

Accounting Standard for Local Bodies (ASLB) 11

Construction Contracts

Accounting Standard for Local Bodies (ASLB) 11

Construction Contracts

	Contents
	Paragraphs
Objective	
Scope	1-2
Definitions	4-11
Construction Contracts	4-10
Contractor	11
Combining and Segmenting Construction Contracts	12-15
Contract Revenue	16-22
Contract Costs	23-29
Recognition of Contract Revenue and Expenses	30-43
Recognition of Expected Deficits	44-48
Changes in Estimates	49
Disclosure	50-56
Effective Date	57-58
Appendix:	
'A'- Illustrative Examples	
'1'- Comparison with IPSAS 11	
'2'- Comparison with existing AS 7	

ACCOUNTING STANDARD FOR LOCAL BODIES (ASLB) -11

CONSTRUCTION CONTRACTS

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objectives and the Preface to the Accounting Standards for Local Bodies¹).*

The Accounting Standard for Local Bodies (ASLB) 11, 'Construction Contracts', issued by the Council of the Institute of Chartered Accountants of India, will be recommendatory in nature in the initial years for use by the local bodies. This Standard will be mandatory for Local Bodies in a State from the date specified in this regard by the State Government concerned².

The following is the text of the Accounting Standard for Local Bodies.

Objective

The objective of this Standard is to prescribe the accounting treatment of costs and revenue associated with construction contracts. The Standard:

- Identifies the arrangements that are to be classified as construction contracts;
- Provides guidance on the types of construction contracts that can arise in the local bodies; and
- Specifies the basis for recognition and disclosure of contract expenses and, if relevant, contract revenues.

Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different reporting periods.

In many cases, construction contracts entered into by local bodies may or may not specify an amount of contract revenue. Rather, funding to support the construction activity will be provided by an appropriation or similar allocation of government revenue, or by aid or grant funds. In these cases, the primary issue in accounting for construction contracts is (a) the allocation of construction costs to the reporting period in which the construction work is performed, and (b) the recognition of related expenses.

¹ Attention is specifically drawn to paragraph 4.2 of the 'Preface to the Accounting Standards for Local Bodies', according to which Accounting Standards are intended to apply only to items which are material.

² Reference may be made to the paragraph 7.1 of the 'Preface to the Accounting Standards for Local Bodies' providing the discussion on the compliance with the Accounting Standards for Local Bodies.

In some other cases, construction contracts entered into by local bodies may be established on a commercial basis or a non-commercial full or partial cost recovery basis. In these cases, the primary issue in accounting for construction contracts is the allocation of both contract revenue and contract costs to the reporting periods in which construction work is performed.

Scope

1. **An entity that prepares and presents financial statements under the accrual basis of accounting, should apply this Standard in accounting for construction contracts.**
2. **This Standard applies to all entities described as Local Bodies in the Preface to the Accounting Standards for Local Bodies³.**
3. **[Refer to Appendix 2]**

Definitions

4. **The following terms are used in this Standard with the meanings specified:**

Construction contract is a contract, or a similar binding arrangement, 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.

Contractor is an entity that performs construction work pursuant to a construction contract.

Cost plus or cost based contract is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs and, in the case of a commercially-based contract, an additional percentage of these costs or a fixed fee, if any.

Fixed price contract is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.

Terms defined in other Accounting Standards for Local Bodies are used in this Standard with the same meaning as in those other Standards.

³ Refer to paragraph 1.3 of the *‘Preface to the Accounting Standards for Local Bodies’*.

