

STAFF PAPER

September 2017

IFRS Interpretations Committee Meeting

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| Project | IFRS 15—Pattern of revenue recognition in a real estate contract | | |
| Paper topic | Initial consideration | | |
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This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee (Committee). Comments on the application of IFRS Standards do not purport to set out acceptable or unacceptable application of IFRS Standards—only the Committee or the International Accounting Standards Board (Board) can make such a determination. Decisions made by the Committee are reported in IFRIC[®] *Update*. The approval of a final Interpretation by the Board is reported in IASB[®] *Update*.

Introduction

1. The IFRS Interpretations Committee (Committee) received a request to clarify whether a real estate developer (the entity) recognises revenue over time applying paragraph 35 of IFRS 15 *Revenue from Contracts with Customers*. Specifically, the submitter asked about contracts for the sale of a real estate unit in a residential multi-unit complex.
2. The objective of the paper is to:
 - (a) provide the Committee with a summary of the matter;
 - (b) present our research and analysis; and
 - (c) ask the Committee whether it agrees with our recommendation not to add the matter to its standard-setting agenda.

Structure of the paper

3. This paper includes:
 - (a) background information;
 - (b) staff analysis; and

- (c) staff recommendation.
4. There are two appendices to the paper:
- (a) Appendix A—Proposed wording of the tentative agenda decision; and
 - (b) Appendix B—Submission.

Background information

5. Appendix B to this paper provides full details of the submission. Below we have reproduced the main facts that we considered in our analysis:
- (a) The entity and the customer enter into a contract for the sale of a real estate unit before the entity constructs the unit, often referred to as ‘off-plan’.
 - (b) On signing the contract, the entity is obliged to deliver the completed real estate unit as specified in the contract—it cannot change or substitute the unit agreed to in the contract. The entity retains legal title to the real estate unit (and any land attributed to it) until construction is complete.
 - (c) The customer pays around 20-30% of the purchase price for the real estate unit as the unit is being constructed, based on a payment schedule agreed to by both parties at contract inception. The customer pays the remainder of the purchase price to the entity after construction is complete.
 - (d) The contract gives the customer an ‘in rem’ right to the real estate unit—the legal term used to refer to the right to the real estate unit under construction. The customer cannot cancel the contract except as noted in (f) below, nor can it change the structural design of the unit. The customer can resell or pledge the right as the real estate unit is being constructed, subject to the entity performing a credit risk analysis of the new buyer of the right (if the customer has not paid the entire purchase price for the unit).
 - (e) If the entity is in breach of its obligations under the contract, the customer, and other customers of real estate units in the residential multi-unit complex, have the legal right to decide together to remove the entity and

hire another real estate developer to complete the construction of the real estate units.

- (f) Although the contract is irrevocable under local law, the courts have accepted requests to cancel the contract in specific circumstances, mainly when it has been proven that the customer is not financially able to fulfil the terms of the contract (for example, if the customer becomes unemployed or has a major illness that affects the customer's ability to work). In this situation, the customer can cancel the contract and is entitled to receive around 80-90% of payments it has already made to the entity. The remainder is retained by the entity as a termination penalty. The entity may also agree to sell the real estate unit at auction if the customer defaults on its payments.
6. Based on the details in the submission, we have prepared the analysis in this paper assuming that the entity:
- (a) has concluded that all of the criteria in paragraph 9 of IFRS 15 are met; and
 - (b) has identified one performance obligation in the contract applying paragraphs 22-30 of IFRS 15—a promise to transfer the real estate unit to the customer.

Summary of our research and analysis

Outreach

7. We decided not to perform outreach on this request for two reasons:
- (a) Since the publication of IFRS 15 we have attended a number of implementation events around the world. From these events we are aware customers buy real estate units 'off plan' in many jurisdictions. We are also aware, however, that contracts and the legislative framework 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 September 2017 meeting.

Application of IFRS requirements

8. The question asked by the submitter is whether the entity recognises revenue over time or at a point in time on contracts for the sale of residential real estate units. 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.

9. 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).

10. Accordingly, at contract inception the entity assesses each of the three criteria in paragraph 35 to determine whether it recognises revenue over time. Otherwise, it recognises revenue at a point in time applying paragraph 38 of IFRS 15.

