



# **ACCOUNTING STANDARDS BOARD**

## **INTERPRETATION OF THE STANDARDS OF GENERALLY RECOGNISED ACCOUNTING PRACTICE**

### **AGREEMENTS FOR THE CONSTRUCTION OF ASSETS FROM EXCHANGE TRANSACTIONS (IGRAP 8)**

### Acknowledgement

This Interpretation of the Standards of Generally Recognised Accounting Practice (IGRAP) is drawn primarily from the equivalent IFRIC Interpretation on *Agreements for the Construction of Real Estate* (IFRIC 15) published by the IFRS® Interpretations Committee of the International Accounting Standards Board (IASB) in July 2008. The IASB has issued a comprehensive body of IFRS® Accounting Standards and IFRIC® Interpretations. Extracts of IFRIC 15 are reproduced in this Interpretation of the Standards of GRAP with the permission of the IASB.

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## Introduction

This pronouncement is set out in paragraphs .01 to .24. All paragraphs in this pronouncement have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This pronouncement should be read in the context of its objective, its basis for conclusions and/or the basis for conclusions of its international equivalent, if applicable, the *Preface to the Standards of GRAP* and the *Framework for the Preparation and Presentation of Financial Statements*<sup>1</sup>.

Standards of GRAP and Interpretations of the Standards of GRAP should also be read in conjunction with any directives issued by the Board prescribing transitional provisions, as well as any regulations issued by the Minister of Finance regarding the effective dates of the Standards, published in the Government Gazette.

Directives should be read in conjunction with the applicable Standards of GRAP and Interpretations of the Standards of GRAP.

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<sup>1</sup> In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting*.

## Interpretation of the Standards of GRAP on *Agreements for the Construction of Assets from Exchange Transactions*

### References

- GRAP 1 *Presentation of Financial Statements*
- GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors*
- GRAP 9 *Revenue from Exchange Transactions*
- GRAP 11 *Construction Contracts*
- GRAP 19 *Provisions, Contingent Liabilities and Contingent Assets*
- Guideline on *Accounting for Public-private Partnerships (PPPs)*
- IGRAP 6 *Loyalty Programmes*

### Background

- .01 In the public sector, entities may undertake the construction of assets, directly or through subcontractors, and may enter into agreements with one or more buyers before construction is complete. Agreements for the construction of assets are widespread and relate to residential, commercial or industrial developments. Such agreements take diverse forms.
- .02 For example, entities that undertake the construction of a residential development may start to market individual units (apartments or houses) “off plan”, i.e. while construction is still in progress, or even before it has begun. Each buyer enters into an agreement with the entity to acquire a specified unit when it is ready for occupation. Typically, the buyer pays a deposit to the entity that is refundable only if the entity fails to deliver the completed unit in accordance with the contracted terms. The balance of the purchase price is generally paid to the entity only on contractual completion, when the buyer obtains possession of the unit.
- .03 Entities that undertake the construction of assets may enter into an agreement with a single buyer. The buyer may be required to make progress payments between the time of the initial agreement and contractual completion. Construction may take place on land the buyer owns or leases before construction begins.

### Scope

- .04 This Interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of assets in exchange transactions directly or through subcontractors. The construction of assets entered into by entities where funding to support the construction activity will be provided by an appropriation or similar allocation of general government revenue or by aid or grant funds are excluded from the scope of this Interpretation.



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- .05 Agreements in the scope of this Interpretation are agreements for the construction of assets in exchange transactions. In addition to the construction of assets in exchange transactions, such agreements may include the delivery of other goods or services.

### Issues

- .06 This Interpretation addresses two issues:
- (a) Is the agreement within the scope of the Standard of GRAP on *Construction Contracts* (GRAP 11) or the Standard of GRAP on *Revenue from Exchange Transactions* (GRAP 9)?
  - (b) When should revenue from the construction of assets in exchange transactions be recognised?

### Consensus

- .07 The following discussion assumes that the entity has previously analysed the agreement for the construction of assets and any related agreements and concluded that it will retain neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the constructed asset to an extent that would preclude recognition of some or all of the consideration as revenue. If recognition of some of the consideration as revenue is precluded, the following discussion applies only to the part of the agreement for which revenue will be recognised.
- .08 Within a single agreement, an entity may contract to deliver goods or services in addition to the construction of an asset (e.g. a sale of land or provision of property management services). In accordance with paragraph .19 of GRAP 9, such an agreement may need to be split into separately identifiable components including one for the construction of an asset. The fair value of the total consideration received or receivable for the agreement shall be allocated to each component. If separate components are identified, the entity applies paragraphs .10 to .12 to the component for the construction of an asset in order to determine whether that component is within the scope of GRAP 9 or GRAP 11. The segmenting criteria of GRAP 11 then apply to any component of the agreement that is determined to be a construction contract.
- .09 The following discussion refers to an agreement for the construction of an asset but it also applies to a component for the construction of an asset identified within an agreement that includes other components.

