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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* - Illustrative examples (Agenda Paper 3D)**

Introduction

1. The staff prepared the following examples :

   - Examples 1 and 2 carry forward the examples presented at the last IFRIC meeting (see paper 2E) with some drafting amendments and the addition of View 2 (highlighted) per paper 3B presented at this meeting.
   - Example 3 carries forward paragraph 13 of D21 that carries forward (with only minor amendments) the second paragraph of guidance from Example 9 in the appendix to IAS 18. The IFRIC took the view that this guidance has widespread application and accurately interprets the requirements of IAS 18 (see BC16 of D21). The staff's view is that this guidance does not need to appear in the consensus and is more in the nature of implementation guidance.

- Example 4 carries forward (with only minor amendments) paragraph 14 of D21. The staff's view is that this guidance does not need to appear in the consensus and is more in the nature of implementation guidance.

2. These examples are set out in the section 'Illustrative examples' of this paper (see from next page).

Questions to the IFRIC

3. Do you believe all these examples are useful and should accompany the Interpretation? If yes, do you have any drafting suggestions? If not, which one should be deleted and why?

Illustrative Examples

These examples accompany, but are not part of, IFRIC X.

a) Applicable standard

Example 1

IE1 An entity (the developer) is developing residential real estate and starts marketing individual units (apartments) while construction is still in progress. Buyers enter into a project agreement that gives them the right to acquire a specified unit when it is ready for occupation. They pay 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 paid only on contractual completion, when buyers obtain possession of their unit. Buyers are able to specify only minor variations to the basic design but they cannot specify or alter major structural elements of the design of their unit. In the jurisdiction, no rights to the underlying real estate asset transfer to the buyer other than through the agreement.

IE2 In this illustrative example, the terms of the agreement and all the surrounding facts and circumstances indicate that the binding agreement gives the buyer an asset in the form of a right to acquire, use and sell the completed real estate at a later date, with the seller retaining effective control and the significant risks and rewards of ownership of the underlying work in progress until that date. Therefore, the real estate sale agreements should be regarded as agreement for the sale of goods (completed real estate) in accordance with IAS 18 *Revenue*.

Example 2

IE3 A developer buys a plot of land for the purpose of building commercial real estate. It designs an office block to build on the land and submits the designs to planning authorities in order to obtain a building permission. The developer markets the office block to potential tenants and signs conditional lease agreements. The developer markets the office block to potential investors and signs with one of them a conditional agreement for the sale of land and the construction of the office block. The total price is a multiple of the rent. The investor cannot put the land or the incomplete office block back to the developer. The developer receives the building permission and all agreements become unconditional.

IE4 In this illustrative example, the real estate agreement should be separated into two components: a component for the sale of land within the scope of IAS 18 (sale of goods) and a component for the construction and the sale of the office block. The component for the construction and the sale of the office block does not meet the definition of a construction contract in accordance with IAS 11. However, the developer will transfer to the investor control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses because the investor will own the land before the construction starts. Therefore, the component for the construction and the sale of the office block [falls within the scope of IAS 11] or [is a contract for the continuous sale goods within the scope of IAS 18].

IE5 Alternatively, assume that the construction of the office block started before the developer signed the agreement with the investor. In that event, the real estate agreement should be separated into two components: a component for the sale of land and the work in progress of the office block in its current state within the scope of IAS 18 (sale of goods) and a component for the completion of the construction of the office block in the scope of [IAS 11] or [IAS 18 (continuous sale of goods)].

b) Revenue recognition

Example 3—Continuing involvement

IE6 In some cases, real estate may be sold with such a degree of continuing involvement by the seller that effective control and the risks and rewards of ownership are not transferred when the buyer obtains possession. Examples are sale and repurchase agreements that include put and call options, and agreements whereby the seller guarantees occupancy of the property for a specified period, or guarantees a return on the buyer's investment for a specified period. In such cases, the nature and extent of the seller's continuing involvement determines how the transaction is accounted for. It may be accounted for as a sale, or as a financing, leasing or some other profit-sharing arrangement. If it is accounted for as a sale of goods (completed real estate) within the scope of IAS 18, the continuing involvement of the seller may delay the recognition of revenue.

Example 4—Remaining obligations under IAS 18

IE7 The IAS 18 conditions for recognising revenue from the sale of the real estate 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). Depends on facts and circumstances, the entity shall recognise its remaining contractual obligations in one of two ways:

(a) to the extent that the entity has to perform further work on the 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.

(b) to the extent that the entity has to deliver further goods or services that are separately identifiable from the real estate already delivered to the buyer, it shall treat the remaining goods or services as a separate component of the sale, in accordance with paragraph 13 of IAS 18. The fair value of the total consideration received and receivable from the buyer shall be allocated between the components already delivered and those not yet delivered. Consideration allocated to the goods or services not yet delivered shall be recognised as revenue only when the applicable revenue recognition conditions have been met for those goods or services.