

Project	Tentative agenda decision
Topic	IFRIC 15 <i>Agreements for the Construction of Real Estate</i> – Meaning of continuous transfer

Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request asking for clarification on the meaning of the term ‘continuous transfer’ in paragraph 17 of *IFRIC 15 Agreements for the Construction of Real Estate*.
2. For ease of reference, the text of the submission is reproduced in Appendix A to this paper.

Purpose of the paper

3. This paper:
 - (a) provides background information on the issue;
 - (b) provides an analysis of the issue;
 - (c) makes a recommendation that the Interpretations Committee should add the issue to its agenda;
 - (d) asks whether the Interpretations Committee agrees with the staff’s recommendation.

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRS Interpretations Committee or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*.

Interpretations are published only after the IFRS Interpretations Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in *IASB Update*.

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Background information

Summary analysis presented in the submission

4. IFRIC 15 prescribes the accounting for revenue from the construction of real estate in situations where the agreement is:
 - (a) a construction contract;
 - (b) an agreement for the rendering of services; or
 - (c) an agreement for the sale of goods.
5. In the submission received, it is made clear that the request is limited to situations (c). However, the staff is aware that the *Revenue Recognition* project is currently developing a revenue model under which no distinction is made between the supply of goods and the supply of services; rather the project concentrates on the pattern of transfer as shown in the contract. Later in the analysis (see paragraph 22 of this paper) and in order to consider current discussions, the staff refers to the boards' recent tentative decisions on services that transfer continuously.
6. The constituent points out that, with respect to accounting for revenue in an agreement for the sale of goods, IFRIC 15 refers to paragraph 14 of IAS 18 *Revenue*. This paragraph sets out conditions that have to be satisfied for an entity to recognise revenue for the sale of goods. Two of the conditions are that:
 - (a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods; and
 - (b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.

The relevant literature is reproduced in full in Appendix A to this paper for ease of reference.

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7. Paragraphs 17 and 18 of IFRIC 15 provide for an accounting treatment for the recognition of revenue where the seller transfers to the buyer control and significant risks and rewards of ownership (and where all other criteria in paragraph 14 of IAS 18 are met):
 - (a) if the seller transfers to the buyer control and significant risks and rewards of ownership continuously as construction progresses: revenue should be recognised by reference to the stage of completion;
 - (b) if the seller transfers to the buyer control and significant risks and rewards of ownership in their entirety at a single point in time: revenue should be recognised upon or after delivery of the goods sold.
8. The constituent is aware that whether transfer is continuous or at a single point in time is a matter of judgement requiring appropriate analysis of facts and circumstances. However, the constituent notes that significant divergence exists in practice in interpreting the meaning of continuous transfer. In addition, such divergences are not limited to some jurisdictions; they occur in several regions, including Asia and South America.

Views presented in the submission

9. The request lists differing views as to how the meaning of continuous transfer is currently interpreted:
 - (a) View A: continuous transfer of control to the buyer means that the buyer must have legal title to the work in progress;
 - (b) View B: legal title may merely be one way of evidencing control;
 - (c) View C: where protective rights of the buyer are such that control no longer rests with the seller this may indicate that there is a continuous transfer to the buyer; and
 - (d) View D: continuous transfer cannot exist for individual units that are part of a block of apartments under construction.

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10. In the light of the existing differing views, the submission therefore asks the Interpretations Committee to clarify (quote from the submission):
 - (a) 'whether continuous transfer of control means that:
 - (i) the buyer actually receives control over the asset in its partially completed state while construction takes place, or
 - (ii) the seller loses control and buyer receives protective rights while actual transfer only takes place at a later date, e.g., completion of construction;
 - (b) whether control means that:
 - (iii) the buyer has or takes legal or physical possession of work in progress while construction takes place, or
 - (iv) it is sufficient that the seller is unable to sell the work in progress to anyone else; and
 - (c) the unit of account, for determining whether control transfers continuously while construction takes place for each individual apartment in a block of apartments or for the entire block.'
11. The staff note that the meaning of control is a major issue that is currently being addressed by the Board. The meaning of continuous transfer is, under current IFRSs, an issue that is specific to off-plan sales within IFRIC 15 and the staff are of the opinion that it is appropriate for the Interpretations Committee to address this.
12. Consequently, at this stage, the staff limit the scope of this project to describe continuous transfer more clearly and to define the unit of account to which continuous transfer applies.

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Staff analysis

Control and continuous transfer

Current literature

13. The staff note that control is only referred to in IAS 18 in paragraph 14(b) with no further guidance as to how to assess that notion of control.
14. The notion of continuous transfer does not exist as such in IAS 18 and is only mentioned in IFRIC 15.
15. In addition, the staff note that, in currently effective IFRSs, continuous transfer is not defined in such a way as to be helpful in determining whether transfer of control occurs at one point in time only or is instead on a continuing basis. This is the core issue in the submission.

