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International Accounting Standards Board

30 Cannon Street
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United Kingdom

Financial Accounting Standards Board

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Subject: Exposure Draft on Revenue from Contracts with Customers

Dear Sir/Madam,

The ABRASCA - Brazilian Association of Publicly Held Companies - welcomes the opportunity to comment on the Exposure Draft named Presentation of Items of Other Comprehensive Income.

We are an association which represents all the listed companies in Brazil engaged, in this matter, in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies.

This response summarizes the views of our real estate members, which may be supported by the opinions of external parties, sent to us for analysis and to enhance the discussion on the subject matter.

If you have any questions about our comments, please contact the following email: alexandre@abrasca.org.br.

Yours sincerely,

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Recognition of revenue

Question 3

Do you think that the proposed guidance in paragraphs 25 – 31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

We suggest that, since control of good and service application is the core of Exposure Draft items 25-31, control transfer of goods not yet physically ready, but over which customer has all rights and control after contract signing, should be more explicit. Mostly, in regard of transfer of goods from the real estate sector, whose standard is interpreted by IFRIC 15, which did not represent the best way to interpret accounting information for the sector, in our country.

Thus, ABRASCA's Work Group of real estate developers went over each item from Exposure Draft items 25 to 31, under discussion hereto, and it realized that there is a **need to change 3 items of the ED: item 30, letter c, item 30, letter d, and item 31**. The major reason, already mentioned, is that these items do not explicit control transfer of goods that are not yet physically ready, but customer has all rights and control over the good after contract signing. Therefore, in order to make the issue more comprehensive, we shall review each item from Exposure Draft items 25-31, with suggestion for change in the text of items 30, letter c; 30, letter d; and 31, as follows.

COMMENTS AND SUGGESTIONS OF CHANGES IN EXPOSURE DRAFT, QUESTION 3

ITEM 25

“25 An entity shall recognize revenue when it satisfies a performance obligation identified in accordance with paragraphs 20-24 by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service.”

Comments:

Developer transfers an asset to buyer at the sale act of an apartment, complying to item 25, and, consequently, in accordance to paragraphs 20 to 24.

The Brazilian real estate activity characteristics, as well as the legislation in force, mandate that developer or constructing firm to comply with certain requirements. These requirements give buyer, **immediately**, all rights over the good subject to contract, before the good or real estate is transferred physically to buyer. Thus, buyer assumes control over the ideal fraction of land, its risks and benefits inherent to purchased real estate.

The negotiation mode practiced by the Brazilian real estate market is defined by means of contract for sale and purchase or another form of contractual relationship between the developer and the buyer that can be changed entirely only by contract denouncing or amendment, respectively.

Real estate entrepreneur may alienate autonomous units (house, apartment, or business space) at three different instances: before initiation of works, during its construction, or, finally, after its completion. However, the buyer controls the good totally, after contract signature.

A significant majority of trading of undertakings takes place during the launching and construction process, therefore, prior to its full construction. Trading systematic occurs also, in majority of cases, within "set price" system, which is just the sales of units under global price contracting comprising fraction of the land and construction with set prices and deadline for delivery defined.

Concerning transfer of ownership, the signed contract has the power of a deed, and it may be taken immediately to register in the competent registry notary, assuring buyer all rights for free use of the good. It allows, mainly, for alienation of this good to a third party, its use as collateral for other contracts, etc. All it takes is seller's agreement if the good is financed by the incorporating firm itself (financial analysis).

Thus, developers comply to all requirement of ED items 20-24, transferring the good to buyer in the act of selling this good, transferring the control of the good.

Ex:

Example of rights and obligations transfer of the good to buyer took place at the expropriation of a building occurring in undertaking still under construction. Developer was indemnified only for remnant units, not alienated yet, and each buyer was indemnified for his respective unit purchase according to a compromise of sale and purchase of the autonomous unit in the undertaking that was the subject of expropriation.

