



IAS 11 CONSTRUCTION CONTRACTS

FACT SHEET

This fact sheet is based on existing requirements as at 31 December 2015 and it does not take into account recent standards and interpretations that have been issued but are not yet effective.

IMPORTANT NOTE

This fact sheet is based on the requirements of the International Financial Reporting Standards (IFRSs). In some jurisdictions, the IFRSs are adopted in their entirety; in other jurisdictions the individual IFRSs are amended. In some jurisdictions the requirements of a particular IFRS may not have been adopted. Consequently, users of the fact sheet in various jurisdictions should ascertain for themselves the relevance of the fact sheet to their particular jurisdiction. The application date included below is the effective date of the initial version of the standard.

IASB APPLICATION DATE (NON-JURISDICTION SPECIFIC)

IAS 11 was adopted by the IASB in April 2001. IAS 11 had originally been issued by the IASC in December 1993. IAS 11 is applicable for annual reporting periods commencing on or after 1 January 1995.

OBJECTIVE

IAS 11 prescribes the accounting treatment of revenue and costs associated with construction contracts.

Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different reporting periods. Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the reporting periods in which construction work is performed.

SCOPE

IAS 11 shall be applied in accounting for construction contracts in the financial statements of contractors.

Construction contracts include contracts for the:

- rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects; and
- destruction or restoration of assets and the restoration of the environment following the demolition of assets.

RECOGNITION AND MEASUREMENT

Combining and segments contracts

IAS 11's requirements are usually applied separately to each construction contract, but in some circumstances it is necessary to apply the standard to the separately identifiable components of a single contract or to a group of contracts to reflect the substance of the contract or group of contracts.

If a contract covers a number of assets, the construction of each asset shall be treated as a separate construction contract when:

- separate proposals have been submitted for each asset;
- each asset has been subject to separate negotiation, and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and
- the costs and revenues of each asset can be identified.

A group of contracts whether with a single customer or with several customers shall be treated as a single construction contract when:

- the group of contracts is negotiated as a single package;
- the contracts are very closely interrelated, that they are, in effect, part of a single project with an overall margin; and
- are performed concurrently or in a continuous sequence.

A contract provision for the construction of an additional asset at the option of the customer shall be treated as a separate construction contract when:

- the asset differs significantly in design, technology or function from the asset or assets covered by the original contract, or
- the price of the asset is negotiated without regard to the original contract price.

Contract revenue and costs

Contract revenue shall comprise:

- the initial amount of revenue agreed in the contract; and
- variations in contract work, claims and incentive payments:
 - to the extent that it is probable that they will result in revenue and
 - are capable of being measured reliably.

Contract costs shall comprise:

- costs that relate directly to the specific contract;
- costs that are attributable to contract activity in general and can be allocated to the contract; and
- such other costs as are specifically chargeable to the customer under the terms of the contract.

Recognition of contract revenue and expenses

When the **outcome of a construction contract can be estimated reliably**, contract revenue and contract costs are recognised by reference to the stage of completion of the contract activity at the reporting date. This involves reporting revenue, expenses and profit attributable to the proportion of work completed. The stage of completion may be estimated in a variety of ways, including the proportion that costs incurred for work performed to date bear to the estimated total contract costs, surveys of work performed or proportion of physical work completed. The entity uses the method that measures reliably the work performed.

Guidance is included in paragraphs 23 and 24 of IAS 11 regarding when the outcome of a contract can be estimated reliably.

When the **outcome of the construction contract cannot be reliably estimated**, revenue shall be recognised only to the extent of contract costs incurred that it is probable will be recoverable, and contract costs are expensed in the period as they are incurred. If the outcome of a contract, previously regarded as not being capable of reliable estimation, becomes capable of reliable estimation, revenue and costs are recognised using the stage of completion method.

Recognition of expected loss

If it is probable that total contract costs will exceed total contract revenue, the expected loss shall be recognised as an expense immediately.

Changes in estimates

The effect of changes in 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 recognised in profit or loss in the period in which the change is made and in subsequent periods.

DISCLOSURES

Refer to Appendix 1 for a checklist to assist with IAS 11 disclosure requirements.

DEFINITIONS

Construction contract	A contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.
Cost plus contract	A construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus a percentage of these costs or a fixed fee.
Fixed price contract	A construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.

RELATED INTERPRETATION

- IFRIC 15 *Agreements for the Construction of Real Estate*

In the real estate industry, entities that undertake the construction of real estate, directly or through subcontractors, may enter into agreements with one or more buyers before construction is complete. Such agreements take diverse forms.

IFRIC 15 applies to the accounting for revenue and associated expenses by entities undertaking such activities, and addresses the following two issues:

- Is the agreement within the scope of IAS 11 *Construction Contracts* or IAS 18 *Revenue*?
- When should revenue from the construction of real estate be recognised?

AUSTRALIAN SPECIFIC REQUIREMENTS

The Australian equivalent standard is AASB 111 *Construction Contracts* and is applicable for annual reporting periods commencing on or after 1 January 2005. The Australian equivalent related interpretation is Interpretation 15 *Agreements for the Construction of Real Estate*.

In respect of not-for-profit public sector entities, costs that may be attributable to contract activity in general and can be allocated to specific contracts also include borrowing costs only when the contractor capitalises borrowing costs in accordance with AASB 123 *Borrowing Costs*.

REDUCED DISCLOSURE REQUIREMENTS (RDR)

On 30 June 2010, the Australian Accounting Standards Board published AASB 1053 *Application of Tiers of Australian Accounting Standards (and AASB 2010-2 Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements)* which established a differential reporting framework, consisting of two Tiers of reporting requirements for preparing general purpose financial statements:

- a. Tier 1: Australian Accounting Standards; and
- b. Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

A Tier 2 entity is a 'reporting entity' as defined in SAC 1 *Definition of the Reporting Entity* that does not have 'public accountability' as defined in AASB 1053 and is not otherwise deemed to be a Tier 1 entity by AASB 1053.

RDR is applicable to annual periods beginning on or after 1 July 2013.

When developing AASB 1053, the AASB concluded that the Australian Government and state, territory and local governments should be subject to Tier 1 requirements. The AASB also decided that General Government Sectors of the Australian Government and state and territory governments should continue to apply AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, without the reduction in disclosures provided by Tier 2. Other public sector entities are able to apply Tier 2 reporting requirements.

The requirements that do not apply to RDR entities are identified in Appendix 1 by shading of the relevant text.

APPENDIX 1 – DISCLOSURE CHECKLIST

This checklist can be used to review your financial statements. You should complete the “Yes / No / N/A” column about whether the requirement is included. To ensure the completeness of disclosures, provide an explanation for “No” answers.

CODE		YES / NO / N/A	EXPLANATION (If required)
IAS 11.39	Has the entity disclosed: a. the amount of contract revenue recognised as revenue in the period; b. the methods used to determine the contract revenue recognised in the period; and c. the methods used to determine the stage of completion of contracts in progress?		
IAS 11.40	Has the entity disclosed the information below for contracts in progress at the reporting date: a. the aggregate amount of costs incurred and recognised profits (less recognised losses) to date; b. the amount of advances received; and c. the amount of retentions?		
IAS 11.42	Has the entity presented: a. the gross amount due from customers for contract work as an asset; and b. the gross amount due to customers for contract work as a liability?		

OTHER MATTERS

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