

INT SB-FRS 115 Agreements for the Construction of Real Estate Accompanying Note on Application of INT SB-FRS 115 in Singapore

This accompanying note is an integral part of INT SB-FRS 115 and is directly adopted from the Accounting Standard Council's Accompanying Note to INT FRS 115. INT SB-FRS 115 is equivalent to INT FRS 115 and this accompanying note is issued as part of INT SB-FRS 115.

Introduction

1 This note takes into account the legal framework in Singapore that is directly relevant to the application of INT FRS 115 in Singapore and summarises the Council's considerations in reaching its consensus on the accounting treatment for the sale of uncompleted residential properties "off-plan".

Scope

2 The scope deals with the accounting treatment for revenue and associated expenses by housing developers who develop more than 4 units of private residential properties in Singapore for sale prior to completion¹ of the properties. These developers are regulated under the Singapore Housing Developers (Control and Licensing) Act (Chapter 130)² (the "Act") and use the standard form of the sale and purchase agreement³ (the "SPA") prescribed in Form D for landed properties and Form E for strata-titled properties of the schedule to the Housing Developers Rules, with each unit sold intended to comprise a lot in a land title plan for landed properties and strata title plan for strata-titled properties. Such a unit sold is referred to as "uncompleted property unit". Such sales are referred to as "standard residential property sales".

Issue

3 The issue is whether standard residential property sales result in the transfer to the purchasers the control and the significant risks and rewards of ownership of the uncompleted property units in their current state as construction progresses, so that the developer should recognise revenue for such sales by reference to the stage of completion using the percentage of completion method.

Consensus

4 The five criteria set out in FRS 18.14, in the context of standard residential property sales, are analysed in turn below.

Whether the developer has transferred to the purchaser the significant risks and rewards of ownership of the uncompleted property units - FRS18.14(a)

¹ This refers to the issue of Certificate of Statutory Completion and individual legal titles for the housing units.

² Statutory Boards are not regulated by the Singapore Housing Developers (Control and Licensing) Act (Chapter 130).

³ Any amendment, deletion or alteration to the standard SPA can only be effected with the approval of the Controller of Housing.

5 The Council noted that no housing development⁴ (“development”) shall be carried out or undertaken in Singapore except by a housing developer who or which is in possession of a licence in writing from the Controller of Housing authorising it to do so. This point together with the various powers vested with the Controller of Housing and the Minister under the Act, underscore the legislative intent to protect the rights of the purchaser of an uncompleted property unit. The provisions in the Act are necessary to protect the rights of the purchaser and justify the basis that the risks of an uncompleted property unit accrue to the purchaser.

6 Standard residential property sales can result in the transfer of the significant risks and rewards of ownership from the time that the SPA is executed, as the purchaser acquires beneficial ownership of the uncompleted property unit. Such beneficial ownership entitles the purchaser to the rewards of ownership such as the ability to sell the purchaser’s beneficial ownership of the uncompleted property unit to another party, with the gain or loss from such a sale being retained by the purchaser. The purchaser is unable to rescind the standard SPA if the developer does not satisfy its obligations and the Council noted that in this regard, the developer passes the risk of ownership to the purchaser upon the execution of the SPA.

7 The developer similarly passes to the purchaser the risks of ownership such as a progressive instalment payment schedule that is designed to progressively match and pay for the contracted purchase price of the uncompleted property unit as the construction progresses. The payment schedule as specified in the standard SPA is also systematically aligned to the stage of completion certified by a qualified person as defined under section 2(1) of the Building Control Act (Chapter 29) (i.e. 30% of the purchase price would be paid to date which is aligned to the completion of the foundation work of the uncompleted property unit etc.).

8 Downward price changes in the market value of the uncompleted property unit sold to the purchaser will not be borne by the developer. The progressive payments by the purchaser represent a payment for an appropriate proportion of the contracted purchase price based on the stage of completion at the date of each of the pre-specified payment intervals.

9 The purchase of an uncompleted property unit exposes the purchaser to losses from the risk of a failure by the developer to complete the property, with the loss of the amounts he has paid to date. The Council noted that the risk of default is mitigated by a requirement in the Act for the developer to operate a separate project account for the development with a bank or finance company.

10 The types of monies to be deposited into and withdrawn from the project account are set out in the Housing Developers (Project Account) Rules. These rules are designed to ensure that monies paid by purchasers in each development are segregated, and utilised only for designated types of payments that relate to the development. The monies shall not be released unless supported by a certificate from the qualified person in charge of the development or documentary proof that payment is due to be made for that designated purpose. This provides a framework that significantly limits the risks to the purchaser of non-completion of the construction of the property.

