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What you need to know

- IFRS 15 creates a single source of revenue requirements for all entities in all industries. The new revenue standard is a significant change from current IFRS.

- The new standard applies to revenue from contracts with customers and replaces all of the revenue standards and interpretations in IFRS, including IAS 11, IAS 18 and related Interpretations (e.g. IFRIC 15).

- IFRS 15 also specifies the accounting treatment for certain items not typically thought of as revenue, such as certain costs associated with obtaining and fulfilling a contract and the sale of certain non-financial assets.

- The requirements to estimate variable consideration and to identify performance obligations in a contract may cause a change in the pattern of revenue recognition for property management and development services.

- Entities that sell real estate will generally be able to recognise revenue and associated profit when control of the property transfers. Judgement will be required to assess whether control transfers (and, therefore, revenue is recognised) over time or at a point in time.

- The standard is effective for annual periods beginning on or after 1 January 2017, with early adoption permitted.
Overview

Real estate entities may need to change their revenue recognition policies and practices as a result of IFRS 15 Revenue from Contracts with Customers, a new standard issued by the International Accounting Standards Board (the IASB) jointly with the new standard issued by the Financial Accounting Standards Board (the FASB) (collectively, the Boards). The new standards will supersede virtually all revenue recognition standards in IFRS and US GAAP, including any industry-specific requirements that real estate entities may use today. Real estate entities no longer have to consider whether contracts are in scope of IAS 11 Construction Contracts or IAS 18 Revenue. Also the related IFRIC 15 Agreements for the Construction of Real Estate will be superseded by IFRS 15.

IFRS 15 specifies the accounting treatment for all revenue arising from contracts with customers. It affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other IFRS requirements, such as IAS 17 Leases). The standard also provides a model for the recognition and measurement of gains and losses on the sale of certain non-financial assets, such as property and equipment and intangible assets.

This publication considers key implications of the new standard for real estate entities. It provides an overview of the revenue recognition model in IFRS 15 with a focus on entities that:

- Own, operate and sell real estate
- Provide property management services
- Construct and sell residential property

This publication supplements our Applying IFRS, A closer look at the new revenue recognition standard (June 2014)\(^1\) (general publication) and should be read in conjunction with that publication.

Real estate entities also may wish to monitor the discussions of both the Boards’ Joint Transition Resource Group for Revenue Recognition (TRG). The Boards created the TRG to support stakeholders with implementation of the new standard. It was also created to help the Boards determine whether additional interpretation, application guidance or education is needed on implementation issues and other matters submitted by stakeholders. The TRG will not make formal recommendations to the Boards or issue application guidance. Any views discussed by the TRG are non-authoritative.

The views we express in this publication are preliminary. We may identify additional issues as we analyse the standard and as entities begin to apply it, and our views may evolve during that process.

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\(^1\) Available on www.ey.com/ifrs
1. Summary of the new standard

IFRS 15 specifies the requirements an entity must apply to measure and recognise revenue and the related cash flows. The core principle of the standard is that an entity will recognise revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring promised goods or services to a customer.

The principles in IFRS 15 are applied using the following five steps:

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract(s)
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations
5. Recognise revenue when (or as) the entity satisfies each performance obligation

An entity will need to exercise judgement when considering the terms of the contract(s) and all of the facts and circumstances, including implied contract terms. An entity will also have to apply the requirements of IFRS 15 consistently to contracts with similar characteristics and in similar circumstances.

On both an interim and annual basis, an entity will generally need to disclose more information than it does under current IFRS. Annual disclosures will include qualitative and quantitative information about the entity’s contracts with customers, significant judgements made (and changes in those judgements) and contract cost assets.
2. Effective date and transition

IFRS 15 is effective for annual periods beginning on or after 1 January 2017. Early adoption is permitted for IFRS preparers, provided that fact is disclosed, and for first-time adopters of IFRS.

The effective date of the standard for public entities applying US GAAP is for periods beginning after 15 December 2016. However, US public entities are not permitted to early adopt the standard.²

All entities will be required to apply the standard retrospectively, using either a full retrospective or a modified retrospective approach.

- The Boards have provided certain practical expedients to make it easier for entities to use a full retrospective approach.

- Under the modified retrospective approach, financial statements will be prepared for the year of adoption using IFRS 15, but prior periods will not be adjusted. Instead, an entity will recognise a cumulative catch-up adjustment to the opening retained earnings (or other appropriate component of equity) at the date of initial application for contracts that still require performance by the entity (i.e., contracts that are not completed). In addition, an entity will be required to disclose for all affected line items, in the current reporting period, the amount by which those line items affected by the application of IFRS 15 as compared to the standards and interpretations that were in effect (i.e., IAS 18, IAS 11 and related interpretations).

For more information about the effective date and transition options, see Section 1 of our general publication.

² US non-public entities will be required to apply the new standard to reporting periods beginning after 15 December 2017. Early adoption is permitted, but not prior to reporting periods beginning after 15 December 2016.
3. Scope

IFRS 15 applies to all contracts with customers to provide goods or services in the ordinary course of business, except for the following contracts, which are specifically excluded from the scope:

- Lease contracts within the scope of IAS 17
- Insurance contracts within the scope of IFRS 4 Insurance Contracts
- Financial instruments and other contractual rights or obligations within the scope of IFRS 9 Financial Instruments or IAS 39 Financial Instruments: Recognition and Measurement, IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IAS 27 Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures
- Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers

Critically for lessors, rental income arising from the leasing of property continues to be within the scope of IAS 17 and, hence, is not within the scope of the new revenue standard. However, depending on decisions reflected in any final leasing standard, service costs may need to be split out and accounted for separately in accordance with IFRS 15.

Entities may enter into transactions that are partially within the scope of IFRS 15 and partially within the scope of other standards. In these situations, the standard requires an entity to apply any separation and/or measurement principles in the other standard first, before applying the transaction price allocation requirements in IFRS 15 (see Section 7). The requirement to separate the total consideration between revenue and non-revenue elements is not new. However, unlike current IFRS, it provides more specific requirements for separating the consideration.

In certain transactions, the seller of real estate may agree to support the operations of the property for a period of time. For example, the seller may commit to pay the acquirer the difference between rent received from the property and a pre-agreed minimum rental level, or, alternatively, an amount such that the acquirer achieves a pre-agreed return on investment. Depending on the specific facts and circumstances, under current IFRS, the acquirer may have accounted for such guarantees as a contingent liability, a provision, a financial liability or as part of revenue transaction.

