

Reference: **IFRS 15-Pattern of revenue recognition in a real estate contract**

The Office of the Chief Accountant of the Securities and Exchange Commission of Brazil would like to offer comments to the staff paper “IFRS 15-Pattern of revenue recognition in the real estate contract”, as we consider them fundamental for the clarification of topics that we believe have been inadequately addressed.

Comments to the staff paper IFRS 15-Pattern of revenue recognition in a real estate contract

Our understanding is that the aforementioned material did not contemplate the actual characteristics of the contract under analysis, thus undermining any decision on the matter. The most relevant comments are presented below:

1) Item 5b - *"The entity retains legal title to the real estate unit (and any land attributed to it) until construction is complete"*. This is a discretion of the parties. On one hand, a mechanism for protection of the entity against customer default and, on the other, a financial convenience for the client, who does not wish to incur expenses of a new registration when the property is delivered promptly. There are no legal impediments for the contract to be registered in the registry binding it exclusively to the buyer.

2) *"The contract gives the customer an 'in rem' right to the real estate unit"* - In several parts of the text, it is stated that the contract is in fact a forward contract, in other words, a financial instrument. This understanding does not apply to the contract under discussion, as this is in fact a contract for the acquisition of property under construction. It is a perfect and finished contract, not to be confused, under any circumstances, with an option or a right to be exercised at a future date. Disbursements made as a result of the agreement with the customer are effective payments of the purchase price of the property under construction (according to the Payment Schedule). Moreover, such payments can be in full, i.e., 100% of the purchase value of the property. There is no room to think that such payments are deposits, awards or any other implying a right to execute at a future date.

3) Item 6b - *"Based on the details in the submission, we have prepared the analysis in this paper assuming that the entity: (a) (...); (b) has identified a performance obligation in the contract applying paragraphs 22-30 of IFRS 15-a promise to transfer the real estate unit to the customer"*. We consider this interpretation a consequence of the inadequate understanding of the nature of the contract, as commented in the previous topic. We understand that this imperfection distorts all other conclusions made throughout the document. In our view, the use of this incorrect premise tarnished the development of the reasoning and led to the conclusion that the performance obligation in the concrete case would be the "promise of transferring a real estate unity to be

concluded at a future date”. This statement does not find any support in the contractual relations established in our jurisdiction. We reaffirm that the transfer of ownership / control occurs when the contract is signed. After this event, the entity operates as a mere construction service provider, committing itself to delivering a concluded real estate unit according to the specifications contained in the descriptive memorandum¹ and within the deadline established in the sale contract.

4) Item 14 - Cites BC 129 of IFRS 15 which describes an example "that a customer clearly controls the asset is created or enhanced", that is, "the construction contract in which the entity is building on the customer's land". In that case, the customer generally controls any work in progress arising from the entity's performance”. In our jurisdiction, when the contract of sale is signed, an ideal fraction of the land is immediately allocated to the buyer, that is, the entity builds on the client's land.

5) Item 16 a + b - opinions about the client's inability to direct the use of the asset under construction are not correct. It is important to emphasize that the client's ability to direct the construction or structural design of the real estate unit is exercised when the property is acquired, that is, when it accepts the specifications contained in the descriptive memorial. It does not seem conceivable to think otherwise for the vertical multi-residential unities building business. This is not an accounting or economic problem, but an engineering one. Moreover, evoking the client's inability to use the asset under construction for other purposes suggests a physical use of a finished property and that prerogative does not exist either for the client or the entity. It should be emphasized that an exclusive prerogative of the client in relation to the use of the unit under construction is to maintain it, and this is not a possibility assigned to the real estate entity.

Regarding the possibility of the client replacing the entity in case it does not perform according to the conditions established in the contract, this is a protective characteristic such as that attributed to the entity in relation to the non-registration of ownership when signing the purchase and sale agreement.

In our opinion, these inadequate interpretations lead to the conclusion that there is no clear evidence of transfer of control during construction (over time), which is incorrect from the perspective of the industry, users, and the capital market regulator.

Impacts on the securities market:

In addition to the aforementioned technical issues, it is essential to verify the impact that the initial consideration will have on the securities markets of our jurisdiction.

¹ The descriptive memorial is a public document mandatory by Federal Law No. 4.591/64, which must be prepared before the release of the enterprise to which it refers. In the preparation of the descriptive memorial, the project should be described in detail and cover all sectors of the project.

The change in revenue recognition criteria will mean the preparation of a set of financial statements that will be useful neither to the administrators (who use this criteria in their management) nor to the other users of these statements, since they would not fairly represent the economic events they are intended to portray. This inability will result (as informed by the industry) in the need to generate an additional set of accounting statements under the current criteria (POC) to serve these users, leading to a significant increase in preparation cost. Such additional set (based on a opposite concept) is intended to be presented in the notes, and it remains to be seen if such presentation is admissible. If such change occurs, it will certainly make the financial statements of these entities incomprehensible and time-consuming for users in our jurisdiction.

Best Regards,

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