

28 March 2011

Sir David Tweedie  
International Accounting Standards Board  
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Dear David,

**RESEARCH ON THE APPLICATION OF THE CONTROL NOTION IN  
RELATION TO THE EXPOSURE DRAFT ON REVENUE FROM  
CONTRACTS WITH CUSTOMERS (THE ED) AND SURVEY OF OFF PLAN  
SALES OF MULTI-UNIT MULTI-LEVEL PRIVATE RESIDENTIAL  
PROPERTIES IN THE ASIA-OCEANIA REGION**

1. In our comment letter to the ED, the Accounting Standards Council (ASC) indicated that we intend to research the control notion further and to propose alternative principles that can be considered by the International Accounting Standards Board (IASB) in its development of a new revenue recognition standard. We further urged the IASB to re-consider the proposed conditions/indicators for revenue recognition and to augment the proposed model with indicators of the concept of continuous transfer of control in the final standard to ensure that they are rooted in broad and robust principles that can be applied to all types of contracts with customers.
2. The ASC had since conducted the aforesaid piece in two tracks. For the first track, the ASC had engaged the Nanyang Technological University of Singapore (NTU) to research the application of the control notion in a broad based context. For the second track, the ASC had prepared an overview of the various business practices relating to the off plan sale of multi-unit multi-level private residential properties (hereinafter referred to as “off plan sales” or “uncompleted property unit”) in the Asia-Oceania (AO) region based on information provided by a number of standard setters from the Asian-Oceanian Standard-Setters Group (AOSSG).
3. The purpose of this letter is to put forward our findings so that the IASB could consider integrating within or develop the control notion as articulated in the ED to reflect the economic substance relating to long-term built-to-purpose contracts and certain off plan sales. The intention is to stimulate discussion with a view to then assisting the IASB in developing the control notion. In drafting this letter, the ASC had taken into account the IASB’s announced tentative decisions to date though the key focus remains on the control notion as articulated in the ED.
4. The NTU report and the overview of the various business practices relating to the off plan sales in the AO region are enclosed for reference. The views and recommendations expressed in this letter are **strictly** that of the ASC and do not necessarily reflect the views of the AOSSG members mentioned in this letter. The ASC had concluded its

views and recommendations taking into account the findings of the NTU report and the information about the business practices relating to off plan sales in their respective jurisdictions provided by the following AOSSG members:

Accounting Standards Board of Japan  
Australian Accounting Standards Board  
Hong Kong Institute of Certified Public Accountants  
Korean Accounting Standards Board  
Macao Financial Services Bureau  
New Zealand Financial Reporting Standards Board  
Philippines Financial Reporting Standards Council  
The Indonesian Institute of Accountants  
The Institute of Chartered Accountants of India

### **Key Issue**

5. Whilst we do not dispute the advantages offered by the control-based model and are broadly supportive of the IASB's efforts to develop a single revenue recognition model that is based on control, we are of the view that the control notion proposed in the ED is too narrow and not rigorous enough to cater to all types of contracts, particularly built-to-purpose contracts and certain off plan sales that straddle over multi-periods.
6. Specifically, the interplay and application of the four indicators of control proposed in the ED<sup>1</sup> whilst appropriate to reflect the economic substance of some contracts are lacking in rigour to reflect the economic substance of long-term built-to-purpose contracts and certain off plan sales. Certain of these indicators of control such as legal title and physical possession are not applicable prior to completion of construction in view of the nature of the assets involved and the way business is generally conducted by the relevant industries.
7. We are therefore concerned that the proposed model would result in revenue recognition which does not faithfully represent the economic substance of the underlying transaction in such contracts, thereby undermining the decision-usefulness of financial statements. In the ensuing paragraphs, we have highlighted the key salient features and economic substance relating to long-term built-to-purpose contracts and certain off plan sales in which the current control notion and indicators proposed in the ED do not sufficiently address.

### **Long-Term Built-to-Purpose Contracts**

8. Long-term built-to-purpose contracts typically involve the construction of an asset (e.g. ship and system development) in accordance with the customer's specifications which is to be delivered at a future agreed upon date.
9. The following paragraphs highlight the salient features of long-term built-to-purpose contracts which we believe the IASB should take into consideration in its formulation of the new revenue recognition standard.

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<sup>1</sup> (1) Unconditional obligation to pay; (2) legal title; (3) physical possession; (4) design or function of the good or service is customer-specific.

