

STAFF PAPER

March 2018

IFRS Interpretations Committee Meeting

Project	Revenue recognition in a real estate contract (IFRS 15)		
Paper topic	Agenda decision to finalise		
CONTACT(S)	Craig Smith	csmith@ifrs.org	+44 (0)20 7246 6462

This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee (Committee). Comments on the application of IFRS Standards do not purport to set out acceptable or unacceptable application of IFRS Standards—only the Committee or the International Accounting Standards Board (Board) can make such a determination. Decisions made by the Committee are reported in IFRIC® *Update*. The approval of a final Interpretation by the Board is reported in IASB® *Update*.

Introduction

1. The purpose of this paper is to provide the IFRS Interpretations Committee (Committee) with an analysis of the comments received on its tentative agenda decision published in September 2017 titled ‘Revenue recognition in a real estate contract’.
2. The Committee received a submission about revenue recognition in a contract for the sale of a unit in a residential multi-unit complex (real estate unit). The real estate developer (entity) and the customer enter into a contract for the sale of the real estate unit before the entity constructs it. Specifically, the submission asked about the application of paragraph 35 of IFRS 15 *Revenue from Contracts with Customers*, which specifies when an entity recognises revenue over time.
3. 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 a real estate unit 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 unit, that is not consumed immediately.
4. 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 unit) 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), the Committee noted 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 a real estate unit that the entity constructs, the asset created is the real estate unit itself. It is not, for example, the right to obtain the real estate unit in the future. The right to sell or pledge this right is not evidence of control of the real estate unit itself.

5. In the fact pattern in the submission the Committee observed that the customer does not have 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.
6. Paragraph BC131 of IFRS 15 explains that the Board developed a third criterion in paragraph 35(c) for recognising revenue over time because it observed, in some cases, it may be unclear whether the asset that is created or enhanced is controlled by the customer. Applying paragraph 35(c), an entity recognises revenue over time if (a) the asset created by an 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.
7. The Committee 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.
8. In the fact pattern in the submission, the Committee observed that the entity does not have an enforceable right to payment for performance completed to date. This is because the customer has the legal right to cancel the contract and, in the event of doing so, the entity is entitled only to a termination penalty that does not compensate the entity for the performance completed to date.
9. Based on the fact pattern described in the submission, the Committee observed 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.

Comment letter summary

10. As noted in Agenda Paper 2A, the Committee received 40 comment letters on this tentative agenda decision, of which 28 are from the Brazilian real estate industry. The comment letters are available on our [website](#).
11. The Brazilian real estate industry and the Brazilian SEC are concerned that the facts in the submission (and thus the facts summarised in the tentative agenda decision) do not accurately reflect the facts in their jurisdiction.
12. After explaining what they identify as the relevant facts, the Brazilian real estate industry and the Brazilian SEC both say they disagree with the Committee’s technical conclusion. They say in their view, in the fact pattern in the submission, the entity is required to recognise revenue over time applying paragraph 35 of IFRS 15. Construtora Tenda also agrees with this conclusion.
13. The Brazilian real estate industry and the Brazilian SEC also say in their view, financial statements will provide less useful information if, in the fact pattern in the submission, entities are required to recognise revenue at a point in time rather than over time. Agenda Paper 2B discusses this concern.
14. Orange and the KASB suggest that the Committee consider and clarify a number of factors when finalising the agenda decision.
15. Five respondents (EY, the ANC, Deloitte, Mazars and the INCP) agree with the Committee’s technical conclusion regarding the application of paragraph 35. Each of those respondents, nonetheless, suggest changes to the wording of the tentative agenda decision.
16. Although not objecting to the Committee’s technical conclusion, the ASBJ has concerns about the Committee providing answers for specific fact patterns. The OIC shares these concerns. Agenda Paper 2B discusses this concern.
17. The Construction Association of Korea and the KASB outline a different fact pattern in Korea. Agenda paper 2B discusses these comments.
18. The remainder of this paper is organised as follows:
 - (a) Fact pattern (paragraphs 21–31);

- (b) Technical conclusion (paragraphs 32–74);
 - (c) Staff recommendation (paragraph 75); and
 - (d) Wording of the agenda decision (paragraphs 76–79).
19. Paragraphs 21-74 discuss comments that relate directly to the fact pattern and the Committee’s technical conclusion in the tentative agenda decision. Appendix A to this paper includes additional detailed comments made by respondents that relate to paragraph 35(b), and the staff analysis of those comments. Appendix B includes additional detailed comments made by respondents that relate to paragraph 35(c). Those additional comments relate to (a) implications of the Committee’s technical conclusion, and (b) implications of what was said in [Agenda Paper 2](#) to the Committee’s September 2017 meeting.
20. The paper has two other appendices:
- (a) Appendix C includes the proposed wording of the agenda decision; and
 - (b) Appendix D includes a ‘clean’ version of the proposed agenda decision, with no mark-up.

Fact pattern

Respondents comments

21. The Brazilian real estate industry and the Brazilian SEC express concerns about the accuracy of the facts the Committee considered in reaching its tentative conclusion. In particular, their comment letters raise concerns about (a) the description of the ‘in rem’ right in the original submission, and (b) the phrase ‘the customer has the legal right to cancel the contract’ used in the Committee’s analysis of paragraph 35(c) in the tentative agenda decision. Having received the comment letters, we had a call with representatives from the Brazilian real estate industry to clarify our understanding of the comments in their comment letters regarding the fact pattern.

'In rem' right

22. The Brazilian real estate industry explains the following with respect to the contract:
- (a) The entity and the customer enter into a contract for the sale of an undivided interest in the land (on which a multi-unit residential complex will be built), and the entity agrees to build and deliver a real estate unit within the complex linked to that undivided interest within a given time, at a specified price, and according to specified conditions.
 - (b) The entity's obligation under the contract is to construct and deliver the real estate unit as specified in the contract—it cannot alter or replace the specified unit. The entity retains legal title to the specified unit until the customer has paid the full purchase price. The Brazilian SEC notes that general market practice is that legal title to the specified real estate unit passes to the customer when construction is complete and the full purchase price is paid—the retention of legal title acts as a credit risk protection mechanism. We understand that the undivided legal title to the land and the complex retained by the entity is split into individual legal titles to each real estate unit when construction is complete.
 - (c) The contract gives the customer an 'in rem' right over an undivided interest in the land and accessions—we understand that accessions refers to the part-constructed multi-unit complex. At contract inception, the customer therefore obtains a right to an undivided interest in the land and the multi-unit complex being constructed on the land. The undivided interest represents a notional fraction of the land and complex under construction that corresponds to the real estate unit specified in the contract. The Brazilian real estate industry and the Brazilian SEC says the 'in rem' right gives the customer a right that is equivalent to ownership.
 - (d) The customer can resell or pledge its right to the undivided interest in the land and part-constructed complex during the period that the complex is being constructed, subject to the entity performing a credit risk analysis of the new buyer of the right (no credit check is required if the customer has paid the entire purchase price for the unit).

