

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)  
QUESTIONS AND ANSWERS (Q&A)**

**Q&A No. 2018-12**

**PFRS 15 IMPLEMENTATION ISSUES AFFECTING THE REAL ESTATE INDUSTRY**

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**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)  
QUESTIONS AND ANSWERS (Q&A)**

**SUMMARY OF THE IMPLEMENTATION ISSUES IDENTIFIED BY THE SPECIAL TASK FORCE**

PFRS 15, *Revenue from Contracts with Customers*, is a complex Standard, introducing far more prescriptive requirements than were previously included in PFRSs, and it may result in substantial changes to revenue recognition policies for some entities. One of those industries that will be affected by PFRS 15 is the real estate industry. PFRS 15 requires the application of significant judgment in some areas, but in other areas it is relatively prescriptive, allowing little room for judgment.

PFRS 15 is required to be applied for annual periods beginning on or after January 1, 2018, and it outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle is that an entity recognizes revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The new Standard focuses on the identification of performance obligations and distinguishes between performance obligations that are satisfied at a point in time and those that are satisfied over time, which is determined by the manner in which control of goods or services passes to the customer. This was the focus of the study conducted by the first special task force created by the PIC. The first task force studied on the accounting issue on “Would the sale of a residential property under pre-completion stage covered by a Contract to Sell (CTS) meet the criteria for revenue recognition over time?” The study resulted to the issuance of PIC Q&A 2016-04, which states that the sale of residential properties under pre-completion stage meet the criteria under paragraph 35 (c) of PFRS 15, and therefore, revenue shall be recognized over time.

Other specific topics on which more prescriptive requirements have been introduced by PFRS 15 include:

1. The identification of a contract with a customer;
2. The identification of distinct performance obligations and the allocation of the transaction price between those obligations;
3. Accounting for variable consideration and significant financing components;
4. Recognition of revenue arising from licenses; and
5. Presentation and disclosure of revenue from contracts with customers, and other balances related to revenue.

Other changes also introduced include –

1. The scope of PFRS 15 has been expanded to cover costs relating to contracts; distinguishing between costs of obtaining a contract and costs of fulfilling a contract, and providing detailed guidance on when it is appropriate to capitalize such costs; and
2. Whereas PAS 11 provides specific requirements for accounting for construction contracts, such contracts are accounted for in accordance with the general principles of PFRS 15.

Considering these other changes introduced by PFRS 15, a Special Task Force was again created by the Philippine Interpretations Committee (PIC) to study the implementation issues affecting the real estate industry. The below enumerated implementation issues are the focus of the study of the Special Task Force.

Requirement of the Standard	Implementation Issues Identified
<p>Step 1 – requires an entity to <i>identify the contract</i> with the customer. A contract does not have to be written in order for it to meet the criteria for revenue recognition; however, it does need to create enforceable rights and obligations. PFRS 15 provides detailed guidance on how to identify a contract.</p>	<p>What elements of a contract for a sale of real estate development would meet the requirements of PFRS 15?</p>
<p>Step 2 – requires an entity to <i>identify the distinct goods or services</i> promised within the contract. Distinct goods or services should be accounted for as separate deliverables. These distinct goods or services are referred to as “performance obligations.” Specific guidance should be considered to determine whether a good or service is distinct.</p>	<p>What are the performance obligations in a contract to sell under both horizontal and vertical developments?</p>
<p>Step 3 – requires an entity to determine the transaction price for the contract. This will be affected by a number of factors including:</p> <ul style="list-style-type: none"> <li>• variable consideration;</li> <li>• the extent to which the recognition of variable consideration should be constrained;</li> <li>• significant financing components within a contract, which will require an adjustment for the time value of money;</li> <li>• if non-cash consideration is received in exchange for transferring promised goods or service; and</li> <li>• if any consideration is payable to the customer as part of the transaction.</li> </ul>	<p>Would a mismatch between the Percentage-of-Completion (POC) and schedule of payments constitute a significant financing component in determining the transaction price given the following scenarios:</p> <ol style="list-style-type: none"> <li>i. Higher payment (buyer pays ahead of the percentage of completion); and</li> <li>ii. Lower payment (percentage of completion is ahead of the buyer’s payment).</li> </ol>
<p>Step 4 – requires an entity to allocate the transaction price determined in Step 3 to the performance obligations identified in Step 2. PFRS 15 requires this allocation to be based on the stand-alone selling price of each performance obligation.</p>	<p>In relation to Step 2 – How should the transaction price be allocated among performance obligations, if applicable?</p>

<p>Step 5 – specifies how an entity should determine when to recognize revenue in relation to a performance obligation, and whether that revenue should be recognized at a point in time or over a period of time. PFRS 15 focuses on when control of the good or service passes to the customer, which may be over time or at a point in time.</p>	<ol style="list-style-type: none"> <li>1. What is the appropriate measure of progress to be used in the revenue recognition of the real estate developer?</li> <li>2. How should the following elements be considered in measuring the progress of satisfying the performance obligation? <ol style="list-style-type: none"> <li>i. Land element</li> <li>ii. Connection fees</li> <li>iii. Borrowing costs</li> <li>iv. Materials delivered on site but not yet installed</li> <li>v. Developer-supplied materials</li> <li>vi. Common amenities/area</li> </ol> </li> <li>3. How should the real estate developer account for the benefits given to sales agents?</li> <li>4. How should the real estate developer amortize the capitalized incremental costs of obtaining a contract?</li> </ol>
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Another issue identified by the Task Force is as follows –

- Is the real estate developer acting as a principal or agent in goods and services that it delivers based on contract of lease with the tenants?

The consensus presented in this paper does not cover any tax implications.

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)  
QUESTIONS AND ANSWERS (Q&A)**

**Q&A No. 2018-12- A**

STEP 1 – Requires an Entity to Identify the Contract with the Customer.

**Issue**

What elements of a contract for a sale of a real estate development would meet the requirements of PFRS 15?

**Background**

In a real estate business, there are three (3) main contracts that the developer and the buyer have to execute; these are the reservation agreement, the contract to sell and the deed of absolute sale.

Reservation agreement refers to an agreement whereby the buyer manifests his intention and offers to purchase from the seller a specific property and requests that property to be reserved for his purchase. This agreement gives the buyer a certain period, normally thirty (30) calendar days from payment of reservation fee, to proceed with the purchase. The amount of reservation fee is only minimal and normally non-refundable.

The obligation of the seller is to reserve a specific property for the buyer's purchase within a certain period in exchange for a reservation fee. The buyer is not obliged to pay the total contract price of the property reserved for him and may cancel his reservation without the consent of the seller. Should the buyer decide to cancel his reservation, the reservation fee will be forfeited by the seller.

However, should the buyer decide to proceed with his purchase, a contract to sell with the seller will be executed upon payment of the down payment and a deed of absolute sale upon full payment of the purchase price.

PFRS 15 paragraph 6 states that, "an entity shall apply this standard to a contract (other than a contract listed in paragraph 5) only if the counterparty is a customer. A customer is party that has contracted with an entity *to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.*"

Based on the above paragraph, it is a revenue contract if the customer obtains goods or services that are an output of an entity's ordinary activities. In the case of a developer, its normal output is the *real estate property*.

In addition, PFRS 15 appendix A defines a contract as an agreement between two or more parties that creates *enforceable rights and obligations*. The standard-setter decided to complement this

definition by specifying criteria that must be met *before an entity can apply the revenue recognition model*. These criteria would be assessed at *contract inception* and would not be reassessed unless there is an indication that there has been a significant change in facts and circumstances.

PFRS 15 paragraph 9 enumerates the following criteria:

- a) The parties to the contract have *approved* the contract (in writing, orally or in accordance with other customary business practices) and are *committed* to perform their obligations;

*This criterion is relevant to make the contract enforceable.*

- b) The entity can identify each party's *rights* regarding the goods or services to be transferred;

*This is relevant to assess the transfer of goods.*

- c) The entity can identify the *payment terms* for the goods or services to be transferred;

*This is relevant to determine the transaction price.*

- d) The contract has *commercial substance* (i.e., the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and

*This is relevant to avoid the artificial inflation of revenue.*

- e) It is *probable that the entity will collect the consideration* to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the *customer's ability and intention to pay* that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession.

*This is relevant because customer's credit risk is an important part to determine whether a contract is valid. This is a consequence of the standard-setter's decision that customer's credit risk should not affect the measurement or presentation of revenue.*

PFRS 15 paragraph 14 requires that if a contract with a customer does not meet the criteria in paragraph 9, an entity shall *continue* to assess the contract to determine whether the criteria in paragraph 9 are subsequently met.

PFRS 15 paragraph 15 requires that when a contract with a customer does not meet the criteria in paragraph 9 and an entity receives consideration from the customer, the entity shall recognize the consideration received as revenue only when *either* of the following events has occurred:

- a) The entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or
- b) The contract has been terminated and the consideration received from the customer is non-refundable.

PFRS 15 paragraph 16 requires that an entity shall recognize the consideration received from a customer as a *liability* until one of the events in paragraph 15 occur or until the criteria in paragraph 9 are subsequently met.

Article 1403(2)(e) of the Civil Code of the Philippines requires that sale of real property or of an interest therein to be in writing and subscribed by the party charged, or by his agent.

## **Consensus**

PFRS 15 paragraph 9 and Article 1403(2) (e) of the Civil Code enumerates the criteria for a valid revenue contract.

The reservation agreement will not meet the foregoing criteria, particularly letters (b) to (e), because the object of this agreement is the reservation right given by the developer to the buyer and not the property itself. Hence, the buyer is not obliged to pay the contract price of the property. In this case, the reservation fee will be initially recorded as a deposit from a customer or a liability and subsequently will be recognized as revenue either when the future performance obligation is transferred or when the reservation fee is forfeited. That is, if the customer proceeds with the purchase, the reservation fee will become part of the consideration for the purchase of the real estate property.

The contract to sell will meet the foregoing criteria because the object is the property itself, which is the normal output of a real estate business. In addition, this contract contains information such as the contracting parties' rights and payment terms, which are essential elements for a valid revenue contract. However, this contract must be signed by the contracting parties to make it enforceable prior to revenue recognition. Also, the developer must assess the commercial substance of the contract and the probability that it will collect the consideration.

However, a valid revenue contract is not limited to a contract to sell. The developer may consider other documents, provided these will meet the foregoing criteria.

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)  
QUESTIONS AND ANSWERS (Q&A)**

**Q&A No. 2018-12-B**

STEP 2 – Requires an Entity to Identify the Distinct Goods or Services Promised within the Contract (Horizontal Development)

**Issues**

What are the performance obligations in the following contracts to sell?