If an entity determines such a guarantee is within the scope of another standard, IFRS 15 requires an entity to first consider whether initial measurement or separation requirements exist in the other applicable standards. For example, if the guarantee is a financial liability, IAS 39 Financial Instruments: Recognition and Measurement would require the financial liability to be initially recognised at fair value. If it is a provision, IAS 37 Provisions, Contingent Liabilities and Contingent Assets would require the provision to be initially recognised at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. In either case, the remainder of the estimated consideration would then be allocated among the other elements in the arrangement (e.g., other performance obligations, including the transfer of the asset). The entity would then evaluate when to recognise revenue in relation to the revenue-elements without considering the guarantee.
If such guarantees are currently within the scope of IAS 18, the existence of a guarantee might indicate that the significant risks and rewards of ownership had not passed to the buyer or that the seller had continuing involvement to the extent usually associated with ownership. In both instances, this would preclude revenue recognition. In contrast, under IFRS 15, the presence of such a guarantee does not, on its own, affect whether an entity can recognise a sale and the associated profit from the transfer of the property. Instead, an entity may need to consider whether it represents consideration payable to a customer and whether variable consideration requirements would apply (See Section 5 and 6 for further discussion).

How we see it

Services included in leasing contracts (e.g., common area maintenance) give rise to revenue from non-lease components that may need to be recognised in accordance with IFRS 15, depending on the decisions reflected in any final leasing standard. This would require these services to be accounted for separately, with potentially a different pattern of revenue recognition when compared to the associated lease rental income. Real estate lessors should follow developments in this area as decisions may change before the Boards complete the leases project.

While it is clear that IFRS 15 applies to sales and transfers of real estate, the requirements for sale-leaseback transactions in IAS 17 have been retained. The Boards’ current joint project on leases is expected to provide new requirements for sale-leaseback transactions that will eventually replace the requirements in IAS 17. The IASB expects to issue a new leases standard in 2015.
4. Identify the contract with the customer

The model in IFRS 15 applies to each contract with a customer. Contracts may be written, oral or implied by an entity’s customary business practices, but must be legally enforceable and meet specified criteria, which are discussed in Section 3.1 of our general publication. An entity is required to combine two or more contracts that it enters into at, or near, the same time with the same customer and account for them as a single contract, if they meet specified criteria.

An assessment of collectability is included as one of the criteria for determining whether a contract with a customer exists. That is, an entity must conclude that it is probable that it will collect the consideration to which it will be entitled (i.e., the transaction price). When performing the collectability assessment, an entity only considers the customer’s ability and intention to pay the expected consideration when due.

How we see it

In most real estate arrangements, a signed, written contract specifies the asset to be transferred or services to be provided in exchange for a defined payment. This generally will result in a straight-forward assessment of most of the contract criteria.

However, entities that sell real estate and provide financing to the buyer may find the collectability evaluation difficult. There is limited application guidance in IFRS 15 to help entities determine whether the terms of seller-provided financing and the borrower’s ability to fulfil those terms, meet the collectability threshold or indicate an implied price concession.

Significant judgement will be required to determine when there is an implied price concession or an impairment loss (see Section 6.2) or whether there is an indication that an arrangement lacks sufficient substance to be considered a contract within the scope of the standard.

IFRS 15 specifies how to account for an arrangement that does not meet the criteria of a contract under the standard (See Section 3.4 of the general publication).
4.1 Contract modifications
A contract modification is a change in the scope or price (or both) of a contract. Changes to existing contracts, such as change orders or upgrades during the construction of a home or apartment complex, are examples of contract modifications.

An entity must determine whether the modification creates a new contract or whether it will be accounted for as part of the existing contract. Two criteria must be met for a modification to be treated separately as a new contract:

1. The additional goods and services are distinct
2. The amount of consideration expected for the added goods and services reflects the stand-alone selling price of those goods or services (see Section 7)

In determining the stand-alone selling price for the new contract, entities have some flexibility, depending on the facts and circumstances. Refer to Section 3.3.1 of our general publication for further details.

A contract modification that does not meet the criteria to be accounted for as a separate new contract is considered a change to the original contract. It is treated as either: (a) the termination of the original contract and the creation of a new contract; or (b) a continuation of the original contract. This depends on whether the goods or services to be provided after the contract modification are distinct. Such modifications are accounted for, as follows:

- A termination of the original contract and creation of a new contract (i.e., on a prospective basis) if the goods and services to be provided as a result of the modification are distinct, but the consideration does not reflect the stand-alone selling price of the new goods or services. The total remaining consideration is allocated to the total remaining performance obligations.
- A continuation of the original contract if the remaining goods or services to be provided are not distinct. As such, they form part of a single performance obligation that is partially satisfied at the date of the modification. Such modifications are accounted for on a cumulative catch-up basis.

See Section 5 for further discussion of identifying performance obligations in the contract.

How we see it
Real estate entities will need to carefully evaluate promised goods or services at the date of a modification to determine whether the remaining goods or services to be transferred are distinct and priced commensurate with their stand-alone selling prices. This assessment is important because the accounting treatment can vary significantly depending on the conclusions reached.

Only contract modifications that add distinct goods or services at their stand-alone selling price can be treated as separate contracts.
5. Identify the performance obligations in the contract

Once an entity has identified the contract with a customer, it evaluates the contractual terms and its customary business practices to identify all the promised goods or services within the contract and determine which of those promised goods or services (or bundles of promised goods or services) will be treated as separate performance obligations.

IFRS 15 identifies several activities common to real estate entities that are considered promised goods and services, including the sale of goods produced or resale of goods purchased (e.g., properties); the performance of a contractually agreed-upon task for a customer (e.g., property management); and the construction or development of a property on behalf of a customer. Separate performance obligations represent promises to transfer a good or service that is:

- A good or service (or a bundle of goods and services) that is distinct
  or
- A series of distinct goods and services that are substantially the same and have the same pattern of transfer to the customer

5.1 Determination of ‘distinct’

IFRS 15 outlines a two-step process for determining whether a promised good or service (or a bundle of goods and services) is distinct:

- Assessment at the level of the individual good or service (i.e., the goods or services are capable of being distinct)
- Assessment of whether the good or service is separately identifiable from other promises in the contract (i.e., the good or service is distinct within the context of the contract)

Both of these criteria must be met to conclude that the good or service is distinct. If these criteria are met, the individual units of account must be separated. This means the transaction price will be allocated to these performance obligations and each performance obligation must be satisfied in order for revenue to be recognised.

In many cases, goods or services are capable of being distinct, but may not be distinct within the context of the contract. The standard provides factors to determine whether goods or services are not separately identifiable and are required to be combined as one performance obligation (i.e., they are not distinct in the context of the contract). These factors, if present, would indicate that the goods and/or services are separately identifiable:

- The entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract into a bundle that represents the combined output for which the customer has contracted.
- The good or service does not significantly modify or customise another good or service promised in the contract.
- The good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract.

