IFRS news

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Revenue TRG discusses optional purchases, licences and other topics

The Revenue Transition Resource group (TRG) continues to debate implementation issue related to the new revenue standard. Michel Vique from Accounting Consulting Services looks into the details.

The TRG discussed customer options for additional goods or services, licenses and some US GAAP topics related to pre-production activities and scope of certain gaming activities at the November meeting. This article considers only the IFRS issues. For more details, see In Transition.

Customer options for additional goods or services

Differentiating optional purchases from variable consideration

Questions have arisen about how to distinguish between a contract that contains an option to purchase additional goods and services, and a contract that includes variable consideration based on a variable quantity of outputs.

There may be minor differences in the timing and measurement of revenue for such contracts, provided there is only one performance obligation and the revenue is recognised in a single reporting period. The main difference would be the required disclosures. However, for contracts with multiple performance obligations, the distinction between the two types of contracts can have a significant effect on the timing of revenue recognition.

Assume an entity enters into an arrangement to provide equipment to its customer and a one-year service of processing transactions. Both are distinct performance obligations. The equipment is transferred to the customer at the beginning of the service period. The consideration paid by the customer is based on the number of transactions processed.

None of the contingent consideration is allocated to the equipment if each transaction is considered an optional purchase and there is no material right. Each transaction would be a separate performance obligation in an independent contract and the revenue related to the transaction would be recognised when the transaction is performed by the entity.

However, if the processing of transactions is considered to give rise to variable consideration, then at contract inception, the total transaction price of the arrangement would include an estimate of the variable consideration (subject to the constraint) and would be allocated to the equipment and service. This approach would result in an acceleration of revenue as opposed to the "option model".

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Identifying the nature of the promise to the customer is critical to the assessment. There may well be a change from current accounting. The staff provided some differences between optional purchases and variable consideration for consideration when evaluating a contract:

- The staff considers that with a customer option, the vendor is not obligated to provide additional distinct goods or services to the customer until he exercises that option.
- By contrast, when a contract includes a variable consideration, the customer has entered into a contract that obligates the vendor to transfer the promised goods or services. The future events that result in additional consideration occur after (or as) control of the goods or services has (or is) transferred.

Significant judgment may be required and detailed disclosure will be necessary. We do not expect further discussion of this topic at the TRG.

Optional purchases and enforceable rights

TRG members agreed that the purchase of the goods or services must be legally enforceable for the related consideration to be included in the transaction price. "Economic compulsion" is not sufficient to conclude that the purchases are legally enforceable. TRG members observed, however, that assessing whether purchases are legally enforceable could require judgment, including, for example, when the parties have a verbal agreement. The TRG is unlikely to discuss this further.

Some TRG members suggested that this could result in accounting that is disconnected from the economic substance of the transaction (read the blog). An entity may be required to recognize a loss upon transfer of a product, even if the entity is virtually assured of recouping that loss on subsequent sales of related products or services. TRG members indicated that this conclusion raises questions about the accounting for the related costs and that it might be helpful to discuss the cost accounting at a future date.

Termination rights and penalties

Some have raised a related implementation question about how to determine the term of a contract when only the customer has the right to terminate, and how termination penalties may affect that analysis. TRG members generally agreed that substantive termination penalties create enforceable rights and obligations and therefore affect the determination of the contract term. However, assessing whether a termination penalty is substantive requires judgment. We do not expect further discussion of this topic.

Licences

The TRG debated several implementation issues related to renewals of "right-to-use" licenses (that is, licences for which the related revenue is recognised at a point in time) and restrictions of time, geography, or usage. The discussion at the TRG meeting did not provide any clarity on this topic. This lack of clarity continues to make it difficult for entities with "right-to-use" licenses to fully assess the impact of the new revenue standard. We expect the boards to discuss this issue further as they finalize their proposed amendments to the licensing guidance.

What's next?

There are no further meetings currently scheduled, however the TRG will be available to discuss relevant issues in 2016 should the need arise.

TRG for Impairment of Financial Instruments weighs in again on IFRS 9 implementation issues

The Transition Resource Group for Impairment of Financial Instruments (ITG) continues discussions on impairment implementation issues.

The ITG discussed ten issues at its December meeting. No further action is expected for all the topics discussed. For more details, see In transition.