- (e) The customer cannot change the structural design of the complex or the real estate unit. 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, negotiate such change with the entity, bear the related costs, etc. If the entity is in breach of its obligations under the contract, the group of customers also has the right to together decide to replace the entity or stop the construction, or each customer may seek to cancel its contract.

Cancellation of contracts

23. The Brazilian real estate industry and the Brazilian SEC say, without breach of contract, the applicable law prevents both the entity and the customer from unilaterally cancelling the contract—ie strict application of the law would say the entity has the right to require the customer to pay all the purchase price in the contract and to take delivery of the real estate unit specified in the contract. This is similar to the scenario described in paragraph B11.
24. The Brazilian real estate industry and the Brazilian SEC also provide information in their comment letters about the nature and effect of court decisions in the jurisdiction. The Brazilian SEC says ‘cancellation of purchase and sale agreement has not been the matter of discussion in courts’. Instead, it says court decisions have concerned ‘the amounts refunded by the developer and the lower courts usually decides that developers can only retain up to 20% of the amounts paid by the customers’. However, the Brazilian SEC goes on to say ‘As the justice is free to access, customers can judicially request to cancel the contract, since a reasonable and strong motivation is present and if a termination agreement has not been reached with the developer’.
25. The Brazilian SEC attached to their comment letter a copy of correspondence between us (the IASB staff) and the submitter. In the correspondence from August 2017, we ask the submitter whether the customer can cancel the contract in an event other than financial incapacity. We note that the submitter responded [emphasis added]:

Yes. The cancellation is only possible if the acquirer negotiates with the developer and the developer agree with the cancellation, **or if the acquirer judicially requests the**

cancellation, and provides proof of a motivation for the termination of the agreement. This motivation may be the buyer financial instability, or default of the developer, such as delayed construction delivery or stationary construction.

26. This response is consistent with the response from EY, which says:

We understand that, in the submitter's jurisdiction, termination rates are reasonably high and not limited to situations of financial difficulty. As such, we understand that it was not merely the existence of legal precedent, but the high rate of termination coupled with refund of consideration that affected enforceability.

27. In addition, the Brazilian real estate industry say:

Although the agreement is irrevocable under local law, the courts have accepted some requests for cancelation of agreements in specific circumstances, particularly where there is evidence that the customer is not financially capable of complying with the terms of the agreement (for example, when the customer becomes unemployed or has a severe illness that affects the customer's ability to work). However, there are no precedents of the higher courts on the matter, or even a law guaranteeing such right. It is subject to review by the judiciary on a case-by-case basis.

28. The Brazilian real estate industry and the Brazilian SEC confirm the legal remedies available to the entity if the customer is in default. Although the entity could pursue its right to payment under the contract, the respondents say the majority of contract cancellations are the result of the entity and the customer agreeing to cancel the contract. Entities often prefer this outcome because it removes the cost and time required to pursue its right to payment via foreclosure, and allows them to resell the real estate unit more quickly.

Staff analysis

29. In general, we think the fact pattern outlined by the Committee in the tentative agenda decision is not significantly different from the fact pattern described by the

respondents. However, we think there are some refinements to the wording the Committee could make.

30. In particular, we note that the comment letters clarified the following regarding the customer’s rights:

- (a) the ‘in rem’ right gives the customer the right to an undivided interest in the land and the part-constructed complex as the complex is being constructed. When the full purchase price is paid and construction is complete, the customer then obtains legal title to the real estate unit specified in the contract.
- (b) 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, negotiate such change with the entity, bear the related costs, etc. If the entity is in breach of its obligations under the contract, the group of customers also has the right to together decide to replace the entity or stop the construction, or each customer may seek to cancel its contract.
- (c) the customer does not have the legal right to cancel the contract as it was described in the Committee’s analysis in the tentative agenda decision. The description in the fact pattern in the tentative agenda decision more accurately described this as the courts accepting requests for cancellation.

31. We therefore recommend that the Committee refine the fact pattern described in the tentative agenda decision as follows, which includes some editorial refinements to the description of the fact pattern. Deletions are struck through and additions are underlined.

In the fact pattern described in the request, the contract ~~for the real estate unit~~ 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 ~~unit~~ complex.
- b. the entity’s obligation under the contract is to construct and deliver the ~~completed~~ real estate unit as specified in the contract—it cannot change or

substitute the specified unit ~~agreed to 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.

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) ~~of the purchase price to the entity~~ after construction is complete.

d. the contract gives the customer a the right to ~~the real estate an undivided interest in the land and the multi-unit complex~~ under construction. The customer cannot cancel the contract, except as noted in b. below, nor can it change the structural design of the complex or the individual unit. The customer can resell or pledge ~~the~~ its right to the undivided interest in the land and the complex real estate unit as the unit complex is being constructed, subject to the entity performing a credit risk analysis of the new buyer of the right (~~no credit check is required if the customer has already paid the entire purchase price for the unit~~).

