Contract Abstract Analysis Tool

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CONTRACT ABSTRACT ANALYSIS

NOTE: Blue text means to refer to CICPAC Revenue Recognition Implementation Guide for more information.

Project Name:

Project Number:

Contract Terms:

Contract Effective Date:

Contract Completion Date:

Contract Type (Select One): Other

If other, please describe.

Original Contract Value:

Updated Transaction Price:

Payment Terms:

STEP 1: IDENTIFY THE CONTRACT WITH THE CUSTOMER

Accounting Guidance Excerpt

ASC Topic 606 includes certain criteria for an agreement to meet the definition of a contract. If all criteria are not met, the contract is not within the scope of ASC 606 and any consideration received would be recognized as a liability. Contracts can be written, oral, or implied.

Contracts entered into at or near the same time with the same customer are combined and treated as a single contract when certain criteria are met.

Consider termination provisions in contracts. If the termination penalty is substantive, the duration of the contract is the entire term stated in the contract. If the termination penalty is not substantive the contract term ends when control of the goods or services already provided transfers to the customer, regardless of the stated contractual term.

A. Does the agreement meet the definition of a contract as described under ASC 606 (RRG. pg. 5)?

1. Approval and commitment of parties (legally enforceable) ☐
2. Identification of the rights of the parties regarding goods or services ☐
3. Identification of the payment terms ☐
4. Commercial substance ☐
5. Collection of payment is probable ☐

If not, which criteria was not met and why.

Did the agreement include a termination provision where either party has a unilateral right to terminate the contract without compensation? If yes, judgment needs to be applied to determine the enforceable term.

☐ Yes ☐ No

If the contract does not meet all criteria under ASC 606, STOP, no further evaluation necessary. Revenue would not be recognized until the consideration has been received, it is nonrefundable, and no performance obligations remain.

B. Did the Company enter into other contracts at or near the same time with the same customer? If so, explain.

If the answer to one or more of the following is "yes", the contracts are Required to be combined:

1. Are the contracts negotiated in one package?
2. Does the payment of one contract depend on the other?
3. Are the goods/services promised considered one performance obligation?

When the contracts are combined for reporting purposes, revenue is recognized at the combined contract level and only one contract asset/liability will be reported on the combined contract level. (RRG. pg. 5).

C. Contract Modifications

Accounting Guidance Excerpt

A contract modification is a change in scope, price or both (RRG. pg. 7). Modification can be approved in writing, by oral agreement, or implied.

If no approval, apply ASC 606 to existing contract until approval is obtained. If approved in scope but not price, the company should estimate the change to the transaction price using the guidance on estimated variable consideration and related constraints.

Contract Modification is accounted for by one of the following three methods (RRG. pg. 7):

1. *A separate contract (performance obligation), if the modification provides distinct goods or services priced at a standalone selling price, adjusted for selling-related costs*
2. *A termination of the existing contract and creation of a new contract if goods or services delivered after the modification are distinct from the goods or services delivered before the modification*
3. *As part of the existing contract, on a cumulative catch-up basis, if remaining goods or services are not distinct and form part of a single performance obligation that is partially satisfied at date of modification*

Have there been any modifications to the contract that have been approved by parties to the contract?

Approved Contract Modifications	Date	Amount	Approved by Scope		Approved by Scope&Price	Method 1	Method 2	Method 3
	3/3/2017		☐	or	☐	☐	☐	☐
			☐	or	☐	☐	☐	☐
			☐	or	☐	☐	☐	☐
			☐	or	☐	☐	☐	☐
			☐	or	☐	☐	☐	☐

Document any comments related to Step 1:

STEP 2: IDENTIFY THE PERFORMANCE OBLIGATIONS IN THE CONTRACT

Accounting Guidance Excerpt

A performance obligation is the unit of account for revenue recognition. Promised goods or services represent separate performance obligations if 1) the goods or services are distinct or 2) the goods and services are part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer (RRG. pg. 19).

Goods and services are distinct if BOTH are met (RRG. pg. 12):

1. *Customer can benefit from goods and services on its own (separate utility)*
2. *Distinct in the context of the contract (separable risk)*
   (Not distinct in context of contract if:
      a. *significant service of integration to provide one combined output*
      b. *one good or service customizes another good or service*
      c. *goods or services are highly interdependent or interrelated)*

Examples of potential performance obligations within a contract: design, engineering, construction, warranty, maintenance

If not distinct, combine goods or services with others until combined bundle is a distinct performance obligation, or all goods or services in contract have been combined into a single performance obligation.

