The year began quietly with few major developments relating to standards, but March has seen a whole series of projects coming to fruition. Some of these are highly concrete, with three very detailed decisions published by the IFRS IC on the application of IFRS 15, which we explore in our ‘A Closer Look’ feature. Others are much more conceptual, such as the publication of the IFRS Conceptual Framework, and still others are forward-looking and are prompted by the European Union’s action plans on sustainable development and the fitness of public reporting by companies.

Meanwhile, the European standards adoption process has started up again, with no fewer than five documents adopted into EU law since this February. At the last count published by EFRAG, there are still six documents due to be adopted in the near future and in time for entities to be able to apply them at the IASB’s proposed effective date.

Enjoy your reading!

Edouard Fossat
Isabelle Grauer-Gaynor
**Proposed amendments to IAS 8**

On 27 March, the IASB published proposed narrow-scope amendments to IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors.

The amendments aim to provide clarifications on retrospective application of a change in accounting policy resulting from an agenda decision published by the IFRS Interpretations Committee (IFRS IC).

An agenda decision is a decision published by the IFRS IC explaining why it decided not to make any modifications or additions to IFRSs following consideration of a particular question put to the committee.

These decisions are not mandatory requirements like standards or interpretations, but they often include useful explanations on how to apply IFRSs. Thus, agenda decisions may result in an entity voluntarily changing its accounting policy (without this necessarily constituting a prior period error correction).

The proposed amendments clarify that, when a change in accounting policy is applied retrospectively following the publication of an agenda decision by the IFRS IC, an entity shall consider the ratio of costs to benefits for users of the financial statements, as well as whether retrospective application is practicable. In other words, retrospective application of the change in accounting policy is only mandatory if the benefits for users of the financial statements exceed the cost to the entity of implementing retrospective application.

The comment period is open until 27 July 2018 and the amendments can be accessed on the IASB’s website via the following link:


**The new Conceptual Framework is here!**

On 29 March 2018, the IASB published its revised Conceptual Framework. As well as updating some concepts to reflect changes to the standards in recent years, such as the definitions of assets and liabilities, the revised version provides guidance on issues that were touched on only briefly or not at all in previous versions, notably measurement bases and the presentation of financial performance. The new Conceptual Framework will not revolutionise current practice but will provide a more solid basis for it, although IFRS standards still take precedence.

The new Conceptual Framework is accompanied by amendments that update references to the Conceptual Framework in IFRSs.

Both documents are available to premium subscribers on the IFRS Foundation’s website.

We will explore the content of the new Conceptual Framework in a forthcoming issue of Beyond the GAAP.

**Costs considered in assessing whether a contract is onerous (IAS 37)**

In November 2017, the IFRS Interpretations Committee (IFRS IC) decided to add a narrow-scope standard-setting project to its agenda, with the objective of clarifying the meaning of the term “unavoidable costs” in the definition of an onerous contract in IAS 37 – Provisions, Contingent Liabilities and Contingent Assets.

At its March meeting, the Committee continued its discussions on the subject, taking into account the comment letters on the project, and recommended that the IASB should:

- specify that the “cost of fulfilling” a contract comprises the “costs that relate directly to the contract”;
- provide examples of costs that do and do not relate directly to a contract; and
- provide these clarifications as a narrow-scope amendment to IAS 37, rather than as an interpretation or as part of the IFRS annual improvements process.

After considering the comment letters submitted, the staff was of the opinion that the concept of “unavoidable costs” in IAS 37 should be aligned with the “costs incurred in fulfilling a contract” as defined in IFRS 15 – Revenue from Contracts with Customers (and IFRS 17 – Insurance Contracts).

In practice, the Committee’s current stance on onerous contracts is similar to that in the old IAS 11 – Construction Contracts (broadly consistent with the cost of fulfilling a contract in accordance with IFRS 15). It is no longer considering offering entities an accounting policy choice between this approach and an “incremental costs” approach, as it did in its tentative agenda decision published in the June 2017 IFRIC Update.

A summary of the most recent IFRS IC discussions is available at the following link:

European highlights

Adoption of amendments to IFRS 2 on the classification and measurement of share-based payment transactions

On 26 February 2018, the European Commission adopted amendments to IFRS 2 – Share-based Payments. Readers will remember that these amendments, published by the IASB on 10 June 2016, provided clarifications of the following issues:

- The impact of vesting conditions and non-vesting conditions on the measurement of cash-settled share-based payment transactions: when measuring the liability for a cash-settled plan, vesting conditions and non-vesting conditions shall be taken into account in the same way as for an equity-settled plan.

