



# LKAS 11 – Construction Contracts

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- **Scope and definitions**
- **Segmenting and combining construction contracts**
- **Recognition of contract revenue and costs**
- **IFRIC 15- LKAS 11 vs. LKAS 18**
- **New developments on revenue recognition**

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- **A construction contract is ...**
  - ... 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.

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Construction contracts

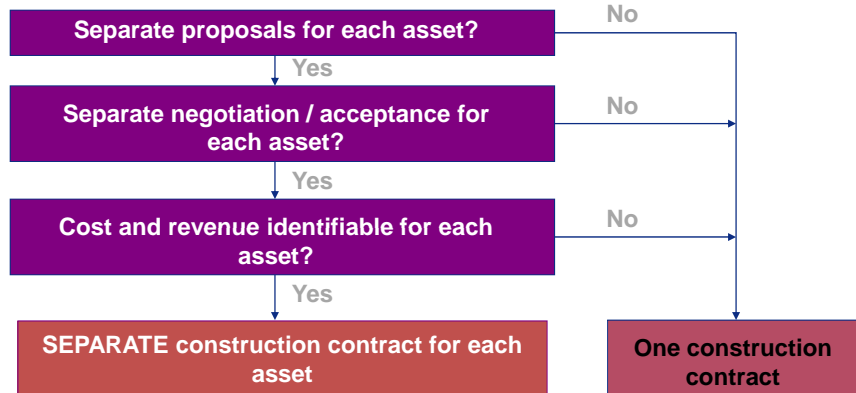
Fixed price

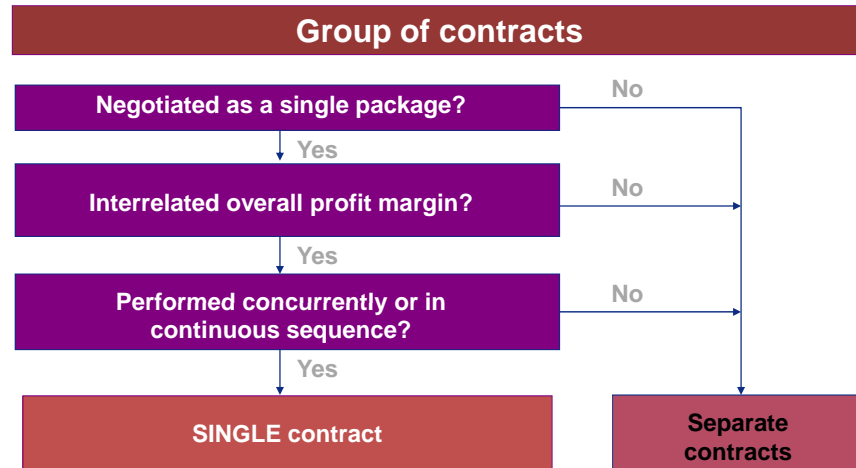
- Contractor and customer agreed
  - a fixed price or
  - a fixed rate per unit of output

Cost plus

- Contractor is reimbursed for
  - allowable or otherwise defined costs, plus
  - a percentage of these costs or a fixed fee

One contract – number of assets





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- **Separate if:**

- additional asset differs significantly from the asset(s) covered by the

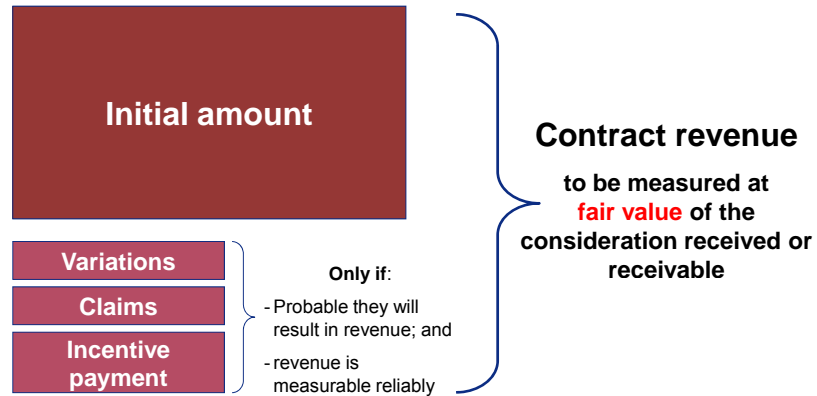
original contract in:

