

## **PUBLIC BENEFIT ENTITY INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 11 CONSTRUCTION CONTRACTS (PBE IPSAS 11)**

**Issued September 2014 and incorporates amendments to 31 January 2017**

This Standard was issued on 11 September 2014 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 9 October 2014.

Reporting entities that are subject to this Standard are required to apply it in accordance with the effective date, which is set out in paragraphs 58.1 to 58.2.

In finalising this Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Tier 1 and Tier 2 PBE Standard has been issued as part of a revised full set of PBE Standards that incorporate enhancements for not-for-profit public benefit entities.

This Standard, when applied, supersedes PBE IPSAS 11 *Construction Contracts* issued in May 2013.

# PBE IPSAS 11 CONSTRUCTION CONTRACTS

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# PBE IPSAS 11 CONSTRUCTION CONTRACTS

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Public Benefit Entity International Public Sector Accounting Standard 11 *Construction Contracts* is set out in the objective, and paragraphs 1–59 and the Application Guidance. All the paragraphs have equal authority. PBE IPSAS 11 should be read in the context of its objective, the NZASB’s Basis for Conclusions on PBE IPSAS 11, the *Public Benefit Entities’ Conceptual Framework* and Standard XRB A1 *Application of the Accounting Standards Framework*. PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## Objective

The objective of this Standard is to prescribe the accounting treatment of costs and revenue associated with construction contracts. The Standard:

- Identifies the arrangements that are to be classified as construction contracts;
- Provides guidance on the types of construction contracts that can arise; and
- Specifies the basis for recognition and disclosure of contract expenses and, if relevant, contract revenues.

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.

Construction contracts entered into by public benefit entities may not specify an amount of contract revenue. Rather, funding to support the construction activity will be provided by an appropriation or similar allocation of general government revenue, or by donations, aid or grant funds. In these cases, the primary issue in accounting for construction contracts is the (a) allocation of construction costs to the reporting period in which the construction work is performed, and (b) the recognition of related expenses.

Construction contracts entered into by public benefit entities may be established on a commercial basis or a non-commercial full or partial cost recovery basis. In these cases, the primary issue in accounting for construction contracts is the allocation of both contract revenue and contract costs to the reporting periods in which construction work is performed.

## Scope

1. **A contractor that prepares and presents financial statements shall apply this Standard in accounting for construction contracts.**
2. [Not used]
- 2.1 **This Standard applies to Tier 1 and Tier 2 public benefit entities.**
- 2.2 **A Tier 2 entity is not required to comply with the requirements in this Standard denoted with an asterisk (\*). Where a Tier 2 entity elects to apply a disclosure concession it shall comply with any RDR paragraphs associated with that concession.**
3. [Not used]

## Definitions

4. **The following terms are used in this Standard with the meanings specified:**

**Construction contract** is a contract, or a similar binding arrangement, 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.

**Contractor** is an entity that performs construction work pursuant to a construction contract.

**Cost plus or cost-based contract** is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs and, in the case of a commercially based contract, an additional percentage of these costs or a fixed fee, if any.

**Fixed price contract** is 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.

**Terms defined in other PBE Standards are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.**

## Construction Contracts

5. A construction contract (the terms construction contract and contract are used interchangeably in the remainder of this Standard) may be negotiated for the construction of a single asset such as a bridge, school, hospital, building, dam, pipeline, road, ship, or tunnel. A construction contract may also deal with the construction of a number of assets that are closely interrelated or interdependent in terms of their design, technology, and function or their ultimate purpose or use – examples of such contracts include those for the construction of reticulated water supply systems, refineries, and other complex infrastructure assets.

6. For the purposes of this Standard, construction contracts include:
  - (a) Contracts for the rendering of services that are directly related to the construction of the asset, for example, those for the services of project managers and architects; and
  - (b) Contracts for the destruction or restoration of assets, and the restoration of the environment following the demolition of assets.
7. For the purposes of this Standard, construction contracts also include all arrangements that are binding on the parties to the arrangement, but which may not take the form of a documented contract. However, provided that the arrangement confers similar rights and obligations on the parties to it as if it were in the form of a contract, it is a construction contract for the purposes of this Standard. Such binding arrangements could include (but are not limited to) a ministerial direction, a cabinet decision, a legislative direction (such as an Act of Parliament), or a memorandum of understanding.
8. Construction contracts are formulated in a number of ways that, for the purposes of this Standard, are classified as fixed price contracts and cost plus or cost-based contracts. Some commercial construction contracts may contain characteristics of both a fixed price contract and a cost plus or cost-based contract, for example in the case of a cost plus or cost-based contract with an agreed maximum price. In such circumstances, a contractor needs to consider all the conditions in paragraphs 31 and 32 in order to determine when to recognise contract revenue and expenses.
9. Cost plus and cost-based contracts encompass both commercial and non-commercial contracts. A commercial contract will specify that revenue to cover the agreed constructor's construction costs and generate a profit margin will be provided by the other parties to the contract. However, an entity may also enter into a non-commercial contract to construct an asset for another entity in return for full or partial reimbursement of costs from that entity or other parties. In some cases, the cost recovery may encompass payments by the recipient entity and specific purpose construction grants or funding from other parties.
10. In many jurisdictions, where one entity constructs assets for another entity, the cost of construction activity is not recovered directly from the recipient. Rather, the construction activity is funded indirectly (a) by way of a general appropriation or other allocation of government funds to the contractor, or (b) from grants from third party funding agencies or other governments. These are classified as fixed price contracts for the purpose of this Standard.

