Notes to the Consolidated Financial Statements
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39. NEW ACCOUNTING STANDARDS

The following standards, amendments to standards and interpretations have been identified as those which may impact the Group in the period of initial application. The Group is required to disclose known or reasonably estimable information relevant to assessing the possible impact that the application of the new accounting standard will have on the Group’s financial statements.

The Group’s preliminary assessment of the impact of new standards and interpretations is set out below:

a) AASB 9 Financial Instruments

AASB 9 Financial Instruments (revised December 2014) and AASB 7/14 Amendment to Australian Accounting Standards arising from AASB 9 (December 2014)

This standard replaces AASB 139 Financial Instruments: Recognition and Measurement. AASB 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculation of impairment on financial assets, and new general hedge accounting requirements. It also carries forward guidance on recognition and derecognition of financial instruments from AASB 139. The standard will become mandatory for reporting periods beginning on or after 1 January 2018. The Group does not intend to early adopt the standard. Retrospective application is required with some exceptions. Restatement of comparative is not required, however, the comparative period can be restated if it can be done so without the use of hindsight.

Accordingly, the Group has undertaken an assessment of the classification and measurement impacts of the new standard and estimated the following impacts:

- the Group does not expect the new standard to have a significant impact on the classification of its financial assets;
- the Group does not hold any financial liabilities at fair value through profit or loss and as such there is no impact of the new standard on financial liabilities;
- as a general rule, mone more hedge relationships may be eligible for hedge accounting. Existing hedge relationships would appear to qualify as continuing hedge relationships upon adoption of the new standard;
- AASB 9 will require extensive new disclosures, in particular surrounding hedge accounting, credit risk and expected credit losses;
- an adjustment in reserves attributable to CIMIC shareholders and to non-controlling interest to the opening balance at 1 January 2018 will be recognised. The charge in method from recognition of incurred losses to recognition of expected credit losses for impairment of financial assets, might lead to a currently estimated adjustment reducing equity by around $500 million (after tax) with regards to the non-current loan receivables from HLC Contracting. External independent advice has been utilised in determining the estimated expected credit loss on application of AASB 9;
- in addition to the above management are currently assessing whether any specific project finance obligations would require the recognition of expected credit losses; and
- otherwise the increase in the loss allowance on financial assets is not expected to be significant.

b) AASB 15 Revenue from Contracts with Customers

AASB 15 Revenue from Contracts with Customers, AASB 2015 Amendments to Australian Accounting Standards arising from AASB 15, AASB 2015-8 Amendments to Australian Accounting Standards — Effective Date of AASB 15, and AASB 2016-1 Amendments to Australian Accounting Standards — Clarifications to AASB 15

AASB 15 establishes a comprehensive framework for determining the timing and quantum of revenue recognised. It replaces existing guidance, including AASB 116 Revenue and AASB 113 Construction Contracts. The core principle of AASB 15 is that an entity shall recognise revenue when control of a good or service transfers to a customer. This standard will become mandatory for reporting periods beginning on or after 1 January 2018. The standard permits either a full retrospective or a modified retrospective approach to adoption.

CIMIC has operations across different industry sectors and geographical locations which are subject to different legal and contractual frameworks. The Group has therefore coordinated with the different operating companies and project teams from across the business to assess the potential impacts of the new standard on the business units of the Group.

Significant judgments and estimates are used in determining the impact, such as the assessment of the probability of customer approval of variations and acceptance of claims, estimation of project completion date and assumed levels of project execution productivity. In making this assessment we have considered, for applicable contracts, the individual status of legal proceedings, including arbitration and litigation. The implementation project is ongoing and therefore all impacts are current estimates which are subject to finalisation prior to final implementation.

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39. NEW ACCOUNTING STANDARDS CONTINUED

b) AASB 15 Revenue from Contracts with Customers continued

Controlled Entities

Construction revenue

The contractual terms and the way in which the Group operates its construction contracts is predominantly derived from projects containing one performance obligation. Contracted revenue will continue to be recognised over time, however, the new standard provides new requirements for variable consideration such as incentives, as well as accounting for claims and variations as contract modifications which all impact a higher threshold of probability for recognition. Revenue is currently recognised when it is probable that a contract will be completed and the revenue will be realised under the new standard, revenue is recognised when it is highly probable that a significant reversal of revenue will not occur for these modifications.

Mining & mineral processing revenue

Revenue from mining contracts and mineral processing is predominantly recognised on the basis of the value of work completed. There are several stages in mine development and production that are dependent on the contract terms which could represent separate performance obligations. Under AASB 15, revenue is required to be allocated to each performance obligation and recognised as the performance obligations have been achieved which can be at a point in time or over time. The appropriate allocation of revenue may result in a change in the timing of revenue recognition that may be accelerated or deferred on contracts compared to current recognition timing, however this is currently not expected to be material to the Group.

