STAFF PAPER

March 2019

IFRS® Interpretations Committee meeting

Project	**Over time transfer of constructed good (IAS 23)**
Paper topic	Agenda decision to finalise

CONTACT	Nicolette Lange	nlange@ifrs.org	+44 (0) 20 7246 6924
	Jawaid Dossani	jdossani@ifrs.org	+44 (0) 20 7332 2742

Introduction

1. At its November 2018 meeting, the IFRS Interpretations Committee (Committee) discussed a submission about the capitalisation of borrowing costs in relation to the construction of a residential multi-unit real estate development (building). In the fact pattern described in the submission:

   (a) a real estate developer (entity) constructs the building and sells the individual units in the building to customers;

   (b) the entity borrows funds specifically for the purpose of constructing the building and incurs borrowing costs in connection with that borrowing;

   (c) before construction begins, the entity signs contracts with customers for the sale of some of the units in the building (sold units);

   (d) the entity intends to enter into contracts with customers for the remaining part-constructed units (unsold units) as soon as it finds suitable customers; and

   (e) the terms of, and relevant facts and circumstances relating to, the entity's contracts with customers (for both the sold and unsold units) are such that, applying paragraph 35(c) of IFRS 15 *Revenue from Contracts with Customers*, the entity transfers control of each unit over time and, therefore, recognises revenue over time. The consideration promised by the customer in the contract is in the form of cash or another financial asset.

2. The submitter asked whether the entity has a qualifying asset as defined in IAS 23 *Borrowing Costs* and, therefore, capitalises any directly attributable borrowing costs.

3. In November 2018, the Committee published a tentative agenda decision. In that tentative agenda decision, the Committee observed that applying IAS 23, any receivable, contract asset and inventory (work-in-progress) are not qualifying assets. The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine whether to capitalise borrowing costs in the fact pattern described in the submission. Consequently, the Committee tentatively decided not to add the matter to its standard-setting agenda.

4. The purpose of this paper is to:

   (a) analyse the comments on the tentative agenda decision; and

   (b) ask the Committee whether it agrees with our recommendation to finalise the agenda decision.

5. There are two appendices to this paper:

   (a) Appendix A—proposed wording of the agenda decision; and

   (b) Appendix B—analysis of other comments.

Comment letter summary

6. We received 17 comment letters on the tentative agenda decision. The comment letters are available on our website and have been reproduced in Agenda Paper 3A for ease of reference.

7. Seven respondents agree with the Committee's conclusions. However, two of these respondents express concerns about the outcome of the tentative agenda decision

(similar to those noted in paragraph 8 of this paper). In addition, some[1] of these respondents have suggestions on the wording of the tentative agenda decision.

8. Respondents who disagree with the Committee's conclusions generally do so because they disagree with the outcome of the agenda decision—in particular, they say:

   (a) the Committee's reading of the applicable requirements does not align with the rationale and intent of IAS 23;

   (b) the pattern of revenue recognition (ie over time or at a point in time) should not affect the capitalisation of borrowing costs; and

   (c) applying the requirements as explained in the tentative agenda decision could lead to significant change in practice and result in less useful information for users of financial statements.

9. Several of these respondents suggest that the Committee not finalise the agenda decision but, instead, either refer the matter to the Board or limit or clarify the scope of the tentative agenda decision.

Staff analysis of main comments

Structure of our analysis

10. Because of the diverse nature of comments, we have separately analysed the main comments that relate to:

   (a) the Committee's reading of the applicable requirements (see paragraphs 12–28 of this paper);

   (b) the pattern of revenue recognition and the capitalisation of borrowing costs (see paragraphs 29–41 of this paper); and

[1] The term 'some respondents' has been used throughout this paper to refer to five respondents or less; the term 'several respondents' has been used to refer to more than five respondents.

(c) the effects of finalising the agenda decision (see paragraphs 42–48 of this paper).

11. Appendix B to this paper analyses all other comments.

The Committee's reading of the applicable requirements

12. Several respondents express concerns about the Committee's reading of the applicable requirements in IFRS Standards. The main matters raised by respondents include:

(a) costs of inventory (work-in-progress) relating to unsold units; and

(b) physical construction of the building.