### **Contractor**

11. A contractor is an entity that enters into a contract to build structures, construct facilities, produce goods, or render services to the specifications of another entity. The term "contractor" includes a general or prime contractor, a subcontractor to a general contractor, or a construction manager.

### **Combining and Segmenting Construction Contracts**

12. The requirements of this Standard are usually applied separately to each construction contract. However, in certain circumstances, it is necessary to apply the Standard to the separately identifiable components of a single contract, or to a group of contracts together, in order to reflect the substance of a contract or a group of contracts.
13. **When a contract covers a number of assets, the construction of each asset shall be treated as a separate construction contract when:**
  - (a) **Separate proposals have been submitted for each asset;**
  - (b) **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**
  - (c) **The costs and revenues of each asset can be identified.**
14. **A group of contracts, whether with a single customer or with several customers, shall be treated as a single construction contract when:**
  - (a) **The group of contracts is negotiated as a single package;**
  - (b) **The contracts are so closely interrelated that they are, in effect, part of a single project with an overall margin, if any; and**

- (c) **The contracts are performed concurrently or in a continuous sequence.**
15. **A contract may provide for the construction of an additional asset at the option of the customer, or may be amended to include the construction of an additional asset. The construction of the additional asset shall be treated as a separate construction contract when:**
- (a) **The asset differs significantly in design, technology, or function from the asset or assets covered by the original contract; or**
- (b) **The price of the asset is negotiated without regard to the original contract price.**

## **Contract Revenue**

16. **Contract revenue shall comprise:**
- (a) **The initial amount of revenue agreed in the contract; and**
- (b) **Variations in contract work, claims, and incentive payments to the extent that:**
- (i) **It is probable that they will result in revenue; and**
- (ii) **They are capable of being reliably<sup>1</sup> measured.**
17. Contract revenue is measured at the fair value of the consideration received or receivable. Both the initial and on-going measurement of contract revenue are affected by a variety of uncertainties that depend on the outcome of future events. The estimates often need to be revised as events occur and uncertainties are resolved. Where a contract is a cost plus or cost-based contract, the initial amount of revenue may not be stated in the contract. Instead, it may need to be estimated on a basis consistent with the terms and provisions of the contract, such as by reference to expected costs over the life of the contract.
18. In addition, the amount of contract revenue may increase or decrease from one period to the next. For example:
- (a) A contractor and a customer may agree to variations or claims that increase or decrease contract revenue in a period subsequent to that in which the contract was initially agreed;
- (b) The amount of revenue agreed in a fixed price, cost plus, or cost-based contract may increase as a result of cost escalation or other clauses;
- (c) The amount of contract revenue may decrease as a result of penalties arising from delays caused by the contractor in the completion of the contract; or
- (d) When a fixed price contract involves a fixed price per unit of output, contract revenue increases or decreases as the number of units is increased or decreased.
19. A variation is an instruction by the customer for a change in the scope of the work to be performed under the contract. A variation may lead to an increase or a decrease in contract revenue. Examples of variations are changes in the specifications or design of the asset, and changes in the duration of the contract. A variation is included in contract revenue when:
- (a) It is probable that the customer will approve the variation and the amount of revenue arising from the variation; and
- (b) The amount of revenue can be reliably measured.
20. A claim is an amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price. A claim may arise from, for example, customer-caused delays, errors in specifications or design, and disputed variations in contract work. The measurement of the amounts of revenue arising from claims is subject to a high level of uncertainty, and often depends on the outcome of negotiations. Therefore, claims are only included in contract revenue when:
- (a) Negotiations have reached an advanced stage, such that it is probable that the customer will accept the claim; and

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<sup>1</sup> Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. Paragraph BC10 of PBE IPSAS 1 *Presentation of Financial Statements* discusses the transitional approach to the explanation of reliability.

- (b) The amount that it is probable will be accepted by the customer can be measured reliably.
21. Incentive payments are additional amounts paid to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when:
- (a) The contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and
- (b) The amount of the incentive payment can be measured reliably.
22. Contractors should review all amounts relating to the construction contract that are paid directly to subcontractors by third party funding agencies, to determine whether they meet the definition of, and recognition criteria for, revenue of the contractor under the terms of the contract. Amounts meeting the definition and recognition criteria for revenue should be accounted for by the contractor in the same way as other contract revenue. Such amounts should also be recognised as contract costs (see paragraph 25). Funding agencies may include national and international aid agencies and multilateral and bilateral development banks.

### Contract Costs

23. **Contract costs shall comprise:**
- (a) **Costs that relate directly to the specific contract;**
- (b) **Costs that are attributable to contract activity in general, and can be allocated to the contract on a systematic and rational basis; and**
- (c) **Such other costs as are specifically chargeable to the customer under the terms of the contract.**
24. Costs that relate directly to a specific contract include:
- (a) Site labour costs, including site supervision;
- (b) Costs of materials used in construction;
- (c) Depreciation of plant and equipment used on the contract;
- (d) Costs of moving plant, equipment, and materials to and from the contract site;
- (e) Costs of hiring plant and equipment;
- (f) Costs of design and technical assistance that are directly related to the contract;
- (g) The estimated costs of rectification and guarantee work, including expected warranty costs; and
- (h) Claims from third parties.

