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Subject **Accounting for 'involuntary' public infrastructure costs in a project development**

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This Paper has been prepared for discussion at a meeting of the Emerging Economies Group and it represents the views of the author and not necessarily those of the Malaysian Accounting Standards Board.

Background

Property developers in Malaysia must apply to their local government authorities[1] (LGAs) for planning permission in respect of development projects and, where planning permission is granted, LGAs may do so, either absolutely or subject to conditions. Typically, therefore, developments cannot take place unless planning permission has been granted by LGAs.

The conditions imposed by LGAs in granting planning permission often include the construction of infrastructure, such as interchanges, playgrounds, schools, places of worship, and other public amenities (public infrastructure) by the developer, at the developer's cost[2].

Issue

This Paper addresses the recognition of obligations to build public infrastructure for a development project in the financial statements of a property development entity.

Current industry practice is typically to accumulate public infrastructure costs as the relevant project progresses (i.e. an accrual basis). That is the following can occur.

(a) Costs incurred in constructing public infrastructure before or during construction of the development itself are recognised and allocated to the overall costs of a development.

(b) Costs incurred in constructing public infrastructure after completion of the development itself are accrued as construction takes place as part of the overall costs of a development. Any formal transfer of the completed public infrastructure to the LGA does not give rise to the separate recognition of income as there is no sale to the LGA.

There is at least one alternative view (identified in this Paper as 'the alternative view') that involves accounting for an obligation to provide public infrastructure as consideration to obtain the development rights under IAS 38 *Intangible Assets.* Those who hold this view believe there is an 'exchange of asset' transaction. That is, the LGA

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1 The same is true in most jurisdictions, although the level of government involved may differ between jurisdictions.

2 Although developers are obliged to meet the conditions of the planning permission granted by LGAs under the law to construct public infrastructure, utilities, facilities or amenities, the developers however, are unlikely to owe any implied obligations to their customers arising out of the law.

grants an intangible asset (being the planning permission) and, in return, expects to receive public infrastructure constructed by the developer. Correspondingly, the developer is regarded as receiving an intangible asset in exchange for accepting an obligation to construct public infrastructure. Those who hold this view believe that the total public infrastructure cost for all phases of a development project should be recognised as an intangible asset on Day-1 when the permission is granted and at the commencement of any phase of the development project. This is regardless of whether the public infrastructure is applicable to the current phase of the project or to other future phases of the project.

This Paper does not address accounting for common infrastructure specified in contracts between a developer and its customers, such as swimming pools or gyms, which are usually transferred to the collective control of customers.

Questions

(1) What is the generally-accepted practice in your jurisdiction on accounting by developers for public infrastructure costs?

(2) Are you aware of any financial statements in which a developer has recognised a liability for the total expected cost of constructing public infrastructure on Day-1; that is, when the developer received the planning permission from the LGA and initial work on the project has commenced. (For example, when work has commenced only on phase 1 of a multi-phase project and the public infrastructure cost relates to the multiple phases of the development project?)

(3) Do you believe that development permission granted by an LGA should be recognised as a separate asset by the developer under IAS 38?

Appendix – analysis of the issue

1. Introduction

1.1 This analysis considers the potential applicability of a range of pronouncements, including:

(a) IASB *Conceptual Framework for Financial Reporting* (March 2018);

(b) IFRS 15 *Revenue from Contracts with Customers*;

(c) IAS 16 *Property, Plant and Equipment*;

(d) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*;

(e) IAS 38 *Intangible Assets*; and

(f) the 'hierarchy' outlined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and the potential relevance of pronouncements of standard-setting bodies other than the IASB and MASB.

Other pronouncements that have not been considered in this Paper, may also be relevant.

1.2 The extent to which each of the above pronouncements are applicable will affect the recognition and measurement of assets and liabilities.

1.3 For illustrative purposes, this Paper uses an example of a RM3 billion two-phase residential property development with the following features.