- i. Contract to sell serviced lot only
- ii. Contract to sell serviced lot and house

**Background**

- a) In the Philippines, real estate developers usually purchase bare land which previously has not been developed and is consequently not connected to any infrastructure (roads, utilities, etc.). In order to sell these blocks of land, developers typically divide a block of land into separate plots and sell together with the promise to develop the infrastructure necessary to service all the plots. Such transactions are referred to as sale of “serviced land or lot” of a subdivision project.
- b) Under Presidential Decree (PD) 957<sup>1</sup>, the developer shall submit its subdivision plans for approval to the National Housing Authority (Authority) in accordance with Subdivision Standards and Regulation, which the latter will then submit to the Director of Lands for further approval in accordance with the procedure prescribed in Section 44 of the Land Registration Act (Act No. 496, as amended by R.A. No. 440).
- c) PD 1216<sup>2</sup> requires that a subdivision should provide road, alleys, sidewalks and reserved open space for parks and recreational use, as may be deemed suitable to enhance the quality of life of the residents therein.
- d) The approved subdivision plan shall not be altered or changed without the permission of the Authority and the written conformity or consent of the duly organized homeowner’s association, or in the absence of the latter, by the majority of the lot buyers in the subdivision.

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<sup>1</sup> PRESIDENTIAL DECREE NO. 957, Subdivision and Condominium buyer's Protective Decree as amended by P.D. 1216), REGULATING THE SALE OF SUBDIVISION LOTS AND CONDOMINIUMS, PROVIDING PENALTIES FOR VIOLATIONS THEREOF

<sup>2</sup> PRESIDENTIAL DECREE No. 1216, DEFINING "OPEN SPACE" IN RESIDENTIAL SUBDIVISIONS AND AMENDING Sec. 31 OF PRESIDENTIAL DECREE NO. 957 REQUIRING SUBDIVISION OWNERS TO PROVIDE ROADS, ALLEYS, SIDEWALKS AND RESERVE OPEN SPACE FOR PARKS OR RECREATIONAL USE



- e) The infrastructure constructed in the serviced land, as detailed in the approved subdivision plans, includes earthworks, concrete (includes road works), drainage and sewer systems, water distribution system, electricity system, perimeter fencing, gate and guardhouse among others (collectively referred to as land development).
- f) The serviced land of a subdivision project may also include the construction of club house, playground, swimming pool and commercial facilities depending on the project plan.
- g) Depending on the construction plan, size of the bare land and the sales take-up, the land development of a serviced lot usually takes two (2) to five (5) years to complete.
- h) While the subdivision project is still in the pre-completion stage (i.e., construction of land development is on-going or has not yet commenced), developers would enter into Contracts to Sell (CTS) with buyers. The developer has the following types of CTS.
  1. *Contract to sell serviced lot only (CTS-L)*. The CTS-L specifies the lot and block numbers of the lot and the lot area with the selling price specified. At a later date, the buyer can have a house constructed on his own or the developer can construct the house. In case of the latter, the house construction is covered by a separate contract.
  2. *Contract to sell serviced lot and house (CTS-HL)*. The CTS-HL specifies the lot and block numbers of the lot and the house model to be constructed. The CTS-HL also contains the lot and floor areas; and attached in it are the plans and specifications of the house model selected by the customer from the various models available for the specific lot size. The CTS-HL specifies one selling price for the house and lot.

## Consensus

Based on the above fact pattern, the performance obligations of the developer are determined as follows:

- i. *Contract to sell (CTS) serviced lot only* – There is only one performance obligation under the CTS. The developer’s obligation is to deliver the “serviced lot” as described above. The developer integrates the plots it sells with the associated infrastructure to be able to transfer the serviced land promised in the contract. The subsequent construction of the house within the serviced lot will give rise to a separate contract if the buyer commissions the developer to perform such activity.
- ii. *Contract to sell (CTS) serviced lot and house* – There is only one performance obligation under the CTS. The developer has the obligation to deliver the house duly constructed in a specific lot and fully integrated into the serviced land in accordance with the approved plan.

Accordingly, in response to issue under Step 4, no allocation of transaction price is necessary as each of the CTS involves a single performance obligation.

## Discussion

A performance obligation is a promise in a contract with a customer to transfer to the customer either:

- a) a good or service (or a bundle of goods or services) that is distinct; or
- b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

A good or service is distinct if (i) the customer can benefit from the good or service on its own together with other resources that are readily available to the customer, and (ii) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract [PFRS 15, paragraph 27).

Factors that indicate that an entity's promise to transfer a good or service to a customer is separately identifiable (in accordance with paragraph 27(b)) include, but are not limited to, the following factors. Analysis of how the factors apply to the above contracts is shown below:

Factors Considered	Analysis
<p>(a) the entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output for which the customer has contracted. In other words, the entity is not using the good or service as an input to produce or deliver the combined output specified by the customer.</p>	<p>In both CTS above, the developer performs significant activities of land development in accordance with the approved subdivision plan. This includes, but is not limited to, provision of drainage, sewerage, water and electricity system which integrates the common areas and saleable lots. These development activities however, are not distinct promises but rather necessary and required inputs relative to the developer's promise to deliver the serviced lot for CTS-L and house and lot for CTS-HL.</p> <p>For CTS-L, the developer integrates the land plot it sells with the infrastructure/land development to be able to transfer the "serviced lot" promised in the CTS.</p> <p>For CTS-HL, the developer integrates the lot, land development and the house as promised in the CTS. This includes further activities such as excavation for the foundation of the house and the integration of the sewerage, drainage, water and electric system embedded in the lot into the structure of the house.</p>
<p>(b) the good or service does not significantly modify or customize another good or service promised in the contract.</p>	<p>For CTS-L, the developer's promise is to deliver the serviced lot only which is integrated into a fully developed land, based on the approved plan. Without integrating the specific lot to the entire land development, this will not render the lot available for future use as specified in the contract. From the perspective of the buyer, the lot should be ready either for house construction (which is not part of the promise under the contract) or for sale to other parties in the future.</p>

	<p>For CTS-HL, the main activity of the developer is to build a house based on agreed specifications in a lot which is integrated into a fully developed land. The construction of the house per se, without integrating it to the lot through excavation and connection of lot development will render the house untenable and not decent for human settlement because running water, ready electricity and sanitary considerations will not be available. Thus, the integration of the house piping and systems built in the foundation and structure of the house into the developed lot modifies and customizes the house significantly into a livable space. The combined output of the lot, land development and house construction enables the provision for a decent human settlement, which is the intended output of PD 957.</p>
<p>(c) the good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract. For example, the fact that a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services in the contract might indicate that the good or service is not highly dependent on, or highly interrelated with, those other promised goods or services</p>	<p>Please see analysis in (b)</p> <p>For CTS-L, the customer is actually buying a serviced lot which is integrated into a fully developed land in accordance with the approved plan. There is no option for the customer to buy a lot without the land development as this will be inconsistent with the plan and CTS.</p> <p>For CTS-HL, the customer is expecting the developer to deliver the house duly constructed in a specified lot which is integrated into a fully developed land. Clearly, the lot is a critical input in the house construction while the land development will make the house ready for use by the customer. Likewise, the CTS does not give the customer option to exclude any components as this will render the main promise to deliver the house inconsistent with terms of the CTS.</p>

Revenue recognition

Under Philippine Interpretation Committee (PIC) Q&A No. 2016-04, sale of residential properties under pre-completion contracts, which includes sale of serviced lots and serviced lot and house, meet the criteria under paragraph 35(c) of PFRS 15; and therefore revenue is recognized over time.

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)  
QUESTIONS AND ANSWERS (Q&A)**

**Q&A No. 2018-12-C**

STEP 2 – Requires an Entity to Identify the Distinct Goods or Services Promised within the Contract (Vertical Development)

**Issue**

What are the performance obligations in the contract to sell a condominium unit?

**Background**

- a) In the Philippines, real estate developers usually purchase bare land or land with existing structures and develops or converts it into a residential condominium building (i.e., low rise, mid-rise or high rise vertical development).
- b) Under Presidential Decree (PD) 957<sup>3</sup>, the developer shall submit its condominium plans for approval to the National Housing Authority (Authority) in accordance with Subdivision Standards and Regulation and National Building Code (Republic Act (RA) No. 6541), which the latter will then submit to the Director of Lands for further approval in accordance with the procedure prescribed in Section 4 of the Condominium Act (RA No. 4726).
- c) The Implementing Rules and Regulations of PD 957 requires that a residential condominium building should provide access roads, parks and playground which could integrate other facilities such as swimming pool, tennis court, etc., basic facilities and services such as service area, water supply, power, sewerage and drainage utilities and garbage disposal. Such improvements in the condominium building are referred to as “common service area and facilities”.
- d) The approved condominium plan shall not be altered or changed without the permission of the Authority and the written conformity or consent of the duly organized condominium corporation, or in the absence of the latter, by the majority of the lot buyers in the condominium.
- e) Depending on the construction plan, size of the bare land and the sales take-up, the construction of the condominium usually takes two (2) to five (5) years to complete.
- f) While the condominium project is still in the pre-completion stage (i.e., construction of land development is on-going or has not yet commenced), developers would enter into Contracts to Sell (CTS) with buyers. The CTS specifically identifies the promised property by its floor and unit number.

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<sup>3</sup> PRESIDENTIAL DECREE NO. 957, Subdivision and Condominium buyer's Protective Decree as amended by P.D. 1216), REGULATING THE SALE OF SUBDIVISION LOTS AND CONDOMINIUMS, PROVIDING PENALTIES FOR VIOLATIONS THEREOF

## Consensus

There is only one performance obligation in the contract to sell a condominium unit. The developer has the obligation to deliver the specific unit with common service area and facilities available to the customer.

Accordingly, in response to issue under Step 4, no allocation of transaction price is necessary as the CTS involves a single performance obligation.

## Discussion

A performance obligation is a promise in a contract with a customer to transfer to the customer either:

- c) a good or service (or a bundle of goods or services) that is distinct; or
- d) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

A good or service is distinct if (i) the customer can benefit from the good or service on its own together with other resources that are readily available to the customer and (ii) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract [PFRS 15, paragraph 27).

Factors that indicate that an entity's promise to transfer a good or service to a customer is separately identifiable (in accordance with paragraph 27(b)) include, but are not limited to, the following factors. Analysis of how the factors apply to the CTS is shown below:

Factors Considered	Analysis
(a) the entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output for which the customer has contracted. In other words, the entity is not using the good or service as an input to produce or deliver the combined output specified by the customer.	In the CTS above, the developer performs significant activities of land development in accordance with the approved condominium plan. The developer integrates the building into the bare land, together with other amenities such as water and power supplies, access to common areas, sewerage and drainage utilities and garbage disposal to make the condominium unit tenable. The common service areas and facilities and other activities while capable of being distinct, are not accounted for separately as it would not result in a faithful depiction of the developer's promise under the contract. The land development, building construction and all amenities form part of the input to the ultimate promise to deliver the condominium unit to the customer.