These costs may be reduced by any incidental revenue that is not included in contract revenue, for example, revenue from the sale of surplus materials at the end of the contract.

25. Contractors should review all amounts relating to the construction contract paid directly by subcontractors and which are reimbursed by third party funding agencies, to determine whether they qualify as contract costs. Amounts meeting the definition of, and recognition criteria for, contract expenses should be accounted for by the contractor in the same way as other contract expenses. Amounts reimbursed by third party funding agencies that meet the definition of, and recognition criteria for, revenue should be accounted for by the contractor in the same way as other contract revenue (see paragraph 22).
26. Costs that may be attributable to contract activity in general and can be allocated to specific contracts include:
- (a) Insurance;
- (b) Costs of design that are not directly related to a specific contract; and
- (c) Construction overheads.

Such costs are allocated using methods that (a) are systematic and rational, and (b) are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of construction activity. Construction overheads include costs such as the preparation and processing of construction



personnel payroll. Costs that may be attributable to contract activity in general and can be allocated to specific contracts also include borrowing costs when the contractor adopts the allowed alternative treatment in PBE IPSAS 5 *Borrowing Costs*.

27. Costs that are specifically chargeable to the customer under the terms of the contract may include some general administration costs and development costs for which reimbursement is specified in the terms of the contract.
28. Costs that cannot be attributed to contract activity or cannot be allocated to a contract are excluded from the costs of a construction contract. Such costs include:
  - (a) General administration costs for which reimbursement is not specified in the contract;
  - (b) Selling costs;
  - (c) Research and development costs for which reimbursement is not specified in the contract; and
  - (d) Depreciation of idle plant and equipment that is not used on a particular contract.
29. Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract. However, costs that relate directly to a contract and that are incurred in securing the contract are also included as part of the contract costs, if they can be separately identified and measured reliably and it is probable that the contract will be obtained. When costs incurred in securing a contract are recognised as an expense in the period in which they are incurred, they are not included in contract costs when the contract is obtained in a subsequent period.

### **Recognition of Contract Revenue and Expenses**

30. **When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract shall be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected deficit on a construction contract to which paragraph 44 applies shall be recognised as an expense immediately in accordance with paragraph 44.**
31. **In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:**
  - (a) **Total contract revenue, if any, can be measured reliably;**
  - (b) **It is probable that the economic benefits or service potential associated with the contract will flow to the entity;**
  - (c) **Both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and**
  - (d) **The contract costs attributable to the contract can be clearly identified and measured reliably, so that actual contract costs incurred can be compared with prior estimates.**
32. **In the case of a cost plus or cost-based contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:**
  - (a) **It is probable that the economic benefits or service potential associated with the contract will flow to the entity; and**
  - (b) **The contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.**
33. The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses, and surplus/deficit that can be attributed to the proportion of work completed. This method provides useful information on the extent of contract activity and performance during a period.
34. Under the percentage of completion method, contract revenue is recognised as revenue in surplus or deficit in the reporting periods in which the work is performed. Contract costs are usually recognised as an expense in surplus or deficit in the reporting periods in which the work to which they relate is performed. However, where it is intended at inception of the contract that contract costs are to be fully recovered from the parties

to the construction contract, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately in accordance with paragraph 44.

35. A contractor may have incurred contract costs that relate to future activity on the contract. Such contract costs are recognised as an asset, provided it is probable that they will be recovered. Such costs represent an amount due from the customer and are often classified as contract work in progress.
36. The outcome of a construction contract can only be estimated reliably when it is probable that the economic benefits or service potential associated with the contract will flow to the entity. However, when an uncertainty arises about the collectability of an amount already included in contract revenue, and already recognised in surplus or deficit, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense rather than as an adjustment of the amount of contract revenue.
37. An entity is generally able to make reliable estimates after it has agreed to a contract that establishes:
  - (a) Each party's enforceable rights regarding the asset to be constructed;
  - (b) The consideration, if any, to be exchanged; and
  - (c) The manner and terms of settlement.

It is also usually necessary for the entity to have an effective internal financial budgeting and reporting system. The entity reviews and, when necessary, revises the estimates of contract revenue and contract costs as the contract progresses. The need for such revisions does not necessarily indicate that the outcome of the contract cannot be estimated reliably.

38. The stage of completion of a contract may be determined in a variety of ways. The entity uses the method that measures reliably the work performed. Depending on the nature of the contract, the methods may include:
  - (a) The proportion that contract costs incurred for work performed to date bear to the estimated total contract costs;
  - (b) Surveys of work performed; or
  - (c) Completion of a physical proportion of the contract work.

Progress payments and advances received from customers often do not reflect the work performed.

