

*ASBJ Statement No. 15*

## **Accounting Standard for Construction Contracts and**

*ASBJ Guidance No. 18*

## **Guidance on Accounting Standard for Construction Contracts**

**December 27, 2007**

**Accounting Standards Board of Japan**

### **Remarks on the Release**

Accounting Standards in Japan has so far allowed the choice between the percentage-of-completion method and the completed-contract method for recognizing revenues and costs of long-term construction contracts. However, there has been an argument that the comparability of financial statements between different companies may be undermined by the adoption of different revenue recognition methods at the option of each company for similar construction contracts. The Accounting Standards Board of Japan (hereinafter “ASBJ”) has therefore identified the revenue recognition criteria for construction contracts as one of the medium-and-long term issues.

ASBJ set up a working group in July 2006 and rolled out the preliminary work to address this issue. In November 2006, the Board established The Technical Committee for Construction Contracts and has discussed broad range of practical problems as well as problems from theoretical perspectives. On December 20, 2007 at its 143rd meeting, the Board approved ASBJ Statement No. 15 (hereinafter “the Accounting Standard”) and ASBJ Guidance No. 18 (hereinafter “the Guidance”; the Accounting Standard and the Guidance are collectively referred to as “the Accounting Standard, etc.”) and publishes them today.

The ASBJ published the exposure draft for the Accounting Standard, etc. on August 30, 2007, solicited public comment and reviewed the comments received, amending part of the proposed standard to reflect the comments received for finalizing the Accounting Standard prior to its public release.

## **Outline of the Accounting Standard**

### **■ Objective**

The objective of this Accounting Standard is to prescribe the contractor's accounting treatment and disclosure of revenue and costs associated with construction contracts.

### **■ Scope**

The Accounting Standard shall be applied to:

(1) Construction Contracts

Contractor contract to which consideration is paid for the outcome of the work and of which basic specifications and details of works are determined by the instruction of customers (e.g., civil engineering, construction, shipbuilding and manufacturing of certain machineries, etc.).

(2) Made-to-order software

### **■ Unit of accounting recognition for construction contracts**

The unit of recognition shall be based on the unit of transaction in light of substance of the mutual agreement in the construction contract.

### **■ Recognition criteria for construction contract**

The percentage-of-completion method shall be applied if the outcome of the construction activity is deemed certain during the course of the activity, otherwise the completed-contract method shall be applied. To be deemed certain for the outcome of construction activity, all of (1) total contract revenue, (2) total contract costs, and (3) the percentage of completion at the end of the reporting period must be reliably estimated.

### **■ Accounting treatment for percentage-of-completion method**

When the percentage-of-completion method is applied, the total contract revenue and total contract costs and the percentage of completion of construction activity at the end of the reporting period shall be reasonably estimated and reported in the statements of income in the period accordingly.

### **1. Method for estimating the percentage of completion at the end of the reporting period**

The percentage of completion at the end of the reporting period shall be estimated based on a method that can rationally reflect the percentage of performance of the contractor's obligation at the end of the reporting period in comparison with the whole obligation of the contractor as promised in the contract (for example, the percentage of the cost incurred to the estimated total cost).

### **2. Changes in estimates**

In applying the percentage-of-completion method, when the estimates of total contract revenue, total contract costs or the percentage of completion of construction activity at the end of the reporting period are changed, the effects of changes shall be recognised as gain or loss in the statements of income in the period when such changes are made.

### **3. Accounts receivable recognised under the percentage-of-completion method**

Accounts receivable recognised during the process of construction as a result of application of the percentage-of-completion method shall be treated as a monetary claim.

#### **■ Accounting treatment under the completed-contract method**

When the completed-contract method is applied, contract revenue and contract costs shall be reported in the statements of income at the time of delivery of the asset immediately after the final completion of the construction.

#### **■ Accounting for expected contract losses**

When it is probable that total contract costs will exceed total contract revenue and the expected loss can be reasonably estimated, the expected loss (contract loss), other than the accumulated amount of profit or loss recognised for that contract in prior period, shall be recognised as a loss in the period in which the expected loss becomes probable and a provision for contract loss shall be recognised.

#### **■ Disclosure**

##### **1. Presentation**

The amount of the provision for contract loss shall be included in the sales cost and the balance of the provision for contract loss shall be accounted for as current liability on the balance sheet. In the case that both the inventories and the provision for contract loss for

the same construction contract are reported, they can be offset for presentation on the balance sheet.

## **2. Notes**

An entity shall disclose:

- Recognition criteria for revenue and costs of construction contracts.
- The method applied to estimate the stage of completion of construction activity as of the closing date.
- The amount of the provision for contract losses in the current period.
- The amount of item (1) or item (2) below in the case that both the inventories and the provision for contract loss for the same construction contract are reported. If several construction contracts exist, the aggregate amount of all of such contracts shall be disclosed.

(1) If the inventories and the provision for contract loss are not offset but individually reported, such fact and the amount of the provision for contract loss in the inventories shall be disclosed.

(2) If the inventories and the provision for contract loss are offset, such fact and the amount of the inventories offset shall be disclosed.

### **■ Effective date, etc.**

- The Accounting Standard shall apply for fiscal years beginning on or after April 1, 2009. Provided, however, it may apply for fiscal years starting within the period beginning with the release after the release of the Accounting Standard, until it may apply for fiscal years beginning on or before March 31, 2009.
- The Accounting Standard shall apply to construction contracts commencing after the year initially applied to the Accounting Standard. However, it can be applied to all construction contracts existing at the beginning of the year in which the Accounting Standard is initially applied. When an entity elects this treatment and applies the percentage-of-completion method to the construction contracts which had been accounted for by the completed-contract method, gains or losses corresponding to the progress of the construction activity in prior periods shall be recognised as unusual gains or losses.
- For construction contracts commenced prior to the application of the Accounting Standard, if contract losses are expected after the application of the Accounting Standard, such losses shall be reported as provision for contract loss in accordance with the Accounting Standard.

- The application of the Accounting Standard is treated as changes in the accounting policy due to the changes in accounting standards.

End of Document