OIC – ORGANISMO ITALIANO DI CONTABILITÀ

**ACCOUNTING STANDARDS**

# Contract Work in Progress

23

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## INTRODUCTION

The Organismo Italiano di Contabilità (OIC), a foundation created under private law with full statutory autonomy, was recognised by Law No. 116 of 11 August 2014 (which converted Decree Law 91/2014) as the "*national institute for accounting standards*" with the following functions:

a) It issues national accounting standards based on best operating practices to prepare financial statements in accordance with the Civil Code;
b) It provides support to parliament and government bodies in the area of accounting regulations and expresses opinions when required by specific legal provisions or at the request of other government institutions;
c) It participates in the process of developing the international accounting standards adopted in Europe and maintains relationships with the International Accounting Standards Board (IASB), European Financial Reporting Advisory Group (EFRAG) and accounting bodies in other countries.

With regard to the activities indicated in paragraphs a), b) and c), it coordinates with national authorities charged with accounting responsibilities.

In the performance of its duties, the OIC pursues objectives of public interest, acts independently, and makes changes to its by-laws to comply with standards of efficiency and cost savings. It reports annually to the Ministry for the Economy and Finance on its activities.

The national accounting standards are approved by the Management Board and subject to a rigorous due process of consultation.

Following consultation and prior to final publication, pursuant to Article 12 of the by-laws, the national accounting standards are subject to the opinion of the Revenue Agency, Bank of Italy, CONSOB, IVASS and Ministries which have jurisdiction on this matter.

Any negative opinion of the above institutions is published together with the accounting standard approved by the Management Board.

The previous edition of this standard was published in August 2014 as an update to the July 2005 version.

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**CONTRACT WORK IN PROGRESS IN CIVIL LAW**

## OBJECTIVE

1. The purpose of accounting standard OIC 23 is to establish the bases for the recognition, classification and measurement of contract work in progress and the information to be disclosed in the notes to the financial statements.

## SCOPE

2. This accounting standard is intended for companies that prepare their financial statements in accordance with the provisions of the Civil Code.
   The provisions of the Civil Code used as a reference for preparing this standard are indicated in the section "*Contract Work in Progress in Civil Law*".

3. This standard shall apply for the purposes of accounting for contract work in progress in the financial statements of contractors or entities performing the work. In the standard, the term "contractor" (or contracting company) is synonymous with "entity performing the work."

4. Rules in other accounting standards shall be followed when they govern specific issues related to contract work in progress.

## DEFINITIONS

5. *A contract work in progress* (or a *contract*) is an agreement, normally with a term of several years, negotiated to construct an asset (or a combination of assets) or to provide goods and services, not in sequence, that together form a single project, or are closely interrelated or interdependent in terms of their design, technology and function or their ultimate use. A construction contract is carried out based on the order of a customer in accordance with technical specifications required.
   A contract work in progress is normally assigned under contracting agreements or other documents with a similar business content (e.g. the sale of a future property and certain types of administrative concessions) concerning the construction of works, buildings, roads, bridges, dams, ships, facilities, the supply of services closely interrelated to the construction of a work (e.g. design services) or the supply of several assets or services agreed to be a single object.

6. *A Contract work in progress with a duration of over a year* is a work completion contract covering a period of more than twelve months. Duration means the period of time from the date the supply of assets and/or services begins and the date the assets and/or services are completed and delivered, both of which are set in the agreement regardless of the date the agreement is finalised.

7. *Fixed-price contracts* are contract works in progress in which the contractor undertakes to carry out the work on the basis of a pre-determined contract price or predetermined prices for individual work items. In order to limit the risks of the obligation assumed, the fixed price may be

subject to cost escalation clauses to adjust it to increases in related costs. Other typical reasons leading to a price change may include a customer's request to modify the original project, which is governed by an appropriate addendum (e.g. change orders issued during contract work) or an adjustment to comply with a law (Article 1664 of the Civil Code).

Fixed price contracts may be associated with units-produced contracts, in which a fixed rate per unit of output is established contractually. Thus, the overall final price varies as a function of the quantity produced.

8. *Cost-plus contracts* are contract works in progress in which the consideration payable to the contractor is determined on the basis of costs incurred, as specifically dictated by the contract, plus a percentage of these costs for the purpose of recovering general and other expenses, which are not specifically reimbursable, in addition to a profit or a fixed amount. In both cases, the determination of the profit is established contractually.

   The contractor's profit may be proportional to costs incurred or predetermined if calculated as a fixed percentage of costs estimated initially. In cost-plus contracts, contractual consideration is not predetermined but calculated as a function of costs incurred by the contractor.

9. *Contract revenues* (or *budgeted revenues*) consist of the total consideration agreed upon by the customer and contractor to construct the assets and/or provide the services specified in the contract.

10. *Contract costs* (or *budgeted costs*) include the costs attributable to a contract that are projected to be incurred to construct assets and/or provide services in the contract.

