13 March 2012

Mr Hans Hoogervorst  
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(By email submission: commentletters@ifrs.org)

Dear Sirs

REVISED EXPOSURE DRAFT ON REVENUE FROM CONTRACTS WITH CUSTOMERS

The Real Estate Developers’ Association of Singapore (REDAS) appreciates the opportunity to comment on the revised Exposure Draft on Revenue from Contracts with Customers (the revised ED) issued in November 2011.

We are heartened by the IASB members’ and staff’s outreach activities including the active engagement of our members in Singapore. In this respect, we would like to express our sincere appreciation to the Board and the Staff for making the effort and spending the time to understand the economics and the underlying legal framework surrounding real estate sales in Singapore and to address our concerns.

We welcome the proposals in the ED, in particular, paragraph 35(b) and illustrative example 7, which address the concerns of the Singapore real estate industry. We strongly support the criteria listed in paragraph 35(b), of the ED, on how an entity could transfer control of a good or service over time. We believe that these criteria are appropriate and would result in revenue being recognised only when there is sufficient degree of certainty that both contracting parties would perform under the contract. The recognition of revenue over time, in our view, faithfully reflects the economic substance of real estate sales in Singapore.

However, the Board should refine the criteria in paragraph 35(b) to clarify the application of the proposed model of determining whether a performance obligation is satisfied over time.

The aspects that require consideration and result in our suggested refinement of paragraph 35(b) of the ED and the addition of another example are (1) how government rules and regulations in the real estate markets should be assessed and (2) the relevance of cash payments made over time while the performance obligation is satisfied.
(1) How government rules and regulations in the real estate markets should be assessed

Given that land is a limited resource and housing is a basic need, it is understandable for governments to actively regulate their housing markets (e.g. measures to match supply and demand etc.) through laws and regulations. Primary aim of such measures is to try to maintain a balance between economic development and social coherence and to encourage certain desired behavior from its residents. Such rules and regulations often form an integral part of the legal and socio-political framework in which real estate transactions take place.

For example, in Singapore, certain development projects (Executive Condominiums or ECs) are earmarked by the government to be sold to a specific group of buyers. This group of buyers has to meet eligibility criteria imposed by the government in the Executive Condominium Housing Scheme Act (Cap. 99A) and the Executive Condominium Housing Scheme (Eligibility) Regulations (Rg 2) on the date of completion of the development and for a certain period thereafter. For details please refer to Appendix A.

Upon signing of the Sales-and-Purchase-agreement (SPA), these buyers however, cannot rescind the agreement without breaching the terms of the SPA by means of failing to comply with the eligibility criteria prior to completion of the development. They are required to pay an upfront deposit at inception of the SPA and to make payments progressively to the developer throughout the development period. Those payments are intended to at least compensate the entity for performance completed to date and are refundable only if the entity fails to deliver the completed unit. The right to rescind rests with the developer if the buyer fails the eligibility criteria. If the buyer becomes ineligible, and the developer terminates the contract, the developer has the right to retain 20% of the purchase price.

To finance the progressive payments, it is common for these buyers to borrow from a financial institution that makes payments directly to the developer. The financial institution has full recourse against the buyers. The developer is precluded under the contractual agreement from transferring the specified unit to another customer.

Under the terms of the agreement, we are of the view that the developer meets the criteria in paragraph 35b(iii) on the basis that:

- the developer is precluded from directing the specified unit to another customer (i.e. the specified unit does not have an alternative use to the developer), and

- the developer has a right to payment for the performance completed to date because the buyers are obliged to make payments progressively throughout the development period and the buyers cannot freely rescind the contract prior to the date of completion.

However, some are arguing that the developer has no right to payment (and therefore the criteria in paragraph 35 (b) (iii) would not be met) as the completion of the contract, and hence the right to payment is conditional on the buyers meeting the eligibility criteria specified in the government regulation at the date of completion of the development.
We believe that this is an inappropriate application of paragraph 35b(iii) due to the following reasons:

1. When buyers enter into an agreement to buy an EC, these buyers either have already met the specified criteria at that date and/or they are certain that they will meet the criteria at the date of completion of the development. Although the buyers could choose to breach the contract and not meet the eligibility criteria, the eligibility criteria are by no means an “option” of the buyer not to honor the contract. Not meeting the eligibility criteria is a breach of contract and should be considered like any other instances of breach of contract or breaches of laws and regulations as stipulated in the respective jurisdiction.

