

IFRS Technical Bulletin

IFRIC 15 'Agreements for the
Construction of Real Estate'

A new Interpretation could signal a change in
revenue recognition for construction companies.

IFRIC 15 'Agreements for the Construction of Real Estate' is an Interpretation aimed at delivering more guidance on the accounting for the construction of real estate, and in particular scenarios where the Contractor generates revenue from the construction project prior to the completion date.

First-time application

IFRIC 15 was recently endorsed by the EU on 22 July 2009 and is effective for EU registered companies for accounting periods beginning on or after 26 July 2009. For those companies based outside the EU, the effective date is for accounting periods beginning on or after 1 January 2009. Early adoption is permitted.

IFRIC 15 is required to be applied retrospectively in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

Key principles

Accounting for the construction of real estate can vary depending on the underlying substance of the agreement. IFRIC 15 addresses the accounting for revenue for entities that undertake construction of real estate directly or through subcontractors. IFRIC 15 requires component accounting.

The Interpretation guides us through two points which have given rise to divergence in practice; namely (1) whether the transaction is a sale of goods or a provision of a service, and (2) the timing of the revenue recognition where the transaction is considered to be a sale of goods.

The provision of a construction service would fall within the scope of IAS 11 'Construction Contracts'. A construction service is generally understood to mean the work done on a specifically negotiated contract for the construction of an asset or combination of assets. In accordance with IAS 11, revenue is recognised based on the percentage of completion method.

The sale of a good or the rendering of a service not within the scope of IAS 11 would fall within the scope of IAS 18 'Revenue'. A sale of goods can be considered as the converse to a construction service, ie the sale of a generic non-tailored asset; but ultimately is all contracts that do not fall within the scope of IAS 11.

Revenue recognition principles depends on the nature of the sale agreement:

- If the entity is required to provide services together with construction materials in order to perform its contractual obligation, the agreement is an agreement for the sale of goods and revenue is recognised in accordance with IAS 18 paragraph 14. It should be noted that risks and rewards may either be transferred continuously throughout the project in which case revenue is recognised continuously, or where the risks and rewards of the project are only transferred at one point in time, then revenue is only recognised at that date.

- If the entity is not required to acquire and supply construction materials, the agreement may be only an agreement for the rendering of services. Revenue would be recognised in accordance with IAS 18 paragraph 20 using the stage of completion method.

The defining line – product or service, and when to recognise income

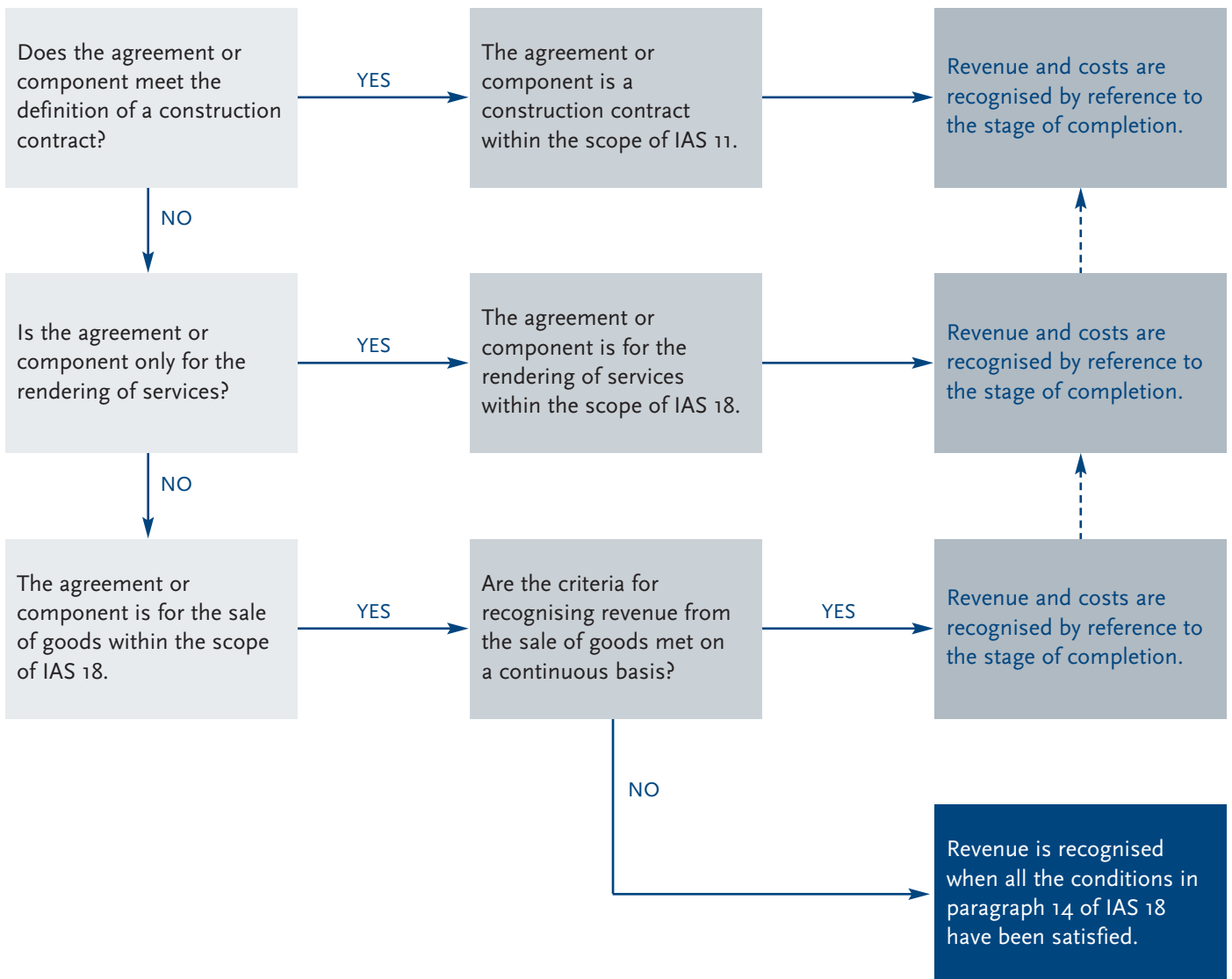
IFRIC 15 states that where the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether or not it exercises that ability), then the contract would be considered to be specifically negotiated, and would hence fall within the scope of IAS 11.

