

STAFF PAPER

November 2017

IFRS Interpretations Committee Meeting

Project	Revenue recognition in a real estate contract that includes the transfer of land (IFRS 15)		
Paper topic	Initial consideration		
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Introduction

1. The IFRS Interpretations Committee (Committee) received a request about the application of IFRS 15 *Revenue from Contracts with Customers* to a particular real estate contract. Specifically, the request asked (a) about the identification of performance obligations in the contract and (b) for each performance obligation identified, whether to recognise revenue over time or at a point in time.
2. The objective of the paper is to:
 - (a) provide the Committee with background information on the matter (paragraphs 4–5);
 - (b) present our research and analysis on identifying performance obligations (paragraphs 7–24) and the pattern of revenue recognition (paragraphs 25–3836); and
 - (c) ask the Committee whether it agrees with our recommendation not to add the matter to its standard-setting agenda (paragraphs 39–40).
3. There are two appendices to the paper:
 - (a) Appendix A—Proposed wording of the tentative agenda decision; and
 - (b) Appendix B—Submission.

Background information

4. Appendix B to this paper provides full details of the submission. Below we have reproduced the main facts we considered in our analysis:
- (a) The entity and a Housing Association (customer) enter into a non-cancellable contract for the sale of a block of real estate units (building) before the entity constructs the units. The contract is for the entire building, which will comprise multiple residential units.
 - (b) On signing the contract, the entity transfers legal title to the plot of land on which the entity will construct the building to the customer. The land has a specified price in the contract and the customer pays this amount on entering into the contract. Legal transfer of the land to the customer cannot be revoked, regardless of what happens during construction of the building.
 - (c) The entity and the customer agree upon the design and specification of the building before the contract is signed. As the building is being constructed:
 - (i) if the customer requests changes to the design and specification, the entity prices the proposed changes based on a methodology specified in the contract; the customer then decides whether to proceed with the changes. The entity can reject the customer's request for change only for a limited number of reasons, such as when the change would breach planning permission.
 - (ii) the developer can request changes to the design or specification only if not doing so would lead to an unreasonable increase in costs or delay to construction. The customer must approve those changes.
 - (d) The customer is required to make milestone payments throughout the construction period, however these do not necessarily correspond to the amount of work completed to date.

5. Our analysis assumes the entity has concluded that the contract is in the scope of IFRS 15 and all the criteria in paragraph 9 of IFRS 15 are met.

Summary of our research and analysis

Outreach

6. We decided not to perform outreach on this request for two reasons:
- (a) We are aware that customers enter into real estate contracts before construction is complete in many jurisdictions. We are also aware, however, that contracts and legislation vary in different jurisdictions, thereby resulting in differing patterns of revenue recognition. As a consequence, we concluded that outreach would not provide additional information about this matter.
 - (b) Because the matter relates to the application of IFRS 15, we considered it to be urgent in nature and thus proceeded to bring it to the Committee's November 2017 meeting.

Identifying Performance Obligations

What IFRS 15 says

7. For any contract within the scope of IFRS 15, an entity identifies the performance obligations in the contract. Paragraph 22 of IFRS 15 outlines the principle for identifying performance obligations:

At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

- (a) a good or service (or a bundle of goods or services) that is distinct; or

(b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 23).

8. Paragraph 27 explains the concept of distinct goods or services:

A good or service that is promised to a customer is distinct if both of the following criteria are met:

(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and

(b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract).

9. Paragraph 28 further explains the criterion in paragraph 27(a):

A customer can benefit from a good or service in accordance with paragraph 27(a) if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits. For some goods or services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events...

10. Paragraph 29 sets out the objective when assessing the criterion in paragraph 27(b), and provides factors that indicate that two or more performance obligations are not distinct within the context of the contract:

In assessing whether an entity's promises to transfer goods or services to the customer are separately identifiable in accordance with paragraph 27(b), the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following:

(a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit.

(b) one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.

(c) the goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfil its promise by transferring each of the goods or services independently.

