



Solution 52.4

Component	Construction contract work in progress
Index	Combining and segmenting construction contracts
Short title	Segmenting contracts

Attention: This guidance is based on the revised standards and interpretations that are mandatory for accounting periods commencing 1 January 2005. A company may early adopt an individual revised standard, but only in its entirety. Guidance based on the previous version of the standards is included in the “Applying IFRS 2004” guidance.

Issue

When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when **[IAS11.8(a)-(c)]**:

- a) separate proposals have been submitted for each asset;
- 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) each asset’s costs and revenues can be identified.

Should a contract for an asset’s construction and operation be accounted for as a single contract or separate contracts?

Background

Entity A develops and sells computer software. The sales take the form of a licence to use the software for a limited period of time, and include after-sales support during the period of the licence. The sales include a significant element of tailoring the basic software to meet the customer’s needs.

Entity A charges its customers a series of fees during the tailoring period. An additional fee is charged at the start of the period of the licence once the tailoring is complete and the customer has accepted the software package. No further amounts are payable during the licence period, either for the use of the software or for the maintenance support.

A’s management has questioned how the revenue from the contract should be recognised.

Solution

Management should account for the tailoring, the licensing and the maintenance support as separate elements.



The tailoring of the software should be accounted for as a construction contract in accordance with the principles of IAS 11, and the fee for the use of the software and the maintenance support should be recognised on a straight-line basis over the period of the licence in accordance with IAS 18.

The allocation of the total contract revenue between the tailoring service, the right to use the software and the maintenance support should be made on the basis of the fair value of the services. The allocation of the revenue based on fair value is likely to differ from an allocation based on the billing schedule.