<p>(b) the good or service does not significantly modify or customize another good or service promised in the contract.</p>	<p>The developer provides a service of integrating the lot, the specific unit in the condominium building and common service area and facilities as promised in the CTS. The construction of the condominium building per se, without integrating it to the lot through excavation and connection of lot development will render the condominium building and common service area and facilities unusable and not decent for human settlement because running water, ready electricity and sanitary considerations will not be available.</p>
<p>(c) the good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract. For example, the fact that a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services in the contract might indicate that the good or service is not highly dependent on, or highly interrelated with, those other promised goods or services</p>	<p>Please see analysis in (b)</p> <p>The buyer is bound by the CTS to buy condominium unit specified in the CTS together with its share in the plot of land and common service area and facilities and will not have the option to take out any of the promises in the CTS.</p>

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)  
QUESTIONS AND ANSWERS (Q&A)**

**Q&A No. 2018-12-D**

STEP 3 – Requires an Entity to Determine the Transaction Price for the Contract

**Issue**

Would a mismatch between the Percentage-of-Completion (POC) and schedule of payments constitute a significant financing component in determining the transaction price given the following scenarios:

- i. Higher payment (buyer pays ahead of the percentage of completion); and
- ii. Lower payment (percentage of completion is ahead of the buyer's payment).

**Background**

A real estate developer recognizes revenue over time using the percentage of completion (POC) method. Under this method, the Developer satisfies its performance obligation to deliver a “portion” of the property to the Customer over time, thus the recognition of revenue. The POC is expressed in percentage (%) based on the progress of the construction which is computed on a consistent basis in accordance with the accounting policy of the Developer.

Now, given that the Developer offers different payment schemes to its Customers, the pattern of collection of these periodic payments may significantly be different from the POC percentage computed at any given time (i.e., end of the reporting period). These circumstances where the Customer's payment of the transaction price does not coincide with the POC percentage of the Project gives rise to possibility of significant financing either by the Customer to the Developer or vice versa. Should contracts from Customers encompass a significant financing component, a portion of the transaction price is regarded as interest income or interest expense.

Paragraph 60 of PFRS 15 states that, “In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.”

Under paragraph 61 of PFRS 15, “The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognize revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (i.e., the cash selling price). An entity shall consider all relevant facts and circumstances in assessing whether a contract contains a financing component and whether that financing component is significant to the contract, including both of the following:

- (a) the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services; and,
- (b) the combined effect of both of the following:
  - (i) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and
  - (ii) the prevailing interest rates in the relevant market.”

In addition, paragraph 63 provides that, “As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.”

However, paragraph 62 of PFRS 15 states that, “Notwithstanding the assessment in paragraph 61, a contract with a customer would not have a significant financing component if any of the following factors exist:

- (a) the customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer.
- (b) a substantial amount of the consideration promised by the customer is variable and the amount or timing of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the entity (for example, if the consideration is a sales-based royalty).
- (c) the difference between the promised consideration and the cash selling price of the good or service (as described in paragraph 61) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.”



## Consensus

- I. Higher payment (buyer pays ahead of the percentage of completion) – when series of regular payments are made by the buyer which are ahead of the percentage of completion and the difference between the timing of payment and the satisfaction of the performance obligation is more than one year, there is significant financing component without predisposition of the circumstances under PFRS 15 paragraph 62. Under these cases, it is proper for the seller to recognize an interest expense because the buyer is ‘as if’ financing the seller by paying more than the amount of satisfied performance obligation.

See Annex ‘A’ attached hereto, showing the illustration under “Higher payment (buyer pays ahead of the percentage of completion)”.

- II. Lower payment (percentage of completion is ahead of the buyer’s payment) – when the percentage of completion is ahead of the regular payments made by the buyer (e.g., POC is 45% but customer pays 20%) and the difference between the timing of payment and the satisfaction of the performance obligation is more than one year, there is significant financing component without predisposition of the circumstances under PFRS 15 paragraph 62. For this case, it is proper for the seller to recognize an interest income because the seller is ‘as if’ financing the buyer by paying less than the amount of satisfied performance obligation.

See Annex ‘B’ attached hereto, showing the illustration under “Lower payment (percentage of completion is ahead of the buyer’s payment)”

**Annex A**  
**Higher payment (buyer pays ahead of the percentage of completion)**

**Illustration**

For purposes of this illustration, assume the following:

Contract inception <sup>1</sup> January 1, 2017

Completion Date December 31, 2021

Payment Options Php5,000,000 in installment

Php4,000,000 at the inception of the contract

Milestones Year	<sup>3</sup> Expected Milestones		Actual Milestones	
	For the Year	Cumulative	For the Year	Cumulative
2017	20.00%	20.00%	22.00%	22.00%
2018	15.00%	35.00%	20.00%	42.00%
2019	25.00%	60.00%	25.00%	67.00%
2020	30.00%	90.00%	23.00%	90.00%
2021	10.00%	100.00%	10.00%	100.00%
<b>Total</b>	<b>100.00%</b>		<b>100.00%</b>	

Assumptions:

1. Unless otherwise stated, the entity concludes that the contract contains a significant financing component because of the effect of both the length of time between when the customer pays for the asset and when the entity transfers the asset to the customer, and the prevailing interest rates in the market.
2. The borrowing rate is 4.15 % which is judged to be consistent with a rate that would be reflected in a separate financing transaction between the entity and its customer. The entity uses the rate that would reflect the credit characteristics of the party receiving financing in the contract as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract as prescribed in PFRS 15.64.
3. The expected milestone of the entity is used as basis of determining the transaction price at the inception of the contract.

<b>Transaction Price if Spot Cash</b>				
<b>Borrowing Rate</b>	<sup>2</sup>	<b>4.15%</b>		
Year	Principal, Beg	Interest expense	Assumed payments based on expected milestones	Principal, End
2017	Php4,000,000	Php166,000	Php800,000	Php3,200,000
2018	3,200,000	132,800	600,000	2,600,000
2019	2,600,000	107,900	1,000,000	1,600,000
2020	1,600,000	66,400	1,200,000	400,000
2021	400,000	16,600	400,000	-
<b>Total</b>		<b>489,700</b>	<b>4,000,000</b>	
<b>Transaction Price</b>			<b>Php4,489,700</b>	

Note: Effectively, the advance payment is paid by the developer as it satisfies the performance obligation, including the interest expense.

<b>Calculation of POC Revenue based on Actual Milestones</b>	
Year	POC Revenue
2017	Php987,734
2018	897,940
2019	1,122,425
2020	1,032,631
2021	448,970
<b>Total</b>	<b>Php4,489,700</b>

**Sample Pro-forma Journal Entries**

Nature	Cash Dr(Cr)	Contract Liability Dr(Cr)	Interest Expense Dr(Cr)	Revenue Dr(Cr)
<b>2017</b>				
To record cash advance received	Php4,000,000	(Php4,000,000)	Php-	Php-
To record interest expense	-	(166,000)	166,000	-
To record revenue	-	987,734	-	(987,734)
<b>Total at December 31, 2017</b>	<b>4,000,000</b>	<b>(3,178,266)</b>	<b>166,000</b>	<b>(987,734)</b>
<b>2018</b>				
To record interest expense	-	(132,800)	132,800	-
To record revenue	-	897,940	-	(897,940)
<b>Total at December 31, 2018</b>		<b>(2,413,126)</b>	<b>132,800</b>	<b>(897,940)</b>
<b>2019</b>				
To record interest expense	-	(107,900)	107,900	-
To record revenue	-	1,122,425	-	(1,122,425)
<b>Total at December 31, 2019</b>	<b>-</b>	<b>(1,398,601)</b>	<b>107,900</b>	<b>(1,122,425)</b>
<b>2020</b>				
To record interest expense	-	(66,400)	66,400	-
To record revenue	-	1,032,631	-	(1,032,631)
<b>Total at December 31, 2020</b>	<b>-</b>	<b>(432,370)</b>	<b>66,400</b>	<b>(1,032,631)</b>
<b>2021</b>				
To record interest expense	-	(16,600)	16,600	-
To record revenue	-	448,970	-	(448,970)
<b>Total at December 31, 2021</b>	<b>-</b>	<b>-</b>	<b>16,600</b>	<b>(448,970)</b>
<b>Total</b>	<b>Php4,000,000</b>	<b>Php-</b>	<b>Php489,700</b>	<b>(Php4,489,700)</b>

## Annex B

### Lower payment (percentage of completion is ahead of the buyer's payment)

#### Illustration

For purposes of this illustration, assume the following:

Contract inception      <sup>1</sup> January 1, 2017

Completion Date      December 31, 2021

Payment Options      Php5,000,000 in installment

Php4,000,000 at the inception of the contract

Year	<sup>3</sup> Expected Milestones		Actual Milestones	
	For the Year	Cumulative	For the Year	Cumulative
2017	20.00%	20.00%	22.00%	22.00%
2018	15.00%	35.00%	14.00%	36.00%
2019	25.00%	60.00%	25.00%	61.00%
2020	30.00%	90.00%	25.00%	86.00%
2021	10.00%	100.00%	14.00%	100.00%
<b>Total</b>	<b>100.00%</b>		<b>100.00%</b>	

#### Assumptions:

1. Unless otherwise stated, the entity concludes that the contract contains a significant financing component because of the effect of both the length of time between when the customer pays for the asset and when the entity transfers the asset to the customer, and the prevailing interest rates in the market.
2. The lending rate is 5.33 % which is judged to be consistent with a rate that would be reflected in a separate financing transaction between the entity and its customer. The entity uses the rate that would reflect the credit characteristics of the party receiving financing in the contract as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract as prescribed in PFRS 15.64.
3. The expected milestone of the entity is used as basis of determining the transaction price at the inception of the contract.

<b>Transaction price</b>		<b>Php4,651,699</b>		
<b>Lending Rate</b>		<sup>2</sup>	<b>5.33%</b>	
Year	Expected revenue based on expected milestones	Collection	Interest Income	Outstanding Balance
2017	Php930,340	Php625,000	Php-	Php305,340
2018	697,755	125,000	16,272	894,367
2019	1,162,925	125,000	47,663	1,979,955
2020	1,395,509	125,000	105,517	3,355,981
2021	465,170	4,000,000	178,849	-
<b>Total</b>	<b>Php4,651,699</b>	<b>Php5,000,000</b>	<b>Php348,301</b>	

Note: Transaction price is the present value of the installment payments discounted to the date the entity expects to satisfy its performance obligation (i.e., based on the expected milestones). Assumes that there is no interest on the first year as payment is made at the end of the year, and that revenue is only earned at the end of the year.

