

IFRIC® Update

From the IFRS® Interpretations Committee



March 2018

Welcome to the March IFRIC Update

The IFRIC Update is a summary of the decisions reached by the IFRS Interpretations Committee (Committee) in its public meetings.

Decisions on an IFRIC Interpretation become final only after the Committee has taken a formal vote on the Interpretation. IFRIC Interpretations require ratification by the International Accounting Standards Board (Board).

The Committee met in London on **13 March 2018**, and discussed:

- **Items on the current agenda**
- [Deferred tax – tax base of assets and liabilities \(IAS 12 *Income Taxes*\) — Agenda Paper 4](#)
- [Costs considered in assessing whether a contract is onerous \(IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*\)—Agenda Paper 5](#)
- [Payments relating to taxes other than income tax \(IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*\)—Agenda Paper 7](#)
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- [Hedge accounting with load following swaps \(IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments—Recognition and Measurement*\)—Agenda Paper 9](#)
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- [Presentation of interest revenue for particular financial instruments \(IFRS 9 *Financial Instruments* and IAS 1 *Presentation of Financial Statements*\)—Agenda Paper 3](#)
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- [Revenue recognition in a real estate contract that includes the transfer of land \(IFRS 15 *Revenue from Contracts with Customers*\)—Agenda Paper 2D](#)
- [Right to payment for performance completed to date \(IFRS 15 *Revenue from Contracts with Customers*\)—Agenda Paper 2E](#)
- **Other matters**
- [Responding to questions submitted—Agenda Paper 2B](#)
- [Committee work in progress—Agenda Paper 10](#)

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Next IFRS Interpretations Committee meeting

The next meeting is:

9 May 2018

Meeting dates, tentative agendas and additional details about the next meeting will be posted to the IFRS [website](#) before the meeting. Further information about the activities of the IFRS Interpretations Committee and instructions for submitting requests to the IFRS Interpretations Committee can be found [here](#).

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Items on the current agenda

Deferred tax: tax base of assets and liabilities (IAS 12 *Income Taxes*)—Agenda Paper 4

The Committee discussed a request about the recognition of deferred tax when a lessee (entity) recognises an asset and liability at the commencement date of a lease applying IFRS 16 *Leases*. A similar question arises when an entity recognises a liability and includes in the cost of an item of property, plant and equipment the costs of decommissioning that asset. The request describes a fact pattern in which the lease payments and decommissioning costs are deductible for tax purposes when paid.

The Committee decided to research developing an Interpretation aimed at addressing the question.

Next steps

The Committee will consider this research at a future meeting.

Costs considered in assessing whether a contract is onerous (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)—Agenda Paper 5

In November 2017, the Committee decided to add a narrow-scope standard-setting project to its agenda. The objective of the project is to clarify the meaning of the term ‘unavoidable costs’ in the definition of an onerous contract in IAS 37.

At this meeting, the Committee discussed what requirements to propose and the form the standard-setting activity should take.

The Committee recommended that the Board should:

- a. propose to specify that the ‘cost of fulfilling’ a contract comprises the ‘costs that relate directly to the contract’;
- b. provide examples of costs that do and do not relate directly to a contract to provide goods or services; and
- c. develop its proposals as a narrow-scope amendment to IAS 37, rather than as an Interpretation of IAS 37 or as part of the annual improvements process.

Next steps

The Committee will discuss disclosure requirements and transition at a future meeting.

Payments relating to taxes other than income tax (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)—Agenda Paper 7

The Committee received a request about how to account for payments relating to uncertain tax treatments that are outside the scope of IAS 12 *Income Taxes* (ie the payments are for taxes other than income tax). In the fact pattern described in the request, an entity is in dispute with a tax authority. The entity determines that it is probable that it does not have an obligation for the disputed amount and, consequently, it does not recognise a liability applying IAS 37. The entity nonetheless pays the disputed amount to the tax authority, either voluntarily or because it is required to do so. The entity has no right to a refund of the amount before resolution of the dispute. Upon resolution, either the tax authority returns the payment to the entity (if the outcome of the dispute is favourable to the entity) or the payment is used to settle the tax liability (if the outcome of the dispute is unfavourable to the entity).