Incorporation of forward-looking economic scenarios

The ITG was asked whether an entity is required to incorporate more than one forward-looking economic scenario in the measurement of expected credit losses and assessment of significant increases in credit risk and, if so, how.

The ITG reaffirmed that the measurement of expected credit losses should reflect an unbiased and probability weighted amount that is determined by a range of outcomes. Accordingly, using a single forward-looking economic scenario would not fully meet this objective when there is a non-linear relationship between the different possible forward-looking economic scenarios and their associated credit losses or risk of a default occurring. However, this is subject to the availability, without undue cost or effort, of relevant, reasonable and supportable forward-looking information.

The ITG observed that IFRS 9 does not prescribe a particular measurement method.

Maximum period to consider when measuring expected credit losses for revolving credit facilities

For revolving credit facilities, expected credit losses are measured over the period that the entity is exposed to risk and expected credit losses would not be mitigated by credit risk management actions, even if this extends beyond the maximum contractual period.

The ITG noted that the starting date of the period to consider is the reporting date.

With respect to the end point of the maximum period to consider, the ITG observed:

- An entity should take into account its normal credit risk management actions that it expects to take.
- The measurement period should not include consideration of management actions to reinstate previously curtailed limits on assets that subsequently cure.
- Credit risk management actions that serve to mitigate credit losses are not limited to actions that terminate the entity's exposure to credit risk.
- If an entity carries out thorough periodic review processes and takes credit risk management actions as part of this process, it may be appropriate to consider that the maximum measurement period should not extend beyond this point.

Estimating cash shortfalls in the measurement of expected credit losses

Inclusion of cash flows from collateral and other credit enhancements

The ITG agreed that expected cash flows from collateral and other credit enhancements that are integral to the contractual terms of the financial assets and are not accounted for separately should be taken into account when measuring expected credit losses. Such an approach does not limit credit enhancements to those that are explicitly included in the terms of the financial asset.

Inclusion of cash flows expected from the sale on a default of a loan

The ITG generally agreed that an entity can include estimated cash flows from expected sales of financial assets that are part of an entity's recovery process when considering possible credit loss or default scenarios for

inclusion in the measurement of expected credit losses. The ITG emphasised that an entity must have the intent and ability (both legally and practically) to sell or otherwise transfer the financial asset to achieve derecognition.

Other issues discussed

The ITG further discussed the following six issues:

- Meaning of effective interest rate
- Scope of the requirements for determining the period over which to measure expected credit losses for revolving credit facilities
- Measurement of expected credit losses for charge cards
- Assessing significant increases in credit risk in respect of financial assets with a maturity of less than 12 months
- Measurement of the loss allowance for credit-impaired financial assets
- Presentation of the loss allowance on the face of the balance sheet for financial assets measured at amortised cost

What's next?

There are no future ITG meetings scheduled or planned. However, the ITG will remain in place and further meetings will be convened if circumstances warrant it.

FASB issues Exposure Draft on Definition of a Business

The IASB has discussed the FASB's proposed amendments and agreed to proceed with an Exposure Draft (ED) expected to be broadly in line with the FASB proposals. Joanna Demetriou from Accounting Consulting Services looks at the details.

The FASB issued an ED "Clarifying the definition of a business" to address observed diversity in practice as to classification of transactions as the acquisition of a business or a group of assets. The different accounting treatment that follows from classification exacerbates the need to reduce diversity.

The proposed amendments provide clarifications, new guidance and illustrative examples on the definition of business. The ED is open for comments until 22 January 2016.

What's new in the definition of business?

The FASB ED proposals are as follows:

- A business is defined as a set of activities and assets that includes, at a minimum, an input and a substantive process that together contribute to the ability to create outputs. "Substantive" process places significant emphasis on the existence of skilled and knowledgeable workforce. There is a structured approach proposed on how to deal with situations in which the acquired set produces outputs, and with situations in which the acquired set does not produce output.
- The requirement that a set of activities and assets is a business if market participants can replace the missing elements has been removed
- The amendment proposes that a set of assets is not a business if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets.
- The definition of outputs is amended to focus on goods and services provided to customers excluding dividends, lower costs and other economic benefits.
- The proposed new guidance also includes examples focusing on real estate and pharmaceutical companies.
- The proposed amendments will be applied prospectively.

Next steps

The IASB's ED is expected to be issued within the next 6 months.