Current project on revenue recognition

16. The staff note that paragraphs 25 to 31 of the exposure draft (ED) *Revenue from Contracts with Customers* propose the following guidance as to the meaning of control:
 - (a) the ability to direct the use of, and receive the benefit from, a good, including the ability to prevent other entities from directing the use of, and receiving the benefit from, that good;
 - (i) the ability to direct the use of a good refers to the present right to use the good for its remaining economic life or to consume the good in the customer's activities;
 - (ii) the ability to receive the benefit from a good refers to the present right to obtain substantially all of the potential cash flows from that good; cash flows can be obtained in many ways such as by using, consuming, selling, exchanging, pledging or holding the good.

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- (b) protective rights against the customer's failure to comply with the contract terms do not preclude a customer from obtaining control of the good.
17. Paragraph 30 of the ED proposes specific indicators to help determine that a customer has obtained control of a good:
- (a) the customer has an unconditional obligation to pay;
 - (b) the customer has legal title;
 - (c) the customer has physical possession; and
 - (d) the design or function of the good is customer-specific.
18. While paragraphs 32 and 33 of the ED refer to continuous transfer of goods, they set out methods of recognising revenue, rather than providing indicators that would help to assess whether transfer of the good is continuous or occurs only upon delivery of the good.
19. In addition, the staff note that the ED does not refer to transfer of risks and rewards when providing guidance for revenue recognition.
20. Recent tentative decisions reached by the boards on the topic of determining the transfer of goods are set out in the IASB Update for January 2011 and are reproduced below for ease of reference:

Determining the transfer of goods and services

The boards affirmed the core principle in the exposure draft that an entity should recognise revenue to depict the transfer of goods and services to a customer.

Goods

For determining the transfer of a good, the boards decided that an entity should recognise revenue when the customer obtains control of the good. The boards also decided that the revenue standard should:

- carry forward most of the proposed guidance on control from the exposure draft;

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- describe rather than define control;
 - add 'risks and rewards of ownership' as an indicator of control; and
 - eliminate 'the design or function of the good or service is customer-specific' as an indicator of control.
21. In the light of current literature and of recent discussions, the staff note that transferring risks and rewards of ownership is to be considered an **indicator** of transfer of control rather than as a **condition** for recognising revenue (as is currently the case in paragraph 14(a) of IAS 18).
22. The latest tentative decisions by the boards on the Revenue Recognition project were made at the joint FASB / IASB meeting in February 2011. Below is reproduced, for ease of reference, the relevant excerpt from the IASB Update for February 2011:
- The boards tentatively decided that an entity satisfies a performance obligation continuously if at least one of the following two criteria is met:
- (a) the entity's performance creates or enhances an asset that the customer controls as the asset is being created or enhanced, or
 - (b) the entity's performance does not create an asset with an alternative use to the entity and at least one of the following conditions is met:
 - (i) the customer receives a benefit as the entity performs each task, or
 - (ii) another entity would not need to reperform the task(s) performed to date if that other entity were to fulfil the remaining obligation to the customer, or
 - (iii) the entity has a right to payment for performance to date even if the customer could cancel the contract for convenience.
23. The staff note that under the *Revenue Recognition* project's current thinking, if a property development contract has the characteristics of a service that transfers

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continuously (using the indicators listed in paragraph 22 of this paper) then revenue would be recognised as the property is created.

Factors that are commonly analysed to determine the revenue recognition pattern

24. The staff gathered inputs from standard setters in several jurisdictions on different indicators that an entity analyses when determining whether the transfer of control and risks and rewards for off-plan sales is on a continuous basis or occurs only at one point in time.
25. The intention of the staff in discussing those indicators is not to assess the correctness (with respect to IFRSs) of analyses of specific facts and circumstances performed in some jurisdictions against those indicators. Rather, the staff note that there is a lack of guidance under IFRSs to help determine continuous transfer of control versus transfer of control at one point in time and that there exists diversity in practice.
26. The following indicators are commonly used in practice:
 - (a) who owns the legal title for the land;
 - (b) who has ownership of the construction in progress;
 - (c) who bears the changes in the market value after the sales contract is signed;
 - (d) whether payments to the seller when milestones are reached are refundable or not;
 - (e) whether the property under construction is buyer-specific; and
 - (f) who bears the risk that the construction may not be completed.
27. The staff believe that those indicators are characteristic of off-plan sale agreements where the only two parties involved are the developer and the buyer. In addition, these indicators illustrate broadly those proposed by the boards in the

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Revenue Recognition project, as reproduced in paragraphs 16, 20 and 22 of this paper.

