IFRIC Meeting

Staff Paper

Agenda reference **5C**

Date **May 2009**

Project	**IAS 38-7 Accounting for Selling Costs of Real Estate Projects**
Topic	**Comment letters on tentative agenda decision**

Introduction

1. In March 2009, the IFRIC published a tentative agenda decision not to add to its agenda an issue to clarify how a real estate developer should account for initial selling and marketing costs incurred during construction that relate to the specific real estate construction project.

2. The IFRIC received four comment letters from respondents.

Summary of comments from respondents

3. Two of the respondents explicitly support the IFRIC's decision not to add the issue to its agenda; the other two do not suggest adding it. All four respondents suggest some changes to the IFRIC's proposed agenda decision wording, including:

    (a) clarifying the distinction between costs incurred in *attempting* to obtain customer contracts (not permitted to be capitalised) and those directly attributable to *securing* a specifically identifiable customer contract (can be capitalised)[1].

    (b) specifying the nature of the asset recognised when capitalising such costs and under which specific standard[2].

    (c) removing the sentence that refers to property, plant and equipment in the second paragraph[3].

[1] PwC, D&T, E&Y, AIC (Germany)
[2] PwC, D&T, E&Y
[3] D&T

4. None of the respondents proposes changing the decision not to take this issue on to the IFRIC agenda. Therefore the staff recommends that the IFRIC confirm its tentative agenda decision after considering whether the tentative wording should be amended before being finalised.

Staff recommendation

5. To address the comment in paragraph 3(a), the staff proposes to use the term 'securing' in lieu of 'obtaining' to be consistent with the wording in paragraph 21 of IAS 11, which discusses capitalisable pre-contract costs related to *securing* a specific real estate contract. The staff also proposes to highlight 'advertising expenses' as an example of costs incurred in *attempting* to obtain customer contracts that are not permitted to be capitalised under any standards, including any identified narrow circumstances. These changes should clarify the distinction between costs that could be capitalised and those not permitted to be capitalised.

6. To address the comment in paragraph 3(b), the staff proposes to identify the nature of asset that is recognised when qualified costs are capitalised. An asset outside the scope of IAS 2 or IAS 16 capitalised by analogy to the narrow circumstances in other standards would be an intangible asset under IAS 38. The staff also proposes to identify 'other standards' in which qualified costs are capitalised in narrow circumstances.

7. With respect to the comment in paragraph 3(c), the staff proposes to retain the sentence referring to property, plant and equipment. Although not a formal agenda request, the staff previously received an informal inquiry from real estate developers about geomancy artifacts frequently used in some jurisdictions. Those geomancy objects are buried in the foundation of new real estate developments as part of feng shui ceremonies, which are then advertised to increase the property's value in those jurisdictions. Criteria in IAS 16 may also be relevant when assessing whether or not such initial costs can be capitalised.

Questions to the IFRIC
Does the IFRIC agree with the staff recommendation to confirm its decision not to add the issue to its agenda? Does the IFRIC agree with the staff recommendations to amend the wording of the tentative agenda decision to address comments received based on the discussion in paragraphs 5-7? Does the IFRIC have any comments on the proposed wording of the final agenda decision in Appendix A?

Appendix A

A1. The Staff proposes the following wording for the final agenda decision, in tracked changes from the tentative agenda decision published in March 2009.

IAS 38 *Intangible Assets*—Accounting for sales costs

The IFRIC was asked to clarify how a real estate developer should account for initial selling and marketing costs incurred during construction that relate to the specific real estate construction project. In accordance with IFRIC 15 *Agreements for the Construction of Real Estate*, revenue for the construction project will be recognised as a 'sale of goods' in accordance with IAS 18 *Revenue*. Examples of such initial selling and marketing costs include:

- advertising expenses for the project
- sales commission paid for selling the units
- fees paid to the bank to list the property to enable buyers to get mortgages.

The IFRIC noted that selling costs cannot be capitalised as inventory if the real estate units are considered to be inventory in accordance with IAS 2 *Inventory*. Similarly, these costs cannot be capitalised as property, plant and equipment unless they are directly attributable to preparing the asset to be used. The IFRIC also noted that paragraph 20 of IAS 11 *Construction Contracts* excludes selling costs from the costs of a construction contract ~~costs even if the specific construction project were within the scope of IAS 11~~. However, the IFRIC noted that other standards conclude that some direct and incremental costs recoverable as a result of ~~obtaining~~ securing a specifically identifiable contract with a customer may be capitalised in narrow circumstances. For example, IAS 11 (paragraph 21 on pre-contract costs) and IAS 18 (paragraph IE 14 on investment management fees), among others, may include relevant guidance. In those narrow circumstances, if additional requirements are met, capitalised costs may represent an identifiable intangible asset arising from contractual or other legal rights in accordance with IAS 38 *Intangible Assets*. (None of those standards permit an entity to capitalise costs incurred in attempting to obtain customer contracts such as advertising expenses.)

Because the accounting for such costs varies depending on specific facts and circumstances, the IFRIC noted that it is not possible to reach a conclusion on the appropriate accounting for broad categories of initial selling and marketing expenses in all circumstances. In the light of the existing guidance in IFRSs, the IFRIC did not expect significant diversity in practice and [decided] not to add this issue to the agenda.