A. Provide a brief description of the stated and implied goods and/or services included in the contract.

B. List each potential performance obligation identified within the contract.

	BOTH Must be Met		
	Capable of Being Distinct	Distinct in Context of Contract	Not Significant
1. ______________________	☐	☐	☐
2. ______________________	☐	☐	☐
3. ______________________	☐	☐	☐

Conclusion:
Based on above, the following represent distinct performance obligations. A service warranty, as described below, would be a distinct performance obligation.

1. ______________________________
2. ______________________________
3. ______________________________

C. Evaluate whether a series of distinct goods or services exist.

Accounting Guidance Excerpt
A series of goods or services are a single performance obligation if goods or services are substantially the same and meet both of the following criteria (RRG. pg. 19):

1. *Each distinct good or service in the series is a performance obligation satisfied over time*
2. *The same method would be used to measure progress toward satisfaction of each good or service in the series*

Is there a series of distinct goods or services? ☐ Yes ☐ No

D. Warranties

Does the company provide a warranty **beyond** providing the customer with assurance the project will perform within agreed upon specifications or function in accordance with its intended purpose?

Describe the service warranty provided:

For service warranties provided for within the contract,

	Value
Is there an option to purchase the warranty separately and if so, how much?	
If no option to purchase, determine the value of the service warranty.	

A service warranty will be accounted for as a distinct performance obligation.

Document any comments related to Step 2:

STEP 3: DETERMINE THE TRANSACTION PRICE

Accounting Guidance Excerpt

The transaction price represents the amount of consideration the company expects to receive in exchange for transferring goods or services to a customer. Transaction price is estimated at contract inception to include any variable considerations, updated each reporting period for any changes in circumstances.

The following components should be considered in determining the transaction price:

- *Variable considerations (and constraint)*
- *Significant financing component*
- *Noncash consideration*
- *Consideration payable to a customer*

Variable consideration can be estimated by either of the following methods (consider historical, current and forecasted information) (RRG. pg. 21).

Expected value - sum of probability weighted amounts in a range of possible outcomes
Most likely amount - single most likely outcome (i.e. 2 possible outcomes)

Variable consideration should be constrained if it is probable that a significant reversal of revenue will occur (RRG. pg. 21). First, determine the value of the variable consideration. If the value has a 70-80% likelihood of revenue reversal, provide further constraint on the value.

Noncash consideration - Topic 606 requires the contractor to recognize noncash consideration for goods or services contributed by the customer for which the contractor takes control (e.g. customer furnished materials, services, equipment). Consider the principal versus agent considerations when evaluating whether the contractor has obtained control of the contributed goods or services.

Measure the noncash consideration at fair value; measure the consideration based on the stand-alone selling price of the goods or services. If the noncash consideration is variable, consider the guidance on constraining estimates of variable consideration.

A. Describe in detail the pricing arrangement in the contract.

B. Does the contract include any of the following types of variable consideration:

	Estimation Method					
	Expected Value or	Most Likely	Estimated Value	Constraint NEGATIVE #	VC to incl. in Trans. Price	Revisions/ Updates
Liq. Damages	☐	☐			$ 0	
Perf. bonus/penalty	☐	☐			$ 0	
Sch. bonus/penalty	☐	☐			$ 0	
Shared savings	☐	☐			$ 0	
Discounts	☐	☐			$ 0	
Refunds/rebates	☐	☐			$ 0	
Econ. Price adj.	☐	☐			$ 0	
Other	☐	☐			$ 0	
Totals			$ 0	$ 0	$ 0	

If any variable consideration was deemed immaterial to the contract, please describe:

C. Significant Financing Component (RRG. pg. 44).

Is there the existence of a significant financing component for the transfer of goods or services to the customer? ☐ Yes ☐ No

If yes, is the practical expedient being used, such that the company expects payment by the customer will be in one year or less? ☐ Yes ☐ No

D. Noncash Consideration

Were there any goods or services contributed by the customer for which the contractor takes control (i.e., materials paid by owner)?

☐ Yes ☐ No

If yes, what is the estimated fair value of the noncash consideration at contract inception, considering any necessary constraint?

E. Consideration Payable to the Customer

Is there any consideration payable to the customer in the form of cash or items (e.g. credit, coupon, or a voucher) that the customer can apply to amounts owed to the company?