The Committee observed that the payment made by the entity gives rise to an asset as defined in the existing *Conceptual Framework for Financial Reporting*, ie the payment creates a resource controlled by the entity as a result of a past event and from which future economic benefits are expected to flow to the entity. On making the payment, the entity has the right to receive future economic benefits either in the form of cash or by using the payment to settle the tax liability. The payment is not a contingent asset as defined in IAS 37 because it is

an asset, and not a possible asset, of the entity. The entity therefore recognises an asset when it makes the payment to the tax authority.

The Committee also observed that the asset recognised may not be clearly captured within the scope of any IFRS Standard. In the absence of a Standard that specifically applies to a transaction, the entity applies paragraphs 10 and 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in developing and applying an accounting policy for the measurement of the asset that results in information that is (i) relevant to the economic decision-making needs of users of financial statements and (ii) reliable.

Next steps

The Committee noted that the Board expects to publish the new *Conceptual Framework for Financial Reporting* around the end of the first quarter of 2018. With this in mind, the Committee will update its analysis to reflect any effect of the new *Conceptual Framework for Financial Reporting* at a future meeting.

Committee's tentative agenda decisions

The Committee discussed the following matters and tentatively decided not to add them to its standard-setting agenda. The Committee will reconsider these tentative decisions, including the reasons for not adding the items to its standard-setting agenda, at a future meeting. The Committee encourages interested parties to submit their responses on the [Open for comment](#) page by 22 May 2018. The Committee will place all such correspondence on the public record unless the writer specifically requests it remain confidential. In that case, the writer must support the request with good reason, for example, commercial confidentiality.

Classification of a particular type of dual currency bond (IFRS 9 *Financial Instruments*)—Agenda Paper 8

The Committee received a request about how a holder would classify a particular financial asset applying IFRS 9. The submitter described a 'dual currency bond' with a par amount denominated in one currency and fixed interest coupon payments denominated in another currency. The fixed interest payments are paid annually and the par amount is repaid at a stated maturity date. The submitter asked whether such a financial instrument has contractual cash flows that are solely payments of principal and interest on the principal amount outstanding applying paragraphs 4.1.2(b) and 4.1.2A(b) of IFRS 9.

On the basis of the responses to outreach performed on the request, the Committee observed that the financial instrument described in the request is not common. Therefore, the Committee has not obtained evidence that the matter has widespread effect.

Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Hedge accounting with load following swaps (IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*)—Agenda Paper 9

The Committee received a request regarding the requirement in IFRS 9 and IAS 39 that a forecast transaction must be 'highly probable' in order to qualify as a hedged item in a cash flow hedge relationship. The request asked how an entity applies that requirement when the notional amount of the derivative designated as a hedging instrument ('Load Following Swap') varies depending on the outcome of the hedged item. In addition, the request asked whether, when assessing or measuring hedge effectiveness, the hedged item must be fixed (in volume terms) at the inception of the hedging relationship, and whether the answers to these questions depend on whether the entity applies IAS 39 or IFRS 9.

On the basis of the responses to outreach performed on the request, the Committee observed that the financial instrument described in the request is not common. Therefore, the Committee has not obtained evidence that the matter has widespread effect.

Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Classification of short-term loans and credit facilities (IAS 7 *Statement of Cash Flows*)—Agenda Paper 6

The Committee received a request asking about the types of borrowings an entity includes in its statement of cash flows as a component of cash and cash equivalents. In the fact pattern described in the request:

- a. an entity has short-term loans and credit facilities (short-term arrangements) that have a short contractual notice period (eg 14 days);
- b. the entity says it uses the short-term arrangements for cash management; and
- c. the balance of the short-term arrangements does not often fluctuate from being negative to positive.

The Committee observed that:

- a. applying paragraph 8 of IAS 7, an entity generally considers bank borrowings to be financing activities. An entity, however, includes a bank borrowing as a component of cash and cash equivalents only in the particular circumstances described in paragraph 8 of IAS 7—ie the banking arrangement is a bank overdraft that (i) is repayable on demand, and (ii) forms an integral part of the entity's cash management.
- b. cash management includes managing cash and cash equivalents for the purpose of meeting short-term cash commitments rather than for investment or other purposes (paragraphs 7 and 9 of IAS 7). Assessing whether a banking arrangement is an integral part of an entity's cash management is a matter of facts and circumstances.
- c. if the balance of a banking arrangement does not often fluctuate from being negative to positive, then this indicates that the arrangement does not form an integral part of the entity's cash management and, instead, represents a form of financing.