11 Based on the above observations, the Council noted that standard residential property sales can result in the transfer of the significant risks and rewards of ownership of the uncompleted property units to the purchaser.

⁴ As defined under section 2 of the Act.

Whether the developer retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the uncompleted property units sold - FRS18.14(b)

12 As the sale involves an uncompleted property that the developer has obligations to complete, the developer would continue to have involvement in the uncompleted property sold to the purchaser. During the construction period, such managerial involvement on the part of the developer arises from the contractual obligation of the developer to complete construction in accordance with agreed contractual terms.

13 The Council noted that the SPA together with the relevant building approvals set out the specifications of the property that cannot be changed unilaterally by the developer. Similarly, the developer does not have the right of an owner to deal freely with the uncompleted property unit - once sold, that unit cannot be sold by the developer to another party or be substituted by the developer for another unit. The Council noted that there are no major decisions that a developer can make to derive ownership benefits, e.g. such as making changes to the specifications and approved plans unless the changes have been approved or are required by the Commissioner of Building Control or any other relevant authority of the uncompleted property.

14 The Council noted that the Act provides, in the event of a developer not meeting its obligations, for the relevant authority to direct the appointment of another developer to carry on the business of the defaulting developer. Such power vested in the Minister underscores the rights of purchasers as owners, since such action is not designed to protect any developer's rights to the property.

15 Based on the above observations, the Council considered that the involvement of the developer is in a managerial capacity acting on behalf of the owners, rather than as an owner and that the developer does not have effective control similar to what an owner would be expected to have.

16 The Council noted that INT FRS 115.17 states that "The entity may transfer to the purchaser control...of the work in progress in its current state as construction progresses." On this point on whether the purchaser obtains control progressively of the uncompleted property unit as construction progresses, the Council has rationalised the concept of control from the dimension of a multi property unit development rather than a single unit property development.

17 The Council noted that absolute control of the uncompleted property unit vests in no one single entity during construction for a multi-unit property development. The standard SPA does not specify that a purchaser is able to take over the uncompleted development during construction (e.g. to engage a different entity to complete the construction). Approaching control from the dimension of a multi-unit property development, the purchaser of a single unit cannot unilaterally change the developer during construction. However, the issue of whether collectively all the purchasers are able to change the developer during construction has not been considered because there has been no such precedence in Singapore to date and hence, inappropriate to speculate with regard to the application of INT FRS 115.

18 The Council noted that a purchaser will not be able to alter the major structural elements of the design of the property unit even after completion of construction and hence, the issue of whether the purchaser has this ability during construction is irrelevant to the application of INT FRS 115. However, the Council noted that there have been instances

where the purchaser of two adjoining property units had entered into a supplementary SPA with the developer to combine the 2 property units during construction. The Council noted that the purchaser had evidenced the ability to alter the specifications of the purchaser's own uncompleted property unit within the unit's parameters during construction.

19 The Council noted that the control the Controller of Housing has over the uncompleted property unit during its construction is primarily on the control of the project account and not on the uncompleted property unit. His role is predominantly to safeguard the interests of the purchaser by ensuring the SPA is a fair agreement between both parties.

20 Historically, when a developer defaulted during the construction of an uncompleted development, the mortgagee financial institution which financed the development via a loan to the developer secured by the land and the development as mortgage had stepped in to take over the development.

21 The Council noted that the courses of action taken by a mortgagee financial institution included the appointment of a receiver which subsequently completed the development as per the original SPA or sold the underlying land without completing the development. Typically, the courses of actions depended on the stage of completion and the percentage of units sold to date.

22 The Council noted that there was a case where a mortgagee financial institution sold the underlying land to another developer when it took over the development during the foundation stage of completion when none of the units were sold. In another case, the mortgagee financial institution took over the development with 25 out of the 52 units already sold. The underlying land was sold to a new developer with the sale subject to the new developer taking over the obligations of the failed developer under its existing SPAs with the purchasers.

23 The courses of action taken by a mortgagee financial institution or a receiver appointed on an uncompleted development in respect of a developer which had defaulted are ultimately driven by commercial justifications. The historical rate of defaults by developers in Singapore is minimal.

24 Notwithstanding the above courses of action that could be taken by a mortgagee financial institution, the Council noted that the Minister may intervene under the Act to ensure that the rights of the purchasers under the SPA are safeguarded. In addition, the Council noted that a purchaser is able to mortgage the uncompleted property unit to obtain a housing loan to settle the progressive payments.

