Report On

Application of the Notion of Control in the Revenue Recognition Model

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Executive Summary

1. The ED uses the revenue recognition principle of satisfaction of performance obligations. The ED further provides that a performance obligation is satisfied by transferring a promised good or service to a customer, and a good or service is transferred when the customer obtains *control* of that good or service. It is not obvious that this revenue recognition principle will lead to more decision-useful information. The adoption of this revenue recognition principle may also lead to unintended adverse consequences on the behavior of the preparers and users of financial statements.

2. Instead of proposing an entirely different model, we believe that the revenue recognition model in the ED can be modified into a robust model that will result in revenue numbers which faithfully represent the economic phenomena that they purport to represent.

3. Therefore, our proposed revenue recognition model continues to adopt the notion of "control" in the ED. However, paragraphs 25 through 32 of the ED are modified to provide for separate descriptions/indicators for goods and services to determine when the customer has obtained control, and to provide for the use of the percentage of completion method under certain specific circumstances.

4. For goods, the definition of control and the indicators of the ED are retained, with some minor modifications.

5. For services, we propose a slightly different definition of when customer has obtained control (based on the risk and reward fall-back of ED 10). Further, if specific conditions are met, control of service is treated as being transferred continuously, and consequently the percentage of completion method should be used if reliable estimates can be made.

6. When a contract with a customer encompasses both goods and services, (e.g., shipbuilding and real estate development with multiple customers), we propose to separate them into distinct performance obligations, which could be either goods or services. If the goods and services are not distinct, the whole contract should be classified as goods or as services depending on the circumstances. We propose that the entire contract should be treated as a sale of goods if the entity builds/constructs/manufactures the asset and then enters into a contract with a

customer to sell the completed asset, while the entire contract should be treated as a contract for services if the entity enters into a contract with a customer either before the commencement or during the process, of building/constructing/manufacturing the asset.

7. We include illustrations on the application of our proposed revenue recognition model to three scenarios

   - Service (audit fee)
   - Long term construction (automobile manufacturing vs shipbuilding)
   - Real estate development (three different projects)

INTRODUCTION

In response to a request by the Accounting Standards Council (ASC), we conducted a study on the application of the notion of control in the revenue recognition model as proposed in the joint IASB/FASB June 2010 Exposure Draft *Revenue from Contracts with Customers* (ED). This report summarizes the objectives, methodology and findings of our study, and proposes a modified model to revenue recognition.

The objectives of the study are to critically assess the theoretical validity of "control" (as opposed to other benchmarks such as performance/activity) as a principle to determine revenue recognition, and to assess whether the proposed drafting of the "control" definition in the ED accurately captures the essence for revenue recognition purposes. As requested by ASC, the study seeks to assess how revenue should be recognized in three specific settings, namely:

- Contracts for services (e.g. auditing),
- Long term contracts (e.g. shipbuilding), and
- Real estate developments (e.g. sale and construction of condominiums)

METHODOLOGY OF THE STUDY

The project team was given one month to complete the project. Given the limited time period for the project, the team was unable to collect any empirical data or conduct any survey on industry practices, current revenue recognition practices and potential impact of the ED (both locally and in the Asia-Oceania region). We were limited to the use of publicly available documents and interviews with auditors and representatives in two key industries. The following outlines our approach to the study:

(i) We use conceptual principles in both accounting and law as a framework to explore the concept of revenue and control. We revisit fundamental accounting definitions of income and revenue, as well as revenue recognition principles, and tie these accounting definitions and principles back to the applicable legal principles.

(ii) We met and discussed with the Technical Team of the Big 4 firms to hear their views of revenue recognition, the applicability of the control notion for revenue recognition, how it will be applied to the specific settings of contracts for services, long term contracts and

real estate developments, and some concerns that their clients have expressed about the ED. We also discussed how revenue is recognized for auditing services.

(iii) We held two focus groups discussions with industry representatives (shipbuilding and real estate developers) to have a better understanding of the revenue-generating activities of the industry, the type of contractual terms common in the industry and the likely impact of the ED on the industry.

(iv) We corresponded with four accounting standard setters/accounting professional bodies in the Asia-Oceania region and in Europe.