- Classification of share-based payment transactions with a net settlement feature for withholding tax obligations: this type of plan shall be classified in its entirety as equity-settled (including the net settlement feature) if the plan would have been settled entirely in equity instruments in the absence of such a feature.

- Modifications to the terms and conditions of a cash-settled plan that change the classification of the transaction from cash-settled to equity-settled. If the terms and conditions are modified in this way:
  - the fair value of the transaction is measured by reference to the fair value of the equity instruments granted at the modification date;
  - the liability for the cash-settled plan is derecognised and the equity-settled plan is recognised in equity to the extent to which services have been rendered (i.e. pro rata); and
  - the difference between the carrying amount of the liability derecognised and the amount recognised in equity is recorded in profit or loss.

The amendments were published in the OJEU on 27 February and become mandatory for financial periods commencing on or after 1 January 2018. Regulation (EU) 2018/289 is available via the following link: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0289&from=EN

Adoption of amendments to IAS 40


These amendments clarify that an entity shall transfer a property to, or from, the "investment property" category when, and only when, there is a change in use of the property, i.e. the property meets or ceases to meet the definition of investment property and there is evidence of the change in use.

The amendments also specify that:

- a change in management's intention does not in isolation constitute evidence of a change in use; and

- the indicators in paragraph 57, points a) to d) are only examples (i.e. the list is not exhaustive).

The amendments were published in the OJEU on 15 March 2018 and become mandatory for financial periods commencing on or after 1 January 2018.

Regulation (EU) 2018/400 is available via the following link: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0400&from=EN

Adoption of amendments to IFRS 9

On 22 March 2018, the European Commission adopted amendments to IFRS 9 – Financial Instruments, entitled Prepayment Features with Negative Compensation, which were published by the IASB on 12 October 2017. The amendments clarify the classification of certain financial assets that may be prepaid (see Beyond the GAAP no. 115, October 2017). Their adoption is timely, as it coincides with first-time application of IFRS 9 and means that entities will not have to apply transitory arrangements for the first quarter of 2018.

The amendments were published in the OJEU on 26 March 2018 and become mandatory for financial periods commencing on or after 1 January 2019. Early application is permitted.

Regulation (EU) 2018/498 is available via the following link: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0498&from=EN
Adoption of IFRIC 22 interpretation

On 28 March 2018, the European Commission adopted interpretation IFRIC 22 – Foreign Currency Transactions and Advance Consideration, which was published by the IASB on 8 December 2016 and which clarifies the accounting treatment of foreign currency transactions that include the payment or receipt of advance consideration (see Beyond the GAAP no. 106, December 2016). The amendments were published in the OJEU on 3 April 2018 and become mandatory for financial periods commencing on or after 1 January 2018.

Regulation (EU) 2018/519 is available via the following link: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0519&from=EN

Adoption of the 2014-2016 cycle of Annual Improvements

On 7 February 2018, the European Commission adopted the Annual Improvements to IFRS 2014-2016 Cycle, which were published by the IASB on 8 December 2016 and comprise minor amendments to the following standards:

- IAS 28 – Investments in Associates and Joint Ventures;
- IFRS 12 – Disclosure of Interests in Other Entities; and
- IFRS 1 – First-time Adoption of International Financial Reporting Standards.

The amendments to IFRS 1 and IAS 28 are mandatory for financial periods commencing on or after 1 January 2018, while the amendments to IFRS 12 should already have been applied to financial periods commencing on or after 1 January 2017 as Regulation (EU) 2018/182 was published in the OJEU on 8 February 2018, i.e. before the date on which the financial statements are authorised for issue. It is available via the following link: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0182&from=EN

EFRAG continuing work on the accounting treatment of investments in equity instruments under IFRS 9


This is part of its ongoing work to respond to a request for technical advice from the European Commission. This request, which arose from the IFRS 9 European adoption process, has two distinct phases.

The first phase involved collecting quantitative information on equity instrument investment portfolios held by long-term investors, and estimating the potential impact of the new IFRS 9 requirements on these portfolios.