39. When the stage of completion is determined by reference to the contract costs incurred to date, only those contract costs that reflect work performed are included in costs incurred to date. Examples of contract costs that are excluded are:
  - (a) Contract costs that relate to future activity on the contract, such as costs of materials that have been delivered to a contract site or set aside for use in a contract, but not yet installed, used, or applied during contract performance, unless the materials have been made specially for the contract; and
  - (b) Payments made to subcontractors in advance of work to be performed under the subcontract.
40. **When the outcome of a construction contract cannot be estimated reliably:**
  - (a) **Revenue shall be recognised only to the extent of contract costs incurred that it is probable will be recoverable; and**
  - (b) **Contract costs shall be recognised as an expense in the period in which they are incurred.**

**An expected deficit on a construction contract to which paragraph 44 applies shall be recognised as an expense immediately in accordance with paragraph 44.**

41. During the early stages of a contract, it is often the case that the outcome of the contract cannot be estimated reliably. Nevertheless, it may be probable that the entity will recover the contract costs incurred. Therefore, contract revenue is recognised only to the extent of costs incurred that are expected to be recoverable. As the outcome of the contract cannot be estimated reliably, no surplus or deficit is recognised. However, even though the outcome of the contract cannot be estimated reliably, it may be probable that total contract costs will exceed total contract revenues. In such cases, any expected excess of total contract costs over total

contract revenues for the contract is recognised as an expense immediately in accordance with paragraph 44.

42. Where contract costs that are to be reimbursed by parties to the contract are not probable of being recovered, they are recognised as an expense immediately. Examples of circumstances in which the recoverability of contract costs incurred may not be probable, and in which contract costs may need to be recognised as an expense immediately, include contracts:
- (a) That are not fully enforceable, that is, their validity is seriously in question;
  - (b) The completion of which is subject to the outcome of pending litigation or legislation;
  - (c) Relating to properties that are likely to be condemned or expropriated;
  - (d) Where the customer is unable to meet its obligations; or
  - (e) Where the contractor is unable to complete the contract or otherwise meet its obligations under the contract.
43. **When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue and expenses associated with the construction contract shall be recognised in accordance with paragraph 30 rather than in accordance with paragraph 40.**

### Recognition of Expected Deficits

44. **In respect of construction contracts in which it is intended at inception of the contract that contract costs are to be fully recovered from the parties to the construction contract, when it is probable that total contract costs will exceed total contract revenue, the expected deficit shall be recognised as an expense immediately.**
45. Entities may enter into construction contracts that specify that the revenue intended to cover the construction costs will be provided by the other parties to the contract. This may occur where, for example:
- (a) Government departments and agencies that are largely dependent on appropriations or similar allocations of government revenue to fund their operations are also empowered to contract with other entities or private sector entities for the construction of assets on a commercial or full cost recovery basis; or
  - (b) Government departments and agencies transact with each other on an arm's length or commercial basis as may occur under a "purchaser-provider" or similar model of government.

In these cases, an expected deficit on a construction contract is recognised immediately in accordance with paragraph 44.

46. As noted in paragraph 9, in some cases an entity may enter into a construction contract for less than full cost recovery from the other parties to the contract. In these cases, funding in excess of that specified in the construction contract will be provided from an appropriation or other allocation of government funds to the contractor, or from grants from third party funding agencies or other governments. The requirements of paragraph 44 do not apply to these construction contracts.
47. In determining the amount of any deficit under paragraph 44, total contract revenue and total contract costs may include payments made directly to subcontractors by third party funding agencies in accordance with paragraphs 22 and 25.
48. The amount of such a deficit is determined irrespective of:
- (a) Whether or not work has commenced on the contract;
  - (b) The stage of completion of contract activity; or
  - (c) The amount of surpluses expected to arise on other commercial construction contracts that are not treated as a single construction contract in accordance with paragraph 14.

### Changes in Estimates

49. The percentage of completion method is applied on a cumulative basis in each reporting period to the current estimates of contract revenue and contract costs. Therefore, the effect of a change in the 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 PBE IPSAS 3 *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 surplus or deficit in the period in which the change is made and in subsequent periods.

## Disclosure

50. **An entity shall disclose:**
- (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.**
- \*51. **An entity shall disclose each of the following for contracts in progress at the reporting date:**
- (a) **The aggregate amount of costs incurred and recognised surpluses (less recognised deficits) to date;**
  - (b) **The amount of advances received; and**
  - (c) **The amount of retentions.**
- \*52. Retentions are amounts of progress billings that are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts, or until defects have been rectified. Progress billings are amounts of contract revenue billed for work performed on a contract, whether or not they have been paid by the customer. Advances are amounts of contract revenue received by the contractor before the related work is performed.
53. **An entity shall present:**
- (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.**
54. The gross amount due from customers for contract work is the net amount of:
- (a) Costs incurred plus recognised surpluses; less
  - (b) The sum of recognised deficits and progress billings for all contracts in progress for which costs incurred plus recognised surpluses to be recovered by way of contract revenue (less recognised deficits) exceed progress billings.
55. The gross amount due to customers for contract work is the net amount of:
- (a) Costs incurred plus recognised surpluses; less
  - (b) The sum of recognised deficits and progress billings for all contracts in progress for which progress billings exceed costs incurred plus recognised surpluses to be recovered by way of contract revenue (less recognised deficits).
- \*56. Guidance on the disclosure of contingent liabilities and contingent assets can be found in PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. Contingent liabilities and contingent assets may arise from such items as warranty costs, claims, penalties, or possible losses.

