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EFRAG COMMENT LETTER ON EXPOSURE DRAFT OF DRAFT INTERPRETATION D21 REAL ESTATE SALES

Dear Stig,

I am writing on behalf of the CNC to give you our comments on the above-mentioned Efrag draft comment letter.

For your information, our draft reply to the IFRIC exposure draft is set out in the Appendix.

We share the EFRAG's concerns as expressed in the covering letter "were the consensus proposed to be applied by analogy to other circumstances and industries ."

However, we think that the EFRAG could go further by stating that :

- The Interpretation applies implicitly to activities other than real estate by analogy by the application of the IAS 8 hierarchy
- The Interpretation should therefore address the issue of the implications of applying its principles to other activities

We strongly support the view expressed in §8 of the Appendix with reference to the lack of evidence in IFRSs that the percentage of completion method only applies to work "being done to the buyer's specifications."

We believe this is a fundamental issue , which if applied to a full spectrum of construction activities leads potentially to a significant restriction of the scope of IAS 11 .

We ,therefore ,believe this issue should be dealt with in the covering letter and that the criticism of the exposure draft should focus on the lack of rationale justifying the proposed interpretation of a “construction contract”.

We hope you find these comments useful and would be pleased to provide any further information you might require.

Yours sincerely,

with best regards



Jean-François Lepetit

APPENDIX



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IFRIC DRAFT INTERPRETATION D21 Real Estate Sales

Dear Joan,

I am writing on behalf of the CNC to give you our comments on the above-mentioned Draft Interpretation.

We fully support the IFRIC in proposing a clarification of the criteria for determining which revenue recognition principles apply to real estate sales.

However, the Draft Interpretation in its current form could be extended, in the absence of a specific exclusion, to activities other than real estate through the application of the IAS 8 hierarchy. We recommend that the IFRIC clarifies whether this is intended and, if so, whether the appropriateness of these principles when applied to other activities has been tested. This is particularly necessary to the extent that the Draft Interpretation may change current accounting practices in activities other than real estate.

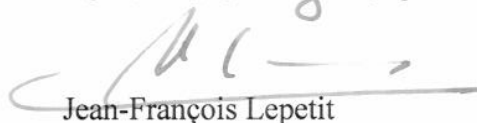
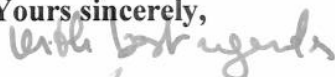
Moreover, the Draft Interpretation introduces principles for applying IAS 11, which do not appear explicitly in that standard and for which no real justification is given in the Basis for Conclusions. In these circumstances other criteria for applying IAS 11 may well be equally or more appropriate.

In particular, we do not think that limiting the application of IAS 11 to contracts for construction services to the buyer's specification is appropriate. Other indicators, including where the buyer has the right to resell the property in its current state or where the buyer is the owner of the land on which construction takes place, provide conclusive evidence of the progressive transfer of control to the buyer, irrespective of whether the construction is to his specification. We urge the IFRIC to present a clear rationale in the Basis for Conclusions in order to strengthen its position.

Our detailed comments are set out in the Appendix.

We hope you find these comments useful and would be pleased to provide any further information you might require.

Yours sincerely,



Jean-François Lepetit

APPENDIX

IFRIC DRAFT INTERPRETATION D 21 Real Estate Sales

1.SCOPE OF THE INTERPRETATION

- 1.1. According to §5 “This (draft) Interpretation shall be applied in accounting for revenue from the sale of real estate.”
- 1.2. The draft (§8 and §9) includes a new interpretation of the definition of “construction contracts”.
- 1.3. Construction contracts as defined by IAS 11 are not restricted to real estate sales.
- 1.4. The new interpretation of the definition of “construction contracts” could therefore apply to other transactions .The application of this draft Interpretation to transactions other than real estate will be possible under the IAS 8 hierarchy since there is no specific exclusion in the text. We therefore recommend that the IFRIC should clarify whether it is intended that this draft Interpretation should be extended to other activities and, if so, whether the necessary research has been done to determine whether the proposed principles are appropriate for other activities since they may produce changes in current practice.