Update: IFRS in the US

IFRS continues to receive attention in the US as evident in recent SEC comments regarding a single set of high quality, global accounting standards. John McKeever from Accounting Consulting Services looks at why IFRS is still important in the US.

With regard to the adoption of IFRS in the US, you no longer hear the phrase "not if, but when". We have seen little recent progress in moving towards adoption in the US. All we know at this point is that adoption of IFRS in the US is not probable in the foreseeable future.

In a June 2015 speech, James Schnurr, SEC Chief Accountant, discussed the future prospects of IFRS in the US. Mr. Schnurr referenced a previous Chairman's recommendation who had suggested that we should "bury IFRS" and how that comment was premature. Ultimately, he noted that while a full-scale adoption or option to apply IFRS instead of US GAAP does not appear to have support among constituents, it does not mean that we "bury" the underlying objective of a single set of high-quality, globally accepted accounting standards.

He further noted it was critical that both, the FASB and IASB continue to work together to achieve this objective. Mr. Schnurr is also contemplating rule-making that will make it easier for US public companies to voluntarily present IFRS financial information in their public filings, in addition to the required US GAAP financial statements.

While adoption of IFRS in the US is not probable in the foreseeable future, it has become increasingly relevant to many US companies, both public and non-public, large and small. This is largely due to

1) cross-border M&A activity,

2) reporting needs of non-US stakeholders and

3) IFRS reporting requirements of non-US subsidiaries.

As such, being financially "bilingual" is increasingly important in the US.

From an investor perspective, the need to understand IFRS is arguably even greater. US investors keep looking overseas for investment opportunities. Recent estimates suggest that over $9 trillion of US capital is invested in foreign securities. The US markets also remain open to non-US companies that prepare their financial statements using IFRS. There are currently over 500 non-US filers with market capitalisation in the multiple of trillions of US dollars who use IFRS without reconciliation to US GAAP.

Although the era of convergence is coming to a close, the impacts of the accounting changes resulting from the Boards' joint efforts have been significant, and the two accounting frameworks have moved closer together during this time (for example, with the new revenue guidance). Although the Boards are no longer formally working together in most areas, differences between the two frameworks continue to be removed. A recent example is the US GAAP change relating to the reporting of discontinued operations. The new guidance is now substantially aligned with IFRS.

With differences between US GAAP and IFRS declining, will this move the US closer to adoption or further away? While only time will tell, we at least know that the SEC Chief Accountant supports a single set of high-quality, globally accepted accounting standards. The next question is what is the path to achieve this objective?

10 reminders for year-end reporting

A busy reporting season looms for many. Here are 10 reminders to consider for 2015 annual financial statements. For more details, see the latest IFRS quarterly update, which also includes a summary of new standards applicable for 2015.

Regulatory interest in impairment reviews

Impairment continues to be an area of concern for regulators. Remember to look out for impairment triggers (both internal and external), paying particular attention to the interest rate environment, commodity prices, country risk and foreign exchange. Ensure that key assumptions align with the information available in the external market. Remember disclosures. Regulators have observed that the discount and terminal growth rates are often incorrectly identified as the only key assumptions and entities often forget to include disclosures of the "key assumptions" on which the cash flow projections are based.

Fair value measurement and related disclosures

Fair value measurement and the related disclosures are an area of concern for regulators. Valuation techniques should be compliant with IFRS requirements, the use of observable inputs should be maximised and where available, issuers should use quoted prices in an active market without adjustment. Where a third party determines fair value, this should be disclosed. Issuers should provide a description of the valuation technique and inputs used, any changes in valuation techniques and reasons for those changes, levels of FV hierarchy, sensitivity to changes in unobservable outputs and whether current use differs from highest and best use.

IFRS 12 disclosures

IFRS 12 aims to enable users to evaluate the nature and risk associated with interests in other entities. IFRS 12 requires disclosure of significant judgements and assumptions made in determining control, joint control or significant influence over an investee. An entity will need to provide disclosures when non-controlling interest (NCI) in a subsidiary is material. An entity should apply judgement to determine whether summarised financial information disclosed about a sub-group of a subsidiary that has material NCI is based on the consolidated information of the sub-group or disaggregated further to present information about individual subsidiaries with material NCIs. This was confirmed by the IFRS IC in January 2015. See more details at IFRSs 10 and 12 - Questions and answers and IFRIC update - January 2015.