Under IFRS 9, the default option is for equity instruments to be measured at fair value through profit or loss. However, they may optionally be measured at fair value through other comprehensive income. This option differs from the IAS 39 “Available for sale” category in two respects: firstly, gains or losses in OCI are allocated directly to retained earnings and never recognised in profit or loss. Secondly, the standard no longer includes an impairment model.


The second phase, which includes the recent Discussion Paper, has two main objectives: first of all, to assess whether the existence of an impairment model is an important element in the re-introduction of recycling of gains and losses; and secondly, if it is an important element, to identify the key characteristics of such an impairment model.

In the Discussion Paper, EFRAG presents arguments for the importance of an impairment model for re-introducing recycling of gains and losses. EFRAG proposes two possible models:

- a “revaluation model”, under which changes in fair value below the original acquisition cost are recognised in profit or loss, and changes in fair value above the original acquisition cost are recognised in OCI and recycled to profit or loss on disposal;
- an impairment model similar to IAS 39 (using the “significant or prolonged decline in fair value” criterion), with some amendments to reduce subjectivity.

EFRAG’s Discussion Paper may be downloaded via the link below, and the comment period is open until 25 May 2018: https://www.efrag.org/News/Project-308/New-EFRAG-Discussion-Paper-on-Equity-Instruments—Impairment-and-Recycling

In addition to the Discussion Paper, EFRAG has also published an academic literature review on the interaction of IFRS 9 and long-term investment decisions, which was carried out on its behalf by independent experts. The review focuses primarily on papers published in accounting and finance journals since 2005 and identifies several themes, including the pros and cons of recycling, the factors that influence investment strategies, and so on.

The literature review is available here: http://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FAcademic%2520literature%2520review%2520on%2520IFRS%2520and%2520long-term%2520investment%2520decisions.pdf
Quantified impacts of IFRS 9: initial findings for the European banking sector

IFRS 9 – Financial instruments, effective since 1 January 2018, introduces numerous changes (in terms of classification, measurement and hedging) which will impact the financial statements of financial institutions.

At the end of February 2018, all major European banks published information on the consequences of IFRS 9 implementation. At the date of transition, the impacts are highly variable across banks, negative for most of them, close to nil for some and sometimes even positive. The indicators presented also vary: whilst the CET1 ratio is a solid common indicator, the level of detail which is provided beyond that ratio varies significantly across the sample.

The results of this study, which covers the 30 lead European banks publishing their financial statements under IFRS, are available on the mazars.com website at the following address:

EFRAG publishes three background briefing papers on insurance contracts

In February and March 2018, EFRAG published three background briefing papers on IFRS 17 – Insurance Contracts, as part of its evaluation of the standard in the run-up to adoption by the European Union. The aim of these briefing papers is to provide simplified explanations of complex and controversial areas of the standard to enable stakeholders to understand the issues and be in a position to comment on EFRAG’s draft endorsement advice.

The topics addressed in the three briefing papers are:

- the level of aggregation of insurance contracts;
- the release of the contractual service margin (CSM, the profit on a group of insurance contracts) to profit or loss; and
- the transition requirements of the standard.

The three documents are available on EFRAG’s website via the following link:
http://www.efrag.org/Activities/289/IFRS-17---Insurance-Contracts#

EFRAG also published a simplified case study in February 2018. It is available on the same webpage as the briefing papers, and entities are invited to complete it by 31 May 2018.

European Commission publishes EU action plan on financing sustainable growth

Following publication of the report by the High-Level Expert Group on Sustainable Finance (see Beyond the GAAP no. 119, February 2018), the European Union published its action plan on financing sustainable growth on 8 March 2018.

The action plan has three aims:

- to reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth;
- to manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and
- to foster transparency and long-termism in financial and economic activity.

Readers of Beyond the GAAP will be particularly interested in those actions relating to the third aim, which are as follows:

- Strengthening disclosure and accounting rule-making, by introducing a fitness check on corporate reporting (see following 'Highlight'); revising the guidelines on non-financial information in the first half of 2018; establishing a European Reporting Lab as part of EFRAG during 2018; requesting asset managers and institutional investors to disclose how they consider sustainability factors in their investment and strategic decision-making processes; and requesting EFRAG to assess the impact of new or revised IFRSs on sustainable investments. On this last point, the Commission will also take account of EFRAG’s work on equity instruments measured at fair value through other comprehensive income under the new IFRS 9 (see ‘Highlight’ above).