Construction Contracts

5. A construction contract (the terms "construction contract" and "contract" are used interchangeably in the remainder of this Standard) may be negotiated for the construction of a single asset such as a bridge, building, dam, pipeline, road, ship or tunnel. A construction contract may also deal with the construction of a number of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use - examples of such contracts include those for the construction of reticulated water supply systems, roads, bridges, flyovers and other complex infrastructure assets.
6. For the purposes of this Standard, construction contracts include:
 - a) Contracts for the rendering of services that are directly related to the construction of the asset, for example, those for the services of project managers and architects; and
 - b) Contracts for the destruction or restoration of assets, and the restoration of the environment following the demolition of assets.
7. For the purposes of this Standard, construction contracts also include all arrangements that are binding the parties to the arrangement, but which may not take the form of a documented contract. For example, components of local body may enter into a formal arrangement for the construction of an asset but the arrangement may not constitute a legal contract because the individual departments of the local body may not be separate legal entities with the power to contract. However, provided that the arrangement confers similar rights and obligations on the parties to it as if it were in the form of a contract, it is a construction contract for the purposes of this Standard. Such binding arrangements could include (but are not limited to) a decision of the body governing the local body, or a memorandum of understanding.
8. Construction contracts are formulated in a number of ways, which, for the purposes of this Standard, are classified as fixed price contracts (lump sum contract), and cost plus or cost based contracts. Some commercial construction contracts may contain characteristics of both a fixed price contract and a cost plus or cost based contract, for example in the case of a cost plus or cost based contract with an agreed maximum price. In such circumstances, a contractor needs to consider all the conditions in paragraphs 31 and 32 in order to determine when to recognise contract revenue and expenses.
9. Cost plus and cost based contracts encompass both commercial and non-commercial contracts. A commercial contract will specify that revenue to cover the contractor's construction costs as agreed and generate a profit margin will be provided by the other parties to the contract. However, an entity may also enter into a non-commercial contract to construct an asset for another entity in return for full or partial reimbursement of costs from that entity or other parties.

In some cases, the cost recovery may encompass payments by the recipient entity and specific purpose construction grants or funding from other parties.

10. In certain cases where one local body constructs assets for another governmental body, the cost of construction activity is not recovered directly from the recipient. Rather, the construction activity is funded indirectly (a) by way of a general appropriation or other allocation of general government funds to the contractor, or (b) from general purpose grants from third party funding agencies or other governments. These are classified as fixed price contracts for the purpose of this Standard.
- 10A. It is possible that a local body performs a construction activity for another entity under the arrangement termed as 'Deposit Works'. This Standard will be applicable to arrangements, if the local body acts as a contractor as defined in this Standard.

Contractor

11. A contractor is an entity that enters into a contract to build structures, construct facilities, produce goods, or render services to the specifications of another entity. The term "contractor" includes a general or prime contractor, a subcontractor to a general contractor, or a construction manager.

Combining and Segmenting Construction Contracts

12. The requirements of this Standard are usually applied separately to each construction contract. However, in certain circumstances, it is necessary to apply the Standard to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance of a contract or a group of contracts.
13. **When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:**
 - (a) **Separate proposals have been submitted for each asset;**
 - (b) **Each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and**
 - (c) **The costs and revenues of each asset can be identified.**
14. **A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:**

- (a) The group of contracts is negotiated as a single package;
 - (b) The contracts are so closely interrelated that they are, in effect, part of a single project with an overall margin, if any; and
 - (c) The contracts are performed concurrently or in a continuous sequence.
- 15. A contract may provide for the construction of an additional asset at the option of the customer or may be amended to include the construction of an additional asset. The construction of the additional asset should be treated as a separate construction contract when:
 - (a) The asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or
 - (b) The price of the asset is negotiated without regard to the original contract price.

Contract Revenue

- 16. Contract revenue should comprise:
 - (a) The initial amount of revenue agreed in the contract; and
 - (b) Variations in contract work, claims and incentive payments to the extent that:
 - (i) It is probable that they will result in revenue; and
 - (ii) They are capable of being reliably measured.
- 17. Contract revenue is measured at the consideration received or receivable. Both the initial and ongoing measurement of contract revenue are affected by a variety of uncertainties that depend on the outcome of future events. The estimates often need to be revised as events occur and uncertainties are resolved. Where a contract is a cost plus or cost based contract, the initial amount of revenue may not be stated in the contract. Instead, it may need to be estimated on a basis consistent with the terms and provisions of the contract, such as by reference to expected costs over the life of the contract.
- 18. In addition, the amount of contract revenue may increase or decrease from one period to the next. For example:
 - (a) A contractor and a customer may agree to variations or claims that increase or decrease contract revenue in a period subsequent to that in which the contract was initially agreed;
 - (b) The amount of revenue agreed in a fixed price, cost plus or cost based contract

may increase as a result of cost escalation or other clauses;