11. *The contract profit* (or *margin*) represents the difference between contract revenues and contract costs.

12. *Actual contract costs* are the costs incurred in relation to a contract during the period from the contract execution date and a specific date prior to the completion of the contract (e.g. the date the financial statements are prepared).

13. *Pre-operating costs* are costs incurred after securing a contract but before construction work or the production process has begun.

14. *The stage of completion* (or *percentage of completion*) represents, in percentage terms or on the basis of physical measurements, the amount of work in progress already completed by the contractor as at a specific date before the completion of the contract (e.g. on the date the financial statements are prepared).

15. *Accrued revenue* (or *accrued consideration*) is the portion of contract revenues determined in relation to the stage of completion of work as at a specific date.

16. *Advances* are amounts charged to customers generally before or at the beginning of work.

17. *Advance payments* (or *instalment billings*) represent the amounts charged (but not as final payments) to customers during a work in progress to cover work performed, but are not necessarily determined as a function of the value of work completed (generally for financial reasons).

18. A *cost escalation* is an increase in contract revenues based on formulas or indices specifically stipulated in the contract for the payment, by the customer, or third parties, of an amount to

reimburse a higher cost resulting from an increase in the cost of certain factors of production.

19. A variation is a request made by the customer for a change in the scope of the original work to be performed under the contract. Change orders may also be the result of needs imposed from completing the work.

20. *Other claims for additional consideration* represent additional consideration to cover higher costs incurred that are attributable to the customer, and for additional work performed or change orders not formalised in additional documents.

21. *Incentives* are additional amounts of contract revenues dictated contractually once specific targets have been achieved (or exceeded).

22. *Retentions* are amounts withheld by the customer when paying contract-related invoices serving as the guarantee provided for in the contract.

23. *Financial statements in ordinary form* are financial statements prepared in accordance with the provisions of the Civil Code by companies that do not prepare abridged financial statements pursuant to Article 2435-*bis* of the Civil Code, and that do not prepare financial statements pursuant to Article 2435-*ter* of the Civil Code (financial statements of micro-undertakings).

## ITEM CLASSIFICATION AND CONTENT

24. Article 2424 of the Civil Code specifies that contract work in progress shall be recorded under balance sheet assets in inventories, in item CI3 "*Contract work in progress*."

25. Receivables for invoices issued for advances, advance payments or final payments shall be recorded in current assets under item CII1 "*from customers*" and in the subsequent items 2, 3, 4 and 5 if related to subsidiaries, associates, parent companies and undertakings subject to the control of parent companies. As a balancing entry for the recording of a receivable, advances and advance payments shall be recognised under liabilities in payable item D6 "*advance payments*." For the final invoicing of work, advances and advance payments shall be reversed from liabilities with a balancing entry in the recognition of a revenue item in item A1 "*Revenues from sales and services*."

26. Allocations for costs to be incurred after the end of the contract and also related to provisions for probable losses on the contract shall be recognised in liability category B "*Provisions for risks and charges*" in item B4 "*Other*."

27. As already clarified in paragraph 25, final payments received shall be recognised in the income statement under item A1 "*Revenues from sales and services*" in the category "*Value of production*," while changes in contract work in progress equal to the change in the balance of work performed, but for which final payment has not been received at the beginning and end of the financial year, shall be recognised in item A3 "*Changes in contract work in progress*" in the same category.

28. Contract costs incurred to carry out contract work in progress shall be recognised in category B "*Cost of production*" in the income statement, and they shall be classified by their nature as required by Article 2425 of the Civil Code.

29. Materials that are purchased to carry out the work, that have not been used, and that are not

subject contractually to payment, shall be recognised under balance sheet assets in inventories in item CI1 "*Raw and ancillary materials and consumables*" and recorded as such.

30. Retentions shall be recorded under receivables pursuant to OIC 15 "Receivables."

**Contract revenue**

31. Contract revenue shall include:
    - the contractually set price;
    - increases due to price revisions;
    - payments for additional goods or services (e.g. variations);
    - additional payments due to events, the impact of which is to be borne by the customer under the contract or by law;
    - incentives due to the contractor upon the achievement of certain goals;
    - price adjustments established under supplemental agreements;
    - other ancillary income (e.g. income from the sale of excess, unused materials or from the disposal of plant and equipment at the end of the contract).

**Contract costs**

32. Contract costs shall include: a) costs directly related to the contract (direct costs); b) costs related to all production activities and allocated to individual contracts (indirect costs); c) any other cost that can be charged to the customer under the terms of the contract.

33. Direct costs include, but are not limited to:
    - costs of materials used to complete the work;
    - labour costs (for work completed at a specific work site, such costs shall include all work site labour, including management staff and general service workers);
    - sub-contractor costs;
    - expenses of moving plant and equipment to the work site;
    - costs to start-up and dismantle the work site;
    - depreciation of the equipment used;
    - costs of hiring plant and equipment;
    - royalties for patents used for the work;
    - costs for specific guarantees and insurance;
    - design costs (if directly related to the contract) and costs for specific contract-related studies.

