

1. Definition and Applicability

Definition

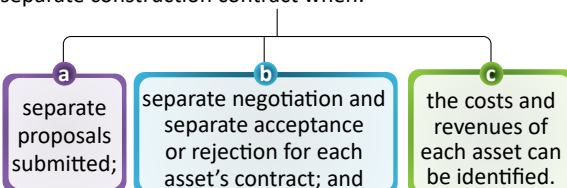
A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

Construction contract is a contract

- Specially negotiated for construction of an asset or group of asset or group of asset closely related.
- Rendering of service related to construction
- Can be for destruction/ demolishing
- AS applies to contractor who work of behalf of others
- AS does not apply to real estate builders

1A. Combining and Segmenting Construction Contracts

When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:



Group of contracts with a single / several customer, treated as a single contract when:

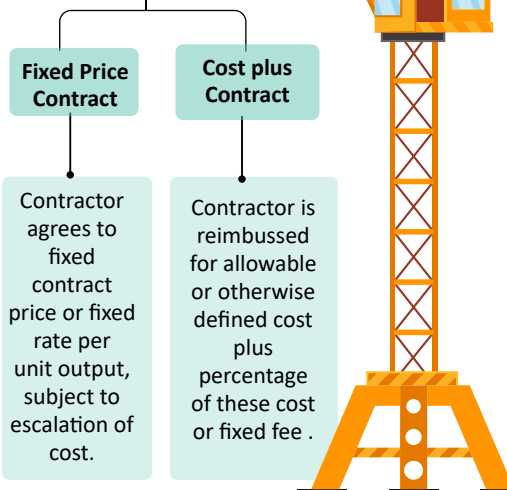
- a** negotiated as a single package;
- b** contract closely interrelated / part of a single project with an overall profit margin; and
- c** performed concurrently or in a continuous sequence.

Construction of additional asset in a contract treated as a separate contract when:

- a** the asset differs significantly in design, technology or function; or
- b** the price of the asset is negotiated without regard to the original contract price.

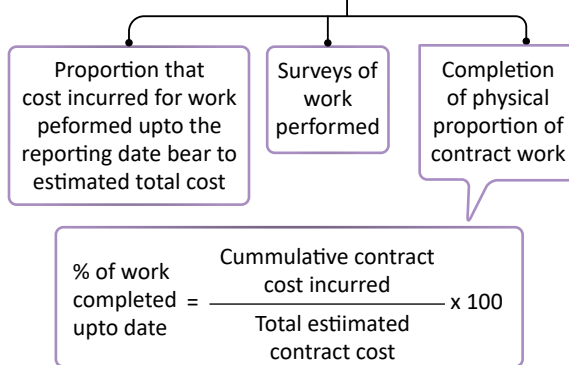
Sample

2. Types of Construction Contracts



3. Methods for determination of stag of completion

Depends on nature of contract



4. Contract Revenue and Cost

A. Contract Revenue

1. Contract revenue should comprise:

- a** the initial amount of revenue agreed in the contract; and
- b** variations in contract work, claims and incentive payments:
 - i** to the extent probable to result in revenue; and
 - ii** capable of being reliably measured.

<p>(b)(1) Variation</p> <p>Caused by customer ↑ or ↓ scope of the work under the contract. Included in contract revenue when:</p> <ul style="list-style-type: none"> a probable customer will approve the variation and the amount; and b revenue can be reliably measured. 	<p>(b)(2) Claims</p> <p>Amount contractor seeks to collect from customer / another party as reimbursement for costs not included in the contract price. May arise from, ex. customer caused delays, errors in specifications or design, and disputed variations in contract work. Included in revenue when:</p> <ul style="list-style-type: none"> a negotiations reached advanced stage such that it is probable that customer will accept the claim; and b amount probable to be accepted by the customer can be measured reliably. 	<p>(b)(3) Incentives</p> <p>Incentive are additional amounts payable to contractor if specified performance standards are met. Incentive included in revenue when:</p> <ul style="list-style-type: none"> a contract is sufficiently advanced that it is probable to meet specified performance standards; and b the amount of the incentive can be measured reliably
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2. Estimate

Contract revenue is affected by future event uncertainties hence may ↑ or ↓ due to:

- (a) variations or claims
- (b) cost escalation clauses (in case of fixed price contracts)
- (c) penalties arising from delays
- (d) changes in number of units where revenue is based on number of units.