Costs of inventory (work-in-progress) relating to unsold units

13. The Committee concluded that any inventory (work-in-progress) for unsold units under construction that the entity recognises is not a qualifying asset. In the fact pattern described in the submission, this asset is ready for its intended sale in its current condition—ie the entity intends to sell the part-constructed units as soon as it finds suitable customers and, on signing a contract with a customer, will transfer control of any work-in-progress relating to that unit to the customer.

Respondents' comments

14. Several respondents disagree with the Committee's conclusion. They say the requirements in IAS 2 *Inventories*, when read together with the requirements in IAS 23, require an entity to capitalise borrowing costs in the fact pattern described in the submission. This is because:

(a) paragraph 10 of IAS 2 requires an entity to include in the cost of inventories 'all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition'. These respondents say borrowing costs incurred in respect of inventory relating to the unsold units is a cost incurred in bringing the inventory to its present location and condition. Accordingly, applying the requirements in IAS 2, the entity should include borrowing costs as part of the costs of inventory.

Some respondents also note that IAS 2 explicitly identifies borrowing costs as a cost of inventory.

(b) paragraph 7 of IAS 23 identifies inventory as an example of a qualifying asset. In the respondents' view, any borrowing costs incurred in respect of inventory (work-in-progress) relating to unsold units are directly attributable to the construction of those units. As a consequence, an entity should capitalise those costs applying IAS 23. Paragraph 8 of IAS 23 states:

> An entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. An entity shall recognise other borrowing costs as an expense in the period in which it incurs them.

15. Those respondents say recognising such borrowing costs as an expense when incurred would fail to provide a faithful representation of the costs of the units, and would result in less useful information for users of financial statements. Paragraph BC9 of IAS 23 explains the Board's rationale for requiring an entity to capitalise borrowing costs applying IAS 23. It states:

> The Board concluded that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are part of the cost of that asset. During the period when an asset is under development, the expenditures for the resources used must be financed. Financing has a cost. The cost of the asset should include all costs necessarily incurred to get the asset ready for its intended use or sale, including the cost incurred in financing the expenditures as a part of the asset's acquisition cost. The Board reasoned that recognising immediately as an expense borrowing costs relating to qualifying assets does not give a faithful representation of the cost of the asset.

16. Some respondents also say:

(a) recognising borrowing costs as an expense when incurred would be inconsistent with the principle of matching revenue with costs[2]. The Comissao de Valores Mobiliarios (CVM) says it considers that IAS 23's 'ultimate aim is to operationalise the principle of matching of cost with revenue'.

(b) the Committee should not consider the requirements in IAS 23 in isolation, but also those in other Standards (such as IAS 2 and IAS 16 *Property, Plant and Equipment*) that contain requirements on the cost of an asset.

Staff Analysis

17. As explained in paragraph 21(c) of Agenda Paper 4 of the Committee's November 2018 meeting (November agenda paper), an entity would recognise an inventory asset for unsold units under construction[3]. Paragraph 17 of IAS 2 states that 'IAS 23 *Borrowing Costs* identifies limited circumstances where borrowing costs are included in the cost of inventories.' An entity therefore applies IAS 23 in determining whether to include borrowing costs in the cost of inventories.

18. Paragraph 7 of IAS 23 states that inventories *may* be qualifying assets depending on the circumstances. Accordingly, an entity assesses whether inventory meets the definition of a qualifying asset (defined in IAS 23 as 'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale').

19. As explained in paragraphs 29–33 of the November agenda paper, in the fact pattern described in the submission we think inventory (work-in-progress) relating to unsold

[2] Paragraph 5.5 of the *Conceptual Framework for Financial Reporting* (2018) states: 'The initial recognition of assets or liabilities arising from transactions or other events may result in the simultaneous recognition of both income and related expenses…The simultaneous recognition of income and related expenses is sometimes referred to as the matching of costs with income. Application of the concepts in the Conceptual Framework leads to such matching when it arises from the recognition of changes in assets and liabilities. However, matching of costs with income is not an objective of the Conceptual Framework. The Conceptual Framework does not allow the recognition in the statement of financial position of items that do not meet the definition of an asset, a liability or equity.