<b>Calculation of POC Revenue based on Actual Milestones</b>	
Year	POC Revenue
2017	Php1,023,374
2018	651,238
2019	1,162,925
2020	1,162,924
2021	651,238
<b>Total</b>	<b>Php4,651,699</b>

<b>Revised amortization table in Year 2</b>				
<b>Transaction price</b>		<b>Php4,651,699</b>		
<b>Lending Rate</b>		<b>5.33%</b>		
Year	Expected revenue based on revised expected milestones below	Collection	Interest income	Outstanding Balance
2017	Php1,023,374	Php625,000	Php-	Php398,374
2018	651,238	125,000	2,972	927,584
2019	1,255,959	125,000	49,433	2,107,976
2020	1,348,992	125,000	112,340	3,444,308
2021	372,136	4,000,000	183,556	-
<b>Total</b>	<b>Php4,651,699</b>	<b>Php5,000,000</b>	<b>Php348,301</b>	
<b>Assume expected milestones are revised as follows:</b>				
	<b>2017 (actual)</b>	22.00%		
	<b>2018 (actual)</b>	14.00%		
	2019	27.00%		
	2020	29.00%		
	2021	8.00%		
	<b>Total</b>	<b>100.00%</b>		

Note: Amortization table has to be revised since the expected milestone at the start of the contract was not realized. As the previous amortization table was based on those expected milestones, the ending outstanding balance will no longer zero out if the table is not updated. Note that under PFRS 15, the initial interest rate should not be changed. This means that there has to be a catch-up adjustment in Year 2 in order to preserve the initial interest rate and initial interest income as required by PFRS 15.

<b>Revised amortization table in Year 3</b>				
<b>Transaction price</b>		<b>4,651,699</b>		
<b>Lending Rate</b>		<b>5.33%</b>		
Year	Expected revenue based on revised expected milestones below	Collection	Interest income	Outstanding Balance
2017	Php1,023,374	Php625,000	Php-	Php398,374
2018	651,238	125,000	2,972	927,584
2019	1,162,925	125,000	69,782	2,035,291
2020	1,116,407	125,000	108,466	3,135,164
2021	697,755	4,000,000	167,081	-
<b>Total</b>	<b>Php4,651,699</b>	<b>Php5,000,000</b>	<b>Php348,301</b>	
<b>Assume expected milestones are revised as follows:</b>				
	<b>2017 (actual)</b>	22.00%		
	<b>2018 (actual)</b>	14.00%		
	<b>2019 (actual)</b>	25.00%		
	2020	24.00%		
	2021	15.00%		
	<b>Total</b>	<b>100.00%</b>		

Note: Amortization table has to be revised since the expected milestone at the start of the contract was not realized. As the previous amortization table was based on those expected milestones, the ending outstanding balance will no longer zero out if the table is not updated. Note that under PFRS 15, the initial interest rate should not be changed. This means that there has to be a catch-up adjustment in Year 3 in order to preserve the initial interest rate and initial interest income as required by PFRS 15.



<b>Revised amortization table in Year 4</b>				
<b>Transaction price</b>		<b>4,651,699</b>		
<b>Lending Rate</b>		<b>5.33%</b>		
Year	Expected revenue based on revised expected milestones below	Collection	Interest income	Outstanding Balance
2017	Php1,023,374	Php625,000	Php-	Php398,374
2018	651,238	125,000	2,972	927,584
2019	1,162,925	125,000	69,782	2,035,291
2020	1,069,890	125,000	110,820	3,091,001
2021	744,272	4,000,000	164,727	-
<b>Total</b>	<b>Php4,651,699</b>	<b>Php5,000,000</b>	<b>Php348,301</b>	
<b>Assume expected milestones are revised as follows:</b>				
	<b>2017 (actual)</b>	22.00%		
	<b>2018 (actual)</b>	14.00%		
	<b>2019 (actual)</b>	25.00%		
	<b>2020 (actual)</b>	23.00%		
	2021	16.00%		
	<b>Total</b>	<b>100.00%</b>		

Note: Amortization table has to be revised since the expected milestone at the start of the contract was not realized. As the previous amortization table was based on those expected milestones, the ending outstanding balance will no longer zero out if the table is not updated. Note that under PFRS 15, the initial interest rate should not be changed. This means that there has to be a catch-up adjustment in Year 4 in order to preserve the initial interest rate and initial interest income as required by PFRS 15.

<b>Revised amortization table in Year 5</b>				
<b>Transaction price</b>		<b>4,651,699</b>		
<b>Lending Rate</b>		<b>5.33%</b>		
Year	Expected revenue based on revised expected milestones below	Collection	Interest income	Outstanding Balance
2017	Php1,023,374	Php625,000	Php-	Php398,374
2018	651,238	125,000	2,972	927,584
2019	1,162,925	125,000	69,782	2,035,291
2020	1,162,924	125,000	110,820	3,184,035
2021	651,238	4,000,000	164,727	-
<b>Total</b>	<b>Php4,651,699</b>	<b>Php5,000,000</b>	<b>Php348,301</b>	
<b>Assume expected milestones are revised as follows:</b>				
	<b>2017 (actual)</b>	22.00%		
	<b>2018 (actual)</b>	14.00%		
	<b>2019 (actual)</b>	25.00%		
	<b>2020 (actual)</b>	25.00%		
	<b>2021 (actual)</b>	14.00%		
	<b>Total</b>	<b>100.00%</b>		

Note: Amortization table has to be revised since the expected milestone at the start of the contract was not realized. As the previous amortization table was based on those expected milestones, the ending outstanding balance will no longer zero out if the table is not updated. Note that under PFRS 15, the initial interest rate should not be changed. This means that there has to be a catch-up adjustment in Year 4 in order to preserve the initial interest rate and initial interest income as required by PFRS 15.

**Sample Pro-Forma Journal Entries**

Nature	Cash Dr(Cr)	Contract Asset Dr(Cr)	Contract Revenue Dr(Cr)	Interest Income Dr(Cr)
<b>2017</b>				
To record revenue	Php-	Php1,023,374	(Php1,023,374)	Php-
To record collection	625,000	(625,000)		-
<b>Total at December 31, 2017</b>	<b>625,000</b>	<b>398,374</b>	<b>(1,023,374)</b>	<b>-</b>
<b>2018</b>				
To record revenue		651,238	(651,238)	-
To record interest	-	2,972	-	(2,972)
To record collection	125,000	(125,000)		-
<b>Total at December 31, 2018</b>	<b>750,000</b>	<b>927,584</b>	<b>(651,238)</b>	<b>(2,972)</b>
<b>2019</b>				
To record revenue	-	1,162,925	(1,162,925)	-
To record interest	-	69,782	-	(69,782)
To record collection	125,000	(125,000)		-
<b>Total at December 31, 2019</b>	<b>875,000</b>	<b>2,035,291</b>	<b>(1,162,925)</b>	<b>(69,782)</b>
<b>2020</b>				
To record revenue	-	1,162,924	(1,162,924)	-
To record interest	-	110,820	-	(110,820)
To record collection	125,000	(125,000)		-
<b>Total at December 31, 2020</b>	<b>1,000,000</b>	<b>3,184,035</b>	<b>(1,162,924)</b>	<b>(110,820)</b>
<b>2021</b>				
To record revenue	-	651,238	(651,238)	-
To record interest	-	164,727	-	(164,727)
To record collection	4,000,000	(4,000,000)	-	-
<b>Total at December 31, 2021</b>	<b>5,000,000</b>	<b>-</b>	<b>(651,238)</b>	<b>(164,727)</b>
<b>Total</b>	<b>Php5,000,000</b>	<b>Php-</b>	<b>(Php4,651,699)</b>	<b>(Php348,301)</b>

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)  
QUESTIONS AND ANSWERS (Q&A)**

**Q&A No. 2018-12-E**

STEP 5 – Specifies How an Entity Should Determine When to Recognize Revenue in Relation to a Performance Obligation (Measurement of Progress)

**Issues**

- a. What is the appropriate measure of progress to be used in the revenue recognition of the real estate developer?
- b. How should the following elements be considered in measuring the progress of the performance obligation?
  - i. Land element
  - ii. Connection fees
  - iii. Borrowing costs
  - iv. Materials delivered on site but not yet installed
  - v. Common amenities/area

**Background**

- A real estate developer enters into contracts with customers for the construction and sale of any of the following real estate units:
  - a) units in a high-rise building which can be for office or residential use
  - b) serviced lot
  - c) serviced lot and house

The real estate developer has concluded that each contract above is a single performance obligation and that revenue is to be recognized over time in accordance with PFRS 15.35(c).

- A real estate developer would usually engage a project manager (can be an internal or external party) who works closely with the contractors, subcontractors, suppliers, architects and engineers, among others, to ensure that the progress of the development is based on plan. The project manager will collate progress reports from various contractors and subcontractors based on the bill of quantity for the labor, overhead and materials provided. For vertical developments, the progress of work is monitored based on major activities such as general construction, architecture, plumbing, electrical and sewerage. For horizontal developments, the progress of work is broken into progress of work of the land development and house construction. The land development is monitored based on major activities such as land clearing, drainage, plumbing, guard house and fencing while monitoring of house construction is similar to that of vertical developments. These major activities are assigned with weight percentages based on the estimated cost of an activity

over the total estimated cost of the project. These are summarized by the project manager to determine the overall progress of work.

- The accounting department of the real estate developer has its monitoring of cost incurred to date. This process would require strict coordination between the construction site and the accounting department in determining the actual costs incurred.
- Other elements of the real estate development also include:
  - a) Land - this is the cost of land on which the real estate development will be constructed
  - b) Connection Fees - these are fees paid to utility providers for the connection of the structure/building to the source of electricity and water.
  - c) Borrowing costs - these are finance costs incurred for loans obtained to develop the property.
  - d) Materials delivered on-site but uninstalled - materials are delivered on site, such as steels and rebars, elevators and escalators, which are yet to be installed/attached to the main structure.
- The real estate developer, as part of its promised performance obligation to the customer, also constructs common service areas, facilities, and amenities (common areas/facilities) such as club house, swimming pool, playground, and sports facilities which are shared by unit owners of the real estate development.
- The real estate developer retains legal title to the real estate unit (and any land attributed to it) until construction is complete. The contract gives the customer a right to the real estate unit under construction. The customer can resell or pledge the right as the real estate unit is being constructed, subject to the real estate developer performing a credit risk analysis of the new buyer of the right (if the customer has not paid the entire purchase price of the unit).