The action plan also includes an evaluation of the sustainable development aspects of IAS Regulation 1606/2002, and raises the possibility of making modifications to IFRSs as part of the European adoption process, if they are deemed not to be conducive to the European public good because they pose an obstacle to long-term investment objectives.

- Fostering sustainable corporate governance and attenuating short-termism in capital markets. To achieve this, the European supervisory authorities are invited to collect evidence of undue short-term pressure from capital markets on corporations and to consider steps that could be taken to limit this.

The action plan will be implemented over 2018 and 2019.

The full text of the document is available via the following link:
European Commission launches fitness check on public reporting by companies

Following publication of its roadmap in February 2018 (see Beyond the GAAP no. 119, February 2018), the European Commission launched an online consultation on 21 March to assess whether the European legislative and regulatory framework on financial and non-financial reporting by companies still meets the EU’s objectives of:

- ensuring stakeholder protection;
- developing the internal market;
- promoting integrated EU capital markets;
- ensuring financial stability; and
- promoting sustainability.

The questionnaire covers the various reporting requirements for all European companies, from financial statements to management reports to non-financial reporting and country-by-country reporting. The questions are divided into sections assessing the fitness of:

- the EU public reporting framework overall;
- the financial reporting framework applicable to all EU companies;
- the EU financial reporting framework for listed companies;
- the EU financial reporting framework for banks and insurance companies;
- the non-financial reporting framework; and
- the challenge posed by digitalisation of information.

Responses must be submitted through the online questionnaire at the following link by 21 July 2018: https://ec.europa.eu/info/consultations/finance-2018-companies-public-reporting_en.

However, the European Commission has also provided a downloadable, printable version of the questionnaire for reference, available here: https://ec.europa.eu/info/sites/info/files/2018-companies-public-reporting-consultation-document_en.pdf

Crossword: last month's solution

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Crossword: What kind of partner are you?

Across
3. This consolidation method has been eliminated under IFRS 11
5. The way in which it is shared does not in itself determine whether a joint arrangement as defined in IFRS 11 exists
7. If a joint arrangement is structured through such a vehicle, classification is more complicated
8. Noun in the name of the joint arrangement in which the parties that have joint control have rights to the assets and obligations for the liabilities
10. An entity’s interests in an arrangement shall only be remeasured if it obtains it
12. The shareholders that have joint control of an arrangement must have such rights to the assets, and obligations for the liabilities, relating to the arrangement in order for it to be classified as a joint operation
13. The number of the standard that covers disclosures relating to joint arrangements
16. When determining how the arrangement is classified, it is important to take into account whether the entity that is the subject of the arrangement sells this to the parties to the arrangement
17. Noun in the name of the second type of joint arrangement covered by IFRS 11

Down
1. The way in which it is shared does not in itself determine the classification of a joint arrangement
2. In a joint arrangement, any decision relating to the relevant activities must be this
4. The provision of these to third parties does not in itself determine that a joint arrangement is a joint operation
6. The type of joint arrangement will affect this in the financial statements under IFRS 11
9. The existence of this type of voting rights may affect whether a joint arrangement as defined in IFRS 11 exists
11. Such control is necessary but not sufficient for an arrangement to be classified as a joint arrangement
14. Number of types of joint arrangement under IFRS 11
15. Parties must have such control for an arrangement to be covered by IFRS 11
A Closer Look

The IFRS Interpretations Committee publishes three important decisions on IFRS 15

In recent months, the IFRS Interpretations Committee has received three referrals on the application of IFRS 15 to specific fact patterns in the real estate development sector. The Committee finalised its positions during its March 2018 meeting and published three decisions all deciding not to add the matter to its standard-setting agenda.

These decisions are interesting on several grounds, apart from the formal responses in the individual cases:

- they are drafted in great detail with educational intent, since the Committee is well aware that the current period is critical (i.e. transition to a major standard that is unlikely to be fully mastered by everyone concerned);
- they provide valuable clarification on two major aspects of IFRS 15: identifying the performance obligations of the contract, and demonstrating the transfer of control over time.

In these respects, their scope extends far beyond the real estate development sector alone.