[3] The unsold units represent assets in the process of production for sale in the ordinary course of the entity's business and, accordingly, applying paragraph 6 of IAS 2 would meet the definition of inventory.

units would not meet the definition of a qualifying asset. The entity intends to enter into contracts with customers for the unsold units as soon as it finds suitable customers, and when it signs a contract with a customer, it (a) would derecognise any inventory asset for the part-constructed unit sold (because it no longer controls the unit), and (b) may recognise a contract asset and/or receivable for consideration receivable from the customer. Hence, on signing a contract with a customer, the entity would no longer have inventory relating to the unit. In other words, any inventory asset relating to unsold units is ready for its intended sale in its current condition and would not necessarily take *a substantial period of time to get ready* for such sale.

20. In the fact pattern described in the submission, the entity has inventory for any part-constructed unsold units only because it has not yet been able to find customers for those units. Any borrowing costs the entity incurs during this period do not relate to the construction of the unsold units themselves—rather, they relate to financing the entity's holding of part-constructed units during the time it takes the entity to find customers. Consequently, we do not agree with respondents who say that recognising borrowing costs as an expense when incurred (a) would not result in a faithful representation of the cost of unsold units—in our view, these are not costs of constructing the units but costs of holding the units whilst finding buyers; and (b) would be inconsistent with the principle of matching revenue with costs.

21. We continue to support the Committee's conclusion that, in the fact pattern described in the submission, any inventory (work-in-progress) relating to unsold units does not meet the definition of a qualifying asset. We recommend no change to the agenda decision in this respect.

Physical construction of the building

Respondents' comments

22. Paragraph 5 of IAS 23 defines a qualifying asset as 'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale'. Respondents say the Committee is reading this definition narrowly, without considering that it was written a long time before IFRS 15 was developed. In their view, an entity could have

a qualifying asset as long as it intends to either use or sell the asset. Therefore, regardless of whether and when the entity transfers control of a part-constructed unit, what matters is the physical construction of the underlying good (in this case, the building). If that physical construction takes a substantial period of time, the entity would have a qualifying asset. The Global Financial Reporting Collective says the definition of a qualifying asset does not require an asset to be controlled or owned by the entity itself.

23. These respondents also say paragraph 23 of IAS 23 supports their view. Paragraph 23 states that an asset is 'normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue'. They do not agree with our analysis in paragraph 33(c) of the November Staff Paper, which states:

> the use of the word 'normally' in paragraph 23 of IAS 23 indicates that the statement in that paragraph is not a rule. On signing a contract with a customer, the entity derecognises any inventory asset for the part-constructed unit because it no longer controls that unit. Accordingly, it no longer has a qualifying asset to which it could capitalise borrowing costs even though physical construction of that unit might not be complete.

24. Some respondents say, although an entity might sell and transfer control of a part-constructed unit as it is being constructed, it does not completely satisfy its performance obligation to transfer the unit to the customer until the physical construction is complete.

Staff Analysis

25. The first element of the definition of a qualifying asset in IAS 23 is 'an asset...'. Similarly, paragraph 8 of IAS 23 states (emphasis added): 'An entity shall capitalise borrowing costs…of a qualifying asset *as part of the cost of that asset*'. Paragraph 4.3 of the *Conceptual Framework for Financial Reporting* (2018) defines an asset as 'a present economic resource controlled by the entity as a result of past events.' Accordingly, we think the requirements in IAS 23 (including the definition of a qualifying asset and the requirements in paragraph 23) can only apply to assets that

the entity controls and recognises in its financial statements. An entity cannot capitalise borrowing costs relating to assets that it no longer controls and recognises.

26. In the fact pattern described in the submission, the entity assesses whether the assets it recognises in respect of the building—ie receivable, contract asset or inventory (work-in-progress) relating to unsold units—meet the definition of a qualifying asset. The entity does not consider the underlying building itself.

27. We note that IAS 23 requires an entity to capitalise borrowing costs on assets that necessarily take a substantial period of time to *get ready for* their intended use or sale; IAS 23 does not require capitalisation of borrowing costs on assets that an entity might transfer to another party over a substantial period of time.