In the fact pattern described in the request, the Committee concluded that the entity does not include the short-term arrangements as components of cash and cash equivalents. This is because these short-term arrangements are not repayable on demand. Additionally, the fact that the balance does not often fluctuate from being negative to positive indicates that the short-term arrangements are a form of financing rather than an integral part of the entity's cash management.

The Committee also noted that paragraphs 45 and 46 of IAS 7 require an entity to (a) disclose the components of cash and cash equivalents and present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in its statement of financial position; and (b) disclose the policy which it adopts in determining the composition of cash and cash equivalents.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to assess whether to include in its statement of cash flows the short-term arrangements described in the request as components of cash and cash equivalents. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Committee's agenda decisions

Presentation of interest revenue for particular financial instruments (IFRS 9 *Financial Instruments* and IAS 1 *Presentation of Financial Statements*)—Agenda Paper 3

The Committee received a request about the effect of the consequential amendment that IFRS 9 made to paragraph 82(a) of IAS 1. That consequential amendment requires an entity to present separately, in the profit or loss section of the statement of comprehensive income or in the statement of profit or loss, interest revenue calculated using the effective interest method. The request asked whether that requirement affects the presentation of fair value gains and losses on derivative instruments that are not part of a designated and effective hedging relationship (applying the hedge accounting requirements in IFRS 9 or IAS 39 *Financial Instruments: Recognition and Measurement*).

Appendix A to IFRS 9 defines the term 'effective interest method' and other related terms. Those interrelated terms pertain to the requirements in IFRS 9 for amortised cost measurement and the expected credit loss impairment model. In relation to financial assets, the Committee observed that the effective interest method is a measurement technique whose purpose is to calculate amortised cost and allocate interest revenue over the relevant time period. The Committee also observed that the expected credit loss impairment model in IFRS 9 is part of, and interlinked with, amortised cost accounting.

The Committee noted that amortised cost accounting, including interest revenue calculated using the effective interest method and credit losses calculated using the expected credit loss impairment model, is applied only to financial assets that are subsequently measured at amortised cost or fair value through other comprehensive income. In contrast, amortised cost accounting is not applied to financial assets that are subsequently measured at fair value through profit or loss.

Consequently, the Committee concluded that the requirement in paragraph 82(a) of IAS 1 to present separately an interest revenue line item calculated using the effective interest method applies only to those assets that are subsequently measured at amortised cost or fair value through other comprehensive income (subject to any effect of a qualifying hedging relationship applying the hedge accounting requirements in IFRS 9 or IAS 39).

The Committee did not consider any other presentation requirements in IAS 1 or broader matters related to the presentation of other 'interest' amounts in the statement of comprehensive income. This is because the consequential amendment that IFRS 9 made to paragraph 82(a) of IAS 1 did not affect those matters. More specifically, the Committee did not consider whether an entity could present other interest amounts in the statement of comprehensive income, in addition to presenting the interest revenue line item required by paragraph 82(a) of IAS 1.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to apply paragraph 82(a) of IAS 1 and present separately, in the profit or loss section of the statement of comprehensive income or in the statement of profit or loss, interest revenue calculated using the effective interest method. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Agenda Paper 3: Report to the Board

Respondents to the tentative agenda decision suggested that the Board consider as part of a research project the presentation of interest by financial institutions in the profit or loss section of the statement of comprehensive income or in the statement of profit or loss.

Revenue recognition in a real estate contract (IFRS 15 *Revenue from Contracts with Customers*)— Agenda Paper 2C

The Committee received a request about revenue recognition in a contract for the sale of a unit in a residential multi-unit complex. Specifically, the request asked about the application of paragraph 35 of IFRS 15, which specifies when an entity recognises revenue over time.

Identifying the contract

An entity accounts for contracts within the scope of IFRS 15 only when all the criteria in paragraph 9 are met. One of these criteria is that it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. Accordingly, an entity applies the requirements in paragraphs 22-30 and paragraphs 35-37 discussed in this agenda decision only to contracts for which the criteria in paragraph 9 are met.

Identifying performance obligations in the contract

Before applying paragraph 35, an entity applies paragraphs 22–30 in identifying as a performance obligation each promise to transfer to the customer a good or service that is distinct. The Committee has included explanatory information about the application of paragraphs 22-30 to real estate contracts in its agenda decision '*Revenue recognition in a real estate contract that Includes the transfer of land*' published in March 2018.