It should be noted that the Committee debated the relevance of responding to very specific questions to which the answers would be closely bound to the particular context in which they were asked. The Committee decided that it was important to respond, once again in light of the timetable and the recent entry into force of IFRS 15. The Committee is nevertheless aware that its role is not to provide answers to all the practical questions raised by the introduction of IFRS 15 when they relate to a context specific to a given jurisdiction. The Committee has also sought to word its answers in such a way that they cannot be improperly used in situations which would deserve a different analysis, given the different facts and circumstances.

Finally, the staff have noted in the agenda papers, in response to comments from some stakeholders following the publication of the related tentative agenda decisions, that the Committee had no need to question the relevance of the conclusion it had reached, in particular in the case where its analysis would lead to recognition of revenue at completion and no longer as work progresses. The IASB has developed principles that must be applied in a consistent manner to all activities, even if this leads to a major change to current practices. The Committee therefore has no right to amend the principles defined by the IASB and considered that the existing provisions of IFRS 15 were sufficient to offer a response to the queries raised.

1. Sale before completion: is the land distinct from the building?

The Committee first discussed this question in November 2017. Eight responses were received as a result of the call for comments that followed the tentative decision not to add this matter to the agenda.

The contract in question relates to the sale before completion of a residential building to a single customer, and includes the sale of the land. The main question relates to the identification of the performance obligations in this contract.

The Committee first recalled the principles set out in IFRS 15, referring both to the relevant paragraphs of the standard (22-30) and to the Bases of Conclusion, all clarified during the publication of amendments to IFRS 15 in April 2016.

The Committee stressed that paragraph 27, which sets out the two conditions that must be met in order to conclude that a good or service is “distinct”, requires the use of judgment:

(a) the customer can benefit from the good or service either on its own or together with other readily available resources (that is, the good or service is capable of being distinct);
(b) the entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract).

The Committee also recalled that assessing the distinct nature of a good or service “within the context of the contract” (the second condition) is influenced by the notion of separability of the risks relating to each of the services promised in the contract that the entity has promised to transfer.

Finally, the Committee stressed that an entity should evaluate whether there is a “transformative” relationship between the promised goods and services rather than considering whether one item depends on the other (i.e. demonstrating that two items have a functional relationship). The objective of the standard is to determine whether the nature of the promise made to the customer is to transfer each of the promised goods or services individually or, instead, to transfer a combined item to which those goods or services are inputs.
In the present case, the Committee conducted the following analysis:

- **First condition: can the land be considered distinct when taken in isolation?**

  The Committee answered this question in the affirmative, observing that a customer could benefit from the land on its own by hiring another developer to construct the building on the land.

- **Second condition: is the land "distinct in the context of the contract"?**

  To answer this question, the Committee considered the factors provided by paragraph 29 of the standard, indicating, as explained in the Bases of Conclusion, that these are just factors and not criteria, and that they are not necessarily relevant in every case.

  The Committee concluded that, while there is a functional relationship between the land and the building, since the building cannot exist without the land, the transformative relationship has not been demonstrated; the risks assumed by the entity when it transfers the land to the customer do not seem inseparable from the risks assumed by the entity when it constructs the building. It also appears that the entity's performance in constructing the building would be the same regardless of whether it has previously transferred to the customer the land on which the building will be constructed.

  The Committee therefore concluded that the second condition of IFRS 15 is satisfied if the entity concludes that:

  - its performance in constructing the building would be the same regardless of whether it also transferred the land, and
  - it would be able to fulfil its promise to construct the building even if it did not also transfer the land (and vice-versa).

  Therefore, although the Committee did not explicitly conclude that a sale before completion of land and a building in the same contract with a single customer must give rise to the recognition of two performance obligations, in practice its guidelines lead to this conclusion.

  In its deliberations, the Committee stressed the fact that the conclusion of its analysis was closely related to the case in question.

  In its decision not to add this matter to its standard-setting agenda, the Committee also considered the obligating event triggering the recognition of revenue for this contract. The analysis and the conclusion reached by the Committee are discussed at point 2.1. below.

## 2. Sale before completion: when should revenue be recognised?

The three agenda decisions published in March 2018 all relate, either directly or indirectly, to the analysis of the obligating event for the recognition of revenue.