Staff analysis

11. The request asks the Committee to consider whether, based on the fact pattern described in the submission, the entity would identify two performance obligations in the contract—one representing the promise to transfer land to the customer and one representing the promise to transfer the building to the customer. In other words, applying paragraphs 27-30 of IFRS 15, are the land and the building each a distinct good or service?
12. In considering this question, it is important to note that the contract is for a plot of land—the land on which the building will be constructed—and for the construction of the entire building. The contract is not, for example, for an individual real estate unit (or units) within the building.

Good or service capable of being distinct (paragraph 27(a))

13. In assessing whether the land and the building are each capable of being distinct, paragraph BC100 explains that the entity should base this assessment ‘on the characteristics of the goods or services themselves instead of the way in which the customer may use the goods or services. Consequently, an entity would disregard any contractual limitations that might preclude the customer from obtaining readily available resources from a source other than the entity.’
14. Accordingly, the entity considers whether the customer could benefit from the land on its own or together with other readily available resources, and could benefit from the construction of the building on its own or together with other readily available resources, regardless of the fact that both goods and services are negotiated as part of the same contract.
15. Based on the fact pattern described in the submission, we think the land and the building are each capable of being distinct. The customer could benefit from the plot of land on its own or together with other resources readily available to it—for example, the customer could hire another developer to construct a building on the land or could use the plot of land for another purpose. Similarly, the customer could benefit from the construction of the building on its own or together with other resources readily available to it—for example, the customer could obtain

construction services from the entity or another developer without any transfer of land.

16. Indeed, many of the goods and services used as inputs to the construction of the building are also capable of being distinct, even though the entity would not identify them as separate performance obligations (because they are not distinct within the context of the contract). For example, in paragraph BC102, the Board explained that ‘as an example, many construction-type and production-type contracts involve transferring to the customer many goods or services that are capable of being distinct (such as various building materials, labour and project management services).’
17. The Board also highlighted this in Example 10, case A of the Illustrative Examples to IFRS 15. In that example, a developer enters a contract with a customer to build a hospital. The developer identifies various promised goods and services in the contract that are each capable of being distinct applying paragraph 27(a), such as engineering, site clearance, foundation, procurement, construction of the structure, piping, wiring, installation of equipment and finishing. In that example, however, the developer identifies only a single performance obligation in the contract because the promise to transfer those goods and services are not separately identifiable applying paragraph 27(b).

Distinct within the context of the contract (paragraph 27(b))

18. The assessment of the criterion in paragraph 27(b) requires judgement taking into account all the facts and circumstances, as explained in paragraph BC105. To assist in making that assessment, the Board developed the factors in paragraph 29. The Board, however, explained in paragraph BC116N that ‘not all of those factors need to exist (or not exist) to conclude that the entity’s promises to transfer goods or services are not (are) separately identifiable....the factors are not intended to be criteria that are evaluated independently of the separately identifiable principle.’
19. Accordingly, in assessing whether a promise in a contract is separately identifiable from other promises in the contract, an entity considers the objective set out in paragraph 29—ie whether the nature of the promise, within the context of the contract, is to transfer each of the goods or services individually or, instead,

to transfer a combined item or items to which the promised goods or services are inputs.

20. The Board explains in paragraphs BC105, BC116J and BC116K that ‘the notion of ‘separately identifiable’ is based on the notion of separable risks...(ie whether the risk that an entity assumes to fulfil its obligation to transfer one of those promised goods or services to the customer is a risk that is inseparable from the risk relating to the transfer of the other promised goods or services)...The evaluation of whether an entity’s promise is separately identifiable considers the relationship between the various goods or services within the contract in the context of the process of fulfilling the contract. Therefore, an entity should consider the level of integration, interrelation or interdependence among the promises to transfer goods or services. The boards observed that rather than considering whether one item, by its nature, depends on the other (ie whether two items have a functional relationship), an entity evaluates whether there is a transformative relationship between the two items in the process of fulfilling the contract...In many cases, the inputs to a combined item concept might be further explained as a situation in which an entity’s promise to transfer goods or services results in a combined item that is more than (or substantively different from) the sum of those individual promised goods and services.’
21. The Board also explains in paragraph BC107 that ‘in circumstances in which an entity provides an integration service, the risk of transferring individual goods or services is inseparable, because a substantial part of the entity’s promise to a customer is to ensure the individual goods or services are incorporated into the combined output. Thus, the individual goods or services are inputs to produce a single output.’ This is particularly relevant in the context of many construction contracts, under which an entity often provides a significant service of integrating the materials, the labour and the project management services into a combined output that is a constructed building. Example 10, case A of IFRS 15 (discussed above in paragraph 17 of the paper) illustrates this. Paragraph IE47 explains that the goods and services (such as site clearance, engineering, procurement, construction of the structure, etc.) are not separately identifiable applying paragraph 27(b) of IFRS 15 because the developer provides a significant service