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 ~~legal rights of the entity and the customer~~:

a. if the entity is in breach of its obligations under the contract, 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 ~~remove~~ replace the entity or otherwise stop ~~and hire another real estate developer to complete the construction of the complex.~~

b. although the contract is irrevocable ~~under local law~~, the courts have accepted requests to cancel contracts in specific 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, if the customer becomes unemployed or has a major illness that affects the customer's ability to work). In this these situations, the customer ~~can~~ contract has been cancelled ~~the contract~~ and the customer has ~~is entitled to received~~ most, but not all, of the payments it has already made to the entity. The entity has retained the remainder ~~is retained by the entity~~ as a termination penalty. ~~The entity may also~~

~~agree to sell the real estate unit at auction if the customer defaults on its payments.~~

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

Technical conclusions

32. A number of respondents raised concerns about the Committee’s technical conclusion in the tentative agenda decision. These relate to:
- (a) whether the customer controls the asset as it being created or enhanced (discussed in paragraphs 33–54 of this paper);
 - (b) whether the entity has an enforceable right to payment for performance completed to date (discussed in paragraphs 55–66 of this paper); and
 - (c) the application of paragraph 9 and paragraphs 22-30 of IFRS 15 (discussed in paragraphs 67–74 of this paper).

Control of the asset as it being created or enhanced

Respondents comments

33. The Brazilian real estate industry, the Brazilian SEC and Construtora Tenda all say that, in the fact pattern in the submission, the customer controls the real estate unit as it is being constructed. In their view, therefore, the criterion in paragraph 35(b) is met.
34. The Brazilian real estate industry says the customer has the ability to direct the use of the part-constructed real estate unit because:
- (a) the ‘in rem’ right allows the customer to resell (or promise to resell) the undivided interest in the land and part-constructed complex and, thus, the real estate unit is being built on the customer’s land;
 - (b) the customer has the ability to direct the construction or design of the real estate unit if all other customers consent and renegotiate the agreement with the developer; and

- (c) the customer (together with the other customers) has the ability to replace the entity in the event the entity defaults on its obligations.
35. The Brazilian real estate industry and the Brazilian SEC say the customer can obtain substantially all of the remaining benefits from the real estate unit as it is being constructed. This is because the customer can use its ‘in rem’ right to settle liabilities, it can sell the right or can offer the right as collateral for loans. Paragraph 33 specifies these as examples of ways in which a customer can obtain benefits from an asset.
36. The respondents say the customer can prevent others from directing the use of, and obtaining the benefits from, the part-constructed real estate unit because the contract between the customer and the entity entitles the customer to that specified unit. The entity is unable to sell the unit to any other customer.
37. The Brazilian SEC says the customer’s ability to direct the construction or structural design of the unit is not relevant to the assessment of the customer’s ability to direct the use of the part-constructed real estate unit. This is because there are operational and engineering restrictions that prevent individual customers in a multi-unit development from being able to do so. If considered to be relevant, then the Brazilian SEC suggests that the Committee consider the unit of account to be the development as a whole because changes to the design and specification of the development are possible with unanimous consent of all customers.
38. In contrast, Orange says it is unclear how a customer could have the ability to direct the use of the asset if it cannot direct the construction or structural design of a part-constructed real estate unit. It says a contract providing the customer with such an ability would modify the nature of the performance obligations in the contract.

Staff analysis

39. Paragraph 35(b) 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 the entity’s performance creates or enhances an asset that the customer controls as the asset is created or enhanced.
40. Paragraph 33 states that ‘control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes

the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset’.

41. In the fact pattern in the submission, the asset in question is the real estate unit specified in the contract. Accordingly, the assessment of paragraph 35(b) focusses on whether the customer controls that real estate unit as the unit is being constructed. We also think the Board’s explanation as to why it included the criterion in paragraph 35(b) is helpful—paragraph BC129 explains that [emphasis added] ‘the boards included this criterion 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’.
42. We agree with respondents that, in the fact pattern in the submission, the contract would appear to give the customer the ability to obtain substantially all of the remaining benefits from the asset and to prevent others from obtaining those benefits. Consequently, respondents’ concerns relate to the Committee’s conclusion regarding the customer’s ability to direct the use of the real estate unit as it is being constructed.

Ability to direct the use of the unit—relevant factors

43. When discussing the submission in September 2017, the Committee considered whether there was any evidence that the customer has the ability to direct the use of the real estate unit as it is being constructed. In our view, to meet the criterion in paragraph 35(b), there must be positive evidence that the customer controls the asset being created or enhanced as it is created or enhanced. The Committee’s assessment was therefore focussed on considering whether there was any such positive evidence—ie the assessment did not, for example, focus on proving that the customer did not control the asset nor that the entity or another party controlled the asset.
44. One aspect of the Committee’s consideration was whether the customer is able to change the structural design of the unit as it is being constructed. In our view, including this consideration as part of the assessment of paragraph 35(b) is appropriate. This is because if the customer were to have the ability to change the structural design of the unit as it is being constructed, then that would provide positive evidence that the customer may have the ability to direct the use of the part-constructed unit. That said, failing to have the ability to change the structural design

of the unit as it is being constructed does not, in isolation, mean that the customer does not control the part-constructed unit. The Committee noted in the tentative agenda decision that an entity considers all relevant factors in assessing whether the customer controls the asset that is being created or enhanced as it is created or enhanced—no one factor is determinative.

45. With respect to the fact pattern in the submission we note that the Brazilian SEC says that the operational and engineering restrictions prevent individual customers in a multi-unit development from being able to change the structural design of the real estate unit. The Committee noted this as part of its analysis in the tentative agenda decision.
46. We think the customer's ability (with the other customers who have agreed to buy real estate units in the multi-unit complex) to *together* decide to change the structural design and negotiate such change with the entity does not provide evidence that the customer has the ability to direct the use of the part-constructed real estate unit. Paragraph 35(b) requires *the customer* alone to have control of the asset being created or enhanced—if the customer's ability depends on getting agreement from others (in this case, the other customers of units within the complex), then in our view this is not relevant to an assessment of whether the customer controls the part-constructed real estate unit.
47. In addition, we disagree with the suggestion that this aspect of the assessment should focus on the customer's ability (with all other customers) to together decide to change the structural design of the *complex*. The promised good/asset in the contract is the specified *real estate unit*—it is not the complex as a whole. Accordingly, we think the assessment of paragraph 35(b) focusses on the customer's rights in relation to the specified real estate unit.

Ability to direct the use of the unit—the 'in rem' right

48. The contract gives the customer the right to an undivided interest in the land and part-constructed complex as the complex is being constructed. On completion of construction, the legal title to the land and the complex as a whole held by the entity is split into individual legal titles to each real estate unit. When the customer has paid

the purchase price for the unit, the customer then obtains legal title to the real estate unit specified in the contract.