- design;
- technology; or
- function; or

- price of the additional asset is negotiated without regard to the original

contract price

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- **If revenue on a contract is recognized, but will be received only after expiry of a specified period of time, then interest should be imputed and expected cash receipt should be discounted to determine the fair value of the amounts receivable.**

- **Eg: Retention**

**Include if:**

- ◆ Related directly to specific contract
- ◆ Attributable to contract activity in general and can be allocated to the contract
- ◆ Other specifically chargeable to the customer under the contract
- ◆ Incurred from the date of and in order to secure the contract only if:
  - relate directly to contract
  - identifiable separately
  - measurable reliably
  - probable that contract will be obtained
  - not expensed previously

**Exclude if:**

- ◆ Cannot be attributed to contract activity or cannot be allocated to a contract:
  - general administration costs not reimbursable under the contract
  - selling costs
  - R&D costs not reimbursable under the contract
  - depreciation of idle PPE not used on a particular contract

**Outcome can be estimated reliably**

- ◆ Recognise by reference to the stage of completion at the end of the reporting period:
  - contract revenue
  - contract costs
- ◆ Recognise immediately any expected loss as an expense

**Outcome cannot be estimated reliably**

- ◆ Recognise revenue only to the extent of incurred contract costs with probable recovery
- ◆ Recognise contract costs as an expense as incurred
- ◆ Recognise immediately any expected loss as an expense

ALL conditions should be met:

**Fixed price contract**

- Total contract revenue measurable reliably
- Probable that economic benefits will flow to the entity
- Contract costs to complete and stage of completion measurable reliably
- Attributable contract costs identifiable clearly and measurable reliably: actual vs. estimates

**Cost plus contract**

- Probable that economic benefits will flow to the entity
- Attributable contract costs (whether or not reimbursable specifically) identifiable clearly and measurable reliably

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**Measures**

**Output**

- ◆ Surveys of work performed
- ◆ Completion of a physical proportion of the contract work

**Input**

$$\frac{\text{cost incurred to date}}{\text{total estimate costs}} \%$$

**NB!**

- No specific method is mandated
- Progress payments and advances often do NOT reflect work performed

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• **A enters into a contract to build a road for Rs.90 million. A's initial estimate of contract costs is Rs.74 million. The contract starts early in 2010**

• **Scenario 1 - At the end of 2010 A can estimate reliably the outcome of the contract**

- Stage of completion is determined based on the completion of physical proportion of the contract work
- Estimated to be 50% physically complete at end of 2010
- Cost incurred to date - Rs.37 million
- A recognises at 31 December 2010:

• **revenue of Rs.45 million; and**

• **expenses of Rs.37 million.**

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• **Scenario 2 - At the end of 2010 A cannot estimate reliably the outcome of the contract**

- Costs incurred - Rs.30 million
- It is probable that the costs will be recovered
- A recognises at 31 December 2010:

• **revenue of Rs.30 million; and**

• **expenses of Rs.30 million.**

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- **Percentage of completion method: application**

- on cumulative basis in each period
- to the current estimates of contract revenue

- **Effect of changes in estimates is accounted for under LKAS 8 - prospectively**

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- **A enters into a contract to build a road for Rs.90 million. A's initial estimate of contract costs is Rs.74 million. The contract starts early in 2009**

- **Stage of completion is determined based on the completion of physical proportion of the contract work**

- **Year-end 2009**

- estimated completed work - 50%
- no changes to estimated costs to complete the work

- **Year-end 2010**

- estimated completed work – 90%
- estimated total costs to complete the work - Rs.80 million

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Changes in estimates – Example (continued)