28. The staff note that these indicators are commonly used across jurisdictions, but they seem to be insufficient in some jurisdictions to provide for reaching a conclusion on whether the transfer of control is on a continuous basis or at one point in time.

Specific fact pattern common to those jurisdictions where the analysis of transfer of control is controversial

29. The staff identified that in those jurisdictions where characterising the transfer of control is controversial, relevant public authorities are involved, in addition to the direct parties to the sale purchase agreement (ie the developer and the buyer). Their role is to protect the buyer if the developer defaults, because they have the power to assign a new developer to complete the construction. Because of the involvement of those relevant authorities, constituents in those jurisdictions find it difficult to conclude whether control lies with the developer or with the buyer.
30. In those instances, clarification would help to achieve common ground for the analysis of transfer of control, hence leading to better consistency when determining the accounting method for recognising revenue.
31. The staff note that two views are presented in the submission as to the meaning of continuous transfer in the specific situation described in paragraph 29 of this paper:
 - (a) View 1: the buyer receives control over the asset in its partially completed state while construction takes place; or
 - (b) View 2: the seller loses control and the buyer receives protective rights, although the transfer to the buyer only takes place at a later date, e.g. upon completion of construction.
32. The staff understand that in those circumstances in which an additional entity is involved whose role is to ensure that the buyer benefits from protective rights,

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control is yet to be received by the buyer, but no longer rests with the seller. The staff believe that this may create a gap where neither the developer nor the buyer has control of the construction while it is in progress.

Analysis of view 1

33. The staff note that view 1 reflects one reading of the words ‘The entity may transfer to the buyer control and the significant risks and rewards of ownership [...]’ in paragraphs 17 and 18 of IFRIC 15.
34. This view is consistent with analysing the transfer of control and significant risks and rewards irrespective of protective rights a public authority may provide to the buyer. The staff understand that this is a common reading of IFRIC 15 where no third party is involved in addition to the buyer and the seller.
35. Those who share view 1 believe that receiving protective rights from a third party is insufficient to characterise the transfer of control and significant risks and rewards from the seller to the buyer. In their opinion, in those cases where neither the developer nor the buyer has control as construction progresses, control is transferred only at one point in time, upon completion of the construction. The consequence of this view is that revenue should not be recognised until completion of the construction.

Analysis of view 2

36. The staff understand view 2 as being an attempt to capture situations where a public authority provides protective rights to the buyer.
37. The staff note that neither IAS 18 or IFRIC 15 contemplated that specific fact pattern.
38. Those who share view 2 are of the opinion that the protective rights provided by the public authorities reflect a partial transfer of control and significant risks and rewards from the seller to the buyer. In their opinion, such a partial transfer would lead to using the percentage of completion method for recognising revenue.

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Partial conclusion

39. The staff think that the effect of an additional party should be analysed together with other indicators such as those listed in paragraph 26 of this paper to reach a conclusion as to whether transfer of control is continuous or occurs only upon completion of the construction.

Agenda criteria assessment

40. The staff's assessment of the Interpretations Committee's agenda criteria is as follows:

- (a) *The issue is widespread and has practical relevance.*

The issues described in this document are widespread and are of practical relevance in the off-plan sale of real estate industry. Geographical diversity extends from Asia to South America.

- (b) *The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). The Committee will not add an item to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.*

There are currently differing views as to what 'continuous transfer' means and how it should be applied in practice.

- (c) *Financial reporting would be improved through elimination of the diverse reporting methods.*

In off-plan sales of real estate, the revenue recognition pattern varies significantly depending on the assessment of the transfer of risks and rewards and control. The staff believe that providing guidance on the meaning of continuous transfer will help enhance comparability.

- (d) *The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.*

The issue is sufficiently narrow in order to be addressed by an interpretation of the IFRS Interpretations Committee.

- (e) *It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.*

Yes.

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- (f) *If the issue relates to current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? (The IFRIC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the IFRIC would require to complete its due process).*

The Board is currently discussing the revenue recognition project with a view to finalise *Revenue from Contracts with Customers* by June 2011. The new standard will incorporate IFRIC 15 *Agreements for the Construction of Real Estate* and might not be effective before 2015.

Staff's recommendations

41. Given the agenda criteria assessment above, the staff recommend that the Interpretations Committee should take the issue onto its agenda with the aim of providing further guidance in IFRIC 15 to help determine whether the transfer of control is on a continuous basis or at one specific point in time.

Questions to the Interpretations Committee

Questions—staff's recommendation

- (a) Does the Interpretations Committee agree with the staff's recommendation to take the issue onto its agenda?
- (b) Does the Interpretations Committee agree that the focus should be on developing indicators of continuous transfer? If not, does the Interpretations Committee think that the staff should develop a description of continuous transfer?
- (c) Does the Interpretations Committee agree that further guidance should be provided on the unit of account?
- (d) Can the Interpretations Committee think of other paths forward on these issues?