(v) We read some of the key comment letters to the ED hosted on the FASB website: http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=1820-100

IMPORTANCE OF APPROPRIATE REVENUE RECOGNITION CRITERIA

The significance of the revenue number

Revenue is a key indicator in the reporting of an entity's financial performance. It is used in the analysis and assessment of an entity's performance and is a critical input in the forecast of the entity's future performance. This is consistent with the objective of the statement of comprehensive income as stated in the IASB conceptual framework, which is to provide information about the financial performance of the entity in a particular time period to help users to "understand the return that the entity has produced on its economic resources" [IASB Conceptual Framework: OB16, p. 12]. Thus, proper and appropriate revenue recognition criteria are critical to presenting a true and fair view of the statement of comprehensive income to facilitate decision-making. Appropriate revenue recognition criteria help ensure that the revenue number will be relevant and faithfully represent what it purports to represent, and the underlying economic substance of the transactions undertaken by the entity will be reflected. Clear revenue recognition guidelines help ensure consistency in application which in turn promotes comparability.

When should revenue be recognized?

The conceptual framework states that revenue is income that arises in the course of the ordinary activities of an enterprise, and *income* is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity. The conceptual framework further states that an

item that meets the definition of an element should be recognized if (*a*) it is probable that any future economic benefit associated with the item will flow to or from the enterprise; and (*b*) the item has a cost or value that can be measured with reliability. The definition and recognition criteria for revenue, by focusing on the change in economic benefits, seem to focus on the revenue-generating activities of the enterprise during the accounting period.

While the ED uses the definition of income and revenue per the conceptual framework**,** (ED: Appendix A, p. 38), however, it seems to have a slightly different approach to revenue recognition compared to the conceptual framework. Paragraph 25 of the ED states that an entity shall recognize revenue when it satisfies a performance obligation by transferring a promised good or service to a customer, and a good or service is transferred when the customer obtains *control* of that good or service. This implies that to recognize revenue, it is no longer sufficient that there is an increase in economic benefits during the accounting period that is likely to flow to the entity. Rather, the entity must have satisfied the performance obligation and the customer must have obtained control of the goods or services before it can recognize revenue. However, it is not obvious that a revenue recognition principle based on the satisfaction of performance obligations will lead to more decision-useful information than a revenue recognition principle that reflects value added activities in the earning process.

In most situations, the increase in economic benefits in the accounting period will coincide with the satisfactory completion of the performance obligation and revenue will be recognized at the same point of time. In the sale of goods, there will be an increase in economic benefits to the entity when the entity transfers the good to the customer who obtains control of the good in exchange for the receipt of or the right to receive the consideration from the customer.

It is however not entirely clear how control is transferred to a customer in contracts for services which may or may not have a final physical deliverable. The confusion may in part be due to the fact that what the customer controls in contracts for services is not clear. The ED also provides for the concept of continuous transfer of control and allows revenue to be recognized in line with the continuous transfer of services. However, there is neither description nor indicators provided to explain how or when control over services is continuously transferred. Under current revenue recognition practices provided in IAS 18, revenue will be recognized as the services are rendered (given that the customer is contractually liable to pay since entity has performed). This is consistent with the conceptual

framework since there is continuous increase in economic benefits as services are rendered. This results in the revenue numbers reflecting the revenue-generating activities of the entity for the accounting period, leading to useful information for decision-making.

The following three examples illustrate the difficulty of applying the control concept in contracts for services, long term contracts and real estate developments:

(i) In auditing services, the auditing firm performs a series of activities that constitute the contractually agreed task over an agreed period of time. Is the control of the service transferred on the completion of the audit and the submission of the final audit report to the customer? Or is control of the service transferred continuously as the audit team performs according to the scope of service agreed with the customer?

(ii) In long term contracts that require the entity to perform a series of activities that leads to the development/construction of an asset (tangible or intangible) for a customer, the asset is transferred at the end of the contract. However, is there continuous transfer of control of service as the entity performs the series of activities?

(iii) In the case of pre-completion sale, while the real estate developer has legal title, the individual customer may have beneficial title (the customer may have the right to resell - see Appendix 2 for further details). Thus control is shared and no one has absolute control. How should the transfer of control be determined?

LIKELY CONSEQUENCES IF THE ED BECOMES A STANDARD

Should the ED become a standard as it is, the likely impact of the revenue recognition model in the ED (ED Model) on the financial statements and the behavior of preparers, users and investors is assessed as follows.

