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5th October 2007

**IASB/IFRIC
30 CANNON STREET,
LONDON EC4M 6XH,
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By Email/Post

Dear Sirs,

COMMENT ON IFRIC DRAT INTERPRETATION D21 – REAL ESTATE SALES

I appreciate the opportunity to provide my comments and views on this Draft as set out below.

To begin with, I would like to commend IASB and IFRIC for this effort as it is indeed important to provide clear guidance on the accounting treatment on property development industry as the existing standards are not clear on this aspect and different accounting treatments have been used in different countries. I take note that to come out with a standard or an interpretation on this issue could be very challenging due to different real estate laws in different countries and different terms between different agreements entered into between the sellers/developers and buyers. The type of real estate project itself can also range from a single building on a piece of land to a high rise building with strata title and common facilities and to a huge township development project.

My Views

As I understand this Draft IFRIC, the approach taken in this Draft IFRIC is that firstly one needs to evaluate if the Sales Agreement meet the definition of Construction Contract under IAS11 and if so, IAS11 should apply. If not, then it should be a sales of goods (completed real estate) where IAS18 should apply(refer to para 7)

In my understanding, it is quite clear that most if not all Sales Agreement for Real Estate Under Development do not strictly or technically meet the definition of Construction Contract provided in IAS11. This is so under the original definition in IAS11 and even with the additional guidance or conditions as provided in this Draft IFRIC. So it is almost certain that IAS11 is out of question.

That being the case, the applicable standard will be IAS18, the main and general standard on revenue recognition. IAS 18 basically deals with sales of goods and provision of services and others in a general way. IAS18 does not provide guidance for sales of real estate under development. However, the Appendix to IAS18 does provide some guidance (Example 9) but it is technically not part of the standard.

I noted that this Draft IFRIC has modified the Example 9 that if IAS18 were to be applicable (because it is not construction contract) then, it is virtually certain that the revenue can only be recognized upon delivery of possession of the real estate ie basically upon completion of the construction.

This Draft IFRIC further argued that the Sales Agreement is essentially or in substance only a right to acquire, use and resell the real estate at a later stage (ie after taking possession).

This Draft IFRIC did not try to view and consider the special nature and characteristics of property development industry and consider if a separate standard should be developed so as to enable the financial statements to provide more useful, relevant and reliable information about the financial performance and position of this industry on a year to year basis. It basically restricts its consideration to either IAS11(% of completion) or IAS18(upon delivery).

This Draft IFRIC and its Basis of Conclusions did not discuss if it has considered many types of sales of agreement that may exist in the market and also the different laws on real estate in different countries before it arrived at the conclusion. For instance, in certain countries, the sales agreement is clearly a sales transaction (not an option to buy) both legally and in substance as the title is ready to be passed to the buyer and the buyer may resell the property and profit from the increase in market price. Also, buyer can not terminate the agreement or can terminate it subject to penalty which is usually significant enough to discourage any termination. Also, the buyers are required by the agreement to make progressive payment in accordance with the progress of the construction. Regrettably this Draft IFRIC did not address such situation.

In the above scenario, the buyers when entering the sales agreement are fully aware that the real estate is not completed yet and will be completed within the specified period in the agreement. In essence, it can be argued that the Sales Agreement is a combination of sales of land plus construction services. The buyers are buying the land and engaging the seller/developer to construct the building and will be paying the seller/developer based on the progress of the construction.

Whichever is the case, if the sales has been effected, the seller/developer is no longer the owner of that piece of land or that unit of interest(in case of strata title property) and should not show that as its assets or inventories in its financial statements. However, the seller has to retain the possession of the land for the purposes of constructing the building.

The question is in this scenario (not an option to buy), can the revenue be recognized based on the percentage of completion basis on those units that have been sold if the other criteria normally attached to percentage of completions are fulfilled? By using percentage of completion does not necessarily mean IAS11 applies. The principles in IAS11 and also the IAS18 on rendering of services and other accounting principles can be used to support its use.

I would therefore strongly suggest that IFRIC give special consideration to the above scenario. To be more specific, I suggest that

- a) IFRIC examine the various typical sales agreements on uncompleted real estate and categorize them as much as possible (or by way of examples)
- b) set out the conditions or considerations where sales can be considered effected(as opposed to option to buy) and where the significant risk and reward can be considered or deemed to be transferred to the buyers and hence revenue can be recognized subject to further conditions
- c) set out further conditions for recognizing the revenue on percentage of completion basis such as percentage of sales, percentage of construction or work done, payment terms etc (this is to avoid pre-mature recognition of revenue)
- d) set out the situations where the revenues should be recognized on component basis such as the land is to be recognized separately from the building
- e) set out the disclosure requirement on the accounting policy chosen where companies need to explain its choice of appropriate accounting policy in greater details
- f) set out the disclosure requirement on additional information for those situations where revenue recognition can only be done at a later stage or upon completion due to non conformance of the conditions set out or because it is only an option to buy (as opposed to a buy and sell transaction). This is important as if revenue were to be deferred to the completion date, the financial statements for the interim periods may not reflect the economic generation activities that took place. The additional information should address this missing link.

The above may sound like a rules-based approach but the wordings may be designed to be biased towards principles with detailed guidance rather than strictly rules-based. This is important as the laws of real estate in each country and the terms of the agreements and the circumstances in each project may be different and hence a principles-based approach will be more desirable than a rules-based approach.

The above can be issued as an interpretation or a separate standard or incorporated within the IAS18. A separate standard will be relevant if this is considered a specialized industry or transaction such as Agriculture-biological assets, insurance contract or share-based payment.

Lastly, since the key issue is revenue recognition on real estate under development, the title of this IFRIC should be changed to reflect such rather than 'Real Estate Sales' which may include sales of completed real estate, a non issue.

I hope my comments and views may be useful in certain ways as you move towards the next step.

Yours truly,

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K H Goh & Co is practicing accounting firm in Malaysia