of integrating the goods and services (the inputs) into the hospital (the combined output) for which the customer has contracted.

Application of paragraph 27(b) to the fact pattern in the submission

22. In the fact pattern described in the submission, the submitter does not ask whether the construction of the building might comprise more than one performance obligation. We assume the facts and circumstances are such that it is clear that the entity has promised to construct the building, and not promised to separately transfer bricks, concrete, roofing, labour, electrical works, plumbing, etc. In the context of identifying performance obligations, the question is whether the promise to transfer the land on which the building will be constructed is separately identifiable from the promise to transfer the building itself. Is the entity transferring the land and separately constructing the building on the land, or is the entity instead constructing the building with the transfer of the land being an embedded part of the overall construction of the building?
23. In considering this question, we think the Board's explanations in the basis as well as the factors in paragraph 29 are helpful. The entity would consider the following:
- (a) Does the transfer of the plot of land have any transformative effect on the construction of the building, and vice versa? Does the entity's promise to transfer the plot of land and construct the building result in a combined item that is more than, or substantively different from, the customer obtaining the plot of land from one entity and obtaining the construction services from another?

It appears clear that the plot of land is essential to the construction of the building—the building cannot exist without the land; the building must have foundations; those foundations will mean digging into the land. This means there is a functional relationship between the land and the building. However, this does not necessarily mean that the risks the entity undertakes in transferring the plot of land to the customer are inseparable from the risks undertaken in constructing the building, ie it does not necessarily mean that the entity provides a significant service

of integrating the land and the building. An important question to ask is whether (i) the entity's performance in constructing the building would be any different if the customer had already owned the plot of land or had purchased it from another entity, and (ii) the entity's performance in transferring the land would be any different if the customer engaged another developer to construct the building? Would the entity be able to fulfil its promise to construct the building even if the customer had purchased the plot of land from another party, and would the entity be able to fulfil its promise to transfer the plot of land even if the customer acquired the construction services from another developer? If the answer to that is 'yes', then in our view the promise to transfer the land would be separately identifiable from the promise to construct the building.

- (b) In this respect, we note the explanation in Example 11, case E of the Illustrative Examples to IFRS 15. That example is one in which an entity sells a piece of off-the-shelf equipment together with specialised consumables to the customer. The conclusion in the example is that the promise to transfer the equipment is separately identifiable from the promise to transfer the consumables. Although the nature of the contract illustrated in Example 11, case E is very different from the fact pattern described in the submission, we think the explanation provided in that example is helpful in assessing whether promises in a contract are separately identifiable. The explanation in IE58I says the following: 'Although the customer can benefit from the consumables in this contract only after it has obtained control of the equipment (ie the consumables would have no use without the equipment) and the consumables are required for the equipment to function, the equipment and the consumables do not each significantly affect the other. This is because the entity would be able to fulfil each of its promises in the contract independently of the other. That is, the entity would be able to fulfil its promise to transfer the equipment even if the customer did not purchase any consumables and would be able to fulfil its promise to

provide the consumables, even if the customer acquired the equipment separately.’

24. We have not set out a conclusion in this paper regarding the identification of performance obligations in the fact pattern described in the submission. We note that this assessment requires judgement, and the conclusion will very much depend on the particular facts and circumstances pertaining to the contract. Although we could reach a conclusion based on the fact pattern described in the submission (and assuming there are no other factors that might affect the assessment), we think what is most helpful is to outline the factors and questions the entity considers in identifying the performance obligations in the contract—ie to draw out what is important in making the assessment in the context of the particular fact pattern described in the submission. If we were to set out a conclusion on the identification of performance obligations, there is a risk that stakeholders might view the role of the Committee to be to provide answers on the identification of performance obligations in numerous revenue contracts. We think this is not the Committee’s role.