(i) The likely effects of the ED Model on the financial statements are as follows:

- Based on the revenue recognition criteria, revenue no longer reflects value added activities in the earning process of the entity (leading to increase in economic benefits) in the financial period. Instead revenue reflects performance obligations that have been satisfied in the financial period. It is not obvious that a revenue recognition principle based on the satisfaction of performance obligations will lead to more decision-useful information than a revenue recognition principle that reflects value added activities in the earning process.

- In contracts for services, it is not entirely clear when revenue should be recognized as the ED is not clear how the control concept is to be applied in contracts for services. There could be different interpretations of similar transactions with the same economic substance, resulting in diversity in interpretations and application.
- For construction-type contracts, it is not clear in the ED that continuous transfer of control applies. There is neither description nor indicators for continuous transfer of control, thus critical judgment will be required to determine if there is continuous transfer of control. As such, there is likely to be diversity of practices and comparability across firms will be compromised. If firms are unable to justify that control is transferred continuously to the customer based on the current set of indicators of control, they may be required to recognize revenue only upon completion of service. As such, the revenue number will no longer reflect the revenue-generating economic activities of the entity. This will be a change from current revenue recognition requirements and will result in significantly different revenue numbers and trends. The general consensus of our discussion groups is that such revenue numbers and trends do not reflect the underlying economic substance of the transactions of the entity, and financial statements will no longer reflect a true and fair view of the performance of the entity and the decision-usefulness of the financial statements will be compromised.

(ii)The likely consequences of the ED Model on the preparers' behavior are as follows:

- In contracts for services and construction-type contracts, if preparers have to recognize revenue only upon the satisfactory completion of performance obligations, preparers may supplement the revenue number with additional disclosures on the revenue-generating activities in the Notes to Accounts.
- Another possibility is that affected firms may restructure transactions in order to achieve their financial reporting objectives (to avoid volatile revenue and earnings numbers). Such a response could be costly to entities and their stakeholders. Accounting should reflect the economic substance of business transactions and should not **drive** how business transactions are to be structured.

(iii) The likely consequences of the ED Model on the behavior of users and investors are as follows:

- Users will need to reassess the meaning and significance of the revenue number and the consequent profit number.

- Should users find that the revenue and earning number no longer reflect the financial performance of the entity in the financial period, they will seek for alternative sources of information outside the financial statements.
- There is also the possibility that the users will learn, and over time they will be able to understand the significance of the revenue number, and there may be no cause for concern.

OUR PROPOSED REVENUE RECOGNITION MODEL

Instead of proposing an entirely different model, we believe that the revenue recognition model in the ED can be modified into a robust model that will result in revenue numbers which faithfully represent the economic phenomena that they purport to represent.

Our proposed model is based on the principle that as soon as an entity has created value (utility) and has received (or is legally entitled to receive) consideration for the value created, it should recognize revenue. We believe that this will result in decision-useful information about the financial performance of the entity in a particular time period. Our proposed model is also consistent with the definition and recognition criteria for income and revenue as stated in the conceptual framework.

Our proposed model, like the model in the ED, is also based on control as the core principle for revenue recognition. The IASB Exposure Draft for *Conceptual Framework for Financial Reporting – The Reporting Entity* (*ED/2010/2*) proposes that control of an entity refers to both power and benefits. *ED/2010/2* further proposes that benefits include both the positive and negative and could be loosely described as risks and reward. In the IASB's *ED 10 Consolidated Financial Statements* issued in December 2008, for structured entities where power can be difficult to assess when considering who controls a structured entity, *ED 10* proposes a risks and rewards "fall back" test. In our proposed model, we apply the power and benefits notion of control to goods, and apply the risks and rewards fall-back test of control to service.

Our proposed revenue recognition model comprises paragraphs 1 through 16 below, to replace paragraphs 25 through 32 of the ED.

1. An entity shall recognize revenue when it satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is

transferred when the customer obtains control of that good or service. (As per para 25).

2. Goods include goods produced by an entity for the purpose of sale and goods purchased for resale, such as merchandise purchased by a retailer or land and other property held for resale. (New para, adapted from IAS 18).

3. Services typically involve the performance by an entity of a contractually agreed task over an agreed period of time. The service may be rendered within a single period or over more than one period. Service contracts include construction contracts. (New para, adapted from IAS 18).

Goods

4. A customer obtains control of a good when the customer has the ability to direct the use of, and receive the benefit from, the good. Control includes the ability to prevent other entities from directing the use of, and receiving the benefit from, the good. (As per para 26, with deletion of word “service”).