49. The respondents that disagree with the Committee’s technical conclusion view the ‘in rem’ right as equivalent to ownership of the specified real estate unit (and land attributed to it). This is because the customer’s right to the undivided interest represents a notional fraction of the land and complex under construction that corresponds to the real estate unit specified in the contract. They also say the entity’s retention of legal title to the specified real estate unit acts only as a credit protection mechanism.
50. On this basis, those respondents say the customer has the ability to direct the use of the real estate unit as it is being constructed because it can resell and pledge its right to the undivided interest as the complex (and the unit) is being constructed.
51. We think the customer’s ability to resell and pledge its right to the undivided interest gives it the ability to direct the use of that right to the undivided interest. However, we think the undivided interest in the land and part-constructed complex is different from the specified real estate unit and, thus, the customer’s ability to resell and pledge its right to the undivided interest is different from having the ability to sell and pledge the specified real estate unit itself. Regardless of the reason for the entity’s retention of legal title to the unit, in our view an important factor in the assessment is that the customer does not hold legal title to the real estate unit until construction is complete. The customer is therefore legally unable to sell or pledge the specified real estate unit itself as the unit is being constructed.
52. The Brazilian real estate industry also say that the entity is building on the customer’s land, as envisioned in the example in paragraph BC129. Paragraph BC129 notes 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’. We think a right to an undivided interest in land (representing a notional fraction of land attributable to one unit in a multi-unit complex) is not what the Board had in mind when it referred to ‘the customer’s land’ in paragraph BC129. We think the example in paragraph BC129 is analogous to the fact pattern described in Agenda Paper 2D—ie a contract for the construction of an entire building on land already owned by the customer.

53. Based on our analysis in paragraphs 43–52, we think respondents have not identified evidence that indicates the customer has the ability to direct the use of the part-constructed real estate unit as it is being constructed. Accordingly, in the fact pattern in the submission we think the criterion in paragraph 35(b) is not met.
54. We note that this conclusion is consistent with the Board’s expectations when developing the criteria in paragraph 35. Paragraph BC131 explains that the Board developed a third criterion in paragraph 35(c) for recognising revenue over time because it observed, in some cases, it may be unclear whether the asset that is created or enhanced is controlled by the customer. Paragraphs BC149–BC152 then specifically discuss contracts for the construction of real estate—in particular, those paragraphs indicate that the Board expected an entity’s assessment of whether to recognise revenue over time for multi-unit residential real estate developments to be based on paragraph 35(c). Paragraph BC152 says ‘the boards decided that clarifying the ‘no alternative use and right to payment for performance completed to date’ criterion would ensure greater certainty and consistency in recognising revenue for multi-unit residential real estate developments’.

Enforceable right to payment for performance completed to date

Respondents comments

55. The Brazilian real estate industry and the Brazilian SEC say the applicable law gives the entity the right to enforce the contract—ie the right to require the customer to pay all the purchase price in the contract and to take delivery of the real estate unit specified in the contract. They also note that the majority of contract cancellations result from the entity and the customer agreeing to cancel the contract; it is less frequent that contract cancellations result from court decisions (as described in paragraph 27 of this paper).
56. Those respondents say that lower court decisions should not define the application of IFRS 15 because such decisions do not guarantee a cancellation right to customers. They say the application of IFRS 15 should be defined by the rights that the applicable law grants to the entity.

57. EY and the Construction Association of Korea say the wording in the tentative agenda decision implies the existence of legal precedent is enough to undermine the enforceability of the entity's right to payment. EY agrees that, in the fact pattern in the submission, the entity does not have an enforceable right to payment for performance completed to date. However, it says in its view it is not merely the existence of legal precedent, but the high rate of cancellation coupled with the refund of consideration, that affects enforceability. EY suggest clarifying this in the agenda decision. Mazars express similar concerns.
58. Orange says we have provided no information about the pervasiveness of court decisions. Orange suggests the Committee should further consider the requirements in paragraphs B11 and B12 to explain why the court decisions are enough to undermine the enforceability of the contract. In addition, the KASB says, in its view, in the fact pattern in the submission a conclusion that all customers have a right to cancel the contract would result in an unreasonable consequence, and suggests that cancellation is considered only a possibility that may arise.

Staff analysis

59. Paragraph 37 states that '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....an entity shall consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for performance completed to date in accordance with paragraph 35(c)...'.
60. Paragraph B12 states that 'in assessing the existence and enforceability of a right to payment for performance completed to date, an entity shall consider 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:...(b) relevant legal precedent indicates that similar rights to payment for performance completed to date in similar contracts have no binding legal effect..?'
61. Paragraph B11 describes a situation in which an entity is entitled to continue to transfer to the customer the goods or service promised in the contract and require the

customer to pay the consideration promised in exchange for those goods or services if the customer acts to terminate the contract without having a right to do so. Paragraph B11 states that ‘in those circumstances, an entity has a right to payment for performance completed to date because the entity has a right to continue to perform its obligations in accordance with the contract and to require the customer to perform its obligations (which include paying the promised consideration)’.

62. Based on these requirements and assuming there was no evidence available to the contrary, we think the entity in the fact pattern in the submission would have an enforceable right to payment for performance completed to date as described in paragraph 35(c). This is because the law entitles the entity to require the customer to pay all the purchase price in the contract and to take delivery of the real estate unit specified in the contract. This is similar to the situation described in paragraph B11.
63. Paragraph B12, however, requires an entity to also consider any legislation or legal precedent that could supplement or override the contractual terms. Although we think this does not mean that an entity must undertake an exhaustive search for evidence, in our view it would be inappropriate to ignore evidence available to the entity. In the fact pattern in the submission, we think the requirements in paragraph B12 say the entity cannot ignore the existence of the court decisions accepting requests to cancel contracts. In our view, those court decisions provide evidence of legal precedent indicating that the contract can be cancelled for reasons other than the entity’s failure to perform as promised, and in those situations the entity is entitled only to a termination penalty that does not compensate it for performance completed to date. We think, therefore, that at all times throughout the duration of the contract the entity is not entitled to an amount that at least compensates the entity for performance completed to date if the contract is cancelled for reasons other than the entity’s failure to perform as promised (as required by paragraph 37).
64. We note that the Brazilian real estate industry and the Brazilian SEC say it is only the lower courts that have accepted requests to cancel contracts. They emphasise that there are no precedents of the higher courts on the matter, and the decisions of the lower courts do not change the entity’s rights granted by the applicable law. In our view, an entity is required to consider all relevant facts available in assessing the criterion in paragraph 35(c). Based on the information in the submission, this includes

the applicable law as well as the lower court decisions. As noted above, we think the lower court decisions provide evidence that contracts can be cancelled for reasons other than the entity’s failure to perform as promised, and in those cases the entity is not entitled to compensation for performance completed to date. If evidence were to become available of the courts enforcing the rights granted to the entity under the applicable law (including in situations for which the customer is not financially able to fulfil its obligations), then such evidence would be relevant to the assessment of the criterion in paragraph 35(c).