Question 1 for the Committee
<p>Does the Committee agree with our analysis of the factors and questions the entity considers when applying paragraphs 27-29 of IFRS 15 to the fact pattern described in the submission?</p>

Pattern of revenue recognition

What IFRS 15 says

25. Having identified the performance obligations in a contract, an entity determines whether it recognises revenue over time or at a point in time for each performance obligation. In this respect, paragraph 32 of IFRS 15 states:

For each performance obligation identified in accordance with paragraphs 22–30, an entity shall determine at contract inception whether it satisfies the performance obligation over time (in accordance with paragraphs 35–37) or

satisfies the performance obligation at a point in time (in accordance with paragraph 38). If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

26. Paragraph 35 states:

An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

(a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);

(b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or

(c) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).

27. Accordingly, at contract inception for each performance obligation, an entity assesses the criteria in paragraph 35 to determine whether it recognises revenue over time. Otherwise, it recognises revenue at a point in time.

Application of paragraph 35 to the fact pattern in the submission

28. In the previous section of this paper, we did not conclude on the identification of one or two performance obligations in the contract described in the submission:

- (a) If one performance obligation is identified, the entity has promised to construct the building for the customer, and an embedded part of that construction is that the plot of land on which the building will be constructed is transferred to the customer.

(b) If two performance obligations are identified, the entity has promised to transfer the plot of land to the customer, and also promised to construct the building on that plot of land.

29. In this section of the paper, we first discuss the application of paragraph 35 to the performance obligation representing the promise to transfer the plot of land. This discussion is relevant only if the entity identifies the promise to transfer the land as a separate performance obligation.

30. We then discuss the application of paragraph 35 to the construction of the building. We also consider whether that analysis might be different if the entity were to identify only one performance obligation in the contract.

Application of paragraph 35 to the transfer of the land

31. For the transfer of the plot of land to the customer, we think that none of the criteria in paragraph 35 of IFRS 15 are met. This is because:

(a) the entity’s performance delivers an asset—the plot of land—that is not consumed immediately. Accordingly, the criterion in paragraph 35(a) is not met.

(b) the entity’s performance does not create or enhance the land. Accordingly, the criteria in paragraphs 35(b) and 35(c) are not met.

32. Consequently, in our view the entity recognises revenue for the transfer of the plot of land at a point in time applying paragraph 38 of IFRS 15.

Application of paragraph 35 to the construction of the building (assuming the promise to transfer the land is a separate performance obligation)

33. In September 2017, the Committee discussed the application of paragraph 35 to the construction of a real estate unit. Details of this analysis can be found in:

(a) paragraphs 8–28 of [Agenda Paper 2](#) to that meeting; and

(b) the tentative agenda decision published in [September 2017 IFRIC Update](#).

34. The tentative agenda decision published in September 2017 said the following about the construction of a real estate unit, which we consider to be applicable to the construction of the building in the fact pattern described in the submission:
- (a) 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.
 - (b) 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.
 - (c) 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.
 - (d) 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.
35. In the fact pattern described in the submission, we think that this means the following:
- (a) The criterion in paragraph 35(a) is not met because the customer does not simultaneously receive and consume the benefits provided by the

entity's construction of the building as the building is being constructed.