    A portion of these costs is incurred during the contract start-up phase and represents pre-operating costs.

34. Indirect costs include, but are not limited to: design costs (if such costs relate to all production activities and are attributable to several contracts); insurance costs and other construction

overheads (see OIC 13 “Inventories”).

35. Indirect costs shall be allocated to individual contracts using systematic and rational methods on the basis of the normal level of construction activity; such methods shall be applied in a manner consistent with all costs with similar characteristics. Indirect costs are usually assigned to individual contracts on the basis of the operating organisation and cost accounting structured in accordance with cost centres.

36. General and administrative costs and research and development costs shall be taken into account when determining contract costs when they can be specifically charged to a customer under the terms of the contract.

37. Costs to secure a contract, including those related to participating in bidding procedures, shall be included in contract costs (and recognised as pre-operating costs as specified in paragraph 57) if the following conditions are met:

    a) The costs are incurred specifically for a contract;
    b) The contract is secured in the same financial year in which the costs are incurred or between the ending date of the financial year and the date financial statements are prepared, or securing the contract is reasonably certain on the date financial statements are prepared;
    c) Costs can be reliably measured and can be recovered from the contract margin.

    Otherwise, such costs shall be recognised in the income statement in the financial year when they are incurred since they represent recurring costs on contracts that have not been signed that are necessary for the contractor’s normal business. When costs incurred in securing a contract are recognised as an expense in the financial year in which they are incurred, they must not be included in contract costs when the contract is obtained in a subsequent financial year.

**Abridged financial statements (Art. 2435-*bis* of the Civil Code) and financial statements of micro-undertakings (Art. 2435-*ter* of the Civil Code)**

38. Pursuant to Article 2435-*bis* of the Civil Code, in the abridged financial statements the balance sheet shall only include items labelled, in Article 2424, with capital letters and Roman numerals. Thus, contract work in progress shall be presented in balance sheet assets under item CI “*Inventories*”; advance payments shall be presented in balance sheet liabilities under item D “*Payables*”; and other provisions shall be presented under item B “*Provisions for risks and charges*.”

    In addition, in the income statement in abridged financial statements, items A2 “*Changes in inventories of work in progress, semi-finished and finished goods*” and A3 “*Changes in contract work in progress*” may be grouped together in a single item called “*Changes in inventories of work in progress, semi-finished and finished goods and contract work in progress*.”

39. The same simplifications shall apply to the financial statements of micro-undertakings pursuant to Article 2435-*ter* of the Civil Code.

## INITIAL RECOGNITION AND SUBSEQUENT MEASUREMENTS

### General comments

40. Article 2426(1)(11) of the Civil Code specifies that contract work in progress may be recorded on the basis of contract payments accrued with reasonable certainty. Bearing in mind that from the time production activities begin, goods or services were ordered from the contractor, and consideration was contractually established, the Civil Code allows the recognition of contract profit in the financial years when the work is carried out (called in practice the "percentage of completion method").

41. Article 2426(1)(9) of the Civil Code specifies that Inventories...shall be recorded at the lower of purchase or production cost, calculated in accordance with sub-paragraph 1), or market value; such lower value may not be maintained in future financial statements if the reasons for doing so no longer apply. Distribution costs may not be included in production cost. This criterion, when applied to the measurement of contracts, is called in practice the "completed contract method."

42. If the contract work in progress lasts for more than one year, the percentage of completion method shall be applied if the conditions specified in paragraphs 43-46 are met. If these conditions are not met, the work shall be measured using the completed contract method.

43. The percentage of completion method shall be applied when the following conditions have been met:
    1) There is a binding contract between the parties, which clearly specifies their obligations, and in particular, the contractor's right to consideration;
    2) The contractor's right to consideration accrues for the contractor with reasonable certainty as the work is completed (see paragraph 46);
    3) There are no uncertainties regarding contractual conditions or external factors of a significance that could cast a doubt on the contracting parties' ability to meet their obligations (e.g. the contractor's obligation to complete the work);
    4) The contract profit can be reliably measured.

44. With regard to the condition stated in paragraph 43, sub-paragraph 4, in fixed-price contracts, the outcome of a contract can be estimated reliably when the following conditions are satisfied:
    – Contract revenue can be measured reliably ;
    – It is reasonably certain that the contract revenues will be collected by the supplier;
    – Contract costs to complete the contract and the stage of contract completion at the end of the reporting period can be measured reliably;
    – The contract costs attributable to the contract can be clearly identified and measured reliably so that contract costs incurred can be compared with prior estimates.

45. With regard to the condition stated in paragraph 43, sub-paragraph 4, in cost-plus contracts, the outcome of a contract can only be estimated reliably if:
    – The contract costs attributable to the contract can be clearly identified and measured reliably, whether or not they are specifically reimbursable;

- It is reasonably certain that the contract revenues will be collected by the supplier.