- (c) The amount of contract revenue may decrease as a result of penalties arising from delays caused by the contractor in the completion of the contract; or
 - (d) When a fixed price contract involves a fixed price per unit of output, contract revenue increases or decreases as the number of units is increased or decreased.
19. A variation is an instruction by the customer for a change in the scope of the work to be performed under the contract. A variation may lead to an increase or a decrease in contract revenue. Examples of variations are changes in the specifications or design of the asset and changes in the duration of the contract. A variation is included in contract revenue when:
- (a) It is probable that the customer will approve the variation and the amount of revenue arising from the variation; and
 - (b) The amount of revenue can be measured reliably.
20. A claim is an amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price. A claim may arise from, for example, customer caused delays, errors in specifications or design, and disputed variations in contract work. The measurement of the amounts of revenue arising from claims is subject to a high level of uncertainty and often depends on the outcome of negotiations. Therefore, claims are only included in contract revenue when:
- (a) Negotiations including dispute resolution mechanism such as arbitration/adjudication by third party acceptable to both the parties to the contract, have reached an advanced stage such that it is probable that the customer will accept the claim; and
 - (b) The amount that it is probable will be accepted by the customer can be measured reliably.
21. Incentive payments are additional amounts paid to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when:
- (a) The contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and
 - (b) The amount of the incentive payment can be measured reliably
22. Contractors should review all amounts relating to the construction contract that

are paid directly to subcontractors by third party funding agencies, to determine whether they meet the definition of, and recognition criteria for, revenue of the contractor under the terms of the contract. Amounts meeting the definition and recognition criteria for revenue should be accounted for by the contractor in the same way as other contract revenue. Such amounts should also be recognised as contract costs (refer to paragraph 25). Funding agencies may include provincial, national and international aid agencies and multilateral and bilateral development banks.

Contract Costs

23. **Contract costs should comprise:**

- (a) Costs that relate directly to the specific contract;**
- (b) Costs that are attributable to contract activity in general and can be allocated to the contract on a systematic and rational basis; and**
- (c) Such other costs as are specifically chargeable to the customer under the terms of the contract.**

24. Costs that relate directly to a specific contract include:

- (a) Site labour costs, including site supervision;
- (b) Costs of materials used in construction;
- (c) Depreciation of plant and equipment used on the contract;
- (d) Costs of moving plant, equipment and materials to and from the contract site;
- (e) Costs of hiring plant and equipment;
- (f) Costs of design and technical assistance that are directly related to the contract;
- (g) The estimated costs of rectification and guarantee work, including expected warranty costs; and
- (h) Claims from third parties.

These costs may be reduced by any incidental revenue that is not included in contract revenue, for example revenue from the sale of surplus materials at the end of the contract.

25. Contractors should review all amounts relating to the construction contract paid directly by subcontractors and which are reimbursed by third party funding agencies, to determine whether they qualify as contract costs. Amounts meeting

the definition of, and recognition criteria for, contract expenses should be accounted for by the contractor in the same way as other contract expenses. Amounts reimbursed by third party funding agencies which meet the definition of, and recognition criteria for, revenue should be accounted for by the contractor in the same way as other contract revenue (refer to paragraph 22).

26. Costs that may be attributable to contract activity in general and can be allocated to specific contracts include:

- (a) Insurance;
- (b) Costs of design that are not directly related to a specific contract; and
- (c) Construction overheads

Such costs are allocated using methods that (a) are systematic and rational, and (b) are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of construction activity. Construction overheads include costs such as the preparation and processing of construction personnel payroll. Costs that may be attributable to contract activity in general and can be allocated to specific contracts also include borrowing costs. The capitalisation of the borrowing costs should be done in accordance with ASLB 4, *'Borrowing Costs'*

27. Costs that are specifically chargeable to the customer under the terms of the contract may include some general administration costs and development costs for which reimbursement is specified in the terms of the contract.