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Appendix A

Appendix A - Text of the submission

The text was rendered anonymous.

[Submitter] request the IFRS Interpretations Committee to address the following issue with respect to the application of IFRIC 15 *Agreements for the Construction of Real Estate* to off-plan sales of real estate.

Issue

In July 2008 the IASB issued IFRIC 15 *Agreements for the Construction of Real Estate*.

This Interpretation addresses the questions (i) whether (a part of) an agreement is within the scope of IAS 11 or IAS 18 and (ii) to the extent the agreement is within the scope of IAS 18, whether it is for the rendering of services or for the sale of goods. This agenda item request is confined to agreements within the scope of IAS 18, for the sale of goods.

IFRIC 15 in par. 16 and BC23 notes that even though the seller has to perform certain services, the conditions referred to in par. 14 (Sale of Goods) of IAS 18 Revenue must be met for revenue to be recognised. Par. 17 and 18 of IFRIC 15 clarify that two of those conditions, i.e. (i) transfer of control to the buyer and (ii) transfer of risks and rewards of ownership to the buyer, may be met either (a) continuously as construction progresses or (b) only in its entirety at a single time (e.g. at completion, upon or after delivery).

Although the condition 'transfer of risks and rewards of ownership' is referred to in par. 14 of IAS 18, the notions 'transfer of control' or 'continuous transfer of control' are not. So there is little guidance in IAS 18 to fall back to when assessing when transfer of control takes place continuously or when it occurs in its entirety. IFRIC 15 does not contain such guidance either. In BC26 the Committee notes that agreements with 'continuous transfer' might not be encountered frequently, but neither the body of the interpretation nor the Basis provide indicators to assess when control transfers continuously. It is only in Illustrative Example 2 (IE6-IE8) that certain indicators are mentioned. However, since the two scenarios laid out in this example are extreme ends on a continuum, the judgement remains very difficult.

We realise that determining whether control transfers to the buyer continuously as construction progresses is a judgement call requiring careful analysis of all facts and circumstances, including legal documentation and an understanding of local law and rights and obligations of buyers and sellers of real estate in a particular jurisdiction. However, we have become aware of significant divergence in interpretation of the circumstances under which control and risks and rewards are deemed to have passed to the buyer continuously as construction progresses. These interpretations go beyond detailed interpretations of a contract or law. They are about the very nature of control. Since the outcome of this assessment has a significant effect on the timing of revenue recognition and therefore on the financial performance of real estate developers and construction companies we believe such a wide diversity of practice is hampering comparability of financial statements prepared under IFRS.

We are aware of the following potential interpretations, although this list is not necessarily exhaustive:

A. Some would argue that continuous transfer of control to the buyer means that the buyer must have legal title to the work in progress. This is based on IE8 where the only variable that is changed from the fact pattern in IE6 is that the seller transfers ownership of the real estate in its current state of completion to the buyer immediately upon signing of the contract. Hence, any additional construction becomes the property of the buyer as construction progresses.

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B. Others would argue that besides legal title there may be other ways in which a buyer can receive control over the work in progress while construction progresses. For example, if the agreement is terminated before construction is completed, the buyer retains the work in progress and the seller has the right to be paid for the work performed. This is based on the third sentence of IE8 and on the fact that legal title may just be one way of demonstrating control.

C. Some would go further and consider that as long as the protective rights of the buyer are such that control no longer rests with the seller, the criteria of continuous transfer are met. For example, if the seller would fail to meet its obligation, the buyer would not own the work in progress, but the state or some other agency would step in and decide the next steps. So it would not be necessary for control to be transferred to the buyer. As long as control does not entirely rest with the seller and there are sufficient protective rights of the buyer, the seller can claim it transfers control continuously while construction progresses.

D. Another view would be that continuous transfer can never take place in the case of individual units in a block of apartments since for technical reasons alone, the foundation and the first floor must be built before construction on the third floor, for example, can even begin. The margin on the sale of units on the first floor may be significantly different from those on the 15th floor. Continuous transfer would therefore mean that all agreements with all buyers are being considered as one unit of account which is inconsistent with IAS 18 as they are not negotiated as one contract.

To illustrate this diversity in practice we attach as an appendix the Accompanying Note on Application of INT FRS 115 issued by the Singapore Accounting Standards Council as part of their equivalent of IFRIC 15 (“Accompanying Note”). The interpretation in the Accompanying Note is different from practice we find in Europe and the Middle-East. Although this Accompanying Note was issued as part of Singapore GAAP, we understand there is an expectation in Singapore that there is no difference on this point between Singapore GAAP and IFRS. We have been made aware of several regulators weighing in on this issue. The interpretation of continuous transfer of control and risks and rewards is relevant in most jurisdictions; we are aware of recent discussions in Singapore, Malaysia, The Philippines, Korea and Brazil.