Applying paragraph 35 of IFRS 15

Paragraph 35 specifies that an entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if any one (or more) of the three criteria in paragraph 35 is met. Paragraph 32 states that if an entity does not satisfy a performance obligation over time, it satisfies the performance obligation at a point in time. Accordingly, the Committee observed that, at contract inception for each performance obligation, an entity applies the criteria in paragraph 35 to determine whether it recognises revenue over time.

Paragraph 35(a)

Applying paragraph 35(a), an entity recognises revenue over time if the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs. In a contract for the sale of real estate that the entity constructs, the Committee observed that paragraph 35(a) is not applicable because the entity's performance creates an asset, ie the real estate, that is not consumed immediately.

Paragraph 35(b)

Applying paragraph 35(b), an entity recognises revenue over time if the customer controls the asset an entity's performance creates or enhances as the asset is created or enhanced. Control refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

Paragraph BC129 explains that the Board included the criterion in paragraph 35(b) to 'address situations in which an entity's performance creates or enhances an asset that a customer clearly controls as the asset is created or enhanced'. Accordingly, the Committee observed that, in applying paragraph 35(b), an entity assesses whether there is evidence that the customer clearly controls the asset that is being created or enhanced (for example, the part-constructed real estate) as it is created or enhanced. An entity considers all relevant factors in making this assessment—no one factor is determinative.

In applying paragraph 35(b), it is important to apply the requirements for control to the asset that the entity's performance creates or enhances. In a contract for the sale of real estate that the entity constructs, the asset created is the real estate itself. It is not, for example, the right to obtain the real estate in the future. The right to sell or pledge a right to obtain real estate in the future is not evidence of control of the real estate itself.

Paragraph 35(c)

Paragraph BC131 explains that the Board developed a third criterion in paragraph 35(c) for recognising revenue over time because it observed that in some cases it may be unclear whether the asset that is created or enhanced is controlled by the customer. The underlying objective of the criterion in paragraph 35(c) is to determine whether the entity transfers control of goods or services to the customer as an asset is being created for that customer (paragraph BC143).

Applying paragraph 35(c), an entity recognises revenue over time if:

- (a) the asset created by the entity's performance does not have an alternative use to the entity; and
- (b) the entity has an enforceable right to payment for performance completed to date.

Paragraph 36 specifies that the asset created does not have an alternative use to an entity if the entity is restricted contractually from readily directing the asset for another use during the creation of that asset or limited practically from readily directing the asset in its completed state for another use.

Paragraph 37 states that, to have an enforceable right to payment, at all times throughout the duration of the contract the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised. Paragraph B12 states that in assessing whether an entity has an enforceable right to payment, the entity considers the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms. This would include an assessment of whether relevant legal precedent indicates that similar rights to payment for performance completed to date in similar contracts have no binding legal effect.

The Committee observed that, although an entity need not undertake an exhaustive search for evidence, it would be inappropriate for an entity to either ignore evidence of relevant legal precedent available to it or anticipate evidence that may or may not become available in the future.

The Committee also observed that the assessment of enforceable rights as described in paragraph 35(c) is focussed on the existence of the right and its enforceability. The likelihood that the entity would exercise the right is not relevant to this assessment. Similarly, if a customer has the right to terminate the contract, the likelihood that the customer would terminate the contract is not relevant to this assessment.

Application of paragraph 35 to the fact pattern in the request

The assessment of whether to recognise revenue over time or at a point in time requires an assessment of the particular facts and circumstances of the contract, taking into account the legal environment within which the contract is enforceable. Accordingly, the outcome of an entity's assessment depends on those particular facts and circumstances.

In the fact pattern described in the request, the contract includes the following features:

- a. *the real estate developer (entity) and the customer enter into a contract for the sale of a real estate unit in a residential multi-unit complex before the entity constructs the complex.*
- b. *the entity's obligation under the contract is to construct and deliver the real estate unit as specified in the contract—it cannot change or substitute the specified unit. The entity retains legal title to the real estate unit (and any land attributed to it) until the customer has paid the purchase price after construction is complete.*
- c. *the customer pays a portion of the purchase price for the real estate unit as the unit is being constructed, and pays the remainder (a majority) after construction is complete.*
- d. *the contract gives the customer the right to an undivided interest in the land and the multi-unit complex under construction. The customer cannot cancel the contract, except as noted in ii. below, nor can it change the structural design of the complex or the individual unit. The customer can resell or pledge its right to the undivided interest in the land and the complex as the complex is being constructed, subject to the entity performing a credit risk analysis of the new buyer of the right.*
- e. *the customer, and the other customers who have agreed to buy real estate units in the multi-unit complex, have the right to together decide to change the structural design of the complex and negotiate such change with the entity.*