5. The customer’s ability to direct the use of a good (ie an asset) refers to the present right to use the asset for its remaining economic life or to consume the asset in the customer’s activities. The customer’s ability to receive the benefit from an asset refers to its present right to obtain substantially all the potential cash flows from the asset (either an increase in cash inflows or decrease in cash outflows). The customers can obtain cash flows from an asset directly or indirectly in many ways such as using, consuming, selling, exchanging, pledging or holding the asset. (As per para 27, with deletion of the word “service”).

6. If an entity retains some right to a good solely as protection against the customer’s failure to comply with the terms of the contract (for example, when an entity retains legal title as protection against the customer’s failure to pay), those rights are protective right and do not preclude a customer from obtaining control of a good. (As per para 28, with replacement of the word “asset” with the word “good”).

7. When assessing whether a customer obtains control of a good, an entity shall consider any related arrangement entered into at or near the same time as, or in contemplation of, the contract (for example, repurchase agreement). (As per para 29 with replacement of the word “asset” with the word “good”).

8. An entity shall assess the transfer of control of goods for each separate performance obligation. Indicators that the customer has obtained control of a good include the following: (a) the customer has legal title or beneficial ownership of the good, (b) the customer has physical possession of the good, (c) substantially all the risks and rewards of ownership of the good have been transferred to the customer. None of the preceding indicators necessarily by themselves determines that the customer has obtained control of the good. (As per para 30 and 31, modified)

Services

9. A customer obtains control of a service when the customer has the ability to receive benefits from the service. Control includes the ability to prevent other entities from receiving benefits from the service.

10. The customer's ability to receive benefit from a service refers to its right to obtain substantially all the potential economic benefits from the service. The customer can obtain economic benefits from a service directly or indirectly in many ways such as using, consuming, selling, or exchanging the service, or for compliance with regulatory requirements.

11. A customer may obtain control of a service either discretely (when the service is completely performed), or continuously (as and when the service is performed).

12. A customer obtains control of the service continuously if all the following conditions are met: (a) the customer specifies the scope of the service, (b) the service is performed solely for the benefit of the customer, and (c) the customer has a legal obligation to pay or the entity has a legal right to receive the consideration as the service is performed progressively.

13. When the promised service is transferred to a customer continuously, an entity shall apply a revenue recognition method that best depicts the transfer of services to the customer. Percentage of completion method shall be used if reasonable estimates of results at completion and reliable measures of progress are available. (Para 32, with deletion of the word "good" and modified to include the use of the "percentage of completion" method)

Goods and services

14. When a contract with a customer encompasses both goods and services (e.g., construction), an entity should determine whether the goods and services therein are distinct performance obligations.

15. If the goods and services therein are distinct performance obligations, then they should be separately accounted for as goods or as services.

16. If the goods and services therein are not distinct performance obligations, the entire contract should be treated as a sale of goods or as a contract for services depending on the circumstances, as follows:

    (a) The entire contract should be treated as a sale of goods if the entity builds/constructs/manufactures the asset and then enters into a contract with a customer to sell the completed asset.

    (b) The entire contract should be treated as a contract for services if the entity enters into a contract with a customer either before the commencement or during the process, of building/constructing/manufacturing the asset.

The rationale for the proposed treatment in paragraph 16 is based on whether, at the time of contract, there is an asset for sale or an asset to be constructed. In paragraph 16(a), the entity builds/constructs/manufactures the asset and then enters into a contract with a customer to sell the completed asset. There is no contract with the customer until the time of sale of the completed asset. Thus, the contract should be treated as a contract for the sale of goods. In paragraph 16(b), the entity enters into a contract with a customer either before the commencement or during the process, of building/constructing/manufacturing the asset. After entering into the contract with the customer, the entity will provide or continue to provide the building/construction/manufacturing service. Thus, the contract should be treated as a contract for services.

Appendix 1 provides illustrations on the application of our proposed model to three scenarios, namely,

- Service (audit fee)
- Long term construction (automobile manufacturing vs shipbuilding)
- Real estate development (three different projects)

Appendix 2 provides detailed description on the business practices and contractual/legal aspects of shipbuilding and real estate developments with a special focus on the business models common in the Asia-Oceania region.

CONCLUSIONS AND LIMITATIONS

Appropriate revenue recognition criteria are critical to presenting a true and fair view of the income statement to facilitate decision-making. To achieve this, revenue recognition criteria should result in revenue numbers which faithfully represent the economic phenomena that they purport to represent.