Transactions & events	**Phase 1**	**Phase 2**
Developer owns two adjacent lots of land	Lot 1	Lot 2
LGA grants permission to develop, conditional on constructing a school and a mosque expected to cost RM500m on two lots of nearby LGA land	1 July 2018	1 July 2018
Expected commencement	1 March 2019	1 October 2023
Expected completion	30 September 2022	30 September 2025
Expected total cost, which includes:	RM2b	RM1b
~ a school to be transferred to LGA control[Ω]	RM350m	~
~ a mosque to be transferred to LGA control[Ω]	~	RM150m
Developer publicly commits to construction, subject to obtaining customer contracts for each phase[β]	1 July 2018	1 July 2018
Developer signs contracts with customers for most residences	31 December 2018	No

Ω For no consideration

β The developer's public statements about Phase 1 and its arrangement with the LGA to proceed with Phase 1 on obtaining customer contracts are regarded as legally binding.

2. Conceptual Framework – potential liabilities associated with the two-phase development

2.1 Since the infrastructure associated with the property development is key to the developer obtaining permission to proceed, it is relevant to consider the extent to which the developer might have, in concept, one or more assets and/or liabilities in respect of the right to construct the development and obligation to construct public infrastructure. If so, it is also relevant to consider whether they might be recognised separately or as part of another asset or liability.

Liability definition

2.2 The IASB *Conceptual Framework for Financial Reporting* (March 2018) includes a liability definition.

> 4.26 A liability is a present obligation of the entity to transfer an economic resource as a result of past events.

Accordingly, there are three criteria that need to be satisfied for a liability to exist:

(1) a present obligation;

(2) the obligation is to transfer an economic resource; and

(3) (1) and (2) need to be the result of past events.

2.3 An obligation is described as follows.

> 4.29 An obligation is a duty or responsibility that an entity has no practical ability to avoid. An obligation is always owed to another party (or parties). The other party (or parties) could be a person or another entity, a group of people or other entities, or society at large. It is not necessary to know the identity of the party (or parties) to whom the obligation is owed.

2.4 In the example, by 31 December 2018, the developer appears to have a present obligation in respect of Phase 1 – that is, no practical ability to avoid developing Phase 1 of the development because it has signed contracts with customers to construct and transfer most of the Phase 1 residences. Although there is an expectation by 31 December 2018 that the developer will proceed with Phase 2 of the development, it does not have a present obligation for Phase 2 since it has the practical ability to avoid that responsibility because it has not yet signed contracts with customers for Phase 2.

2.5 In the example, by 31 December 2018, the developer's obligation regarding Phase 1 has the potential to require the developer to transfer an economic resource to another party [CF.4.37], being the customers and the LGA. Obligations to transfer an economic resource include obligations to deliver goods or provide services [CF.4.39(b)].

2.6 In the example, by 31 December 2018, the developer's obligation regarding Phase 1 is the result of past events, being the contracts with customers[CF.4.43]. There are no relevant past events in respect of Phase 2.

Unit of account

2.7 CF.4.49 says (emphasis added):

> 4.49 **A unit of account is selected for an asset or liability when considering how recognition criteria and measurement concepts will apply** to that asset or liability and to the related income and expenses. …

2.8 CF.4.51 and CF.4.53 contain criteria to be applied in determining unit of account. CF.4.51 and CF.4.53 say (emphasis added):

> 4.51 A unit of account is selected to provide useful information, which implies that:
>
> (a) the information provided about the asset or liability and about any related income and expenses must be relevant. **Treating a group of rights and obligations as a single unit of account may provide more relevant information than treating each right or obligation as a separate unit of account if, for example, those rights and obligations**:
>
> (i) **cannot be or are unlikely to be the subject of separate transactions**;
>
> (ii) cannot or are unlikely to expire in different patterns;
>
> (iii) have similar economic characteristics and risks and hence are likely to have similar implications for the prospects for future net cash inflows to the entity or net cash outflows from the entity; or
>
> (iv) **are used together in the business activities conducted by an entity to produce cash flows and are measured by reference to estimates of their interdependent future cash flows**.
>
> (b) **the information provided about the asset or liability and about any related income and expenses must faithfully represent the substance of the transaction or other event from which they have arisen**. Therefore, it may be necessary to treat rights or obligations arising from different sources as a single unit of account, or to separate the rights or obligations arising from a single source (see paragraph 4.62). Equally, **to provide a faithful representation of unrelated rights and obligations, it may be necessary to recognise and measure them separately**.
>
> 4.53 Sometimes, both rights and obligations arise from the same source. For example, some contracts establish both rights and obligations for each of the parties. If those rights and obligations are interdependent and cannot be separated, they constitute a single inseparable asset or liability and hence form a single unit of account. For example, this is the case with executory contracts (see paragraph 4.57). Conversely, if rights are separable from obligations, it may sometimes be appropriate to group the rights separately from the obligations, resulting in the identification of one or more separate assets and liabilities. In other cases, it may be more appropriate to group separable rights and obligations in a single unit of account treating them as a single asset or a single liability.