28. Costs that cannot be attributed to contract activity or cannot be allocated to a contract are excluded from the costs of a construction contract. Such costs include:

- (a) General administration costs for which reimbursement is not specified in the contract;
- (b) Selling costs;
- (c) Research and development costs for which reimbursement is not specified in the contract; and
- (d) Depreciation of idle plant and equipment that is not used on a particular contract

29. Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the formal completion of the contract. However, costs that relate directly to a contract and which are incurred in securing the contract are also included as part of the contract costs if they can be separately identified and measured reliably and it is probable that the contract will be obtained. When costs incurred in securing a contract are recognised as an expense in the period in which they are incurred, they are not included in contract costs when the contract is obtained in a subsequent period.

Recognition of Contract Revenue and Expenses

- 30. When the outcome of a construction contract can be estimated reliably contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected deficit on a construction contract to which paragraph 44 applies should be recognised as an expense immediately in accordance with paragraph 44.**
- 31. In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:**
 - (a) Total contract revenue, if any, can be measured reliably;**
 - (b) It is probable that the economic benefits or service potential associated with the contract will flow to the entity;**
 - (c) Both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and**
 - (d) The contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates .**
- 32. In the case of a cost plus or cost based contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:**
 - (a) It is probable that the economic benefits or service potential associated with the contract will flow to the entity; and**
 - (b) The contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.**
- 33. The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and surplus/deficit, which can be attributed to the proportion of work completed. This method provides useful information on the extent of contract activity and performance during a period.**
- 34. Under the percentage of completion method, contract revenue is recognised as**

revenue in the income and expenditure account in the reporting periods in which the work is performed. Contract costs are usually recognised as an expense in the income and expenditure account in the reporting periods in which the work to which they relate is performed. However, where it is intended at inception of the contract that contract costs are to be fully recovered from the parties to the construction contract, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately in accordance with paragraph 44.

35. A contractor may have incurred contract costs that relate to future activity on the contract. Such contract costs are recognised as an asset provided it is probable that they will be recovered. Such costs represent an amount due from the customer and are often classified as contract work in progress.
36. The outcome of a construction contract can only be estimated reliably when it is probable that the economic benefits or service potential associated with the contract will flow to the entity. However, when an uncertainty arises about the collectability of an amount already included in contract revenue, and already recognised in the income and expenditure account, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense rather than as an adjustment of the amount of contract revenue.
37. An entity is generally able to make reliable estimates after it has agreed to a contract, which establishes:
 - (a) Each party's enforceable rights regarding the asset to be constructed;
 - (b) The consideration, if any, to be exchanged; and
 - (c) The manner and terms of settlement.

It is also usually necessary for the entity to have an effective internal financial budgeting and reporting system. The entity reviews and, when necessary, revises the estimates of contract revenue and contract costs as the contract progresses. The need for such revisions does not necessarily indicate that the outcome of the contract cannot be estimated reliably.

38. The stage of completion of a contract may be determined in a variety of ways. The entity uses the method that measures reliably the work performed. Depending on the nature of the contract, the methods may include
 - (a) The proportion that contract costs incurred for work performed to date bear to the estimated total contract costs;
 - (b) Surveys of work performed; or
 - (c) Completion of a physical proportion of the contract work.

Progress payments and advances received from customers often do not reflect

the work performed.

39. When the stage of completion is determined by reference to the contract costs incurred to date, only those contract costs that reflect work performed are included in costs incurred to date. Examples of contract costs, which are excluded, are:

(a) Contract costs that relate to future activity on the contract, such as costs of materials that have been delivered to a contract site or set aside for use in a contract but not yet installed, used or applied during contract performance, unless the materials have been made specially for the contract; and

(b) Payments made to subcontractors in advance of work to be performed under the subcontract.