25 The Council considered the two alternative scenarios posed in paragraphs IE6 to IE8 of illustrative example 2 accompanying INT FRS 115, the Council noted that legal title of the property unit would only pass to the purchaser upon the completion. The developer would execute a proper conveyance to the purchaser of the property unit and also hand over to the purchaser the title to the property unit, namely the subsidiary strata certificate of title (for a strata-titled property) or the certificate of title (for a landed property). This certificate is an official document issued by the Registrar of Titles stating that the person named in the certificate is the legal owner of the property described in the certificate.

26 To protect the purchaser's interest, the purchaser (i.e. "caveator") may lodge a caveat⁵ against the specific uncompleted property unit under section 115(1) of the Land Titles Act (Chapter 157). The caveat is a precautionary step taken by the caveator pending completion of the uncompleted property unit. The caveat also serves as a notice to others that the caveator has an interest in the uncompleted property unit (i.e. an encumbrance).

27 The Council noted that a caveat lodged on an uncompleted property unit can prevent the developer from dealing with the underlying land independently of the caveator. So long as a caveat remains effective, the Registrar of Titles shall not register any dealing which is prohibited by the caveat. Upon lodgment of a transaction which is prohibited by a caveat, the Registrar of Titles shall serve on the caveator a notice of his intention, at the expiration of 30 days from the date of the service of the notice, to register the transaction. The ability of a caveator to be notified and object to another party's registration of a transaction of the underlying land in which a caveat had been lodged earlier, evidences control associated with ownership of the uncompleted property unit.

28 The Council noted that a missing control factor prior to the completion of construction is that the purchaser does not possess physical control of the completed unit. Prior to the transfer of the legal title, the Council noted that there is a progressive alignment of the monies deposited into the project account and the progressive build up and value accretion of the physical property unit that evidences that the purchaser progressively accumulates control over the uncompleted property unit as progressive payments are made to the project account.

29 Accordingly, the legal framework and the caveat system in Singapore taken as a whole provide an equitable right of the purchaser over the uncompleted property unit. This together with the project account and the progress payments made by the purchaser, evidences that the purchaser obtains control over the uncompleted property unit as construction progresses. Collectively, the various mechanisms in the legal framework, over and above contractual rights, establish a purchaser's control over the uncompleted property unit. This is reflected in the historically minimal rate of defaults on developments in Singapore.

Whether the amount of revenue can be measured reliably - FRS18.14(c)

30 The Council noted that the considerations relating to the reliability of measurement of revenue should be based on standard accounting principles and require no further consideration for purposes of this note.

Whether it is probable that the economic benefits associated with the transaction will flow to the developer - FRS18.14 (d)

⁵ A caveat is a legal document lodged at the Singapore Land Authority by someone (known as a "caveator") against a property in which the caveator claims an interest. The Land Titles Act (Chapter 157) allows any person who claims an interest in the property to lodge a caveat. When a caveat is lodged, the Registrar of Titles will notify it against the property. A caveat may be lodged by any party who has an interest in the property and that party is usually a:-

- purchaser who has paid a deposit to buy a particular property; or
- financial institution which has granted a loan to the owner or the purchaser; or
- Central Provident Fund (CPF) Board when CPF funds are released from the owner's or the purchaser's CPF account(s).

31 The Council considered the issue of whether the regulatory restrictions in the Act on the use of the monies received from purchasers and deposited in the project account poses a significant uncertainty on the ultimate receipt of the sale proceeds. One related argument is that these monies are the property of the purchasers and held in trust on their behalf. The Council noted that the monies are considered as belonging to the developer, notwithstanding the regulatory restrictions, and that the monies are applied towards the payment of construction costs that the developer would otherwise have to finance. The Council also noted that the developer is allowed to withdraw the balances in the project account ahead of the completion of construction if the developer furnishes a banker's guarantee of equivalent amount to the Controller of Housing and has obtained the Controller of Housing's approval.

32 The Council also considered a scenario where sales of uncompleted property units have been made, but there is considerable uncertainty as to the ability of the developer to sell sufficient units and its ability to continue as a going concern. In such a situation, the Council felt that there would be significant doubt as to the eventual completion of the project and realisation of the attributable profit relating to the sales made to date, since the project could result in a loss overall.

Whether the costs incurred or to be incurred in respect of the transaction can be measured reliably - FRS18.14(e)

33 The Council noted that the considerations relating to the reliability of measurement of costs are no different from standard accounting principles and require no further consideration for purposes of this note.

Conclusion

34 The Council noted that standard residential property sales in Singapore meet the criteria set out in FRS 18.14 that would require such sales to be accounted for on a percentage of completion method. However, in some situations specific to the circumstances of a development project as described in paragraph 32, there might be uncertainties that would require the completion of construction method to be applied, consistently with the principles set out in FRS 18 for the treatment of revenue when such uncertainties exist.