We are aware of the fact that the IASB is finalising a standard on revenue recognition (“Revenue ED”) which contains the notion of continuous transfer of control. Analogising to the Revenue ED seems inappropriate as it intends to apply one model to all sources of revenue, i.e. sale of goods and rendering of services. Continuous transfer of control would also apply to contracts that are currently dealt with in IAS 11. Percentage of completion accounting as required by IAS 11 provides the same result as continuous transfer would under IAS 18. This probably explains why the indicators of continuous transfer of control in the Revenue ED contains notions that go beyond the indicators in the illustrative example in IFRIC 15 and seem to be taken from IAS 11, for example whether the buyer has a significant say in the design of the asset. The problems encountered when applying IFRIC 15 may also surface when applying the final revenue recognition standard if issued on the basis of the Revenue ED. We also note that it may take a few years before that standard becomes mandatory.

We ask the Committee to clarify whether:

- continuous transfer of control means that (i) the buyer actually receives control over the asset in its partially completed state while construction takes place, or (ii) the seller loses control and buyer receives protective rights while actual transfer only takes place at a later date, e.g., completion of construction;
- control means that (i) the buyer has or takes legal or physical possession of work in progress while construction takes place, or (ii) it is sufficient that the seller is unable to sell the work in progress to anyone else; and

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- the unit of account, for determining whether control transfers continuously while construction takes place is each individual apartment in a block of apartments or the entire block.

Reasons for the IFRS Interpretations Committee to address the issue:

(a) The issue is widespread and has practical relevance

This issue is relevant in every sale of off-plan real estate in every jurisdiction and therefore widespread.

(b) The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). The Committee will not add an item to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.

As indicated above, there is evidence of significantly divergent interpretation emerging in practice.

(c) Financial reporting would be improved through elimination of the diverse reporting methods

The assessment of whether control and risks and rewards are transferred continuously to the buyer as construction progresses determines the choice between two very different revenue recognition methods and therefore has a significant effect on the financial performance of companies in this sector. Divergence in practice would seriously hamper comparability of financial statements.

(d) The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process

Yes, we believe IFRIC 15 can be clarified within the confines of IAS 18 and the Framework.

(e) It is probable that the Committee will be able to reach a consensus on the issue on a timely basis

Yes, we believe the Committee will be able to clarify the wording of IFRIC 15 on a timely basis to limit divergence of practice.

(f) If the issue relates to a current or planned IASB project, there is a pressing need to provide guidance sooner than would be expected from the IASB's activities. The Committee will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the Committee requires to complete its due process.

We are aware of the fact that the Board is currently finalising its standard on Revenue Recognition which will absorb IFRIC 15. The effective date of this new standard, however, is not expected to be within the next few years. We therefore believe the Committee is able to help practice during the years IFRIC 15 is still applicable by clarifying the wording of IFRIC 15.

Literature

IAS 18 Revenue

- 14 Revenue from the sale of goods shall be recognised when all the following conditions have been satisfied:
- (a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;
 - (b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

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- (c) the amount of revenue can be measured reliably;
- (d) it is probable that the economic benefits associated with the transaction will flow to the entity; and
- (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

IFRIC 15 *Agreements for the Construction of Real Estate*

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 The entity 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. In this case, if all the criteria in paragraph 14 of IAS 18 are met continuously as construction progresses, the entity shall recognise revenue 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 The entity may transfer to the buyer control and the significant risks and rewards of ownership of the real estate in its entirety at a single time (eg at completion, upon or after delivery). In this case, the entity shall recognise revenue only when all the criteria in paragraph 14 of IAS 18 are satisfied.

BC23 and BC26

BC23 The IFRIC also noted that construction activities often require an entity that undertakes the construction of real estate, directly or through subcontractors, to provide services together with construction materials. However, the entity delivers to the buyer a real estate asset, either completed or in its current stage of completion. Therefore, the IFRIC concluded that the criteria in paragraph 14 of IAS 18 for recognition of revenue from the sale of goods should apply to such agreements.

BC26 The IFRIC noted that agreements with 'continuous transfer' might not be encountered frequently. However, the IFRIC decided that the Interpretation should address the accounting for such agreements because some respondents to D21 identified agreements with these characteristics.

IE 6-IE8

Example 2

IE6 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

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to the buyer other than through the agreement. Consequently, the construction takes place regardless of whether sale agreements exist.

IE7 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 entity retains control and the significant risks and rewards of ownership of the work in progress in its current state 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).