### **Consensus**

- a. The real estate developer may use either output method or input method in measuring the progress of the performance obligation provided that the method selected faithfully depicts the entity's performance in transferring control of the real estate development. The method selected should be consistent for each performance obligation identified.
- b. The assessment on how the following elements are treated in the measurement of progress follow:
  - i. Land element – excluded
  - ii. Connection fees – excluded
  - iii. Borrowing cost – excluded
  - iv. Materials delivered on-site but not yet installed – excluded
  - v. Common amenities/area – included

## Discussion

- a. When an entity has determined that a performance obligation is satisfied over time, the standard requires the entity to select a single revenue recognition method for the relevant performance obligation that faithfully depicts the entity's performance in transferring control of the goods or services.

Paragraphs 41 - 43 of PFRS 15 state that, "*Appropriate methods of measuring progress include output methods and input methods. Paragraphs B14–B19 provide guidance for using output methods and input methods to measure an entity's progress towards complete satisfaction of a performance obligation. In determining the appropriate method for measuring progress, an entity shall consider the nature of the good or service that the entity promised to transfer to the customer.*"

*When applying a method for measuring progress, an entity shall exclude from the measure of progress any goods or services for which the entity does not transfer control to a customer. Conversely, an entity shall include in the measure of progress any goods or services for which the entity does transfer control to a customer when satisfying that performance obligation.*

*As circumstances change over time, an entity shall update its measure of progress to reflect any changes in the outcome of the performance obligation. Such changes to an entity's measure of progress shall be accounted for as a change in accounting estimate in accordance with PAS 8 Accounting Policies, Changes in Accounting Estimates and Errors."*

While the standard requires an entity to update its estimate related to the measure of progress selected, it does not permit a change in method. According to BC161 of PFRS 15, "*The boards decided that an entity should apply the selected method for measuring progress consistently for a particular performance obligation and also across contracts that have performance obligations with similar characteristics. An entity should not use different methods to measure its performance in satisfying the same or similar performance obligations, otherwise that entity's revenue would not be comparable in different reporting periods. The boards also noted that if an entity were permitted to apply more than one method to measure its performance in fulfilling a performance obligation, it would effectively bypass the requirements for identifying performance obligations.*"

Based on the above provisions of PFRS 15, a performance obligation is accounted for using the method the entity selects (i.e., either the specific input or output method it has chosen) from inception until the performance obligation is fully satisfied.

### Output methods

Output methods recognize revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed and units produced or units delivered. When an entity evaluates whether to apply an output method to measure its progress, the entity shall consider whether the output selected would faithfully depict the entity's performance towards complete satisfaction of the performance obligation. An output method would not provide a faithful depiction of the entity's performance if the output selected would fail to measure some of the goods or services for which control has transferred to the customer. For example, output methods based on units produced or units delivered would not faithfully depict an entity's performance in satisfying a performance obligation if, at the end of the reporting period, the entity's performance has produced work in progress or finished goods controlled by the customer that are not included in the measurement of the output.

An objective evidence of the progress of work based on output method is the monthly project accomplishment report prepared by the construction manager which integrates the surveys of performance to date of the construction activities that are sub-contracted and that are fulfilled by the developer itself.

### Input methods

Input methods recognize revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labor hours expended, costs incurred, time elapsed or machine hours elapsed) relative to the total expected inputs to the satisfaction of that performance obligation. Most common source of information for input method is the cost accumulated by the accounting department.

Paragraph B19 of PFRS 15 states, *"A shortcoming of input methods is that there may not be a direct relationship between an entity's inputs and the transfer of control of goods or services to a customer. Therefore, an entity shall exclude from an input method the effects of any inputs that, in accordance with the objective of measuring progress in paragraph 39, do not depict the entity's performance in transferring control of goods or services to the customer. For instance, when using a cost-based input method, an adjustment to the measure of progress may be required in the following circumstances:*

- (a) *When a cost incurred does not contribute to an entity's progress in satisfying the performance obligation. For example, an entity would not recognise revenue on the basis of costs incurred that are attributable to significant inefficiencies in the entity's performance that were not reflected in the price of the contract (for example, the costs of unexpected amounts of wasted materials, labour or other resources that were incurred to satisfy the performance obligation).*

(b) *When a cost incurred is not proportionate to the entity's progress in satisfying the performance obligation. In those circumstances, the best depiction of the entity's performance may be to adjust the input method to recognise revenue only to the extent of that cost incurred. For example, a faithful depiction of an entity's performance might be to recognise revenue at an amount equal to the cost of a good used to satisfy a performance obligation if the entity expects at contract inception that all of the following conditions would be met:*

- (i) *the good is not distinct;*
- (ii) *the customer is expected to obtain control of the good significantly before receiving services related to the good;*
- (iii) *the cost of the transferred good is significant relative to the total expected costs to completely satisfy the performance obligation; and*
- (iv) *the entity procures the good from a third party and is not significantly involved in designing and manufacturing the good.”*

b. Below is the analysis on how certain cost items incurred by the real estate developer are treated in the measurement of progress:

i. Land	<p>As the cost to procure the land is not proportionate to the entity's progress in satisfying the performance obligation, under paragraph B19(b) of PFRS 15, it should be excluded in the measure of progress when the input method is used. The entity, however, needs to assess if it can recognize revenue to the extent of the cost of the land.</p> <p>Under paragraph B19 (b), revenue can be recognized to the extent of the cost incurred if all conditions laid out in the paragraph are met. One such condition is for the customer to obtain control of the good significantly before receiving services related to the good.</p> <p>Paragraph 33 of PFRS 15 defines control as the ability to direct the use of, and obtain substantially all of the remaining benefits from the asset. For the fact pattern presented, the customer does not obtain control of the land upfront or prior to completion of construction for the following reasons:</p> <ul style="list-style-type: none"> <li>• The customer has no ability to direct the use of any land attributed to the real estate unit being purchased other than for its current use.</li> <li>• Although the customer is exposed to changes in market value (appreciation or depreciation) of the real estate unit (including the attributed land), which may indicate that the customer has</li> </ul>
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	<p>the ability to obtain substantially all of the remaining benefits from the unit, it still does not give the customer control of the unit since the customer does not have the ability to direct the use of the unit (including any land attributed to it).</p> <ul style="list-style-type: none"><li>• Although the customer has the right to resell or pledge its right to the real estate unit (including any land attributed to it), the right to sell or pledge this right is not evidence of control of the real estate unit itself (including any land attributed to it). This position is consistent with the position taken by the IFRS Interpretations Committee (IFRIC) in its meeting held in September 2017. In that meeting, IFRIC indicated that, <i>“in a contract for the sale of a real estate unit that an entity constructs, the asset created is the real estate unit itself. It is not, for example, the right to obtain the real estate unit in the future. The right to sell or pledge this right is not evidence of control of the real estate unit itself.”</i></li></ul> <p>In view of the above, control of the land is not transferred to the buyer upfront, but rather, when the construction has been completed. Thus, paragraph B19 (b)(ii) is not met and the entity cannot recognize revenue relating to the cost of the land element.</p> <p>As the land is necessary for the entity to fulfill its performance obligation to the customer, the cost of the land will be accounted for as fulfillment cost in accordance with paragraph 95 of PFRS 15. The fulfillment cost would be amortized over the period of performance. A rational basis of allocation would be the measure of progress used for the performance obligation, which is percentage of completion.</p> <p><i>(Refer to Annex A - Example 1 - Accounting for land and other components of real estate development in revenue and cost recognition)</i></p>
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ii. Connection fees	Similar to land, the customer is not expected to obtain control of the good (i.e., connection) significantly before receiving the services related to the goods (i.e., real estate unit) and thus paragraph B19(b)(ii) is not met and the cost of the connection fees cannot be included in the measure of progress. The connection fees will also be treated as fulfillment cost and amortized over the period of performance.
iii. Borrowing costs	Borrowing costs (whether or not they are capitalized in accordance with PAS 23) are excluded in the measure of progress since these do not contribute to an entity's progress in satisfying the performance obligation (PFRS 15.B19(a)).
iv. Materials delivered on site but not yet installed	Paragraph B19(b)(ii) is not met as control over the uninstalled materials is not transferred to the customer upon delivery to the site but only when these are installed or when they become part of the constructed building.
v. Common amenities/area	Common amenities/area are part of the promised performance obligation to the customer. The entity's accomplishment in the construction of these common amenities and area contribute to the entity's performance of transferring the control of goods and services to the customer.

## **Annex A**

*Example 1 - Accounting for land and other components of real estate development in revenue and cost recognition*

*Example 2 - Determination of Percentage of Completion for Vertical Development*

*Example 3 - Determination of Percentage of Completion for Horizontal Development with House and Lot*

## Annex A

### Example 1 – Accounting for the land and other components of development in revenue and cost recognition.

Real estate developer develops a mid-rise condominium building divided into 10 saleable units. Total estimated development costs and other costs expected to be incurred by the real estate developer follows:

Land	Php 1,000,000
Connection fees	200,000
Construction costs – Building	3,000,000
Construction costs – Common area	800,000
Total	Php 5,000,000

Costs of land and connection fees (Inventory – fulfillment costs) were incurred by the real estate developer prior to the start of development. Construction costs – building, and construction costs – common area (Inventory – development costs) pertain to the estimated costs the real estate developer expects to incur until project completion.

Area of each of the saleable unit is approximately 100 square meter (sqm), resulting to a total area of 1,000 sqm for the entire development. Cost per square meter of inventory – fulfillment costs is Php1,200 (Php1,200,000 cost of land and connection fees divided by 1,000 sqm) while cost per square meter of inventory – development costs is Php3,800 (Php3,800,000 total cost of borrowing costs and construction costs of building and common area divided by 1,000 sqm).

Total contract price of each unit is Php1,000,000. Milestone completion of the mid-rise condominium building follows:

	Incremental	Cumulative
Year 1	50%	50%
Year 2	30%	80%
Year 3	20%	100%

Assuming that four (4) units were sold in year 1 and two (2) units were sold in year 2, below are the illustrative entries to record the related revenue and costs.