2.9 Although the economic benefits associated with many assets can only be enjoyed when they are used in conjunction with other assets (and liabilities), the Framework criteria suggest that the permission to develop Lot 1 of land is not a separate unit of account from Lot 1 itself. This is because:

(a) the permission to develop Lot 1 cannot be traded separately from Lot 1 [CF.4.51(a)(i)]; and

(b) the ability to generate cash flows associated with the permission to develop Lot 1 of land are wholly interdependent with Lot 1 [CF.4.51(a)(iv)]. This would apply whether the developer chose to continue with the development or to sell Lot 1, since the value of Lot 1 with permission to develop would presumably be higher than the value of Lot 1 without permission to develop.

Executory contracts

2.10 In relation to executory contracts, CF.4.56 and CF.4.57 say (emphasis added):

> 4.56 An executory contract is a contract, or a portion of a contract, that is equally unperformed—neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent.
>
> 4.57 **An executory contract establishes a combined right and obligation to exchange economic resources**. The right and obligation are interdependent and cannot be separated. Hence, **the combined right and obligation constitute a single asset or liability**.

2.11 In the example, as at 31 December 2018, the developer may have: one executory set of contracts with customers relating to a liability to construct residences and RM350m for a nearby school for Phase 1 offset by an asset that is a right to receive consideration from customers for residences, which seems supported by the criteria in CF.4.51(a)(iv) and CF4.51(b).

2.12 The alternative view is that, as at 31 December 2018, the developer has:

(a) one executory set of contracts with customers relating to a liability to construct residences for Phase 1 offset by an asset that is a right to receive consideration from customers for residences; and

(b) one non-executory contract with the LGA relating to a liability to construct a school for RM350m and an asset that is the right to develop Phase 1, assuming that right is separable from a right to develop Phase 2.

2.13 However, for the obligation to the LGA for the school to be a non-executory contract at 31 December 2018, it would be necessary to regard the developer's promise to construct the school as being performance under the contract, not the construction of the school itself (which is yet to be constructed).

2.14 There may also be other views, including a view that, as at 31 December 2018, the developer has:

(a) one executory set of contracts with customers relating to a liability to construct residences for Phase 1 offset by an asset that is a right to receive consideration from customers for residences; and

(b) one non-executory contract with the LGA relating to a liability to construct a school for RM350m that is not offset by an asset. This would effectively be an onerous contract under IAS 37.66 to 69, leading to the recognition of a provision in the balance sheet and a loss in profit or loss for the period ending 31 December 2018.

However, identifying an onerous contract for the whole RM350m involves presuming that the permission to proceed with Phase 1 on Lot 1 has no value, which seems improbable.

Recognition

2.15 Under CF.5.7, assets and liabilities are recognised when:

(a) they would result in relevant information; and

(b) can be faithfully represented.

2.16 An asset or liability may not be relevant when it is uncertain whether it exists or the probability of an inflow or outflow of economic benefits is low. Neither of these factors affects assets and liabilities in respect of Phase 1 as at 31 December 2018.

2.17 Whether an asset or liability can be faithfully represented might be affected by measurement uncertainty.

Summary regarding liabilities

2.18 Based on the above discussion of the Framework, the following views seem relevant.

(a) The developer has a set of executory contracts with customers for constructing residences and the RM350m school associated with Phase 1 that do not give rise to present obligations and are therefore not liabilities (or assets) [CF.4.47].