- (b) The entity's performance creates the building under construction. Accordingly, the entity assesses whether, as the building is being constructed, the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the part-constructed building. There are a number of important differences between the fact pattern described in this submission and the fact pattern in the request discussed by the Committee at the September 2017 that affects the assessment of the criterion in paragraph 35(b):
 - (i) The entity is constructing an entire building for the customer, rather than constructing and transferring only one unit within a larger multi-unit complex to the customer.
 - (ii) The customer obtains legal title to the entire plot of land on which the building is being constructed at contract inception, as opposed to obtaining legal title to a notional fraction of the land when construction is complete. Legal transfer of the land to the customer cannot be revoked, regardless of what happens during construction of the building. The entity is, therefore, constructing the building on land owned by the customer.
 - (iii) The customer has the right to make changes to the design and specification of the building during its construction, subject to some limitations described in paragraph 4(c) of this paper. The entity can make changes only for specified reasons, which are subject to approval by the customer.
- (c) In our view, these facts indicate that the criterion in paragraph 35(b) is met. The customer controls the part-constructed building as it is being constructed because it has both of the following:
 - (i) The ability to direct the use of the part-constructed building as it is being constructed. The customer has this ability by being able to change the design and specification of the building as it is being constructed. The terms of the contract

also enable the customer to prevent the entity or others from directing the use of the building as it is being constructed.

- (ii) The ability to obtain substantially all of the remaining economic benefits from the part-constructed building. The entity cannot redirect the building for another use or to another entity. Accordingly, on signing the contract, the customer has the ability to obtain substantially all of the remaining economic benefits from the building.

- (d) In reaching this conclusion, we note the Board’s observation in paragraph BC129 when explaining the criterion in paragraph 35(b): ‘For example, 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.’

36. We have not analysed the criterion in paragraph 35(c) in this paper because the entity is likely to do so only if the criteria in paragraphs 35(a) or 35(b) are not met. In addition, we analysed that criterion in some detail in Agenda Paper 2B for the November 2017 Committee meeting and also in [Agenda paper 2](#) for the September 2017 Committee meeting. As a consequence, we think there would be little additional helpful information that we might say about that criterion in the context of the fact pattern in this submission.

[Application of paragraph 35 to the construction of the building \(assuming the identification of a single performance obligation that embeds the transfer of the land to the customer\)](#)

37. We considered whether our analysis of the application of paragraph 35 to the construction of the building (outlined above in paragraphs 33-36 of this paper) would change if the entity were to identify a single performance obligation in the contract. In that case, the entity’s promise to construct the building would also embed the transfer of the plot of land to the customer.

38. Based on the fact pattern described in the submission, we think the analysis would not be different if the entity were to identify only a single performance obligation in the contract. Even though the performance obligation would embed the transfer of the plot of land, the customer owns that land from contract inception and also

has the ability to direct the design and specification of the building (as discussed above). Accordingly, we think the assessment of paragraph 35(b)—whether the customer controls the part-constructed building as it is being constructed on land already owned by the customer—would not be different.

Question 2 for the Committee

2. Does the Committee agree with our analysis of the application of paragraph 35 to the transfer of the land and the building in the fact pattern described in the submission?

Should the Committee add this matter to its standard setting agenda?

Is it necessary to add to or change IFRS Standards to improve financial reporting?¹

39. On the basis of our analysis in paragraphs 7–38 of the paper, we think the principles and requirements in IFRS 15 provide an adequate basis for an entity to (a) identify the performance obligations in the contract and (b) determine whether to recognise revenue over time or at a point in time in the fact pattern described in the submission.

Staff recommendation

40. Based on our assessment of the Committee’s agenda criteria in paragraphs 5.16-5.17 of the *Due Process Handbook* (discussed in paragraph 39 above), we recommend that the Committee does not add this matter to its standard-setting agenda. Instead, we recommend publishing an agenda decision that outlines how the entity applies the applicable requirements in IFRS 15 to the fact pattern described in the submission.

¹ Paragraph 5.16(b) of the *Due Process Handbook*.

Questions 3 and 4 for the Committee

3. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda?
4. Does the Committee have any comments on the proposed wording of the tentative agenda decision outlined in Appendix A to this paper?

Appendix A—Proposed wording of the tentative agenda decision

IFRS 15 *Revenue from Contracts with Customers*—Revenue recognition in a real estate contract that includes the transfer of land

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

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

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

Identifying performance obligations in the contract

Applying paragraphs 22–30 of IFRS 15, an entity identifies as a performance obligation each promise to transfer to the customer a good or service (or a bundle of goods or services) that is distinct.