Paragraph 35(a) - Simultaneous receipt and consumption of the benefits of the entity's performance

11. We think the criterion in paragraph 35(a) is not met. The customer does not simultaneously receive and consume the benefits provided by the construction of the real estate unit as the entity constructs the unit. This is because the entity's performance creates an asset, ie work in progress—the part-constructed real estate unit.

Paragraph 35(b) - Customer controls the asset as it is created or enhanced

12. Paragraph B5 of IFRS 15 states:

In determining whether a customer controls an asset as it is created or enhanced in accordance with paragraph 35(b), an entity shall apply the requirements for control in paragraphs 31–34 and 38. The asset that is being created or enhanced (for example, a work-in-progress asset) could be either tangible or intangible.

13. Paragraph 33 of IFRS 15 defines control as the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.
14. Paragraph BC129 of IFRS 15 explains that the Board included this criterion to address situations in which an entity's performance creates or enhances an asset that a customer *clearly controls* as the asset is created or enhanced. Paragraph BC129 mentions as an example a construction contract in which the entity is building on the customer's land. In that case, the customer generally controls any work in progress arising from the entity's performance.

Analysis of the fact pattern in the submission

15. In assessing whether the customer controls the asset as specified in paragraph 35(b) of IFRS 15, it is important to first identify the asset being created or enhanced. In the fact pattern described in the submission, the entity's performance creates the real

estate unit under construction. Accordingly, the entity assesses whether, as the unit is being constructed, the customer has the ability to direct the use of, and obtain substantially all the remaining benefits from, the part-constructed real estate unit.

16. The submitter outlines a number of factors the entity would consider in assessing whether the customer has the ability to direct the use of, and obtain substantially all the remaining benefits from, the real estate unit as it is being constructed:
- (a) According to local law, the contract gives the customer an ‘in rem’ right to the real estate unit under construction. The submitter explains that, in its view, the ‘in rem’ right is equivalent to having a right to the real estate unit itself. The customer is able to resell the right, to pledge it, and so on. Having said that, legal title to any attributed land, and to the unit itself, passes to the customer only when construction is complete. The customer also has no ability to direct the construction or structural design of the unit, nor does it appear to be able to use the part-constructed real estate unit in any other way. Although the customer can resell or pledge the ‘in rem’ right, it would appear to be unable to sell the actual unit itself without holding legal title to it. The customer’s ability to resell or pledge the right to the unit would appear to give the customer rights to direct the use of the unit that are similar to those that might arise from a forward contract for the purchase of real estate. In both cases, we think the customer’s rights do not demonstrate that the customer has the ability to direct the use of the real estate unit as it is being constructed.
 - (b) The customer, together with the other customers of real estate units in the residential multi-unit complex, have the legal right to decide together to replace the entity if the entity fails to meet its obligations under the contract. We think this right, exercisable only if the entity fails to perform as promised, is protective in nature. It does not, in isolation, give the customer the ability to direct the use of the real estate unit as the unit is being constructed.
 - (c) The submitter notes the customer is exposed to changes in the market value (appreciation or depreciation) of the real estate unit. Although this factor may indicate that the customer has the ability to obtain substantially all of

the remaining benefits from the unit, it does not give the customer control of the unit. This is because the customer does not have the ability to direct the use of the unit. Again, a forward contract might also expose a customer to changes in the market value of the real estate to be purchased but this would not give the customer control of the real estate.

17. In the fact pattern described in the submission, we think the criterion in paragraph 35(b) is not met.

Paragraph 35(c) – No alternative use and enforceable right to payment

18. As noted in paragraphs BC131 and BC132 of IFRS 15, the Board observed that, in some cases, applying the criteria in paragraph 35(a) and (b) of IFRS 15 could be challenging. Consequently, the Board developed a third criterion for recognising revenue over time, included in paragraph 35(c).
19. To recognise revenue over time applying paragraph 35(c), both legs of the criterion in that paragraph must be met, ie the asset created by an entity’s performance must not have an alternative use to the entity and the entity must have an enforceable right to payment for performance completed to date.

Does the real estate unit have an alternative use to the entity?