In other words, these three decisions all help to clarify how to interpret the IFRS 15 requirements on the transfer of control to the customer, and in particular how to apply paragraph 35.

Readers will recall that, under this paragraph, an entity transfers control of a good or service over time and, hence, satisfies a performance obligation and recognises revenue over time if at least one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs;
- (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;
- (c) the entity's performance does not create an asset that the entity could use in any other way, and the entity has an enforceable right to payment 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.

### 2.1. Sale before completion of a residential complex to a customer with immediate transfer of legal title to the land

This is the continuation of the question considered at point 1. above.

The background is as follows:

- The contract concluded between the entity and the customer is non-cancellable.
- At contract inception, the entity irrevocably transfers to the customer legal title to the land on which the entity will construct the building. The customer pays for the land immediately.
- Before the contract is signed, the parties agree upon the structural design and specification of the building (which may be subsequently amended at the request of either party, in accordance with the circumstances and conditions stipulated in the contract).

The customer is required to make milestone payments throughout the construction period. However, these payments do not necessarily correspond to the amount of work completed to date.

The Committee analysed the three (non-cumulative) criteria set out in IFRS 15 paragraph 35 in order to determine whether the transfer of control of the land, on the one hand, and the building, on the other, happens over time (this analysis must be conducted separately for each of the
The Committee observed that:

- the demonstration of an enforceable right to payment.

In this instance, the Committee concludes that the transfer of control of the land takes place at inception, when the contract is signed.

The Committee finds that the criterion in paragraph 35(a) does not apply to the building, because the transferred asset is not consumed immediately by the customer. It then immediately concludes that the criterion in paragraph 35(b) applies, since the building is constructed on land that the customer controls. The customer therefore takes control of the building as it is being constructed. This practical illustration of the criterion in paragraph 35(b) is clearly envisaged by the standard’s Bases for Conclusion.

**2.2. Sale before completion of a real estate unit, where the customer has the right to an undivided ownership interest in the land and the residential complex under construction and where the case law as regards termination of the contract is not favourable to the entity**

The Committee first discussed this question in November 2017. This raised other questions on IFRS 15 in the real estate development sector (discussed in November 2017 and also presented in this article). This decision is therefore the most detailed in terms of the texts on the transfer of control over time.

Forty responses were received as a result of the call for comments that followed the tentative agenda decision. Of these responses, 28 came from the real estate development sector in Brazil, the country in which the referral originated. The Brazilian regulator also responded, indicating that it disagreed with the legal interpretation of the case submitted. This illustrates the difficulty of the analyses to be conducted, and the risks of “extrapolating” from a position taken in a specific jurisdiction.

Following a lengthy reminder of the IFRS 15 requirements on the transfer of control over time, the Committee made two important observations. They enable us to understand the basis of the analysis in the case in question, and more generally, the appropriate way to apply IFRS 15.35(c) on the demonstration of an enforceable right to payment.

The Committee observed that:

- although an entity need not undertake an exhaustive search for evidence, it would be inappropriate for an entity to either ignore evidence of relevant legal precedent available to it or to anticipate evidence that may or may not become available in the future. IFRS 15 states that in assessing whether an entity has an enforceable right to payment, the entity considers the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms;

- the assessment of enforceable rights as described in paragraph 35(c) is focused on the existence of the right and its enforceability. The likelihood that the entity would exercise the right is not relevant to this assessment. For example, if a customer has the right to terminate the contract, the likelihood that it would do so is not relevant to the assessment required by IFRS 15.35(c).

These observations are fundamental, quite apart from the consequences they have for the particular case studied by the Committee.

The Committee also stresses that determining the obligating event for revenue recognition requires a case-by-case analysis, taking account of the jurisdiction in which the contract is enforceable. Conclusions may therefore vary from one situation to another, depending on the facts and circumstances.

In the present instance, the real estate development contract has the following characteristics:

- The real estate unit sold is specifically identified in the contract and cannot be substituted by the entity.
- The entity retains legal title to the real estate unit (and any land attributed to it) until the customer has paid the purchase price after construction is complete.
- The customer pays a portion of the purchase price as the unit is being constructed, and pays the remainder (a majority) after construction is complete.
- The contract gives the customer the right to an undivided interest in the land and the multi-unit complex under construction.
- The customer cannot cancel the contract.
- Nor can it unilaterally change the structural design of the complex or the individual unit. The customer, and the other customers who have agreed to buy real estate units in the same multi-unit complex, have the right to together decide to change the structural design of the complex and negotiate such change with the entity.
- The customer can resell or pledge its right to the undivided interest in the land and the complex as the complex is being constructed, subject to the entity performing a credit risk analysis of the new buyer of the right.

