Chapter 17

ASBE 15 CONSTRUCTION CONTRACTS

Introduction ¶17-100
Definitions and types of construction contracts ¶17-210
Definitions ¶17-210
Segmenting and combining construction contracts ¶17-220
Contract revenue and contract costs ¶17-300
Contract revenue ¶17-310
Contract costs ¶17-320
Recognition of contract revenue and contract expenses ¶17-400
Outcome of a contract can be estimated reliably ¶17-410
Outcome of a contract cannot be estimated reliably ¶17-420
Disclosure ¶17-500
Appendix ¶17-600

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¶17-100 Introduction

ASBE 15 *Construction Contracts* deals with the recognition and measurement of long-term construction contracts, ie those for which the date at which the contract activity is entered into and the date at which the contract activity is completed fall into different accounting periods.

Given that the construction contract takes a number of years to complete, the question arises as to when the revenue and costs arising therefrom should be recognised.

Specifically, the question is whether the revenue and costs are to be recognised only at the point of completion (completed contract method) or over each and every accounting period during which the construction activity is performed (percentage of completion method).

ASBE 15, which supersedes the Standard, *Construction Contracts (2002)*, specifically requires the use of the percentage of completion method and provides guidance on how the percentage of completion may be determined. ASBE 15 becomes operative for listed enterprises in China from 1 January 2007. Other enterprises are encouraged to apply its provisions.

DEFINITIONS AND TYPES OF CONSTRUCTION CONTRACTS

¶17-210 Definitions

Construction contract is defined in ASBE 15 as 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 (para 2).

The negotiation of the contract price of construction contracts would result in the classification of contracts into one of the two broad categories below:

(a) a fixed price contract; and

(b) a cost plus contract.

A *fixed price* contract is a construction contract in which the construction price is determined based on a fixed contract price, or a fixed unit price of output. The price is not subject to adjustment arising from costs incurred by the contractor (para 3).

A *cost plus* contract is a construction contract in which the construction price is determined based on contract allowable or otherwise defined costs, plus a percentage of these costs or a fixed fee (para 3).

¶17-220 Segmenting and combining construction contracts

Paragraph 4 of ASBE 15 provides that the requirements of ASBE 15 are usually applied to each construction contract, such as a building, bridge, dam, road, ship, tunnel, aircraft, etc.

In certain circumstances, however, a construction contract may deal with the construction of a number of assets in a single contract or a group of contracts. To reflect the substance of a contract or a group of contracts, it is necessary to segment the separately identifiable components of a single contract, or to combine a group of contracts (para 4).

Segmenting a contract is a process of dividing a single contract, which covers more than one asset, into two or more profit centres for accounting purposes. Paragraph 5 of ASBE 15 provides that where a contract covers the construction of a number of assets, the construction of each asset should be treated as a single (or separate) construction contract when:

(a) each asset has its own independent (or separate) construction plan;

(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 revenue and costs of each asset can be identified separately.

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An example would be the construction of a building, covering the canteen, recreation facilities, etc. Each of these assets is treated as a single (individual or separate) construction contract if all the aforesaid conditions in paragraph 5 of ASBE 15 are satisfied.

For accounting purposes, a group of contracts may be combined if they are so closely interrelated that they are, in substance, parts of a single contract with an overall profit margin. Therefore, paragraph 7 of ASBE 15 provides that a group of contracts (whether with a single customer or with several customers) should be combined and treated as a single construction contract when:

(a) the group of contracts is signed as a single package;

(b) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and

(c) the contracts are performed concurrently or in a continuous sequence.

An example of a group of contracts would be the construction of a railway system jointly by two local government authorities linking two provinces in China. One single tender is submitted for the project but two separate contracts were entered into as it involves two different parties. In this case, it is likely that the project is negotiated and finally signed as a single package because one contract cannot be independently awarded without the other. The contract will ascertain the overall profit margin in the tender submission. The railway construction work will be performed concurrently or in a continuous sequence. Therefore, the "two" separate contracts for this "single" project should be treated as a single construction contract.

A contract may also provide for the construction of additional assets at the option of the customer or may be amended to include the construction of an additional asset. ASBE 15 requires the construction of the additional asset to be treated as a separate construction contract when (para 6):

(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 AND CONTRACT COSTS

¶17-300 Contract revenue and contract costs

In accounting for construction contracts under ASBE 15, it is useful to first examine:

(a) what constitutes the contract revenue; and

(b) what cost elements should be included in the contract costs.

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Transfer for the year	103,000	–
At the end of the year	108,000	–
Accumulated depletion and impairment		
At the beginning of the year	–	–
Depletion for the year	(1,377)	–
Transfer for the year	(20,000)	–
At the end of the year	(21,377)	–
Net book value		
At the end of year	86,623	–

The enterprise assesses, at the end of each accounting date, whether there is any indication that interests in proved mineral properties may be impaired. If any such indication exists, impairment loss is recognised for the amount by which the carrying amount of a cash generating unit exceeds the higher of its fair value less costs of disposal and its value in use, which is the present value of expected future cash flows derived from the continued use of its assets.