The request also notes the following:

- i. *if the entity is in breach of its obligations under the contract, the customer and the other customers have the right to together decide to replace the entity or otherwise stop the construction of the complex.*
- ii. *although the contract is irrevocable, courts have accepted requests to cancel contracts in particular circumstances, for example when it has been proven that the customer is not financially able to fulfil the terms of the contract (if, for example, the customer becomes unemployed or has a major illness that affects the customer's ability to work). In these situations, the contract has been cancelled and the customer has received most, but not all, of the payments it has already made to the entity. The entity has retained the remainder as a termination penalty.*

The courts' acceptance of requests for cancellation provides evidence of legal precedent. This legal precedent is relevant to the assessment of the entity's enforceable right to payment as described in paragraph 35(c). It is assumed that the evidence of legal precedent is assessed as sufficient to indicate that the entity is not entitled to an amount that at least compensates it for performance completed to date in the event of cancellation for reasons other than the entity's failure to perform as promised.

It is also assumed that all the criteria in paragraph 9 are met and that the entity identifies a single performance obligation applying paragraphs 22–30.

The criterion in paragraph 35(a) is not met because the entity's performance creates an asset that is not consumed immediately.

Paragraph 35(b)

The entity's performance creates the real estate unit under construction. Accordingly, in applying paragraph 35(b) the entity assesses whether, as the unit is being constructed, the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the part-constructed real estate unit. The Committee observed the following:

- a. *although the customer can resell or pledge its contractual right to the undivided interest in the land and multi-unit complex as the real estate unit is being constructed, it is unable to sell or pledge the part-constructed real estate unit itself before construction is complete.*
- b. *the customer has no ability to change the structural design of the real estate unit as the unit is being constructed, nor can it use the part-constructed real estate unit itself in any other way. The customer's right together with the other customers to decide to change the structural design of the complex does not provide the customer with the ability to direct the use of the real estate unit—this is*

- because the customer requires the agreement of the other customers to negotiate changes to the structural design, and thus the customer does not have the ability to make those changes.
- c. the customer's right together with the other customers to replace the entity or stop the construction of the complex, only in the event of the entity's failure to perform as promised, is protective in nature and is not indicative of control.
 - d. the customer's exposure to changes in the market value of the real estate unit may indicate that the customer has the ability to obtain substantially all of the remaining benefits from the unit. However, it does not give the customer the ability to direct the use of the unit as it is being constructed.

The Committee observed that there is no evidence that the customer has the ability to direct the use of the real estate unit as it is being constructed, and thus the customer does not control the part-constructed unit. Consequently, the criterion in paragraph 35(b) is not met.

In the agenda decision '*Revenue recognition in a real estate contract that includes the transfer of land*' published in March 2018, the Committee discusses a fact pattern involving the construction of real estate for which it concludes the criterion in paragraph 35(b) is met.

Paragraph 35(c)

The entity cannot change or substitute the real estate unit specified in the contract with the customer, and thus the customer could enforce its rights to the unit if the entity sought to direct the asset for another use. Accordingly, the contractual restriction is substantive and the real estate unit does not have an alternative use to the entity as described in paragraph 35(c).

The entity, however, does not have an enforceable right to payment for performance completed to date as described in paragraph 35(c). This is because, in the fact pattern described in the request, there is relevant legal precedent indicating that the entity is not entitled to an amount that at least compensates it for performance completed to date in the event of cancellation for reasons other than the entity's failure to perform as promised. In the event of the courts accepting requests to cancel contracts, the entity is entitled only to a termination penalty that does not compensate the entity for performance completed to date.

Based on the fact pattern described in the request, the Committee concluded that none of the criteria in paragraph 35 of IFRS 15 are met. Accordingly, the entity would recognise revenue at a point in time applying paragraph 38 of IFRS 15.