28. Accordingly, we recommend no change to the agenda decision in this respect.

The pattern of revenue recognition and the capitalisation of borrowing costs

Respondents' comments

29. Several respondents say the tentative agenda decision draws an inappropriate distinction between the cost of units transferred to customers over time versus at a point in time. This is because an entity might capitalise borrowing costs on units transferred to customers at a point in time (when construction is complete), whereas it would not on units transferred over time (as the unit is being constructed). In both situations, respondents say the entity is constructing the building until physical construction is complete and, if it incurs borrowing costs to finance that construction, it should capitalise those borrowing costs. Not doing so would lead to different outcomes (eg different costs and different margins) for similar projects.

30. For example, the Institute of Chartered Accountants of India (ICAI) says:

> Logically, the methods and principles to determine costs to fulfil a contract under two revenue recognition models…should not be different. Cost accumulation principles should not be dependent [on the] outcome of revenue recognition methods.

31. The Malaysian Accounting Standards Board (MASB) says:

> …The contract costs that are not yet customer receivables are akin to an inventory work-in-progress and the underlying physical asset is the relevant asset for the purposes of IAS 23. The transfer of control of a good or service noted in IFRS 15.35(c) is not a physical transfer of the underlying work in progress in the case of units under development and the application of IAS 23 should not be affected by the over-time nature of sales…

32. The CVM says:

> …if an entity satisfies its performance obligations over time, then there is a partial and continuous transfer of control (continuous sale) which only ends when the contract is completed and the entity achieves the intended sale, for purposes of application of IAS 23. Therefore, all costs for constructing and producing the asset, including borrowing costs that are attributable to the contract, should be recognised as costs of the contract.

33. With respect to sold units, the MASB says the conclusions in the tentative agenda decision imply that the entity cannot have inventory, and disagrees with this implication. It says an entity first recognises all costs (in relation to sold and unsold units) as 'inventory' and then transfers the portion of those accumulated costs that relate to sold units to a contract cost asset. In the MASB's view, the initial recognition of all costs as inventory justifies capitalising borrowing costs that are directly attributable to the construction of the building.

Staff analysis

34. IFRS 15 specifies the accounting for an individual contract with a customer—ie the accounting for rights and obligations that arise from the contract. Applying paragraph 31 of IFRS 15, an entity recognises revenue when (or as) it satisfies a performance obligation by transferring a promised good or service (ie an asset) to a

customer. An asset is transferred when (or as) the customer obtains control of that asset.

35. If an entity transfers control of a good or service (and therefore satisfies a performance obligation) over time, it recognises revenue over time. In contrast, if the entity transfers control of a good or service (and therefore satisfies a performance obligation) at a point in time, it recognises revenue at that point in time. The difference in accounting treatment is not arbitrary—rather, it reflects that the two contracts are fundamentally different and give rise to different rights and obligations for the entity. In particular, the nature of the entity's promise to a customer and the timing of transfer of the promised goods or services in an 'over-time' contract is different from the nature of the promise and timing of transfer in a 'point-in-time' contract.

36. To illustrate, assume two different contracts with customers that both involve the construction of a real estate property. The terms of the contracts are such that:

(a) the customer obtains control of the property only when construction is complete (Contract Point-in-Time); and

(b) the customer obtains control of the property as the property is being constructed (Contract Over-Time).

37. The difference in accounting for these two contracts arises from the different rights and obligations of the entity in each contract:

(a) in Contract Point-in-Time, the nature of the entity's promise to the customer is to transfer a fully constructed property. The entity would recognise revenue when it satisfies its performance obligation at the point in time at which the customer obtains control of the fully constructed property (paragraph 38 of IFRS 15). Before this date, applying IAS 2 the entity recognises inventory (work-in-progress) for the property under construction.

(b) in Contract Over-Time, the nature of the entity's promise to the customer is to transfer the property as it is being constructed—in other words, to provide construction services (together with embedded materials). Because the customer obtains control of the property as the property is being constructed, the entity satisfies its performance obligation and recognises revenue over time as it constructs the property. The customer, and not the entity, controls the property as it is being constructed and, thus, the entity would not recognise inventory (work-in-progress) for that part-constructed property. Instead, applying IFRS 15 it would recognise a receivable or a contract asset representing its right to consideration in exchange for transferring the part-constructed property to the customer.[4]

The nature of borrowing costs incurred during construction

38. In Contract Point-in-Time, the customer obtains control of the property when construction is complete. The entity therefore retains control of the property (recognised as inventory) as it is being constructed, and would generally be entitled to consideration only when it transfers control of the property to the customer.[5] Accordingly, the entity may be required to obtain financing for the construction of the property during the construction period and may incur borrowing costs in doing so.

