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Superseded by IFRS 15. IAS 11 prescribes the contractor's accounting treatment of revenue and costs associated with construction contracts. Work under a construction contract is usually performed in two or more accounting periods. Consequently, the primary accounting issue is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed. IAS 11 requires: when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract to be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period; and when the outcome of a construction contract cannot be estimated reliably: revenue to be recognised only to the extent of contract costs incurred that is probable will be recoverable; and contract costs to be recognised as an expense in the period in which they are incurred. When it is probable that total contract costs will exceed the total contract revenue, the expected loss is recognised as an expense immediately. In April 2001 the International Accounting Standards Board (IASB) adopted IAS 11 Construction Contracts, which had originally been issued by the International Accounting Standards Committee in December 1993. IAS 11 Construction Contracts replaced parts of IAS 11 Accounting for Construction Contracts (issued in March 1979). This Standard was superseded by IFRS 15 Revenue from Contracts with Customers. The International Accounting Standards Committee issued the the International Accounting Standard 11, Construction Contracts. The objective of IAS 11 is to prescribe the accounting treatment of revenue and costs associated with construction contracts. This Standard uses the recognition criteria established in the framework for the preparation and presentation of financial statements to determine when contract revenue and contract costs should be recognised as revenue and expenses in the income statement. It also provides practical guidance on the application of these criteria. This article presents a closer look of standard (objective, scope, definitions, accounting treatment, recognition, presentation and disclosures). Muthupandian, K S, 2008. "IAS 11 Construction Contracts - A Closer Look," MPRA Paper 40027, University Library of Munich, Germany. Handle: RePEc:pra:mprapa:40027 All material on this site has been provided by the respective publishers and authors. You can help correct errors and omissions. When requesting a correction, please mention this item's handle: RePEc:pra:mprapa:40027. See general information about how to correct material in RePEc. 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For technical questions regarding this item, or to correct its authors, title, abstract, bibliographic or download information, contact: Joachim Winter (email available below). General contact details of provider: . Please note that corrections may take a couple of weeks to filter through the various RePEc services. 1. IAS 11 3/22/2009 CONSTRUCTION CONTRACTS IAS 11 1 2. IAS 11 3/22/2009 OBJECTIVE Accounting treatment of revenue and costs associated with construction contracts Allocation to accounting periods in which contract work is performed When contract revenue and costs should be recognised as revenue and expenses in the income statement Practical guidance on application 2 3. IAS 11 3/22/2009 SCOPE Construction contracts in the financial statements of contractors 3 4. IAS 11 3/22/2009 DEFINITIONS Construction contract: Contract for construction of interrelated assets including - Service contracts for architects & project managers Destruction & restoration of assets and environment Fixed price contract: Contractor agrees a fixed contract price or fixed rate per unit with escalation clauses Cost plus contract: Contractor is reimbursed for allowable defined costs plus a percentage or a fixed fee Some contracts are a mix of the above 4 5. IAS 11 3/22/2009 COMBINING AND SEGMENTING CONSTRUCTION CONTRACTS Apply standard to each contract in turn Split contracts into components when: A contract covers a number of assets Separate proposals were submitted for each asset Negotiation, acceptance or rejection of each part of the contract is possible Costs and revenues of each asset can be identified Group contracts together when: Negotiated as a single package Part of single project with overall profit margin Performed concurrently or in continuous sequence Accounting treatment reflects economic substance of contracts Treat construction of additional assets (contract amendment) as a separate contract when: Asset is significantly different in design, technology or function Price is negotiated without regard to original contract price 5 6. IAS 11 3/22/2009 CONTRACT REVENUE Fair value of consideration receivable Uncertainties are revised as events occur e.g. Variations or claims affecting revenue Escalation clauses affecting costs Penalties from delays Increase in units produced when revenue is fixed per unit Contract revenue shall comprise Initial amount agreed Incentive payments Contract is sufficiently advanced that exceeding terms is probable Amount can be measured reliably Variations in work, claims or incentives Probable to result in revenue Can be reliably measured Negotiation of claims are at advanced stage Probable that customer will accept the claim 6 7. IAS 11 3/22/2009 CONTRACT COSTS Costs that relate directly to a specific contract Costs for securing the contract if not expensed when incurred Site labour and supervision Materials in construction Depreciation of plant and equipment Moving plant, equipment and materials to and from site Hiring plant and