

INTERNAL PROCESS FOR DRAFTING ASC 606-COMPLIANT CONSTRUCTION CONTRACTS

Creating guidelines for drafting compliant contracts, including contracts with variable consideration, is critical for construction companies. These guidelines should be developed with input from every department involved in the process, including accounting, finance, pre-construction, project management, IT and HR. The team should work together to create decision trees/checklists that ensure all contracts comply with ASC 606.

HOW THIS RULE WORKS

- ▶ A team should be formed to develop a checklist/decision tree of the items to be included in any contract the company enters into.
- ▶ The team should have members from every department involved in the project, including accounting, finance, pre-construction, project management, IT and HR.

Checklist for Drafting All ASC 606-Compliant Construction Contracts

- ☐ Does the contract include more than one good or service that could be considered distinct?
- ☐ Are these goods and services substantially the same?
- ☐ Do they have the same pattern of distribution to the customer?
- ☐ Are the goods or services in the contract highly independent or highly interrelated?
- ☐ Is there a combined output due to integrated goods or services?
- ☐ Does one or more of the goods or services in the contract significantly modify one or more of the other goods or services in the contract?
- ☐ Does the contract provide a standalone benefit that is distinct in the context of the contract?
- ☐ Does the contract include any stand-ready performance obligations?
- ☐ Review the language used for variable considerations (e.g., claims and pending change orders, unpriced change orders, shared savings, price concessions, liquidating damages, unit price contracts with variable units, and incentive and penalty provisions).
- ☐ Review any references to reversal of revenue as measured against cumulative revenue.
- ☐ Evaluate any unique terms in the contract for compliance.

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Checklist for Drafting ASC 606-Compliant Construction Contracts with Variable Considerations

- ☐ List all variable considerations associated with a given contract or performance obligation, including variable considerations such as claims and pending change orders, unpriced change orders, incentive and penalty provisions, shared savings, price concessions, liquidating damages and unit prices.
- ☐ Using historical, current and forecasted information
 - ☐ Assess the likelihood and amount of any revenue reversal
 - ☐ Assess the likelihood of any probable price constraints
 - ☐ Assess contract penalty provisions
 - ☐ Examine unpriced and unapproved change orders
- ☐ Determine which, if any, items can be grouped together because they have similar characteristics.
- ☐ Document the amount of variable consideration used in the bidding and proposal process as well as in establishing prices for promised goods.
- ☐ Each period, the amount of estimated variable consideration should be calculated using (1) the expected value method or (2) the most likely amount method.
- ☐ Contract penalty provisions must be examined for variable considerations.

The checklist/decision tree drafted by the team should not be considered definitive. Instead, it should be reevaluated for every contract type.

This determination requires the contractor to use a significant amount of judgment. To avoid making an error, be sure to review your determination with a professional with expertise in ASC 606.

HAVE QUESTIONS?

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