Furthermore:

- If the entity is in breach of its obligations under the contract, the customer and the other customers have the right to together decide to replace the entity or otherwise stop the construction of the complex.
- Although the contract is irrevocable, courts have accepted requests to cancel contracts in particular circumstances, for example when it has been proven that the customer is not financially able to fulfil the terms of the contract (if, for example, the customer becomes unemployed or has a major illness that affects the customer’s ability to work). In these situations, the contract has been cancelled and the customer has received back most, but not all, of the payments it has already made to the entity. The entity has retained the remainder as a termination penalty.
In the view of the Committee, this last point provides evidence of legal precedent which is relevant to the assessment of the entity’s enforceable right to payment as described in paragraph 35(c).

Having rapidly set aside the criterion of paragraph 35(a) which is not satisfied (see the remark in section 2.1. above), the Committee analyses the facts and circumstances in the light of the requirements of the criterion in paragraph 35(b). It concludes that:

- although the customer can resell or pledge its contractual right to the undivided interest in the land and multi-unit complex as the real estate unit is being constructed, it is unable to sell or pledge the part-constructed real estate unit itself before construction is complete;
- the customer has no ability to change the structural design of the real estate unit as the unit is being constructed, as it requires the agreement of the other customers to negotiate changes to the complex;
- the customer’s right together with the other customers to replace the entity or stop the construction of the complex solely in the event of the entity’s failure to perform as promised, is protective in nature and is not indicative of control;
- the customer’s exposure to changes in the market value of the real estate unit may indicate that the customer has the ability to obtain substantially all of the remaining benefits from the unit. However, it does not give the customer the ability to direct the use of the unit as it is being constructed.

For all these reasons, none of which takes precedence over the others, the Committee concludes that the criterion in paragraph 35(b) is not met.

Finally, therefore, the Committee analyses the factors to be taken into account to assess whether the criterion in paragraph 35(c) is met. The Committee first observes that there is a contractual restriction preventing the entity from redirecting the building to another customer. The Committee then considers whether there is a right to payment, and if it is enforceable. Given the legal precedent presented above, the Committee decided that the right to payment, although contractual, is not enforceable. This is because a court can accept a request to cancel the contract, so that the entity would only receive a termination penalty and not an amount corresponding to the transaction price of the performance completed to date.

The Committee therefore concluded that the transfer of control takes place at a point in time, rather than over time.

2.3. Sale before completion of a real estate unit: can the right to payment be assessed on an overall basis (i.e. taking account of sums obtained in the event of resale)?

The Committee first discussed this question in November 2017. Nine responses were received as a result of the call for comments that followed the tentative decision not to add this matter to the agenda.

In the present case, the customer pays 10% of the purchase price for the real estate unit at contract inception. The remainder is paid after construction is complete. The entity retains legal title to the real estate unit (and any land attributed to it) until the customer has paid the whole purchase price. The customer has the right to cancel the contract at any time. In this case, the entity is legally required to make reasonable efforts to resell the real estate unit to a third party. On resale, the entity enters into a new contract with the third party (the original contract is not novated to the third party). If the resale price to be obtained from the third party is less than the original purchase price (plus selling costs), the customer is legally obliged to pay the difference to the entity.

The question posed to the Committee is whether, in this case, the entity has an enforceable right to payment in application of IFRS 15.35(c). The Committee assumes that:

- the entity identifies a single performance obligation (i.e. no separation of the land and the building);
- the criteria 35(a) and 35(b) are not met;
- the first condition of paragraph 35(c) is met (i.e. no alternative use of the real estate).

IFRS 15.37 and the clarifications in paragraph B9 of the application guidance state that an entity has an enforceable right to payment for performance completed at a given date if it is entitled to an amount that at least compensates it for completed performance if the contract is terminated by the customer or another party for reasons other than the entity’s failure to perform as promised. An amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date (for example, recovery of the entity’s costs to fulfill the performance obligation, plus a reasonable profit margin) rather than compensation for only the entity’s potential loss of profit if the contract is terminated.