20. Paragraph 36 of IFRS 15 says the asset created by an entity’s performance does not have an alternative use to an entity if the entity is either (a) *restricted contractually* from readily directing the asset for another use during the creation or enhancement of that asset or (b) limited practically from readily directing the asset in its completed state for another use. Paragraph B7 of IFRS 15 says a contractual restriction must be substantive in this respect, and describes when such a restriction is (and is not) substantive.
21. The contract for the real estate unit is for a specific unit in a specific location, and the entity cannot change or substitute the unit agreed to in the contract. We think this is a substantive contractual restriction as described in paragraph B7 of IFRS 15, because the customer would be able to enforce its right to the unit if the entity were to seek to direct the unit for another use.

22. In addition, paragraph B6 of IFRS 15 says the possibility of the contract being terminated is not relevant for this consideration. Therefore the fact that the entity would be able to resell the real estate unit if the customer cancelled the contract does not affect the assessment.

23. Accordingly, we think this leg of the criterion in paragraph 35(c) is met.

Does the entity have an enforceable right to payment?

24. Paragraphs 37 and B9–B13 of IFRS 15 provide additional requirements for determining whether the entity has an enforceable right to payment for performance completed to date. Paragraph 37 states:

... 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.

25. Paragraph B12 of IFRS 15 says in assessing the existence and enforceability of a right to payment for performance completed to date, an entity considers the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms.

26. Based on the fact pattern described in the submission, it would appear that there is a legal precedent that permits the cancellation of contracts for the sale of residential real estate units for reasons other than the entity's failure to perform as promised. The courts have accepted requests to cancel the contract in specific circumstances, for example when it has been proven that the customer is not financially able to fulfil the terms of the contract (because of unemployment or major illness). In this situation, the entity is entitled to retain only a proportion of the payments received to date, rather than payment for performance completed to date. Accordingly, the entity does not have an enforceable right to payment for performance completed to date.

27. As mentioned earlier in the paper, to recognise revenue over time both legs of the criterion in paragraph 35(c) must be met, ie the asset should have no alternative use to the entity *and* the entity should have an enforceable right to payment for performance completed to date. Because the entity does not have an enforceable right to payment

for performance completed to date, the criterion in paragraph 35(c) of IFRS 15 is not met.

Conclusion

28. In our view, in the fact pattern described in the submission, 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.

Questions 1 for the Committee

Does the Committee agree with our analysis of the application of paragraph 35 of IFRS 15 to the fact pattern described in the submission?

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

Is the matter widespread and expected to have a material effect on those affected?¹

29. Based on information obtained since IFRS 15 was issued, we think contracts for ‘off plan’ sales of residential real estate units is common in many jurisdictions, and also that recognising revenue on these contracts over time versus at a point in time could have a material effect on the amounts that entities report.

Is it necessary to add to or change IFRS Standards to improve financial reporting?²

30. On the basis of our analysis in paragraphs 8-28 of the paper, we think the principles and requirements in IFRS 15 provide an adequate basis for an entity to determine whether to recognise revenue over time or at a point in time in the fact pattern described in the submission.

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

² Paragraph 5.16(b) of the *Due Process Handbook*.

Staff recommendation

31. Based on our assessment of the Committee’s agenda criteria in paragraphs 5.16-5.17 of the *Due Process Handbook* (discussed in paragraphs 27 and 28 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 relevant requirements in IFRS 15 to the contracts described in the submission.

Questions 2 and 3 for the Committee

2. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda?
3. 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*—Pattern of revenue recognition in a real estate contract

The Committee received a request about the pattern of revenue recognition in a contract for the sale of a unit in a residential multi-unit complex (real estate unit). Specifically, the request asked about the application of paragraph 35 of IFRS 15, which specifies when an entity can recognise revenue over time.

The contract for the real estate unit includes the following features:

- a. The real estate developer (entity) and the customer enter into a contract for the sale of a real estate unit before the entity constructs the unit.
- b. On signing the contract, the entity is obliged to deliver the completed real estate unit as specified in the contract—it cannot change or substitute the unit agreed to in the contract. The entity retains legal title to the real estate unit (and any land attributed to it) until construction is complete.
- c. The customer pays a portion of the purchase price for the real estate unit as the unit is being constructed, and pays the remainder (a majority) of the purchase price to the entity after construction is complete.
- d. The contract gives the customer a right to the real estate unit under construction. The customer cannot cancel the contract, except as noted in ii. below, nor can it change the structural design of the unit. The customer can resell or pledge the right as the real estate unit is being constructed, subject to the entity performing a credit risk analysis of the new buyer of the right (if the customer has not paid the entire purchase price for the unit).

