Tentative agenda decision—Over time transfer of constructed good

The IFRS Interpretations Committee tentatively decided not to add this matter to its standard-setting agenda at its meeting in November 2018. The Committee will reconsider the following tentative agenda decision, including the reasons for not adding the matter to the standard-setting agenda, at a future meeting. The Committee encourages interested parties to submit their responses using the link below.

Tentative agenda decision

The Committee received a request about the capitalisation of borrowing costs in relation to the construction of a residential multi-unit real estate development (building).

In the fact pattern described in the request:

a. a real estate developer (entity) constructs the building and sells the individual units in the building to customers.

b. the entity borrows funds specifically for the purpose of constructing the building and incurs borrowing costs in connection with that borrowing.

c. before construction begins, the entity signs contracts with customers for the sale of some of the units in the building (sold units).

d. the entity intends to enter into contracts with customers for the remaining part-constructed units (unsold units) as soon as it finds suitable customers.

e. the terms of, and relevant facts and circumstances relating to, the entity's contracts with customers (for both the sold and unsold units) are such that, applying paragraph 35(c) of IFRS 15 *Revenue from Contracts with Customers*, the entity transfers control of each unit over time and, therefore, recognises revenue over time. The consideration promised by the customer in the contract is in the form of cash or another financial asset.

The request asks whether the entity has a qualifying asset as defined in IAS 23 and, therefore, capitalises any directly attributable borrowing costs.

Applying paragraph 8 of IAS 23, an entity capitalises borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Paragraph 5 of IAS 23 defines a qualifying asset as 'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale'.

Accordingly, the entity assesses whether, in the fact pattern described in the request, it recognises an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Depending on the particular facts and circumstances, the entity might recognise a receivable, a contract asset and/or inventory.

The Committee concluded that, in the fact pattern described in the request, the entity does not capitalise borrowing costs. The Committee observed that:

a. any receivable that the entity recognises is not a qualifying asset. Paragraph 7 of IAS 23 specifies that financial assets are not qualifying assets.

b. any contract asset that the entity recognises is not a qualifying asset. The contract asset (as defined in Appendix A to IFRS 15) would represent the entity's right to consideration that is conditioned on something other than the passage of time in exchange for transferring control of a unit. The intended use of the contract asset—to collect cash or another financial asset—is not a use for which it necessarily takes a substantial period of time to get ready.

c. any inventory (work-in-progress) for unsold units under construction that the entity recognises is not a qualifying asset. In the fact pattern described in the request, this asset is ready for its intended sale in its current condition—ie the entity intends to sell the part-constructed units as soon as it finds suitable customers and, on signing a contract with a customer, will transfer control of any work-in-progress relating to that unit to the customer.

The Committee concluded that the principles and requirements in IAS 23 provide an adequate basis for an entity to determine whether to capitalise borrowing costs in the fact pattern described in the request. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Deadline for submitting comment letters: 6 February 2019