3b. Interests in unproved mineral properties

	2013 RMB'000	2012 RMB'000
Cost		
At the beginning of the year	100,000	–
Additions for the year	3,000	100,000
Transfer for the year	(103,000)	–
At the end of the year	–	100,000
Accumulated depletion and impairment		
At the beginning of the year	(20,000)	–
Impairment for the year	–	(20,000)
Transfer for the year	20,000	–
At the end of the year	–	(20,000)
Net book value		
At the end of the year	–	80,000

The enterprise conducts impairment test for interests in unproved mineral properties once a year. Impairment loss is recognised for the amount by which the carrying amount of a cash generating unit exceeds the higher of its fair value less costs of disposal and its value in use, which is the present value of expected future cash flows derived from the continued use of its assets.

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Chapter 30

ASBE 28 CHANGES IN ACCOUNTING POLICIES AND ESTIMATES, AND CORRECTIONS OF ERRORS

Introduction .... ¶30-100
Accounting policies .... ¶30-200
Selection of accounting policies .... ¶30-210
Consistency of accounting policies .... ¶30-220
Changes in accounting policies .... ¶30-300
Applying changes in accounting policies .... ¶30-310
Accounting estimates .... ¶30-400
Changes in accounting estimates .... ¶30-410
Corrections of accounting errors .... ¶30-500
Impracticability exemption .... ¶30-600
Disclosure .... ¶30-700

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¶30-100 Introduction

ASBE 28 *Changes in Accounting Policies and Estimates, and Corrections of Errors* supersedes the Standard, *Changes in Accounting Policies and Accounting Estimates and Corrections of Errors (2001)*. It prescribes the recognition and measurement of the application of accounting policies, changes in accounting policies and accounting estimates, corrections of prior period errors, and the disclosure of related information according to the requirements of the *Basic Standard*. It becomes operative for listed enterprises in China from 1 January 2007. Other enterprises are encouraged to apply its provisions.

The objective of ASBE 28 is to enhance the usefulness of accounting information by prescribing the criteria for selecting and changing accounting policies, ensuring the comparability and consistency of information presented on the occurrence of changes in accounting policies and estimates, and corrections of accounting errors in order to enable users of financial reports to understand properly the accounting information concerning the financial position, financial performance and cash flows of an enterprise.

ASBE 28, however, does not apply to the income tax effects of corrections of prior period errors and of retrospective adjustments made to changes in accounting policies (see ASBE 18 *Income Taxes* for details).

ACCOUNTING POLICIES

¶30-200 Accounting policies

Accounting policies are the specific principles, bases and accounting methods applied by an enterprise for recognition, measurement and presentation of items in financial statements (para 3). The *Application Guidance* specifically provides that accounting policies include the accounting measurement basis or bases used in the financial statements (eg historical cost, net realisable value, fair value or recoverable amount).

An enterprise should disclose significant accounting policies in the notes that are necessary for a proper understanding of the financial statements by the users. Each enterprise should consider the nature of its operations and the accounting policies that the users of its financial statements would expect to be disclosed for that type of enterprise. For example, an enterprise would be expected to disclose its accounting policies for revenue recognition in respect of its sale of goods, rendering of services and the use of enterprise assets by others. Additionally, the disclosure should include the applied methods to determine the stage of completion of transactions involving the rendering of services.

The disclosure of significant accounting policies principally include the following:

(a) consolidation policy, ie principles applied for the preparation of consolidated financial statements;

(b) method of determining the cost of inventories transferred out;

(c) recognition and measurement of biological assets;

(d) recognition and measurement of fixed assets;

(e) recognition and measurement of intangible assets;

(f) measurement of exchange of non-monetary assets;

(g) recognition and measurement of investment properties;

(h) recognition and measurement of long-term equity investments;

(i) revenue recognition;

(j) recognition of contract revenue and expenses; and

(k) accounting for borrowing costs.

Disclosure of significant accounting policies is also required for business combinations, estimated liabilities and contingent liabilities, events after the balance sheet date, government grants, foreign currency translation, finance leases and operating leases, income taxes, financial instruments, share-based payment, etc.

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¶30-210 Selection of accounting policies

The *Application Guidance* requires that in determining an appropriate accounting policy for a transaction or other event, an enterprise should take into account the requirements of ASBE 28 as well as the practical circumstances of its business. The selected accounting policies must be approved by the shareholders, board of directors, general manager or similar bodies and filed in accordance with the requirements of laws, administrative rules, etc.

When an Accounting Standard specifically applies to a transaction, other event or condition, the accounting policy applied to that item should be determined by applying the Standard and its appropriateness considered to suit the enterprise's own practical circumstances. For example, an enterprise has leased an asset under operating lease for its use. In this case, the enterprise would refer to ASBE 21 *Leases* for determining the proper accounting treatment.

In the absence of a specific Accounting Standard or an Interpretation that specifically applies to a transaction, other event or condition, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides that management should use its judgment in developing and applying an accounting policy that results in information that is:

(a) relevant to the economic decision-making needs of users; and

(b) reliable in that the financial statements:

  (i) represent faithfully the financial position, financial performance and cash flows of the enterprise;

  (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

  (iii) are neutral, ie free from bias;

  (iv) are prudent; and

  (v) are complete in all material respects.

In making the judgment, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* further provides that management should refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements and guidance in the Accounting Standards and Interpretations dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the IASB *Conceptual Framework for Financial Reporting*.

In addition, management may consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to

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