### Determining whether the agreement is within the scope of GRAP 9 or GRAP 11

- .10 Determining whether an agreement for the construction of an asset is within the scope of GRAP 9 or GRAP 11 depends on the terms of the agreement and all the surrounding facts and circumstances. Such a determination requires judgement with respect to each agreement.

- .11 GRAP 11 applies when the agreement meets the definition of a construction contract set out in paragraph .08 of GRAP 11: “a contract or similar binding arrangement, specifically negotiated for the construction of an asset or a combination of assets ...”. An agreement for the construction of assets meets the definition of a construction contract when the buyer is able to specify the major structural elements of the design of the asset before construction begins and/or specify major structural changes once construction is in progress (whether or not it exercises that ability). When GRAP 11 applies, the construction contract also includes any contracts or components for the rendering of services that are directly related to the construction of the asset in accordance with paragraph .10(a) of GRAP 11 and paragraph .08 of GRAP 9.
- .12 In contrast, an agreement for the construction of assets in which buyers have only limited ability to influence the design of the asset, e.g. to select a design from a range of options specified by the entity, or to specify only minor variations to the basic design, is an agreement for the sale of goods within the scope of GRAP 9.

## **Accounting for revenue from the construction of assets**

### ***The agreement is a construction contract***

- .13 When the agreement is within the scope of GRAP 11 and its outcome can be estimated reliably, the entity shall recognise revenue by reference to the stage of completion of the contract activity in accordance with GRAP 11.
- .14 The agreement may not meet the definition of a construction contract and therefore be within the scope of GRAP 9. In this case, the entity shall determine whether the agreement is for the rendering of services or for the sale of goods.

### ***The agreement is an agreement for the rendering of services***

- .15 If the entity is not required to acquire and supply construction materials or provide technical service, the agreement may be only an agreement for the rendering of services in accordance with GRAP 9. In this case, if the criteria in paragraph .20 of GRAP 9 are met, GRAP 9 requires revenue to be recognised by reference to the stage of completion of the transaction using the percentage of completion method. The requirements of GRAP 11 are generally applicable to the recognition of revenue and the associated expenses for such a transaction (see paragraph .21 of GRAP 9).

### ***The agreement is an agreement for the sale of goods***

- .16 If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the asset to the buyer, the agreement is an agreement for the sale of goods and the criteria for recognition of revenue set out in paragraph .29 of GRAP 9 apply.
- .17 The entity may transfer to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. In this case, if all the criteria in paragraph .29 of GRAP 9 are met continuously as construction progresses, the entity shall recognise revenue by reference to the stage

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of completion using the percentage of completion method. The requirements of GRAP 11 are generally applicable to the recognition of revenue and the associated expenses for such a transaction.

- .18 The entity may transfer to the buyer control and the significant risks and rewards of ownership of the asset in its entirety at a single time (e.g. at completion, upon or after delivery). In this case, the entity shall recognise revenue only when all the criteria in paragraph .29 of GRAP 9 are satisfied.
- .19 When the entity is required to perform further work on assets already delivered to the buyer, it shall recognise a liability and an expense. The liability shall be measured in accordance with the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets*. When the entity is required to deliver further goods or services that are separately identifiable from the asset already delivered to the buyer, it would have identified the remaining goods or services as a separate component of the sale, in accordance with paragraph .08.

## Disclosures

- .20 When an entity recognises revenue using the percentage of completion method for agreements that meet all the criteria in paragraph .29 of GRAP 9 continuously as construction progresses (see paragraph .17), it shall disclose:
  - (a) how it determines which agreements meet all the criteria in paragraph .29 of GRAP 9 continuously as construction progresses;
  - (b) the amount of revenue arising from such agreements in the period; and
  - (c) the methods used to determine the stage of completion of agreements in progress.
- .21 For the agreements described in paragraph .20 that are in progress at the reporting date, the entity shall also disclose:
  - (a) the aggregate amount of costs incurred and recognised surpluses (less recognised deficits) to date; and
  - (b) the amount of advances received.

