

Right to payment for performance completed to date (IFRS 15 Revenue from Contracts with Customers)—March 2018

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

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

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

Paragraph B9 states that an amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date, rather than compensation for only the entity's potential loss of profit if the contract were to be terminated. The Committee observed that it is the payment the entity is entitled to receive under the contract with the customer relating to performance under that contract that is relevant in determining whether the entity has an enforceable right to payment for performance completed to date.

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

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

The assessment of whether an entity has an enforceable right to payment for performance completed to date requires an entity to consider the rights and obligations created by the contract, taking into account the legal environment within which the contract is enforceable. Accordingly, the Committee observed that the outcome of an entity's assessment depends on the particular facts and circumstances of the contract.

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

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

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

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

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

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

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