The request also noted the following legal rights of the entity and the customer:

- i. If the entity is in breach of its obligations under the contract, the customer, and other customers of real estate units in the residential multi-unit complex, have the right to together decide to remove the entity and hire another real estate developer to complete the construction of the real estate units.
- ii. Although the contract is irrevocable under local law, the courts have accepted requests to cancel the contract in specific circumstances, mainly when it has been proven that the customer is not financially able to fulfil the terms of the contract (for example, if the customer becomes unemployed or has a major illness that affects the customer's ability to work). In this situation, the customer can cancel the contract and is entitled to receive most, but not all, of the payments it has already made to the entity. The remainder is retained by the entity as a termination penalty. The entity may also agree to sell the real estate unit at auction if the customer defaults on its payments.

In analysing the request, the Committee has assumed that, applying paragraphs 22-30 of IFRS 15, the entity has identified one performance obligation in the contract—a promise to transfer the real estate unit to the customer.

Paragraph 35 of IFRS 15 specifies that an entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if any one of the three criteria in paragraph 35 is met. Paragraph 32 of IFRS 15 states that if an entity does not satisfy a performance obligation over time, it satisfies the performance obligation at a point in time. Accordingly, the Committee observed that, at contract inception, an entity assesses each of the three criteria in paragraph 35 to determine whether it recognises revenue over time.

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

Paragraph 35(b) of IFRS 15 specifies that, to recognise revenue over time, the customer must control the asset that an entity's performance creates or enhances as the asset is created or enhanced. Control refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

In the fact pattern described in the request, the entity's performance creates the real estate unit under construction. Accordingly, the entity assesses whether, as the unit is being constructed, the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the part-constructed real estate unit. The Committee observed the following:

- a. although the customer can resell or pledge its right to the real estate unit under construction, it does not have legal title to the unit, nor does it have any ability to direct the construction or structural design of the unit as the unit is being constructed.
- b. the customer's legal right (together with other customers) to replace the entity, only in the event of the entity's failure to perform as promised, is protective in nature and is not indicative of control.

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. The Committee observed that, based on the fact pattern described in the request, there is no evidence that the customer has the ability to direct the use of the real estate unit as it is being constructed, and thus that the customer clearly controls the part-constructed unit.

Paragraphs BC131 and BC132 of IFRS 15 explain that the Board developed a third criterion in paragraph 35(c) for recognising revenue over time because it observed, in some cases, applying the criteria in paragraph 35(a) and (b) of IFRS 15 could be challenging.

Paragraph 35(c) specifies that, to recognise revenue over time, the asset created by an entity's performance must not have an alternative use to the entity and the entity must have an enforceable right to payment for performance completed to date.

Paragraph 36 of IFRS 15 states that the asset created does not have an alternative use to an entity if the entity is restricted contractually from readily directing the asset for another use during the creation of that asset. The Committee observed that, in the fact pattern described in the request, the entity cannot change or substitute the real estate unit, and thus the entity is restricted contractually from readily directing the unit for another use during its construction.

Based on the fact pattern described in the request, the entity however does not have an enforceable right to payment for performance completed to date. This is because, in the case of cancellation of the contract by the customer, the entity is entitled only to a termination penalty that does not compensate the entity for the performance completed to date. Paragraph 37 of IFRS 15 states that, to have an enforceable right to payment, at all times throughout the duration of the contract the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer for reasons other than the entity's failure to perform as promised. Paragraph B12 of IFRS 15 says, in assessing the existence and enforceability of a right to payment, an entity considers the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms.

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

The Committee concluded that the principles and requirements in IFRS 15 provide an adequate basis for an entity to determine whether to recognise revenue at a point in time or over time 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

B1. We have reproduced the submission below. We have deleted details that would identify the submitter of this request.

