



Accounting & Auditing News

IFRS 15 — Revenue from Contracts with Customers: Part 2 – Differences vs. IAS 11— Construction Contracts

Revenue Recognition

Under IAS 11, Construction Contracts (IAS 11.22-35)

When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract shall be recognized as revenue and expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period. (IAS 11.22)

Under IFRS 15, Revenue from Contracts with Customers (IFRS 15.31-45)

An entity shall recognize 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. (IFRS 15.31)

An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognizes revenue over time, if one of the following criteria is met: (IFRS 15.35)

- a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);
- b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or
- c) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37). (IFRS 15.31)

If a performance obligation is not satisfied over time in accordance with paragraphs 35–37, an entity satisfies the performance obligation at a point in time. To determine the point in time at which a customer obtains control of a promised asset and the entity satisfies a performance obligation, the entity shall consider the requirements for control in paragraphs 31–34. (IFRS 15.38)

Analysis of the Change

The guidance in IFRS 15 is much more specific than that previously included in IAS 11, and some entities may find that revenue previously recognized at a point in time should now be recognized over time, or vice versa. Whether revenue should be recognized over time or at a point in time will often depend on a careful analysis of specific contract terms. In determining whether revenue is recognized at a point in time or over time, it is important for an entity to consider the following factors:

- Careful assessment whether the entity could have an alternative use for the asset under construction and the entitlement of the entity to be paid for the work performed to date.
- It is important to focus on any contractual terms allowing the customer to cancel, curtail or significantly modify the contract and whether if such circumstances arose, the seller would always be contractually entitled to adequate compensation for work performed to date.

Assessment of these factors, and others will need to be made in the context of both the contract terms and the local legal government.

Where an entity concludes that revenue should be recognized over time, it will need to consider how to measure progress towards complete satisfaction of performance obligations. IFRS 15 specifies that the measure of progress shall exclude any goods or services for which the entity does not transfer control to the customer. As such, the measure of progress (and therefore the percentage of revenue to be recognized) may be affected by whether or not control of the land on which property is being constructed is transferred to the buyer (and the timing of that transfer)

How to Identify Different Goods and Services within a Contract?

Under IAS 11, Construction Contracts

No specific guidance.

Under IFRS 15, Revenue from Contracts with Customers (IFRS 15.22-30)

Factors that indicate that an entity's promise to transfer a good or service to a customer is separately identifiable (in accordance with paragraph 27(b)) include, but are not limited to, the following: (IFRS 15.29)

- a) the entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output for which the customer has contracted. In other words, the entity is not using the good or service as an input to produce or deliver the combined output specified by the customer.
- b) the good or service does not significantly modify or customize another good or service promised in the contract.
- c) the good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract. For example, the fact that a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services in the contract might indicate that the good or service is not highly dependent on, or highly interrelated with, those other promised goods or services.

Analysis of the Change

IAS 11 lacks specific guidance in identifying distinct goods and services within a contract, whereas IFRS 15 provides a more detailed guidance, in particular, the new rules on how revenue is allocated between different items. Consequently entities may have to amend their current accounting policies.

Construction companies often have multi-element contracts and IFRS 15 may affect the determination of whether certain elements of a contract are recognized separately, which may have significant impact on the profile of revenue recognition (e.g. the new standard may affect whether a parcel of land that is sold as part of a contract for the construction of a building is considered to constitute a distinct good to be accounted for separately). It may also affect the identification of separate service obligations (and the timing of the recognition of the related revenue) included in a construction contract covering the design, construction, and operation phases of a certain project.

Capitalization of Contract Cost

Under IAS 11, Construction Contracts (IAS 11.27)

A contractor may have incurred contract costs that relate to future activity on the contract. Such contract costs are recognized as an asset provided it is probable that they will be recovered. Such costs represent an amount due from the customer and are often classified as contract work in progress. (IAS 11.27)

Under IFRS 15, Revenue from Contracts with Customers (IFRS 15.91-99)

An entity shall recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs. (IFRS 15.91)

The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission). (IFRS 15.92)

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

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

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

Analysis of the Change

In addition to more prescriptive guidance on revenue recognition, the new standard introduces specific criteria for determining whether to capitalize certain costs, distinguishing between those costs associated with obtaining a contract (e.g. sales commissions) and those cost associated with fulfilling a contract. Costs incurred that are directly attributable to obtaining contracts with customers will be accounted dependent on the nature (or type) of costs incurred (e.g. design cost which qualify as a cost of fulfilling a contract will generally be capitalized if they meet certain criteria, including an expectation that the cost will be recovered, whereas costs of obtaining a contract prior to the contract being awarded such as legal cost, will usually be expensed as they are costs that will have been incurred whether or not the contract is obtained.)

Effect of Time Value of Money on Revenue

Under IAS 11, Construction Contracts

No specific guidance.

Under IFRS 15, Revenue from Contracts with Customers (IFRS 15.60-65)

In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract. (IFRS 15.60)

Analysis of the Change

IFRS 15 introduces new and more extensive on financing arrangement and the impact of the time value of money. Under the new standard, the financing component, if it is significant, is accounted for separately from revenue. This applies to payments in advance as well as in arrears, but subject to an exemption where the period between payment and transfer of goods or services will be less than one year. This new guidance may change current accounting practices in some cases.

Contract Modification

Under IAS 11, Construction Contracts (IAS 11.38)

The percentage of completion method is applied on a cumulative basis in each accounting period to the current estimates of contract revenue and contract costs. Therefore, the effect of a change in the estimate of contract revenue or contract costs, or the effect of a change in the estimate of the outcome of a contract, is accounted for as a change in accounting estimate (see IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors). The changed estimates are used in the determination of the amount of revenue and expenses recognized in profit or loss in the period in which the change is made and in subsequent periods. (IAS 11.38)

Under IFRS 15, Revenue from Contracts with Customers (IFRS 15.18-21)

A contract modification is a change in the scope or price (or both) of a contract that is approved by the parties to the contract. In some industries and jurisdictions, a contract modification may be described as a change order, a variation or an amendment. A contract modification exists when the parties to a contract approve a modification that either creates new or changes existing enforceable rights and obligations of the parties to the contract. A contract modification could be approved in writing, by oral agreement or implied by customary business practices. If the parties to the contract have not approved a contract modification, an entity shall continue to apply this Standard to the existing contract until the contract modification is approved. (IFRS 15.18)

An entity shall account for a contract modification as a separate contract if both of the following conditions are present: (IFRS 15.20)

- a) the scope of the contract increases because of the addition of promised goods or services that are distinct (in accordance with paragraphs 26–30); and

- b) the price of the contract increases by an amount of consideration that reflects the entity's stand-alone selling prices of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract. For example, an entity may adjust the stand-alone selling price of an additional good or service for a discount that the customer receives, because it is not necessary for the entity to incur the selling-related costs that it would incur when selling a similar good or service to a new customer.

Analysis of the Change

IAS 11 included only limited guidance on how to account for modifications to contract. IFRS 15 include detailed guidance on whether a contract modification should be accounted for prospectively or retrospectively. These requirements may result in a change of practice for some entities.

Note: The above is based on the existing provisions of the related standards. Additional differences may still be noted upon actual implementation.

Watch out for the Part 2B (Differences vs. IAS 18) of this publication next week.

Please contact the Technical Research Group at +63 2 581 9000 local 9088/9078 or e-mail phtr@deloitte.com for questions regarding this publication.



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