We believe that the revenue recognition model based on the notion of control as proposed in the ED may not result in decision-useful information. This is particularly true in contracts for services, long term contracts and real estate developments with multiple customers. In all these cases, it is not clear how control as currently defined in the ED can be applied. The circumstances under which there is continuous transfer of control are also unclear. As such, for certain industries, the revenue number under the ED may not faithfully represent the underlying economic substance of the revenue-generating activities during the

accounting period and this may imply that the financial statements may not be a true and fair reflection of the financial performance of the entity for the period.

We believe that our proposed model has addressed the shortcomings of the ED Model on revenue recognition. Our proposed model continues to adopt the notion of “control” in the ED. However, paragraphs 25 through 32 of the ED are modified to provide for separate descriptions/indicators for goods and services to determine when the customer has obtained control. For contracts for services, our proposed model also suggests a set of conditions to determine if there is continuous transfer of control. The illustrations in Appendix 1 illustrate how our proposed model is to be applied in the three specific settings of contracts for services, long term contracts and real estate developments with multiple customers.

Our study is subject to various limitations. Due to the tight deadline given, the team had only one month to work and complete the project. As a result, the study has to be very focused in the questions to be addressed, and it was not possible to collect any empirical data or conduct any survey or experimental studies to assess the implications of using the recommendations in the ED versus the existing revenue recognitions standards. The tight deadline also resulted in limited correspondences with the accounting professional bodies/standard-setters in Asia-Oceania.

References

Conceptual Framework for Financial Reporting 2010, IASB, Sep 2010.

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Exposure Draft, ED 10 Consolidated Financial Statements, IASB, December 2008.

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IAS 18: Revenue.

IASB Staff Paper, Determining the Transfer of Goods and Services (Revenue Recognition Project), January 12, 2011.

Appendix 1

ILLUSTRATIONS OF THE PROPOSED MODEL

Illustration 1: Service (Audit fee)

AAA is a public accounting firm. It provides audit and assurance services.

On 30 June 2010, AAA enters into a contract with XYZ Ltd to provide statutory auditing service.

The contract provides for audit fee to be charged based on time cost, and is billable/payable after the interim audit and again after the final audit.

The interim audit is to be performed during November and December 2010, and the final audit to be carried out during February and March 2011.

Issue: when should the interim audit fee be recognized as revenue?

In this case, the contract is for rendering of service, and (i) scope of service is specified by the customer, (ii) the benefit of audit accrues to the customer only, and (iii) the customer has a legal obligation to pay as audit progresses after the interim audit. The customer has obtained control of the service continuously.

Thus, AAA should recognize the interim audit fee as revenue after it is performed in December 2010 (and not in March 2011 when the whole audit is completed).

Illustration 2: Long term construction (automobile manufacturing vs shipbuilding)

ABC Auto Ltd (ABC) is an automobile manufacturer.

ABC generally designs and manufactures cars for the mass market.

This is an example of the circumstance where the entity manufactures the asset and then enters into a contract with a customer to sell the completed asset. ABC will therefore recognize revenue applying the recognition model for “goods”. Generally, ABC will recognize revenue only when the cars are sold and the customer has obtained control of the cars.

XYZ Marine Ltd (XYZ) is a shipbuilder.

Generally, XYZ will start to build a ship after it has received an order from its customer. The ship will be built in accordance with the customer’s specification, and the customer will generally “supervise” the construction. The contract may or may not provide for progress payments. However, in the event of default by the customer, XYZ will have the legal right to claim cost incurred plus profit margin.

This is an example of the circumstance where the entity enters into a contract with a customer before the commencement of building the asset. After entering into the contract with the customer, the entity will provide the building service. XYZ will therefore recognize revenue applying the recognition model for “services”. Given that (i) the scope of service is specified by the customer, (ii) the benefit of service accrues to the customer only, and (iii) the customer has a legal obligation to pay as service is performed progressively, the customer has obtained control of the service continuously.

Thus, XYZ will recognize revenue from the shipbuilding using the percentage of completion method.

Illustration 3: Real estate development

CCC Ltd is a real estate developer. In April 2010, CCC commences development of three real estate projects.

The first project (Project A) involves development of a bungalow for a wealthy individual. The customer has designed the bungalow and bought all the building materials. CCC's role is to build the bungalow. This project is expected to be completed by mid 2011.

The second project (Project B) involves development of a commercial building. CCC designs the building and incurs all the cost of construction (including building material costs). CCC plans to sell the building once it is completed by end of 2011.