(b) The developer has one set of executory contracts with customers referred to in (a) and one 'contract' with the LGA for RM350m school that is non-executory and may give rise to a recognisable liability at 31 December 2018, when the developer is committed to Phase 1.

Discussion based on a view that there are two units of account

2.19 The following discussion is based on the view that the permission granted by the LGA to undertake the property development is the basis for a separate unit of account to construct the RM350m school for Phase 1 that gives rise to a recognisable liability at 31 December 2018. That liability must be associated with an asset and/or expense.

Asset definition

2.20 CF.4.3, CF.4.4, CF.4.20 and CF.4.21 effectively define 'asset' and say (emphasis added):

> 4.3 An asset is a present **economic resource controlled by the entity** as a result of past events.
>
> 4.4 An **economic resource is a right that has the potential to produce economic benefits**.
>
> 4.20 **An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it**. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it. It follows that, if one party controls an economic resource, no other party controls that resource.
>
> 4.21 An entity has the present ability to direct the use of an economic resource if it has the right to deploy that economic resource in its activities, or to allow another party to deploy the economic resource in that other party's activities.

2.21 The LGA's permission to proceed with Phase 1 and Phase 2 of the property development could be regarded as a right that has the potential to produce economic benefits. And that right would be controlled by the developer.[3]

Asset recognition

2.22 Under CF.5.7, assets and liabilities are recognised when:

(a) they would result in relevant information; and

(b) can be faithfully represented.

2.23 By way of example, based on the amount relevant for the liability discussed above for constructing the RM350m school that the developer has committed to construct for Phase 1, as at 31 December 2018, the following journal entries might be relevant:

Description	Debit	Credit
Asset relating to permission to develop Phase 1	RM350m	
Liability to construct school associated with Phase 1		RM350m

2.24 Whether an asset of RM350m for permission to develop Phase 1 is relevant is a matter for judgement, and the following observations are offered as to whether a separate asset relating to permission to develop Phase 1 of RM350m would be a faithful representation.

(a) There is no evidence that the 'potential to produce economic benefits' should be measured as an amount corresponding to the cost of construction of the school associated with Phase 1 to be transferred to the LGA. The potential to produce economic benefits for the developer is more likely to relate to its future profits from the development itself. This may imply that the permission to develop Phase 1 is not separable from the Phase 1 development itself – that is, any 'permission asset' is not a separate unit of account.

(b) Ignoring (a), if it were appropriate to measure the permission to develop at the expected cost of infrastructure associated with the development to be transferred to the LGA, it would relate to the whole development, not only Phase 1. That is, if the basis for measuring the asset for permission to develop is by reference to the cost of constructing associated infrastructure to be transferred to the LGA, the amount would be RM500m for both Phase 1 (RM350m for the school) and Phase 2 (RM150m for the mosque). [However, also refer to the discussion of intangible assets below.]

3 The right to develop land is ordinarily attached to the relevant land and the developer would control that right by controlling the land. [The author is not aware of any jurisdictions in which a right to develop land is specific to the developer that currently owns the land and would expire if the developer were to sell the land.] Accordingly, the right to develop is a feature of the land that could be transacted with the land, although the timeframe imposed by an LGA for development might impede the ability to transfer the land and permission to another developer.

3. IFRS

3.1 Although the Framework is used in determining accounting policies, it is not mandatory. [However, please refer to the discussion below under the heading 'IAS 8'.] CF.SP1.1 and SP1.2 note:

> SP1.1 The Conceptual Framework for Financial Reporting (Conceptual Framework) describes the objective of, and the concepts for, general purpose financial reporting. The purpose of the Conceptual Framework is to:
>
> (a) assist the International Accounting Standards Board (Board) to develop IFRS Standards (Standards) that are based on consistent concepts;
>
> (b) assist preparers to develop consistent accounting policies when no Standard applies to a particular transaction or other event, or when a Standard allows a choice of accounting policy; and
>
> (c) assist all parties to understand and interpret the Standards.
>
> SP1.2 The Conceptual Framework is not a Standard. Nothing in the Conceptual Framework overrides any Standard or any requirement in a Standard.