EU state aid

The European Commission (EC) has been investigating four key cases in relation to EU state aid. For two cases, the EC has already ordered the Member States to recover the State aid which it considered to be illegal. These decisions have already attracted a great deal of media attention, and we recommend that entities carefully assess the need for disclosure of estimation uncertainty if they could be affected.

Taxation

Regulators around the world are continuing to focus on tax accounting and disclosures. One area subject to particular attention is the reconciliation between a company's notional and effective tax rate. Companies were challenged when;

- reconciling items had been aggregated at a level that did not provide sufficient information for investors to understand the sustainable tax rate;
- the description of reconciling items was inconsistent with the strategic report and unclear; and
- only current and not total tax had been reconciled.

Tax uncertainties are increasing given recent challenges by global and European institutions and national governments. Therefore disclosures of tax risks, accounting policies, judgements and estimates are becoming increasingly important.

Presentation and classification in cash flow statements

Many regulators have highlighted cash flows as an area where they continue to challenge companies and find recurring errors. Cash flow statements are often prepared late in the financial reporting process. The classification of an item as an operating, financing or investing activity can require judgement. Some of the most common areas of concern identified are:

- Cash flows from hedging activities are classified in the same manner as the transaction subject to the hedge.
- Purchases of own shares are classified as a financing activity.
- Loans to related parties are classified as an investing activity.
- Transaction costs incurred in a business combination are classified within operating activities.
- Where an acquirer repays an acquiree's existing debt, this should be classified as a financing activity if the choice to repay was at the acquirer's discretion, otherwise it is an investing activity.
- Payments to non-controlling interests (NCI) are classified as a financing activity.
- Material cash flows relating to additional or exceptional activities should be clearly presented in the cash flow statement.

Other points of focus where errors occur or better disclosure is required are non-cash transactions and where it is appropriate to use netting.

Supplier financing arrangements

The level of questions around the accounting for supplier financing arrangements remains high. Such arrangements raise the question of whether the trade payables that are the subject of the supplier financing should be derecognised and replaced by a bank borrowing. The accounting for supplier finance arrangements will depend on the specific facts and circumstances.

Debt restructurings

We continue to see a large number of questions on the restructuring of issued debt instruments, for example loan facilities or bond financing. Some key areas to consider are:

- IAS 39 requires assessment of whether the new and old debt have substantially different terms when the exchange or modification is with same borrower/lender. Further areas requiring judgment are the treatment of gain or loss on modification/extinguishment and the treatment of fees incurred as part of the renegotiation.
- A non-bank entity may use a bank as an intermediary, for example, to buy back the original bonds and place the modified bonds with investors. A key consideration requiring careful judgement is whether the bank is acting as an agent or as principal, which is highly judgemental.
- The accounting for modifications when a credit facility is not drawn.

Cash pooling arrangements

Many groups have cash pooling arrangements. IAS 32 provides guidance on offsetting financial assets and financial liabilities. These arrangements take various forms including notional sweeping arrangements when no cash is swept but interest is earned on the net position. In these cases, offsetting is not appropriate as there is no actual sweep and no intention to offset the cash positions. Applying the guidance can be complex. It is important to understand the operational and contractual arrangements when assessing these arrangements.

Sale and lease back transactions

We have seen an increase in questions relating to sale and leaseback transactions. Care needs to be applied when assessing these transactions. Substance may indicate that some transactions are not leases but rather collateralised borrowings. Similarly, care needs to be applied in assessing whether commercial substance exists in intra-group sale and lease back arrangements.

Cannon Street Press

Insurance contracts

The IASB continued its discussions on its project on insurance contracts. In November the IASB decided to keep different models for different insurance contracts. For direct participating contracts, the variable fee approach will apply, whereas for other contracts, including indirect participating contracts, the general model will be applicable.

Comparison of the general model and the variable fee approach

Under the variable fee approach, all liabilities are remeasured at current interest rates. Under the general model, part of the liability (the contractual service margin) is remeasured at the interest rate at the inception of the contract.

Under the variable fee approach, changes in financial guarantees are reflected in the contractual service margin, whereas under the general model, they are reflected in P&L.

