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International Accounting Standards Board

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: **March 2008, London**
Project: **D21 *Real Estate Sales* - Redrafting proposals (Agenda Paper 3C)**

The staff propose below some redrafting to illustrate the two Views set out in agenda paper 3B (View 2 is highlighted). At the next IFRIC meeting, the staff will provide the redrafted basis for conclusions in line with the decisions taken at this meeting.

References

- 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 Entities that undertake real estate development may enter into agreements to sell the real estate before they have completed its construction.

2 Such agreements are widespread in residential real estate developments. Developers 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 to acquire a specified unit when it is ready for occupation. Typically, the buyer pays a deposit that is refundable only if the developer fails to deliver the completed unit in accordance with the contracted terms. The balance of the purchase price is generally paid only on contractual completion, when the buyer obtains possession of the unit.

3 However, real estate sale agreements may take other forms. For example, they may relate to commercial or industrial developments. They may involve the sale of the whole development to a single buyer. The buyer may be required to make progress payments between the time of the initial agreement and contractual completion. Construction may be complete before the sale agreement is reached.

Scope

5 This Interpretation shall be applied in accounting for revenue from the sale of real estate, regardless of the stage of completion of the construction.

Issues

6 The Interpretation addresses two issues:

(a) whether a real estate sale agreement should be regarded as a construction contract within the scope of IAS 11 or an agreement for the sale of goods within the scope of IAS 18; and

(b) how revenue from the sale of real estate should be recognised.

Consensus

Identifying the real estate sale

7 Under a single agreement, an entity may deliver goods or services in addition to a real estate sale. In accordance with paragraph 13 of IAS 18, such an agreement may need to be split into separately identifiable components including one for the sale of real estate. The fair value of the consideration received or receivable shall be allocated to each component. If separate components are identified, the entity applies paragraphs 8-10 of this Interpretation to the component for the sale of real estate in order to determine whether that component falls 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.

[See Flowchart Boxes 1-7 and 9]

Applicable standard

8 Determining whether a real estate sale agreement should be regarded as a construction contract within the scope of IAS 11 or an agreement for the sale of goods within the scope of IAS 18 depends on the terms of the agreement and all the surrounding facts and circumstances. Such a determination requires judgement.

9 IAS 11 applies if the sale agreement meets the following definition of a construction contract set out in IAS 11: 'a contract specifically negotiated for the construction of an asset or a combination of assets …' An agreement for the sale 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). In contrast, an agreement for the sale of real estate in which construction takes place independently of the sale 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 seller, or to specify only minor variations to the basic design, is a contract for the sale of goods (the completed real estate) within the scope of IAS 18. *[See Flowchart View 1 or 2 – Box 8]*

10 [View 1: If the seller transfers to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses, the real estate sale agreement also falls within the scope of IAS 11.] *[See Flowchart View 1 – Boxes 11 and 9]*

or

[View 2: The real estate sale agreement may not meet the definition of a construction contract as described in paragraph 9 but the seller 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, Such an agreement is a contract for the sale of goods (the continuous sale of real estate) within the scope of IAS 18.] *[See Flowchart View 2 – Boxes 11 and 12]*

Indications that the seller transfers control and the significant risks and rewards of ownership of the work in progress in this way may include, for example:

(i) the construction takes place on land the buyer owns or leases before construction begins;

(ii) the buyer has a right to take over the work in progress (albeit with a potential penalty) during construction, eg to engage a different contractor to complete the construction;

(iii) in the event the agreement is terminated before construction is complete, the buyer retains the work in progress and the seller has the right to be paid for work performed (subject to buyer acceptance).

Revenue recognition

11 If the real estate sale agreement (or component) falls within the scope of IAS 11, the entity shall apply the percentage of completion method in accordance with paragraphs 22-35 of IAS 11. *[See Flowchart View 1 or 2 – Box 10]*

12 [View 2: If the real estate sale agreement (or component) is for the continuous sale of real estate within the scope of IAS 18, the entity shall apply the percentage of completion method because the requirements of IAS 18 are satisfied continuously as work progresses. The entity should refer to paragraphs 22-35 of IAS 11 for application guidance because the requirements of that Standard are generally applicable to the recognition of revenue and the associated expenses for such a transaction.] *[See Flowchart View 2 – Box 13]*

13 If the real estate sale agreement (or component) is for the sale of completed real estate within the scope of IAS 18, revenue shall be recognised when all the conditions in paragraph 14 of IAS 18 have been satisfied. Theses conditions may be satisfied before the entity has performed all of its contractual obligations to the buyer (eg remedying minor defects, completing internal decoration or delivering communal amenities). Depending on facts and circumstances, the entity shall recognise any remaining obligations in accordance with paragraph 13 or 19 of IAS 18. *[See Flowchart View 1 or 2 – Boxes 14 and 15]*

[Disclosures

15 *Note: additional disclosures may be needed if View 2 is preferred (see paragraphs 26 and 32 of agenda paper 3B). In that event, the staff will draft a paragraph in the Interpretation that requires such disclosures for the next IFRIC meeting.*]

Amendments to the appendix to IAS 18

16 This Interpretation supersedes Example 9 in the appendix to IAS 18.

17 The appendix to IAS 18 is amended as described below.

All of the text under the heading '9 *Real estate sales*.' is deleted.

New text is inserted under the heading as follows:

'This example was superseded by IFRIC X *Real Estate Sales*.'

Effective date and transition

18 An entity shall apply this Interpretation for annual periods beginning on or after [date to be set at three months after the Interpretation is finalised]. Earlier application is permitted. If an entity applies the Interpretation for a period beginning before [date to be set at three months after the Interpretation is finalised], it shall disclose that fact.

19 Changes in accounting policy shall be accounted for in accordance with IAS 8.

Question to IFRIC members: Do you agree with these drafting proposals? Do you have any suggestions?