### *Performance of contractually specified key performance milestones and progress payments*

10. A key feature of long-term built-to-purpose contracts is that the vendor is contractually bound to complete specified key performance milestones. In return for completing each contractually specified key performance milestone, the vendor is entitled to an irrevocable and unconditional right to specified consideration.
11. Although the customer generally does not obtain physical possession of or legal title to the built-to-purpose asset during construction, the economic substance of such contracts is that the vendor has transferred an economic benefit progressively as each key performance milestone is performed. The achievement of such performance milestones has created value for the customer in that the asset is progressively built up to its specifications for which the customer has an unconditional and irrevocable obligation to pay for the value that is created by the vendor.

### *Unique non-fungible asset*

12. Another objective evidence that the vendor has created value for the customer through its achievement of the performance milestones is that the built-to-purpose asset is unique and non-fungible. This unique and non-fungible nature of the asset would preclude the vendor from directing the asset to another customer. In other words, the vendor does not have the right of an owner to deal freely with the asset, i.e. the vendor cannot direct the use of, and receive the benefit from, the asset.
13. In this regard, we note and are broadly supportive of the IASB's tentative decision arising from its February 2011 meeting to include "*the entity's performance does not create an asset with alternative use to the entity*" as a criterion for continuous satisfaction of a performance obligation. We believe that this criterion should be developed further by the IASB for incorporation into the final revenue recognition standard.

### *Other aspects and customer's right to take over the asset during construction*

14. Based on the IASB staff paper in January 2011 (i.e. agenda paper 6A) which described a service as "an entity performing, or standing ready to perform, an agreed-upon task or series of tasks for the benefit of a customer", it is ambiguous whether a long-term built-to-purpose contract is considered the sale of a good or the rendering of service. Regardless of whether such contracts are considered the sale of a good or the rendering of service, the economic reality is that the vendor through the performance of the key performance milestones is transferring an economic benefit continuously to the customer.
15. Typically, for long-term built-to-purpose contracts, the customer cannot take over the uncompleted built-to-purpose asset during construction as this necessarily assumes a scenario where there is a contract breach. Thus, the question of whether a customer possesses the right to take over the uncompleted built-to-purpose asset during construction should not be considered as revenue recognition principles ought to be premised on an already established examination that the contract parties are able to and would perform their respective contract obligations, rather than be premised on the contractual rights of each party in the event of a contract default.

16. Furthermore, such a customer's take-over feature differentiates a construction contract from a built-to-purpose contract despite that the earnings process for both contract types is economically similar. It would seem counter intuitive if revenue is recognised differently for two contracts with economically similar earnings process simply because of the absence of a right to take over the asset by the customer during construction for the later. The absence of a customer's right to take over the uncompleted built-to-purpose asset does not negate the fact that the vendor has transferred a benefit to the customer progressively as defined key performance milestones are performed.
17. In addition, the legal framework for many of these built-to-purpose assets (e.g. ship) is such that the legal title to the asset can realistically be drawn up and transferred to the customer only upon completion of construction of the asset.
18. In this regard, the NTU research recommended a segregation of whether such contracts should be accounted for as a sale of good or rendering of service by considering the contract arrangement. For contracts that are entered into with a customer prior to or during the asset building process (i.e. sell-then-build situation), they would be considered as rendering of services.
19. The ASC is of the view that this NTU research recommendation is an area that the IASB could consider to enable the economic substance of the long term built-to-purpose contracts to be faithfully represented in the financial statements.

#### **Off Plan Sales in AO Jurisdictions**

20. In general, off plan sale is permitted in all of the AO jurisdictions represented in the survey. The common features for off plan sales in these AO jurisdictions are that the customer obtains legal title and physical possession to the property unit only at completion of construction and the customer does not have the ability to specify major changes to the design or function of the property unit at any point in time (i.e. even after obtaining legal title). These common features largely stem from the "collective control" attribute of the underlying asset which precludes the customer from taking over the physical work-in-progress or assuming legal title until completion of construction or from specifying major changes to the design or function of the property unit either before, during or after completion of construction (please refer to our "Collective Control" section for further details).
21. The indicators of control proposed in the ED (i.e. legal title, physical possession and customer-specific design or function) would therefore not be relevant in the assessment of whether control has indeed been transferred to the customer during construction for off plan sales. Accordingly, a revenue recognition model that is built around such indicators would fail to recognise those salient features of these contracts that provide strong evidence that the customer has obtained the ownership rights associated with the uncompleted property unit as construction progresses or that the developer does not have the right of an owner to deal freely with the uncompleted property unit.
22. The following paragraphs highlight only the key common features of off plan sales in the AO jurisdictions surveyed which we believe the IASB should take into consideration in its formulation of the new revenue recognition standard so as to ensure that the standard is rooted in broad and robust principles.