46. With regard to the condition stated in paragraph 43, sub-paragraph 2, payment may, for example, be considered accrued when the contract grants the company performing the work the right to compensation of costs incurred and an appropriate profit if the customer withdraws.

47. For contracts with a duration of less than a year, the percentage of completion method or completed contract method may be used.

**Combining and segmenting contract work in progress**

48. The contractual consideration for a contract may be agreed to as an aggregate figure for the entire work, or fractionally for individual works or for each phase.

49. If a contract is related to several works or phases, it is possible to use the fractional payments specified in the contract for several phases of it to determine revenues accrued on such works, or to measure the work carried out for such phases, provided the following conditions are met:
    - The contract calls for well separated phases or works;
    - Each phase or work was subject to separate bids, and this is documented;
    - It is possible to clearly identify the costs and revenues of each phase or work;
    - The assignment of different margins to individual phases or works of the contract reflects proven market situations, since this diversity reflects different degrees of risk or differences in the demand/supply ratio;
    - Payments for individual phases or elements of the contract must generate margins comparable with those that would be obtained if all phases or elements were provided to different customers, and this is supported by documented experience;
    - The potentially lower amount of the total contract payment as compared with the sum of payments related to individual phases or works as applied in independent and separate negotiations of such payments is due to the reduction in costs resulting from the combined execution of various phases or jobs (savings in supervision, fixed expenses, etc.).

50. A group of contracts shall be treated as a single contract when the following conditions are met:
    - The group of contracts was negotiated jointly as a single package and there is appropriate documentation supporting this;
    - The contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin;
    - The contracts are performed concurrently or in a continuous sequence;
    - The business plans for the contracts show common costs.

**Percentage of completion method**

51. The application of the percentage of completion method requires:
    - the measurement of balances of contract work in progress in an amount corresponding to the revenue accrued at the end of each financial year, determined in reference to the stage of completion of work;

- the recognition of revenues in the financial year in which payments are received definitively;
- the recognition of contract costs in the financial year in which the work is performed, except for probable losses to be incurred to complete the contract, which are to be recognised in the financial year in which they are projected pursuant to paragraph 86.

52. Revenue recognition (item A1 of the income statement) shall be carried out only when it is certain that the accrued revenue has been definitively made to the contractor as payment for the value of work performed. This certainty is normally based on stages of completion established through negotiations with the customer and accepted by the customer.
53. If the contract clearly indicates calculation procedures, increases due to price revisions can be determined reliably, and thus, in the absence of disputes, they shall be recognised in contract revenues as the work they relate to is completed.
54. If formally determined by the parties (formal variations), variations shall constitute an increase or decrease in contract revenues.
55. During the contract work, the contractor may submit claims for consideration in addition to those specified contractually. Since the determination of additional consideration is subject to a high degree of uncertainty over the amounts to be paid and the timing of collection, and frequently depends on the outcome of negotiations between the parties, only the amounts of additional consideration whose payment and determination are certain or reasonably certain shall be included in contract revenues. This additional consideration is certain when the claim for an additional payment is accepted by the customer by the reporting date; they are reasonably certain when, despite the absence of a formal acceptance, as at the reporting date it is reasonably certain that the claim will be accepted on the basis of the most recent information and historical experience.
56. Incentives shall be included in contract revenues only if the goal has been achieved and substantiated by the customer's acceptance by the reporting date, or, despite the absence of formal acceptance, as at the reporting date it is reasonably certain that the incentive will be achieved and accepted on the basis of the most recent information and historical experience.
57. Pre-operating costs included in contract work in progress shall be accrued in the income statement as a function of the stage of work completion determined using the procedures specified for applying the percentage of completion method. If the cost-to-cost method is applied (see paragraph 64), the stage of completion of work shall be determined by comparing contract costs incurred up to a certain date (excluding pre-operating costs) with total estimated contract costs (excluding pre-operating costs).
58. If a method is used whereby the measurement of work is a function of projected revenues and costs, the costs to be incurred after the end of the contract shall be included under contract costs and in the cost budget. At the end of the contract, appropriate provisions for risks and charges shall be made in the amount of those costs not incurred.
    If, instead, the physical measurements method, or other similar methods, are applied, provisions for risks and charges shall be made gradually as a function of progress made on the contract.
59. Financial expenses may be included in contract costs, and accordingly contribute to the profit or loss for the financial year as a function of the stage of work, when the following conditions have

been met:

a) Based on contractual provisions or other considerations, financial aspects constitute a determining factor in measuring the contract's profitability;

b) The contractor does not receive advances or advance payments in an amount that would avoid significant imbalances in cash flows, and thus, the amount financed by the customer is not material;

c) The percentage of completion is estimated using the cost-to-cost method or other methods in which the measurement of work is a function of projected revenues and costs. Financial expenses may not be recognised as contract costs if the physical measures method or a similar method is used;

d) Interest is recoverable out of contract revenues, and this can be substantiated in a contract budget that takes this into account.