If the promised good or service is not distinct, the entity has to combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. A distinct bundle is accounted for as a single performance obligation, illustrated in the following example:
Illustration 5-1 — Construction of a residential home

Homebuilder B enters into a contract to build a new home for a customer on land owned by Homebuilder B. Ownership of the home and land are transferred to the customer when construction is completed. The homebuilder is responsible for the overall management of the project and identifies various goods and services to be provided, including design work, procurement of materials, site preparation and foundation pouring, framing and plastering, mechanical and electrical work, installation of fixtures (e.g., windows, doors, cabinetry) and finishing work.

Analysis

Homebuilder B first evaluates whether the customer can benefit from each of the various goods and services, either on their own or together with other readily available resources. Homebuilder B determines that these goods and services are regularly sold separately to other customers by other contractors. Therefore, the customer could generate economic benefit from each of the goods and services (either on their own or together with the other goods and services that are readily available to the customer), although they would have to be provided in the context of a different property. Consequently, Homebuilder B determines that the goods and services are capable of being distinct.

Homebuilder B then evaluates whether the goods and services are distinct within the context of the contract. Homebuilder B determines that the contract provides a significant service of integrating the various goods and services (the inputs) into the new home (the combined output). Therefore, Homebuilder B’s promise to transfer the various individual goods and services in the contract are not separately identifiable from other promises in the contract. That is, the various goods and services are all transferred to the customer as a completed home.

Because both criteria for identifying a distinct good or service are not met, Homebuilder B determines the goods and services are not distinct and accounts for all of the goods and services in the contract as a single performance obligation. See Section 8 for discussion of satisfaction of performance obligations.

It is unclear how amenities (e.g. swimming pools, golf courses, health club facilities) provided by a developer will be accounted for under IFRS 15. Often, amenities are sold or transferred in connection with the sale of individual units of a real estate project. In evaluating these transactions, entities would consider:

- The parties involved (e.g., customer and homeowner’s association)
- Whether separate performance obligations exist and what they are (e.g., goods or services)
- To which parties the promises (potentially performance obligations) are made

How we see it

All real estate entities will need to determine whether separate performance obligations exist within their contracts. We expect these judgements may be more complex for homebuilders, developers of residential apartments and entities that, in addition to property sales, provide property management services, because the nature of these contracts requires the entity to perform multiple activities that may (or may not) represent separate performance obligations.
5.2 Series of distinct goods and services that are substantially the same and have the same pattern of transfer

Goods and services that are part of a series of distinct goods and services that are substantially the same and have the same pattern of transfer to the customer must be accounted for as a single performance obligation to that customer if both of the following criteria are met:

- Each distinct good or service in the series that the entity promises to transfer consecutively represents a performance obligation that would be satisfied over time (see Section 8.1) if it were accounted for separately.
- The entity would measure its progress toward satisfaction of the performance obligation using the same measure of progress for each distinct good or service in the series (see Section 8.1.4).

Property management services (e.g., maintenance, cleaning, leasing, administrative and support services), would likely meet both criteria. However, because property management service contracts are usually comprised of multiple underlying activities, significant judgement may be required to determine which activities within a services contract would meet both criteria. The following illustrates how a real estate entity may evaluate performance obligations in a property management contract:

**Illustration 5-2 - Identifying performance obligations in a property management contract**

Operator R enters into a five-year contract with Owner S to provide property management services for a regional shopping centre. The contract stipulates that Operator R will perform the following functions:

- Manage day-to-day operations of the centre for a fee of 5% of the property’s quarterly lease revenues
- Provide leasing services for a fee of CU5 per square foot for new lease agreements and CU3 per square foot for lease agreement renewals

Operator R evaluates each of the services provided in the contract to identify whether separate performance obligations are present. Operator R also considers the underlying activities that comprise each of the services to determine whether they meet the criteria to be accounted for as a single performance obligation (or whether the service may be several performance obligations).

Operator R determines that the leasing services are distinct from the management services (i.e., the leasing and management services are not combined to form a single performance obligation). Both services are capable of being distinct and are distinct in the context of the contract because the entity does not provide a significant service of integrating the services; neither service significantly modifies or customises the other service; and the services are not highly dependent on, or highly interrelated with each other. The activities that are necessary to perform the day-to-day management of the property are independent of those that are required to negotiate and execute leases with tenants.
Illustration 5-2 – Identifying performance obligations in a property management contract (cont’d)

Analysis of management services

Operator R evaluates the activities that must be performed in order to manage the day-to-day operations of the property. Operator R identifies a number of activities that comprise the overall property management services, including maintenance, cleaning, security, landscaping, snow removal, tenant relationship management and administrative and support services. While each of these activities are individually capable of being distinct, Operator R concludes that they are not distinct within the context of the contract because the ultimate objective of the management services is to perform any activities that are necessary to ensure the property is open and operating as intended.

In addition, Operator R determines that the management services represent a series of services that are substantially the same and have the same pattern of transfer to Owner S. While the specific activities that occur each day may vary slightly (e.g., landscaping may occur in the summer, while snow removal occurs in the winter), the overall service of property management is substantially the same and has the same pattern of transfer (i.e., transfers daily) over the term of the contract. Furthermore, each distinct service represents a performance obligation that would be satisfied over time (i.e., over the length of the contract, not at a point in time) and has the same measure of progress (e.g., time elapsed), thereby meeting the required criteria.

Analysis of leasing services

Operator R evaluates the activities that comprise the leasing services. Operator R identifies several activities that occur throughout the leasing process, including monitoring of upcoming vacancies, new tenant identification, proposal preparation, lease negotiation and document preparation. While certain of these activities may be capable of being distinct (e.g., document preparation could be outsourced), Operator R concludes they are not distinct within the context of the contract, because the ultimate objective of the leasing services is to execute individual leases with tenants to maintain the overall occupancy of the property.

How we see it

As illustrated above, entities will first need to determine which services in the contract are distinct and therefore could represent separate performance obligations. Then, these services will need to be evaluated to determine whether they are substantially the same, have the same pattern of transfer and meet the two criteria discussed above (and, therefore, must be combined into one performance obligation). This evaluation may require significant judgement when a property manager performs activities beyond the day-to-day operations of the property.

For example, a retail property manager may be responsible for identifying and executing leases with seasonal tenants, attracting on-site events or placing advertisements around the property. If an entity determines that these activities represent separate performance obligations and the contract does not specify separate revenues that reflect the stand-alone selling prices of these services, the base management fee must be allocated to each separate performance obligation (see Section 7).
6. Determine the transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties. The entitled amount is meant to reflect the amount to which the entity has rights under the present contract and this amount may differ from the contractual price (e.g., if the entity expects or intends to offer a price concession).