IFRS 15

3.2 IFRS 15 deals with contracts that involve entities satisfying performance obligations to customers. Appendix A to IFRS 15 defines a 'performance obligation' as:

> 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.

3.2 IFRS 15.31 says (emphasis added):

> 31 An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) **the customer obtains control** of that asset.

3.3 Performance obligations within IFRS 15 relate only to goods or services that pass into customers' control. Accordingly, for Phase 1, contracts with customers relate only to the residences and not the RM350m school that will be controlled by the LGA.

IAS 37

3.4 IAS 37.1 and IAS 37.3 say:

> 1 This Standard shall be applied by all entities in accounting for provisions, contingent liabilities and contingent assets, except:
>
> (a) those resulting from executory contracts, except where the contract is onerous; and
>
> (b) [deleted]
>
> (c) those covered by another Standard.
>
> 3 Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. This Standard does not apply to executory contracts unless they are onerous.

3.5 IAS 37.10 includes the following definitions.

> A provision is a liability of uncertain timing or amount.

> An onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

3.6 Assuming for the purposes of discussion that the promise to construct a school associated with Phase 1 to be transferred to the LGA is not part of the executory contract to develop Phase 1 as at 31 December 2018, it is conceivable that the promise is a liability of uncertain timing or amount and, therefore, falls within the 'provision' definition. That is because:

(a) the time over which the school associated with Phase 1 must be constructed may or may not be as expected – for example, the developer may be depending on the LGA performing other tasks before it can complete the infrastructure; and/or

(b) the cost of constructing the school may be different from expectations.

3.7 In respect of recognition, the requirements in IAS 37.14 are highly similar to those in the Framework and are not considered here. That is, if the definition of a provision were met in relation to the promise to construct the school associated with Phase 1 to be transferred to the LGA, its recognition under IAS 37 would be as per the Framework discussion above.

3.8 IAS 37.53 and IAS 37.54 refer to the presentation of expenses and assets relating to provisions only in the context of reimbursements [IAS 37.]. Otherwise, IAS 37.8 says:

> 8. Other Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard.

Accordingly, in terms of the debit associated with a provision, it is necessary to look at other IFRS.

IAS 38

3.9 IAS 38.8 includes the following definition.

> An intangible asset is an identifiable non-monetary asset without physical substance.

3.10 IAS 38.12 explains:

> 12 An asset is identifiable if it either:
>
> (a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or
>
> (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

3.11 Any asset associated with obtaining permission to undertake a property development:

(a) would not meet the condition in IAS 38.12(a) because it is not separable from the property development itself;

(b) could meet the condition in IAS 38.12(b) on the basis of being an 'other right'.

However, in relation to IAS 38.12, the LGA is exercising its regulatory function over planning decisions that apply to property and is therefore difficult to dis-

associate with any right granted to develop property from the property itself. That is, the value of having permission to develop on a lot of land is associated with the land that the developer currently controls, not the developer itself. This is discussed later in this Paper in the context of IAS 16.

3.12 In respect of recognition, IAS 38.21 says:

> 21 An intangible asset shall be recognised if, and only if:
>
> (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
>
> (b) the cost of the asset can be measured reliably.
>
> 22 An entity shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

3.13 In respect of measurement, IAS 38.24 says:

> 24 An intangible asset shall be measured initially at cost.

And IAS 38.8 (emphasis added) defines cost.

> Cost is the amount of **cash or cash equivalents paid** or the fair value of other **consideration given** to acquire an asset at the time of its acquisition or construction, or, when applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, eg IFRS 2 *Share-based Payment*.

3.14 The measurement of any recognised asset associated with obtaining permission to undertake a property development would involve:

(a) identifying costs/consideration already incurred; or

(b) identifying another IFRS that attributes an amount to the asset.