60. The application of the percentage of completion or stage of completion method entails, but is not limited to, the following:

- determining the amount of contract revenues;
- preparing a cost budget in accordance with the procedure that must be followed for performing the work;
- recognising actual costs during the contract work;
- ensuring that the recognition of contract cost is to be done promptly and in keeping with the physical progress of work;
- periodically updating the cost budget reflecting changes between actual and budgeted costs that occurred as work moved forward. Updating the budget and ensuring costs are complete for a stage of completion entail correlating accumulated costs to the stage of completion and adding the costs necessary for completion;
- updating the projection of contract revenues;
- determining the stage of completion using the most appropriate method;
- determining periodically whether a loss will be incurred to complete the contract;
- making provisions for costs to be incurred after the end of the contract, including those costs for which documentation has not been received.

**Methods for determining the stage of completion**

61. The stage of completion of work (or percentage of completion) makes it possible to determine accrued revenue at the end of each financial year, and thus, the balance of contract work in progress (item CI3) and the value of production generated during the financial year to be recognised in the income statement (item A3).
There are different methods for determining the stage of completion of work. Contractors shall adopt the method that reliably measures the work performed taking into account the type of contract and the forecasting and internal reporting system.

62. Several methods are based on the contract’s book values or data. Others are based on measuring completed production. The cost-to-cost method, hours-worked or value-added method are some of the methods based on the contract’s book values or data. The physical measures method and

units delivered method are some of the methods based on the measurement of completed production.

63. It should be noted that there are cases in which, at the beginning of the contract, there is not a sufficient basis for a reasonable estimate of the activity performed by the business. In these cases, it is necessary to wait until a certain amount of progress has been made before recognising a profit on work completed.
The method selected to determine the stage of completion shall remain constant over time for similar types of contracts in the same undertaking.

***Cost-to-cost method***

64. To determine the percentage of completion using the cost-to-cost method, contract costs incurred to date are compared to total estimated contract costs. The percentage shall be subsequently applied to total estimated contract revenue, thereby obtaining the value to be attributed to work completed, and thus, the revenues accrued at that date. The actual costs to be used are those suitable for measuring the stage of completion.
In particular, the application of that method assumes:
    – the existence of an internal procedure system that produces reliable estimates and updated estimates of total contract revenues and costs;
    – the objective ability to make such estimates, taking into account the type of work, contractual provisions, etc.

65. Updating estimates may result in a change in overall costs and revenues, and thus, in contract profit. The impact of changes in the estimated contract profit related to work performed shall be accrued in the financial year in which the update occurs.

66. The change in the estimated contract profit has a positive or negative impact on the year-end measurement of work performed at that date, and subject to the value of work at the beginning of the financial year, its impact calculated on activity already performed shall be fully reflected on the value of production for the financial year, while future financial years shall reflect the new estimate to the extent related to activities to be performed.

67. When determining the percentage of completion using the cost-to-cost method, all costs shall be excluded that are related to future activities, the inclusion of which could result in a distorted profit in relation to the actual stage of completion of the contract (e.g. materials acquired to execute the contract that have not been used, and the amount invoiced by sub-contractors in excess of work they have completed). If these costs were taken into account in determining the percentage of completion, the work progress would be proportionately greater than its actual physical progress. Thus, these costs shall be suspended and not used for measuring the work performed. Specifically, materials acquired to carry out the work shall be reported under inventories and recorded as such.

68. When determining the percentage of completion using the cost-to-cost method, components or parts that have not been installed, but that were produced for a particular purpose by the undertaking or third parties, i.e. exclusively in accordance with the specifications indicated in the contract’s technical designs shall be included.

69. The accumulated costs to be used as a basis for determining the percentage of completion shall reflect the progress of work performed, meaning the construction work completed (value added).

70. When applying the cost-to-cost method, the costs of work already performed by sub-contractors shall normally be included in costs, and advances shall therefore be excluded. Contracts with sub-contractors change on a case-by-case basis. The inclusion of these costs based on the stage of completion of work done by sub-contractors or their completion of individual phases or the completion of all work assigned to them, depends on various factors, the sub-contractor's facilities for verifying the stage of completion, the practical ability of doing so, etc.

***Hours worked method***

71. Using the hours worked method, work progress is calculated as a function of hours worked as a percentage of total hours projected. The application of this method is summarised below:
    - the breakdown of total projected contract revenues into:
        - projected material costs and other direct costs (e.g. insurance, royalties) excluding labour;
        - total value added for the remainder;
    - the projection of total direct labour hours necessary to complete the work, and the calculation of hourly value added (as a ratio of total value added to total projected hours);
    - the measurement of work in progress as at a specific date as the sum of:
        - actual costs of materials used in production and other costs incurred (excluding labour);
        - accrued value added calculated by multiplying direct hours actually worked by hourly value added.

72. For outsourced production, the labour hours of third parties may be assimilated to the sub-contractor's internal labour hours. Alternatively, their cost may be assimilated to material costs and other direct costs. The second alternative is frequently the easier one to apply, but for its proper application, it assumes it is possible to reliably project, from the start of the contract, what part of work will be assigned to third parties.