	2009 Rs.m	2010 Rs.m	2011 Rs.m	Total Rs.m
Revenue	45 <sup>1</sup>	36 <sup>3</sup>	9	90
Costs	37 <sup>2</sup>	35 <sup>4</sup>	8	80
Profit	8	1	1	10
GPM	17.7%	2.8%	11.1%	11.1%



Calculations:

1.  $90 \times 50\% = 45$
2.  $74 \times 50\% = 37$
3.  $90 \times 90\% - 45 = 36$
4.  $80 \times 90\% - 37 = 35$

Change in estimates

Expected losses – Example 3

- **A enters into a contract to build a road for Rs.90 million. A's initial estimate of contract costs is Rs.74 million. The contract starts early in 2010**
- **At the end of 2010, the estimated costs to complete the work increase to Rs.95 million, with no increase in contract revenue.**
  - *A has to recognise the expected loss of Rs.5 million immediately*

Calculation

Total revenue	=	90
Total estimated cost	=	(95)
Estimated loss	=	5



- **Issues addressed by IFRIC 15**
  - Applicable standard (LKAS 11 or LKAS 18)
  - Timing of revenue recognition
- **Scope**
  - Agreement for the construction of real estate
  - Component for the construction of real estate identified within an agreement that includes other components

Is buyer *able* to specify the major structural elements of design and / or major structural changes?

YES

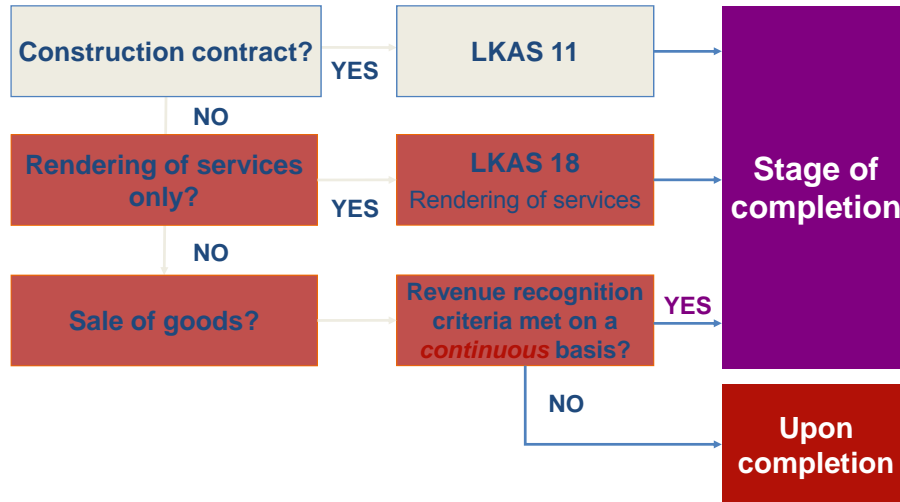
LKAS 11

NO

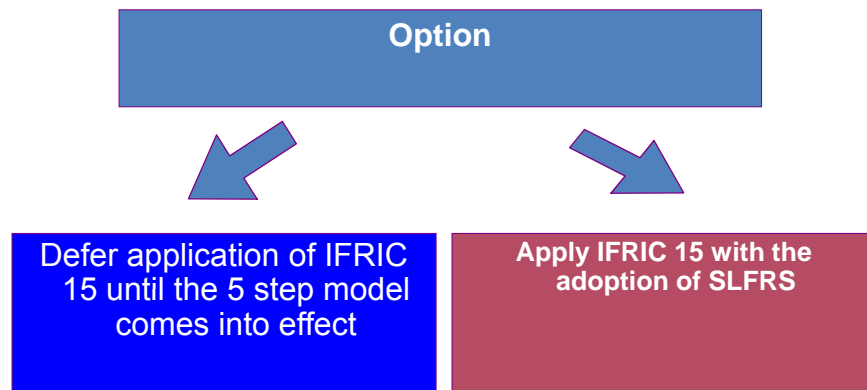
LKAS 18

**NOT an accounting policy choice!!!**

When and how recognize revenue?