## Transitional provisions

- .22 ***All changes resulting from the application of this Interpretation shall be accounted for in accordance with the requirements of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors.***

## Effective date

### Initial adoption of the Standards of GRAP



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- .23** *This Interpretation becomes effective with reference to the effective date of the applicable Standards of GRAP as determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999, as amended.*

### **Entities already applying Standards of GRAP**

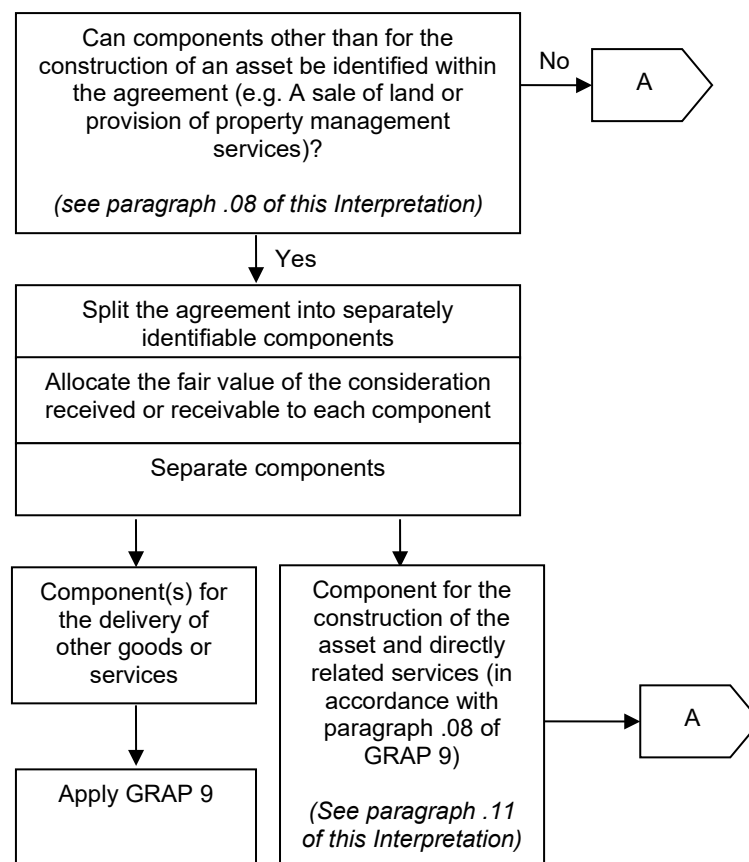
- .24** *An entity shall apply this Interpretation for annual financial statements covering periods beginning on or after 1 April 2011.*

