

Guidance on the IFRS 15 requirements relating to Contract Costs

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Whilst IFRS 15 is primarily a standard on revenue recognition, it contains specific requirements relating to contract costs. Companies may therefore need to change their accounting for those costs on adoption of IFRS 15 for annual reporting periods beginning on or after 1 January 2018.

IFRS 15 contains new requirements when it comes to accounting for contract costs. IFRS 15's guidance on contract fulfilment costs is somewhat similar to the requirements in IAS 11 Construction Contracts. However, it is important to remember that IFRS 15 applies to all customer contracts not only to construction contracts.

Note: While there *is* a practical expedient to expense contract acquisition costs, it is crucial to remember that there is **no** practical expedient to expense costs to fulfil a contract.

IFRS 15 introduces specific guidance on accounting for the following types contract costs:

- Incremental costs incurred in obtaining a contract, and
- Costs incurred to fulfil a contract.

1. What are incremental costs incurred in obtaining a contract?

Contract acquisition costs are those costs which have been incurred to obtain a contract that would not be incurred if not obtained. A common example of this is sales commission. Prior to the adoption of IFRS 15, entities would typically treat these costs in one of the following ways:

- expense the costs of obtaining a contract as incurred,
- include them as part of contract costs under IAS 11 Construction Contracts, or
- capitalize them under IAS 38 Intangible Assets as 'directly attributable' costs.

In terms of IFRS 15, an entity is required to recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.

There is a practical expedient to expense such costs if the amortization period would be one year or less.

Any other costs of obtaining a contract must be expensed when incurred, unless they are explicitly chargeable to the customer regardless of whether the contract is obtained.

2. What are costs incurred to fulfil a contract?

Contract fulfilment costs are simply those costs which are required to be incurred in order to fulfil (i.e. perform/deliver) a contract.

If the costs incurred in fulfilling a contract with a customer are in the scope of another IFRS (e.g. IAS 16, Property, Plant and Equipment or IAS 38 Intangible Assets) an entity shall account for the costs of fulfilling the contract in accordance with those other IFRSs.

IFRS 15 requires costs incurred to fulfil a contract to be recognized as an asset only if those costs meet all of the following criteria:

- the costs are **directly** related to a contract (or a specific anticipated contract)
- the costs generate or enhance resources of the entity that will be used in satisfying the performance obligations; **and**
- the costs are expected to be recovered.

Direct costs include costs such as:

- direct labour;
- direct material;
- allocation of costs that relate directly to the contract (e.g. depreciation);
- costs that are explicitly chargeable under the contract; or
- other costs that were incurred because of the contract (e.g. payment to subcontractors).

The asset recognized is then amortized on a systematic basis consistent with the pattern of transferring the goods or services.