2.DEFINITION OF A CONSTRUCTION CONTRACT

2.1. We refer to the following definition of a “construction contract” set out in the draft Interpretation §8 and §9:

“§8 IAS 11 defines a construction contract as “a contract specifically negotiated for the construction of an asset or a combination of assets.” A sale agreement meets this definition (of a construction contract) if it is an agreement for the seller to provide **construction services to the buyer’s specifications**.

§9 Features that, individually or in combination, may indicate that an agreement is for the seller to provide construction services to the buyer’s specifications include:

- (a) The buyer being able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether it exercises that ability or not);
- (b) the seller transferring to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. Indications that the seller transfers control of the work in progress in this way may include, for example:
 - i. the construction taking place on the land that is owned or leased by the buyer
 - ii. the buyer having a right to take over the work in progress (albeit with a penalty)during construction , e.g. to engage a different contractor to complete the construction;
 - iii. in the event of the agreement being terminated before construction is complete, the buyer retaining the work in progress and the seller having the right to be paid for work performed (subject to buyer acceptance).”

2.2. The draft Interpretation introduces principles for the application of IAS 11, which do not appear explicitly in that standard and which are not sufficiently justified in the Basis for Conclusions. According to the above definition, IAS 11 only applies to real estate sales when they are contracts for **construction services to the buyer's specifications**. In all other cases IAS 18 applies

2.3. We disagree with the interpretation that IAS 11 **only** applies to contracts for construction services to the buyer's specification on the grounds that it is too restrictive.

2.4. IAS 11 is widely applied, at present, to contracts for the construction of assets irrespective of whether the customer has the ability to specify or modify "major structural elements of the design" of the asset.

2.5. In our view, the meaning of "specifically negotiated" shall not necessarily be reduced to contracts for which the buyer may change the technical specifications. We strongly believe that "specifically negotiated" includes a concept of "unique" and non-fungible asset. Through this concept, it is clear that:

- A Mercedes limousine may be constructed for a specific client with specific options (colour, leather, TV set...) but remains a non-unique asset. Thus, it is clear that it is not a construction contract even if it was specifically negotiated between Mercedes and a specific client
- An apartment may be a unique penthouse and be subject to a specific commercial negotiation without the buyer being involved in its basic design.

2.6. The draft Interpretation introduces the concept that a "construction contract" is necessarily a contract for construction services to the **buyer's specification**. This concept is not currently a feature of IAS 11 and will introduce a different revenue recognition principle according to whether the contract is to customer's specification or not. We contest the validity of this distinction and recommend that contracts for the construction of assets should continue to give rise to revenue as work is performed irrespective of whether they are to customer's specification.

2.7. In §9 (b) above, the draft Interpretation sets out indications of the progressive transfer of risks, rewards and control to the buyer. These indications determine whether IAS 11 and the stage of completion revenue recognition principle shall be applied to the transaction as opposed to IAS 18. They should therefore be as clear and complete as possible.

2.8. Whilst we recognise that the indications given in 9(b) are only examples, we question whether they are sufficiently complete as they all address the ability to restrict access. Control is also evidenced as the capacity to sell or pledge an asset. We suggest that the list of indicators of transfer of control should be completed to include explicitly the right of the buyer to sell or pledge the asset in its current state of completion.

2.9. We suggest that the guidance given in §9 and §10 could be improved in order to make it possible to establish a clear hierarchy of characteristics that establish conclusively, which of IAS 11 and IAS 18 applies. At present it would seem possible for a contract to have features common to both §9 and §10 e.g. construction on buyers land but where the buyer only has limited ability to specify design. Where a contract has both features of §9 and §10, guidance is required as to how to decide whether IAS 11 or IAS 18 applies. We, therefore, suggest that the (draft) Interpretation should make it clear which indications represent conclusive evidence when either IAS 11 or IAS 18 is applicable so that the terms of §9 and §10 are mutually exclusive, or that features of IAS 11 are pre-eminent.