## Effective Date

57–58. [Not used]

- 58.1 **A public benefit entity shall apply this Standard for annual financial statements covering periods beginning on or after 1 April 2015. Earlier application is permitted for not-for-profit public benefit entities as long as the full suite of PBE Standards is applied at the same time.**
- 58.2 **2016 Omnibus Amendments to PBE Standards, issued in January 2017, added a footnote to paragraph 16. An entity shall apply that amendment for annual financial statements covering periods beginning on or after 1 January 2017.**

**Withdrawal and Replacement of PBE IPSAS 11 (May 2013)**

59. This Standard, when applied, supersedes PBE IPSAS 11 *Construction Contracts* issued in May 2013.

## Application Guidance

### *Agreements for the Construction of Real Estate*

*This Application Guidance is an integral part of PBE IPSAS 11.*

#### Issues

AG1. This Application Guidance addresses two issues:

- (a) Is the agreement within the scope of PBE IPSAS 11 or PBE IPSAS 9 *Revenue from Exchange Transactions*?
- (b) When should revenue from the construction of real estate be recognised?

#### Consensus

- AG2. The following discussion assumes that the entity has previously analysed the agreement for the construction of real estate and any related agreements and concluded that it will retain neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the constructed real estate to an extent that would preclude recognition of some or all of the consideration as revenue. If recognition of some of the consideration as revenue is precluded, the following discussion applies only to the part of the agreement for which revenue will be recognised.
- AG3. Within a single agreement, an entity may contract to deliver goods or services in addition to the construction of real estate (e.g., a sale of land or provision of property management services). In accordance with paragraph 18 of PBE IPSAS 9, such an agreement may need to be split into separately identifiable components including one for the construction of real estate. The fair value of the total consideration received or receivable for the agreement shall be allocated to each component. If separate components are identified, the entity applies paragraphs AG5–AG7 to the component for the construction of real estate in order to determine whether that component is within the scope of PBE IPSAS 11 or PBE IPSAS 9. The segmenting criteria of PBE IPSAS 11 then apply to any component of the agreement that is determined to be a construction contract.
- AG4. The following discussion refers to an agreement for the construction of real estate but it also applies to a component for the construction of real estate identified within an agreement that includes other components.

#### **Determining whether the agreement is within the scope of PBE IPSAS 11 or PBE IPSAS 9**

- AG5. Determining whether an agreement for the construction of real estate is within the scope of PBE IPSAS 11 or PBE IPSAS 9 depends on the terms of the agreement and all the surrounding facts and circumstances. Such a determination requires judgement with respect to each agreement.
- AG6. PBE IPSAS 11 applies when the agreement meets the definition of a construction contract set out in paragraph 4 of PBE IPSAS 11: ‘a contract, or a similar binding arrangement, specifically negotiated for the construction of an asset or a combination of assets ...’. An agreement for the construction of real estate meets the definition of a construction contract when the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether or not it exercises that ability). When PBE IPSAS 11 applies, the construction contract also includes any contracts or components for the rendering of services that are directly related to the construction of the real estate in accordance with paragraph 6(a) of PBE IPSAS 11 and paragraph 7 of PBE IPSAS 9.
- AG7. In contrast, an agreement for the construction of real estate in which buyers have only limited ability to influence the design of the real estate, e.g., to select a design from a range of options specified by the entity, or to specify only minor variations to the basic design, is an agreement for the sale of goods within the scope of PBE IPSAS 9.

#### **Accounting for revenue from the construction of real estate**

*The agreement is a construction contract*

- AG8. When the agreement is within the scope of PBE IPSAS 11 and its outcome can be estimated reliably, the entity shall recognise revenue by reference to the stage of completion of the contract activity in accordance with PBE IPSAS 11.

AG9. The agreement may not meet the definition of a construction contract and therefore be within the scope of PBE IPSAS 9. In this case, the entity shall determine whether the agreement is for the rendering of services or for the sale of goods.

*The agreement is an agreement for the rendering of services*

AG10. If the entity is not required to acquire and supply construction materials, the agreement may be only an agreement for the rendering of services in accordance with PBE IPSAS 9. In this case, if the criteria in paragraph 19 of PBE IPSAS 9 are met, PBE IPSAS 9 requires revenue to be recognised by reference to the stage of completion of the transaction using the percentage of completion method. The requirements of PBE IPSAS 11 are generally applicable to the recognition of revenue and the associated expenses for such a transaction (PBE IPSAS 9 paragraph 20).

*The agreement is an agreement for the sale of goods*

AG11. If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the real estate to the buyer, the agreement is an agreement for the sale of goods and the criteria for recognition of revenue set out in paragraph 28 of PBE IPSAS 9 apply.

AG12. The entity may transfer to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. In this case, if all the criteria in paragraph 28 of PBE IPSAS 9 are met continuously as construction progresses, the entity shall recognise revenue by reference to the stage of completion using the percentage of completion method. The requirements of PBE IPSAS 11 are generally applicable to the recognition of revenue and the associated expenses for such a transaction.

AG13. The entity may transfer to the buyer control and the significant risks and rewards of ownership of the real estate in its entirety at a single time (e.g., at completion, upon or after delivery). In this case, the entity shall recognise revenue only when all the criteria in paragraph 28 of PBE IPSAS 9 are satisfied.

AG14. When the entity is required to perform further work on real estate already delivered to the buyer, it shall recognise a liability and an expense. The liability shall be measured in accordance with PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. When the entity is required to deliver further goods or services that are separately identifiable from the real estate already delivered to the buyer, it would have identified the remaining goods or services as a separate component of the sale, in accordance with paragraph AG3.