73. The hours worked method is particularly appropriate when the labour component is far more significant than the materials used, and thus, in those cases when processing is significant and complex.

74. In accordance with the conditions necessary for applying the percentage of completion criterion, an essential prerequisite for using the hours worked method is, in particular, the ability to prepare reliable and updated forecasts of direct costs and the hours of labour needed to complete the contract.

***Units delivered method***

75. This method may be used for production work, which is frequently carried out by the contractor at its own plants, for long-term contracts that call for the supply of a number of equal or uniform products, where the production flow is in line with the flow of deliveries (or acceptances), and where the revenues and costs of individual units, or in any case, the percentage margin, is the same or substantially the same for all units.

76. Only the product units delivered (or accepted) are measured at contractual prices. Work in

progress or finished goods not delivered (or not accepted) are therefore measured at production cost and classified as inventory.

***Physical measures method***

77. The physical measures method is used for recognising the quantities produced (as the number of units produced, the size of works completed, the duration of production work completed, etc.) and measuring such quantities at contractual prices including, for example, compensation for price revisions and any other additional compensation. A condition for using this method is that prices shall be specifically indicated in the contract or otherwise objectively determinable for each work or production step in the unit of measure used to recognise the quantities produced.

78. Subject to the case specified in paragraph 49, it should be noted that the proper allocation of the contract profit to each financial year assumes that the unit prices specified in the contract or otherwise determined for each work or production stage reasonably reflect the same percentage margin relative to related production costs. If there is clearly no correspondence between costs and unit prices, it is necessary to make appropriate adjustments to individual prices, even if they are specifically indicated in the contract, by looking at the contract on the whole and considering it as a unique situation.

79. The application of this method requires that the costs for activities for which there are no prices specified in the contract shall be suspended and posted to the income statement as a function of the percentage of completion of work. The costs of materials purchased and not used for the jobs being measured shall be suspended and treated as inventory.

**Completed contract method**

80. Using the completed contract method, contract revenues and profit shall be recognised only when the contract is completed, i.e., on the date the risks and rewards associated with the asset created or services provided are transferred. Thus, the use of this method entails measuring inventories for works carried out, but not completed, at their production cost.

81. Using the completed contract method, contract work in progress shall be measured at the lower of cost and market value. Thus, the principles stated in OIC 13 “Inventories” are applicable with the necessary adjustments specified in this standard.

82. The transfer of risks and rewards shall be deemed to be completed when the following conditions have been met:
    1) The construction of the asset has been completed, and it has been accepted by the customer;
    2) Testing has been successfully completed; if testing is postponed for reasons beyond the contractor’s control, the contract can be considered to be completed provided the other conditions in paragraphs 3 and 4 are met, and the testing request is documented;
    3) Any costs to be incurred after completion are immaterial and have, in any case, been allocated;
    4) Any impact related to uncertainties connected with these contracts that are still pending despite the completion of construction may be reasonably estimated, and it is possible to make appropriate allocations for them.

83. The following shall be recognised in the income statement for the financial year in which the contract is considered completed:

a) total contract costs consisting of the beginning balance of work in progress, costs incurred during the financial year and provisions for costs to be incurred after the end of the contract; and

b) total contract revenues consisting of advances and advance payments charged in preceding financial years and included under advance payments in liabilities; revenues invoiced during the financial year; and revenues to be invoiced that reflect agreed to payments.

84. Financial expenses may be included in contract costs when the following conditions have been met:

a) The contractor does not receive advances or advance payments in an amount that would avoid significant imbalances in cash flows, and thus, the amount financed by the customer is not material;

b) Interest is recoverable out of contract revenues, and this can be substantiated in a contract budget that takes this into account.

**Probable losses**

85. If it is likely that the total estimated costs of an individual contract will exceed total estimated revenues, the contract must be measured at cost (thereby eliminating any profits recognised in preceding financial years), and the probable loss for the completion of the contract shall be recognised as a decrease in contract work in progress. If this loss is greater than the contract work in progress, the contractor shall recognise an appropriate provision for risks and charges equal to the excess.

86. The probable loss shall be recognised in the financial year in which it is foreseeable based on an objective and reasonable assessment of existing circumstances. The loss shall be recognised regardless of the stage of completion of the contract. This loss may not be offset with profits projected on other contracts. Thus, for the purposes of recognising losses, contracts shall be considered individually.

**Financial income and expenses**

87. Financial income and expenses are positive and negative income components, and shall be recognised directly in the income statement at the time they accrue or are incurred regardless of whether the completed contract method or percentage of completion method is used. Normally, contract work in progress is actually financed by customers making advances and advance payments; thus, the performance of the contract, including over several years, does not entail significant imbalances or cash surpluses, and thus, does not lead to financial income and expenses.

