Construction

IFRS 15 Revenue – Are you good to go?

April 2017

kpmg.com/ifrs
Are you good to go?

IFRS 15 will change the way many construction companies account for their contracts.

To help you drive your implementation project to the finish line, we’ve pulled together a list of key considerations that all construction companies need to focus on.
For each of the following, documenting your analysis and the conclusions drawn will be essential.
Performance obligations

Do the different elements of your construction contracts meet the new ‘distinct’ test to be accounted for separately?

- Capable of being distinct
- Distinct in the context of the contract

A traditional construction contract will often be a single PO, but think about...

Multi-stage developments | Construction service | Specialised fit-outs
Over-time recognition

Meeting the definition of a construction contract is no longer a reason to use percentage of completion accounting.

Instead, assess whether one of these three criteria are met:

- **Customer consumes benefits as entity performs**
  - e.g. construction services

- **Customer controls asset as it’s created**
  - e.g. building on customer land

- **Asset has no alternative use and right to payment exists**
  - e.g. non-cancellable contracts
Work in progress

Does your accounting policy for work in progress meet the requirements of IFRS 15?

You’ll need to...

- Capitalise amounts related to future performance

You can no longer...

- Recognise work in progress as a balance sheet ‘true up’ to ensure a smooth profit margin
Measure of progress

Does your measure of progress depict performance under the contract?

Use either

- **Output method**
  - e.g. survey of construction

- **Input method**
  - e.g. cost-to-cost method

Don’t assume existing policy will be fully compliant
- e.g. different treatment for uninstalled materials
Loss-making contracts

There is no specific guidance in IFRS 15 on accounting for loss-making construction contracts

You are now required to assess losses at the contract level using the onerous contract guidance in IAS 37
Does your accounting policy reflect the enforceability requirement for contract modifications?

Is the contract modification enforceable?

Yes

Account for it

No

Do not account for it

Don’t ask ‘Will it be approved?’

Ask ‘Has it been approved?’
Bid costs

Will you **capitalise** or expense your bid costs?

As a cost of obtaining the contract if...
- Incurred as a result of obtaining the contract
  - e.g. sales commissions
- Recovery is expected

As a cost to fulfil a contract if it...
- Relates directly to anticipated contract
  - e.g. design work included in bid document
- Is part of the cost of satisfying the contract
Variable consideration

If the contract price contains variable consideration, have you decided on the estimation method and applied the constraint?

- Expected value
- Most likely amount

Could there be a significant revenue reversal?

For example...

CPI escalators | Cost escalation clauses | Completion and performance bonuses
Construction contracts can include significant financing components

Do deferred or advance payment terms in your contracts give rise to one?

Calculations can be complex, especially for contracts recognised over time

Practical expedient – No need to recognise if period between payment and performance is < 1 year
Have you identified all of the areas where differences exist between IFRS 15 and your existing accounting?

Use the helpful guidance in our Transition Options and Issues In-Depth publications

IFRS 15 is more detailed than the existing revenue requirements, so you may find unexpected changes in your accounting.
Disclosure requirements

Have you identified the additional information and processes needed to meet the disclosure requirements?

Read our Guide to annual financial statements – IFRS 15 supplement

Under IFRS 15, you’ll need to provide more detailed information about contract terms, as well as how and when you recognise revenue
## Checklist of actions

### Have you…?

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<tr>
<td>✔️</td>
<td>Determines whether your contracts include <strong>more than one performance obligation</strong>?</td>
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<td>Identified contracts that meet the criteria for <strong>over-time recognition</strong>?</td>
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<td>Checked that your accounting policy for <strong>work in progress</strong> meets IFRS 15’s requirements?</td>
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<td>Checked <strong>measure of progress</strong> for contracts recognised over time?</td>
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<td>Assessed your <strong>loss-making contracts</strong> using the guidance in IAS 37?</td>
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<td>Documented your accounting policy for <strong>claims and variations</strong>?</td>
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### Have you…?

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<tr>
<td>□</td>
<td>Decided whether you will capitalise any of your <strong>bid costs</strong>?</td>
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<td>Revised your estimates of <strong>variable consideration</strong> elements – e.g. completion and performance bonuses?</td>
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<td>Identified and calculated any <strong>significant financing components</strong>?</td>
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<td>Identified and quantified your <strong>transition adjustments</strong>?</td>
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<td>□</td>
<td>Identified the additional information needed to meet the <strong>disclosure requirements</strong>?</td>
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How did you do?

How many of our 11 questions have you answered ‘yes’?

All 11 – You’re good to go!
5-10 – You’re on your way
0-4 – You really need to engage
Don’t forget the broader business impacts

Have you…

— updated your management reporting, including KPIs?
— developed a transition plan for parallel runs, including reconciliations?
— thought about the tax implications?
— calculated the impact on bonus schemes?
— compared your approach with peers?
Find out more

Talk to your usual KPMG contact

Use our Transition toolkit

Follow the discussion on LinkedIn