Thus, clearly characterizing indelible transfer of rights, obligations, and risks of unit to each buyer, even though each buyer could not change acquired product during construction process.

ITEMS 26 and 27

"26 A customer obtains control of a good service when the customer has the ability to direct the use of, and receive the benefit from, the good or service. Control includes the ability to prevent other entities from directing the use of, and receiving the benefit from, a good or service."

"27 The customer's ability to direct the use of a good or service (ie an asset) refers to the present right to use asset for its remaining economic life or to consume the asset in the customer's activities, The customer's ability to receive the benefit from an asset refers to its present right to obtain substantially all of the potential cash flows from that asset (either an increase in cash inflows or a decrease in cash outflows). The customer can obtain cash flows an asset directly or indirectly in many ways such as by using, consuming, selling, exchanging, pledging or holding the asset."

Comments:

Developers comply to items 26 and 27 as already mentioned; there is immediate transfer of benefit of the good to buyer of the real estate who owns the rights over purchased asset.

When a customer decides to buy an unit of a certain undertaking, a house, a shop, or an apartment, the contract between developer and buyer is celebrated under the form of a compromise of purchase or sale or of a definite sale and purchase. This legal instrument

(contract) has a commutative bilateral onerous feature, providing rights and obligations to both parties.

The right of use passes to buyer, who may sell, for example, the real estate even if it is not ready yet.

Ex: A customer buys a real estate in the drawing plant, in the beginning of works, for R\$ 500 thousand. The building and, consequently, his apartment will be physically ready to live in two years. After 8 months from purchase, he becomes aware that there are interested people in buying his apartment for R\$ 800 thousand, a valuation of R\$ 300 thousand in just 8 months, and he decides to sell it. The buyer will assume all the rights that he has to sell the real estate as he has control over the good. Therefore, fulfilling a desire to get a financial profit of R\$ 300 thousand.

ITEM 28

“28 If entity retains some rights to an asset solely as protection against the customer’s failure to comply with the terms of the contract (for example, when an entity retains legal title as protection against the customer’s failure to pay), those rights are protective rights and do not preclude a customer from obtaining control of an asset.”

Comments:

Developers comply to item 28, retaining some rights to preserve the continuity of works and for credit protection, which does not preclude buyer’s control rights.

Evidently, if and while there is a negative balance before the developer, it is normal the existence of contractual clauses foreseeing i) guarantees; and ii) developer’s agreement to validate cession of rights based in credit protection and in the need of a risk analysis.

By the way, this agreement (due to contract) also occurs after completion of works.

Even if cession without agreement is admitted, cession could be considered as valid as long as solidarity of joint buyer before developer is kept.

These rights are, undoubtedly, under the equity and legal control of the joint buyer, in as much as he may cede it to third parties (inter vivos disposition), and they are transmitted to successors in case of death, they may be pawned by any creditor due to buyer’s debt of any other nature.

Another example is that once the contract for sale and purchase is celebrated, developer will not be able to alienate the same unit to third parties, with risk of committing a fraud offense.

Moreover, once the contract for sale and purchase is formalized, the unit that is the object of contract leaves the realm of developer’s equity as guarantee to its other eventual creditors. It means that this unit may not be pawned in any execution promoted by diverse creditors. Only future receivables from that promise will be at disposition of these other creditors.

ITEM 29

“29 When assessing whether a customer obtains control of an asset, an entity shall consider any related arrangements entered into at or near the same time as, or in contemplation of, the contract (for example, repurchase agreements).”

Comments:

Developers comply to requirements in item 29. There is not the possibility for developer to compulsory repurchase the good or real estate. The contract for sale of real estate does not foresee this.

As previously mentioned, the negotiation mode practice in the Brazilian real estate market is defined by contracts for sale and purchase of a real estate, compromise of sale and purchase or another mode of contractual relationship between developer and buyer, which can be changed, entirely or partially, only through denouncing or amendment to contract, respectively. If there is intension of total dissolution of contract, parties must agree upon its effectiveness, and there will be reimbursement for costs and expenditures incurred by developer.