The transaction price may be less than the stated contract price if an entity concludes that it has offered, or is willing to accept, a price concession or other discount. Such concessions or discounts are forms of variable consideration (see Section 6.2 below) that an entity would estimate at contract inception and reduce from the contract price to derive the transaction price. The estimated transaction price would then be evaluated for collectability. The following example illustrates these concepts:

<table>
<thead>
<tr>
<th>Stated contract price</th>
<th>CU2,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price concession – amount entity estimates it will offer or accept as a reduction to the contractual price</td>
<td>(CU200,000)</td>
</tr>
<tr>
<td>Transaction price</td>
<td>CU1,800,000</td>
</tr>
</tbody>
</table>

The consideration promised in a contract may include fixed and/or variable amounts. When determining the transaction price, entities must estimate the variable consideration, which is subject to a constraint (see Section 6.1.1). The requirement to estimate variable consideration at contract inception in property management contracts and certain real estate sales agreements may represent a significant change for real estate entities. The transaction price also will include the fair value of any non-cash consideration, the effect of a significant financing component (i.e., the time value of money) and the effect of any consideration paid or payable to a customer.

6.1 Variable consideration

The transaction price may vary in amount and timing as a result of discounts, credits, price concessions, incentives or bonuses. In addition, consideration may be contingent on the occurrence or non-occurrence of a future event or earned as a percentage of an underlying measure (e.g., sales, profits, operating performance).

An entity is required to estimate variable consideration using either the ‘expected value’ method (i.e., the sum of probability-weighted amounts) or the ‘most likely amount’ method (i.e., the single-most likely outcome), whichever better predicts the amount of consideration to which it will be entitled. That is, the method selected is not meant to be a ‘free choice’. The entity is required to apply the selected method consistently throughout the contract and update the estimated transaction price at the end of each reporting period.

The Boards indicated that the most likely amount approach may be the better predictor when the entity expects to be entitled to only one of two possible amounts (e.g., a contract in which an entity is entitled to receive all or none of a specified performance bonus, but not a portion of that bonus). The following provides an illustration of a real estate entity estimating variable consideration resulting from future profit participation from a sale of real estate.

3 IFRS 15.53(b)
Illustration 6-1: Estimating variable consideration

Developer D sells a newly constructed commercial property with a cost basis of CU1.9 million for CU2 million, plus a right to receive 5% of future operating profit from the property for the first year. Developer D has no additional ongoing performance obligations. Developer D determines there are a number of possible outcomes for consideration to be received based on the performance of the property (i.e., the buyer’s ability to secure tenants for the entire property at favorable rental rates). The buyer currently has executed leases or letters of intent from prospective tenants for 50% of the property.

Analysis: Developer D has to determine whether the ‘expected value’ or ‘most likely amount’ method better predicts the variable consideration to be received. Developer D determines that the ‘expected value’ method is the better predictor of the variable consideration since multiple outcomes are possible.

Based on the buyer’s current pre-leasing, Developer D estimates the following future profit participation:

<table>
<thead>
<tr>
<th>Future profit</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>CU 500,000</td>
<td>10%</td>
</tr>
<tr>
<td>CU 250,000</td>
<td>70%</td>
</tr>
<tr>
<td>CU 0</td>
<td>20%</td>
</tr>
</tbody>
</table>

Assume for purposes of this illustration that the constraint, discussed further below, does not limit the amount that can be included in the transaction price at contract inception (i.e., assume it is highly probable that a significant revenue reversal will not occur). Using a probability-weighted estimate, Developer D would include CU225,000 [(CU500,000 x 10%) + (CU250,000 x 70%) + (CU0 x 20%)] in the transaction price associated with this variable consideration. That is, the transaction price would be CU2,225,000.

Developer D updates its estimate of the transaction price at the end of the next reporting period. After considering that the buyer now has letters of intent or executed leases for 75% of the property, Developer D determines it is now 75% likely to receive future profit participation of CU500,000 and 25% likely to receive CU250,000. As a result, Developer D’s estimate of variable consideration is updated to CU437,500 [(CU500,000 x 75%) + (CU250,000 x 25%)] and additional revenue of CU212,500 (CU2,437,500 — CU2,225,000) is recognised.

6.1.1 Constraining estimates of variable consideration

To include variable consideration in the estimated transaction price, the entity has to first conclude that it is ‘highly probable’ that a significant revenue reversal will not occur when the uncertainties related to the variability are resolved. The Boards provided factors that may indicate that revenue is subject to a significant reversal:

- The amount of consideration is highly susceptible to factors outside the entity’s influence (e.g., market volatility, judgement or actions of third parties, weather conditions).
- The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
• The entity’s experience (or other evidence) of similar types of contracts is limited or that experience (or other evidence) has limited predictive value.

• The entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.

• The contract has a large number and broad range of possible consideration amounts. 4

The indicators provided by the Boards are not meant to be an all-inclusive list. Therefore, additional factors may be relevant when making an evaluation. In addition, the presence of any one of these indicators does not necessarily mean that it is highly probable that a change in the estimate of variable consideration will result in a significant revenue reversal.

For example, when determining how the constraint affects the estimate of variable consideration, sellers of real estate and property managers will need to consider a variety of factors, including their experiences with similar arrangements, uncertainties that may exist in the latter years of a long-term contract, and market and other factors that may be outside of their control. All entities will want to make sure they sufficiently and contemporaneously document the reasons (including supporting and non-supporting evidence considered) for their conclusions reached.

When an entity is unable to conclude that it is highly probable that a change in the estimate of variable consideration that would result in a significant revenue reversal will not occur, the amount of variable consideration included in the transaction price is limited. In addition, when an arrangement includes variable consideration, an entity is required to update both its estimate of the transaction price and its evaluation of the constraint throughout the term of the contract to depict conditions that exist at the end of each reporting period.

The following provides an illustration of the application of the constraint to the estimation of variable consideration:

Illustration 6-2: Evaluating the constraint

Assume the same facts as in Illustration 6-1 except that the buyer of the property has just begun negotiations with prospective tenants. The buyer has not signed lease agreements for a significant amount of space and negotiations are proving problematic. Profits are highly dependent on whether a lease can be signed with a key anchor tenant.

Analysis

Developer D uses the ‘expected value’ method and estimates it is 25% likely to receive future profit participation of CU1,500,000, 50% likely to receive CU250,000 and 25% likely to receive none. Using a probability-weighted estimate (prior to considering the constraint), Developer D would include variable consideration within the transaction price of CU500,000 [(CU1,500,000 x 25%) + (CU250,000 x 50%) + (CU0 x 25%)]. However, the amount of variable consideration within the transaction price is constrained to CU250,000 because the entity estimates there is a 75% probability of receiving at least that amount (i.e., the amount for which it is highly probable that a significant reversal will not occur).

4 IFRS 15.57
6.1.2 Price concessions

As discussed in Section 4, before determining that a contract is in the scope of the new standard, an entity has to assess whether it is probable that it will collect the consideration to which it expects to be entitled in exchange for transferring goods or services (i.e., the transaction price). When determining the transaction price, an entity must evaluate its intention or willingness at the outset of the contract to accept less than the stated contract price (i.e., offer or accept a price concession). A price concession is a form of variable consideration and, as such, must be considered when estimating the amount to which an entity expects to be entitled under the contract.