65. In September 2017, the Committee discussed whether an entity considers likelihood in its assessment of the criterion in paragraph 35(c)—that likelihood could relate to the entity exercising its right to payment or it could relate to the cancellation of the contract. The Committee concluded that the likelihood that an entity would exercise its right or that a customer would cancel the contract is not relevant to the assessment—the assessment is focussed on the existence of the right and its enforceability. Although we agree with EY that a high rate of cancellation strengthens the evidence of legal precedent, we continue to agree with the Committee’s conclusion that likelihood of cancellation is not part of the assessment of paragraph 35(c). In support of the Committee’s conclusion, we note that paragraph B12 states (emphasis added) ‘in assessing the **existence and enforceability** of a right to payment for performance completed to date...’.
66. Based on our analysis in paragraphs 59-65, we think the criterion in paragraph 35(c) is not met in the fact pattern in the submission.

Paragraph 9 and paragraphs 22-30 of IFRS 15

Respondents comments

67. Orange and INCP note that the tentative agenda decision does not mention how the requirements in paragraph 9(e) regarding collectability interact with the criterion in paragraph 35(c)—an entity’s enforceable right to payment for performance completed to date. Orange suggests that the agenda decision include such information.
68. Mazars notes that the conclusion in the tentative agenda decision that there is one performance obligation has been made by including a statement that ‘any land

attributed to the real estate unit is not distinct.’ It says this conclusion is unsubstantiated. Mazars suggests developing a rationale for the Committee’s conclusion, bearing in mind the extensive analysis in the tentative agenda decision ‘Revenue Recognition in a Real Estate Contract that Includes the Transfer of Land’ published in November 2017.

Staff analysis

Paragraph 9

69. The submission said ‘The current understanding is that in our jurisdiction at contract inception the criteria 9(e) is met’. Accordingly, the submitter did not ask the Committee to address paragraph 9, and the staff analysis in Agenda Paper 2 for the September 2017 meeting assumed that the criteria in paragraph 9 were met.
70. Paragraph 9 states that ‘an entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met’. An entity therefore first applies paragraph 9—if any of the criteria in paragraph 9 are not met, then the entity applies paragraphs 10-16 of IFRS 15 rather than the rest of the Standard.
71. The criterion in paragraph 9(e) states 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 paragraph 35(c) to a contract (assessing whether it has an enforceable right to payment for performance completed to date) only if the entity has already determined that it is probable that it will collect the consideration to which it will be entitled applying paragraph 9(e).
72. We also note that the assessment required by paragraph 9(e) is different from the assessment required by paragraph 35(c). Applying paragraph 9(e), an entity considers likelihood—ie to meet the criterion in paragraph 9(e), the entity must determine that it is *probable* that it will collect the consideration to which it is entitled. As noted earlier in the paper, the assessment of the criterion in paragraph 35(c) focusses on the *existence* of the entity’s right and its enforceability.
73. In the light of the comments received, we recommend adding a paragraph to the agenda decision to state that an entity first applies paragraph 9; it then applies the

requirements in IFRS 15 discussed in the agenda decision only if the paragraph 9 are met.

Paragraphs 22-30

74. The submission received by the Committee does not ask for clarification about the number of performance obligations in the contract. The Committee therefore assumed there was one performance obligation. Because the submitter did not ask the Committee to address this matter, we recommend not including any analysis of it in the agenda decision. Instead, we suggest that the agenda decision note that Committee assumed the entity has identified one performance obligation in the contract.

Staff recommendation

75. Based on our analysis in paragraphs 32–74 of this paper, we recommend confirming the tentative agenda decision published in [IFRIC Update](#) in September 2017. If the Committee agrees with our recommendation, the next section of the paper discusses and suggests some improvements to the wording of the tentative agenda decision.

Question 1 for the Committee

1. Does the Committee agree with our recommendation to finalise the agenda decision?

Wording of the tentative agenda decision

76. It is clear from some comments received that we could improve some of the wording in the tentative agenda decision to clarify the Committee’s conclusions. Therefore, in this section of the paper we propose some changes to the wording of the analysis in the tentative agenda decision.
77. We have identified the following improvements:
- (a) The sentences that discuss the asset subject to the control assessment in paragraph 35(b): ‘...It is not, for example, the right to obtain the real estate

unit in the future. The right to sell or pledge this right is not evidence of control of the real estate unit itself'. Orange suggests clarifying the intention of these sentences, noting that their intention may be to explain that, while indicative of having the ability to obtain the benefits from the real estate unit, the right to sell or pledge the right is not indicative of having the ability to direct the use of the unit. Deloitte suggests amending the second sentence to read 'The right to sell or pledge a this right to obtain a real estate unit is not evidence of control of the real estate unit itself.' We think Deloitte's suggestion improves the clarity of the sentence and, thus, recommend changing the wording as suggested. We also think that change will help to address Orange's comment.

- (b) 'although the customer can resell or pledge its contractual right to the real estate unit under construction...'. EY says that phrase could be misunderstood as referring to a current right to the asset under construction, and does not clearly distinguish between the current right to the unit under construction and the current right to receive the unit in the future when it is constructed. It also notes that the first part of that sentence refers to 'sell or pledge', whereas the second part of the sentence refers only to 'sell'. We recommend changing this phrase to reflect the refinement to the fact pattern discussed earlier in the paper—ie the customer's contractual right is a right to an undivided interest in the land and part-constructed multi-unit complex. We think that change, together with some editorial changes to that sentence, will improve the clarity.
- (c) 'the customer has a legal right to cancel the contract'. The ANC notes that this phrase in the Committee's analysis is not the same as the fact pattern, which says: '...the courts have accepted requests to cancel contracts...'. As discussed in paragraph 30 of this paper, the description of the fact pattern in the tentative agenda decision more accurately described the facts than the wording in the analysis. We suggest therefore changing the wording of the analysis in the agenda decision to align with the description of the fact pattern.

