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**International  
Accounting Standards  
Board**

*This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.*

*These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.*

## **INFORMATION FOR OBSERVERS**

**Board Meeting:**        **May 2008, London**

**Project:**            ***IFRIC X—Agreements for the Construction of Real Estate***

**Subject:**            **Flowchart and Illustrative Examples (Agenda Paper 4A)**

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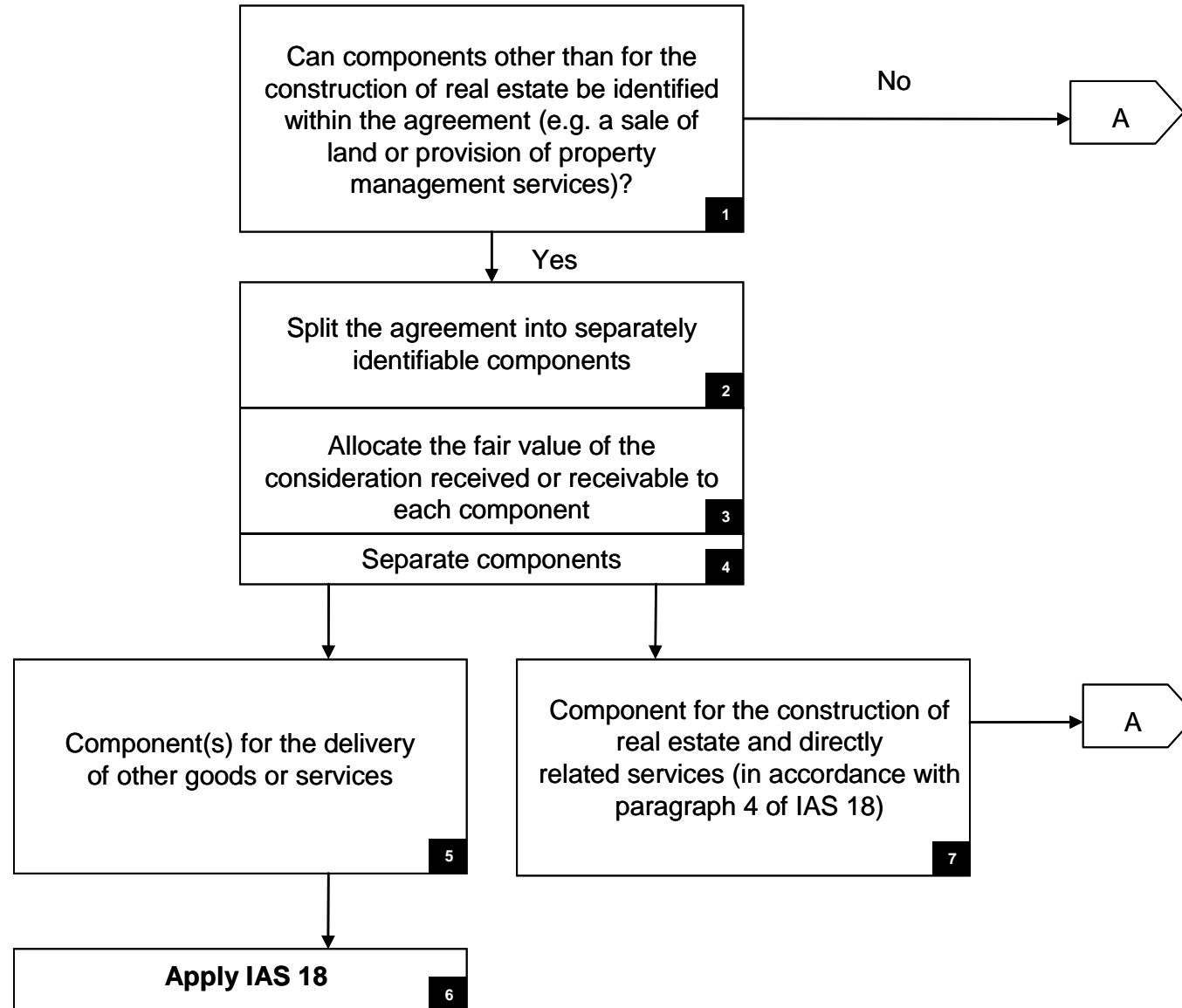
### **Background**