How we see it

While the Boards noted, in the Basis for Conclusions\(^5\), that entities are required to evaluate the magnitude of a potential revenue reversal relative to total consideration (i.e., fixed and variable), the Boards did not include any quantitative requirements for evaluating the significance of the amount. As a result, entities will need to use significant judgement when making this assessment.

6.2 Non-cash consideration

The new standard specifies that when an entity receives, or expects to receive, non-cash consideration (e.g., in the form of goods or services), the fair value of the non-cash consideration (measured in accordance with IFRS 13 Fair Value Measurement) is included in the transaction price. If an entity cannot reasonably estimate the fair value of the non-cash consideration, it is required to measure the non-cash consideration indirectly, by reference to the estimated stand-alone selling price of the goods or services promised to the customer.

6.3 Significant financing component

A significant financing component may exist when the receipt of consideration does not match the timing of the transfer of goods or services to the customer (i.e., the consideration is prepaid or is paid after the services are provided).

Entities will not be required to adjust the transaction price for this component if the financing is not significant to the contract. Furthermore, an entity is not required to assess whether the arrangement contains a significant financing component unless the period between the customer’s payment and the entity’s transfer of the goods or services is greater than one year.

When an entity concludes that a financing component is significant to a contract, it determines the transaction price by discounting the amount of promised consideration. The entity uses the same discount rate that it would use if it were to enter into a separate financing transaction with the customer. The discount rate has to reflect the credit characteristics of the borrower in the arrangement; using a rate explicitly stated in the contract that does not correspond with market terms in a separate financing arrangement would not be acceptable. Subject to certain limitations, the transaction price will need to be accreted when there is a prepayment that is determined to be a significant financing component.

\(^5\) IFRS 15.BC217
7. Allocate the transaction price to the performance obligations

Once the performance obligations have been identified and the transaction price has been determined, an entity is required to allocate the transaction price to the performance obligations, generally in proportion to their stand-alone selling prices (i.e., on a relative stand-alone selling price basis), with two exceptions (see Section 7.1). The transaction price is not reallocated to reflect changes in stand-alone selling prices after contract inception.

To allocate the transaction price on a relative selling price basis, an entity must first determine the stand-alone selling price (i.e., the price at which an entity would sell a good or service on a stand-alone basis at contract inception) for each performance obligation. Generally, the observable price of a good or service sold separately provides the best evidence of stand-alone selling price. However, in many situations, stand-alone selling prices will not be readily observable. In those cases, the entity has to estimate the stand-alone selling price based on information that is reasonably available.

When determining stand-alone selling prices, an entity is required to use observable information, if available. If stand-alone selling prices are not directly observable, an entity will need to make estimates based on information that is reasonably available. Possible estimation approaches include an adjusted market assessment approach, an expected cost plus a margin approach or a residual approach. An entity is required to apply estimation methods consistently in similar circumstances.

As such, IFRS 15 will require a real estate seller to separately estimate the stand-alone selling prices of the real estate asset and associated services, if any, and allocate total consideration received in the contract on a relative stand-alone selling price basis.

How we see it

Entities that regularly provide third-party management services may already be equipped to make these estimates. However, entities that infrequently provide these services on a stand-alone basis, but elect to do so in connection with the sale of a real estate asset, may need to develop new processes to estimate the stand-alone selling price and retain sufficient documentation to support the reasonableness of their estimates.

Under the relative stand-alone selling price method, once an entity determines the stand-alone selling price for the performance obligations in an arrangement, the entity allocates the transaction price to those performance obligations based on the proportion of the stand-alone selling price of each performance obligation to the sum of the stand-alone selling prices of all of the performance obligations in the arrangement.
7.1 Exceptions to the relative stand-alone selling price method

The standard provides two exceptions to the relative selling price method of allocating the transaction price. The first requires an entity to only allocate a discount in a contract to the specific goods or services to which it relates, rather than proportionately to all of the separate performance obligations. To apply this exception, the entity must meet certain criteria\(^6\) that are unlikely to be satisfied in most types of real estate contracts.

The second exception requires variable consideration to be allocated entirely to a specific part of a contract, such as one or more (but not all) performance obligations or one or more (but not all) distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation, if both of the following criteria\(^7\) are met:

- The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service).

- Allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the standard's overall objective of allocating revenue in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

In the Basis for Conclusions\(^8\), the Boards discussed an example of a contract to provide hotel management services for one year (i.e., a single performance obligation that is a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer) for which the consideration is variable and based on the operating results of the hotel. In this example, the variable consideration that relates specifically to an entity's efforts to transfer the services for a certain period within a contract (e.g., a month, a quarter), which are distinct from the services provided in other periods within the contract, are allocated to those distinct periods instead of being spread over the entire performance obligation.

The following illustration depicts the application of this exception by a property manager that determines that the services it is providing represent a single performance obligation:

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\(^6\) IFRS 15.82

\(^7\) IFRS 15.85

\(^8\) IFRS 15.BC285

Property managers may allocate variable consideration to the period in which the related services were performed, if certain criteria are met.
Illustration 7-1: Property management fees

On 1 January 2018, Operator E enters into a one-year contract with a shopping centre owner to provide property management services. Operator E receives a 5% management fee, based on the shopping centre's quarterly lease revenues, as defined in the agreement. This is a form of variable consideration.

Analysis

Operator E concludes that the management services represent a single performance obligation recognised over time. This is on the basis that it is providing a series of distinct services that are substantially the same and have the same pattern of transfer (i.e., the services transfer to the customer over time and Operator E uses time elapsed to measure progress).

Operator E determines that the transaction price is allocated to each individual quarter because the quarterly management fee relates specifically to the entity's efforts to satisfy the performance obligation during each quarter. In addition, the allocation is consistent with the objective of allocating an amount that depicts the consideration to which the entity expects to be entitled in exchange for transferring the promised services.

For example, if the lease revenue generated by the property was CU2.0 million in the first quarter of 2018, Operator E would recognise revenue of CU100,000 (CU2.0 million x 5%) for the period ending 31 March 2018.

How we see it

Property managers will need to evaluate their contracts to determine whether the exception for allocating variable consideration will apply to contracts that are based on a percentage of the operating results of the underlying property, including contracts that an entity concludes contain only one performance obligation. Some entities may find that applying the exception (and, therefore, recognising management fees that relate specifically to the entity's efforts to transfer the service in a distinct period) is relatively straight-forward. However, certain contracts may contain multiple revenue streams that relate to a single performance obligation. For example, in addition to a variable fee, a contract could also include a fixed fee that would generally be recognised over the term of the contract using the entity's selected measure of progress (e.g., time elapsed).