☐ Yes ☐ No

If yes, what is the value that should be accounted for as a reduction in the transaction price, considering any necessary constraint?

Document any comments related to Step 3:

STEP 4: ALLOCATE THE TRANSACTION PRICE TO THE PERFORMANCE OBLIGATIONS

Accounting Guidance Excerpt

The transaction price is allocated to each performance obligation to represent the amount of consideration expected to be received in exchange for transferring the goods or service to the customer (RRG. pg. 13).

The allocation among performance obligations is in proportion to its stand-alone selling price. The stand-alone selling price is the price of the good or service if sold separately to a customer. (RRG. pg. 13).

If the stand-alone selling price is not directly observable, estimate the amount using one of these methods:

1. *Adjusted market assessment approach*
2. *Expected cost plus a margin approach (most widely used)*
3. *Residual approach*

A. For each performance obligation identified in step 2, determine the stand-alone selling price.

	Stand-alone selling price	%
P.O. 1		0%
P.O. 2		0%
P.O. 3		0%
Totals	$ 0	0%

Based on the stand-alone selling price percentages above, what is the allocation of the transaction price?

	Allocated Transaction Price
P.O. 1	
P.O. 2	
P.O. 3	
Totals	$ 0

Does the contract include variable consideration that is only attributable to one or more performance obligations, but not all? Describe below.

If the transaction price has been changed, has the change been allocated in the same manner as the original allocation?

☐ Yes ☐ No

Document any comments related to Step 4:

STEP 5: RECOGNIZE REVENUE WHEN OR AS THE COMPANY SATISFIES A PERFORMANCE OBLIGATION

Accounting Guidance Excerpt

Under ASC 606, the company recognizes revenue when or as it satisfies a performance obligation either at a 1) point in time or, 2) over time. A good or service is transferred when or as the customer obtains control. (RRG. pg. 9)

Over time recognition: (RRG. pg. 9)

1. *Goods or services are received and consumed by customer simultaneously*
2. *Customer controls the asset created during performance as the asset is created*
3. *Performance of the contract does not create an asset with alternative use and there is enforceable right to payment for performance created to date*

Only if none of the overtime criteria are met will the contractor recognize revenue at a point in time.

If recognized over time, an appropriate method must be selected (input or output) to measure progress. Once method is selected it must be used until the performance obligation is satisfied. Changing methods is not allowed.

A combination of over time and point in time can be used.

If progress can't be initially measured, recognize revenue at point in time (similar to completed contract method) until progress can be measured.

A. For each performance obligation identified in step 2, determine if revenue is recognized at a point in time or over time. (RRG. pg. 9-10)

	Point in Time	Over Time
P.O. 1	☐	☐
P.O. 2	☐	☐
P.O. 3	☐	☐

For each performance obligation identified where revenue is recognized **over time**, indicate the method of measuring progress. (RRG. pg. 9)

	Method	
P.O. 1	☐ Input	☐ Output
P.O. 2	☐ Input	☐ Output
P.O. 3	☐ Input	☐ Output

If applying the cost-to-cost method, are there any unexpected inefficient costs that should be excluded in the recognition of revenue? Describe below.

Document any comments related to Step 5:

CONTRACT COSTS

Accounting Guidance Excerpt
ASC 340-40 provides guidance for certain costs related to contracts with customers.

Incremental costs - costs that would have not been incurred if the contract had not been awarded to the contractor (i.e. sales commission) (RRG. pg. 41)

Fulfillment costs - costs incurred in fulfilling a contract that are not under the scope of other guidance (e.g. inventory, intangible, property (RRG. pg. 39) and equipment) if the following conditions are met:

1. *costs are directly related to the contract*
2. *costs enhance resources of the contractor that will be used in satisfying the performance obligation*
3. *costs are expected to be recovered*

Examples: bond and insurance premiums, set-up costs, mobilization costs, engineering, design, materials, or supplies

Costs incurred for a contract that is not yet awarded should be capitalized based on likelihood of recovery. (RRG. pg. 41)

Costs expensed as incurred include: 1) general and administrative costs 2) salaries related to working on proposal 3) costs of wasted materials, labor, or other resources not reflected in the price of the contract 4) costs related to prior satisfied performance obligation 5) costs an entity can't determine if relates to an unsatisfied or satisfied performance obligation. (RRG. pg. 40)

The company amortizes the contract costs on a systematic basis consistent with the pattern of transfer of the good or service to which it relates. In most cases, use straight line basis over period of performance of contract. (RRG. pg. 39)

Costs should be evaluated for impairment under current guidance. (RRG. pg. 41)

Use practical expedient if amortization period is one year or less. (RRG. pg. 41)

A. Did the company incur any incremental costs of obtaining the contract? ☐ Yes ☐ No

Describe:

B. Did the company incur any costs to fulfill the contract? ☐ Yes ☐ No

List fulfillment costs and value.