- (d) Respondents identified an additional fact that was not included in the tentative agenda decision—ie the customer, and the other customers who have agreed to buy real estate units, have the right to together decide to change the structural design and negotiate such change with the entity. We recommend addressing this fact in the Committee’s analysis to explain that this fact does not provide the customer with the ability to direct the use of the unit.
78. Appendix C to this paper outlines these recommended changes as a mark-up to the tentative agenda decision. Appendix C also includes some editorial suggestions, mainly to remove any unnecessary detail in what is a long agenda decision.
79. Appendix D to this paper includes a ‘clean’ version of the proposed agenda decision, without any mark-up.

Question 2 for the Committee

2. Does the Committee agree with our recommendations regarding the wording of the agenda decision outlined in Appendix C to this paper?

**Appendix A: Additional detailed comments from respondents—
Paragraph 35(b)**

A1. The table below outlines additional detailed comments from respondents about the Committee’s technical conclusion on paragraph 35(b), together with our analysis of those comments:

Respondents comments	Staff analysis
<p>1. Orange says it is unclear why the Committee assesses each of the criteria in paragraph 35. It says the Committee should use the Basis for Conclusions on IFRS 15 to identify the relevant criteria in paragraph 35 to apply to the fact pattern in the submission. In its view, the entity should assess only the criterion in paragraph 35(c) based on the discussion in paragraphs BC149–BC152.</p> <p>Orange also say there is an inherent tension between paragraph 35(b) and 35(c), which it thinks cannot be resolved through an agenda decision. It also says there is the risk of the criterion in paragraph 35(c) becoming the default criterion to paragraph 35(a) because it thinks IFRS 15 does not explain sufficiently how to assess the criterion in paragraph 35(b).</p>	<p>Paragraph 38 says if an entity does not satisfy a performance obligation over time applying paragraphs 35–37, it satisfies the performance obligation at a point in time. Paragraph 35 also says, to recognise revenue over time, only one of its criteria is required to be met.</p> <p>Accordingly, in our view, an entity is required to assess all the criteria in paragraph 35 to determine whether to recognise revenue over time. Only if the entity determines that none of those criteria are met does it recognise revenue at a point in time.</p> <p>We note that the Basis for Conclusions explains the Board’s decisions; although helpful in explaining what the Board had in mind when developing the requirements, the Basis cannot be used to override requirements in the Standards.</p> <p>Regarding paragraph 35(b), we think the principles and requirements in IFRS 15 are sufficient for an entity to determine its accounting. Paragraph 35(b) requires an entity to assess whether the customer controls the asset being created or enhanced as it is being created or enhanced—IFRS 15 defines control and provides</p>

	<p>requirements to help entities assess control in paragraphs 31-38.</p> <p>In addition, we note that the criterion in paragraph 35(b) is assessed separately from the criterion in paragraph 35(c). For this reason, we see no inherent tension between those criteria in terms of an entity’s assessment of them.</p> <p>We suggest no change in this respect to the agenda decision.</p>
<p>2. The Brazilian SEC says in Agenda Paper 2 to the September 2017 meeting, the staff implied that physical possession of the part-constructed real estate unit is relevant to the assessment of whether the customer has the ability to direct the use of that unit. It says, in its view, in the fact pattern in the submission physical possession is not relevant.</p>	<p>We agree that in the fact pattern in the submission (one in which the customer does not have physical possession of the unit), the absence of physical possession does not, in isolation, affect the assessment of paragraph 35(b). In saying that, if the customer had physical possession, then that is an indicator of the transfer of control as specified in paragraph 38.</p> <p>Because it does not affect the assessment of paragraph 35(b) in the fact pattern in the submission, Agenda paper 2 to the September 2017 meeting did not mention this factor nor was it mentioned in the tentative agenda decision.</p> <p>We suggest no change in this respect in the agenda decision.</p>
<p>3. Orange says the tentative agenda decision does not discuss the role of legal title of the asset. It notes that paragraph 38 lists legal title as an indicator of the transfer of control, but that it and paragraph BC138 go on to say that if legal</p>	<p>IFRS 15 is clear that, in isolation, the transfer of legal title does not equate to the transfer of control. Similarly, the absence of legal title, in isolation, does not equate to the customer not having control. The analysis in this paper and the proposed agenda decision explains that, in the fact</p>

<p>title is retained by the entity solely as protection against the customer’s failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.</p> <p>Mazars says, in its view, the transfer of legal title of a real estate unit under construction to the customer (as the asset is being constructed) is usually important in assessing whether control is transferred over time applying paragraph 35(b). In its view, the fact that the entity retains legal title to the real estate unit until construction is complete is sufficient to conclude that paragraph 35(b) is not met.</p>	<p>pattern in the submission, the entity’s retention of legal title affects the customer’s ability to direct the use of the real estate unit—it does so because the customer is unable to sell or pledge the real estate unit itself as it is being constructed without legal title to it. The agenda decision also addresses the more general point that legal title does not, in isolation, equate to control by stating that ‘an entity considers all relevant factors in making this assessment—no one factor is determinative.’</p> <p>We suggest no change in this respect in the agenda decision.</p>
<p>4. Orange says the agenda decision does not refer to paragraph BC130, which says ‘the basis for this criterion [in paragraph 35(b)] is consistent with the rationale for using the ‘percentage-of-completion’ revenue recognition approach in previous revenue guidance in US GAAP’.</p> <p>Orange says it is unclear whether the Committee is endorsing the view of some that, based on paragraph BC130, the application of paragraph 35(b) is restricted to contracts that contain clauses indicating that the customer owns any work in progress as the asset is being constructed.</p>	<p>The Committee did not discuss the explanation in paragraph BC130 at its September 2017 meeting. This is because such an explanation referring to consistency with previous US GAAP has no relevance to an assessment of the criterion in paragraph 35(b). In our view, such a reference to previous requirements would create confusion.</p> <p>We suggest no change in this respect in the agenda decision.</p>
<p>5. Orange says it disagrees with the distinction being drawn in the tentative</p>	<p>In the tentative agenda decision, when assessing the criterion in paragraph 35(b) the Committee</p>