### **Disclosures**

\*AG15. When an entity recognises revenue using the percentage of completion method for agreements that meet all the criteria in paragraph 28 of PBE IPSAS 9 continuously as construction progresses (see paragraph AG12), it shall disclose:

- (a) How it determines which agreements meet all the criteria in paragraph 28 of PBE IPSAS 9 continuously as construction progresses;
- (b) The amount of revenue arising from such agreements in the period; and
- (c) The methods used to determine the stage of completion of agreements in progress.

\*AG16. For the agreements described in paragraph AG15 that are in progress at the reporting date, the entity shall also disclose:

- (a) The aggregate amount of costs incurred and recognised surpluses (less recognised deficits) to date; and
- (b) The amount of advances received.

## **Basis for Conclusions**

*This Basis for Conclusions accompanies, but is not part of, PBE IPSAS 11.*

BC1. The New Zealand Accounting Standards Board (NZASB) has modified IPSAS 11 *Construction Contracts* for application by Tier 1 and Tier 2 public benefit entities. Where applicable, disclosure concessions have been identified for Tier 2 entities and the language generalised for use by public benefit entities. The NZASB considered that the requirements of IPSAS 11 are generally appropriate for application by public benefit entities.

## **Interpretations**

BC2. The guidance from NZ IFRIC 15 *Agreements for the Construction of Real Estate* is incorporated into PBE IPSAS 11 as Application Guidance. The NZASB considered that the guidance is useful for determining whether an agreement for the construction of real estate should be treated as a construction contract in accordance with PBE IPSAS 11 or as revenue in accordance with PBE IPSAS 9 *Revenue from Exchange Transactions*.



## Implementation Guidance

*This guidance accompanies, but is not part of, PBE IPSAS 11.*

### Disclosure of Accounting Policies

IG1. The following are examples of accounting policy disclosures for a department that enters non-commercial construction contracts with other government agencies for full, partial, or no cost recovery from the other parties to the contract. The department is also empowered to enter into commercial construction contracts with other entities, and to enter full cost recovery construction contracts with certain hospitals and universities.

#### *Non-commercial Contracts*

IG2. Contract costs are recognised as an expense on the percentage of completion method, measured by reference to the percentage of labour hours incurred to date to estimated total labour hours for each contract. In some cases, certain construction activity and technical supervision have been subcontracted to private sector contractors for a fixed “completion of contract” fee. Where this has occurred, the subcontracted costs are recognised as an expense on the percentage of completion method for each subcontract.

IG3. Contract revenue from full cost recovery contracts and partial cost recovery contracts entered into by the Department is recognised by reference to the recoverable costs incurred during the period, measured by the proportion that recoverable costs incurred to date bear to the estimated total recoverable costs of the contract.

#### *Commercial Contracts*

IG4. Revenue from fixed price construction contracts is recognised on the percentage of completion method, measured by reference to the percentage of labour hours incurred to date to estimated total labour hours for each contract.

IG5. Revenue from cost plus or cost-based contracts is recognised by reference to the recoverable costs incurred during the period plus the fee earned, measured by the proportion that costs incurred to date bear to the estimated total costs of the contract.

### The Determination of Contract Revenue and Expenses

IG6. The following examples deal with a non-commercial and a commercial construction contract. The examples illustrate one method of determining the stage of completion of a contract and the timing of the recognition of contract revenue and expenses (see paragraphs 30–43 of this Standard).

#### *Non-commercial Contracts*

IG7. The Department of Works and Services (the construction contractor) has a contract to build a bridge for the Department of Roads and Highways. The Department of Works and Services is funded by appropriation. The construction contract identifies construction requirements, including anticipated costs, technical specifications, and timing of completion, but does not provide for any recovery of construction costs directly from the Department of Roads and Highways. The construction contract is a key management planning and accountability document attesting to the design and construction qualities of the bridge. It is used as input in assessing the performance of the contracting parties in delivering services of agreed technical specification within projected cost parameters. It is also used as input to future cost projections.

IG8. The initial estimate of contract costs is 8,000. It will take three years to build the bridge. An aid agency has agreed to provide funding of 4,000, being half of the construction costs – this is specified in the construction contract.

IG9. By the end of Year 1, the estimate of contract costs has increased to 8,050. The aid agency agrees to fund half of this increase in estimated costs.

IG10. In Year 2, the Government on the advice of the Department of Roads and Highways approves a variation resulting in estimated additional contract costs of 150. The aid agency agrees to fund 50% of this

variation. At the end of Year 2, costs incurred include 100 for standard materials stored at the site to be used in Year 3 to complete the project.

IG11. The Department of Works and Services determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed to date bear to the latest estimated total contract costs.

IG12. A summary of the financial data during the construction period is as follows:

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>
Initial amount of revenue agreed in contract	4,000	4,000	4,000
Variation	–	100	100
<b>Total Contract Revenue</b>	<b>4,000</b>	<b>4,100</b>	<b>4,100</b>
Contract costs incurred to date	2,093	6,168	8,200
Contract costs to complete	5,957	2,032	–
<b>Total estimated contract costs</b>	<b>8,050</b>	<b>8,200</b>	<b>8,200</b>
Stage of completion	26%	74%	100%

IG13. The stage of completion for Year 2 (74%) is determined by excluding from contract costs incurred for work performed to date the 100 for standard materials stored at the site for use in Year 3.