#### Year 1

Real estate receivable	2,000,000	
Real estate sales <sup>a</sup>		2,000,000
<sup>a</sup> (4 units sold at Y1 x Php1,000,000 x 50% POC at Y1)		

Cost of real estate sales	1,000,000	
Inventory – fulfillment costs <sup>b</sup>		240,000
Inventory – development costs <sup>c</sup>		760,000
<i><sup>b</sup> (4 units sold at Y1 x 100 sqm x 50% POC at Y1 x Php1,200/sqm)</i>		
<i><sup>c</sup> (4 units sold at Y1 x 100 sqm x 50% POC at Y1 x Php3,800/sqm)</i>		

### Year 2

Real estate receivable	2,800,000	
Real estate sales <sup>e</sup>		2,800,000
<i><sup>e</sup> (4 units sold at Y1 x Php1,000,000 x 30% incremental POC at Y2) + (2 units sold at Y2 x Php1,000,000 x 80% cumulative POC at Y2)</i>		
Cost of real estate sales	1,400,000	
Inventory – fulfillment costs <sup>f</sup>		336,000
Inventory – development costs <sup>g</sup>		1,064,000
<i><sup>f</sup> (4 units sold at Y1 x 100 sqm x 30% incremental POC at Y2 x Php1,200/sqm) + (2 units sold at Y2 x 100 sqm x 80% cumulative POC at Y2 x Php1,200/sqm)</i>		
<i><sup>g</sup> (4 units sold at Y1 x 100 sqm x 30% incremental POC at Y2 x Php3,800/sqm) + (2 units sold at Y2 x 100 sqm x 80% cumulative POC at Y2 x Php3,800/sqm)</i>		

### Year 3

Real estate receivable	1,200,000	
Real estate sales <sup>h</sup>		1,200,000
<i><sup>h</sup> (4 units sold at Y1 x Php1,000,000 x 20% <u>incremental</u> POC at Y3) + (2 units sold at Y2 x Php1,000,000 x 20% <u>incremental</u> POC at Y3)</i>		
Cost of real estate sales	600,000	
Inventory – fulfillment costs <sup>i</sup>		144,000
Inventory – development costs <sup>j</sup>		456,000
<i><sup>i</sup> (4 units sold at Y1 x 100 sqm x 20% incremental POC at Y3 x Php1,200/sqm) + (2 units sold at Y2 x 100 sqm x 20% incremental POC at Y3 x Php1,200/sqm)</i>		
<i><sup>j</sup> (4 units sold at Y1 x 100 sqm x 20% incremental POC at Y3 x Php3,800/sqm) + (2 units sold at Y2 x 100 sqm x 20% incremental POC at Y3 x Php3,800/sqm)</i>		

### Example 2 – Determination of Percentage of Completion for Vertical Development

Real estate developer builds a two-tower residential condominium development. The two towers stand on a common podium which serves as foundation for both buildings and will allow tenants to share access to the swimming pool, sports facilities and playground (podium and the latter amenities will be collectively referred to as common areas).

Real estate developer has determined that the sale of residential units to customers is a performance obligation that will be satisfied over time and that input method (e.g., costs incurred to date divided by total estimated costs) is the appropriate method that faithfully depicts the real estate developer's

transfer of control of the development to the customer. Each of the building will occupy the same area of land and podium. Building 2 however will have more floors, thus will have more saleable area.

Real estate developer has determined that the most suitable allocation method<sup>1</sup> for the cost of land is based on area occupied of each building and for the common area will be based on the saleable area of the buildings. Real estate developer estimates that the following costs will be incurred. Costs allocation to each building is also shown below.

<sup>1</sup>This is just for illustration purposes and other reliable basis of allocating the cost of land to each building maybe applied.

*Table 2.1 Summary of Costs*

	Total Costs	Building 1	Building 2
Specific costs:			
Development costs <sup>a</sup>	Php 5,000,000	Php 2,000,000	Php 3,000,000
Common costs:			
Land <sup>b</sup>	1,500,000	750,000	750,000
Common area <sup>c</sup>	500,000	200,000 <sup>d</sup>	300,000 <sup>e</sup>
TOTAL	Php 7,000,000	Php 2,950,000	Php 4,050,000
Total costs excluding land	Php 5,500,000	Php 2,200,000	Php 3,300,000

<sup>a</sup> Total saleable area of the development is 20,000 sqm for Building 1 and 30,000 sqm for Building 2.

<sup>b</sup> Each building occupies the same area of land, thus, cost of land is equally divided into Building 1 and Building 2.

<sup>c</sup> Allocation of cost of common area in proportion to saleable area of each building in relation to total saleable area.

<sup>d</sup> 500,000\* [20,000/(20,000+30,000)]

<sup>e</sup> 500,000\* [30,000/(20,000+30,000)]

Real estate developer incurred the following costs per year from the start of the project until project completion:

*Table 2.2 Summary of Costs Incurred*

			Development Costs		Total
	Land	Common area	Building 1	Building 2	
Year 1	Php 1,500,000	Php 100,000	Php 500,000	Php –	Php 2,100,000
Year 2	–	350,000	900,000	400,000	1,650,000
Year 3	–	50,000	600,000	900,000	1,550,000
Year 4	–	–	–	1,100,000	1,100,000
Year 5	–	–	–	600,000	600,000
Total	Php 1,500,000	Php 500,000	Php 2,000,000	Php 3,000,000	Php 7,000,000

Based on the above information, real estate developer calculates percentage of completion for each of the five (5) years as follows:

*Table 2.3 Calculation of percentage of completion for Building 1*

	Building 1				
	Share in Common area	Development Costs	Total Cost for the Year	Total Cumulative Cost	Percentage of Completion <sup>b</sup>
Year 1	Php 40,000	Php 500,000	Php 540,000	Php 540,000	25%
Year 2	140,000	900,000	1,040,000	1,580,000	72%
Year 3	20,000	600,000	620,000	2,200,000	100%
Year 4	–	–	–	2,200,000	100%
Year 5	–	–	–	2,200,000	100%
Total	Php 200,000 <sup>a</sup>	Php 2,000,000	Php 2,200,000		

<sup>a</sup> Cost of common area is divided between the two buildings in proportion to their saleable area (500,000)\*[20,000/(20,000+30,000)].

<sup>b</sup> Percentage of completion is determined by dividing the total actual cumulative cost by the total estimated cost excluding land cost.

*Table 2.4 Calculation of percentage of completion for Building 2*

	Building 2				
	Share in Common area	Development Costs	Total Cost for the Year	Total Cumulative Cost	Percentage of Completion <sup>b</sup>
Year 1	Php 60,000	Php –	Php 60,000	Php 60,000	2%
Year 2	210,000	400,000	610,000	670,000	20%
Year 3	30,000	900,000	930,000	1,600,000	48%
Year 4	–	1,100,000	1,100,000	2,700,000	82%
Year 5	–	600,000	600,000	3,300,000	100%
Total	Php 300,000 <sup>a</sup>	Php 3,000,000	Php 3,300,000		

<sup>a</sup> Cost of common area is divided between the two buildings in proportion to their saleable area (500,000)\*[30,000/(20,000+30,000)]

<sup>b</sup> Percentage of completion is determined by dividing the total actual cumulative cost by the total estimated cost excluding land cost

### Example 3 – Determination of Percentage of Completion for Horizontal Development with House and Lot

Real estate developer sells residential house and lot in a horizontal project with two phases. The buyers of the properties in both phases will share access to the amenities which includes club house, swimming pool, other sports facilities and playground (collectively referred to as common areas). Real estate developer has determined that the sale of the house and lot packages to customers is a performance obligation that will be satisfied over time and that input method (e.g., costs incurred to date divided by total estimated costs) is the appropriate method that faithfully depicts the real estate developer's transfer of control of the development to the customer.

Phases 1 and 2 have the same saleable area of land and each phase offers 10 house and lot packages. Each of the 20 units has the same lot area but housing units in Phase 2 have bigger floor areas.

Real estate developer has determined that the most suitable allocation method for the cost of land, land development and common area will be based on the saleable area of land.

Real estate developer estimates that the following costs for the development will be incurred. Also shown below is the allocation per phase.

*Table 3.1 Summary of Costs*

	Land and Common Area	Cost Allocation	
		Phase 1	Phase 2
Specific costs:			
Construction cost <sup>a</sup>		Php 100,000	Php 200,000
Land development costs <sup>b</sup>		1,000,000	1,000,000
Common costs:			
Land <sup>b</sup>	Php 1,500,000	750,000	750,000
Common area <sup>b</sup>	1,000,000	500,000	500,000
<b>TOTAL</b>	<b>Php 2,500,000</b>		
Costs excluding land	Php 1,000,000		

<sup>a</sup> Specific costs for each of the housing unit

<sup>b</sup> Cost is allocated equally to each phase because Phases 1 and 2 have the same saleable land area

Construction of the house starts only when a contract is entered into with a buyer. Real estate developer incurred the following costs per year from the start of the project until project completion:

*Table 3.2 Summary of Cost Incurred*

	Land	Common Area	Land Development Costs – Phase 1	Land Development Costs – Phase 2	Total
Year 1	Php 1,500,000	Php 200,000	Php 300,000	Php –	Php 2,000,000
Year 2	–	500,000	600,000	300,000	1,400,000
Year 3	–	300,000	100,000	350,000	750,000
Year 4	–	–	–	250,000	250,000
Year 5	–	–	–	100,000	100,000
<b>Total</b>	<b>Php 1,500,000</b>	<b>Php 1,000,000</b>	<b>Php 1,000,000</b>	<b>Php 1,000,000</b>	<b>Php 4,500,000</b>

There were no sales made in Year 1. In Year 2, real estate developer sold one (1) house and lot package in Phase 1. In Year 3, real estate developer sold one (1) house and lot package in Phase 1 and two (2) house and lot packages in Phase 2. Construction costs for each housing unit were incurred by the real estate developer in the following manner:

*Table 3.3 Costs of Construction of Housing Units*

	H&L 1 – Phase 1	H&L 2 – Phase 1	H&L 1 – Phase 2	H&L 2 – Phase 2
Year 1	Php –	Php –	Php –	Php –
Year 2	50,000	–	–	–
Year 3	50,000	100,000	50,000	100,000
Year 4	–	–	150,000	75,000
Year 5	–	–	–	25,000
Total	Php 100,000	Php 100,000	Php 200,000	Php 200,000

Percentage of completion is determined by the real estate developer for each of the five (5) years as follows:

*Table 3.4 Calculation of percentage of completion for House and Lot#1- Phase 1*

House and Lot #1 - Phase 1						
	Share in Common Area <sup>a</sup>	Land Development Costs <sup>b</sup>	Housing Costs	Total Cost for the Year	Total Cumulative Cost	Percentage of Completion <sup>c</sup>
Year 1	Php 10,000	Php 30,000	Php –	Php 40,000	Php 40,000	16%
Year 2 <sup>d</sup>	25,000	60,000	50,000	135,000	175,000	70%
Year 3	15,000	10,000	50,000	75,000	250,000	100%
Year 4	–	–	–	–	250,000	100%
Year 5	–	–	–	–	250,000	100%
Total	Php 50,000	Php 100,000	Php 100,000	Php 250,000		