Paragraph 27 of IFRS 15 specifies that a good or service promised to a customer is distinct if (a) the customer can benefit from the good or service on its own or together with other resources readily available to the customer (ie the good or service is capable of being distinct); and (b) the promise to transfer the good or service is separately identifiable from other promises in the contract.

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

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

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

Application of paragraph 27 to the fact pattern in the request

The Committee observed that the land and the building are each capable of being distinct and thus the criterion in paragraph 27(a) is met. The customer could benefit from the plot of land on its own or together with other resources readily available to it. For example, the customer could hire another developer to construct a building on the land. Similarly, the customer could benefit from the construction of the building on its own or together with other resources readily available to it. For example, the customer could obtain the construction services from the entity or another developer without any transfer of land.

In assessing the criterion in paragraph 27(b)—ie whether the promise to transfer the plot of land is separately identifiable from the promise to construct the building, the Committee observed that the entity considers the following:

- a. does the transfer of the plot of land have any transformative effect on the construction of the building, and vice versa? In other words, would the entity’s performance in constructing the building be any different if the customer had already purchased the plot of land from another party and vice versa? There is a functional relationship between the land and the building—the building cannot exist without the land; its foundations will be built into the land. However, this does not necessarily

mean that the risks the entity undertakes in transferring the plot of land to the customer are inseparable from the risks undertaken in constructing the building.

- b. would the entity be able to fulfil its promise to transfer the plot of land even if the customer purchased the construction services from another developer, and would it be able to fulfil its promise to construct the building even if the customer had purchased the plot of land from another party?

The Committee observed that the promise to transfer the land would be separately identifiable from the promise to construct the building on that land if the entity concludes that (a) its performance in constructing the building would be the same regardless of whether the customer had purchased the land from it or other party, and (b) it would be able to fulfil its promise to construct the building even if the customer had purchased the land from another party, and it would be able to fulfil its promise to transfer the land even if the customer purchased the construction services from another developer.

Application of paragraph 35 to the fact pattern in the request

If the entity identifies two performance obligations in the contract, those performance obligations would represent (a) a promise to transfer the plot of land to the customer, and (b) a promise to construct the building on that plot of land. The entity determines whether to recognise revenue over time for each performance obligation by applying the criteria in paragraph 35 of IFRS 15. If none of the criteria in paragraph 35 are met, the entity recognises revenue at a point in time.

Application of paragraph 35 to the promise to transfer land

The entity's performance delivers the plot of land to the customer, which is not consumed immediately and, thus, the criterion in paragraph 35(a) is not met. The entity's performance also does not create or enhance the land and, thus, the criteria in paragraphs 35(b) and 35(c) are not met.

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

Application of paragraph 35 to the promise to construct the building

The Committee discussed the application of paragraph 35 to a promise to construct a real estate unit in [September 2017]. The following observations made by the Committee in its [tentative] agenda decision 'Revenue recognition in a real estate contract (IFRS 15)' are also applicable to the promise to construct the building in the fact pattern described in the request²:

² The references to 'real estate unit' in the [tentative] agenda decision have been changed to 'building' in this [tentative] agenda decision.

- a. in a contract for the sale of a building that the entity constructs, the Committee observed that paragraph 35(a) is not applicable because the entity's performance creates an asset, ie the building, that is not consumed immediately.
- b. 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 building) as it is created or enhanced. An entity considers all relevant factors in making this assessment—no one factor is determinative.
- c. 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 building that the entity constructs, the asset created is the building itself. It is not, for example, the right to obtain the building in the future.

[The paragraph above will be updated depending on the outcome of the Committee's consideration of comment letters received on the IFRS 15 tentative agenda decision published in September 2017.]

In the fact pattern described in the request, the Committee observed that the criterion in paragraph 35(a) is not met. This is because the customer does not simultaneously receive and consume the benefits provided by the entity's construction of the building as the building is being constructed—the entity's performance creates an asset that is not consumed immediately, the part-constructed building.

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

The Committee observed that, in the fact pattern described in the request, the customer controls the part-constructed building as it is being constructed because it has both of the following:

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

Accordingly, the criterion in paragraph 35(b) is met. The Committee noted the Board's observation in paragraph BC129 of IFRS 15 that 'in the case of a construction contract in

which the entity is building on the customer's land, the customer generally controls any work in progress arising from the entity's performance'.