ITEM 30, letter a

“30 An entity shall assess the transfer of control of goods or services for each separate performance obligation. Indicators that the customer has obtained control of a good or service include the following:

- a) The customer has an unconditional obligation to pay-if a customer is unconditionally obliged to pay for a good or service, typically that is because the customer has obtained control of the good or service in exchange. An obligation to pay is unconditional when nothing other than the passage of time is required before the payment is due.

Comments ITEM 30 , letter a:

Developers comply to item “a”, customers are unconditionally obliged to pay for a good or real state, transferring control to customer. Payment modalities include, cash payment in the act of purchase or through financing with set schedule.

Amounts paid by customers (purchasers) and/or liberated by financing agent are applied in the production of the undertaking, and they are not considered as advancement of funds as it happens in other markets practices in which amounts received from customers are unavailable to developer, in a security account, during project execution.

Usually, customer pays a value (down payment) and remaining amounts are paid monthly, which are part of the price directly paid to developer and, mandatorily, used in the production of said unit. If there is bank financing, amounts are disbursed directly to developer and applied in the production of the unit, as well.

ITEM 30, letter b

“30 An entity shall assess the transfer of control of goods or services for each separate performance obligation. Indicators that the customer has obtained control of a good or service include the following:

- b) The customer has legal title-legal title often indicates which party has the ability to direct the use, and receive the benefit from, a good. Benefits of legal title include the ability to sell a good, exchange it for another asset, or use it to secure or settle debt. Hence, the transfer of legal title often coincides with the transfer of control. However, in some cases, possession of legal title is a protective right and may not coincide with the transfer of control to a customer.

Comments ITEM 30 , letter b:

Developers comply to item “b”, as previously mentioned, when a customer decides to purchase an unit, i.e. a house, a shop, or apartment, the contract between developer and customer is celebrated under the mode of a compromise of purchase and sale or a definite contract for sale and purchase. This legal instrument (contract) is a legal bond that gives customer the right to usufruct the real estate, including the possibility of immediate sale, its exchange for another good and, objectively, the benefit of the good. That is, control is transferred to customer after the legal bond is celebrated.

The use right belongs now to customer, and he may even sell the real estate while it is not ready yet.

Ex: A customer buys a real estate in the drawing plant, in the beginning of works, for R\$ 500 thousand. The building and, consequently, his apartment will be physically ready to live in two years. After 8 months from purchase, he becomes aware that there are interested people in buying his apartment for R\$ 800 thousand, a valuation of R\$ 300 thousand in just 8 months, and he decides to sell it. The buyer will assume all the right that he has to sell the real estate as he has control over the good. Therefore, fulfilling a desire to get a financial profit of R\$ 300 thousand.

ITEM 30 , letter c:

“30 An entity shall assess the transfer of control of goods or services for each separate performance obligation. Indicators that the customer has obtained control of a good or service include the following:

- c) The customer has physical possession-in many cases, the customer’s physical possession of a good gives the customer the ability to direct the use of that good. In some cases, however, physical possession does not coincide with control of a good. For example, in some consignment and in some and repurchase arrangements, an entity may have transferred physical possession but retained control of a good. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of a good that the customer controls.

Comments

Physical possession does not determine control in the case of the kind of good sold by Brazilian developers. Actually, we have the sale of a good to be delivered in the future in accordance to a project previously approved by basic legislation for the sector by municipal, state, and federal authorities. It may not be changed in its essence after signature of the compromise of purchase and sale, since units are developed in a vertical building. However, customer at signature starts to usufruct the good in its construction stage. He may alienate, inclusively, to third parties without developer’s agreement, except if this later provides financing for the new customer . The transfer of the good or its control happens even without its physical possession, since it is a good for future delivery.

However, there is transfer of ownership, signed contract has the power of a deed, immediately taken to registration in competent real estate registry, assuring customer all rights of free use of the good.