ICASL Ruling on Deferring Application of IFRIC 15

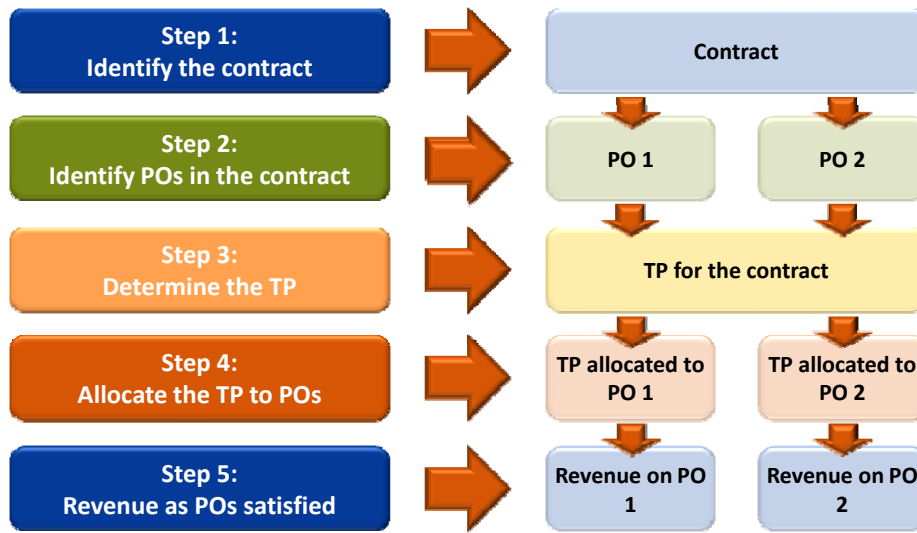


• **A new revenue recognition model that applies to revenue from contracts with customers**

– **Single standard would replace:**

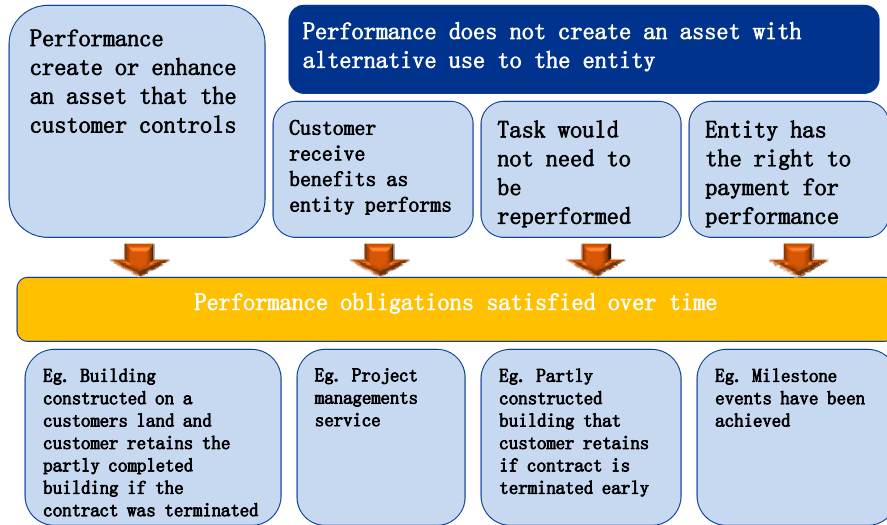
- IAS 11 *Construction contracts*
- IAS 18 *Revenue*
- IFRIC 13 *Customer Loyalty Programmes*
- IFRIC 15 *Agreements for the Construction of Real Estate*
- IFRIC 18 *Transfers of Assets from Customers*
- SIC-31 *Revenue – Barter Transactions Involving Advertising Services*

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PO: Performance obligation  
TP: Transaction price

### Criteria for Recognizing Revenue Over Time



## Questions



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**Thank you.**