Tentative decisions

The IASB tentatively decided that the variable fee approach should not be amended. For financial guarantees embedded in insurance contracts, the changes in the fair value of the underlying items referenced in the insurance contract are recognised in the statement of comprehensive income in each period.

Furthermore, the IASB tentatively decided not to require or permit in the general model the remeasurement of the contractual service margin using current discount rates.

Consequential issues arising from the variable fee approach

The IASB tentatively decided:

- that an entity should be permitted to measure at fair value through profit or loss investment properties, investments in associates, owner occupied property, own debt and own shares if they are underlying items held for a contract with direct participation features;
- to simplify the measurement of the contractual service margin under the retrospective transition approach for contracts with direct participation features;
- that an entity should apply the option to recognise changes in the value of the guarantee embedded in the insurance contract with direct participation features in profit or loss in specified circumstances prospectively from the date of the initial application of the standard.

Classification and measurement of share-based payment transactions (proposed amendments to IFRS 2)

The IASB considered a summary and analysis of the comment letters received on the ED published in November 2014 and the IC's recommendations. The IASB tentatively decided to proceed with finalising the proposed amendments as recommended by the IC, subject to some revisions as follows:

- to add a disclosure example on the estimated amount of cash that an entity expects to pay in connection with the withholding of the employee's tax obligation, when a share-based payment award with net settlement features is classified as equity-settled using the proposed exception, and
- to make clear that the proposed exception for the classification of a share-based payment award with net settlement features does not apply to any shares withheld in excess of the tax withholding obligation.

Santa and the new leasing standard

Alexander Woodford gives us some entertainment over the holiday season with his take on the latest accounting challenges faced by Father Christmas.

The Chief Financial Reporting Elf was relaxing in his grotto this Christmas Eve morning having just sent out a memo regarding Santa's exciting new project in the manufacturing of reindeer cheese. It had been a quiet few months, with the deferral of IFRS 15 bringing welcome news, but hearing the sound of footsteps approaching his door, the Elf feared this was about to change.

Without knocking, Santa burst into the grotto. He was visibly red of face, short of breath and waving a small red book with the IASB logo on its cover.

"Have you seen this? Given this whole thing started almost 20 years ago, I had hoped this was never going to arrive!" he puffed, launching the book towards the Elf's desk.

Picking it up, and becoming rather red in the face himself, the Elf exclaimed "Ah, the exclusive pre-publication copy of the new leasing standard!"

"When we entered into the sale and leaseback of this place following the global economic crisis to raise some much needed cash, I was hoping this would remain off our balance sheet forever!" Santa said as he gestured through the window towards the North Pole.

"Indeed, that will all be on balance sheet with a liability to pay the rentals" exclaimed Elf. "We were probably lucky that we got away without it being an operating lease to start with when we said the North Pole was not a specialised asset!"

Santa did not look impressed one bit.

"But, look on the bright side Santa! This is going to have a positive effect on EBITDARF!" continued the Elf, referencing Santa's favourite alternative performance measure, Earnings before Interest, Tax, Depreciation, Amortisation and Reindeer Food, which was the main focus of his commentary in the annual report.

"Ah that is helpful indeed, and as long as we are careful with the new regulatory guidelines on Alternative Performance Measures which you keep mentioning!" said Santa, looking slightly calmer.

"There are some other positives in here Santa. Let me explain!" said the Elf getting up off his stool and walking to the warm fireplace.

"Take the contracts we negotiate every year giving us the right to use people's chimneys for deliveries. Our contract only covers each Christmas at a time with no option for renewal (as we know we only deliver to those that have good behaviour), and there's an exemption for short term leases like this being recognised on the balance sheet!"

"Also, not all of the money we pay the manufacturer for that sleigh every month will be on the balance sheet! Most of it is for service and maintenance costs, which will need to split from the rental payments and account for as we do today!"

Santa still didn't look impressed, so the Elf ran over to the window overlooking the reindeers. "Ok, well, what about this one. If we go ahead with your plans to make cheese from the reindeer milk Santa, the arrangements under which we rent the reindeer will become out of scope, as they will then qualify as biological assets since we will be undergoing agricultural activity with them!"

Santa looked confused, looking at Prancer and his very large antlers exclaiming "Well that won't help with the male reindeers will it?"

The Elf looked deflated and made a note in his note book to disclose a judgement around the gender of reindeer in next year's accounts.