2. Given the significant amount of payments made by the buyers during the development phase, it is reasonable to assume that buyers would enter into such an agreement only if they are certain that they would meet the specified criteria. It would in fact be unreasonable to assume otherwise as a buyer who fails to meet the specified criteria would earn zero return on any cash outlay and in addition, has to pay interest to the financial institution for the amount of financing obtained. In practice, failed transactions due to non-compliance with the rules and regulations rarely occur including out of a deliberate choice by the buyers. This is evidenced by the very low rate of such failed transactions in a range below 0.05% in the Singapore market.

3. Revenue from commercial contractual arrangements should be recognised based on commercial terms. Government regulation is primarily designed for social and political reasons and should not be the key determining factor that drives the accounting treatment of an otherwise commercial transaction.

The risk of non-compliance with the eligibility criteria could instead be analogised to a “right of return” on sale of a product. Under the ED, such right does not automatically lead to a failed sale accounting if the entity can predict the level of return based on past experience or similar experience of other entities. The developer should instead apply B2 – B9 to account for the risk of failed sales arising from a breach of contract.

We believe that the wording in paragraph 35b(iii) needs to be improved to clarify that the right to payment should be assessed based on the assumption that both contracting parties are expected to perform under the terms of the contract.

We also suggest including an additional example in the Illustrative Examples accompanying the ED on government rules and regulations impacting real estate development and sales transactions. We believe that the example should be written for application across a number of jurisdictions as government regulation in that industry is pervasive.

Our suggested changes and our suggested illustrative example are included below.
(2) The relevance of cash payments made over time while the performance obligation is satisfied

The other aspect that requires clarification is the relevance of cash payments as evidence of the right to payment for performance as stated in paragraph 35 (b)(iii). We believe Illustrative example 7 (IE 6) appropriately describes situations where the right to payments is sufficiently evidenced by the receipt of progressive payments. The proposed wording in paragraph 35 (b)(iii) could be interpreted such that the timing of cash payment receipts is not relevant.

We believe that for real estate sales, the right to payment is best evidenced by the receipt of cash payments as developers rarely enforce the right to payment when the buyers breach the contract. In practice, developers rather terminate the contract and re-sell the property to another buyer.

The right to enforce payment, in our view, is usually not substantive as it is neither economically nor technically viable to exercise such right. If the buyer is unwilling or unable to pay, the most economically sensible action by the developer is to re-market the property. Only then can the developer continue construction as it is not feasible to cease construction only on the affected unit when the apartment is part of a multi-unit development.

We believe that the wording in paragraph 35b(iii) needs to be improved to clarify the above.

Our suggested changes are included below.

Suggested changes

Our suggested changes (in bold blue underline) to paragraph 35(b)(iii) are as follow:

35. An entity transfers control of a good or service over time and, hence, satisfies a performance obligation and recognises revenue over time if at least one of the following two criteria is met:
   (a) ...
   (b) the entity’s performance does not create an asset with an alternative use to the entity (see paragraph 36) and at least one of the following criteria is met:
      (i) ... 
      (ii) ...
   (iii) the entity has a right to payment for performance completed to date and it expects all contracting parties to fulfill the contract as promised. The right to payment must be substantive and for performance completed to date does not need to be for a fixed amount. However, the entity must be entitled to an amount that is intended to at least compensate the entity for performance completed to date even if the customer can terminate the contract for reasons other than the entity’s failure to perform as promised. Compensation for performance completed to date includes payment that approximates the selling price of the goods or services transferred to date (for example, recovery of the entity’s costs plus a reasonable profit margin) rather than compensation for...
only the entity’s potential loss of profit if the contract is terminated. The right
to payment is usually best evidenced by the receipt of cash.

**Suggested illustrative example**

An example we would suggest based on the Singapore background is detailed below. We believe that this example is applicable across a number of jurisdictions where government regulation in the industry is pervasive.

