



European Financial Reporting Advisory Group ■

COMMENT ON THE EFRAG'S ASSESSMENTS OF IFRIC 15 'AGREEMENTS FOR THE CONSTRUCTION OF REAL ESTATE'

Comments should be sent to commentletter@efrag.org or uploaded via our website by 22 September 2008

- 1 Please provide the following details about yourself:
- (a) Your name or, if you are responding on behalf of an organisation or company, its name:
- Confederation of Swedish Enterprise
- _____
- _____
- (b) Are you/ls your organisation or company a:
- Preparer User Other (please specify)
- Industry federation
- _____
- (c) Please provide a short description of your activity/ the general activity of your organisation or company:
- Industry federation on a national level
- _____
- (d) Country where you/your organisation or company is located:
- Sweden
- _____
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2 EFRAG’s initial assessment of IFRIC 15 is that it meets the technical criteria for endorsement. In other words, it is not contrary to the true and fair principle and it meets the criteria of understandability, relevance, reliability and comparability. EFRAG’s reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

Yes No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG’s endorsement advice.

1) We reject the conclusion, see Appendix 2 paragraph 13, that IFRIC 15 represents a reasonable interpretation of the term ‘construction contract’, as used by IAS 11. The criterium of the buyer’s potential to decide on major structural elements or major structural change is narrowing down the contents of IAS 11, disregarding among other things that in many cases the construction contract buyer’s party is no more concerned with how an asset is structurally achieved than the buyer of other complex investments whose concern instead regards the effective expected performance of an asset, often expressed in terms of quantitative functional requirements. The basic assumption of IFRIC 15 that differentiation of components within an IAS 18 agreement should be carried out is contrary to clarifying to users the economic substance of the operation.

Moreover IFRIC 15 is conceived in such a way that it seemingly shadows the applicability of the general principle on component differentiation of IAS 18, paragraph 13. The relation of this paragraph to its application in an IFRIC 15 case is not analysed and not commented on.

So IFRIC 15, to our view, does not straighten out but obscure the contents of present IAS 11/IAS 18 application.

The Efrag document, see Appendix 2 paragraph 14, repeats the truism of IFRIC 15 that IAS 11 is to be applied when there is a construction contract at hand. The contribution of IFRIC 15 is to increase not decrease the complexity of reaching a decision of what type of contract is at hand. To the statement of Appendix 2 paragraph 14 should be added that even if the outcome cannot be estimated reliably, IAS 11 is still applicable to the degree the conditions of IAS 11.33 are fulfilled.

2) The conclusion by Efrag, see Appendix 2 paragraph 27,

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recognizes that there is a problem with IFRIC 15 related with interpretation by analogy. Efrag recognizes that there is no universal answer for all types of agreements in this respect. Instead it has to be resolved by using judgement and fact and circumstances of individual transactions, which is another way of saying case-by-case. At the same time Efrag considers Appendix 2, item 2 that the present situation where IAS 11 and IAS 18 interpretation exist for the same type of transactions is undesirable and an issue to be addressed. Our point of view is that IFRIC 15 does not contribute to facilitate for preparers or users to evaluate what type of approach, IAS 11 or IAS 18, is the most relevant for reflecting the basic operational concept chosen by the entity.

- (b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of IFRIC 15? If there are, what are those issues and why do you believe they are relevant to the evaluation?

IFRIC 15 and Efrag misses what to the construction companies constitute the strategic development idea of construction and real estate business. This holds both for commercial and residential products. The development operation is directed to value-increasing activities into which land forms an integral part and does not by economic terms constitute a separate subject other than in the capacity of a technical component to be provided to the project along with all other material input needed for the fulfillment a project agreement. The identification of a revenue total of land separated from the total project reflects an other type of business inventory selling of land (with or without by chance subsequent construction opportunities) with a totally different business concept than that of project development. Efrag fails to recognize that difference and its implications for a relevant revenue recognition model for the whole project.

- 3 EFRAG is also assessing the costs that will arise for preparers and for users to implement IFRIC 15, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment are set out in Appendix 3. To summarise, EFRAG’s initial assessment is that IFRIC 15 is:

- (a) likely to involve some preparers in some additional year one and ongoing costs. However, EFRAG’s initial assessment is that, when considered in aggregate, those costs will not be significant.