IE8 Alternatively, assume that, in the jurisdiction, the law requires the entity to transfer immediately 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. The entity would need to consider all the terms of the agreement to determine whether this change in the timing of the transfer of ownership means 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. For example, the fact that if the agreement is terminated before construction is complete, the buyer retains the work in progress and the entity has the right to be paid for the work performed, might indicate that control is transferred along with ownership. If it does, and if all the criteria in paragraph 14 of IAS 18 are met continuously as construction progresses, the entity recognises revenue by reference to the stage of completion using the percentage of completion method taking into account the stage of completion of the whole building and the agreements signed with individual buyers.

Appendix:

Accompanying Note on Application of INT FRS 115 in Singapore

This accompanying note is an integral part of INT FRS 115.

Introduction

1 This note takes into account the legal framework in Singapore that is directly relevant to the application of INT FRS 115 in Singapore and summarises the Council's considerations in reaching its consensus on the accounting treatment for the sale of uncompleted residential properties "off-plan".

Scope

2 The scope deals with the accounting treatment for revenue and associated expenses by housing developers who develop more than 4 units of private residential properties in Singapore for sale prior to completion¹ of the properties. These developers are regulated under the Singapore Housing Developers (Control and Licensing) Act (Chapter 130) (the "Act") and use the standard form of the sale and purchase agreement² (the "SPA") prescribed in Form D for landed properties and Form E for strata-titled properties of the schedule to the Housing Developers Rules, with

¹ This refers to the issue of Certificate of Statutory Completion and individual legal titles for the housing units.

² Any amendment, deletion or alteration to the standard SPA can only be effected with the approval of the Controller of Housing.

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each unit sold intended to comprise a lot in a land title plan for landed properties and strata title plan for strata-titled properties. Such a unit sold is referred to as “uncompleted property unit”. Such sales are referred to as “standard residential property sales”.

Issue

3 The issue is whether standard residential property sales result in the transfer to the purchasers the control and the significant risks and rewards of ownership of the uncompleted property units in their current state as construction progresses, so that the developer should recognise revenue for such sales by reference to the stage of completion using the percentage of completion method.

Consensus

4 The five criteria set out in FRS 18.14, in the context of standard residential property sales, are analysed in turn below.

Whether the developer has transferred to the purchaser the significant risks and rewards of ownership of the uncompleted property units - FRS18.14(a)

5 The Council noted that no housing development³ (“development”) shall be carried out or undertaken in Singapore except by a housing developer who or which is in possession of a licence in writing from the Controller of Housing authorising it to do so. This point together with the various powers vested with the Controller of Housing and the Minister under the Act, underscore the legislative intent to protect the rights of the purchaser of an uncompleted property unit. The provisions in the Act are necessary to protect the rights of the purchaser and justify the basis that the risks of an uncompleted property unit accrue to the purchaser.

6 Standard residential property sales can result in the transfer of the significant risks and rewards of ownership from the time that the SPA is executed, as the purchaser acquires beneficial ownership of the uncompleted property unit. Such beneficial ownership entitles the purchaser to the rewards of ownership such as the ability to sell the purchaser’s beneficial ownership of the uncompleted property unit to another party, with the gain or loss from such a sale being retained by the purchaser. The purchaser is unable to rescind the standard SPA if the developer does not satisfy its obligations and the Council noted that in this regard, the developer passes the risk of ownership to the purchaser upon the execution of the SPA.

7 The developer similarly passes to the purchaser the risks of ownership such as a progressive instalment payment schedule that is designed to progressively match and pay for the contracted purchase price of the uncompleted property unit as the construction progresses. The payment schedule as specified in the standard SPA is also systematically aligned to the stage of completion certified by a qualified person as defined under section 2(1) of the Building Control Act (Chapter 29) (i.e. 30% of the purchase price would be paid to date which is aligned to the completion of the foundation work of the uncompleted property unit etc.).

8 Downward price changes in the market value of the uncompleted property unit sold to the purchaser will not be borne by the developer. The progressive payments by the purchaser

³ As defined under section 2 of the Act.

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represent a payment for an appropriate proportion of the contracted purchase price based on the stage of completion at the date of each of the pre-specified payment intervals.

9 The purchase of an uncompleted property unit exposes the purchaser to losses from the risk of a failure by the developer to complete the property, with the loss of the amounts he has paid to date. The Council noted that the risk of default is mitigated by a requirement in the Act for the developer to operate a separate project account for the development with a bank or finance company.

10 The types of monies to be deposited into and withdrawn from the project account are set out in the Housing Developers (Project Account) Rules. These rules are designed to ensure that monies paid by purchasers in each development are segregated, and utilised only for designated types of payments that relate to the development. The monies shall not be released unless supported by a certificate from the qualified person in charge of the development or documentary proof that payment is due to be made for that designated purpose. This provides a framework that significantly limits the risks to the purchaser of non-completion of the construction of the property.