39. However, in Contract Over-Time, it is the customer that controls the property as it is being constructed. If the customer pays for the property in a manner that is consistent with the transfer of control, the entity would not need to finance the construction of the part-constructed property and would not incur borrowing costs on that part-constructed property. However, if the customer pays in arrears (for example, on completion of construction), the entity may need to borrow funds and may incur borrowing costs. In this situation any borrowing costs incurred relate to financing the contract from the time of providing the service to the customer to the time of receiving payment for that service. As a consequence, the entity is providing both

[4] Paragraph 108 of IFRS 15 states: '[a] receivable is an entity's right to consideration that is unconditional'. Appendix A of IFRS 15 defines a contract asset as '[a]n entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance)'.

[5] An entity may also receive consideration in advance in some 'point-in-time' contracts. When that is the case, applying paragraph 60 of IFRS 15 an entity would consider whether the agreed timing of payments provides the entity with a significant benefit of financing the transfer of property to the customer. In those circumstances, the contract contains a significant financing component.

construction services and financing services to the customer. This is consistent with the nature of the assets the entity recognises (ie receivable and/or contract asset, which represent the entity's right to consideration). This is also why IFRS 15 requires an entity to assess whether a contract with a customer contains a significant financing component. Paragraphs 60 and BC229 of IFRS 15 state (emphasis added):

> 60. In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer…
>
> BC229 Some contracts with customers include a financing component… *A contract that has a financing component includes, conceptually, two transactions—one for the sale and one for the financing*. The boards decided to require an entity to adjust the promised amount of consideration for the effects of financing components if those financing components are significant, for the following reasons:
>
> (a) not recognising a financing component could misrepresent the revenue of a contract. For example, *if a customer pays in arrears*, ignoring the financing component of the contract would result in full revenue recognition on the transfer of the good or service, despite the fact that *the entity is providing a service of financing to the customer*…

40. The following table illustrates the differences between Contract Point-in-Time and Contract Over-Time:

	Contract Point-in-Time	**Contract Over-Time**
Nature of promise in the contract	Transfer a constructed property.	Transfer a property as it is being constructed—ie to provide construction services (together with embedded materials).
Timing of transfer of promised goods or services (and thus recognition of revenue)	At the point in time at which construction is complete.	Over time as the property is being constructed.
Nature of any borrowing costs incurred	To finance construction of the property.	To provide financing services to the customer.

Conclusion

41. Based on our analysis, we do not agree with respondents who say the pattern of revenue recognition should not affect the capitalisation of borrowing costs. We think the nature of borrowing costs incurred is different in contracts for which an entity recognises revenue over time and those for which it recognises revenue at a point in time. The nature of the assets recognised by an entity is also different in 'over-time' contracts versus 'point-in-time' contracts. Accordingly, the assessment of whether an entity capitalises borrowing costs applying IAS 23 differs in these situations and could result in different outcomes. Differences in outcomes reflect the differing nature of the entity's promise to the customer in the respective contracts.

The effects of finalising the agenda decision

Respondents' comments

42. Several respondents say the agenda decision, if finalised, would have a significant effect on residential real estate developers in several jurisdictions. Some respondents also say the agenda decision could affect entities in other industries that recognise revenue over time. For example, the MASB says:

> …the tentative agenda decision may also affect the current practice in some manufacturing industries that capitalise borrowing cost to specifically-designed machinery, equipment and vehicles for customers…

43. Some respondents suggest that the Committee not finalise the tentative agenda decision but instead refer the matter to the Board. For example:

    (a) the Institute of Indonesia Chartered Accountants suggests conducting a more in-depth analysis of the effects—accordingly, it suggests referring the matter to the Board.

    (b) the ICAI suggests that the Board reconsider the principles in IFRS 15 in the context of borrowing costs.

    (c) the MASB says the Board did not identify the possible consequences of the agenda decision at the time it developed IFRS 15. If the Board had done so, the MASB would have sought a consistent measurement outcome regardless of the pattern of revenue recognition. Accordingly, the MASB suggests that the Board address this matter 'through a full due process rather than the Committee's truncated due process'.