This example is modified from the current illustrative example 7 included in the ED. The suggested modifications are in bold blue underline and bold red strikethrough.

*IExx [IGxx] The following example illustrates the requirements in paragraphs 35 and 36 on determining whether an asset has an alternative use to an entity and if one of the criteria is met for satisfaction of a performance obligation over time on determining whether a right to payment exists, which is one of the criteria for determining whether a performance obligation is satisfied over time.*

**Example X – Determining whether a right to payment exists**

An entity is developing residential real estate and starts marketing individual units (apartments). The entity has entered into the minimum number of contracts that are needed to begin construction.

The buyers of the units have to qualify under specific rules stipulated by the government in order to regulate the market. Such rules apply to all similar transactions in the jurisdiction and are not specific to the development the entity is undertaking. The buyers have to comply with the rules when title transfers and throughout a certain time period thereafter.

A customer enters into a binding sales contract for a specified unit that is not yet ready for occupancy. The customer pays a non-refundable deposit at inception of the contract and also promises to make payments throughout the contract. Those payments are intended to compensate the entity for performance completed to date and are refundable only if the entity fails to deliver the completed unit or in case of breach of contract when the entity decides to retain the unfinished unit instead of the payments received. The entity receives the final payment only upon completion of the contract (when the customer obtains possession of the unit). At inception of the contract the customer may not yet qualify under the government rules, but both the customer and the entity are contractually committed to perform under the contract which requires the customer to comply with the government rules at the latest at completion of development.

To finance the payments, the customer borrows from a financial institution that makes payments directly to the entity on behalf of the customer. The lender has full recourse against the customer. The customer can sell his or her interest in the partially completed unit, which would require approval of by the government and consent by the lender, but not the entity. The customer is able to specify minor variations to the
basic design of the unit but cannot specify or alter major structural elements of the unit's design. The contract precludes the entity from transferring the specified unit to another customer.

The asset (apartment) created by the entity's performance does not have an alternative use to the entity because the contract has substantive terms that preclude the entity from directing the unit to another customer, it is specific to the unit and the unit is not replaceable. The entity concludes that it has a right to payment for performance completed to date because the customer is obliged to compensate the entity for its performance by the payments made throughout the contract rather than only a loss of profit if the contract is terminated. In addition, the entity expects to fulfil the contract as promised and also expects the customer to fulfil the contract as promised, including compliance with government rules and regulations. In case of breach of contract by the customer, for example because of non-compliance with government rules, the entity will retain the asset, partially refund the payments to the customer and resell the asset to another customer.

Therefore, the terms of the contract and the surrounding facts and circumstances indicate that the entity has a performance obligation that it satisfies over time.

To recognise revenue for that performance obligation, the entity would measure its progress towards completion in accordance with paragraphs 38-48. The entity shall apply B2 - B9 to account for the risk of failed sale arising from the customer’s breach of contract.

Should you require any further clarifications, we would be pleased to assist you. Please contact the REDAS Secretariat via email at geoklee@redas.com.

Yours faithfully,

Wong Heang Fine
President
REDAS

Copy

Mr Michael Lim,
Chairman, Singapore Accounting Standards Council

Mr Tham Sai Choy,
Chairman, Financial Reporting Committee, Institute of Certified Public Accountants of Singapore
Appendix A

The eligibility criteria as specified by the Executive Condominium Housing Scheme Act (Cap. 99A) and the Executive Condominium Housing Scheme (Eligibility) Regulations (Rg 2) are as follows:

- Buyer must be a Singapore Citizen
- Buyer must be at least 21 years old at time of application
- Buyer must form a proper family nucleus
- The family nucleus must comprise of at least 2 Singapore citizens or 1 Singapore citizen and 1 Singapore Permanent Resident, depending on the family nucleus formed
- Gross monthly household income must not exceed S$12,000
- Buyer, buyer’s spouse, any occupiers listed in the application or their spouses must not own or dispose or have an estate or interest in any other flat, house, building or land within 30 months from the date of application and between the application date and the date of taking possession of the EC.
- For fiancé-fiancée scheme marriage certificate must be produced on completion of the EC unit.
- Buyers are required to occupy the apartment for a period of 5 years.