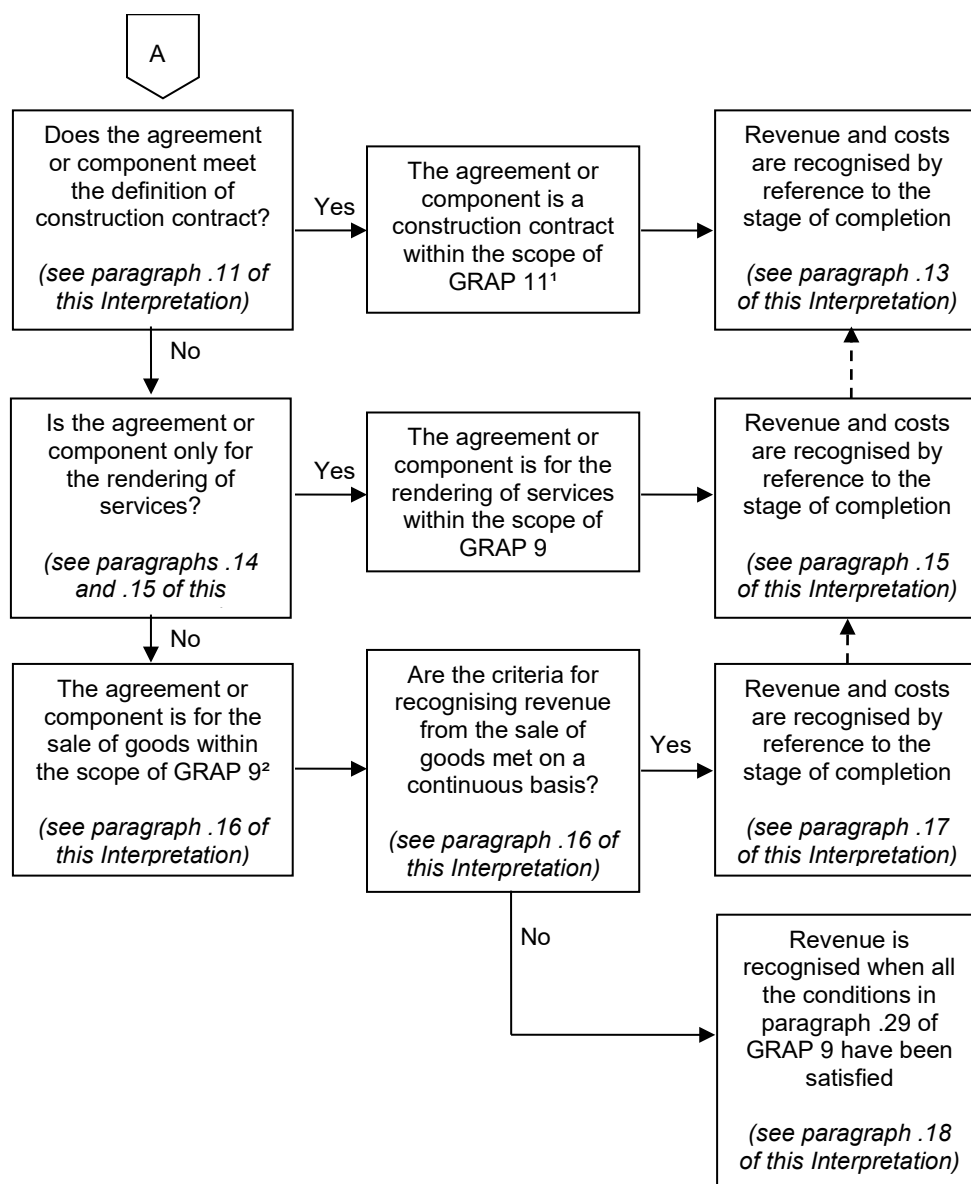
## Appendix A

### Information note

### Analysis of a single agreement for the construction of assets

*This appendix is illustrative only and does not form part of this Interpretation. The purpose of this appendix is to illustrate the application of this Interpretation and to assist in clarifying its meaning.*





<sup>1</sup> The construction contract may need to be segmented in accordance with paragraph .17 of GRAP 11

<sup>2</sup> Directly related services may need to be separated in accordance with paragraph .19 of GRAP 9

## Appendix B - Illustrative examples

*This appendix is illustrative only and does not form part of this Interpretation. The purpose of this appendix is to illustrate the application of this Interpretation and to assist in clarifying its meaning.*

### Example 1

- IE1 An entity buys a plot of land for the construction of a commercial asset. It designs an office block to build on the land and submits the designs to planning authorities in order to obtain building permission. The entity markets the office block to potential tenants and signs conditional lease agreements. The entity markets the office block to potential buyers and signs with one of them a conditional agreement for the sale of land and the construction of the office block. The buyer cannot put the land or the incomplete office block back to the entity. The entity receives the building permission and all agreements become unconditional. The entity is given access to the land in order to undertake the construction and then constructs the office block.
- IE2 In this illustrative example, the agreement should be separated into two components: a component for the sale of land and a component for the construction of the office block. The component for the sale of land is a sale of goods within the scope of GRAP 9.
- IE3 Because all the major structural decisions were made by the entity and were included in the designs submitted to the planning authorities before the buyer signed the conditional agreement, it is assumed that there will be no major change in the designs after the construction has begun. Consequently, the component for the construction of the office block is not a construction contract and is within the scope of GRAP 9. The facts, including that the construction takes place on land the buyer owns before construction begins and that the buyer cannot put the incomplete office block back to the entity, indicate that the entity transfers to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. Therefore, if all the criteria in paragraph .29 of GRAP 9 are met continuously as construction progresses, the entity recognises revenue from the construction of the office block by reference to the stage of completion using the percentage of completion method.
- IE4 Alternatively, assume that the construction of the office block started before the entity signed the agreement with the buyer. In that event, the agreement should be separated into three components: a component for the sale of land, a component for the partially constructed office block and a component for the construction of the office block. The entity should apply the recognition criteria separately to each component. Assuming that the other facts remain unchanged, the entity recognises revenue from the component for the construction of the office block by reference to

the stage of completion using the percentage of completion method as explained in paragraph IE3.

- IE5 In this example, the sale of land is determined to be a separately identifiable component from the component for the construction of the asset. However, depending on facts and circumstances, the entity may conclude that such a component is not separately identifiable.