3.15 In respect of (a), the costs already incurred to obtain permission to develop Phase 1 and Phase 2 would probably be costs for preparing paperwork necessary to obtain permission and other similar costs – the expected costs for constructing the school associated with Phase 1 have not been 'paid'. Alternatively, it might be argued that the promise to construct the school is 'consideration given' for the purpose of IAS 38.8. However, consideration in the form of a promise to spend RM350m to construct infrastructure is may not have a value of RM350m – for example, the promise may have a fair value of a much lesser amount due to uncertainty about whether the promise will be met.

3.16 In respect of (b), there appear to be no relevant other IFRS that would attribute an amount to the asset.

IAS 8

3.17 IAS 8.10, IAS 8.11 and IAS 8.12 (footnote omitted) say:

> 10 In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:
>
> (a) relevant to the economic decision-making needs of users; and
>
> (b) reliable, in that the financial statements:
>
> (i) represent faithfully the financial position, financial performance and cash flows of the entity;

> (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
>
> (iii) are neutral, ie free from bias;
>
> (iv) are prudent; and
>
> (v) are complete in all material respects.
>
> 11 In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:
>
> (a) the requirements in IFRSs dealing with similar and related issues; and
>
> (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*).
>
> 12 In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.

3.18 If it is judged that there is no IFRS that specifically applies to the promise to construct infrastructure associated with a property development, IAS 8.10 requires an entity to use judgement in developing policies that will result in relevant and reliable information. In doing so, the entity looks at:

(a) IFRSs dealing with similar and related issues [IAS 8.11]; which, for example, could include IFRS 15 (which has already been considered above) and/or IAS 16 – as considered below;

(b) the Framework [IAS 8.11] – which has already been considered above;

(c) other accounting literature and accepted industry practices [IAS 8.12] – not discussed in any detail in this Paper because an exhaustive survey of practice has not been conducted. At this stage, the author is aware of industry practice in some jurisdictions, which is to treat the costs of associated infrastructure as costs accumulating to the whole project as it progresses, and those accumulating costs form the basis for assets and liabilities.

Applying IAS 16 by analogy under IAS 8.11

3.23 There two potential ways in which IAS 16 might apply by analogy to the example considered in this Paper.

(a) The permission to proceed with the development of Phase 1 and Phase 2 could regarded as adding value to the developer's two lots of land.

(b) The permission to proceed with a development project that is conditional on meeting a related obligation is addressed in the context of dismantling, removing and restoring obligations under IAS 16.

Land value analogy

3.24 The value of land without permission to develop is less than the value of land with the permission to develop. Assuming the developer applies the cost approach to measurement under IAS 16, any additional value associated with permission to develop land would only be recognised when a cost is incurred [IAS 16.16].

3.25 In the case of Lot 1, that cost could be considered to be the cost of constructing the school, as the school construction costs are incurred. In the case of Lot 2,

that cost could be considered to be the cost of constructing the mosque, as the mosque construction costs are incurred.

3.26 This approach tends to view the land as a separate unit of account from anything constructed on the land. If, for example, the school were to be constructed after the Phase 1 residences are constructed and sold to customers, it would not seem to be relevant to wait until the school is constructed before adding the value to the land, which by that time would already have been sold along with the residences.

3.27 A possible alternative would be for the developer to change its accounting policy[4] to the revaluation approach and to revalue Lot 1 and Lot 2 to their fair values in accordance with IAS 16.31. Fair value is "The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date".[5] If, by coincidence, the fair value was equivalent to the expected costs for constructing the school and the mosque, the credit entry for all the costs would be a corresponding revaluation surplus for those costs [IAS 16.39]. However, it should be noted that:

(a) to the extent the fair value increment is less than the expected costs of constructing the school and mosque, the balance of the credit entry would need to be allocated elsewhere (that is, not to the revaluation reserve); and

(b) the revaluation basis must be applied to a class of assets [IAS 16.29]. Accordingly, if the developer chooses to apply the revaluation approach, it would need to do for all of its land holdings that are within the same class of property, plant and equipment as Lot 1 and Lot 2.