<p>agenda decision between the asset that is created or enhanced (in the fact pattern in the submission, the part-constructed real estate unit) and the rights created by the contract (the right to obtain the real estate unit in the future). It says, in its view, such a distinction is not based on requirements in IFRS 15 and, thus, would go beyond the scope of an agenda decision.</p>	<p>emphasised the importance of assessing control of the correct asset. Paragraph 35(b) states ‘the entity’s performance creates an asset (for example, work in progress) that the customer controls as the asset is created or enhanced’. Accordingly, we think the Committee’s emphasis on assessing the asset that the entity’s performance creates or enhances reflects the requirements in paragraph 35(b).</p> <p>That emphasis does not imply that an entity ignores the rights created by the contract; it says simply that, in the fact pattern in the submission, the asset created by the entity’s performance (as described in paragraph 35(b)) is not the right to obtain the real estate in the future. The entity assesses the rights it obtains in the contract to determine whether those rights give it control of the asset that the entity’s performance creates or enhances.</p>
<p>6. Orange says the agenda decision should discuss whether the customer has the ability to prevent others from directing the use of the real estate unit (as specified in paragraph 33).</p>	<p>Paragraph 33 says ‘control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset’.</p> <p>In the fact pattern in the submission, the Committee concluded that the customer does not have the ability to direct the use of the part-constructed real estate unit. Accordingly, to assess whether the customer controls the unit, it did not need to go further and assess whether the</p>

	<p>customer has the ability to prevent others from directing the use of the unit.</p> <p>We suggest no change in this respect in the agenda decision.</p>
--	---

**Appendix B: Additional detailed comments from respondents—
Paragraph 35(c)**

B1. The table below outlines additional detailed comments from respondents about the Committee’s technical conclusion on paragraph 35(c), together with our analysis of those comments:

Respondents comments	Staff analysis
<p>1. Orange says it thinks referring to Illustrative Example 17 of IFRS 15 (IE17) in the agenda decision would help articulate the main question in the fact pattern in the submission, which is whether the court decisions negate the entity’s right to enforce the contract.</p>	<p>IE17 illustrates paragraph 35(c) by assessing in three different fact patterns whether the entity has an enforceable right to payment for performance completed to date. The fact pattern in the submission, however, is not directly comparable to any of the fact patterns discussed in IE17. For this reason, we think referring to IE17 does not help in analysing the fact pattern in the submission. In addition, we fear that referring to IE17 might encourage what some respondents fear—which is that providing illustrations might result in some stakeholders analogising to non-analogous situations. (Agenda paper 2B discusses these comments from respondents.)</p> <p>We suggest no change in this respect in the agenda decision.</p>
<p>2. Orange says there is no discussion of the effect of common clauses and mechanisms allowing termination of contracts in particular extreme situations (eg death, bankruptcy). It says it is concerned that the tentative agenda decision might be read as forbidding the</p>	<p>By ‘common clauses and mechanisms’ relating to liquidation or death (and because of the reference to foreclosure legislation), we think Orange is referring to bankruptcy laws and laws relating to the wind-up of estates upon death. In our view, these laws are typically unrelated to the ability of the customer to cancel a contract and, thus,</p>

<p>application of paragraph 35(c) in these situations. Orange compares the courts accepting cancellation of contracts in the fact pattern in the submission to the entity foreclosing the contract, saying they are similar. It says it sees both as a subsequent credit event that should not prevent the recognition of revenue over time.</p>	<p>unrelated to an assessment of paragraph 35(c). For example, typical bankruptcy law provides an entity owed funds by a defaulting party with the right to claim compensation for all amounts due under a contract. The legislation governs the requirements of the liquidator/receiver/executor of the defaulting party’s estate and how to allocate available funds to the party’s creditors. In contrast, in the fact pattern in the submission if the courts accepts requests for cancellation, the entity is entitled only to retain part of the payments already made by the customer.</p> <p>We suggest no change in this respect in the agenda decision.</p>
<p>3. Orange says the Committee did not consider whether compensation for loss of profit could be in a form other than cash. In its view, compensation for loss of profit could be the customer transferring control of a part-constructed real estate unit back to the entity.</p>	<p>An entity applies paragraph 35(c) to determine <i>whether</i> an entity transfers control of a good or service over time to the customer. If we were to consider the real estate unit to be compensation on cancellation, then that would already assume that the customer controls the unit and transfers it back to the entity. We think it would be inappropriate to assume control has transferred when assessing whether control has transferred.</p> <p>We suggest no change in this respect in the agenda decision.</p>
<p>4. Orange and the KASB say there are similarities between a sale with a right of return and the fact pattern in the submission (ie a fact pattern in which the contract may be cancelled, possibly resulting in the asset being returned to the</p>	<p>Paragraphs B20-B27 specify requirements that apply to the transfer of products with a right of return. Paragraph B20 explains the contracts to which those requirements apply—it states [emphasis added]: ‘In some contracts, an entity transfers control of a product to a customer and</p>

entity). They therefore suggest that the Committee consider the applicability of the requirements in paragraphs B20–B27.

also grants the customer the right to return the product for various reasons...’. Accordingly, it is clear that those requirements apply only when the entity has already transferred control of a product (assessed applying paragraphs 31-38) and, after having done so, the customer decides to return the product.

In contrast, paragraph 35 applies in assessing *whether* an entity transfers control of a good or service over time to the customer. Those respective paragraphs are therefore dealing with different scenarios. We think it would be inappropriate to apply requirements that apply only when the entity has already transferred control to the customer in scenarios for which that is not the case.

We suggest no change in this respect in the agenda decision.

Appendix C: Proposed wording of the agenda decision

- C1. We propose the following wording for the agenda decision, shown as mark-up from the tentative agenda decision (new text is underlined and deleted text is struck through).

