STAFF PAPER

February 2012

IASB Meeting

Project	**IFRIC 15 *Agreements for the Construction of Real Estate***
Paper topic	Request for Board direction by the IFRS Interpretations Committee

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Purpose

1. In July 2008 the IASB issued IFRIC 15 *Agreements for the Construction of Real Estate*. This interpretation included the notion of the 'continuous transfer of control of a good'. The Interpretations Committee has received two submissions requesting clarification of the notion of continuous transfer of a good.
2. The Committee discussed this topic three times in 2011. At their most recent discussions, in November 2011, the Committee decided to refer the topic to the Board for direction as to the appropriate course of action to take to address this matter.
3. The purpose of this paper is to discuss what those appropriate courses of action might be and to provide the Board with a staff recommendation based on that discussion.

Staff recommendation

4. The staff recommend that the Board should reply to the Committee's request in terms of option A—retain IFRIC 15 as issued. This paper lays out the reasons why we have come to this recommendation.

Structure of the paper

5. The paper is organised as follows:

   (a) background;

   (b) the Board's revenue recognition project

   (c) Option A–retain IFRIC 15 as issued;

   (d) Option B–revise IFRIC 15 to include the Board's tentative decisions about continuous transfer, which were included in the revenue exposure draft;

   (e) Option C–revise IFRIC 15 to include indicators of the transfer of control and risks and rewards for use in interpreting IAS 18;

   (f) Option D–withdraw IFRIC 15; and

   (g) summary and staff recommendation.

Background

6. In July 2008 the IASB issued IFRIC 15 *Agreements for the Construction of Real Estate*. This interpretation addresses two questions:

   (a) whether an agreement is within the scope of IAS 11 *Construction Contracts* or IAS 18 *Revenue*; and

   (b) whether an agreement is a construction contract, an agreement for the rendering of services or an agreement for the sale of goods.

7. IFRIC 15 restricts the application of IAS 11 to agreements in which the buyer is able to specify the major structural elements of the design. This restriction affected many multiple-unit developments, such as apartment blocks, because individual buyers within such developments cannot alter the way in which their unit is integrated into the overall design. Consequently, applying IFRIC 15 resulted in many arrangements that had previously been accounted for in accordance with IAS 11 being redesignated as an agreement for the sale of goods in accordance with IAS 18.

8. IFRIC 15 states that control and the significant risks and rewards of ownership of the WIP can transfer as construction progresses or at a single time. The question that needs to be answered is-how do you know when that transfer is continuous or when it occurs at a single time?

9. Trying to answer that question has given rise to a high level of uncertainty in several jurisdictions. Within those jurisdictions, all construction entities that build multi-unit residential properties (ie apartments) have been affected. A very broad group of entities has therefore been affected and different jurisdictions have dealt with this uncertainty in different ways.

10. Singapore, for example, has issued a local interpretation saying that local law established a basis for concluding that continuous delivery accounting was permitted. Malaysia, which has adopted IFRSs this year, has introduced two frameworks. MFRS is the same as IFRSs, but their alternative framework, FRS, excludes both IFRIC 15 and IAS 41 *Agriculture*.

11. The Committee is also aware that this issue has caused both a high degree of uncertainty and extensive debate between standard-setters, preparers and the accounting firms.

The Board's revenue recognition project

12. Revenue recognition is one of the Board's major current projects. When the new revenue recognition standard is issued it will replace IAS 11, IAS 18 and related interpretations, including IFRIC 15. Originally the Committee did not address the issues raised by the application of IFRIC 15 because they were waiting for the new revenue recognition standard to be issued.

13. In June 2011 the Board decided to re-expose their revenue proposals. The second revenue recognition exposure draft was issued in November 2011 and is open for public comment until 13 March 2012. The project time-line for issuing the revenue standard, therefore, is now :

Nov 2011	Mar 2012	Q4 2012/ Q 1 2013	Not earlier than 1 January, 2015
Re-exposure	Comment period	Issue IFRS	Effective date

14. The Board has discussed the topic at the centre of the IFRIC 15 problems, continuous transfer, as part of its redeliberations of the revenue recognition project. Throughout the redeliberation process the Board's proposals about continuous transfer have been tested against a range of transactions, including those that proved difficult to assess when applying IFRIC 15. Accordingly, the revenue ED proposals have been developed in a way that the staff think will resolve the IFRIC 15 issue, by clarifying when transfer takes place continuously and when it takes place at a single time.

15. If the revenue recognition standard did not provide a solution to the IFRIC 15 application issues, the Board would need to provide standards-level guidance itself to resolve this issue of continuous transfer. However, because the revenue recognition standard will resolve the IFRIC 15 problem, direction to the Committee is only needed to cover the time until the new revenue recognition standard is effective.

16. The time line in paragraph 13 indicates the effective date of the new revenue standard will not be before 2015 and may be later. This means that current diversity in practice will continue until at least 2015. Accordingly, the Committee are asking the Board for direction as to the appropriate course of action until the new revenue standard is effective.

17. There are several courses of action open to the Committee. The Board could request the Committee to:

    (a) retain IFRIC 15 as issued;

    (b) revise IFRIC 15 either to include indicators of the transfer of control or to include a discussion of continuous transfer; or

    (c) withdraw IFRIC 15.