Some property management contracts contain incentive fees that are based on the performance of the underlying property over a different period rather than the base management fees (e.g., annually versus quarterly). The following illustration depicts the complexity that entities may face and the significant judgement that may be required when recognising revenues from these arrangements:
Illustration 7-2: Incentive-based fees

Assume the same facts as in Illustration 7-1, except that Operator E also receives a fee of 2% of the property’s annual net operating income (NOI). The shopping centre has stabilised occupancy and no significant tenant vacancies are expected during the term of the agreement. The shopping centre is located in a region that periodically receives significant snowfall during the period from December to May, which results in extensive snow removal costs in certain years.

Analysis

Operator E evaluates variable consideration in the form of the incentive fee. While most of the property’s operating costs are predictable, Operator E determines that the variability of snow removal costs can significantly affect NOI of the property. Because of the potential variability in NOI, Operator E uses the ‘expected value’ method and concludes that there is an equal (33.3%) likelihood of the property generating NOI of CU1.2 million, CU1.5 million and CU1.8 million. Based on this approach, Operator E initially estimates that it will earn CU30,000 \(0.02 \times (CU1.2 \text{ million} \times 33.3\%) + (CU1.5 \text{ million} \times 33.3\%) + (CU1.8 \text{ million} \times 33.3\%))\) from the incentive fee.

In this scenario, the incentive fee is based on the annual NOI of the property. However, Operator E must determine whether any of the variable consideration needs to be recognised in the specific period (i.e., quarter) when the underlying services were performed. Operator E considers whether it is highly probable that a significant reversal in the incentive fees will not occur prior to the end of the annual period. This assessment requires consideration of the unique facts and circumstances of the arrangement.

Assume Operator E cannot conclude at contract inception that it is highly probable a significant reversal of revenue (from the incentive fees) will not occur because NOI could be significantly affected by snow removal costs. Snow removal costs result from factors that are beyond its influence (e.g., future weather patterns). Therefore, Operator E applies the constraint to the annual incentive fee. It only includes in the allocable transaction price the fees that would be earned from the estimated outcome of NOI for which it is highly probable that a significant reversal in incentive fees will not occur. In making this assessment Operator E concludes that the 66.6% chance of earning at least CU30,000 (CU1.5 million x 0.02) does not make that outcome ‘highly probable’. As such, Operator E constrains the amount included in the transaction price to CU24,000 (CU1,200,000 x 0.02) given it considers there is a 100% probability it will receive, at least, that amount. Operator E would subsequently update its estimate of the transaction price (and its evaluation of the constraint on variable consideration) at the end of each reporting period.
8. Satisfaction of performance obligations

An entity recognises revenue only when it satisfies a performance obligation by transferring control of a promised good or service to a customer. Control may be transferred over time or at a point in time.

Control of the good or service refers to the ability to direct its use and to obtain substantially all of its remaining benefits (i.e., the right to cash inflows or reduction of cash outflows generated by the good or service). Control also means the ability to prevent other entities from directing the use of and receiving the benefit from a good or service.\(^9\)

Recognising revenue upon a transfer of control is a different approach from the ‘risks and rewards’ model in current IFRS. IAS 18 currently requires that five criteria be satisfied before revenue can be recognised from the sale of goods. These criteria include ensuring there is no continuing managerial involvement to a degree usually associated with ownership or effective control over the goods sold.\(^10\) The existence of continuing managerial involvement might indicate that control of goods has not passed to a buyer, but its existence alone does not preclude revenue recognition under IFRS 15.

IFRS 15 requires that an entity determines whether it will transfer control of a promised good or service over time at contract inception. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time. These concepts including the indicators that would be used to assess when control has passed to the buyer are explored further in the following sections.

The criteria in IFRS 15 for a performance obligation to be satisfied over time differ from the current requirements in IFRIC 15, which may result in different accounting outcomes.

8.1 Performance obligations satisfied over time

An entity transfers control of a good or service over time (rather than at a point in time) when any of the following criteria are met:

- The customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs.
- The entity’s performance creates or enhances an asset (e.g., work in process) that the customer controls as the asset is created or enhanced.
- The entity’s performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

8.1.1 Customer simultaneously receives and consumes benefits as the entity performs

In some instances, the assessment of whether a customer simultaneously receives and consumes the benefits of an entity’s performance will be straightforward (e.g., daily cleaning services, for which the simultaneous receipt and consumption by the customer is readily evident). However, in circumstances in which simultaneous receipt and consumption is less evident, the standard clarifies that revenue recognition over time is appropriate if “an entity determines that another entity would not need to substantially re-perform the work that the entity completed to date if that other entity were...”

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\(^9\) IFRS 15.33
\(^10\) IAS 18.14
to fulfil the remaining performance obligation to the customer.” In making this determination, entities will not consider practical or contractual limitations that limit the transfer of the remaining performance obligation.

Real estate entities that provide property management and other services will need to carefully evaluate their contracts to determine whether the services performed are simultaneously received and consumed by the customer (i.e., real estate owner). It may be apparent that services such as routine and recurring maintenance, cleaning and administrative and support services functions meet the criteria for recognition of revenue over time. However, determining whether other services, such as leasing or development activities, are simultaneously received and consumed by the real estate owner, or that another entity would not need to substantially re-perform activities completed to date, will require significant judgement. These judgements will also be affected by an entity’s conclusion about the number of performance obligations (i.e., single or multiple) in the contract (see Section 5).

8.1.2 Customer controls asset as it is created or enhanced

The second situation in which control of a good or service is transferred over time is where the customer controls the asset as it is being created or enhanced. For example, many construction contracts contain clauses indicating that the customer owns any work-in-progress as the contracted item is being built.

In many jurisdictions, the individual units of an apartment block are only accessible by the purchaser on completion or near completion. However, the standard does not restrict the definition of control to the purchaser’s ability to access and use (i.e., live in) the apartment. In IFRS 15.33, the standard specifies:

<table>
<thead>
<tr>
<th>Extract from IFRS 15</th>
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<tr>
<td>33 The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:</td>
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<tr>
<td>(a) using the asset to produce goods or provide services (including public services);</td>
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<tr>
<td>(b) using the asset to enhance the value of other assets;</td>
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<tr>
<td>(c) using the asset to settle liabilities or reduce expenses;</td>
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<tr>
<td>(d) selling or exchanging the asset;</td>
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<tr>
<td>(e) pledging the asset to secure a loan; and</td>
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<tr>
<td>(f) holding the asset.</td>
</tr>
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In some jurisdictions it may be possible to pledge unfinished apartments or sell or exchange the unfinished apartment. Accordingly, it may be possible that this criterion is met for some residential developers. Careful consideration will be required of the specific facts and circumstances.

We plan to discuss the application of this criterion to construction contracts in an upcoming publication covering engineering and construction services.
8.1.3 Asset with no alternative use and right to payment

The third situation in which control is transferred over time has the following two requirements that must both be met:

- The entity’s performance does not create an asset with alternative use to the entity.
- The entity has an enforceable right to payment for performance completed to date.

