CONSTRUCTION & A/E REVENUE RECOGNITION TERMINOLOGY

Current Terminology	New Standard Terminology
Profit Center	
Contract	**Performance Obligation**
Each contract was the default profit center. Segmenting was permitted, but margins on "phases" had to vary significantly and certain criteria had to be met. Though uncommon, combination of contracts so closely related they could not be accounted for separately was also permitted.	The focus shifts to identifying promises to deliver goods or services, or performance obligations, within the contracts. You must segregate performance obligations within a single contract if distinct, within the context of the contract—it is separable in pricing, delivery, and customer benefit from the rest of the project. Similarly, two or more contracts may need to be combined if they are negotiated as a package, resulting in one performance obligation, and the consideration to be paid under one contract is dependent on the outcome of the other. It is generally expected that most individual contracts will continue to serve as the profit center under the new standard.
Price	
Contract Value	**Transaction Price**
The original contract price plus any approved change orders and certain amounts for unapproved or unpriced change orders.	The total amount of consideration in a contract you expect to be entitled to as you deliver design or construction services. This total is allocated to any separately identified performance obligations within the contract based on relative standalone (actual or estimated) selling prices.
Project Costs	
Uninstalled Materials	**Uninstalled Materials**
The cost of uninstalled materials specifically produced, fabricated, or constructed for a project should be included in the costs used to measure extent of progress—ordinary percentage of completion accounting applies. If not specifically produced, fabricated, or constructed for a project (could be installed on another project), the cost of the materials should be capitalized and reported as inventory until installed.	Just as before, determine if costs of uninstalled materials should be accounted for as inventory and capitalized. If you determine the uninstalled items are not inventory, reflect them as project costs. If reflected as a project cost, determine if the costs incurred for uninstalled inventory are proportionate to progress under the performance obligation—include in POC calculation if so. More likely, they will not be proportionate until installed. In this case, remove the cost amount from both transaction price and estimated project costs before determining percentage of completion. Add back the uninstalled materials cost amount to revenues determined under POC to arrive at the total revenue to be recognized. No worries—we'll address this as an example in a future episode!
Customer-Furnished Materials	**Noncash Consideration**
The value of materials supplied by the customer is added to contract revenues and costs only if the contractor bears the risk of nature, type, characteristics, specification, or ultimate performance of such materials within the overall project.	The fair value of materials furnished by customers shall be considered noncash consideration, estimated and included in the transaction price and estimated costs. If the contractor controls customer-contributed equipment or services, the fair value of such noncash consideration should also be estimated and included in the transaction price.

Current Terminology	New Standard Terminology
Project Costs	
Wasted Materials and Rework	**Wasted Materials and Rework**
The cost of wasted materials and rework is currently included as a job cost. Total estimated job costs are re-estimated periodically to incorporate impacts of all over- and under-runs.	These costs are what they are. The difference under the new standard is that waste and rework should not be added to total estimated costs for inclusion in determining POC and recognizing revenue. The reason: These costs are not held as being indicative of making progress on a performance obligation. However, other types of cost over-runs are reflected within updates to total estimated job cost.
Changes to Contracts	
Change Order	**Contract Modification**
Generally, an approved, priced change order would be added into total estimated contract revenues and costs with cumulative adjustment of revenues and profit recognized based on the combined overall amended margin and percentage of contract completion.	You must consider if each modification to a contract is a distinct good or service, and priced as such, in which case it should be accounted for as a separate performance obligation. If not, there are two considerations: 1) If the remaining goods or services to be delivered under the modified contract are distinct from others already delivered under the contract, prospective adjustment based on remaining estimated costs and revenues is warranted; 2) If not, back to the old way of doing things!
Unpriced or Unsigned Changes to Contracts	
Unsigned or Unpriced Change Orders or Claims	**Contract Modifications with Variable Consideration**
If approval and collection from the customer was probable, you would recognize revenue up to amount of costs incurred.	This area is more complicated. If scope changes are approved, but the pricing is not yet determined, you should estimate the contract modification price, determine whether to update or segregate the modification from the transaction price, and recognize revenue to the extent you believe a significant reversal will not occur in the future. There are a couple methodology choices—use the "most likely amount," or calculate a probability-weighted "expected value." For unsigned change orders and claims, first consider if the rights and obligations created under the contract modification are enforceable. If so, the same procedure applies—recognize revenue to the extent you believe a significant reversal will not occur in the future. If not enforceable, just recognize the added costs until approval is obtained.

CONSTRUCTION & A/E REVENUE RECOGNITION TERMINOLOGY

Current Terminology	New Standard Terminology
Incentives and Penalties	
Bonus/Award or Liquidated Damages (LDs)	**More Variable Consideration**
Measurable bonuses or awards are currently not included in contract revenues until it is probable performance requirements will be met or exceeded—generally at or near the end of the contract. LDs and other penalties are assessed for probability of incurring penalties on an ongoing basis and recognized as a reduction in contract value when identified as probable.	No change in terminology, but a significant change in how to account for these provisions. For bonuses or awards, include the expected or most likely amount of estimated bonuses in the overall transaction price (total contract revenues) if it's probable a significant reversal in the total amount of revenue recognized will not occur. For penalties such as LDs, include amounts expected or most likely to be incurred as a reduction in the transaction price. These estimates would be updated, and catch-up adjustments made as necessary, each year.
Retention	
Disclosure Only Required	**Significant Financing Component**
The concept of an operating cycle equal to the length of a contract in SOP 81-1 shielded contractors and A/E firms from having to consider discounting retention stretch out more than one year. Disclosures of retention totals and the amount collectible more than one year from the reporting date covered you.	The time value of money must be considered when arriving at the transaction price. If retention is significant and will not be collected within one year of the transfer of goods and services, the new standard requires those amounts be discounted using a relevant rate. The discount amount would be recognized as interest income.