MAZARS' LONG-TERM CONTRACTS CLUB

Contract modifications

IAS 11 reminder

IAS 11 defines variations and claims and states that they should be included in revenue to the extent that it is probable that they will result in revenue and they are capable of being measured reliably.

Under IAS 11, the construction of an additional asset is treated as a separate contract when:

- the asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or
- the price of the asset is negotiated without regard to the original contract price.

IFRS 15 defines a contract modification as a change in the scope or price (or both) of a contract, which exists when the parties to a contract approve a modification that either creates new or changes existing enforceable rights and obligations.

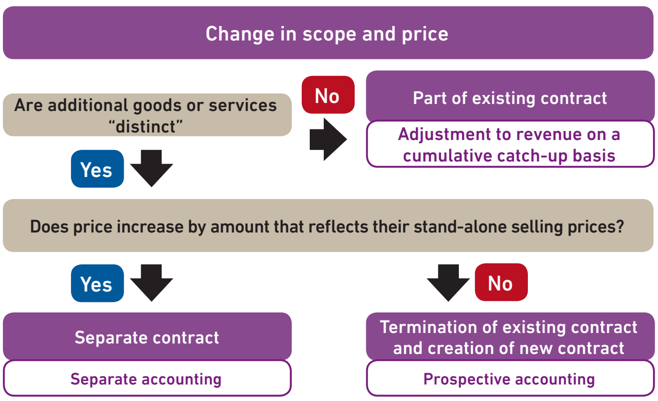
IFRS 15 states that a contract modification may exist even though the parties have:

- a dispute about the scope or price (or both) of the modification; or
- approved a change in the scope of the contract but have not yet determined the corresponding change in price, as the price can be determined by applying the requirements on variable consideration.

Change in scope and price

A company accounts for a contract modification of scope and price prospectively if the goods or services are distinct and retrospectively, by adjusting revenue on a cumulative catch-up basis, if the goods or services are not distinct. The prospective approach involves accounting for the modification as a separate contract, if the price of the contract increases by an amount of consideration that reflects stand-alone selling prices, and as a termination of the existing contract and the creation of a new contract, if the price of the contract does not increase by an amount of consideration that reflects stand-alone selling prices.

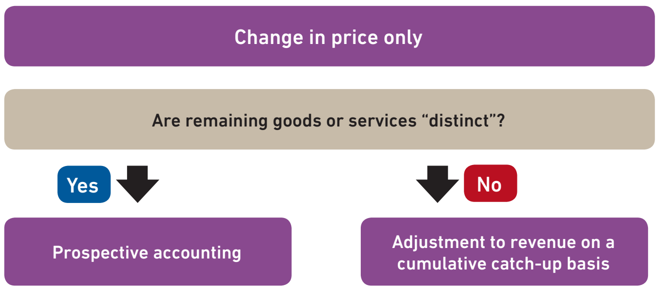
This is represented in the following decision tree:



Change in price only

A company accounts for a contract modification of price only prospectively, as a termination of the existing contract and the creation of a new contract, if the goods or services are distinct and retrospectively, by adjusting revenue on a cumulative catch-up basis, if the goods or services are not distinct.

This is represented in the following decision tree:



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Key implications:

The new legal definition of a contract modification, as well as the new guidance for accounting for contract modifications may lead to changes in accounting practices. In addition situations where there is a dispute or undetermined price may now be accounted for as contract modifications. We recommend that the enforceability of rights and obligations in significant contract modifications are analysed on a legal basis and that companies consider the need for changes to systems and processes based on the new criteria for accounting for contract modifications. The impact of any changes to reported figures should be assessed, as well as the need to communicate such changes to key stakeholders.

About Mazars' Long-term Contracts Club

Mazars' Long-term Contracts Club is a series of hands-on, technical workshops designed for organisations involved in long-term contracts. IFRS 15 comes into effect on 1 January 2018 and brings a number of changes for companies with long-term contracts. These workshops consider some of the most pressing issues related to the new standard and help organisations understand the requirements, anticipate the challenges and implement the standard effectively.

The series includes:

- Introduction to the main principles of IFRS 15
- Identification of performance obligations
- Revenue recognition on transfer of control
- Incremental costs of obtaining a contract
- Identification of contracts, including contract modifications
- Variable consideration
- Existence of a significant financing component
- Disclosures on remaining performance obligations
- Presentation of contract assets and liabilities
- Licensing
- Principal versus spent considerations

Mazars' Financial Reporting Advisory team

Mazars' technical experts have impressive experience in a wide variety of accounting, financial reporting and narrative reporting matters. We support numerous technical projects, including GAAP conversions, and have a proven track record in helping our clients to successfully apply new accounting and financial reporting standards, important in today's fast-changing technical environment.

How we can help you

We can help you prepare for IFRS 15 and, more immediately, IAS 8 which requires companies to disclose information relating to the impact of IFRS 15 on their financial statements.

Impact assessments

IAS 8 requires a company to disclose information relating to the impact of IFRS 15 on their financial statements. With regulators expecting more and more detailed qualitative and quantitative disclosures in respect of the application of IFRS 15, we can perform impact assessments to assist with identifying the key areas of differences.

Contract analysis

With the effective date of the new Standard fast approaching, we can use our contract analysis tool to help you understand IFRS 15's impact on existing contracts, as well as future contracts you are negotiating, giving you the opportunity to prepare for transition, as well as avoid or mitigate unwanted implications.

Please get in touch

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