### *Collective control*

23. An important feature of off plan sales in the AO jurisdictions surveyed is that there is an element of “collective” control. The ownership rights of a single customer in a multi customers-single vendor situation are different from a single customer-single vendor situation.
24. A single customer in a collective control situation cannot unilaterally take over the physical work-in-progress during construction as this would affect the rights of the other customers and the contractual obligations of the developer to the collective pool of customers. Similarly, a single owner in a collective control situation cannot unilaterally deal with the underlying land after completion of construction without infringing on the collective rights of the other owners.
25. For the same reasons, a single customer in a collective control situation is not able to specify the major design or function of his property unit at any point in time, i.e. even after he obtains legal title and physical possession to his property unit.
26. Furthermore, the legal title of a property unit in a collective control situation is typically defined as the ownership of the airspace the unit actually occupies, plus an undivided interest in the ownership of the common elements (including the land and common built-up areas of the property) that are jointly owned with the other unit owners. Accordingly, the legal framework for collective control situations is that the legal title to a property unit can realistically be drawn up and transferred to the single customer only upon completion of construction of the entire development.
27. Based on the above, we do not see any plausible rationale as to how physical possession or legal title or the ability to specify major design or function could be used as a key indicator of control to determine if the customer obtains control of the good or service during construction in a collective control scenario. We note however that the IASB had tentatively decided in its January 2011 meeting to eliminate “the design or function of the good or service is customer-specific” as an indicator of control.

### *Ownership rights in the form of equitable interest*

28. An important facet of the control notion in relation to contracts where there is a tangible asset formation is the ownership rights of the customer associated with the work-in-progress, which may not necessarily be conferred only through the assumption of legal title.
29. A pertinent feature of off plan sale in some AO jurisdictions is that the ownership rights of the customer are represented by an equitable interest in the uncompleted property unit which vests in the customer before legal title passes. This is in stark contrast to the business practices in other AO jurisdictions where the contract is in substance a right to purchase a property unit at a future date which is generally not transferable.
30. Such equitable interest is akin to beneficial ownership which entitles the customer to an unfettered ability to sell the uncompleted property unit to another party at any time after the contract for the off plan sale is entered into, with the gain or loss from such a sale being retained by the customer. The equitable interest also entitles the customer to pledge the uncompleted property unit as collateral for a loan to purchase the property unit.

31. Correspondingly, a customer who holds an equitable interest in an uncompleted property would have an unconditional obligation to pay for the uncompleted property and would not be able to revoke the contract.
32. We are of the view that this equitable interest feature is aligned with the ED's definition of control "*A customer obtains control...when the customer has the ability to direct the use of, and receive the benefit from...(paragraph 26)*" and "*the customer can obtain the benefit from an asset...by using, consuming, selling, pledging or holding the asset (paragraph 27)*".
33. In this regard, we believe that the previous example 9 (produced below) in IAS 18 *Revenue* relating to real estate sales (hereinafter referred to as IAS 18 example) which had been superseded by IFRIC Interpretation 15 *Agreements for the Construction of Real Estate* adequately captures the notion that equitable interest in a property is a key feature of ownership rights relating to off plan sales.

*"Revenue is normally recognised when legal title passes to the buyer. However, in some jurisdictions the equitable interest in a property may vest in the buyer before legal title passes and therefore the risks and rewards of ownership have been transferred at that stage."*

34. The ownership rights of a customer with an equitable interest in the property unit are the same during or after construction except that the customer does not obtain physical possession or legal title during construction. Hence, we do not see any plausible rationale not to include the pertinent element of ownership rights denoted by an equitable interest as a key indicator of control.
35. If the notion or indicators of control developed by the IASB do not recognise this equitable interest, we believe it would fail to faithfully depict the party that has control over the uncompleted property unit. In addition, it would fail to appreciate the economic difference between two economically different situations (i.e. equitable interest in the property unit vis-à-vis a right to purchase a property unit at a future date).