40. When the outcome of a construction contract cannot be estimated reliably:

(a) Revenue should be recognised only to the extent of contract costs incurred that it is probable will be recoverable; and

(b) Contract costs should be recognised as an expense in the period in which they are incurred.

An expected deficit on a construction contract to which paragraph 44 applies should be recognised as an expense immediately in accordance with paragraph 44.

41. During the early stages of a contract it is often the case that the outcome of the contract cannot be estimated reliably. Nevertheless, it may be probable that the entity will recover the contract costs incurred. Therefore, contract revenue is recognised only to the extent of costs incurred that are expected to be recoverable. As the outcome of the contract cannot be estimated reliably, no surplus or deficit is recognised. However, even though the outcome of the contract cannot be estimated reliably, it may be probable that total contract costs will exceed total contract revenues. In such cases, any expected excess of total contract costs over total contract revenues for the contract is recognised as an expense immediately in accordance with paragraph 44.

42. Where contract costs that are to be reimbursed by parties to the contract, are not probable of being recovered, they are recognised as an expense immediately. Examples of circumstances in which the recoverability of contract costs incurred may not be probable and in which contract costs may need to be recognised as an expense immediately include contracts:

a) Which are not fully enforceable, that is, their validity is seriously in question;

b) The completion of which is subject to the outcome of pending litigation or legislation;

- c) Relating to properties that are likely to be condemned or expropriated;
 - d) Where the customer is unable to meet its obligations; or
 - e) Where the contractor is unable to complete the contract or otherwise meet its obligations under the contract.
- 43. When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue and expenses associated with the construction contract should be recognised in accordance with paragraph 30 rather than in accordance with paragraph 40.**

Recognition of Expected Deficits

- 44. In respect of construction contracts in which it is intended at inception of the contract that contract costs are to be fully recovered from the parties to the construction contract, when it is probable that total contract costs will exceed total contract revenue, the expected deficit should be recognised as an expense immediately.**
- 45.** Local Bodies may enter into construction contracts which specify that the revenue intended to cover the construction costs will be provided by the other parties to the contract. This may occur where, for example:
- (a) Local Bodies that are largely dependant on appropriations or similar allocations of government revenue to fund their operations are also empowered to contract with any public sector undertaking or private sector entities for the construction of assets on a commercial or full cost recovery basis; or
 - (b) Components of Local Bodies transact with each other on an arm's length or commercial basis as may occur under a "purchaser-provider" or similar other arrangements.
- In these cases, an expected deficit on a construction contract is recognised immediately in accordance with paragraph 44.
- 46.** As noted in paragraph 9, in some cases an entity may enter into a construction contract for less than full cost recovery from the other parties to the contract. In these cases, funding in excess of that specified in the construction contract will be provided from an appropriation or other allocation of government funds to the contractor, or from general purpose grants from third party funding agencies or other governments. The requirements of paragraph 44 do not apply to these construction contracts.
- 47.** In determining the amount of any deficit under paragraph 44, total contract revenue and total contract costs may include payments made directly to subcontractors by third party funding agencies in accordance with paragraphs 22 and 25.

48. The amount of such a deficit is determined irrespective of:
- (a) Whether or not work has commenced on the contract;
 - (b) The stage of completion of contract activity; or
 - (c) The amount of surpluses expected to arise on other commercial construction contracts that are not treated as a single construction contract in accordance with paragraph 14.

Changes in Estimates

49. The percentage of completion method is applied on a cumulative basis in each reporting period to the current estimates of contract revenue and contract costs. Therefore, the effect of a change in the estimate of contract revenue or contract costs, or the effect of a change in the estimate of the outcome of a contract, is accounted for as a change in accounting estimate (see ASLB 2, *'Accounting Policies, Changes in Accounting Estimates and Errors'*⁴). The changed estimates are used in the determination of the amount of revenue and expenses recognised in the income and expenditure account in the period in which the change is made and in subsequent periods.