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(b) likely to involve users in no year one or ongoing incremental costs.

Do you agree with this assessment?

Yes No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

1) Efrag states that some entities need to change the way they account for some or all of their agreements. Clearly this is an obvious, and according to our perception a rather cynic, conclusion. But it should also be observed that - contrary to what is pronounced by IFRIC 15.10 where the determination on applicable revenue recognition "requires judgement with respect to each agreement" - companies cannot afford to apply a sophisticated judgement process to differentiate the handling of its stock (IAS 11 or IAS 18 at one point of time or IAS 18 goods or IAS 18 goods on a continuous transfer of risk and rewards or IAS 18 services). What has to be considered is the volume dimension of ongoing projects, to be expressed in the magnitude of thousands. To this estimate a factor minimum of 20-50 has to be applied in case individual sales agreements will have to be considered within a project and even more so provided there is also an expected break down on components within a project.

The implementation aspect breaks down to two main issues:

- a. Providing internal rules and criteria and system reorganization for forthcoming projects.
- b. Making the requirement of retroactive application feasible.

The latter issue is one to be especially highlighted. Defining IFRIC 15 judgement on agreement for ongoing projects starting a number of years back in combination with the volume dimension should be considered as a particular obstacle both relating to the assessment of the cost aspects of implementation and to the time required for preparation in advance of the transition, see also question 5 below.

2) If a user in the capacity of a financial analyst or financial advisor is confronted to new revenue recognition rules he will have to establish reconciliation rules for his aggregated time series of financial performance data in question. Also other types of users will be confronted with the same problem. In combination with the loss of relevant financial statement information relative to the presently applied revenue recognition criteria, see also question 4 below, we see IFRIC 15 as a cost issue also to the users' side.

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- 4 IFRIC 15 is likely to result in improvements in the quality of the information provided. EFRAG’s initial assessment is that the benefits to be derived from applying IFRIC 15 will exceed the costs involved.

Do you agree with this assessment?

Yes No

If you do not, please explain why you do not and what you think the implications should be for EFRAG’s endorsement advice?

According to paragraph 37 Efrag believes that IRIC 15 will eliminate the cause of the current diversity in practice and improve the comparability of information. It is very hard to see the point in that, taking into regard

a. the high degree of sophistication to link an agreement to the relevant accounting treatment prescribed by IFRIC 15 provoking a new set a judgement to be used “with the respect to each agreement” (IFRIC 15 paragraph 10) which irrespective of whether you like it or not will result in a new set of uncertainties to the practices between different preparers.

b. the fact that IFRIC 15 creates a gap which doesn't exist today between accounting according to IFRS and internal accounting. This gap will probably force companies to publish some kind of non-regulated proforma presentations besides the IFRS presentation. The IFRS operating segment presentations, with a complicated bridge to IFRS, will not alone fill this information gap. In the short perspective of interim reporting periods the information value of the operations threatens to be even more seriously distorted.

Our conclusion is that IFRIC 15 doesn't give a workable and business oriented interpretation of accounting for agreements for the construction of real estate. Instead it creates more complications for most parties involved".

In relation to the specific issue of IFRIC 15 we do not think it should be endorsed on the merits of improving accounting.

- 5 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on IFRIC 15.

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Do you agree that there are no other factors?

Yes No

If you do not, please explain why you do not and what you think the implications should be for EFRAG’s endorsement advice?

1) Specific attention has to be given to the regulation of the transition date. In view of the radical change IFRIC 15 brings to present accounting and its requirement of retroactive application an EU endorsement decision of IFRIC 15 should allow for a transition date no sooner than for annual periods on or after 1 January 2010.

2) This transition date should be combined with a rule of prospective application to new agreements after 1 January 2010. We suggest that EFRAG would take up this issue with the IFRIC to provide for this.

3) An EU enforcement decision has to take in account the crossreferences on components, see IFRIC 15.BC11, to IFRIC 12 and IFRIC 13 requiring that also these two preceding interpretations have their endorsement process finalized.

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