"No, but the lease we have for Rudolph's nose can be exempt as it is clearly a low value asset!" said the Elf, smiling once more to himself while watching the lead reindeer's nose flicker in the early morning light as snow started to fall outside.

Santa looked a little happier at this prospect, and turned his attention to the pile of red and white packaged costumes in the corner. "What about the thousands of Santa costumers we rent out every year then, will we have to change what we do with these?"

"No!" replied the Elf gleefully, "Given we are the lessor, those will remain pretty much as they are today!"

"Good, so it isn't all bad news then." said Santa immediately regretting his words as he heard Mrs Claus calling for him.

Some things never change, thought the Elf as he watched Santa rush out of his grotto once more towards the faint but furious shouts of the Chief Operating Decision Maker. Clearly she had just read the memo on the reindeer cheese project, and noticed just how much this was going to eat into next year's capex budget!

Have you seen the latest PwC IFRS blogs

Katja van der Kuij wonders about free things – will economically similar cases be treated similarly under the new revenue standard?

Brian Peters calls entities that would like to avoid an income statement charge from pension accounting for action

Lihor Spazzoli muses on mankind's clinging to 'names' even when they are incorrect

2016 accounting horoscope

Karl Janse van Rensburg takes a look into the stars for us…

Aquarius (20/01-18/02)

You are at a crossroads and need to re-evaluate your future. Ask yourself: Is Po a tele tubby? If your answer is yes, then maybe it is time to move on.

Gemini (21/05-21/06)

The IASB and the FASB have confirmed that relationships are complicated, so, where possible, avoid any in 2016. Who are we kidding, you're an accountant…

Libra (23/09-22/10)

A chord could be playing on your heartstrings - or Cupid could be simply having a whale of a time…a tall dark stranger is waiting in your future and his name is Leasing.

Pisces (19/02-20/03)

Your hedge has been growing this month. It could be time to get the shears out or it may no longer be effective as the neighbours may be able to see into your garden.

Cancer (22/06-22/07)

It's time to take a deep breath, take stock and find your zen. Don't be a hero and think of early adoption. Effective dates have moved on and so should you.

Scorpio (23/10-21/11)

You are full of adventure and ready to take on the world. While you're feeling adventurous, why not shake things up a little? Try a Twix instead of a Kit-Kat out of the vending machine today.

Aries (21/03-19/04)

As an accountant, you know the cost of everything and the value of nothing. Don't be stingy, you deserve some TLC after reading IFRS EDs. You may find yourself increasing your credit limit.

Leo (23/07-22/08)

Now would be a great time for travel. Oh wait, it's busy season. Never mind, with Mars in your sign, plan not to see daylight for at least another few months.

Sagittarius (22/11-21/12)

It is usually your job to entertain. Bite your tongue, though, or you might end up CC-ing the IASB on an email you meant to send to a co-worker about how you really feel about the new leasing standard.

Taurus (20/04-20/05)

You are still trying to get onto the property ladder. Don't worry; just keep on extending the lease term and you'll be rewarded with a nice house. On paper, that is…

Virgo (23/08-22/09)

You feel the need to reverse the impairment on your body caused over the holiday season. Remember to add the necessary disclosures!

Capricorn (22/12-19/1)

Throw away those old books piled up to the ceiling and have a chat with your new found colleague sitting next to you. You might even want to share your 2016 PwC Manual…the best ones start off that way….

IC Rejections in short - IAS 11

Vivian Lai of Accounting Consulting Services examines the practical implications of IFRIC rejections related to IAS 11.

Looking for an answer? Maybe it was already addressed by the experts.

The Interpretations Committee (IC) regularly considers anywhere up to 20 issues at its periodic meetings. A very small percentage of the issues discussed result in an interpretation. Many issues are rejected; some go on to become an improvement or a narrow scope amendment. The issues that are not taken on to the agenda end up as "IFRIC rejections", known in the accounting trade as "not an IFRIC" or NIFRICs. The NIFRICs are codified (since 2002) and included in the "green book" of standards published by the IASB although they technically have no standing in the authoritative literature. This series covers what you need to know about issues that have been "rejected" by the IC. We go standard by standard and continue with IAS 11 as per below.

IAS 11, "Construction Contracts" deals with contracts specifically negotiated for the construction of an asset, or combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use. In the construction industry projects include numerous tasks and objectives which can be challenging. This is also true to some extent when it comes to accounting for constructions contracts. Over the last 13 years, six matters have been raised with the IC on IAS 11.