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

Appendix B—Submission

A1. We have reproduced the submission below. We have deleted details that would identify the submitter of this request.

Submission

I read with interest the recent IFRIC Update (September 2017) regarding Paragraph 35 of IFRS 15 and its application to real estate contracts.

The contract in question fits one of two of the typical contracts used in the housing sector, however the second type is not addressed and appears to be a point of disagreement in the sector, with potentially materially divergent outcomes.

Discussing this second contract type with various counterparts in the industry, the application is far from clear and is material to the financial statements as the volume and nature of the contract type is significant.

As such I would like to propose a potential agenda item for consideration.

The issue:

- An entity enters into a contract with a customer for the delivery of a distinct collection of real estate units.
- The design and specification of the final units are agreed and locked pre contract.
- The contract is structured so that legal title to the land the units sit on is passed to the customer on signing, with no recourse for related funds, and no way to put the transaction back onto the entity. The entity is unconditionally entitled to a certain amount of cash, again without recourse once title has passed.
- The contracts relate to distinct blocks of Apartments, or distinct Houses. There are no notional allocations of land to units; only land that directly, and only, relates to the contract is transferred.
- The development of the units is done on the (now) customers land, to the spec agreed. The customer can request any changes to the plan and the developer must either:

- reject the changes based on a limited range of reasons, for example a beach of planning conditions.
- produce prices for the proposed changes based on a methodology specified in the contract. The customer can then decide to proceed with the changes.
- The developer can request changes to the design or specification only if not doing so would lead to an unreasonable increase in costs and/or delay to the construction.
- The customer and their agent (a property development consultant firm) have unlimited rights to access the site to ensure compliance of the works (subject to compliance with certain terms on reporting arrival, compliance with site health and safety, not interfering with the works).
- The contract for the development has milestone payments to the entity, but these do not necessarily relate to the stage of work in progress.
- The entity can be replaced under the contract only if it is in breach of the contract.
- The contract is irrevocable under local law, and there are no examples of the transaction being unwound, with the land being transferred back to the entity.

Aspects to be considered:

- **Single performance obligation or two?**

The transfer of the land and the related contract price is irrecoverable from the entity, and is clearly separated in the contract, does this make the transfer of land distinct from the development of the building under IFRS15 para 27?

- **Development over time?**

Does the legal transfer of the land on which the development is to sit to the customer, along with the lack of design control of the entity mean the customer controls the asset under construction and thus meets IFRS para 35b for the development revenue to be recognised over time?

Current emerging practice:

- There is no agreement in the industry on how to deal with the implementation of IFRS 15, with three main current points of view.
 1. The passing of legal title and lack of control on the entity's side post contract, indicate that control has passed to the customer from the date of transfer of legal title (contract date). There are two performance obligation in the contract
 - a) the transfer of the land b) the development of the units.
 - **This leads to some revenue being recognised on the land transfer (the amount the entity is unconditionally entitled to for the transfer) and the development of the units is over time, as the customer controls the units so meets IFRS15 para 35b.**
 2. The passing of legal title and lack of control on the entity's side post contract, indicate that control has passed to the customer from the date of transfer of legal title (contract date). There is one performance obligation in the contract
 - a) the final delivery of the units
 - **This leads to the whole contract being assessed over time, including the amount attributable in the contract as relating to the land**
 3. The entity still controls the asset
 - **The contract must be assessed against IFRS15 para35 a and c to see if it over time, otherwise it is all point in time.**

These types of contract are very common in the housing sector [in our jurisdiction].

Due to the material nature and wide spread use of these contracts I believe financial reporting would be improved by a reduction in the diverse potential reporting methods.

The issue is one of interpretation, and is well within the confines of IFRS Standards and the *Conceptual Framework for Financial Reporting*.

The issue is narrow enough to be dealt with by the Interpretations Committee.

The solution developed will be applicable for the lifecycle of IFRS 15 as these contract are one of industry standards