18. These options are discussed below.

Option A—Retain IFRIC 15 as issued

19. The Board could ask the Committee to retain IFRIC 15 as issued as a mechanism for assessing whether control and the risks and rewards of ownership transfer continuously or at a single time.

20. In November 2011 the staff presented a paper to the Committee on IFRIC 15. In that paper, the staff provided the Committee with two examples of real estate transactions in two different jurisdictions, A and B. These jurisdictions were anonymous in the paper. The local standard-setters in each country believe that the examples used are a fair representation of the facts in their respective jurisdictions.

21. That paper compares the local facts and circumstances with two criteria for revenue recognition that are stated in IAS 18:

> (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; (paragraph 14)

22. The paper looks at these recognition criteria from three perspectives:

    (a) significant risks and rewards of ownership;

    (b) effective control over goods sold; and

    (c) continuing managerial involvement to the degree associated with ownership.

23. The November paper, 5A *IFRIC 15–Continuous transfer to the customer*, is included as Appendix A.

24. The staff's conclusion in that paper, based on a careful review of the facts presented, was that the facts in A and B were substantially different and that continuous transfer of control occurred in Jurisdiction A in the example, but not in the example used for Jurisdiction B. Although the Committee members accepted that the facts differed, they did not believe that they could adequately identify the key factors that were required to make a determination about that transfer. Some Committee members took the view that in the case of a multi-unit development control of individual units always transfers at a single time, contract completion.

25. In Option A we propose that the conclusion reached by the staff in Paper 5A is reasonable and is supported by the analysis included in that paper. To prepare the analysis required you do need to make a careful assessment of the facts and that

assessment may be time-consuming and painstaking with regard to detail. This is, in part, a consequence of the significant and complex role that laws and regulations can play in determining the rights and obligations of parties to a sales transaction.

26. The application of IFRIC 15 will require a careful assessment of the facts of each transaction. However, the staff think that when a careful assessment is made of the facts and circumstances of individual transactions, as illustrated in paper 5A, it is possible to arrive at a conclusion as to whether control and the risks and rewards of ownership transfer continuously or at a single time.

27. The need for such a detailed analysis grates with many. In their view IAS 18 is a 'general' standard, the application of which should be straightforward. On the other hand they would accept that some standards, such as IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 12 *Income Taxes*, regularly require specialist analysis because of the complexity of financial instruments or tax laws. The level of analysis required in paper 5A to apply IFRIC 15 in some jurisdictions is already common when applying IAS 39 and IAS 12, but is not generally common when applying IAS 18.

28. IFRIC 15 as issued provides a mechanism for concluding whether control and the risks and rewards of ownership transfer continuously or at a single time. This option also has no associated time delay as it does not require any amendment to existing IFRSs. The main disadvantage of this option is that some would want more specific guidance for the interim period until the revenue recognition standard is issued to remove the need to perform such a detailed review of local contractual terms and laws.

Option B—Revise IFRIC 15 to include the Board's tentative decisions about continuous transfer, which were included in the revenue exposure draft

29. The Board could ask the Committee to clarify the concept of continuous transfer of a good by including the Board's recent decisions on continuous transfer, which were made as part of the revenue redeliberations, in a revised IFRIC 15.

30. There are some limitations to this exercise:

(a) IFRIC 15 is an interpretation based on IAS 11 and IAS 18. These standards do not share the same principle that underlies the revenue exposure draft. It may not be possible to bridge that technical gap.

(b) The work would have to be done on the basis of the revenue exposure draft because the IFRS is not expected to be issued until early next year.

(c) The exposure draft asks a question specifically about continuous transfer. It is possible, therefore, that the Board's tentative decisions on continuous transfer may be amended.

(d) There has been some criticism in the past that the guidance in IFRIC 15 borrowed too many ideas from the revenue project, rather than merely interpreting IAS 11 and IAS 18.

(e) The time taken to devise a solution, re-draft IFRIC 15 and obtain Board approval might not be completed before the new standard is issued. A reasonably possible timetable would be:

Apr 2012	May 2012	July 2012	Sep 2012	Dec 2012	May 2013	1 Jan 2014
Staff Draft	IFRIC decides	Revision drafted	Board approves	Comment ends	Issue revision	Effective date/ early application

Option C—Revise IFRIC 15 to include indicators of the transfer of control and risks and rewards for use in interpreting IAS 18

31. IFRIC 15 may contain sufficient guidance to enable specialist IFRS technical advisers to answer the question of continuous control, but many others, including proficient IFRS generalists, find it difficult to apply IFRIC 15 to individual cases. Additional application guidance could help.

32. The Board could ask the Committee to clarify when control transfers by including indicators of the transfer of control and the risks and rewards of ownership in a revised IFRIC 15. Many constituents request that indicators should be included in the Board's standards to help them in applying the standards.

33. However, the identification of those indicators may be difficult:

(a) The Board will remember from their discussions on revenue that the identification and selection of indicators is a difficult and time-consuming process.