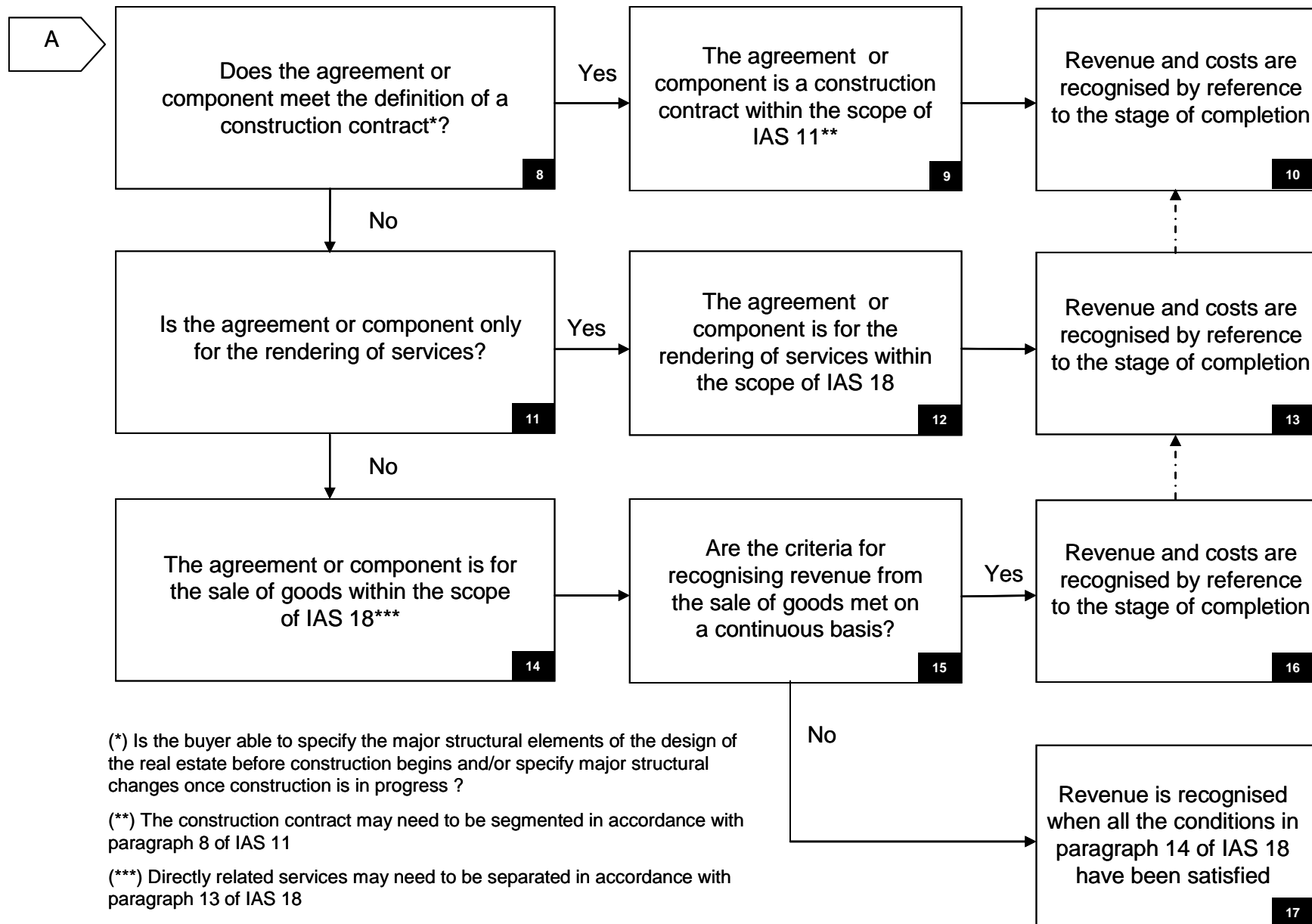
1. After the March IFRIC meeting, the staff asked Board members whether they expressed concerns about the IFRIC's approach on the accounting for revenue and associated expenses by entities that undertake the construction of real estate. For that purpose, the staff sent a Flowchart for comments. In their comments, Board members generally supported (or did not object to) the IFRIC's conclusion as a legitimate interpretation of paragraph 14 of IAS 18.
2. At its May meeting, the IFRIC completed its redeliberation on D21 *Real Estate Sales*, voted and confirmed the consensus. The IFRIC also decided that the Flowchart and the Illustrative Examples will accompany the final Interpretation. The May IFRIC Update summarises the main decisions taken at that meeting.
3. In order to facilitate the Board's ratification of the final Interpretation at its meeting in June, the staff present at the May IASB meeting, the Flowchart and the Illustrative Examples approved by the IFRIC at its May meeting, subject to minor drafting changes.