## **Example 2**

- IE6 An entity is developing residential assets and starts marketing individual units (apartments) while construction is still in progress. Buyers enter into a binding sale agreement that gives them the right to acquire a specified unit when it is ready for occupation. They pay a deposit that is refundable only if the entity fails to deliver the completed unit in accordance with the contracted terms. Buyers are also required to make progress payments between the time of the initial agreement and contractual completion. The balance of the purchase price is paid only on contractual completion, when buyers obtain possession of their unit. Buyers are able to specify only minor variations to the basic design but they cannot specify or alter major structural elements of the design of their unit. No rights to the underlying asset transfer to the buyer other than through the agreement. Consequently, the construction takes place regardless of whether sale agreements exist.
- IE7 In this illustrative example, the terms of the agreement and all the surrounding facts and circumstances indicate that the agreement is not a construction contract. The agreement is a forward contract that gives the buyer an asset in the form of a right to acquire, use and sell the completed asset at a later date and an obligation to pay the purchase price in accordance with its terms. Although the buyer might be able to transfer its interest in the forward contract to another party, the entity retains control and the significant risks and rewards of ownership of the work in progress in its current state until the completed asset is transferred. Therefore, revenue should be recognised only when all the criteria in paragraph .29 of GRAP 9 are met (at completion in this example).
- IE8 Alternatively, assume that, the law requires the entity to transfer immediately to the buyer ownership of the asset in its current state of completion and that any additional construction becomes the property of the buyer as construction progresses. The entity would need to consider all the terms of the agreement to determine whether this change in the timing of the transfer of ownership means that the entity transfers to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. For example, the fact that if the agreement is terminated before construction is complete, the buyer retains the work in progress and the entity has the right to be paid for the work performed, might indicate that control is transferred along with ownership. If it does, and if all the criteria in paragraph .29 of GRAP 9 are met continuously as construction progresses, the entity recognises revenue by reference to the stage of completion

using the percentage of completion method taking into account the stage of completion of the whole building and the agreements signed with individual buyers.

### **Example 3**

- IE9** Determining whether the entity will retain neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the constructed asset to an extent that would preclude recognition of some or all of the consideration as revenue depends on the terms of the agreement and all the surrounding facts and circumstances. Such a determination requires judgement. This Interpretation assumes the entity has reached the conclusion that it is appropriate to recognise revenue from the agreement and discusses how to determine the appropriate pattern of revenue recognition.
- IE10** Agreements for the construction of an asset may include such a degree of continuing managerial involvement by the entity undertaking the construction that control and the significant risks and rewards of ownership are not transferred even when construction is complete and the buyer obtains possession. Examples are agreements in which the entity guarantees occupancy of the property for a specified period, or guarantees a return on the buyer's investment for a specified period. In such circumstances, recognition of revenue may be delayed or precluded altogether.
- IE11** Agreements for the construction of an asset may give the buyer a right to take over the work in progress (albeit with a penalty) during construction, e.g. to engage a different entity to complete the construction. This fact, along with others, may indicate that the entity transfers to the buyer control of the work in progress in its current state as construction progresses. The entity that undertakes the construction of the asset will have access to the land and the work in progress in order to perform its contractual obligation to deliver to the buyer completed the asset. If control of the work in process is transferred continuously, that access does not necessarily imply that the entity undertaking the construction retains continuing managerial involvement with the asset to the degree usually associated with ownership to an extent that would preclude recognition of some or all of the consideration as revenue. The entity may have control over the activities related to the performance of its contractual obligation but not over the asset itself.

## **Comparison with the IFRIC Interpretation on *Agreements for the Construction of Real Estate* (July 2008)**

This Interpretation is drawn primarily from the IFRIC Interpretation on *Agreements for the Construction of Real Estate* (IFRIC 15). The main differences between this Interpretation and IFRIC 15 are as follows:

- In the basis for conclusions to IFRIC 15, it is clarified that the IFRIC might be applied by analogy to industries other than real estate. Accordingly, the heading and text of this Interpretation have been amended to *Agreements for the Construction of Assets from Exchange Transactions* to clarify that this Interpretation does not only apply to the construction of real estate but also to residential, commercial and industrial developments. The term “asset” has been used to clarify the application. The equivalent heading and text in IFRIC 15 is *Agreements for the Construction of Real Estate*.
- The scope of this Interpretation has been clarified to explain that this Interpretation only applies to the construction of assets in exchange transactions.
- This Interpretation uses different terminology, in certain instances, from IFRIC 15. The most significant example is the use of the term “surplus” and “deficit”. The equivalent terms in IFRIC 15 are “profit” and “loss”.
- The definition used for “construction contract” in this Interpretation is similar to the definition in GRAP 11. The definition used in IFRIC 15 is similar to the definition in the IAS Standard on *Construction Contracts*.
- Examples not applicable to the South African public sector have been deleted from this Interpretation.