The Committee concluded that the principles and requirements in IFRS 15 provide an adequate basis for an entity to determine whether to recognise revenue over time or at a point in time for a contract for the sale of real estate. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Revenue recognition in a real estate contract that includes the transfer of land (IFRS 15 *Revenue from Contracts with Customers*)—Agenda Paper 2D

The Committee received a request about revenue recognition in a contract for the sale of land and a building to be constructed on the land. Specifically, the request asked (a) about the identification of performance obligations in the contract and (b) for each performance obligation identified, whether the real estate developer (entity) recognises revenue over time or at a point in time.

Identifying performance obligations in the contract

Applying paragraphs 22–30, an entity identifies as a performance obligation each promise to transfer to the customer a good or service (or a bundle of goods or services) that is distinct, or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Paragraph 27 specifies that a good or service promised to a customer is distinct if:

- a. the customer can benefit from the good or service on its own or together with other resources readily available to the customer (ie the good or service is capable of being distinct); and
- b. the entity's promise to transfer the good or service is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract).

The assessment of the criteria in paragraph 27 requires judgement.

Paragraph BC100 notes that an entity assesses the criterion in paragraph 27(a) based on the characteristics of the goods or services themselves. Accordingly, an entity disregards any contractual limitations that might preclude the customer from obtaining readily available resources from a source other than the entity.

Paragraph 29 explains that the objective underlying the criterion in paragraph 27(b) is to determine whether the nature of the promise, within the context of the contract, is to transfer each of the promised goods or services individually or, instead, to transfer a combined item to which those goods or services are inputs. Paragraph 29 also specifies some factors that indicate that two or more promises to transfer goods or services are not separately identifiable.

Paragraphs BC105, BC116J and BC116K note that the notion of ‘separately identifiable’ in paragraph 27(b) is influenced by the notion of separable risks (ie whether the risk an entity assumes to fulfil its obligation to transfer one of those promised goods or services to the customer is a risk that is inseparable from the risk relating to the transfer of the other promised goods or services). The evaluation of whether an entity’s promise is separately identifiable considers the relationship between the various goods or services within the contract in the context of the process of fulfilling the contract. Therefore, an entity considers the level of integration, interrelation or interdependence among the promises to transfer goods or services. Rather than considering whether one item, by its nature, depends on the other (ie whether two items have a functional relationship), an entity evaluates whether there is a transformative relationship between the two items in the process of fulfilling the contract.

A real estate contract for the transfer of land and a building

The following paragraphs outline factors an entity considers in assessing whether, for a contract that involves the transfer of land and a building that the entity constructs on the land, the promise to transfer land is a separate performance obligation. The land represents all of the area on which the building will be constructed and the contract is for the entire building. Those paragraphs do not consider whether the entity identifies one or more performance obligations in relation to the transfer of the building.

When assessing the criterion in paragraph 27(a), the entity assesses whether the customer could benefit from the land on its own or together with other resources readily available to it. For example, could the customer hire another developer to construct a building on the land? Similarly, the entity assesses whether the customer could benefit from the construction of the building on its own or together with other resources readily available to it. For example, could the customer obtain the construction services from the entity or another developer without any transfer of land? In a contract for the transfer of an area of land and of an entire building to be constructed on the land, the Committee concluded that the land and the building are each capable of being distinct.

The entity then assesses the criterion in paragraph 27(b) and its underlying objective explained in paragraph 29 (ie determining whether the nature of the promise, within the context of the contract, is to transfer the land and the building individually or, instead, to transfer a combined item to which the land and building are inputs). In assessing the criterion in paragraph 27(b), the Committee observed that the entity considers, among other factors, the following:

- a. whether the entity provides a significant service of integrating the land and the building into a combined output as described in paragraph 29(a)—for example, is there a transformative relationship between the transfer of the land and the construction of the building in the process of fulfilling the contract? Would the entity’s performance in constructing the building be any different if it did not also transfer the land and vice versa? There is a functional relationship between the land and the building—the building cannot exist without the land; its foundations will be built into the land. However, this does not necessarily mean that the risks the entity assumes in transferring the land to the customer are inseparable from the risks it assumes in constructing the building.
- b. whether the land and the building are highly interdependent or highly interrelated as described in paragraph 29(c)—for example, would the entity be able to fulfil its promise to transfer the land even if it did not construct the building, and would it be able to fulfil its promise to construct the building even if it did not transfer the land?

The Committee concluded that the promise to transfer the land would be separately identifiable from the promise to construct the building on that land if the entity concluded that (a) its performance in constructing the building would be the same regardless of whether it also transferred the land; and (b) it would be able to fulfil its promise to construct the building even if it did not also transfer the land, and would be able to fulfil its promise to transfer the land even if it did not also construct the building.