88. Financial expenses shall be capitalised when: a) the conditions established by OIC 16 “Tangible Assets” have been met, and b) the conditions indicated in paragraph 59, if the percentage of completion method is used, and paragraph 84, if the completed contract method is used, have been met.

**Revenue or cost adjustments after the end of the contract**

89. For contracting companies that carry out construction contract work (especially over several years), following the end of the contracts, other income and losses may arise respectively for revenues that could not be recognised due to uncertainty over their generation, and for cost adjustments relative to estimates made based on information available at that time. The other income and losses shall be recognised in the financial year when they arise as "*Value of production*" or "*Cost of production*" for that financial year.

**Change in measurement bases and estimates**

90. The change from the percentage of completion method to the completed contract method (or vice versa) constitutes a change in accounting principles.

91. If the percentage of completion method is used, the change from one methodology for determining the stage of completion of work to another constitutes a change in accounting estimates.

92. The change from the capitalisation of financial expenses to the posting of these expenses directly in the income statement (or vice versa) constitutes a change in accounting principles.

93. See OIC 29 for regulations concerning changes in accounting principles and changes in accounting estimates.

**NOTES TO THE FINANCIAL STATEMENTS**

**Information on companies that prepare financial statements in ordinary form**

94. Article 2427(1)(1) of the Civil Code states that the notes to the financial statements must disclose the basis for measuring financial statement items, making value adjustments and converting amounts not expressed originally in the currency used as legal tender in the country.
In this regard, the following should be disclosed for contract work in progress:
    – whether the completed contract method or percentage of completion method was used;
    – the methodology used to estimate the stage of completion;
    – the criteria used to account for costs to secure the contract, pre-operating costs and costs to be incurred after the end of the contract;
    – the accounting treatment of financial expenses if they were taken into account in measuring contract work in progress;
    – how probable losses in value recognised were accounted for.

95. Article 2427(1)(4) of the Civil Code states that the notes to the financial statements must disclose changes made to the balances of other asset liability and shareholders' equity items.

96. Article 2427(1)(8) of the Civil Code requires the disclosure of the amount of financial expenses allocated during the financial year to amounts recorded in balance sheet assets, separately for each item.

97. Article 2427(1)(9) of the Civil Code requires the disclosure of the total amount of commitments, guarantees and contingent liabilities not reflected in the balance sheet, indicating the nature of the valuable security provided; existing commitments concerning pension and similar benefits, and commitments assumed in relation to subsidiaries, associates and parent companies and undertakings subject to the control of the latter shall be disclosed separately. To accomplish this, the notes to the financial statements shall disclose information on contractual commitments for work and services to be carried out at the end of the financial year. In addition, the notes to the financial statements shall also disclose the contractor's exposure to the customer for all work not conclusively verified and paid for.

98. Article 2423(4) of the Civil Code specifies that: It is not necessary to comply with recognition, measurement, presentation and disclosure requirements when doing so has an immaterial impact on providing a true and fair view. However, requirements concerning the regular maintenance of accounting entries shall remain unchanged. Companies shall disclose in the notes to the financial statements the criteria used to implement this provision.

99. The notes to the financial statements shall disclose the following information if relevant:
   - the impact of updating budgets;
   - the amount of claims for additional consideration, included in inventories and the value of production, and the amount of value adjustments applied to inventories;
   - the distinction between advances and advance payments, unless this was already reflected in the balance sheet;
   - for contracting companies with investments in consortia, the list and related description of significant investments in consortia, indicating the ownership interest, provisions that involve significant commitments and work obtained from or provided to consortia.

**Information on companies that prepare abridged financial statements (Art. 2435-*bis* of the Civil Code)**

100. In accordance with Article 2435-bis of the Civil Code and pursuant to Article 2427(1) of the Civil Code, the notes to the financial statements of companies that prepare abridged financial statements shall disclose:
   - the basis for measuring financial statement items, making value adjustments and converting amounts not expressed originally in the currency used as legal tender in the country (No. 1);
   - the amount of financial expenses allocated during the financial year to amounts recorded in balance sheet assets, separately for each item (No. 8);
   - the total amount of commitments, guarantees and contingent liabilities not reflected in the balance sheet, indicating the nature of the valuable security provided; existing commitments concerning pension and similar benefits, and commitments assumed in relation to subsidiaries, associates and parent companies and undertakings subject to the control of the latter shall be disclosed separately (No. 9).

101. Article 2423(4) of the Civil Code specifies that it is not necessary to comply with recognition, measurement, presentation and disclosure requirements when doing so has an immaterial impact on providing a true and fair view. However, requirements concerning the regular maintenance of accounting entries shall remain unchanged. Companies shall disclose in the notes to the financial

statements the criteria used to implement this provision.

**Information on micro-undertakings (Article 2435-*ter* of the Civil Code)**

102. Micro-undertakings are exempt from preparing the notes to the financial statements if the information required by Article 2427(1)(9 and 16) of the Civil Code is presented at the foot of the balance sheet.