Dismantling, removing, restoring analogy

3.28 IAS 16.16 and IAS 16.18 say (emphasis added):

> 16 The cost of an item of property, plant and equipment comprises:
>
> (a) its purchase price, …
>
> (c) **the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item** during a particular period for purposes other than to produce inventories during that period.
>
> 18 An entity applies IAS 2 *Inventories* to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period. The obligations for costs accounted for in accordance with IAS 2 or IAS 16 are recognised and measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

3.29 These requirements are often applied when the construction of an asset causes damage that later needs to be rectified – for example, a property developer that damages a government-controlled roadway and/or footpath adjacent to the property. In that case, the costs of rectifying the damage are capitalised into the property. The costs may be incurred directly by the developer using its own labour and materials to rectify the damage or the costs might be an invoice from the controlling government entity that rectifies the damage.

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4 IAS 8 permits a change of accounting policy when it would meet the criteria in IAS 8.14.

5 IFRS 13 *Fair Value Measurement*, Appendix A.

3.30 The same accounting treatment could be extended by analogy to the school associated with Phase 1 of the development in the example. Accordingly, the obligation would be treated as a cost integral to the Phase 1 development of residences and recognised as residences are constructed. For example, if the school were scheduled to be constructed after the residences, the cost of constructing the school would be accrued as the residences are constructed.

3.31 In the same way that an unavoidable cost of an item of property, plant and equipment includes the costs of dismantling and removing that item and restoring the site on which it is located, constructing the school is an unavoidable cost of developing Phase 1. However, as required in the context of IAS 16, the unavoidable cost is not recognised up-front; rather, it is recognised as part of the relevant asset.

4. Summary discussion and conclusions

4.1 This Paper concludes that the most fundamental issue to address before considering whether a separate liability exists in relation to a LGA granting a right to proceed with a property development is whether that liability is a separate unit of account under IFRS.

4.2 This Paper further concludes that the Phase 1 development of residences and associated school would seem to be one unit of account based on the following.

(a) The developer would proceed with the development on the basis that it is expected to be commercially viable based on all the cash flows – that is the group of rights and obligations relating to Phase 1 involve cash flows relating to the residences and associated infrastructure are interdependent [CF.4.51(a)(iv)];

(b) In judging whether a separate liability for Phase 1 infrastructure would meet the Framework recognition criteria, consideration needs to be given to the difficulties associated with identifying and measuring the related asset and/or expense. Assuming a liability were recognised, the following would need to be considered.

(i) The corresponding recognition of an expense would imply that Phase 1 of the development has given rise to an onerous contract (which is assumed not to be the case in the example), which would not be a faithful representation.

(ii) The basis for recognising a corresponding asset is not clear. If recognising an asset were justified on the basis that the LGA granted permission to proceed with Phase 1 and Phase 2 of the development, that asset would **not** be restricted to Phase 1 and would, therefore, presumably be measured based on the expected cost of both Phase 1 and Phase 2 infrastructure (the school and the mosque) to be transferred to the LGA. However, until the developer has contracts with customers relating to Phase 2, it is not committed to constructing the mosque and does not have a present obligation for its construction.

(iii) If an asset were to be recognised, there is no evidence that the 'potential to produce economic benefits' should be measured as an amount corresponding to the cost of construction associated infrastructure. The potential to produce economic benefits for the developer is more likely to relate to its future profits from the development itself, implying that the whole of Phase 1 (residences and associated school) is a single unit of account.

(c) There is undoubtedly a value associated with receiving permission to develop land, which would be an enhancement to that land value – it would not be a separate asset associated with the developer itself. The analogy with IAS 16.16 and regarding the LGA permission to develop Lot 1 and Lot 2 as enhancing the value of that land would involve the developer applying the revaluation approach to measuring land in order to avoid practical difficulties associated with the timing of costs incurred for constructing the school and mosque.

(d) The analogy with IAS 16.16 and treating obligations for dismantling, removal and restoration as part of the cost of property, plant and equipment seems to be a particularly relevant basis for including the infrastructure costs as a part of the cost of developing each Phase. The costs associated with the school can be attributed to the Phase 1 residential development and the costs associated with the mosque can be attributed to the Phase 2 residential development.

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