11 Based on the above observations, the Council noted that standard residential property sales can result in the transfer of the significant risks and rewards of ownership of the uncompleted property units to the purchaser.

Whether the developer retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the uncompleted property units sold - FRS18.14(b)

12 As the sale involves an uncompleted property that the developer has obligations to complete, the developer would continue to have involvement in the uncompleted property sold to the purchaser. During the construction period, such managerial involvement on the part of the developer arises from the contractual obligation of the developer to complete construction in accordance with agreed contractual terms.

13 The Council noted that the SPA together with the relevant building approvals set out the specifications of the property that cannot be changed unilaterally by the developer. Similarly, the developer does not have the right of an owner to deal freely with the uncompleted property unit - once sold, that unit cannot be sold by the developer to another party or be substituted by the developer for another unit. The Council noted that there are no major decisions that a developer can make to derive ownership benefits, e.g. such as making changes to the specifications and approved plans unless the changes have been approved or are required by the Commissioner of Building Control or any other relevant authority of the uncompleted property.

14 The Council noted that the Act provides, in the event of a developer not meeting its obligations, for the relevant authority to direct the appointment of another developer to carry on the business of the defaulting developer. Such power vested in the Minister underscores the rights of purchasers as owners, since such action is not designed to protect any developer's rights to the property.

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15 Based on the above observations, the Council considered that the involvement of the developer is in a managerial capacity acting on behalf of the owners, rather than as an owner and that the developer does not have effective control similar to what an owner would be expected to have.

16 The Council noted that INT FRS 115.17 states that “The entity may transfer to the purchaser control...of the work in progress in its current state as construction progresses.” On this point on whether the purchaser obtains control progressively of the uncompleted property unit as construction progresses, the Council has rationalised the concept of control from the dimension of a multi property unit development rather than a single unit property development.

17 The Council noted that absolute control of the uncompleted property unit vests in no one single entity during construction for a multi-unit property development. The standard SPA does not specify that a purchaser is able to take over the uncompleted development during construction (e.g. to engage a different entity to complete the construction). Approaching control from the dimension of a multi-unit property development, the purchaser of a single unit cannot unilaterally change the developer during construction. However, the issue of whether collectively all the purchasers are able to change the developer during construction has not been considered because there has been no such precedence in Singapore to date and hence, inappropriate to speculate with regard to the application of INT FRS 115.

18 The Council noted that a purchaser will not be able to alter the major structural elements of the design of the property unit even after completion of construction and hence, the issue of whether the purchaser has this ability during construction is irrelevant to the application of INT FRS 115. However, the Council noted that there have been instances where the purchaser of two adjoining property units had entered into a supplementary SPA with the developer to combine the 2 property units during construction. The Council noted that the purchaser had evidenced the ability to alter the specifications of the purchaser’s own uncompleted property unit within the unit’s parameters during construction.

19 The Council noted that the control the Controller of Housing has over the uncompleted property unit during its construction is primarily on the control of the project account and not on the uncompleted property unit. His role is predominantly to safeguard the interests of the purchaser by ensuring the SPA is a fair agreement between both parties.

20 Historically, when a developer defaulted during the construction of an uncompleted development, the mortgagee financial institution which financed the development via a loan to the developer secured by the land and the development as mortgage had stepped in to take over the development.

21 The Council noted that the courses of action taken by a mortgagee financial institution included the appointment of a receiver which subsequently completed the development as per the original SPA or sold the underlying land without completing the development. Typically, the courses of actions depended on the stage of completion and the percentage of units sold to date.

22 The Council noted that there was a case where a mortgagee financial institution sold the underlying land to another developer when it took over the development during the foundation stage of completion when none of the units were sold. In another case, the mortgagee financial institution took over the development with 25 out of the 52 units already sold. The underlying

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land was sold to a new developer with the sale subject to the new developer taking over the obligations of the failed developer under its existing SPAs with the purchasers.

23 The courses of action taken by a mortgagee financial institution or a receiver appointed on an uncompleted development in respect of a developer which had defaulted are ultimately driven by commercial justifications. The historical rate of defaults by developers in Singapore is minimal.

24 Notwithstanding the above courses of action that could be taken by a mortgagee financial institution, the Council noted that the Minister may intervene under the Act to ensure that the rights of the purchasers under the SPA are safeguarded. In addition, the Council noted that a purchaser is able to mortgage the uncompleted property unit to obtain a housing loan to settle the progressive payments.