Asset with no alternative use

An asset created by an entity has no alternative use if the entity is either restricted contractually or practically from readily directing the asset to another use (e.g., selling it to a different customer). An entity has to make this assessment at contract inception and does not update its assessment unless the parties approve a contract modification that substantively changes the performance obligation.

The Boards specified that a contractual restriction on an entity’s ability to direct an asset for another use must be substantive. In other words, a buyer could enforce its rights to the promised asset if the entity sought to sell the unit to a different buyer. In contrast, a contractual restriction may not be substantive if the entity could instead sell a different unit to the buyer without breaching the contract or incurring significant additional costs.

Furthermore, a practical limitation exists if an entity would incur significant economic losses to direct the unit for another use. A significant economic loss may arise when significant costs are incurred to redesign or modify a unit or when the unit is sold at a significantly reduced price.

Enforceable right to payment for performance completed to date

An entity has an enforceable right to payment for performance completed to date if, at any time during the contract term, the entity would be entitled to an amount that at least compensates it for work already performed. This right to payment, whether by contract or by law, must be present, even in instances in which the buyer can terminate the contract for reasons other than the entity’s failure to perform as promised.

To meet this criterion, the amount to which an entity is entitled must approximate the selling price of the goods or services transferred to date, including a reasonable profit margin. Compensation for a reasonable profit margin does not need to equal the profit margin expected for complete fulfilment of the contract. However, it must at least reflect either:

- A proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity’s performance under the contract before termination
- A reasonable return on the entity’s cost of capital for similar contracts

The standard clarifies that including a payment schedule in a contract does not, by itself, indicate that the entity has an enforceable right to payment for performance completed to date. 12 The entity needs to examine information that may contradict the payment schedule and may represent the entity’s actual right to payment for performance completed to date (e.g., an entity’s legal right to continue to perform and enforce payment by the buyer if a contract is terminated without cause).

12 IFRS 15.B13

The laws or legal precedent of a jurisdiction may affect an entity’s conclusion of whether a present right to payment is enforceable.
However, the standard states that:

**Extract from IFRS 15**

B11 In some contracts, a customer may have a right to terminate the contract only at specified times during the life of the contract or the customer might not have any right to terminate the contract. If a customer acts to terminate a contract without having the right to terminate the contract at that time (including when a customer fails to perform its obligations as promised), the contract (or other laws) might entitle the entity to continue to transfer to the customer the goods or services promised in the contract and require the customer to pay the consideration promised in exchange for those goods or services. In those circumstances, an entity has a right to payment for performance completed to date because the entity has a right to continue to perform its obligations in accordance with the contract and to require the customer to perform its obligations (which include paying the promised consideration).

It may be difficult to demonstrate whether a real estate developer meets this criterion in practice.

**How we see it**

IFRIC 15 outlines three methods of accounting for revenue from the construction of real estate. The appropriate method depends on whether the agreement is a construction contract; an agreement for the rendering of services; or an agreement for the sale of goods. The judgement needed to determine the type of agreement is one of the more complex areas of current real estate accounting. However, the requirements in IFRS 15 apply to all contracts with customers to provide goods or services removing this area of judgement.

While for some entities there may be no change in the timing of revenue recognition, there may be a significant impact for other entities. There will be contracts that would currently qualify for revenue recognition over time (as a construction contract or an agreement for the rendering of services) that will not meet the criteria for performance obligations satisfied over time under IFRS 15. Conversely, there will be entities that would previously have recognised revenue at a point in time (as a sale of goods) that may now meet the criteria for revenue recognition over time.

**8.1.4 Measuring progress**

When a performance obligation is satisfied over time, IFRS 15 provides two methods for measuring progress under the contract: input methods or output methods. While the standard requires an entity to continuously update its estimates related to the measure of progress selected, it does not allow a change in method. A performance obligation is accounted for under the method the entity selects (i.e., either an input or an output method) until it has been fully satisfied.

Under the input method, revenue is recognised “on the basis of the entity's efforts or inputs to the satisfaction of the performance obligation ... relative to the total expected inputs to the satisfaction of that performance obligation”.\(^{13}\)

\(^{13}\) IFRS 15.B18
The standard includes resources consumed, labor hours expended, costs incurred and time elapsed as possible input methods. The standard also notes it may be appropriate to recognise evenly expended inputs on a straight-line basis.

Under the output method, revenue is recognised “on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract”\(^\text{14}\). Measurements of output may include surveys of performance completed to date, appraisals of results achieved, milestones reached and time elapsed.

The standard does not indicate a preference for either method, but it does require that an entity apply the method it selects to similar arrangements in similar circumstances. If an entity does not have a reasonable basis to measure its progress, the Boards decided that too much uncertainty would exist. Therefore, revenue is not recognised until progress can be measured. There are, however, circumstances in which an entity may not be able to reasonably measure the outcome of a performance obligation (for example, in the early stages of a contract), but it expects to recover the costs incurred in satisfying the performance obligation. In such circumstances, the entity must recognise revenue only to the extent of the costs incurred until such time that it can reasonably measure the outcome of the performance obligation.

8.2 Control transferred at a point in time

Control is transferred at a point in time if none of the criteria for a good or service to be transferred over time are met. In many situations, the determination of when that point in time occurs is relatively straight-forward. However, in some circumstances, this determination is more complex.

The Boards have provided indicators for entities to consider when determining whether control of a promised asset has been transferred:

- The entity has a present right to payment for the asset.
- The customer has legal title to the asset.
- The entity has transferred physical possession of the asset.
- The customer has the significant risks and rewards of ownership of the asset.
- The customer has accepted the asset.

None of these indicators are meant to be individually determinative. The Boards also clarified that the indicators are not meant to be a checklist and not all of them must be present to determine that the customer has gained control. An entity needs to consider all relevant facts and circumstances to determine whether control has transferred. For example, the presence of a repurchase option in a contract may indicate that the customer has not obtained control of the asset, even though it has physical possession.

How we see it

In many real estate transactions, control may transfer when the buyer obtains legal title and physical possession of the asset. However, since transfer of legal title is not required, certain entities may conclude that their specific facts and circumstances indicate that control transfers at a point prior to transfer of legal title. Judgement and consideration of the specific facts and circumstances will be required in these instances.

\(^{14}\text{IFRS 15.B15}\)
9. Other measurement and recognition topics

IFRS 15 also includes application guidance that has requirements for warranties and contract costs (e.g., real estate project costs) that may result in changes in practice for certain real estate entities.

