

AS-7

Name: Construction Contract

Scope

Prescribes principles of accounting for construction contracts in FS of contractors.

Types of Contract

- Fixed price contract - Price agreed as fixed sum or a fixed rate P.U. of O/P.
- Cost plus Contract - Contractor is reimbursed for allowable costs + Percentage of these cost or fixed fee.

Definition

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

Purpose

- Prescribe acc. treatment of revenue & costs associated with contracts
- Because date of which contract entered & completion is different & even in diff acc periods
- Thus for, allocation of ~~costs~~ contract revenue & contract costs over that period

Construction contract includes

- contracts for rendering of services
- directly related to creation of an asset
- ~~contract~~ contract for destruction of assets

Combining & segmenting construction contract

- Separate contracts to be treated ~~one~~ ^{separately}, when

- 1) separate proposals
- 2) separate negotiations & able to accept or reject part of it
- 3) cost & revenue → identifiable

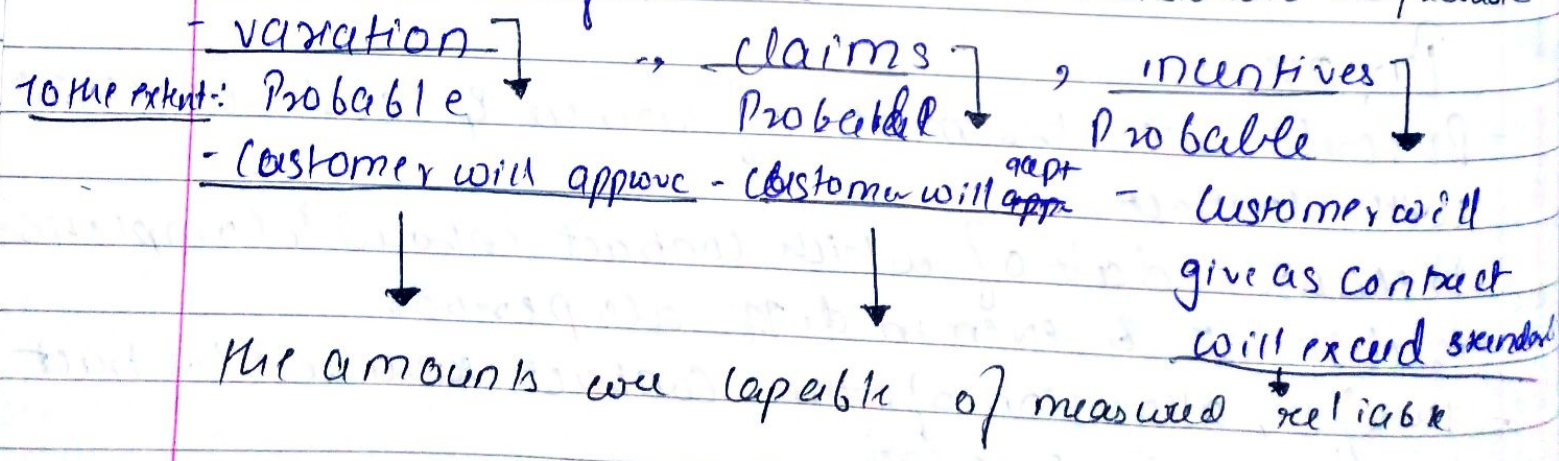
- Contracts to be treated one, when

- 1) negotiated as single package
- 2) closely interrelated or have single profit margin
- 3) performed concurrently

Contract revenue

- includes

- initial amt. of revenue → measured considered realizable



- Contract cost

includes

- cost directly related to specific contract
- site labour cost
- cost of material
- depⁿ of plant/equip.
- cost of moving plant
- cost of buying plant
- cost of design
- claim from third party
- estimated cost of rectification + warranty cost

- cost attributable to contract activity & can be ~~then~~ ^{allocated} to the contract

- insurance
- cost of design
- Construct OH
- cost of preparation & processing personnel payroll

- costs specifically chargeable to customer

- general admin cost
 - development cost
- Reimbursement of which is specified.

Costs of securing the contract also included if

- separately identifiable
- measured reliably
- Probable that contract will be obtained.

Recognition

1) % completion method

- used

- when outcome of construction contract estimated reliably

How to say outcome is measured reliably

(a) In case of fixed price contract

- Total contract revenue measured reliably

- Economic benefit associated with contract will flow to enterprise

- Both - contract cost to complete & stage of completion can be measured reliably

- Contract cost attributable to contract clearly identified & measured reliably

(b) In case of cost plus contract

- Economic benefit associated with contract will flow to enterprise

- Contract cost attributable to contract clearly identified & measured reliably

Under % completion method

- 1) revenue of completed stage \leftarrow matched with expense of completed stage
- 2) Revenue \rightarrow recognised in P&I for which work is performed
 expense \rightarrow recognised in P&I for which work they relate is performed.
- 3) future cost recognised as an asset $\left\{ \begin{array}{l} \rightarrow \text{they are probable they recover} \\ \rightarrow \text{classified as WIP} \end{array} \right.$
- 4) uncertainty treated as expense

Determination of stage of completion

- 1) ~~Proportion~~ Proportion that contract cost incurred for work performed upto reporting date
 $=$ estimated total cost
- 2) survey
- 3) completion of a physical proportion

When method 1 followed

- future costs not to be considered
- only cost upto that period considered

- 2) When outcome cannot be reliably estimated
 - revenue recognised only to extent of contract cost incurred of which recovery is probable
 - contract cost recognised in the period they incurred

Recognition of expected losses

When it is probable that total contract cost ^{will} exceed total contract revenue - provision for loss created

- whether or not contract commenced
- ~~is~~ irrespective of stage of completion

Disclosure

- (a) - contract revenue recognised in the period
- methods used to determine the contract revenue
 - method used to determine stage of completion of contract
- (b) - aggregate amt. of cost incurred & recognised profit (less recog. losses) upto reporting date
- amt. of advances
 - amt. of retention
- (c) - gross due from customer as an asset
gross due to customer as liability

	Cost incurred	xxx
+	recognised recognised profit	xxx
(-)	recognised loss	(xxx)
(-)	progress billings	(xxx)
	gross amt due <u>from</u> / <u>to</u> customer	xxx / (xxx)