<sup>a</sup> Common area costs are divided equally among the number of house and lot packages for both phases given the same land saleable area for all packages (20 packages for both phases)

<sup>b</sup> Land development costs are divided equally among number of house and lot packages for Phase 1 given the same saleable area for all packages in Phase 1

<sup>c</sup> POC determined by dividing the total actual cumulative cost by the total estimated cost per housing unit excluding land cost

<sup>d</sup> Revenue will be recognized starting Year 2 being the time the house and lot package was sold to a buyer



*Table 3.5 Calculation of percentage of completion for House and Lot#2- Phase 1*

House and Lot #2 - Phase 1						
	Share in Common Area <sup>a</sup>	Land Development Costs <sup>a</sup>	Housing Costs	Total Cost for the Year	Total Cumulative Cost	Percentage of Completion <sup>b</sup>
Year 1	Php 10,000	Php 30,000	Php –	Php 40,000	Php 40,000	16%
Year 2	25,000	60,000	–	85,000	125,000	50%
Year 3 <sup>d</sup>	15,000	10,000	100,000	125,000	250,000	100%
Year 4	–	–	–	–	250,000	100%
Year 5	–	–	–	–	250,000	100%
Total	Php 50,000	Php 100,000	Php 100,000	Php 250,000		

<sup>a</sup> Common area costs are divided equally among the number of house and lot packages for both phases given the same land saleable area for all packages (20 packages for both phases)

<sup>b</sup> Land development costs are divided equally among number of house and lot packages for Phase 1 given the same land saleable area for all packages in Phase 1

<sup>c</sup> POC determined by dividing the total actual cumulative cost by the total estimated cost per housing unit excluding land cost

<sup>d</sup> Revenue will be recognized starting Year 3 being the time the house and lot package was sold to a buyer

*Table 3.6 Calculation of percentage of completion for House and Lot#1- Phase 2*

House and Lot #1 - Phase 2						
	Share in Common Area <sup>a</sup>	Land Development Costs <sup>b</sup>	Housing Costs	Total Cost for the Year	Total Cumulative Cost	Percentage of Completion <sup>c</sup>
Year 1	Php 10,000	Php –	Php –	Php 10,000	Php 10,000	3%
Year 2	25,000	30,000	–	55,000	65,000	19%
Year 3 <sup>d</sup>	15,000	35,000	50,000	100,000	165,000	47%
Year 4	–	25,000	150,000	175,000	340,000	97%
Year 5	–	10,000	–	10,000	350,000	100%
Total	Php 50,000	Php 100,000	Php 200,000	Php 350,000		

<sup>a</sup> Common area costs are divided equally among the number of house and lot packages for both phases given the same saleable area for all packages (20 packages for both phases)

<sup>b</sup> Land development costs are divided equally among number of house and lot packages for Phase 2 given the same land saleable area for all packages in Phase 2

<sup>c</sup> POC determined by dividing the total actual cumulative cost by the total estimated cost per housing unit excluding land cost

<sup>d</sup> Revenue will be recognized starting Year 3 being the time the house and lot package was sold to a buyer

Table 3.7 Calculation of percentage of completion for House and Lot#2- Phase 2

House and Lot #2 - Phase 2						
	Share in Common Area <sup>a</sup>	Land Development Costs <sup>b</sup>	Housing Costs	Total Cost for the Year	Total Cumulative Cost	Percentage of Completion <sup>c</sup>
Year 1	Php 10,000	Php –	Php –	Php 10,000	Php 10,000	3%
Year 2	25,000	30,000	–	55,000	65,000	19%
Year 3 <sup>d</sup>	15,000	35,000	100,000	150,000	215,000	61%
Year 4	–	25,000	75,000	100,000	315,000	90%
Year 5	–	10,000	25,000	35,000	350,000	100%
Total	Php 50,000	Php 100,000	Php 200,000	Php 350,000		

<sup>a</sup> Common area costs are divided equally among the number of house and lot packages for both phases given the same land saleable area for all packages (20 packages for both phases)

<sup>b</sup> Land development costs are divided equally among number of house and lot packages for Phase 2 given the land same saleable area for all packages in Phase 2

<sup>c</sup> POC determined by dividing the total actual cumulative cost by the total estimated cost per housing unit excluding land cost

<sup>d</sup> Revenue will be recognized starting Year 3 being the time the house and lot package was sold to a buyer

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)  
QUESTIONS AND ANSWERS (Q&A)**

**Q&A No. 2018-12-F**

STEP 5 – Specifies How an Entity Should Determine When to Recognize Revenue in Relation to a Performance Obligation (Measurement of Progress)

**Issue**

When applying the OUTPUT METHOD, how should costs incurred in fulfilling the performance obligation (i.e., land and building development costs) be measured?

**Background**

- A real estate developer enters into contract with customers for the construction and sale of residential units. The real estate developer has concluded that each contract contains a single performance obligation (i.e., the delivery of the residential unit) and that revenue is to be recognized over time in accordance with PFRS 15.35(c).
- The real estate developer applies output method to measure the progress of the development, generally based on the survey of work performed by internal engineers.
- The real estate developer typically incurs upfront costs such as land costs and connection fees, which are accounted for as fulfillment costs, and land and building development costs, which contribute to the construction progress of the development project.

**Consensus**

Assuming the following additional case facts:

Total units available for sale:	10
Selling price per unit:	Php800,000
Number of units sold at Year 1	4

	Total	Per Unit <sup>1</sup>
Fulfilment costs (land costs and connection fees)	Php1,000,000	Php100,000
Land and building development costs	3,000,000	300,000

<sup>1</sup> Calculated based on the total costs divided by the total units for sale (10)

Percentage of completion (POC) based on output method (i.e., physical survey) and actual costs incurred per year are as follow:

	Physical POC (Cumulative)	Physical POC (Increment)	Actual Costs (Cumulative)	Actual Costs (Increment)	Actual Cost Per Unit (Increment) <sup>2</sup>
Year 1	25.00%	25.00%	Php900,000	Php900,000	Php90,000
Year 2	47.50%	22.50%	1,500,000	600,000	60,000
Year 3	70.00%	22.50%	2,250,000	750,000	75,000
Year 4	100.00%	30.00%	3,000,000	750,000	75,000

<sup>2</sup> Calculated based on the actual costs per year divided by the number of total units for sale (10)

Given the case facts above, how much revenue and costs for the four (4) units sold at Year 1 should be recognized by the real estate developer from Year 1 to Year 4?

1. Costs relating to (partially) satisfied performance obligation should be expensed as incurred.

*PFRS 15.98 states that an entity shall recognise the following costs as expenses when incurred:*

- (a) general and administrative costs (unless those costs are explicitly chargeable to the customer under the contract, in which case an entity shall evaluate those costs in accordance with paragraph 97);*
- (b) costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the price of the contract;*
- (c) costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (i.e., costs that relate to past performance); and*
- (d) costs for which an entity cannot distinguish whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations (or partially satisfied performance obligations).*

PFRS 15.98(c) requires that costs relating to (partially) satisfied performance obligations should be expensed as incurred. This means that the real estate developer should recognize contract costs (i.e., land and building development costs) as expense as the work to which they relate is performed.

In addition, PFRS 15.BC308 clarifies that only costs that give rise to resources that will be used in satisfying performance obligations in the future and that are expected to be recovered are eligible for recognition as assets. Those requirements ensure that only costs that meet the definition of an asset are recognized as such and that an entity is precluded from deferring costs merely to normalize profit margins throughout a contract by allocating revenue and costs evenly over the life of the contract. To provide a clear objective for recognizing and measuring an asset arising from the costs to fulfil a contract, the boards decided that only costs that relate directly to a contract should be included in the cost of the asset.

*Based on PFRS 15.95, if the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, PAS 2 Inventories, PAS 16 Property, Plant and Equipment or PAS 38 Intangible Assets), an entity shall recognize an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:*

- (a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);*

- (b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and  
(c) the costs are expected to be recovered.

2. Revenue and cost that will be recognized by the real estate developer follow:

	Year 1	Year 2	Year 3	Year 4	Cumulative
Revenue <sup>a</sup>	Php800,000	Php720,000	Php720,000	Php960,000	Php3,200,000
Cost <sup>b, c</sup>	460,000	330,000	390,000	420,000	1,600,000
Margin	340,000	390,000	330,000	540,000	1,600,000
% Margin	42.50%	54.17%	45.83%	56.25%	50.00%

<sup>a</sup> [Selling price per unit (800,000) x 4 units sold x incremental POC for the year]

<sup>b</sup> [Fulfilment costs per unit (100,000) x 4 units sold x incremental POC for the year] + [Actual cost per unit during the year x 4 units sold]

<sup>c</sup> Costs assumes that there are no uninstalled materials at year-end. Uninstalled materials meet all the criteria under PFRS 15.95 and may be capitalized as an asset and will form part of expense when consumed to satisfy the performance obligation

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)  
QUESTIONS AND ANSWERS (Q&A)**

**Q&A No. 2018-12-G**

STEP 5 – Specifies How an Entity Should Determine When to Recognize Revenue in Relation to a Performance Obligation (Costs to Obtain a Contract)

**Issues**

- a. How should the real estate developer account for the benefits given to sales agents?
- b. How should the real estate developer amortize the capitalized incremental costs of obtaining a contract?

**Background**

- A real estate developer enters into contracts with customers for the construction and sale of residential units. The developer has concluded that:
  - a. Each contract (i.e., each residential unit) is a single performance obligation
  - b. Revenue is to be recognized over time in accordance with PFRS 15.35(c) – cost-to-cost is the appropriate method to measure progress
- The developer has sales agents who are responsible for the marketing and sale of its residential units. These real estate sales agents typically receive the following benefits from the developer:
  - a. Fixed monthly living allowance which is granted to sales agents regardless of whether they booked sales or not.
  - b. Transportation allowance which is granted to sales agents regardless of whether they booked sales or not.
  - c. Sales commission equivalent to a certain percentage of the total contract price of the residential unit being sold, paid as follows: 20% paid upon reservation, 30% upon signing of contract, and 50% upon full payment.

**Consensus**

- a. The assessment on the costs incurred by the real estate developer are as follows:
  - i. Fixed monthly living allowance and transportation allowance – expensed as incurred.
  - ii. Sales commission – expensed for the portion paid prior to signing the contract (20% of sales commission), capitalized as an asset for the portion that would be incurred after signing the contract (80% of sales commission).