#### *Risks and rewards of ownership*

36. In the aforementioned IAS 18 example, the risks and rewards of ownership are deemed to have been transferred to the customer when the equitable interest vests in the customer. As such, the risks and rewards of ownership are seen as intrinsically linked to equitable interest.
37. By discarding the risks and rewards of ownership from the new revenue recognition model, the danger is that the revenue number no longer reflects the economic substance of off plan sales in some AO jurisdictions where the risks and rewards of ownership of the uncompleted property is transferred to the customer progressively.
38. The use of risks and rewards of ownership as an indicator of control has its merits for off plan sales (as well as for other types of contracts), as this involve an examination of the facts and circumstances of the business practices of off plan sales in different jurisdictions by focusing on the substance of the transactions rather than the form of the transactions (i.e. identifying when legal title or physical possession is obtained by the customer). Currently, the control indicators as stated in the ED particularly legal title

and physical possession could be seen as absolute indicators (i.e. the customer can only obtain control at a single point in time).

39. Accordingly, we believe that risks and rewards of ownership should be included as an indicator of control as exposure to risks and rewards is a consequence of controlling an asset. In this regard, we note and are fully supportive of the IASB's tentative decision arising from its January 2011 meeting to add "risks and rewards of ownership" as an indicator of control.

#### *Unique non-fungible asset*

40. Another common feature of off plan sales in the AO jurisdictions surveyed is that each property unit is unique and non-fungible. As such, once a property unit is sold, a developer is precluded from selling the same property unit to another customer or substituting it with another property unit. Consequently, the developer does not have the right of an owner to deal freely with the asset, i.e. the developer cannot direct the use of, and receive the benefit from, the asset.
41. As mentioned in paragraph 13, we believe that the criterion of "alterative use" should be further developed by the IASB for incorporation in the final revenue recognition standard.

#### *Performance of contractually specified key performance milestones and progress payments*

42. One final key feature in off plan sales in some AO jurisdictions is that the developer is contractually bound to complete specified key performance milestones. In return for completing each contractually specified key performance milestone, the developer is entitled to an irrevocable right to consideration. In other words, the customer is required to make unconditional progress payments during construction which are aligned with the key performance milestone specified in the contract. In some AO jurisdictions, such unconditional progress payments are closely aligned with the stage of construction.
43. A developer in performing the respective key performance milestone transfers an economic benefit to the customer who is required to make an unconditional payment to the developer as a result. We believe that revenue should be recognised progressively by the developer as such economic benefits are transferred by the developer to the customer.

#### **Conclusion**

44. In summary, the commonality between a long term built-to-purpose contract and off plan sales in some AO jurisdictions is that both involve the construction of a unique non-fungible asset by the vendor through the performance of contractually specified key milestones over multi-periods and aligned with unconditional and irrevocable progress payments from the customer. Furthermore, in the case of off plan sales in some AO jurisdictions, the ability of the customer to sell or pledge the property unit, which is a key element of control, is predicated on the vesting of equitable interest in the property unit rather than upon the passing of legal title at a later date.
45. As demonstrated in the earlier paragraphs, the current indicators of control proposed in the ED are not robust enough to capture the economics of such contracts which differentiate them from a standard single vendor-single customer contract for the sale of

a fungible asset. We had also noted that the IASB had tentatively accorded different status to control in relation to whether it is a transfer of goods or a transfer of services (i.e. the application of the alternative use criterion to determine if an entity satisfies a performance obligation continuously does not need to consider if the customer obtains control of that service). In light of this tentative IASB's decision, it increases the importance of the necessary distinction that has to be made between the transfer of a good and the transfer of a service. However, we wish to reiterate that the purpose of this letter is to highlight the salient features and economic substance relating to long term built-to-purpose contracts and off plan sales in some AO jurisdictions for consideration by the IASB in its formulation of the new revenue recognition standard.

46. We hope that this letter will contribute to the IASB's deliberation and should you require any further clarification, please contact either Suat Cheng Goh at [Goh Suat Cheng@acra.gov.sg](mailto:Goh_Suat_Cheng@acra.gov.sg) or Ivan Koo at [Ivan Koo@mof.gov.sg](mailto:Ivan_Koo@mof.gov.sg).

Yours faithfully



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