Submission

POTENTIAL AGENDA ITEM REQUEST

The issue:

Technical discussions regarding the application of IFRS 15 to the real estate industry in our jurisdiction have been very time-consuming. IFRS 15 brings new concepts, which means replacing the old approach of recognizing revenues based on “risks and rewards” transferred to customers (IAS 18 - Revenue and IAS 11 - Construction Contracts) for the new approach based on “control over goods or services” transferred to customers (IFRS 15 – Revenue from Contracts with Customers), which takes into account the perspective of the customer (IFRS n. 15, §BC 121). The debate focuses on off-plan sale of multi-unit residential property (sell then build contracts).

There are some multi-unit residential contracts - “purchase and sale agreement” - causing controversies regarding the applicable accounting approach (“over time” or “at a point in time”).

In typical “vertical residential purchase and sale” contracts, real estate entities develop and perform the launching of building projects, with sales of units occurring before the beginning of the construction, i.e., off-plan sale. Units that are not sold before the construction are kept in stock until they are finally sold.

A real estate entity (developer) is the one that develops and sells real estate units to be constructed to which notional fraction of the land is attributed. Although possible before construction is completed, the general practice is that the title of the land and also any part of the total construction will be passed to the customer when the construction is completed. Moreover, all units under construction are in a condominium regime that normally is specified as so after conclusion of construction.

According to the [local laws], the contract gives to the customer an in rem right to the real estate unit under construction. It means that the customer is able to resell this right, to pledge it, and so on.

At contract inception, the buyer controls the majority of economic benefits arising from the asset (cash flows), although the customer does not have yet physical possession, because the unit is under construction and, therefore, the unit is not ready for use (housing, lease etc)³. After signing the agreement, the buyer is exposed to the market value changes (appreciation or depreciation) of its residential unit under construction. The buyer may resell the residential unit under construction to third parties upon a credit risk analysis of the new buyer by the real estate entity, in case the entire price of the unit has not been completely paid yet (in case the total price of the unit is totally paid, the real estate developer cannot impose any restriction to the transaction). Real estate entities have the obligation to deliver a completed real estate unit as specified in the contract. The real estate developer cannot change the original project, unless all customers approve the change, meaning that each customer is buying a residential unit, but not an option to buy it in a future time period.

Customer generally pays around 20-30% of the purchase price of the apartment during the construction phase based on a payment schedule agreed upon between the parties at contract inception. The real estate entity holds legal title of the unit as a form of credit protection against the customer's failure to pay according to contract's provisions. So, holding legal title of property is a way of protecting itself against customer's failure to pay according to the terms of the contract.

After construction is physically completed, the customer settle the remaining balance payable to the real estate entity in cash or through a loan funded by a financial institution; in the latter, customer is once more subjected to a credit risk analysis, but this time by the financial institution, then he/she receives the property title of the unit, but the financial institution holds mortgage rights over it.

Under [local] law applicable to Real Estate Development, the contract is irrevocable, meaning that the agreement is binding on both parties (customers and real estate developer). In other words, at inception the agreement does not involve the acquisition of a right to buy

³ Once the unit is a work-in-progress no one can use it, either the company neither the buyer.

the unit in the future (it is not a call option), but instead involves the purchase of the real estate unit itself. Moreover, under the Real Estate Development Law there is no possibility to cancel the agreement.

Although the contract is irrevocable under the Real Estate Development Law, court decisions have accepted cancellation of the contract in specific circumstances, that is, under proof of customer's financial incapacity to fulfil the terms of the contract. Those circumstances would emerge, for instance, if the customer loses his/her job. Nonetheless, cancellations are part of the entity's business model and it does not change the business model of off-plan sale of real estate units. In other words, given that the industry has a long operating cycle, although a customer's credit analysis is done at contract inception, conditions may change over time. So, in order to be able to cancel a contract, buyers would have to demonstrate that they are financially incapable to comply with their obligations under the contract.

According with IFRS 15 item 9, an entity shall identify a contract and the revenue recognition process only begins if the five criteria stated are met, which includes the item 9(e): "it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer." Moreover, according with IFRS 15 item 13: "If a contract with a customer meets the criteria in item 9 at contract inception, an entity shall not reassess those criteria unless there is an indication of a significant change in facts and circumstances." The current understanding is that in our jurisdiction at contract inception the criteria 9(e) is met.