In assessing the criterion in paragraph 27(b), paragraph BC116N notes that the factors in paragraph 29 are not intended to be criteria that an entity evaluates independently of the ‘separately identifiable’ principle in

paragraph 27(b). In some instances, one or more of the factors may be less relevant to the evaluation of that principle.

Applying paragraph 35 of IFRS 15

Paragraph 35 specifies that an entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if any one (or more) of the three criteria in paragraph 35 is met. Paragraph 32 states that if an entity does not satisfy a performance obligation over time, it satisfies the performance obligation at a point in time. Accordingly, the Committee observed that, at contract inception for each performance obligation, an entity applies the criteria in paragraph 35 to determine whether it recognises revenue over time.

The Committee has included explanatory information about the application of paragraph 35 to real estate contracts in its agenda decision '*Revenue recognition in a real estate contract*' published in March 2018.

Application of paragraph 35 to the fact pattern in the request

The assessment of whether to recognise revenue over time or at a point in time requires an assessment of the particular facts and circumstances of the contract, taking into account the legal environment within which the contract is enforceable. Accordingly, the outcome of an entity's assessment depends on those particular facts and circumstances.

In the fact pattern described in the request, the contract includes the following features:

- a. *the entity and the customer enter into a non-cancellable contract for the sale of a building yet to be constructed by the entity that will comprise residential units. The contract is for the sale of the entire building.*
- b. *at contract inception, the entity irrevocably transfers to the customer legal title to the land on which the entity will construct the building. The contract specifies a price for the land, which the customer pays on signing the contract.*
- c. *the entity and the customer agree upon the structural design and specification of the building before the contract is signed. As the building is being constructed:*
 - i. *if the customer requests changes to the structural design or specification, the entity prices the proposed changes based on a methodology specified in the contract; the customer then decides whether to proceed with the changes. The entity can reject the customer's request for changes for only a limited number of reasons, such as if the change would breach planning permission.*
 - ii. *the entity can request changes to the structural design or specification only if not doing so would lead to an unreasonable increase in costs or delay to construction. The customer must approve those changes.*
- d. *the customer is required to make milestone payments throughout the construction period. However, these payments do not necessarily correspond to the amount of work completed to date.*

It is assumed that (i) all the criteria in paragraph 9 are met and (ii) the entity identifies two performance obligations applying paragraphs 22–30—a promise to transfer the land to the customer and a promise to construct the building on that land.

Application of paragraph 35 to the promise to transfer land

The entity's performance transfers the land to the customer. The land is not consumed immediately and, thus, the criterion in paragraph 35(a) is not met. Nor does the entity's performance create or enhance the land and, thus, the criteria in paragraphs 35(b) and 35(c) are not met.

Consequently, the entity recognises revenue for the transfer of the land to the customer at a point in time applying paragraph 38 of IFRS 15.

Application of paragraph 35 to the promise to construct the building

The criterion in paragraph 35(a) is not met because the entity's performance creates an asset that is not consumed immediately.

Paragraph 35(b)

In assessing the criterion in paragraph 35(b), the entity assesses whether, as the building is being constructed, the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the part-constructed building.

The customer controls the part-constructed building as it is being constructed because the customer has the following:

- a. the ability to direct the use of the building as it is being constructed. The customer has this ability through its control of the land, and by being able to change the structural design and specification of the building as it is being constructed. The contract also enables the customer to prevent the entity or others from directing the use of the building.
- b. the ability to obtain substantially all of the remaining economic benefits from the building. The entity cannot redirect the building for another use or to another entity. Accordingly, on signing the contract, the customer has the ability to obtain substantially all of the remaining benefits from the building. The contract also enables the customer to prevent the entity or others from obtaining the benefits from the building.

Accordingly, the criterion in paragraph 35(b) is met. The Board observed in paragraph BC129 that 'in the case of a construction contract in which the entity is building on the customer's land, the customer generally controls any work in progress arising from the entity's performance'.

The Committee concluded that the principles and requirements in IFRS 15 provide an adequate basis for an entity to recognise revenue in the fact pattern described in the request. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Right to payment for performance completed to date (IFRS 15 Revenue from Contracts with Customers)—Agenda Paper 2E

The Committee received a request about whether to recognise revenue over time or at a point in time in relation to a contract for the sale of a unit in a residential multi-unit complex (real estate unit). Specifically, the request asked whether, in the fact pattern described in the request, the real estate developer (entity) has an enforceable right to payment for performance completed to date as described in paragraph 35(c) of IFRS 15.