Describe	Value	Significant to the Contract	
		☐ Yes	☐ No
		☐ Yes	☐ No
		☐ Yes	☐ No

C. For any significant incremental and/or fulfillment costs identified above, does the practical expedient apply. (RRG. pg. 41)

☐ Yes ☐ No

D. If cost capitalization is required, list the amortization period. (RRG. pg. 39)

E. Evaluate any impairment of capitalized costs. (RRG. pg. 41)

Document any comments related to Contract Costs:

UNINSTALLED MATERIALS

Accounting Guidance Excerpt
If costs are not proportionate to progress in satisfying the performance obligation, an entity must carve out these costs if using a cost-to-cost input method.

The following conditions must be met to be uninstalled materials (RRG. pg. 26):
1. *equipment or materials are not distinct*
2. *customer will obtain control of equipment or materials before receiving services related to it*
3. *cost of the equipment or materials is significant to the total expected costs to satisfy the performance obligation*
4. *contractor procures equipment or materials from a third party and is not significantly involved in its design and manufacture*

A. Do the materials meet the definition of inventory? (RR. pg. 26) ☐ Yes ☐ No

B. Do the materials meet the definition of uninstalled materials? (RR. pg. 26) ☐ Yes ☐ No

Have the materials been transferred to the job site awaiting installment? ☐ Yes ☐ No

Determine if control has been transferred to the customer. (RR. pg. 26)

Describe:

C. What is the value of the uninstalled materials to be carved out of the cost formula?(RR. pg. 31)

D. Once the materials are installed, did you add the cost and estimated costs to the formula? (only if an insignificant amount of margin being recorded in one period) (RR. pg. 31)

☐ Yes ☐ No

E. Were there any other costs not indicative of progress towards completion that should be excluded from the cost-to-cost formula? (RRG. pg. 31) ☐ Yes ☐ No

Describe:

Step	Internal Control Considerations	Reference
2	Contractors should develop fact patterns for certain types of contracts they typically enter into to simplify the determination of performance obligations, but extreme care must be taken to avoid inappropriately determining performance obligations for unique contacts. Contractors should determine performance obligations initially during the contract writing/acceptance processes, but care must be taken to ensure additional change order and other contract modifications do not represent new performance obligations requiring a separate stream for revenue recognition. Project accountants and the finance department should work closely with preconstruction and project management to ensure all agree on the various promises within a contract. Adoption of a checklist or decision tree to be completed for each new contract that supports the ultimate conclusions, including questions such as: • Does a contract include more than one contract/service that could be considered distinct? • Are goods and services part of series of distinct goods/services that are substantially the same? • Does the contract include significant service or integrating goods or services to provide a combined output contracted for by customer? • Does one or more of the goods or services significantly modify or customize one or more of the other goods or services in the contract? • Are the goods or services highly interdependent or highly interrelated? • Are you providing a stand-alone benefit which is distinct from other items in the contract?	RRG. pg. 14
3	Internal control processes should be developed to identify variable considerations in each contract. Following should be taken into account: • Internal analysis should be done by contract owner and contract type of the contractor's experience. This is to assess where penalties applied. • Education of project management teams to alert accounting department regarding the inclusion of penalty provision and notification of likelihood of incurring the penalty. • Contractors should analyze all claims outstanding continually. • Factors outside the entity influence such as volatility in the market, weather conditions, judgment or actions of third parties should be considered as part of reviewing constraint.	RRG. pg. 23

3 Checklist should be developed to identify financing components in each contract at inception: RRG. pg. 46

- Is there a long period of time (> 1 year) between delivery of goods/ services and receipt of payment?
- Is financing component significant to the contract?
- What is the prevailing interest rate in the market?
- Discount the contract transaction price to 'cash' price.
- Create separate line items on work-in-progress schedule to account for financing component.