In the event of a **contract cancellation**, customers are entitled to reimbursement of payments made (generally 80-90%) and the other part (10-20%) is kept by the real estate entity as a termination penalty. After cancellation, the real estate entity has the right to enter into a new contract with a new buyer, so it can readily direct this unit to the new customer, without incurring significant costs. Moreover, although the real estate entity will receive the unit back, it will not have an enforceable right to payment for performance completed to date, in the event of contract cancellation (that has been accepted by courts in case of customer's financial incapacity to meet the contractual provisions).

On the other hand and under certain circumstances, for instance, if the real estate developer fails to comply with its obligations under the contract, buyers may decide as a group to notify the entity to fulfil its obligations in a 30 days deadline. If the default is not cured within the term provided by law, buyers have the ability given by law to remove the real estate

developer and hire another one to complete the construction of the real estate project. These circumstances arise not only if the real estate company goes bankrupt, but also if the real estate entity fails to perform key obligations under the agreement (project flaws) or fails to cure significant delays. So this aspect of the Real Estate Development Law is not exclusively a guarantee against bankruptcy of the real estate developer.

The uncertain future event of cancellation of a contract would be treated as follows:

- a) Through the analysis of each contract; or
- b) Through an overall analysis of the estimate of cancellations of customers portfolio (i.e. adjusted time series)

In both cases, the necessary adjustments in financial statements would be made in order to reflect the risk of not receiving the consideration contracted with the customer.

Considering the Real Estate Development Law, economic environment and the contractual characteristics described, we ask:

For the residential multi-unit type of contracts summarized above, should the real estate entity apply paragraph 35 (b) or 35 (c) to define the timing of revenue recognition?

Current Practice:

Currently, the POC method is being used for accounting of “purchase and sale” contracts. Auditors add an emphasis of a matter affirming that financial statements of real estate entities do not state compliance with “IFRS as issued by the IASB”, but instead, in accordance with “IFRS applicable to real estate entities in our jurisdiction” and this situation has been endorsed by the stock market regulator, but it disagrees with this emphasis of a matter. Nevertheless, the POC method has been considered by real estate entity and stock market analysts the preferred method for recognising revenue because it provides information that is useful for investment decisions by users of financial statements.

Reasons for the IFRS IC to address the issue:

The real estate industry has a long operating cycle, which demands from the managers constant monitoring over the building projects. The focus of the industry is to keep the gross margins of the project as a whole over time. Any variations between the expected costs and the costs incurred tend to be offset in the selling price of the remaining units. If

all units were sold before the construction begins, the real state entity bears the risk of cost variations in the future.

Real estate residential contracts and legal environment may vary from jurisdiction to jurisdiction, although challenges observed in our jurisdiction may also be observed in many other countries which further motivate this request. This is a critical issue that must be taken into consideration when applying IFRS. Additionally, there have been differing views on the use of items 9(e), 35(b) and 35(c) of IFRS 15 for the real estate industry.

As we could identify after researching the subject (application of IFRS 15 to real estate entities in other IFRS jurisdictions), Malaysia⁴ has decided to account for its real estate contracts by applying the “POC method”, meaning that the performance obligation is satisfied **over time** in its real estate contracts⁵.

Our jurisdiction is committed to fully comply with IFRS. Its accounting and auditing environment (regulation and supervision system) is periodically assessed by multilateral organizations such as the International Monetary Fund and the World Bank and it would be unfavorable for the soundness of our stock market to have a “carve-out” disclaimer regarding IFRS 15 application. Considering this fact, we would respectfully appreciate the IFRS IC opinion on this topic.

As stated above, the application of items 35(b) and 35(c) of IFRS 15 have been challenging. The consideration of the topic by IFRIC might contribute to the clear understanding of these requirements not only in [our country], but also in other jurisdictions that might face similar challenges.

⁴ [<http://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/malaysia/>]

⁵ FRSIC Consensus 25 - Application of MFRS 15 “Revenue from Contracts with Customers” on Sale of Residential Properties, issued by the Malaysian Institute of Accountants (“MIA or Institute”) on 30 July 2015.