The third project (Project C) involves development of a 500-unit condominium. CCC designs the condominium and incurs all the cost of construction (including building material costs). By 31 December 2010, CCC has sold 300 units, and the project is deemed to be 30% completed.

Analysis

For Project A, CCC is providing (construction) service, and since (i) scope of service is specified by the customer, (ii) the benefit of service accrues to the customer only, and (iii) the customer has a legal obligation to pay as service is performed progressively, the customer has obtained control of the service continuously. Therefore, CCC should use the percentage of completion method to recognize revenue from Project A.

Project B is an example of the circumstance where the entity constructs the asset and then enters into a contract with a customer to sell the completed asset. CCC will therefore recognize revenue from Project B applying the recognition model for "goods". CCC will recognize revenue only when the building is sold and the customer has obtained control of the commercial building.

For Project C, for the year ended 31 December 2010, revenue on the 300 units that have been sold should be recognized using the percentage of completion method, and no revenue should be recognized for the 200 units that have not been sold.

The 300 units that have been sold are examples of the circumstance where the entity enters into a contract with a customer either before the commencement or during the process, of building the asset. After entering into the contract with the customer, the entity will provide or continue to provide the construction service. CCC will recognize revenue from these 300 units applying the recognition model for "service". Given that (i) the customers choose the unit purchased, (ii) the major benefit (ie price changes) accrues to the customers and CCC cannot sell the unit to other parties, and (iii) the customers have legal obligation to pay as construction progresses, the customers have obtained control of the service continuously. Therefore, CCC should use the percentage of completion method to recognize revenue from the 300 units.

The 200 units that have not been sold as at 31 December 2010 are examples of the circumstance where the entity constructs the asset without any contract. CCC will therefore recognize revenue from these 200 units applying the recognition model for "goods". CCC will recognize revenue only when the units are subsequently sold.

If 150 of these 200 units were sold as at 31 December 2011 when the construction is 70% complete, then, in respect of the year 2011, these 150 units are examples of the circumstance where the entity enters into a contract with a customer during the process of constructing the asset. After entering into the contract with the customer, the entity will continue to provide the construction service. CCC will recognize revenue from these 150 units applying the recognition model for "service". Based on the same argument for recognizing revenue of the 300 units discussed above, the percentage of completion method should also be used to recognize 70% of the revenue from the sale of these 150 units for 2011. As for the remaining 50 units, CCC should recognize revenue from these units only when the units are subsequently sold.

Appendix 2

HOUSING DEVELOPERS AND SINGAPORE'S SELL-THEN-BUILD MODEL

In Singapore, new residential property developments are usually sold to buyers under a sell-then-build model. Under this model, the buyer purchases a unit in the development. At the time of the sale and purchase agreement, the unit has yet to be completed, and the buyer is required to pay the purchase price of the unit according to progressive stages of work done. Such residential development projects of more than 4 units are regulated under the Housing Developers (Control and Licensing) Act. Developers have to be licensed by the Comptroller of Housing for every residential property to be developed and must comply with the Housing Developers Rules and the Housing Developers (Project Account) Rules. In order to sell units in the development before completion, developers need to obtain a sale licence and building plan approval.

The process of buying an uncompleted unit in a private residential property development begins with the Sale and Purchase Agreement between the developer and the customer. The customer selects the particular unit and specifications of the unit are specified in the Sale and Purchase Agreement. The specifications of the unit will include the ceiling, finishes, floor, windows, door and sanitary fittings that will be used or provided. The developer cannot re-sell to another customer the particular unit that has been sold to the customer. The statutory form for the agreement is prescribed by the Housing and Developers Rules under the Housing Developers (Control and Licensing) Act. Amendments or additions to this prescribed statutory form can only be made with the written approval of the Comptroller of Housing and any unauthorized amendments are null and void.

The Sale and Purchase Agreement is a contract by the developer to sell, build and complete a condominium unit to the customer. According to the terms of the Sale and Purchase Agreement, the developer's main obligation is to build the unit in accordance with the specifications in the Sale and Purchase Agreement.

In the sell-then-build model, the Sale and Purchase Agreement incorporates the statutory scheme for progress payments to be made by the customer for the purchase of a unit up to completion of the unit. Such payments made are required to be deposited into a Project Account for the development project. The developer can make withdrawals from the Project Account only for purposes of the development project. If the developer goes into liquidation, the funds in the Project Account do not form part of the property of the developer. The Sale

and Purchase Agreement also sets out the liquidated damages payable by the developer for failure to deliver possession of the unit on the date for transfer.