IG14. The amounts of contract revenue and expenses recognised in surplus or deficit in the three years are as follows:

	<b>To Date</b>	<b>Recognised in prior years</b>	<b>Recognised in current year</b>
<b>Year 1</b>			
Revenue (4,000 × .26)	1,040		1,040
Expenses (8,050 × .26)	2,093		2,093
<b>Year 2</b>			
Revenue (4,100 × .74)	3,034	1,040	1,994
Expenses (8,200 × .74)	6,068	2,093	3,975
<b>Year 3</b>			
Revenue (4,100 × 1.00)	4,100	3,034	1,066
Expenses (8,200 × 1.00)	8,200	6,068	2,132

*Commercial Contracts*

IG15. The Department of Works and Services (the contractor), while predominantly funded by appropriation, is empowered to undertake limited construction work on a commercial basis for private sector entities. With the authority of the Minister, the Department has entered a fixed price commercial contract for 9,000 to build a bridge.

IG16. The initial amount of revenue agreed in the contract is 9,000. The contractor’s initial estimate of contract costs is 8,000. It will take three years to build the bridge.

IG17. By the end of Year 1, the Department’s estimate of contract costs has increased to 8,050.

IG18. In Year 2, the customer approves a variation resulting in an increase in contract revenue of 200 and estimated additional contract costs of 150. At the end of Year 2, costs incurred include 100 for standard materials stored at the site to be used in Year 3 to complete the project.

IG19. The Department determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed to date bear to the latest estimated total contract costs. A summary of the financial data during the construction period is as follows:

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>
Initial amount of revenue agreed in contract	9,000	9,000	9,000
Variation	–	200	200
Total Contract Revenue	9,000	9,200	9,200
Contract costs incurred to date	2,093	6,168	8,200
Contract costs to complete	5,957	2,032	–
Total estimated contract costs	8,050	8,200	8,200
Estimated surplus	950	1,000	1,000
Stage of completion	26%	74%	100%

IG20. The stage of completion for Year 2 (74%) is determined by excluding from contract costs incurred for work performed to date the 100 for standard materials stored at the site for use in Year 3.

IG21. The amounts of revenue, expenses and surplus recognised in the three years are as follows:

	<b>To Date</b>	<b>Recognised in prior years</b>	<b>Recognised in current year</b>
<b>Year 1</b>			
Revenue (9,000 × .26)	2,340		2,340
Expenses (8,050 × .26)	2,093		2,093
Surplus	247		247
<b>Year 2</b>			
Revenue (9,200 × .74)	6,808	2,340	4,468
Expenses (8,200 × .74)	6,068	2,093	3,975
Surplus	740	247	493
<b>Year 3</b>			
Revenue (9,200 × 1.00)	9,200	6,808	2,392
Expenses (8,200 × 1.00)	8,200	6,068	2,132
Surplus	1,000	740	260

### Contract Disclosures

#### *Appropriation/Aid Funded Contracts and Full Cost Recovery Contracts*

IG22. The Department of Works and Services was recently created as the entity to manage the construction of major buildings and roadworks for other government entities. It is funded predominantly by appropriation, but with the approval of the Minister is empowered to undertake construction projects financed by national or international aid agencies. It has its own construction capabilities and can also subcontract. With the approval of the Minister, the Department may also undertake construction work on a commercial basis for other entities and on a full cost recovery basis for hospitals and universities.

IG23. The Department of Works and Services has reached the end of its first year of operations. All its contract costs incurred have been paid for in cash, and all its progress billings (to aid agencies that have commissioned construction work) have been received in cash. No advances to the Department for construction work were made during the period. Contract costs incurred for contracts B and C include the cost of materials that have been purchased for the contract but which have not been used in contract performance to date. No commercial contracts have been undertaken this year. (See below for examples of commercial contracts.)

- Contract A is funded out of general appropriation revenue. (The contract includes no “contract revenue” as defined.)

CONSTRUCTION CONTRACTS

- Contract B is with the Department of Education and the XX Aid Agency, which is funding 50% of the construction costs. (50% of the contract cost is to be reimbursed by parties to the contract and therefore is “contract revenue” as defined.)
- Contract C is totally funded by the National University. (The terms of the arrangement specify that all of the contract costs are to be reimbursed by the National University from the University’s major construction fund. Therefore, “contract revenue” as defined equals contract costs.)