Revenue recognition in a real estate contract (IFRS 15 *Revenue from Contracts with Customers*)

The Committee received a request about revenue recognition in a contract for the sale of a unit in a residential multi-unit complex (~~real estate unit~~). ~~The real estate developer (entity) and the customer enter into a contract for the sale of the real estate unit before the entity constructs it.~~ Specifically, the request asked about the application of paragraph 35 of IFRS 15, which specifies when an entity recognises revenue over time.

~~In considering this request, the Committee first considered the requirements in IFRS 15 and then discussed the application of those requirements to the fact pattern described in the request.~~

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 those 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 that meet the criteria in paragraph 9.

Identifying performance obligations in the contract

Before applying paragraph 35 ~~of IFRS 15~~, 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 of IFRS 15 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 of IFRS 15 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 ~~assesses each of the three~~ 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 a real estate ~~unit~~ 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 ~~unit~~, that is not consumed immediately.

Paragraph 35(b)

Applying paragraph 35(b), an entity recognises revenue over time if the customer controls the asset that 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 of IFRS 15 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 ~~unit~~) 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 a real estate ~~unit~~ that the entity constructs, the asset created is the real estate ~~unit~~ itself. It is not, for example, the right to obtain the real estate ~~unit~~ in the future. The right to sell or pledge ~~this a right to obtain real estate in the future~~ is not evidence of control of the real estate ~~unit~~ itself.

Paragraph 35(c)

Paragraph BC131 of ~~IFRS 15~~ explains that the Board developed a third criterion in paragraph 35(c) for recognising revenue over time because it observed, 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 an 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 of ~~IFRS 15~~ 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 of ~~IFRS 15~~ 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. In assessing whether it has an enforceable right to payment, an entity considers the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms.

The Committee 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.

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 a real estate unit. Consequently, the Committee ~~decided~~ not to add this matter to its standard-setting agenda.

Illustration of the Application of the requirements paragraph 35 to the fact pattern in the request

The assessment of whether to recognise revenue ~~is recognised~~ over time or at a point in time requires an ~~entity to consider the rights and obligations created by~~ assessment of the particular facts and circumstances of 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 those particular facts and circumstances pertaining to the contract.

In the fact pattern described in the request, the contract ~~for the real estate unit~~ 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 ~~unit~~ complex.
- b. the entity's obligation under the contract is to construct and deliver the ~~completed~~ real estate unit as specified in the contract—it cannot change or substitute the specified unit agreed to 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.
- 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) ~~of the purchase price to the entity~~ after construction is complete.
- d. the contract gives the customer a the right to the real estate an undivided interest in the land and the multi-unit complex under construction. The customer cannot cancel the contract, except as noted in b. below, nor can it change the structural design of the complex or the individual unit. The customer can resell or pledge ~~the~~

its right to the undivided interest in the land and the complex real estate unit as the unit complex is being constructed, subject to the entity performing a credit risk analysis of the new buyer of the right (no credit check is required if the customer has already paid the entire purchase price for the unit).

- 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 legal rights of the entity and the customer:

- a. if the entity is in breach of its obligations under the contract, 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 remove replace the entity or otherwise stop and hire another real estate developer to complete the construction of the complex.
- b. A although the contract is irrevocable, under local law, the courts have accepted requests to cancel contracts in specific particular circumstances, mainly for example when it has been proven that the customer is not financially able to fulfil the terms of the contract (if, for example, if the customer becomes unemployed or has a major illness that affects the customer's ability to work). In this these situations, the customer can contract has been cancelled the contract and is entitled to the customer has received most, but not all, of the payments it has already made to the entity. The entity has retained the remainder is retained by the entity as a termination penalty. The entity may also agree to sell the real estate unit at auction if the customer defaults on its payments.

Identifying the performance obligation

The nature of the promise in the contract is to deliver a completed real estate unit to the customer. Any land attributed to the real estate unit is not distinct applying paragraphs 22-30 of IFRS 15. Accordingly, the Committee observed that there is one performance obligation in the contract.

It is 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(a)

~~The customer does not simultaneously receive and consume the benefits provided by the entity's construction of the real estate unit as the unit is being constructed. This is because the entity's performance creates an asset that is not consumed immediately—the part-constructed real estate unit. Consequently, the Committee observed that the criterion in paragraph 35(a) of IFRS 15 is not met.~~

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 ~~real estate undivided interest in the land and multi-unit complex as the real estate unit is being constructed~~ under construction, it is unable to sell or pledge the part-constructed real estate unit itself before construction is complete ~~without holding legal title to it.~~
- b. the customer has no ability to ~~direct the construction or~~ 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 must have the unilateral ability to direct the use of the unit—in assessing paragraph 35(b), the entity does not consider customer rights that can be exercised only on agreement by other parties.
- c. the customer's ~~legal~~ 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 real estate 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, ~~based on the fact pattern described in the request, there is no evidence that~~ the customer ~~does not have~~ 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 Committee observed that~~ the contractual restriction is substantive and the real estate unit does not have an alternative use to the entity.

The entity, however, does not have an enforceable right to payment for performance completed to date. This is because ~~the customer has the~~ there is evidence of legal right to cancel precedent indicating that the contract and, in can be cancelled for reasons other than the entity's failure to perform as promised. In the event of the courts accepting requests to cancel contracts ~~doing so~~, the entity is entitled only to a termination penalty that does not compensate the entity for ~~the~~ performance completed to date.

Based on the fact pattern described in the request, the Committee ~~observed~~ 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.

Appendix D: Proposed wording of the agenda decision

D1. This appendix includes the proposed wording for the agenda decision in Appendix C but with no mark-up.

Revenue recognition in a real estate contract (IFRS 15 *Revenue from Contracts with Customers*)

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 those 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 that meet the criteria in paragraph 9.

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 that 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, 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 an 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. In assessing whether it has an enforceable right to payment, an entity considers the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms.

The Committee 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.

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 a real estate unit. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

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 b. 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:

- a. 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.
- b. 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.

It is 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 must have the unilateral ability to direct the use of the unit—in assessing paragraph 35(b), the entity does not consider customer rights that can be exercised only on agreement by other parties.
- 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.

The entity, however, does not have an enforceable right to payment for performance completed to date. This is because there is evidence of legal precedent indicating that the contract can be cancelled 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.