If progress payments of the purchase price are not paid by the customer as they fall due, the customer would be liable to pay interest. A default by the customer on any progress payment and interest for more than 14 days after it is due is regarded as a repudiation of the Sale and Purchase Agreement. In such a case, the developer has the right to annul the Sale & Purchase Agreement, forfeit 20% of the purchase price, recover outstanding interest and to resell the unit.

After entering into the Sale and Purchase Agreement, a customer has the right to resell his unit to another buyer at market price. The original customer assumes price risk because any difference between the current market price and the original sale price accrues to the customer.

Until completion and the issuance of the strata title, the customer of a unit does not have title. The title of the land remains with the developer during the construction and development of the project. On completion, there will be a conveyance of the unit from the developer to the customer and the customer will also obtain the title to the unit.

Sell-then-Build model in Asia Oceania Region

In the Asia Oceania region, some form of the sell-then-build model is commonly used, although there are legal differences across the different jurisdictions over the exact contract form and industry practice involved. In Korea, housing development projects by private construction companies use a form of the sell-then-build model. In Malaysia, the sell-then-build model is also used.

The Build-then-Sell model

The other alternative is the build-then-sell model, where the developer sells the units in the project only when they are completed. An example of this build-then-sell model would be the development of a commercial building which is sold only on completion of the building.

This build-then-sell model is commonly used in Australia for both residential and commercial buildings. In Malaysia, both build-then-sell and sell-then-build models co-exist alongside each other and developers can choose either option.

SHIPBUILDING

A shipbuilding contract is essentially a contract where the shipbuilder agrees to build and deliver a vessel in accordance with the customer's specifications for a price. The shipbuilder faces construction risks and the risk of the customer's non-performance. The customer, on the other hand, faces the risk of the builder's non-performance and market risks. Negotiations may be based on the shipbuilder's standard form but the final terms and conditions of the shipbuilding contract will depend on the allocation of risks and other factors such as the nature of the project and the bargaining strength of the parties. The following are common terms found in shipbuilding contracts.

Payment obligation

The main issue regarding the payment obligation is the extent to which the contract price is to be paid before delivery. Contractual terms regarding payment obligations can range from a lump sum payment at the time of contract to a lump sum payment on completion. Very often, in practice, the parties negotiate a compromise for progress payments to be made on the satisfaction of specified key milestones. The agreement usually requires the customer (or an independent party) to sign an acceptance certificate at each of the key milestones to indicate the satisfaction of the key milestones.

Where the customer has to pay a substantial part of the contract price before delivery, the customer will usually require security in the form of a refund guarantee.

Rectification of defects

The agreement will commonly provide that the customer has the right to appoint representatives to the shipyard to supervise the construction, have access to the vessel and any other place where work is being done as well as the right to attend tests and trials of the vessel. The customer's representative has the right to require the shipbuilder to rectify defects in workmanship, without additional payment.

Title and security

As a general rule, the shipbuilder retains title to the vessel under construction until delivery. In some cases though, the terms of the agreement may provide for title to pass to the customer as construction progresses and the ship is paid for.

Default by the parties

The customer's main obligation is to make progress payments as they fall due and to take delivery of the vessel. In the event of the customer's default to pay, the shipbuilder is entitled to rescind the contract and the customer is liable to pay interest on the payments due and costs and expenses incurred. When the shipbuilder rescinds the contract, he has the right to sell the vessel. The shipbuilder is entitled to claim unpaid instalments with interest from the proceeds of sale where the vessel is sold in a completed state. Where the vessel is sold in an uncompleted state, the shipbuilder is entitled to claim, from the proceeds of sale, the costs of construction, less instalments already paid, and loss of profits. Where the proceeds of sale are insufficient, the shipbuilder has a right of recourse against the customer for the outstanding balance.

The main obligation of the shipbuilder is to deliver the vessel on time, failing which liquidated damages are payable by the shipbuilder. In the event of prolonged delay beyond a specified period of time, the customer will have the right to rescind the contract. In that event, the customer will usually be entitled to claim a refund of the instalments already paid with interest. If the contract permits, the customer may have the option of having the vessel to be completed by another shipyard, in which case, the customer would have the right to claim the additional cost of having the ship completed.