 18 are met, IAS 18 requires revenue to be recognised by reference to the stage of completion of the transaction using the percentage of completion method. The requirements of IAS 11 are generally applicable to the recognition of revenue and the associated expenses for such a transaction (IAS 18 paragraph 21).

The agreement is an agreement for the sale of goods

- 16 If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the real estate to the buyer, the agreement is an agreement for the sale of goods and the criteria for recognition of revenue set out in paragraph 14 of IAS 18 apply.
- 17 The entity may transfer to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. In this case, if all the criteria in paragraph 14 of IAS 18 are met continuously as construction progresses, the entity shall recognise revenue by reference to the stage of completion using the percentage of completion method. The requirements of IAS 11 are generally applicable to the recognition of revenue and the associated expenses for such a transaction.
- 18 The entity may transfer to the buyer control and the significant risks and rewards of ownership of the real estate in its entirety at a single time (eg at completion, upon or after delivery). In this case, the entity shall recognise revenue only when all the criteria in paragraph 14 of IAS 18 are satisfied.
- 19 When the entity is required to perform further work on real estate already delivered to the buyer, it shall recognise an expense in accordance with paragraph 19 of IAS 18. The liability shall be measured in accordance with IAS 37. When

the entity is required to deliver further goods or services that are separately identifiable from the real estate already delivered to the buyer, it would have identified the remaining goods or services as a separate component of the sale, in accordance with paragraph 8 of this Interpretation.

Disclosures

- 20 When an entity recognises revenue using the percentage of completion method for agreements that meet all the criteria in paragraph 14 of IAS 18 continuously as construction progresses (see paragraph 17 of the Interpretation), it shall disclose:
- (a) how it determines which agreements meet all the criteria in paragraph 14 of IAS 18 continuously as construction progresses;
 - (b) the amount of revenue arising from such agreements in the period; and
 - (c) the methods used to determine the stage of completion of agreements in progress.
- 21 For the agreements described in paragraph 20 that are in progress at the reporting date, the entity shall also disclose:
- (a) the aggregate amount of costs incurred and recognised profits (less recognised losses) to date; and
 - (b) the amount of advances received.

Effective date and transition

- 22 An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the Interpretation for a period beginning before 1 January 2009, it shall disclose that fact.
- 22 Changes in accounting policy shall be accounted for retrospectively in accordance with IAS 8.