## Flowchart

4. The main changes from the March version sent to Board members are as follows:
  - The flowchart clarifies what is meant by a ‘real estate sale agreement or component’, that is, *an agreement or component for the construction of real estate* (see boxes 1 and 7);
  - It illustrates that the identification of a component for the sale of land should be undertaken when analysing any potential components. Depending on facts and circumstances, the entity may or may not conclude that such a component is separately identifiable from the component for the construction of real estate (see boxes 1 and 2). Therefore, the examples of the sale of land and the provision of property management services now appear in box 1 instead of box 5 in the March version;
  - It reflects that the agreement may be only for the rendering of services (see boxes 11-13);
  - From box 14, it clarifies that, when the agreement is for the sale of goods, the criteria may be met either continuously or at a single point of time (eg at completion, upon or after delivery);
5. In its final version, the Flowchart will include paragraph references to the Interpretation.

**Analysis of an agreement for the construction of real estate:**





## Illustrative Examples

### Example 1

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- IE1 An entity buys a plot of land for the construction of commercial real estate. It designs an office block to build on the land and submits the designs to planning authorities in order to obtain building permission. The entity markets the office block to potential tenants and signs conditional lease agreements. The entity markets the office block to potential buyers and signs with one of them a conditional agreement for the sale of land and the construction of the office block. The buyer cannot put the land or the incomplete office block back to the entity. The entity receives the building permission and all agreements become unconditional. The entity then undertakes the construction of the office block.
- IE2 In this illustrative example, the agreement should be separated into two components: a component for the sale of land and a component for the construction of the office block. The component for the sale of land is a sale of goods within the scope of IAS 18.
- IE3 Because all the major structural decisions were made by the entity and were included in the designs submitted to the planning authorities before the buyer signed the conditional agreement, it is assumed that there will be no major change in the designs after the construction has begun. Consequently, the component for the construction of the office block is not a construction contract and is within the scope of IAS 18. The facts that the construction takes place on land the buyer owns before construction begins and that the buyer cannot put the incomplete office block back to the entity are indicators that the entity 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. Therefore, because the criteria in paragraph 14 of IAS 18 are met continuously as construction progresses, revenue from the construction of the office block should be recognised using the percentage of completion method.
- IE4 Alternatively, assume that the construction of the office block started before the entity signed the agreement with the buyer. In that event, the agreement should be separated into two components: a component for the sale of land and the partially constructed office block and a component for the completion of the office block. The entity should apply the recognition criteria separately to each component. Assuming that the other facts remain unchanged, the entity should use the percentage of completion method for the construction component as explained in IE3.

## Example 2

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- IE5 An entity is developing residential real estate and starts marketing individual units (apartments) while construction is still in progress. Buyers enter into a binding sale 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 entity fails to deliver the completed unit in accordance with the contracted terms. Buyers are also required to make progress payments between the time of the initial agreement and contractual completion. 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. Consequently, the construction takes place independently of the agreement for the construction of individual units.
- IE6 In this illustrative example, the terms of the agreement and all the surrounding facts and circumstances indicate that the agreement is not a construction contract. The agreement is a forward contract that gives the buyer an asset in the form of a right to acquire, use and sell the completed real estate at a later date and an obligation to pay the purchase price in accordance with its terms. Although the buyer might be able to transfer its interest in the forward contract to another party, the seller retains control and the significant risks and rewards of ownership of the work in progress until the completed real estate is transferred. Therefore, revenue should be recognised only when all the criteria in paragraph 14 of IAS 18 are met (at completion in this example).
- IE7 Alternatively, assume that, in the jurisdiction, the law requires the seller to immediately transfer to the buyer ownership of the real estate in its current state of completion and that any additional construction becomes the property of the buyer as construction progresses. This indicates that the entity 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. Therefore, because the criteria in paragraph 14 of IAS 18 are met continuously as construction progresses, the entity should recognise revenue using the percentage of completion method taking into account the agreements signed with individual buyers and the stage of completion of the whole building.

### **Example 3**

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IE8 Agreements for the construction of real estate may include such a degree of continuing involvement by the seller that control and the significant risks and rewards of ownership are not transferred even when construction is complete and the buyer obtains possession. Examples are agreements in which 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 circumstances, recognition of revenue may be delayed or precluded altogether. The Interpretation assumes the seller has reached the conclusion that it is appropriate to recognise revenue from the agreement and discusses how to determine the appropriate pattern of revenue recognition.