IG24. The status of the three contracts in progress at the end of Year 1 is as follows:

	<b>Contract</b>			<b>Total</b>
	<b>A</b>	<b>B</b>	<b>C</b>	
Contract Revenue recognised in accordance with paragraph 30	–	225	350	575
Contract Expenses recognised in accordance with paragraph 30	110	450	350	910
Contract Costs funded by Appropriation	110	225	–	335
Contract Costs incurred in the period	110	510	450	1,070
– recognised as expenses (para 30)	110	450	350	910
– recognised as an asset (para 35)	–	60	100	160
Contract Revenue (see above)	–	225	350	575
Progress Billings (para 52)	–	225	330	555
Unbilled Contract Revenue	–	–	20	20
Advances (para 52)	–	–	–	–

The amounts to be disclosed in accordance with the standard are as follows:

Contract revenue recognised as revenue in the period (para 50(a))	575
Contract costs incurred to date (para 51(a)) (there are no recognised surpluses/less recognised deficits)	1,070
Gross amount due from contract customers for contract work (determined in accordance with paragraph 54 and presented as an asset in accordance with paragraph 53(a))	150
The amounts to be disclosed in accordance with the standard are as follows:	
Contract revenue recognised as revenue in the period (para 50(a))	575
Contract costs incurred to date (para 51(a)) (there are no recognised surpluses/less recognised deficits)	1,070
Gross amount due from contract customers for contract work (determined in accordance with paragraph 54 and presented as an asset in accordance with paragraph 53(a))	150

Amounts to be disclosed in accordance with paragraphs 51(a) and 53(a) are as follows (*Note: contract revenue for B is 50% of contract costs*):

	<b>A</b>	<b>B</b>	<b>C</b>	<b>Total</b>
Contract costs incurred	110	510	450	1,070
Progress billings	0	225	330	555
Due from aid agencies and customers	–	30	120	150

IG25. The amount disclosed in accordance with paragraph 51(a) is the same as the amount for the current period because the disclosures relate to the first year of operation.

*Commercial Contracts*

IG26. The Division of National Construction Works has been established within the Department of Works and Services to undertake construction work on a commercial basis for other entities at the direction, and with the approval, of the Minister. The Division has reached the end of its first year of operations. All its contract costs incurred have been paid for in cash, and all its progress billings and advances have been received in cash. Contract costs incurred for contracts B, C, and E include the cost of materials that have been purchased for the contract, but which have not been used in contract performance to date. For contracts B, C, and E, the customers have made advances to the contractor for work not yet performed.

IG27. The status of its five contracts in progress at the end of Year 1 is as follows:

	<b>Contract</b>					<b>Total</b>
	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>	
Contract revenue recognised in accordance with paragraph 30	145	520	380	200	55	1,300
Contract expenses recognised in accordance with paragraph 30	110	450	350	250	55	1,215
Expected deficits recognised in accordance with paragraph 44	–	–	–	40	30	70
Recognised surpluses less recognised deficits	35	70	30	(90)	(30)	15
Contract costs incurred in the period	110	510	450	250	100	1,420
Contract costs incurred recognised as contract expenses in the period in accordance with paragraph 30	110	450	350	250	55	1,215
Contract costs that relate to future activity recognised as an asset in accordance with paragraph 35	–	60	100	–	45	205
Contract revenue (see above)	145	520	380	200	55	1,300
Progress billings (para 52)	100	520	380	180	55	1,235
Unbilled contract revenue	45	–	–	20	–	65
Advances (para 52)	–	80	20	–	25	125

CONSTRUCTION CONTRACTS

The amounts to be disclosed in accordance with the Standard are as follows:

Contract revenue recognised as revenue in the period (para 50(a))	1,300
Contract costs incurred and recognised surpluses (less recognised deficits) to date (para 51(a))	1,435
Advances received (para 51(b))	125
Gross amount due from customers for contract work – presented as an asset in accordance with paragraph 53(a)	220
Gross amount due to customers for contract work – presented as an asset in accordance with paragraph 53(b)	(20)

The amounts to be disclosed in accordance with paragraphs 51(a), 53(a), and 53(b) are calculated as follows:

	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>	<b>Total</b>
Contract costs incurred	110	510	450	250	100	1,420
Recognised surpluses less recognised deficits	35	70	30	(90)	(30)	15
	145	580	480	160	70	1,435
Progress billings	100	520	380	180	55	1,235
Due from customers	45	60	100	–	15	220
Due to customers	–	–	–	(20)	–	(20)

IG28. The amount disclosed in accordance with paragraph 51(a) is the same as the amount for the current period because the disclosures relate to the first year of operation.

## Comparison with IPSAS 11

PBE IPSAS 11 *Construction Contracts* is drawn from IPSAS 11 *Construction Contracts*.

The significant differences between the two standards are as follows:

- (a) The guidance from NZ IFRIC 15 *Agreements for the Construction of Real Estate* is incorporated into PBE IPSAS 11 as Application Guidance.
- (b) PBE Standards require the presentation of a statement of comprehensive revenue and expense. IPSASs require the presentation of a statement of financial performance.

## History of Amendments

PBE IPSAS 11 *Construction Contracts* was issued in September 2014.

This table lists the pronouncements establishing and substantially amending PBE IPSAS 11. The table is based on amendments issued as at 31 January 2017.

Pronouncements	Date issued	Early operative date	Effective date (annual financial statements ... on or after ...)
PBE IPSAS 11 <i>Construction Contracts</i>	Sept 2014	Early application is permitted for not-for-profit public benefit entities	1 April 2015
<i>2016 Omnibus Amendments to PBE Standards</i>	Jan 2017	–	1 Jan 2017

Table of Amended Paragraphs in PBE IPSAS 11		
Paragraph affected	How affected	By ... [date]
Paragraph 16	Amended	<i>2016 Omnibus Amendments to PBE Standards</i> [Jan 2017]
Paragraph 58.2	Added	<i>2016 Omnibus Amendments to PBE Standards</i> [Jan 2017]