However, if the Contractor builds a housing estate, and allows the buyer for example to choose their own kitchen and bathroom, this would not meet the IAS 11 criteria. Minor decisions to personalise the property by the buyer would not pass the risk of ownership to the buyer.

A few examples

- A Contractor builds a generic housing estate and starts marketing the properties. A buyer is found and that buyer pays a deposit and potentially stage payments. In this situation, the Contractor would still be considered to retain the control of the project, and risks and rewards would not be considered to pass to the buyer until the date of completion. The sale would be accounted for in accordance with IAS 18 and revenue recognised in total at completion date.
- If the Contractor sells an 'off-plan' house. It is considered there are essentially, two components to the sale. The sale of land and the sale of the house.
 - The sale of the land would be recognised under IAS 18, whereby the land would be transferred at one point in time. Hence, the revenue would be recognised at that date.
 - The sale of the house, assuming that planning consents have been given and that all structural decisions have been made prior to sale, would also be recognised under IAS 18. On the proviso that the buyer cannot be released from the sale, the Contractor would have transferred all risks and rewards of construction to the buyer, and the revenue would be recognised on a continuous basis over the construction period.
- The Contractor sells a property and guarantees a level of rental income that the buyer will receive for the next 5 years. In this situation, the Contractor has not transferred all of its risk to the buyer. In circumstances where a Contractor has some element of continuing managerial involvement, revenue relating to that separate component should be deferred.

IFRIC 15 decision tree



Implications of IFRIC 15

IFRIC 15 could have some fundamental implications for certain companies that under the new guidance are deemed to have recognised their income either in accordance with the wrong accounting standard, or have recognised too much in advance.

The Interpretation has a fully retrospective application rule therefore companies would be required to review all active contracts to determine:

- if they still meet the recognition criteria in IAS 11, or if the contract would now fall within the scope of IAS 18,
- at what point the project risks and rewards are transferred to the buyer, and
- if any of the components of the contract are delivered after the others, which may result in an element of revenue being deferred.

Disclosure

The IFRIC brings in additional disclosure requirements for contracts that are for the sale of goods, and therefore fall within the scope of IAS 18, and where the revenue recognition criteria are met continuously throughout the project. These disclosures are similar to those required for IAS 11 construction contracts. The additional disclosures are:

- How the entity determines which agreements meet all the criteria in paragraph 14 of IAS 18 continuously as construction progresses,
- The amount of revenue arising from such agreements in the period, and
- The methods used to determine the stage of completion of agreements in progress.



M A Z A R S

Please get in touch...

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