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International Accounting Standards Board

INFORMATION FOR OBSERVERS

IFRIC meeting:	**January 2008, London**
Project:	**D21 *Real Estate Sales* – Comment letter analysis - Other clarifications on applying IAS 11 or IAS 18 (Agenda Paper 2C)**

Introduction

1. Respondents to D21 suggested the following clarifications:
   - Address the issue of sale agreements with multiple components;
   - Add 'the ability to sell or pledge the underlying asset' as a feature in paragraph 9(b);
   - Refer to effective control instead of control.

Staff analysis

Address the issue of sale agreements with multiple components

2. Some respondents (e.g. CL1 Grant Thornton, CL24 KPMG, CL50 EFRAG) are concerned that the current draft Interpretation does not address the issue of agreements with multiple components that often arise in practice.

‘D21 is silent on the interaction between the indicators of when a construction contract approach should be applied, and the criteria in IAS 11 and IAS 18 for segmenting / separating contracts. For example, in the case of a multi-element property development, should the indicators in 9(a) and 9(b) be applied to the arrangement as a whole, or should the arrangement first be analysed into its separate elements? If the latter, should the analysis be based on the segmentation criteria in IAS 11.8 or the separation principles in IAS 18.13? In our view, greater clarity on this interaction would assist in reducing divergence in views in accounting for more complex commercial developments.’ [CL24, KPMG]

‘We think it is a pity that the Draft Interpretation does not clarify the unit of account, because we believe different conclusions could probably be reached depending on whether the unit of account was e.g. the whole apartment block, the individual apartment, a contract or elements of a contract’ [CL50, EFRAG]

3. The staff note that IFRIC 12 *Service Concession Arrangements* deals with a similar issue. Paragraph 13 of IFRIC 12 states that ‘The operator shall recognise and measure revenue in accordance with IASs 11 and 18 for the services it performs. If the operator performs more than one service (ie construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable shall be allocated by reference to the relative fair values of the services delivered, when the amounts are separately identifiable…’

4. In addition, BC31 of IFRIC 12 explains further:

‘The IFRIC noted that IAS 18 requires its recognition criteria to be applied separately to identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and is recognised as revenue over the period during which the service is performed. The IFRIC concluded that this requirement was relevant to service arrangements within the scope of the Interpretation. Arrangements within the scope of the Interpretation involve an operator providing more than one service, ie construction or upgrade services, and operation services. Although the contract for each service is generally negotiated as a single contract, its terms call for separate phases or elements because each separate phase or element has its own distinct skills, requirements and risks. The IFRIC noted that, in these circumstances, IAS 18 paragraphs 4 and 13 require the contract to be separated into two separate phases or elements, a construction element within the scope of IAS 11 and an operations element within the scope of IAS 18. Thus the operator might report different profit margins on each phase or element. The IFRIC noted that the amount for each service would be identifiable because such services were often provided as a single service. The IFRIC also noted that the combining and segmenting criteria of IAS 11 applied only to the construction element of the arrangement.'

5. In the context of real estate, some complex agreements may contain several components, eg the sale of a land and the construction of a building. According to some respondents, there is divergence of revenue recognition for those agreements. Therefore, the staff suggest:

   - Adding a paragraph in the consensus about multiple components (see paragraph 11 of agenda paper 2E);
   - Explaining the rationale in the basis for conclusion with a reference to IFRIC 12 (see paragraphs BC13 and BC14 of agenda paper 2E);
   - Adding an illustrative example (see example 2 in agenda paper 2E) dealing with a commercial real estate development with multiple components (basically a sale of land and the construction of real estate).

Add 'the ability to sell or pledge the underlying asset' as a feature in paragraph 9(b)

6. Some respondents (e.g. CL6 CNC, CL16 Mazars) suggest adding 'the ability to sell or pledge the underlying asset' as a feature in paragraph 9(b).

   'Whilst we recognise that the indications given in 9(b) are only examples, we question whether they are sufficiently complete as they all address the ability to restrict access. Control is also evidenced as the capacity to sell or pledge an asset. We suggest that the list of indicators of transfer of control should be completed to include explicitly the right of the buyer to sell or pledge the asset in its current state of completion' [CL6, Conseil National de la Comptabilité (CNC) (France)]

7. The staff agree that this feature is relevant in the context of paragraph 9(b) of D21 but are of the view that it might not be understood properly and could lead to diversity. In many residential real estate developments, buyers often have a right to acquire units but have no right to the underlying asset itself in its current state of completion. Introducing the above feature would confuse the guidance because it is not itself a distinguishing feature between IAS 11 and IAS 18 (an entity can also sell or pledge its forward contract to acquire the completed real estate at a future date). Therefore, the staff do not support adding this feature to paragraph 9(b).

Refer to effective control instead of control

8. Some respondents suggest referring to 'effective control' instead of 'control'

   'in case the IFRIC should retain the proposed indicators in IFRIC D21.9(b) and IFRIC D21.10(b), we propose the wording be aligned with IAS 18.14(b) and refer to 'effective control' instead of 'control', because the term 'effective control' signifies the necessity of a substance over form approach when assessing whether control actually exists.' [CL11, Institut der Wirtschaftsprüfer (IDW) (Germany)]

9. The staff agree with this proposal (see agenda paper 2E).

Questions to the IFRIC

10. Does the IFRIC agree with the staff analysis and the suggestion to add example 2 in the Interpretation (see paragraphs IE3-IE5 in agenda paper 2E)?