44. The Hong Kong Institute of Certified Public Accountants (HKICPA) does not agree with the Committee's conclusions on inventory (work-in-progress) related to unsold units. It suggests that the Committee limit the scope of the agenda decision to address only receivables and contract assets.

Staff Analysis

45. Respondents to the Committee's tentative agenda decision on 'Liabilities in relation to a joint operator's interest in a joint operation' raised similar concerns about the potential effects of finalising an agenda decision. Paragraphs 52–53 of Agenda Paper 9 for this meeting explain why we think it is important for the Committee to respond to questions submitted to it in a timely manner.

46. In considering the matter in this paper, the Committee tentatively decided not to add it to the standard-setting agenda because it concluded that the requirements in IFRS Standards provide an adequate basis for an entity to determine the appropriate accounting. Based on our analysis in this paper, we continue to agree with the Committee's conclusions and, on that basis, recommend finalising the agenda decision.[6]

47. As discussed in paragraphs 55–58 of Agenda Paper 9 for this meeting, we acknowledge that the explanatory material in the agenda decision might provide an entity with new information which could result in an entity determining that it needs to change its previous accounting policy. We understand that this might take some time to implement. Our recommendation in that agenda paper is that the Committee include the Board's view on the timing of implementing an accounting policy change that results from an agenda decision in *IFRIC® Update*.

48. We recommend including wording along the lines of the following:

> The process for publishing an agenda decision might often result in explanatory material that provides new information that was not otherwise available and could not otherwise reasonably have been expected to be obtained. Because of this, an entity might determine that it needs to change an accounting policy as a result of an agenda decision. It is expected that an entity would be entitled to sufficient time to make that determination and implement any change (for example, an entity may need to

[6] See paragraph 50 of this paper for our recommendation

obtain new information or adapt its systems to implement a change).

Other comments

49. Appendix B to this paper summarises other comments received, together with our analysis of those comments. Based on our analysis, we recommend no changes to the agenda decision.

Staff recommendation

50. We recommend that:

    (a) The agenda decision is finalised as published in *IFRIC Update* in November 2018 with no changes. Appendix A to this paper sets out the proposed wording of the final agenda decision.

    (b) *IFRIC Update* include wording similar to that in paragraph 48 of this paper to address the timing of implementing any change in accounting policy.

Question for the Committee
Does the Committee agree with our recommendation to: (a) finalise the agenda decision set out in Appendix A to this paper? (b) include wording similar to that in paragraph 48 of this paper in *IFRIC Update*?

Appendix A—Proposed wording of the agenda decision

A1. We propose the following wording for the final agenda decision, which is unchanged from the tentative agenda decision except to remove the square brackets in the last paragraph.

Over time transfer of constructed good (IAS 23 *Borrowing Costs*)

The Committee received a request about the capitalisation of borrowing costs in relation to the construction of a residential multi-unit real estate development (building).

In the fact pattern described in the request:

(a) a real estate developer (entity) constructs the building and sells the individual units in the building to customers.

(b) the entity borrows funds specifically for the purpose of constructing the building and incurs borrowing costs in connection with that borrowing.

(c) before construction begins, the entity signs contracts with customers for the sale of some of the units in the building (sold units).

(d) the entity intends to enter into contracts with customers for the remaining part-constructed units (unsold units) as soon as it finds suitable customers.

(e) the terms of, and relevant facts and circumstances relating to, the entity's contracts with customers (for both the sold and unsold units) are such that, applying paragraph 35(c) of IFRS 15 *Revenue from Contracts with Customers*, the entity transfers control of each unit over time and, therefore, recognises revenue over time. The consideration promised by the customer in the contract is in the form of cash or another financial asset.

The request asks whether the entity has a qualifying asset as defined in IAS 23 and, therefore, capitalises any directly attributable borrowing costs.

Applying paragraph 8 of IAS 23, an entity capitalises borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Paragraph 5 of IAS 23 defines a qualifying asset as 'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale'.

Accordingly, the entity assesses whether, in the fact pattern described in the request, it recognises an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Depending on the particular facts and circumstances, the entity might recognise a receivable, a contract asset and/or inventory.

The Committee concluded that, in the fact pattern described in the request, the entity does not capitalise borrowing costs. The Committee observed that:

(a) any receivable that the entity recognises is not a qualifying asset. Paragraph 7 of IAS 23 specifies that financial assets are not qualifying assets.