103. Micro-undertakings that prepare notes to the financial statements shall comply with paragraphs 100-101.

## EFFECTIVE DATE

104. This edition of OIC 23 shall apply to financial statements related to financial years beginning on or after 1 January 2016.

## FIRST-TIME APPLICATION PROVISIONS

105. Any impact resulting from the application of amendments made to the previous version of OIC 23 may be reflected in the financial statements prospectively pursuant to OIC 29. Thus, components of items related to transactions that have not exhausted their impact on the financial statements may continue to be recorded in accordance with the previous principle.

**CONTRACT WORK IN PROGRESS IN CIVIL LAW**

Following is a list of the rules of the Civil Code that apply to the accounting treatment and to the disclosure in the notes to the financial statements of contract work in progress:

- Article 1664: "*Qualora per effetto di circostanze imprevedibili si siano verificati aumenti o diminuzioni nel costo dei materiali o della mano d'opera, tali da determinare un aumento o una diminuzione superiori al decimo del prezzo complessivo convenuto, l'appaltatore o il committente possono chiedere una revisione del prezzo medesimo. La revisione può essere accordata solo per quella differenza che eccede il decimo.*
  *Se nel corso dell'opera si manifestano difficoltà di esecuzione derivanti da cause geologiche, idriche e simili, non previste dalle parti, che rendono notevolmente più onerosa la prestazione dell'appaltatore, questi ha diritto a un equo compenso".*
- Article 2423(4): "*Non occorre rispettare gli obblighi in tema di rilevazione, valutazione, presentazione e informativa quando la loro osservanza abbia effetti irrilevanti al fine di dare una rappresentazione veritiera e corretta. Rimangono fermi gli obblighi in tema di regolare tenuta delle scritture contabili. Le società illustrano nella nota integrativa i criteri con i quali hanno dato attuazione alla presente disposizione*".
- Article 2426(1)(9): "*le rimanenze …. Sono iscritti al costo di acquisto o di produzione, calcolato secondo il numero 1), ovvero al valore di realizzazione desumibile dall'andamento del mercato, se minore; tale minor valore non può essere mantenuto nei successivi bilanci se ne sono venuti meno i motivi. I costi di distribuzione non possono essere computati nel costo di produzione*".
- Article 2426(1)(11): "*i lavori in corso su ordinazione possono essere iscritti sulla base dei corrispettivi contrattuali maturati con ragionevole certezza*".
- Article 2427(1)(1): "*La nota integrativa deve indicare i criteri applicati nella valutazione delle voci del bilancio, nelle rettifiche di valore e nella conversione dei valori non espressi all'origine in moneta avente corso legale nello Stato".*
- Article 2427(1)(4): "*La nota integrativa deve indicare le variazioni intervenute nella consistenza delle altre voci dell'attivo e del passivo*".
- Article 2427(1)(8): "*La nota integrativa deve indicare l'ammontare degli oneri finanziari imputati nell'esercizio ai valori iscritti nell'attivo dello stato patrimoniale, distintamente per ogni voce".*
- Article 2427(1)(9): "*La nota integrativa deve indicare l'importo complessivo degli impegni, delle garanzie e delle passività potenziali non risultanti dallo stato patrimoniale, con indicazione della natura delle garanzie reali prestate; gli impegni esistenti in materia di trattamento di quiescenza e simili, nonché gli impegni assunti nei confronti di imprese controllate, collegate nonché controllanti e imprese sottoposte al controllo di quest'ultime sono distintamente indicati*".
- Article 2435-*bis*(2): "*Nel bilancio in forma abbreviata lo stato patrimoniale comprende solo le voci contrassegnate nell'art. 2424 con lettere maiuscole e con numeri romani; le voci A e D*

*dell’attivo possono essere comprese nella voce CII; (...); nelle voci CII dell’attivo e D del passivo devono essere separatamente indicati i crediti e i debiti esigibili oltre l’esercizio successivo”.*

- Article 2435-*bis*(3): “*Nel conto economico del bilancio in forma abbreviata le seguenti voci previste dall’art. 2425 possono essere tra loro raggruppate:*
  - voci A2 e A3
  - ....”.
- Article 2435-*bis*(5): “*Fermo restando le indicazioni richieste dal …, quarto … comma dell'articolo 2423, … la nota integrativa fornisce le indicazioni richieste dal primo comma dell’articolo 2427, numeri 1), ...8), 9)...*”.
- Article 2435-*ter*(2): “*Fatte salve le norme del presente articolo, gli schemi di bilancio e i criteri di valutazione delle micro-imprese sono determinati secondo quanto disposto dall’articolo 2435-bis. Le micro imprese sono esonerate dalla redazione: ... 2) della nota integrativa quando in calce allo stato patrimoniale risultino le informazioni previste dal primo comma dell’articolo 2427, numeri 9) e 16); ...”.*

Le disposizioni del codice civile in tema di classificazione delle voci sono richiamate nel principio contabile OIC 12 “Composizione e schemi del bilancio d’esercizio”