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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: May 2008, London
Project: D21 *Real Estate Sales* – Draft interpretation (Agenda Paper 2D)

The staff redrafted the Interpretation in accordance with View 2 on which the IFRIC agreed at the March meeting. The staff welcome comments on these redrafting proposals.

IFRIC Interpretation X

Agreements for the Construction of Real Estate

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 In the real estate industry, entities that undertake the construction of real estate may enter into agreements with a buyer or 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.
- 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 not retain continuing managerial involvement with or 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 consideration received or receivable 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.
- 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 takes 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, the entity shall recognise revenue using the percentage of completion method 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 If 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, the criteria in paragraph 14 of IAS 18 may be met continuously as construction progresses. In these circumstances, it is appropriate to recognise revenue as the criteria are met 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 If the entity transfers to the buyer control and the significant risks and rewards of ownership of the real estate in its entirety at a single point of time (eg at completion, upon or after delivery), the criteria for recognising revenue from the sale of goods set out in paragraph 14 of IAS 18 may only be met at that point. In these circumstances, revenue is recognised 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 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 [If View A is followed: When the criteria for recognising revenue from the sale of goods set out in paragraph 14 of IAS 18 are met continuously (see paragraph 17), the entity shall provide the disclosures required by paragraphs 39–45 of IAS 11.] [To be completed after the May meeting. See agenda paper 2B]

Effective date and transition

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