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D21 Comment letters
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Dear Sirs

Exposure Draft of Proposed Interpretation D21, Real Estate Sales

The Danish Accounting Standards Committee is pleased to comment on the International Financial Reporting Interpretation Committee's (IFRIC) exposure draft to IFRIC D21, Real Estate Sales (referred to as D21).

The Committee supports the IFRIC's efforts to provide further guidance on recognition of revenue related to the real estate sales because of the current divergence in practice in respect of the identification of the applicable standard for revenue recognition for sales of units (for instance sale of a multi unit real estate building) within the real estate industry.

However, we find that the current divergence in practice does not only relate to sale of real estates, but also relates to other industries such as construction of machinery and other large assets (such as airplanes and ships). This divergence seems to be caused by the limited guidance within current IAS 11 in general, and not only in relation to real estate sales. Consequently, even though paragraph 5 of D21 limits the scope of the interpretation to sale of real estate, the guidance in D21 is likely to have a wider application, as it, with reference to the IAS 8 hierarchy, may be used by analogy to determine whether contracts other than those for real estate sales meet the definition of a construction contract.

This, in our opinion, is a wider issue that calls for an amendment to IAS 11 rather than an interpretation. We would therefore have preferred that the necessary clarifications had been made as amendments to IAS 11, rather than as an interpretation. However, we acknowledge that such an approach would not currently be appropriate due to the Board's revenue recognition project. Hence, we support the current scope of the interpretation provided it is limited to sale of real estate only which we also understand was what IFRIC was contemplating in the first place with D21. As a result, it may be considered to clarify the limited scope of D21 further.

In our view, the critical condition in the definition of a construction contract as described in paragraph 3 of IAS 11 is that the contract is specifically negotiated and hence that the buyer has the ability to significantly influence the design and specification of the asset. We therefore

generally support the proposals in D21. However, we have concerns about some aspects of D21, as currently drafted. Our most significant concerns are mentioned below.

Scope

Paragraph 5 indicates that D21 should be applied ... *in accounting for revenue from the sale of real estate* which seems to be a wider scope than the multi-unit real estate sales we understood was the issue giving rise to the IFRIC considering the need for an interpretation.

We have concerns that the D21 might unintended be applied by analogy (through the hierarchy) to other construction contracts since D21 ... *addresses the meaning of the term 'construction contract'* ... IAS 11 and IAS 18 are general standards and the term 'construction contract' also is quite general.

With that in mind and even that the D21 according to its scope paragraph concerns real estate sales only we suggest that IFRIC considers how it can be avoided that the consensus is applied by analogy to the examples mentioned in paragraph 4 of IAS 11 (*A construction contract may be negotiated for the construction of a single asset such as a bridge, building, dam, pipeline, road, ship or tunnel ...*). With an understanding that the scope is intended to be narrow IFRIC might consider to specifically addressing analogising (as was done with IFRIC 10).

Identification of the applicable standard

Paragraphs 9(a) and 9(b) of D21 provide indicators of a construction contract and state that the indicators may either individually or in combination lead to a contract being classified as a construction contract.

We note that the indicators in paragraph 9(a) relate to the degree to which the buyer specifies the design of the asset. Conversely, paragraph BC5(b) suggests that the IFRIC regards the transfer of control and risks and rewards of ownership from the seller to the buyer as a crucial feature of a construction contract, and hence it seems that IFRIC on this basis has concluded that the indicators in paragraph 9(b) of D21 may be sufficient to determine whether a contract is a construction contract.

We believe that the characteristic of a construction contract, as defined in paragraph 3 of IAS 11, is that the buyer has the ability to specify the design and specifications of the asset and hence, the seller should not be able to determine the design of the asset with only limited changes to be made by the buyer. We also note that the definition in IAS 11 does not require, or even imply, that the transfer of risks and rewards during the construction phase is necessary, and hence, we do not find that such a condition is crucial when determining whether a contract is a construction contract.

In our view, the indicators in paragraph 9(a) therefore *override* the indicators in paragraph 9(b) and hence, we do not believe that the indicators in paragraph 9(b) in themselves are sufficient to classify a contract as a construction contract. We are concerned that the application of the conditions in paragraph 9(b) will lead to standardised assets, for example windmills, which are built on the buyer's land being accounted for as construction contracts, even though it is common to account for such transactions as sale of goods. In addition, we note that it is not uncommon that transactions are structured so that the land is transferred to for example a trust before commencement of the construction of the building. It is unclear whether such a contract regarding the construction of a standardised building would be a construction contract when applying the conditions in paragraph 9(b).

We also note that when applying the indicators in paragraph 9(b) many of the contracts regarding a standardised asset or variations of a standardised asset may be regarded as being within the scope of IAS 11.

In addition, we note that the interpretation in several places makes a reference to *completed real estate* (for example paragraphs 7 and BC5(b)) and the interpretation thereby implies that only sales of *completed real estate* should be accounted for under IAS 18. However, we note that in many cases a contract to sell a partially constructed building should be accounted for as sales of goods. Consequently, we recommend that references to *completed real estate* are deleted from the interpretation.

In conclusion, we find that only the paragraph 9(a) indicators can be derived from IAS 11 itself and that the proposed indicators in paragraph 9(b) should be deleted. We recommend that IFRIC expands the guidance on the application of the indicators in 9(a). We would expect such additional guidance to explain that the specific nature of a construction contract implies that delivery of an asset which deviates more than insignificantly from the asset specified in the contract will have significantly less value to the customer.

Remaining obligations

Paragraph 14 of D21 states “.....*before the entity has performed all of its contractual obligations to the buyer. If so the entity shall recognise its remaining obligations in one of two ways...*” (Emphasis added)

We recommend that IFRIC deletes this wording from D21 in the final interpretation, as it does not provide any additional guidance on how to apply paragraph 13 and 19 of IAS 18.

Basis for conclusion

Under US GAAP guidance exists in SFAS 66 Accounting for Sales of Real Estate. It establishes standards for recognition of profit on all real estate sales transactions without regard to the nature of the seller's business. Some provisions in SFAS 66 were developed over several years to deal with complex transactions that are frequently encountered in enterprises that specialise in real estate transactions.

Realising that real estate transactions are complex and presuming that SFAS 66 is to be understood as also dealing with the nature of the sale agreement we believe D21 is not sufficiently clear in explaining (in BC5) why paragraph 37 of SFAS 66 is not considered further.

Closing

Should you have any questions or if you wish to discuss any of the issues raised in this letter, please contact us.

Yours sincerely

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