Disclosure

- 50. An entity should disclose:**

- (a) The amount of contract revenue recognised as revenue in the period;**
- (b) The methods used to determine the contract revenue recognised in the period; and**
- (c) The methods used to determine the stage of completion of contracts in progress.**

- 51. An entity should disclose each of the following for contracts in progress at the reporting date:**

- (a) The aggregate amount of costs incurred and recognised surpluses (less recognised deficits) to date;**
- (b) The amount of advances received; and**
- (c) The amount of retentions**

52. Retentions are amounts of progress billings that are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified. Progress billings are amounts of

⁴The Accounting Standard for Local Bodies is under preparation.

contract revenue billed for work performed on a contract whether or not they have been paid by the customer. Advances are amounts of contract revenue received by the contractor before the related work is performed.

53. An entity should present:

- (a) The gross amount due from customers for contract work as an asset; and**
- (b) The gross amount due to customers for contract work as a liability.**

54. The gross amount due from customers for contract work is the net amount of:

- (a) Costs incurred plus recognised surpluses; less
- (b) The sum of recognised deficits and progress billings for all contracts in progress for which costs incurred plus recognised surpluses to be recovered by way of contract revenue (less recognised deficits) exceeds progress billings.

55. The gross amount due to customers for contract work is the net amount of:

- (a) Costs incurred plus recognised surpluses; less
- (b) The sum of recognised deficits and progress billings for all contracts in progress for which progress billings exceed costs incurred plus recognised surpluses to be recovered by way of contract revenue (less recognised deficits).

56. Guidance on the disclosure of contingent liabilities and contingent assets can be found in ASLB on, '*Provisions, Contingent Liabilities and Contingent Assets*'⁵ Contingent liabilities and contingent assets may arise from such items as warranty costs, claims, penalties or possible losses.

Effective Date

57. [Refer to Appendix-1]

58. [Refer to Appendix-1]

⁵ The Accounting Standard for Local Bodies is under preparation.

Appendix A

The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

Disclosure of Accounting Policies

IG1. The following are the examples of accounting policy disclosures for a local body which enters non-commercial construction contracts with other government agencies for full, partial or no cost recovery from the other parties to the contract. The local body is also empowered to enter into commercial construction contracts with private sector entities and Public Sector Undertakings (PSUs) and to enter full cost recovery construction contracts as may be specified by appropriate agencies with certain state hospitals and state universities.

Non-Commercial Contracts

IG2. Contract costs are recognised as an expense on the percentage of completion method, measured by reference to the percentage of labour hours incurred to date to estimated total labour hours for each contract. In some cases, certain construction activity and technical supervision have been subcontracted to private sector contractors for a fixed "completion of contract" fee. Where this has occurred, the subcontracted costs are recognised as an expense on the percentage of completion method for each subcontract.

IG3. Contract revenue from full cost recovery contracts and partial cost recovery contracts entered into by the local body is recognised by reference to the recoverable costs incurred during the period, measured by the proportion that recoverable costs incurred to date bear to the estimated total recoverable costs of the contract.

Commercial Contracts

IG4. Revenue from fixed price construction contracts is recognised on the percentage of completion method, measured by reference to the percentage of labour hours incurred to date to estimated total labour hours for each contract.

IG5. Revenue from cost plus or cost based contracts is recognised by reference to the recoverable costs incurred during the period plus the fee earned, measured by the proportion that costs incurred to date bear to the estimated total costs of the contract.

The Determination of Contract Revenue and Expenses

IG6. The following examples deal with a non-commercial and a commercial

construction contract. The examples illustrate one method of determining the stage of completion of a contract and the timing of the recognition of contract revenue and expenses (see paragraphs 30 to 43 of the Standard).

