

Technical Accounting Alert

Interpretation 15 Agreements for the Construction of Real Estate

Introduction

On 3 July 2008 the International Financial Reporting Interpretations Committee (IFRIC) published IFRIC 15 *Agreements for the Construction of Real Estate* (IFRIC 15).

This was released in Australia by the AASB as Interpretation 15 in August 2008.

Publication of the Interpretation was prompted by the desire to standardise accounting practice for agreements to sell real estate before construction is complete. Such arrangements include 'off-plan' sales by real estate developers of apartments or houses (sales before completion of the apartments or houses). Standardisation is considered necessary because two different views have arisen as to the applicable revenue recognition standard:

1. some have considered off-plan sale agreements to be construction contracts and accounted for them under AASB 111 *Construction Contracts* with revenue being recognised by reference to the stage of completion as construction progressed;
2. others have accounted for them as sales of goods under AASB 118 *Revenue*, with revenue being recorded when control and the risks and rewards of ownership had been transferred to the buyer (typically when the unit is ready for occupation and handed over to the buyer).

Issues addressed

Interpretation 15 notes that an agreement for the delivery of goods or services in addition to the construction of real estate may need to be split into identifiable components, which are accounted for separately. The accounting for the real estate component then follows the guidance in Interpretation 15.

Interpretation 15 then addresses two issues concerning agreements for real estate sales before construction is complete:

- Is the agreement within the scope of AASB 111 or AASB 118?
- When should revenue from the construction of real estate be recognised?

Consensus

Interpretation 15 states that the answer to these two questions will depend on the terms of the agreement and the surrounding facts and circumstances, and will require the exercise of judgement.

Does AASB 111 apply?

Interpretation 15 states that AASB 111 will be applied where an agreement for the construction of real estate meets the definition of a construction contract ('a contract specifically negotiated for the construction of an asset or a combination of assets...' (AASB 111.3)). Interpretation 15 explains that this definition will be met when the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (irrespective of whether the entity exercises that ability or not).

If AASB 111 applies revenue should be recognised by reference to the stage of completion of the construction.

An agreement in which construction could take place independently of the agreement and where buyers have only limited ability to influence the design of the real estates, or can specify only minor variations to the basic design, will not meet the definition of a construction contract. It should therefore be accounted for under AASB 118.

Where the agreement is within the scope of AASB 118

Where an agreement does not meet the definition of a construction contract and therefore falls within the scope of AASB 118, it is necessary to consider whether the agreement is for the rendering of services or for the sale of goods.

Interpretation 15 suggests that an agreement may be for the rendering of services if the supplier does not provide the construction materials. If the supplier is required to provide both services and materials to fulfil its obligations, the agreement is for the sale of goods.

Agreement for the rendering of services

If the agreement is for the rendering of services (such as the provision of property management services), revenue should be recognised by reference to the state of completion of the transaction in accordance with AASB 118.20. The pattern of revenue recognition is therefore consistent with AASB 111's requirements.

Agreement for the sale of goods

Where the agreement is for the sale of goods, then the revenue recognition criteria set out in AASB 118.14 apply. In particular, revenue is recognised only when control and the risks and rewards of ownership have transferred to the buyer.

In some cases control and the significant risks and rewards of ownership of the work in progress are continuously transferred to the buyer as construction progresses. If so, revenue should be recognised in accordance with the stage of completion of construction (subject to the other criteria set out in AASB 118.14 being met). The pattern of revenue recognition will then be broadly consistent with AASB 111. Interpretation 15 does not provide any further guidance on how to determine if control and risks and rewards are continuously transferred to the buyer. Our preliminary analysis is that this is rarely the case for off-plan sale agreements.

More typically control and the significant risks and rewards of ownership of the real estate will transfer in entirety to the buyer at a single point in time (eg on completion or upon or after delivery of the real estate). Interpretation 15 specifies that in such a scenario, revenue will only be recognised when that point in time is reached (subject to the other criteria in AASB 118.14 being met).

Flow chart and illustrative examples

To assist preparers in applying Interpretation 15, a flow chart and illustrative examples have been included in it.

Effective date and transition

Interpretation 15 must be applied for annual periods commencing on or after 1 January 2009. Earlier application is permitted.

Further information

For further information on any of the information included in this TA alert, please contact your local Grant Thornton Australia representative or a member of the National Audit Support team at NAS@grantthornton.com.au