9.1 Warranties

Warranties are commonly included in arrangements to sell goods or services, whether explicitly stated or implied based on the entity’s customary business practices. The new standard identifies two types of warranties:

- Warranties that promise the customer that the delivered product is as specified in the contract are called ‘assurance-type warranties’. The Boards concluded that these warranties do not provide an additional good or service to the customer (i.e., they are not separate performance obligations). By providing this type of warranty, the selling entity has effectively provided a quality guarantee. For example, homebuilders and developers of residential apartments often provide various warranties against construction defects and the failure of certain operating systems for a period of time. IFRS 15 requires an entity to account for such warranties in accordance with IAS 37.

- Warranties that provide a service to the customer (in addition to assurance that the delivered product is as specified in the contract) are called ‘service-type warranties’. If the customer has the option to purchase the warranty separately or if the warranty provides a service to the customer beyond fixing defects that existed at the time of sale, the entity is providing a service-type warranty. The Boards determined that this type of warranty represents a distinct service (i.e., it is a separate performance obligation). Therefore, an entity allocates a portion of the transaction price to the warranty, based on the estimated stand-alone selling price of the warranty. The entity recognises the allocated revenue over the period the warranty service is provided. Service-type warranties may be infrequent in the real estate industry.

Rental guarantees provided in conjunction with real estate development activities are often considered in conjunction with warranties. Since a rental guarantee is not a warranty over a good or service (e.g., product defects) at the point of delivery, it may represent a separate performance obligation under IFRS 15, or a financial liability or provision that is not within the scope of IFRS 15 (See Section 3 for further discussion).

9.2 Real estate project costs

Under IFRS 15, incremental costs of obtaining a contract (i.e., costs that would not have been incurred if the contract had not been obtained) are recognised as an asset if the entity expects to recover them. Recovery can be direct (i.e., through reimbursement under the contract) or indirect (i.e., through the margin inherent in the contract). As a practical expedient, the standard permits an entity to immediately expense contract acquisition costs if the asset that would have resulted from capitalising such costs would have been amortised in one year or less.
The standard cites sales commissions as an example of an incremental cost that may require capitalisation. For example, sales commissions paid to real estate agents that are directly related to sales achieved during a time period would likely represent incremental costs that would require capitalisation. In contrast, some bonuses and other compensation that are based on other quantitative or qualitative metrics (e.g., profitability, earnings per share, performance evaluations) are unlikely to meet the criteria for capitalisation because they are not incremental to obtaining a contract. Likewise, costs incurred for model units, advertising and sales overhead may not qualify for capitalisation under IFRS 15.

IFRS 15 also includes requirements for recognising costs incurred to fulfil a contract that are not in the scope of another standard. For most real estate entities, costs incurred to fulfil a contract (e.g., the costs to construct a building, such as materials and labour) are already within the scope of another standard (e.g., IAS 16 Property, Plant and Equipment) and, therefore, are excluded from the scope of IFRS 15. IFRS 15 also provides requirements on amortisation and impairment of assets capitalised in accordance with its requirements.
10. Disclosures

The stated objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, qualitative and quantitative disclosures are required about contracts with customers; significant judgements, and changes in judgements, made in applying the standard to those contracts; and any assets recognised from the costs to obtain or fulfil a contract with a customer. These requirements are explored further in the following sections.

10.1 Contracts with customers

10.1.1 Disaggregation of revenue

The disclosure requirements begin with revenue disaggregated into categories to illustrate how the nature, amount, timing and uncertainty about revenue and cash flows are affected by economic factors. While the standard does not specify how revenue is required to be disaggregated, the application guidance provides some examples of categories as follows:

**Extract from IFRS 15**

B89 Examples of categories that might be appropriate include, but are not limited to, all of the following:

- (a) type of good or service (for example, major product lines);
- (b) geographical region (for example, country or region);
- (c) market or type of customer (for example, government and non-government customers);
- (d) type of contract (for example, fixed-price and time-and-materials contracts);
- (e) contract duration (for example, short-term and long-term contracts);
- (f) timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time); and
- (g) sales channels (for example, goods sold directly to consumers and goods sold through intermediaries).

Real estate entities will need to consider their specific facts and circumstances as well as how they disaggregate revenue in other communications (e.g., press releases, other public filings) to determine how best to meet this disclosure requirement.

10.1.2 Contract balances

The disclosures related to contract balances are extensive and intended to enable users to understand the relationship between the revenue recognised and changes in overall balances of total contract assets and liabilities in a particular reporting period.
For example, disclosures required include: revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period; revenue recognised in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (e.g., changes in transaction price; an explanation of the timing of satisfaction of performance obligations compared to the typical timing of payment; and an explanation of the significant changes in the contract asset and liability balances during the period (e.g., due to business combinations, cumulative catch-up adjustments, impairment).

10.1.3 Performance obligations
Entities are required to disclose the aggregate amount of transaction price allocated to remaining performance obligations and provide an explanation of when they expect to recognise the amounts using both quantitative and qualitative disclosures.

10.2 Significant judgements
The standard specifically requires disclosure of significant judgements and estimates made in determining the transaction price, allocating the transaction price to performance obligations and determining when performance obligations are satisfied.

For example, for real estate entities that recognise revenue at a point in time, but conclude that this occurs in advance of passing of the legal title, disclosure would be required of the significant judgements made in evaluating at which point in time the entity transfers control of an asset to the customer.

10.3 Assets recognised from the costs to obtain or fulfil a contract
The standard requires disclosure of information about assets recognised from the costs to obtain or fulfil a contract. These disclosures are intended to explain the types of costs recognised as assets (e.g. sales commissions) and how those assets are subsequently amortised or impaired.

10.4 Practical expedients
There are several practical expedients within the standard, which may lead to financial results that differ from a full application of the standard. As such, entities are required to disclose their use of practical expedients in their annual financial statements in the year of adoption and thereafter. For example, if an entity elects to use the practical expedient associated with determining whether a significant financing component exists, the entity must disclose that fact.

How we see it
IFRS 15 significantly increases the volume of disclosures required in entities’ financial statements, particularly annual financial statements.

For some real estate entities there may be no change in the timing of revenue recognition under IFRS 15, but the new disclosure requirements may, nonetheless, require significant additional efforts with changes to accounting systems, internal controls, accounting policies and procedures to collect and disclose the required information. In light of the expanded disclosure requirements and the potential need for new systems to capture the data needed for these disclosures, entities may wish to prioritise this portion of their implementation plans.
11. Next steps

We encourage real estate entities to gain an understanding of the new standard and evaluate how it will affect their specific revenue recognition policies and practices.

Entities should consider whether they will need to make any changes to their accounting policies, accounting systems or internal control over financial reporting.

Real estate entities may also wish to monitor the discussions of the Boards and the TRG and the industry task forces formed by the American Institute of Certified Public Accountants (AICPA) to discuss the application of the new standard to common transactions.15

15 The AICPA has established 16 industry working groups to help develop a new Accounting Guide on Revenue Recognition under US GAAP, which would not be authoritative. For more information see http://www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition/pages/revenuerecognition.aspx
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