- b. The real estate developer will amortize the capitalized incremental costs using the percentage of completion method (same as measure of progress in satisfying the performance obligation under the related revenue contract).

**Discussion**

- a. Paragraphs 91-94 of PFRS 15 state that, “An entity shall recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.

*The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).*

*Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognized as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.*

*As a practical expedient, an entity may recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that the entity otherwise would have recognized is one year or less.”*

The analysis of the fixed monthly living and transportation allowances, and sales commissions provided by the real estate developer to its real estate agent based on PFRS 15 par. 91-94 are as follows:

<p>Fixed monthly living allowance and transportation allowance</p>	<p>Expensed as incurred.</p> <p>The fixed monthly living allowance and transportation allowance provided to the real estate agents do not meet the capitalization criteria since the real estate developer would still incur these costs regardless of whether the contract to sell residential condominium unit is obtained from the customer</p>
<p>Sales commission (paid in installment)</p>	<p>Expensed for the portion paid prior to signing the contract (20% of sales commission), capitalized as an asset for the portion that would be incurred after signing the contract (80% of sales commission).</p> <p>The 20% of the sales commission paid upon reservation will still be paid to the real estate broker even if the customer does not proceed with the purchase of residential unit. As such, this portion of the sales commission represents cost that the entity would incur regardless of whether a contract is obtained and should be recognized as an expense.</p>

	<p>The remaining 80% of the sales commission which would be paid after signing of the contract represents cost that the real estate developer would not have incurred if the contract to sell residential unit has not been obtained. Further, the real estate developer can expect to recover this contract acquisition cost through indirect recovery (i.e., through the consideration / payments inherent in the contract).</p> <p>Upon signing of the contract, the real estate developer will recognize the remaining 80% as an asset and record a corresponding liability (to consider effect of discounting), since upon revenue recognition the real estate developer must have already concluded that the parties are 'committed to perform their respective obligations'. The fact that the payment of the sales commission will occur over time does not affect whether the full 80% sales commission is capitalized upon obtaining the contract. The accrual of commission the entity expects to pay is appropriate since the entity has a present obligation resulting from a past event and the amount of commission is reliably estimable.</p> <p>As required by paragraph 101 of PFRS 15, the asset is subject to impairment assessment.</p>
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- b. Based on PFRS 15 paragraph 99, an asset recognized in accordance with paragraph 91 or 95 shall be amortized on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

The real estate developer recognizes revenue over time (percentage of completion) which represents a continuous transfer of control to the customer. Consequently, the capitalized incremental costs of obtaining the contract will be amortized using the percentage of completion method since this represents the transfer to the customer of the goods or services to which the capitalized asset relates.



**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)  
QUESTIONS AND ANSWERS (Q&A)**

**Q&A No. 2018-12-H**

**Issue**

Is the real estate developer acting as a principal or customer in goods and services that it delivers based on contract of lease with the tenants?

**Accounting for Common Usage Service Area (CUSA) Charges**

**Background**

- Real estate developer has existing commercial building that is being leased out to tenants. Based on the contract of lease, the real estate developer bills and charges the tenant for the following every month. The details are incorporated in the monthly printed bill.
  - a. Electricity usage – Actual consumption of electricity in kilowatt hour (kwh) based on the readings of sub-meters installed in the commercial building multiplied by the rate per kwh as determined by the real estate developer based on the actual rate charged by the electricity distribution company plus a certain percentage mark-up (e.g. 10%) as distribution charges.
  - b. Water usage – Actual consumption of water in cubic meter based on the readings of sub-meters installed in the commercial building multiplied by the rate per cubic meter as determined by the entity based on the actual rate charged by the water utility company plus a certain percentage mark-up (e.g. 10%) as distribution charges.
  - c. Air conditioning charges – Charges to the tenant for the air conditioning services provided by the real estate developer for the common areas and the occupied area of the tenant. Air conditioning charges rate per square meter (sqm) is determined by the developer and this is multiplied by the total area occupied by the tenant.
  - d. Common use service area (CUSA) expenses – Electricity consumption, security, maintenance and all other common area expenses incurred by the real estate developer in its administration of the commercial building. A CUSA rate per sqm is pre-determined by the developer and this is multiplied by the total area occupied by the tenant. The contract of lease provides that the rates stipulated may be adjusted whenever the cost of the electricity, labor and other charges changes.
- Real estate developer is primarily responsible for ensuring that the leased space is available for the tenant/customer's use based on the lease agreement. The responsibility of the real estate developer is to provide for the free and uninterrupted passage and running of water, drainage, electricity, telecommunications or other public utilities or services. They maintain an administrative office which are fully staffed to resolve any issues or concerns of the tenants in relation to these facilities.

- Based on the general terms and conditions of the contract of lease, the real estate developer may shut off all utilities to the premises occupied by the tenant/customer at any time if they have failed to pay the outstanding billings due to the real estate developer.

### **Consensus**

The principal vs. agent analysis of the goods and services provided by the real estate developer follows:

- a. Electricity usage – Agent
- b. Water usage – Agent
- c. Air-conditioning charges – Principal
- d. Common use service area (CUSA) charges and administrative and handling fees – Principal

### **Discussion**

Based on PFRS 15.B34, when another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (i.e., the entity is a principal), or to arrange for those goods or services to be provided by the other party (i.e., the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer. If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others.

In accordance with PFRS15.B34A, to determine the nature of its promise, the entity shall:

- (a) identify the specified good or service to be provided to the customer in the contract (i.e., whether it is to provide the specified goods or services, or to arrange for those goods and services to be provided by another party); and,
- (b) assess whether it controls each specified good or service before that good or service is transferred to the customer.

Appropriately identifying the good or service to be provided is a critical step in determining whether an entity is a principal or an agent in a transaction. In many situations, especially those involving tangible goods (e.g., sale of residential unit), identifying the specified good or service may be straightforward. However, the assessment may require significant judgment in other situations, such as those involving intangible goods or services (e.g., right to access utilities).

In addition, PFRS 15.BC385O provides that the fact that the entity will not provide the goods or services itself is not determinative. Instead, the entity evaluates whether it controls the right to goods or services before that right is transferred to the customer. In doing so, it is often relevant to assess whether the right is created only when it is obtained by the customer, or whether the right to goods or services exists before the customer obtains the right. If the right does not exist before the customer obtains it, an entity would be unable to control that right before it is transferred to the customer.

In addition, the second step in determining the nature of the entity’s promise (i.e., whether it is to provide the specified goods or services or to arrange for those goods or services to be provided by another party) based on PFRS 15. B34A is for the entity to determine whether the entity controls the goods and services before it is transferred to the customer. An entity cannot provide the specified goods or service to a customer (and, therefore, be a principal) unless it controls the good or service prior to its transfer. That is, the Board noted in the Basis for Conclusions, control is the determining factor when assessing whether an entity is a principal or an agent.

Control of an asset refers to the ability to direct the use of and obtain substantially all the remaining benefits from the asset.

In addition, the standard provides three indicators of when an entity controls the specified good or service (and is, therefore, a principal) as follows:

- a. The entity is primarily responsible for fulfilling the promise to provide the specified goods or service;
- b. The entity has inventory risk before the specified goods or service has been transferred to the customer or after the transfer of control to the customer; and,
- c. The entity has discretion in establishing the price for the specified good or service.

Principal vs. agent analysis of the real estate developers’ performance obligation based on the definition of control as well as the indicators of control follows:

<p>Electricity and Water usage</p>	<p>Conclusion: Agent</p> <p>The specified goods or service that the entity promised to the tenant is for the entity to arrange for the electricity and water supply to be provided by a utility company (i.e., right to obtain electricity and water supply).</p> <p><u>Indicators of control</u></p> <ul style="list-style-type: none"> <li>a. Not met. The utility company, and not the real estate developer, is primary responsible for the provisioning of the utilities. The real estate developer, being the assigned administrator of the building is the party who coordinates with the utility companies to ensure that tenants have access to utilities</li> <li>b. Not applicable. Utilities are not inventoriable.</li> <li>c. Not met. Real estate developer does not have the discretion on the pricing of the services provided since the price is based on the actual rate charged by the utility providers.</li> </ul>
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<p>Common use service area (CUSA) expenses and air conditioning charges</p>	<p>Conclusion: Principal</p> <p>The specified goods or service that the entity promised to the tenant is for the entity to arrange for the maintenance of the common service area (e.g., cleaning, maintenance, security, lighting, etc.) and provision of air conditioning services to be provided by another party. The right to the subcontractor services providing the maintenance services mentioned never transfers to the tenant. Instead, the entity retains the right to direct the service provider as it chooses.</p> <p><u>Control</u></p> <p>The entity has the ability to direct the use of and obtain substantially all the remaining benefits from the services being delivered to the tenants. The entity can direct the maintenance, security and cleaning and administrative services.</p> <p><u>Indicators of control</u></p> <ul style="list-style-type: none"> <li>vi. Met. Real estate developer is the party responsible to provide the necessary services to the common use service area and to provide proper ventilation and air conditioning to the leased premises.</li> <li>vii. Not applicable. Services are not inventoriable.</li> <li>viii. Met. Real estate developer has the discretion on how to price the CUSA and air conditioning charges.</li> </ul>
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## **References**

PFRS 15, *Revenue from Contracts with Customers*

PAS 1, *Presentation of Financial Statements*

PAS 2, *Inventories*

PAS 40, *Investment Properties*

PIC Q&A No. 2016-04, Application of PFRS 15 "Revenue from Contracts with Customers" on sale of residential properties under pre-completion contracts

PRESIDENTIAL DECREE NO. 957, Subdivision and Condominium buyer's Protective Decree 9 (as amended by P.D. 1216), REGULATING THE SALE OF SUBDIVISION LOTS AND CONDOMINIUMS, PROVIDING PENALTIES FOR VIOLATIONS THEREOF

PRESIDENTIAL DECREE No. 1216, DEFINING "OPEN SPACE" IN RESIDENTIAL SUBDIVISIONS AND AMENDING Sec. 31 OF PRESIDENTIAL DECREE NO. 957 REQUIRING SUBDIVISION OWNERS TO PROVIDE ROADS, ALLEYS, SIDEWALKS AND RESERVE OPEN SPACE FOR PARKS OR RECREATIONAL USE

## **Transition and Effective Date**

The consensus in these Q&As are effective on the same date as the effective date of PFRS 15.

Date approved by PIC: January 31, 2018

(Original signed)

**PIC Members**

**Wilson P. Tan, Chairman**

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Date approved by FRSC: February 14, 2018