The new revenue standard requires entities to review the terms and conditions of their existing contracts to identify all goods and services sold to customers. **Do you fully understand the financial and accounting implications of your contracts?** IFRS 15 contains new guidance in determining whether a cost should be capitalized or expensed when incurred. **Have you assessed the practical impacts on your planning?** Under the new standard, revenue recognition over time (percentage of completion) is not an automatic right but subject to certain critical conditions. One or more of the new requirements will affect revenue recognition for UAE companies. **Are you ready for the new standard?**

In May 2014, the International Accounting Standards Board (“IASB”) has published a new standard, IFRS 15 Revenue from contracts with customers (IFRS 15), which replaces all existing revenue guidance including IAS 18 Revenue (IAS 18) and IAS 11 Construction contracts (IAS 11). Under IFRS 15, the performance obligation for each contract must be identified, impacting the percentage of completion on certain projects.

**IFRS 15 core principle**

The core principle of the new revenue standard is that revenue reflects the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

A five-step model is provided by IFRS 15:
- Identify the contract(s) with a customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to performance obligations in the contract
- Recognize revenue when (or as) a performance obligation is satisfied

**Do you have more than one performance obligation?**

IFRS 15 requires an entity to identify a promise in the contract to transfer a distinct good or service to a customer - also known as a performance obligation. A good or service is distinct from other goods and services if:
- the goods or services provide stand-alone benefits to the customer; and
- the goods or services are distinct within the context of the contract.

Under IAS 11, a traditional construction contract relating to an asset or a combination of assets that are closely inter-related or interdependent is typically the unit of account for contract.

If the different elements of construction contract are highly inter-related and integrated, it may be possible to account for the contract as a single performance obligation. If this cannot be demonstrated, the entity may be required to recognize revenue across multiple performance obligations.
What costs can be capitalized during the bid process?

Under IAS 11, pre-contract costs are capitalized when it is probable that the contract will be obtained.

Under IFRS 15, an entity only recognizes an asset for the incremental costs of obtaining a contract with a customer only if it expects to recover those costs. A practical expedient allows an entity to expense such costs as incurred if the amortization period of the asset is less than a year. The incremental costs of obtaining a contract are mainly the sales commissions incurred as a result of winning a contract, and are capitalized.

How should a contractor measure contract progress?

If performance obligations are satisfied over time, an entity uses a measure of progress that depicts the transfer of goods or services to the customer in order to determine the amount of revenue to be recognized during the period.

Under IAS 11, contract revenue and profit are recognized with reference to the stage of completion.

Whilst there appears to be no difference in the methods for determining the percentage of completion to date, the contractor needs to determine whether an input or output method appropriately depicts its performance under the contract.

IFRS 15 limits the use of input method when there is no direct relationship between an entity’s inputs and transfer of control. As such, an entity that uses an input method should consider the need to adjust the measure of progress that were not reflected in the price of the contract.

How should variations and claims be accounted for?

Under IAS 11, a variation has to be probable for the amount to be included as contract revenue. A claim must be at an advanced stage of negotiation to be included as contract revenue.

Under IFRS 15, contract modifications must only be approved to be recognized.

Therefore, it is possible under IFRS 15 to recognize variations at a later stage.

How should loss-making contracts be accounted for?

Under IAS 11, expected contract losses are immediately recognized as an expense.

IFRS 15 does not provide specific guidance on loss-making contracts. Under IAS 37 Provisions, Contingent Liabilities and Contingent Assets, a provision should be recognised for loss-making contracts. Loss-making contracts are considered as onerous contracts and measured at the best estimate of the unavoidable costs.

Therefore, under IFRS 15 the profit or loss could potentially be lower than the IAS 11.