Services revenue

Services revenue arises from maintenance and other services supplied to infrastructure assets and facilities which may involve a range of services and processes. Under AASB 15, these are predominantly to be recognised over time with reference to inputs on satisfaction of the performance obligations. The services that have been determined to be one performance obligation are highly inter-related and fulfilled over time therefore revenue continues to be recognised over time. As with construction revenue, incentives, variations and claims exist which are subject to the same higher threshold criteria of any recognising revenue to the extent it is highly probable that a significant reversal of revenue will not happen.

Tender costs & contract costs

Currently under AASB 111 Construction Contracts, costs incurred during the tender process are capitalised within net contract debtors when it is deemed probable the contract will be won. Under the new standard costs can only be capitalised if they are both expected to be recovered and either would not have been incurred if the contract had not been won or if they are intrinsic to the delivery of a project. Other contract costs and fulfillment costs are not expected to be material.

Conclusion

The expectation is that the above adjustments, across all controlled entities, are accounted for as a cumulative catch up on the original contract under AASB 15. While the Group’s analysis is still ongoing, based on the current assessment, an adjustment in reserves attributable to CIMIC shareholders and to non-controlling interest in the opening balance at 1 January 2018 will be recognised.

The higher recognition thresholds in the new standard might lead to a currently estimated adjustment reducing equity by around $500 million (after tax).

Joint Ventures - HLG Contracting ("HLG")

As HLG is accounted for as an equity method joint venture, the book carrying value of CIMIC’s investment in HLG reflects the Group’s share of HLG’s operating results, including HLG’s recognition of Construction revenue through the Group’s recognition of its share of HLG’s profit or losses. While HLG is a non-controlled entity, CIMIC has performed an analysis of the impact that might be expected due to the adoption of AASB 15. Based on the information currently available to CIMIC as a shareholder of HLG and applying consistent recognition criteria as outlined in “Construction revenue”. As HLG is a jointly controlled investment, CIMIC does not expect the same degree of control over HLG’s implementation project as it does over its own and therefore this estimate of the projected impact is subject to a higher degree of estimation uncertainty. Based on this analysis an adjustment to HLG’s book value, which will also be reflected in CIMIC’s equity to the opening balance at 1 January 2018 will be recognised. The higher recognition threshold in the new standard might lead to a currently estimated adjustment reducing equity by around $250 million (after tax).
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39. NEW ACCOUNTING STANDARDS CONTINUED

b) AASB 15 Revenue from Contracts with Customers continued

Transition
The Group plans to adopt AASB 15 using the cumulative effect method, with the effect of initially applying this standard recognised at the date of initial application (i.e. 1 January 2018). As a result under AASB 15 there will be an adjustment to the opening balance of the Group’s equity.

c) Other impacts of AASB 9 and AASB 15

Tax Impacts
Adjustments under the new standards are subject to tax effect accounting and therefore the net deferred tax position will also be impacted, notwithstanding the finalisation of all adjustments. Adopting the new standards might lead to a currently estimated increase of the Group’s net deferred tax assets of around $100 million. The equity reductions as discussed in Notes 38 a) and 39 b) are after tax calculations and as such already take into account this tax impact.

Impact on cash flows and guidance:
Adjustments arising on application of AASB 9 and AASB 15 are not expected to have an impact on the cash flows to be derived by the CIMIC Group.

Net profit after tax guidance for 2018 takes into account the application of the new accounting standards.

c) AASB 16 Leases

AASB 16 Leases specifies how to recognise, measure and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise right-of-use assets and lease liabilities for almost all leases. Lessor accounting remains similar to the current standard – i.e. leases will continue to classify leases as finance or operating leases. AASB 16 applies to annual reporting periods beginning on or after 1 January 2019 and replaces AASB 117 Leases and the related interpretations.

As at the reporting date, the Group has non-cancellable operating lease commitments of $950.8 million, refer to Note 32: Commitments. The Group manages its owned and leased assets so that there is an appropriate level of equipment to meet its current obligations and to tender for new work. The decision as to whether to lease or purchase an asset is dependent on a broad range of considerations at the time including financing, risk management and operational strategies following the anticipated completion of a project.

Some of the operating leases currently held expire prior to the implementation of the standard and decisions on future leases will be made as projects are tendered for. As such the Group has not finalised its quantification of the effect of the new standard, however the following impacts are expected:
- the total assets and liabilities on the balance sheet will increase with a decrease in total net assets, due to the reduction of the capitalised asset being on a straight line basis whilst the liability reduces by the principal amount of repayments. Net current assets will show a decrease due to an element of the liability being disclosed as a current liability;
- the straight-line operating lease expense will be replaced with a depreciation charge for the right-of-use assets and interest expense on lease liabilities;
- interest expenses will increase due to the unwinding of the effective interest rate implicit in the lease. Interest expense will be greater earlier in a lease life due to the higher principal value causing profit variability over the course of a lease life. This effect may be partially mitigated due to a number of leases held in the Group at different stages of their terms; and
- repayment of the principal portion of all lease liabilities will be classified as financing activities.