Developer uses resource directly gotten from customer and, mostly, funds from financing institutions by means of signing a financing contract of the endeavor between the developer and the financing institution for the development of the alienated good. The obligation of developer to build the undertaking remains, before the financing institution, in accordance to previously approved conditions and project that are submitted to evaluation by the financing institution. Mandatorily, the financing institution only disburses financing resources if there was a minimum sale percentage of units of the endeavor, since this sale constitutes payment collaterals for the financing, making it clear the existence of ownership transfer to third parties when developer alienates units to its customers.

Therefore, it is a fixed price contract in which the disbursement of funds targeted to construction is conditioned to “**progress of works** in percentage evidenced in the Endeavor Follow Up Report – ERA, according to physical-financial schedule approved by the financing institution...”. This follow up, for disbursement purposes, “will be undertaken by financing institution’s engineering, been understood that inspection will be carried out exclusively for measuring progress of works and to check application of funds...”.

It is important to highlight that Brazilian legislation requires registration of security (contract) at the enrollment of the autonomous unit to materialize real right (of ownership or acquisition). However, with or without registration, the contract bonds parties and it has liability power.

The major effect of a contract is to create a legal bond between parties, having as the first consequence “*the bonding power of the contract*”, which translates as **non-retractable**.

The contract, once perfect and finished, only is cancelled either by agreement of rescission (new bilateral manifestation of will) or by legal sentence.

This means that neither developer or customer, unilaterally, to untie from obligations yielded with the contract of purchase of the autonomous unit.

The duty for parties (developer and customer) to respect and abide the alienation contract for the autonomous unit derives, still, from “the social function of the contract”, because the contract is, above all, an economic phenomenon. Its major social function is to “serve for circulation of wealth, providing security to market flow”.

A regulatory example of the mandatory power of a contract of sale and purchase within the scope of real estate development: developer cannot change the project or deviate from the development plan, except with unanimous authorization of stakeholders or by legal requirement (Federal Law no. 4,591, article. 43, item IV). In the other hand, as it is a contract for sale of goods, customers have only a limited possibility to influence in the real estate, such as, the possibility to select a project from a range of options specified by the developer or to specify small variation in the basic project.

SUGGESTION FOR CHANGING THE TEXT

- c) The customer has physical possession-in many cases, the customer’s physical possession of a good gives the customer the ability to direct the use of that good. In some cases, however, the good is not already done physically but the control is with the customer before it, for example, in some real estate sales. In some cases, however, physical possession does not coincide with control of a good. For example, in some consignment and in some and repurchase arrangements, an entity may have transferred physical possession but retained control of a good.

Conversely, in some bill-and-hold arrangements, the entity may have physical possession of a good that the customer controls.

ITEM 30 , letter d:

“30 An entity shall assess the transfer of control of goods or services for each separate performance obligation. Indicators that the customer has obtained control of a good or service include the following:

- d) The design or function of the good or service is customer-specific a good or service with a customer-specific design or function might be of little value to an entity because the good or service lacks an alternative use. For instance, if an entity cannot sell a customer-specific asset to another customer, it is likely that he would require the customer to obtain control of the asset (and pay for any work completed to date) as it is created. A customer’s ability to specify only minor changes to the design or function of a good or service or to choose from a range of standardized options specified by the entity typically would not indicate a customer-specific good or service. However, a customer’s ability to specific changes to the design or function of their good or service would indicate that a customer obtains control of the asset as it is created.”

Comments:

It is not simple to be able to change the project of a building or its apartments as there are engineering, densification of real estate development site, land occupation, environmental restrictions, and others as well. As previously stated, in Brazil, the majority of real estate development is sold before or during construction, and at this stage customer becomes owner or promising purchaser of an ideal fraction of the land and of facilities to be built.

Developer sell and customer purchases, in the purchase and sale at set price, a future unit duly specified in its descriptive features (private, common and total area, ideal fraction of land, location, internal division, descriptive memorial of specifications of project works, etc.).