(b) any contract asset that the entity recognises is not a qualifying asset. The contract asset (as defined in Appendix A to IFRS 15) would represent the entity's right to consideration that is conditioned on something other than the passage of time in exchange for transferring control of a unit. The intended use of the contract asset—to collect cash or another financial asset—is not a use for which it necessarily takes a substantial period of time to get ready.

(c) any inventory (work-in-progress) for unsold units under construction that the entity recognises is not a qualifying asset. In the fact pattern described in the request, this asset is ready for its intended sale in its current condition—ie the entity intends to sell the part-constructed units as soon as it finds suitable customers and, on signing a contract with a customer, will transfer control of any work-in-progress relating to that unit to the customer.

The Committee concluded that the principles and requirements in IAS 23 provide an adequate basis for an entity to determine whether to capitalise borrowing costs in the fact pattern described in the request. Consequently, the Committee ~~[~~decided~~]~~ not to add this matter to its standard-setting agenda.

Appendix B: Analysis of other comments

B1. The table below outlines other comments, together with our analysis and conclusions.

Respondents' comments	Staff analysis and conclusions
1. *Effect of marketing activities and timing of entering into contracts with customers* Some respondents say the tentative agenda decision implies that the timing of market activities or of entering into contracts can change whether borrowing costs are capitalised. These respondents disagree with this outcome.	*We recommend no change to the agenda decision in this respect* We do not agree with respondents that an entity's assessment of whether to capitalise borrowing costs would change only because it markets a unit for sale or because it decides to enter into a contract with a customer. The assessment of whether to capitalise borrowing costs depends on the assets an entity recognises and whether, applying IAS 23, those assets meet the definition of a qualifying asset. If, for example, an entity's contracts with customers are such that it transfers control of a property only when construction is complete, it would continue to recognise inventory relating to that property until that point in time. The entity would assess whether the inventory relating to the part-constructed property would meet the definition of a qualifying asset. That assessment is unaffected by whether and when the entity markets the property and/or enters into a contract with a customer.

Respondents' comments	Staff analysis and conclusions
	In the fact pattern described in the submission, the entity is marketing the unsold units for sale. This provides evidence of the entity's intention with respect to the unsold units (ie that it intends to enter into contracts with customers as soon as it finds customers and, given the nature of its contracts, it would transfer control of any part-constructed unit to that customer as soon as it signs the contract).
2. *Cost to fulfil a contract applying IFRS 15* Some respondents say, applying paragraph 95 of IFRS 15, an entity should capitalise borrowing costs as a 'cost to fulfil the contract' because these costs are incurred in fulfilling the contract with the customer.	*We recommend no change to the agenda decision in this respect* Paragraph 95 of IFRS 15 states: If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria… Accordingly, an entity first assesses whether borrowing costs incurred are within the scope of another IFRS Standard. Because IAS 23 applies

Respondents' comments	**Staff analysis and conclusions**
	to borrowing costs, an entity would apply IAS 23 to those costs, and not paragraph 95 of IFRS 15. Paragraph BC307 of IFRS 15 states: '…Consequently, if the other Standards preclude the recognition of any asset arising from a particular cost, an asset cannot then be recognised under IFRS 15…'
3. Nature of contract assets The Accounting Standards Board of Japan (ASBJ) agrees with the Committee's conclusion that, in the fact pattern described in the submission, any contract asset is not a qualifying asset. However, it says some contract assets could take a substantial period of time to get ready to collect cash or another financial asset, and it is necessary to consider the nature of the asset. The ASBJ says the Committee could consider amending paragraph 7 of IAS 23 to specify that contract assets representing a right to collect cash or another financial asset are not qualifying assets.	*We recommend no change to the agenda decision in this respect* In the fact pattern described in the submission, the intended use of the contract asset is to collect cash or another financial asset[7]—this does not necessarily take a substantial period of time to get ready for its intended use. We think that this is also the reason IAS 23 specifically states that a receivable is not a qualifying asset. Accordingly, we recommend no change to the tentative agenda decision in this respect.

[7] In the fact pattern described in the submission, the consideration promised by the customer is in the form of cash or another financial asset.