(b) IAS 18 does not have a Basis for Conclusions nor does it discuss the notion of continuous transfer of a good. It may not be possible technically to devise indicators for a notion that was not envisaged in the original standard.

(c) Many constituents believe that indicators are difficult to apply unless they have a clear hierarchy or can be ranked in some way. If IFRIC 15 were revised to include indicators, constituents might find that an assessment made on indicators did not provide any clearer guidance than is already contained in IFRIC 15.

34. The time taken to devise a solution, re-draft IFRIC 15 and obtain Board approval might not be completed before the new standard is issued. A reasonably possible timetable would be:

July 2012	Sep 2012	Dec 2012	Jan 2013	Apr 2013	Sep 2013	1 Jan, 2014
Develop Indicators	IFRIC approves	Revision drafted	Board approval	Comment period ends	Issue revision	Effective date

Option D—Withdraw IFRIC 15

35. The Board could withdraw IFRIC 15. This would return global IFRSs to their pre-IFRIC 15 state.

36. IFRIC 15 was issued because there was widespread concern that the IAS 11 definition of a construction contract would allow revenue to be recognised continuously for any specifically negotiated asset:

> A *construction contract* is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

37. The Committee was originally asked to interpret this because some first-time adopters of IFRSs were concerned that *all* contracts are specifically negotiated. They were also concerned that many constructed assets have a degree of interdependence.

38. The submitters that originally requested guidance would argue that withdrawal of IFRIC 15 would result in continuous recognition of revenue from the application of IAS 11 to a number of transactions for which continuous transfer was not the Board's intention, such as Australian, US and UK agreements for the construction of apartments and the manufacture of some machinery.

39. In addition, the withdrawal of IFRIC 15 might not solve the current uncertainty nor reduce diversity in applying IFRIC 15. Instead, withdrawal of IFRIC 15 might simply create tension in deciding whether the contract is a construction contract in accordance with the definition in IAS 11 or a contract for the sale of goods, recognised in accordance with IAS 18.

40. A proposal to withdraw IFRS 15 would need to be exposed for comment as it would represent a proposed change to IFRSs. The time taken to draft the withdrawal and obtain Board approval might not be completed before the new standard is issued. A reasonably possible timetable would be:

Apr 2012	May 2012	July 2012	Sep 2012	Dec 2012	May 2013	1 Jan 2014
Staff paper	IFRIC decides	Withdrawal drafted	Board approves	Comment ends	Issue revision	Effective date

Summary and staff recommendation

41. The staff recommend that the Board direct the Committee to retain IFRIC 15 as issued until the new revenue recognition standard is issued. That recommendation is based on the staff's conclusion drawn from Paper 5A (Appendix A). In that paper, the staff concluded that it is possible to determine whether transfer takes place continuously or at a single time. In the staff's view, Paper 5A provides sufficient analysis to support the staff's conclusion that transfer takes place continuously in Jurisdiction A, but takes place at a single time in Jurisdiction B. The analysis required to make that determination is time-consuming, but that process is a necessary element of arriving at that determination.

42. The staff think that the following points are important to an assessment of their recommendation of Option A:

(a) IFRIC 15 is a source of significant uncertainty in a number of jurisdictions and has damaged local working relationships.

(b) Acknowledging that a detailed analysis of the facts and circumstances in the application of IFRIC 15 can, in some circumstances, lead to a conclusion of continuous transfer (as illustrated in paper 5A) will be helpful for constituents who may find this illustration useful in analysing their own facts and circumstances. Consequently, by acknowledging the conclusions reached in paper 5A and by deciding to retain IFRIC 15 as issued, Option A would provide greater clarity immediately. The other options all involve a time delay and are unlikely to be completed before the new revenue recognition standard is issued.

(c) Options B and C are based on revising IFRIC 15 to include the Board's tentative decisions about continuous transfer, which were included in the revenue exposure draft, or to include indicators of the transfer of control and risks and rewards for use in interpreting IAS 18. Neither solution may be technically feasible and either is likely to be time-consuming to develop. The new revenue standard is likely to be issued before either could be completed.

(d) Option D, withdrawal of IFRIC 15, is unlikely to resolve the uncertainty. It would be likely to move the tension from 'is transfer continuous?' back to 'is it a construction contract?'

43. The staff recommend that the Board should reply to the Committee in the following terms:

(a) The Board accepts the staff view that the new revenue recognition standard will resolve the issue of continuous transfer.

(b) In the meantime, the application of IFRIC 15 will require a careful assessment of the facts of each transaction. However, the Board think that when a careful assessment is made of the facts and circumstances of individual transactions, as illustrated in paper 5A, it is possible to arrive at a conclusion as to whether control and the risks and rewards of ownership transfer continuously or at a single time. The Board acknowledges that the facts and circumstance may vary considerably between jurisdictions.

(c) The Board takes the view that the conclusion drawn by the staff in Paper 5A, that transfer of control is continuous in Jurisdiction A but at a single time in Jurisdiction B, is reasonable in the light of the facts and circumstances presented in the examples and the analysis presented in that paper.

Question
Do you agree with the staff recommendation to respond to the Committee's request for direction, incorporating the matters referred to in paragraph 43 above?