equipment Directly related design and technical assistance Estimate costs of rectification and guarantee work, including warranty costs Claims from third party Incidental income not included in revenue, e.g. sale of surplus materials Attributable to contract activity or can be allocated on systematic basis Insurance Allowed alternative treatment of borrowing costs under IAS 23 Design and technical assistance Construction overheads e.g. preparation and processing of construction payroll Other costs specifically chargeable to customer under terms of contract Reimbursement of certain administration costs 7 8. IAS 11 3/22/2009 COSTS NOT ATTRIBUTABLE TO CONTRACT ACTIVITY Reimbursement note specified in contract General administration costs Selling costs Research and development costs Depreciation of idle plant and equipment not used on a particular contract Costs incurred in securing the contract and expensed when they are incurred 8 9. IAS 11 3/22/2009 RECOGNITION OF CONTRACT REVENUE AND EXPENSES When outcome of contract can be reliably estimated Recognise revenue and costs by reference to stage of completion of contract activity at the balance sheet date Fixed price contract Total contract revenue can be measured reliably Probable economic benefits will flow to the entity Both costs to complete and stage of completion can be measured reliably Costs can be clearly identified and measured reliably so that actual costs can be compared with prior estimates Cost plus contract Probable economic benefits will flow to the entity Contract costs specifically reimbursable can be clearly identified and reliably measured 9 10. IAS 11 3/22/2009 STAGE OF COMPLETION Stage of completion is not reflected by progress payments and advances Various methods: Contract costs to date/total estimated contract costs Only include costs for work performed to date, not future work to be performed Do not include advanced payments for work to be performed Surveys of work performed Physical completion of proportions of contract work Percentage of completion Percentage of completion method: Match contract revenue with contract costs Recognise revenue in the period in which work is performed Recognise costs as expense in period in which work to which they relate is performed Contract work in progress: Future costs treated as asset if probable that they will be recovered Uncollectable amount already included in contract revenue is adjusted as expense rather than revised contract revenue Report revenue, expenses and profit attributed to the portion of work completed 10 11. IAS 11 3/22/2009 RELIABLE ESTIMATES Contract work in progress: when: Rights regarding assets under construction are enforceable Consideration agreed Manner and terms of settlement agreed Effective internal financial budgeting and reporting system designed Revision of costs and revenue as activity progresses does not mean reliable measurement is not possible 11 12. IAS 11 3/22/2009 RECOGNITION OF EXPECTED LOSSES Recognise immediately as an expense on a contract by contract basis irrespective of profits expected on other contracts When outcome cannot be estimated reliably: Recognise costs as expense in period in which they are incurred When probable that expensed costs will be recovered, recognise related revenue No profit is recognised until probable Expected losses are recognised immediately as an expense Costs not probable of being recovered are recognised as expense immediately Contract not enforceable or validity in question Completion dependent on outcome of litigation Condemned properties Customer unable to meet obligation Contractor unable to complete 12 13. IAS 11 3/22/2009 CHANGES IN ESTIMATES Change of estimate in percentage of completion method is accounted for as a change in accounting estimate per IAS 8 Recognise change in estimate prospectively - adjust revenue and expenses in income statement in the period in which the change is made 13 14. IAS 11 3/22/2009 DISCLOSURE Amount recognised as contract revenue in income statement Methods used to determine: contract revenue for the period stage of completion Contracts in progress Aggregate amount of costs incurred and recognised profits less recognised losses to date Advances received Retentions Assets and liabilities Gross amount due from contract customers Costs incurred + recognised profit - (recognised losses + progress billings) For all contracts where costs to date + recognised profits > progress billings Gross amount due to customers Costs incurred + recognised profits - (recognised losses + progress billings) Contingent liabilities Follow IAS 37 for warranty costs, claims, penalties or possible losses 14 15. IAS 11 3/22/2009 SUMMARY Income, expenses and profit is recognised according to stage of completion on a contract by contract basis Various methods can be used to determine stage of completion Revenue and costs are recognised in income statement according to the stage of completion Profit is recognised according to stage of completion when it is probable that costs will be recovered Losses are recognised immediately when it is estimated that they will be incurred Assets are recognised for future recoverable costs where gross value of work completed > progress billings Liabilities are recognised for receipt advances for work not yet performed or where gross value of work completed < progress billings Disclose methods used to determine stage of completion, amounts recognised and contingent liabilities Examples at the back of IAS 11 15



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