Pre-contract costs (August 2002)

Entities in some industries incur significant "pre-contract" costs. The IC was asked to provide guidance regarding when is it appropriate to recognise an asset (versus an expense) for pre-contract costs.

The IC agreed that IAS 11 provides guidance for pre-contract costs relating to construction contracts and that this guidance can be applied to analogous circumstances. However, the IC noted that a great deal of care should be taken when determining whether pre-contract costs should be capitalised.

Pre-completion contracts for the sale of residential properties (November 2004)

The IC was asked to consider the application of IAS 11 and IAS 18 for sale of residential development properties.

The IC agreed that pre-completion contracts might not meet the definition of construction contracts in IAS 11. If pre-completion contracts did not meet the definition of construction contracts, the guidance in IAS 18 would prohibit revenue recognition before legal title was transferred, if the risks and rewards of ownership did not pass to the buyer before then.

The board subsequently issued IFRIC 15, "Agreements for construction of real estate", to clarify which standard (IAS 18, "Revenue", or IAS 11, "Construction contracts") should be applied to particular transactions.

Classification of contract assets (June 2005)

During its project on service concession arrangements, the IC considered that the "amount due from customers" is a financial asset. However, an entity should not capitalise interest for construction contracts, as they are not qualifying assets (as defined by IAS 23), but rather accrue interest on the financial asset arising from these construction contracts. In 2006 IFRIC 12, "Service concession arrangements" was issued, which includes guidance on this topic.

Allocation of profit in a single contract (November 2006)

The IC considered in its deliberations of service concession arrangements whether it is appropriate to determine different profit margins for different components of a single contract.

For a single contract for construction and other services not directly related to construction activities, IAS 18 requires the contract to be separated into two components, a construction component within the scope of IAS 11 and a service component within the scope of IAS 18, in

order to reflect the substance of the transaction. As such, different profit margins might be recognised on the different components of a single contract.

Subsequently this was included in IFRIC 12, "Service Concession Agreements".

Accounting for sales costs (May 2009)

The IC was asked to clarify how a real estate developer should account for selling and marketing costs incurred during construction that relate to a specific real estate construction project. The IC noted that some direct and incremental costs recoverable as a result of securing a contract with a customer might be capitalised in narrow circumstances.

The accounting for such costs varies depending on specific facts and circumstances. Thus the IC noted that it is not possible to reach a conclusion on the appropriate accounting for broad categories of selling and marketing costs in all circumstances. The issue was not added to the agenda.

Summary of IAS 11 rejections

Topic	Summary conclusion
Pre-contract costs (August 2002)	The IC was asked to provide guidance regarding when is it appropriate to recognise an asset (versus an expense) for pre-contract costs when supplying products or services. The IC noted that IAS 11 provides guidance that can be applied in analogy.
Project accounting – contractee's accounting (September 2004)	The IC was asked to provide guidance on the proper accounting by the contractee as a construction project develops from contract signature to completion. The IC did not take this topic on its agenda in view this was an issue on application rather than the principle of the standard.
Pre-completion contracts for the sale of residential properties (November 2004)	The IC was asked to consider the application of IAS 11 and IAS 18 for sale of residential development properties. The IC agreed that pre-completion contracts might not meet the definition of construction contracts in IAS 11. This matter was subsequently addressed under IFRIC 15, "Agreements for construction of real estate".
Classification of contract assets (June 2005)	During its project on service concession arrangements the IC considered that the "amount due from customers" is a financial asset. However, an entity should not capitalise interest for construction contracts, but rather accrue interest on the financial asset arising from these construction contracts. Subsequently the IC deferred this issue until further progress was made on the service concession project.
Allocation of profit in a single contract (November 2006)	The IC considered different profit margins might be recognised on the different components of a single contract that is separated into a construction component and a service component. This was subsequently covered in IFRIC 12, "Service Concession Agreements".
Accounting for sales cost (May 2009)	The IC was asked to clarify how a real estate developer should account for selling and marketing costs incurred during construction that relate to the specific real estate construction project. The IC noted that some direct and incremental costs recoverable as a result of securing a specifically identifiable contract with a customer may be capitalised in narrow circumstances.

The bit at the back.....

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