Applying paragraph 35(c), an entity recognises revenue over time if (i) the asset created by an entity's performance does not have an alternative use to the entity; and (ii) the entity has an enforceable right to payment for performance completed to date. The underlying objective of the criterion in paragraph 35(c) is to determine whether the entity transfers control of goods or services to the customer as an asset is being created for that customer (paragraph BC143).

Paragraph 37 states that, to have an enforceable right to payment, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised.

Paragraph B9 states that an amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date, rather than compensation for only the entity's potential loss of profit if the contract were to be terminated.

The Committee observed that it is the payment the entity is entitled to receive under the contract with the customer relating to performance under that contract that is relevant in determining whether the entity has an enforceable right to payment for performance completed to date.

The Committee has also included explanatory information about the application of paragraph 35(c) to real estate contracts in its agenda decision '*Revenue recognition in a real estate contract*' published in March 2018.

Application of paragraph 35(c) to the fact pattern in the request

The assessment of whether an entity has an enforceable right to payment for performance completed to date requires an entity to consider the rights and obligations created by the contract, taking into account the legal

environment within which the contract is enforceable. Accordingly, the Committee observed that the outcome of an entity's assessment depends on the particular facts and circumstances of the contract.

In the fact pattern described in the request, the contract includes the following features:

- a. *the entity and the customer enter into a contract for the sale of a real estate unit in a residential multi-unit complex before the entity constructs the unit. The entity's obligation under the contract is to construct and deliver the real estate unit as specified in the contract. The entity retains legal title to the real estate unit (and any land attributed to it) until the customer has paid the purchase price after construction is complete.*
- b. *the customer pays 10% of the purchase price for the real estate unit at contract inception, and pays the remainder after construction is complete.*
- c. *the customer has the right to cancel the contract at any time before construction is complete. If the customer cancels the contract, the entity is legally required to make reasonable efforts to resell the real estate unit to a third party. On resale, the entity enters into a new contract with the third party—ie the original contract is not novated to the third party. If the resale price to be obtained from the third party is less than the original purchase price (plus selling costs), the customer is legally obliged to pay the difference to the entity.*

It is assumed that the entity identifies a single performance obligation applying paragraphs 22-30. It is also assumed that (i) the entity has determined that the contract does not meet the criteria in paragraphs 35(a) and 35(b); and (ii) the contract meets the first part of the criterion in paragraph 35(c) because the entity's performance does not create an asset with an alternative use to the entity.

The Committee observed that the principle in paragraph 31 of IFRS 15 for the recognition of revenue requires the customer to have obtained control of a promised good or service. Accordingly and as noted above, the underlying objective of the criterion in paragraph 35(c) is to determine whether the entity is transferring control of goods or services to the customer as an asset is being created for that customer. In line with this objective, it is the payment the entity is entitled to receive under the existing contract with the customer relating to performance under that contract that is relevant in determining whether the entity has an enforceable right to payment for performance completed to date. The consideration received by the entity from the third party in the resale contract is consideration relating to that resale contract—it is not payment for performance under the existing contract with the customer.

In the fact pattern described in the request, the payment to which the entity has a right under the existing contract with the customer is a payment for the difference between the resale price of the unit, if any, and its original purchase price (plus selling costs). That payment does not at all times throughout the duration of the contract entitle the entity to an amount that at least approximates the selling price of the part-constructed real estate unit and, thus, it does not compensate the entity for performance completed to date. Accordingly, the entity does not have an enforceable right to payment for performance completed to date as described in paragraph 35(c) of IFRS 15.

Based on the fact pattern described in the request, the Committee concluded that none of the criteria in paragraph 35 of IFRS 15 are met. Accordingly, the entity would recognise revenue at a point in time applying paragraph 38 of IFRS 15.

The Committee concluded that the principles and requirements in IFRS 15 provide an adequate basis for an entity to determine whether it has an enforceable right to payment for performance completed to date. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Other matters

Responding to questions submitted—Agenda Paper 2B

The Committee discussed its approach in responding to questions submitted to it, including those that involve highly-specific fact patterns.

Committee work in progress—Agenda Paper 10

There are no new or ongoing matters that have not yet been presented to the Committee.

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