3. Recognition

Contract revenue is recognized in proportion of work completed.

When work completed cannot be reliable measured, then revenue is recognized to the extent of cost incurred only (no Profit – No Loss method) provided realization certainty exists

4. Contract Revenue and Cost

B. Contract Cost

Following cost are treated as part of cost of construction for % of work completed.

Comprises

- Cost that relate directly to the specific contract
Eg. Site labour cost, supervisor cost, cost of material used in construction, dep. of P&M used, cost of moving/ hiring P&M, warranty costs, designing costs etc.
- Cost that are attributable to contract activity and can be allocated
Eg. Insurance indirectly related designing costs, construction OH etc.
- Other Costs & specifically chargeable to customer
* Cost for securing contract + Costs incurred only once contract is secured are added

Excludes

- General administration overhead not specifically reimbursable
- Selling Costs
- Abnormal loss
- Research & development cost unless specifically reimbursable
- B. cost unless AS 16 permits.
- Dep. on idle p&m, not used in contract

Stage of Completion: Methods

- Material at site to be excluded from cost incurred.
- Include it in subsequent years when material is consumed
- advance payments to subcontractors

5. Recognition of Contract Revenue and Expenses

1. When to recognize Revenue & Costs?

When the outcome can be estimated reliably.
Considered outcome is reliably estimatable when:

a. Fixed price contract

- all conditions satisfied:
- total revenue measurable reliably;
 - probable economic benefits will flow to the enterprise;
 - both contract costs to complete and the stage of contract completion can be measured reliably; and
 - contract costs can be clearly identified, measured and compared with prior estimates reliably.

b. Cost plus contract

- all conditions satisfied:
- probable economic benefits will flow to the enterprise; and
 - costs attributable to contract, can be clearly identified and measured reliably.

2. How much Revenue & Expense to be recognized?

Revenue and expenses recognized as to the stage of completion of a contract known as percentage of completion method.

- Revenue recognised in the accounting periods in which work is performed.
- Contract costs usually recognized in the accounting periods in which the work to which they relate is performed.
- Costs incurred of future activity shown as asset if probable to be recovered as work in progress under amount due from customer.
- Expected excess of total contract costs over total contract revenue is recognised immediately.
- Any uncertainty on collectability of amount already recognized as revenue Dr to P&L and revenue not reversed

6. Onerous Contracts

- Expected Costs > Revenue from contracts
- » AS 7 requires full loss to be provided for and not just proportionate to % of work completed.
 - » Provision for loss is made for loss to not otherwise recognized.
 - Amount of such a loss is determined irrespective of whether work has commenced or stage of completion etc.
 - Contract costs recovery of which is not probable are recognised as an expense immediately. (Examples claims not fully enforceable, completion subject to pending litigation or legislation, relating to properties that are likely to be condemned or expropriated, customer unable to meet obligations; or contractor is unable to complete the contract.)



7. Changes in Estimates

- » Application of % of ,completion on a cumulative basis in each accounting period to current estimates of contract revenue and contract cost
- » Effect of change in estimates of contract revenue or cost to be accounted as change in estimate
- » The change estimates are used in determination of amount of revenue and expense recognised in statement of profit and loss in period in which the change in made and in subsequent period.

8. Disclosure

1. Policy and methods

- Method use for recognition of revenue
- Method used for determination of % of work completed
- Accounting policy with respect to construction contracts.

2. Revenue, cost and debtors

- Revenue recognized (Income)
- Cost incurred (Expense)
- Retention (Billed but not received) (Asset)
- Advance (Received but not bill) (Liability)
- Provision for loss, if any (adjusted in Amount due from (to) customer)

3. Amount due from (to) customer

Cost incurred (work certified + work not certified)	xx
+ Profit recognised	xx
(-) Loss recognised (100% loss in case of onerous contracts)	(xx)
(-) Progress billing (Amount received + Amount billed not received)	(xx)
Gross amount due from customer	xxx