25 The Council considered the two alternative scenarios posed in paragraphs IE6 to IE8 of illustrative example 2 accompanying INT FRS 115, the Council noted that legal title of the property unit would only pass to the purchaser upon the completion. The developer would execute a proper conveyance to the purchaser of the property unit and also hand over to the purchaser the title to the property unit, namely the subsidiary strata certificate of title (for a strata-titled property) or the certificate of title (for a landed property). This certificate is an official document issued by the Registrar of Titles stating that the person named in the certificate is the legal owner of the property described in the certificate.

26 To protect the purchaser's interest, the purchaser (i.e. "caveator") may lodge a caveat⁴ against the specific uncompleted property unit under section 115(1) of the Land Titles Act (Chapter 157). The caveat is a precautionary step taken by the caveator pending completion of the uncompleted property unit. The caveat also serves as a notice to others that the caveator has an interest in the uncompleted property unit (i.e. an encumbrance).

27 The Council noted that a caveat lodged on an uncompleted property unit can prevent the developer from dealing with the underlying land independently of the caveator. So long as a caveat remains effective, the Registrar of Titles shall not register any dealing which is prohibited by the caveat. Upon lodgment of a transaction which is prohibited by a caveat, the Registrar of Titles shall serve on the caveator a notice of his intention, at the expiration of 30 days from the date of the service of the notice, to register the transaction. The ability of a caveator to be notified and object to another party's registration of a transaction of the underlying land in which a caveat had been lodged earlier, evidences control associated with ownership of the uncompleted property unit.

28 The Council noted that a missing control factor prior to the completion of construction is that the purchaser does not possess physical control of the completed unit. Prior to the transfer of the

⁴ A caveat is a legal document lodged at the Singapore Land Authority by someone (known as a "caveator") against a property in which the caveator claims an interest. The Land Titles Act (Chapter 157) allows any person who claims an interest in the property to lodge a caveat. When a caveat is lodged, the Registrar of Titles will notify it against the property. A caveat may be lodged by any party who has an interest in the property and that party is usually a:-

- purchaser who has paid a deposit to buy a particular property; or
- financial institution which has granted a loan to the owner or the purchaser; or
- Central Provident Fund (CPF) Board when CPF funds are released from the owner's or the purchaser's CPF account(s).

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legal title, the Council noted that there is a progressive alignment of the monies deposited into the project account and the progressive build up and value accretion of the physical property unit that evidences that the purchaser progressively accumulates control over the uncompleted property unit as progressive payments are made to the project account.

29 Accordingly, the legal framework and the caveat system in Singapore taken as a whole provide an equitable right of the purchaser over the uncompleted property unit. This together with the project account and the progress payments made by the purchaser, evidences that the purchaser obtains control over the uncompleted property unit as construction progresses. Collectively, the various mechanisms in the legal framework, over and above contractual rights, establish a purchaser's control over the uncompleted property unit. This is reflected in the historically minimal rate of defaults on developments in Singapore.

Whether the amount of revenue can be measured reliably - FRS18.14(c)

30 The Council noted that the considerations relating to the reliability of measurement of revenue should be based on standard accounting principles and require no further consideration for purposes of this note.

Whether it is probable that the economic benefits associated with the transaction will flow to the developer - FRS18.14 (d)

31 The Council considered the issue of whether the regulatory restrictions in the Act on the use of the monies received from purchasers and deposited in the project account poses a significant uncertainty on the ultimate receipt of the sale proceeds. One related argument is that these monies are the property of the purchasers and held in trust on their behalf. The Council noted that the monies are considered as belonging to the developer, notwithstanding the regulatory restrictions, and that the monies are applied towards the payment of construction costs that the developer would otherwise have to finance. The Council also noted that the developer is allowed to withdraw the balances in the project account ahead of the completion of construction if the developer furnishes a banker's guarantee of equivalent amount to the Controller of Housing and has obtained the Controller of Housing's approval.

32 The Council also considered a scenario where sales of uncompleted property units have been made, but there is considerable uncertainty as to the ability of the developer to sell sufficient units and its ability to continue as a going concern. In such a situation, the Council felt that there would be significant doubt as to the eventual completion of the project and realisation of the attributable profit relating to the sales made to date, since the project could result in a loss overall.

Whether the costs incurred or to be incurred in respect of the transaction can be measured reliably - FRS18.14(e)

33 The Council noted that the considerations relating to the reliability of measurement of costs are no different from standard accounting principles and require no further consideration for purposes of this note.

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Conclusion

34 The Council noted that standard residential property sales in Singapore meet the criteria set out in FRS 18.14 that would require such sales to be accounted for on a percentage of completion method. However, in some situations specific to the circumstances of a development project as described in paragraph 32, there might be uncertainties that would require the completion of construction method to be applied, consistently with the principles set out in FRS 18 for the treatment of revenue when such uncertainties exist.