

Project	IFRIC 15 <i>Agreements for the Construction of Real Estate</i> – Meaning of continuous transfer
Topic	Update on outreach activities and latest Board’s decisions

Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request asking for clarification on the meaning of the term ‘continuous transfer’ in paragraph 17 of *IFRIC 15 Agreements for the Construction of Real Estate*.
2. This issue was discussed at the Interpretations Committee meeting in March 2011.

Purpose of the paper

3. This paper:
 - (a) provides background information on the issue;
 - (b) provides an update on the current Board project on revenue recognition;
 - (c) provides an update on outreach activities carried out since the last Interpretations Committee meeting;
 - (d) asks the Interpretations Committee’s views on possible ways forward on this issue.

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRS Interpretations Committee or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*.

Interpretations are published only after the IFRS Interpretations Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in *IASB Update*.

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Background information

Meeting in March 2011

4. We partially reproduce below the March 2011 IFRIC Update for ease of reference:

[...]

Several Committee members observed that IFRIC 15 provides a principle for determining when continuous transfer is achieved and they thought that any further guidance that the Committee might give would be in the form of implementation guidance. They also noted that the Board project on revenue recognition is currently developing guidance on the meaning of transfer and continuous transfer, with a view to finalising the new IFRS by 30 June 2011. The Committee recommended that the Board should consider the fact pattern of the submission received in its revenue recognition project.

Before concluding on this issue, the Committee asked for further input on this issue from interested parties. At the next meeting in May, the staff will update the Committee as a result of this further work and of developments on the revenue recognition project.

Objective for this meeting

5. At this meeting we plan to give an update of the outreach activities performed by the staff.
6. This paper also provides an example of a situation that specifically illustrates the issue in the submission with the aim to obtain feedback from the Committee on the outcome of applying IFRIC 15 to that example.

Outreach activities performed

Criteria/indicators to characterise the transfer of control

7. The revenue recognition project team liaised with standard setters in some of those jurisdictions in which real estate sales agreements have the characteristics described in the original submission.

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8. The project team provided those constituents with the criteria/indicators below from the revenue recognition project set up to determine the transfer of control in a sales transaction. The staff asked them to give their feedback as to the application of those criteria/indicators to their real estate sales agreement.

An entity should recognise revenue to depict the transfer of goods or services to a customer.

Goods

An entity should recognise revenue when the customer obtains control of the good. The customer obtains control of a good when it has the ability to direct the use of, and receive the benefit from, the good.

Indicators that the customer has obtained control of a good:

- a. The customer has an unconditional obligation to pay.
- b. The customer has legal title.
- c. The customer has physical possession.
- d. The customer has the risks and rewards of ownership.

Services

To recognise revenue for a service, an entity must determine that a performance obligation is satisfied continuously. An entity satisfies a performance obligation continuously if at least one of the following two criteria is met:

- a. The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced. [An entity should use the guidance on control of a good to make that determination.]
- b. The entity's performance does not create an asset with alternative use to the entity and at least one of the following is met:
 1. The customer receives a benefit as the entity performs each task.
 2. Another entity would not need to reperform the task(s) performed to date if that other entity were to fulfil the remaining obligation to the customer without the benefit of any inventory controlled by the entity.
 3. The entity has a right to payment for performance to date.

9. In addition, as part of the discussions with the constituents, the project team mentioned that the current distinction between the sale of goods and the sale of services is not expected to be carried forward in the new standard on revenue

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recognition. The focus is primarily on the depiction of the way the control transfers.

Illustrative example

10. To illustrate the problem, below are outlined features of a transaction involving the construction and sale of apartments in a 300-unit, multi-story, development. This example amalgamates several features that are seen in the jurisdictions where application of IFRIC 15 has been a particular challenge. The example is therefore not a description of any one particular jurisdiction's transactions.
 - (a) The developer begins construction when it has sales contracts for a minimum number of units. For illustration, assume 90%. Obviously, the developer must build all 300 units, since they occupy a single building. A sale agreement is for a specific unit -- for example, floor 6 southeast corner.
 - (b) Construction financing for units under contract is provided by the buyer. The buyer takes on a loan and the lender makes payments to the developer based on the progress of construction. Payments by the buyer are upon achievement of technically certified milestone that reflect the state of completion of the construction. The lender has full recourse against the buyer.
 - (c) As part of the financing agreement, the seller transfers a 1/300th undivided interest in the land and common areas to the buyer, who immediately pledges it as additional collateral to the lender.
 - (d) Once a sale agreement is in place, the developer cannot sell, pledge, or otherwise hypothecate the unit.
 - (e) The buyer cannot terminate the agreement except by defaulting. If the developer fails to perform, housing regulators step in and appoint a new developer to finish the construction. Buyers and developers are 'locked-in'.

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- (f) The buyer can sell his or her interest in a partially completed unit on the open market. The lender must approve the buyer's credit, but the developer's approval is not required. Sales of partially completed units are less frequent than sales of completed units, but are not unusual.
 - (g) The buyer can make choices about apartment finish (carpeting, wall treatments and the like) and appliances. Because this is a 300 unit building, the buyer obviously cannot demand alterations in structure or design.
11. We believe that an analysis of the features in that example against the criteria/indicators proposed in paragraphs 8 of this paper leads to the conclusion that control transfers continuously.

Feedback from constituents reached

12. While constituents find that criterion a. for the continuous settlement of a performance obligation may be insufficient on its own to help characterise the transfer of control and the revenue recognition pattern, they agree that criterion b. and more specifically b.1 and b.3 are helpful to reach a conclusion as to the continuous transfer of control. In addition, they note that both the perspective of the buyer and the perspective of the customer are taken into account for the purpose of the analysis of transfer of control.

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Questions to the Interpretations Committee

Questions

- (a) Does the Interpretations Committee believe that the criteria/indicators proposed by the Board in its most recent decisions are sufficient to conclude to continuous transfer of control in situations such as the one described in this paper?
- (b) If no, what other criteria/indicators would the Interpretations Committee think be of help?
- (c) Does the Interpretations Committee believe that IFRIC 15 would lead to a different answer in the specific example presented?
- (d) What ways forward would the Interpretations Committee recommend be explored?