Relying on the provisions of IFRS 15, the Committee concluded that the existence of a right to payment in accordance with paragraph 35(c) must be assessed only in respect of the amount that the entity is entitled to receive under the existing contract with the customer relating to performance under that contract. Therefore, the consideration received by the entity from a third party cannot be compared with a payment for performance under the existing contract with the customer; it is consideration to which the entity is entitled relating to that resale contract.

In the event that the customer cancels the contract for reasons of convenience, the entity’s entitlement to payment corresponds to the difference between the original selling price (plus costs to resell) and the resale price to a third party (where applicable). In practice, this means that the amount to which the entity is entitled does not correspond at all times throughout the duration of the contract to an amount that approximates the selling price of performance completed to date. This consideration may well be lower in the event that the real estate under construction is sold to another customer. The second condition of paragraph 35(c)
is therefore not met. The revenue for the contract would therefore be recognised at a point in time, and not over time.

Some commentators disagree with this conclusion. They believe that the right to payment should be assessed overall (i.e. including the consideration received by the entity from both the first and second customers), without taking account of the way in which the entity is compensated and by whom. In its agenda paper, the Committee's staff indicated that it was not relevant to take both contracts into account in order to assess entitlement to payment, since they cannot be combined in application of the IFRS 15 principles on combining contracts. The staff also clarified that the important thing is not that the customer makes the payment directly to the entity, it is rather that the consideration to which the entity is entitled in the event of cancellation corresponds to the performance under the existing contract with the customer, and not the performance under another contract.

The important lessons to be learned from the Committee's positions on these three questions on situations encountered in the real estate sector form a useful addition to the guidance emerging from the work of the TRG. And it is easy to understand why the Committee should take up the baton now that the transitional phase is complete and the standard has finally (or perhaps already) come into effect. There is little doubt that the Committee will continue to receive queries about IFRS 15, given the many practical questions surrounding its application.

Key points

In March 2018, the IFRS Interpretations Committee issued a definitive position on three practical questions regarding the application of IFRS 15 to real estate activities resembling off-plan sales.

However, the scope of these decisions extends far beyond the real estate development sector alone, since they:

- Illustrate, through a practical example, how the clarifications to the standard issued in April 2016 should be applied in order to identify the performance obligations in a contract. The Committee stressed that the interdependence of two contract promises was not a sufficient basis on which to conclude that they formed a single performance obligation. An entity must demonstrate that there is a transformative relationship between the two promises, and the Committee explains how this relationship should be identified.

- Clarify how to assess the existence of an enforceable right to payment for performance to date in application of the criteria in paragraph 35(c) on the transfer of control over time. The Committee observed that:
  - Legal precedents should be taken into account, where these could affect the terms of the contract. For example, even where a contract is non-cancellable, where the courts agree to authorise cancellation by the customer for reasons other than the entity’s failure to perform as promised, this should be taken into account, and the consideration to which the entity would then be entitled must be assessed. If the customer can cancel the contract by paying a mere termination penalty and not an amount corresponding to the transaction price of the performance completed to date, the criterion of paragraph 35(c) is not met. However, the Committee also states that it is unnecessary to extrapolate where there are no legal precedents.
  - That in assessing the amount to which an entity would be entitled in the event of early termination of the contract, only the consideration due from the customer under the existing contract should be taken into account. Therefore, entities should not take an overall approach which would also include consideration that the entity could receive in the event that the good were sold to another customer, where the first customer would only have to pay the difference between the initial selling price (+ the costs of sale) and the resale price.

Given the very recent entry into force of IFRS 15, the Committee has provided an unusual amount of detail regarding both the texts and the reasoning it has applied to reach its conclusions. A further reason to take a close look at the emerging guidance on this complex standard.
Events and FAQ

Frequently asked questions

IFRS

- Accounting treatment of an intra-group share-based payment.
- Is it possible/necessary to recognise deferred tax relating to income from the subsidiaries of a professional real estate collective investment undertaking (OPPCI)?
- Does an entity which is a de facto agent fall within the scope of consolidation?
- Accounting treatment of a welcome bonus under IFRS 15.
- Lifting of performance conditions for share-based payments (IFRS 2) and business combinations (IFRS 3).

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

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