There are instances that, due to marketing reasons, developer allows, under certain conditions, customer requests changes in the descriptive memorial or in the internal division of alienated unit by means of customization projects before beginning of works or even afterwards, as long as some minimum deadline is respected.

These conditions are extremely restrictive, due to practical (engineering, etc.) or legal reasons.

Customer will not impose, in absence of expressed contractual provision, on the developer the execution of such customization.

However, as stated, the constraint is that the real estate developer, due to engineering restrictions, cannot accept certain changes desired by purchaser, such as the construction of a bigger balcony or a veranda, or a swimming pool, etc. Rather, there is possibility for small customizations, depending on the contract, in the interior of the apartment.

Even in case of sale of a ready unit, customer does not have condition to change the project, since it is inserted in a vertical building and its changes becomes unfeasible due to technical impossibility of implementing it. What happens at most in ready units are rehabilitations that do not change the essence of the product. It is possible to change internal measurements of spaces, for example, to enlarge living room, diminishing the bathroom, etc., but it is not possible to increase total area of the real estate or to develop a balcony.

Thus, relevant changes in the product does not occur in essence, either traded in the drawing plan or in a finished unit.

SUGGESTION OF TEXT

d) The design or function of the good or service is customer-specific a good or service with a customer-specific design or function might be of little value to an entity because the good or service lacks an alternative use. For instance, if an entity cannot sell a customer-specific asset to another customer or assets which are such a specialized nature that only the customer can use them without major modifications, it is likely that the would require the customer to obtain control of the asset (and pay for any work completed to date) as it is created.”

ITEM 31

“31 Not one of the preceding indicators determines by itself whether the customer has obtained control of the good service. Moreover, some indicators may not be relevant to a particular contract (for example, physical possession and legal title would not be relevant to services).”

Developers, aligned to previously stated, comply to item 31, but they highlight that, in the specific case, physical possession does not establish control of good. Thus, we suggest that text to include not only the features of services, but this non-relevance also in the real estate development.

SUGGESTION OF TEXT

“31 Not one of the preceding indicators determines by itself whether the customer has obtained control of the good service. Moreover, some indicators may not be relevant to a particular contract (for example, physical possession, and legal title would not be relevant to services and some real estate sales).

EXAMPLE 17 – SALE OF AN APARTMENT UNIT

To better illustrate the understanding described above, we prepared an example of a typical sale of an apartment unit, similarly to Example 17 of the Exposure Draft, page 64, currently in public hearing:

"The entity develops and performs the launching of a vertical building project, with sales of the units before the beginning of the construction, i.e., off-plan. The entity (real estate developer) at this point, is still the owner of a piece of land and of a construction project, which will be developed in such land. The units (apartments) are sold to clients by means of a purchase and sale agreement, which is irreversible and irretrievable. As from the moment of sale and signature of the agreement, the unit is no longer available to the real estate developer, and the related risks and benefits are transferred to the purchaser. The installments paid by the clients to the real estate developer, whether with their own resources or through bank financing arrangements, during the period of launching and construction of the project, are used by the real estate developer directly for costing of the construction. The purchase and sale agreement guarantees the purchaser control over the apartment, since, as mentioned above, the property could be sold (disposed of) by the purchaser after the agreement has been signed, in the applicable market. The unit does not need to be physically ready.



The legal guarantee is the agreement, and the purchaser has control thereover as soon as the agreement is signed. During the construction period, the purchaser may modify the project of his unit (for example, floor, color etc.), provided the common project (building structure) is not changed and the deadline is not impacted. In such example, the purchaser obtains control as from the execution of the purchase and sale agreement, therefore before the unit is physically ready. Consequently, in this example, the client obtains control over the unit upon execution of the agreement, becoming the owner of an undivided interest in the land and future constructions therein, as the construction work takes place. Thus, the obligation of the real estate developer is completed as it constructs the sold unit. The client also obtains control over the unit, irrespective of its completion.”

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