<table>
<tr><th>Respondents’ comments</th><th>Staff analysis and conclusions</th></tr>
<tr><td>

4. Management’s intentions

The Israel Accounting Standards Board says the tentative agenda decision implies that inventory is not a qualifying asset because the entity is able to sell it in its current condition. The respondent said (a) it is unclear whether the intent to sell the inventory in its current condition matters, and (b) not considering intent could have unintended consequences for other inventories (such as land) because an entity would generally be able to sell that inventory at any stage of production.

In contrast, some respondents say the focus on intent could provide opportunities for entities to achieve desired accounting outcomes by changing their intention with regards to a property. Some respondents say intent is not something that is generally used in IFRS Standards.

</td><td>

The definition of a qualifying asset in paragraph 5 of IAS 23—'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale’—requires an entity to consider intent. We think reconsidering this requirement is beyond the scope of the Committee’s discussion on this question.

We think the agenda decision is clear that the entity considers intent when assessing whether inventory meets the definition of a qualifying asset. The tentative agenda decision states (emphasis added):

> …The Committee observed that: …
>
> c. any inventory (work-in-progress) for unsold units under construction that the entity recognises is not a qualifying asset. In the fact pattern described in the request, this asset is ready for its *intended sale* in its current condition—ie *the entity intends to sell* the part-constructed units as soon as it finds suitable customers and, on signing a contract with a customer, will transfer control of any work-in-progress relating to that unit to the customer.

</td></tr>
</table>

Respondents' comments	**Staff analysis and conclusions**
5. *Requests for clarification* a. The Institute of Singapore Chartered Accountants (ISCA) says it is unclear whether the conclusions in the tentative agenda decision also apply to similar situations in which an entity recognises revenue at a point in time. b. The ASBJ suggests clarifying that the Committee's observation on contract assets not being a qualifying asset applies in the context of the fact pattern described in the submission.	*We recommend no change to the agenda decision in this respect* a. An important factor in the fact pattern described in the submission (and in the tentative agenda decision) is that the entity recognises revenue over time. The agenda decision does not address contracts for which an entity recognises revenue at a point in time. b. The Committee's conclusions in the tentative agenda decision relating to the contract asset are based on the fact pattern described in the submission (and in the tentative agenda decision). The tentative agenda decision states (emphasis added): The Committee concluded that, *in the fact pattern described in the request*… b. any contract asset *the entity* recognises is not a qualifying asset…

Respondents' comments	**Staff analysis and conclusions**
6. Requirements in IAS 11 Some respondents say IAS 11 specified that borrowing costs represent contract costs and thus entities had capitalised borrowing costs. They say the Board did not explicitly change this requirement when it developed IFRS 15 and, on this basis, entities should still be able to capitalise borrowing costs.	*We recommend no change to the agenda decision in this respect* IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018. The requirements in IFRS 15 replace those in IAS 11, which was withdrawn. Consequently, considering requirements in IAS 11 (not carried forward to IFRS 15) would be inappropriate.
7. Consideration of other fact patterns Some respondents asked about the implications of the agenda decision on other fact patterns, such as when: a. an entity uses borrowings to acquire land and finance the construction of the building. However, the entity transfers the land to the customer only when construction is complete. [HKICPA] b. an entity does not know the pattern of revenue recognition until it enters into a contract with a customer, which could happen at any stage during construction. [HKICPA] c. an entity changes its intention with respect to the type of contracts it enters into with customers [eg MASB].	*We recommend no change to the agenda decision in this respect* The tentative agenda decision does not address such fact patterns, which are different from the fact pattern described in the submission. Considering these fact patterns is beyond the scope of the question submitted to the Committee.

Respondents' comments	Staff analysis and conclusions
8. Other matters The CVM says: a. borrowing costs are directly attributable to particular contracts—accordingly, an entity should present borrowing costs as part of cost of goods sold. b. the tentative agenda decision implies that borrowing costs do not relate directly to a contract. The CVM is of the view that an entity should include such costs when assessing whether a contract is onerous—the CVM refers to Exposure Draft *Onerous Contracts—Costs to Fulfil a Contract* (Amendments to IAS 37) in making this comment.	*We recommend no change to the agenda decision in this respect* Considering these matters is beyond the scope of the question submitted to the Committee.