Non-Commercial Contracts

- IG7. The Engineering and Public Works Department of a local body (the construction contractor) has a contract to build a bridge for the Department of Roads and Highways. The local body is funded by appropriation. The construction contract identifies construction requirements including anticipated costs, technical specifications and timing of completion but does not provide for any recovery of construction costs directly from the Department of Roads and Highways. The construction contract is a key management planning and accountability document attesting to the design and construction qualities of the bridge. It is used as input in assessing the performance of the contracting parties in delivering services of agreed technical specification within projected cost parameters. It is also used as input to future cost projections.
- IG8. The initial estimate of contract costs is 8,000. It will take three years to build the bridge. An aid agency has agreed to provide funding of 4,000 being half of the construction costs - this is specified in the construction contract.
- IG9. By the end of Year 1, the estimate of contract costs has increased to 8,050.
- IG10. In Year 2, the Department of Roads and Highways approves a variation resulting in estimated additional contract costs of 150. The aid agency agrees to fund 50% of the variation including the variation of year 1. At the end of Year 2, costs incurred include 100 for standard materials stored at the site to be used in Year 3 to complete the project.
- IG11. The local body determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed to date bear to the latest estimated total contract costs.
- IG12. A summary of the financial data during the construction period is as follows:

	Year 1	Year 2	Year 3
Initial amount of revenue agreed in contract	4,000	4,000	4,000
Variation in contract revenue	–	100	100
Total Contract Revenue	4,000	4,100	4,100
Contract costs incurred to date	2,093	6,168	8,200
Contract costs to complete	5,957	2,032	–
Total estimated contract costs	8,050	8,200	8,200
Stage of completion	26%	74%	100%

IG13. The stage of completion for Year 2 (74%) is determined by excluding from contract costs incurred for work performed to date the 100 for standard materials stored at the site for use in year 3.

IG14. The amounts of contract revenue and expenses recognised in the income and expenditure account in the three years are as follows:

	To Date	Recognised in prior years	Recognised in current year
Year 1			
Revenue (4,000 x .26)	1,040		1,040
Expenses (8,050 x .26)	2,093		2,093
	<hr/>		<hr/>
Year 2			
Revenue (4,100 x .74)	3,034	1,040	1,994
Expenses (8,200 x .74)	6,068	2,093	3,975
	<hr/>		<hr/>
Year 3			
Revenue (4,100 x 1.00)	4,100	3,034	1,066
Expenses (8,200 x 1.00)	8,200	6,068	2,132
	<hr/>		<hr/>

Commercial Contracts

IG15. The local body's Engineering and Public Works Department (the contractor) while predominantly funded by appropriation is empowered to undertake limited construction work on a commercial basis for private sector entities. With the authority of the governing board of the local body, the local body has entered a fixed price commercial contract for 9,000 to build a bridge.

IG16. The initial amount of revenue agreed in the contract is 9,000. The contractor's initial estimate of contract costs is 8,000. It will take three years to build the bridge.

IG17. By the end of Year 1, the local body's estimate of contract costs has increased to 8,050.

IG18. In Year 2, the customer approves a variation resulting in an increase in contract revenue of 200 and estimated additional contract costs of 150. At the end of Year 2, costs incurred include 100 for standard materials stored at the site to be used in Year 3 to complete the project.

IG19. The local body determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed to date bear to the latest estimated total contract costs. A summary of the financial data during the construction period is as follows:

	Year 1	Year 2	Year 3
Initial amount of revenue agreed in contract	9,000	9,000	9,000
Variation	–	20 0	20 0
Total Contract Revenue	9,000	9,200	9,200
Contract costs incurred to date	2,093	6,168	8,200
Contract costs to complete	5,957	2,032	
Total estimated contract costs	8,050	8,200	8,200
Estimated Surplus	950	1,000	1,000
Stage of completion	26%	74%	100%

IG20. The stage of completion for Year 2 (74%) is determined by excluding from contract costs incurred for work performed to date the 100 for standard materials stored at the site for use in Year 3.

IG21. The amounts of revenue, expenses and surplus recognised in the income and expenditure in the three years are as follows:

	To Date	Recognised in prior years	Recognised in Current Year
Year 1			
Revenue (9,000 x .26)	2,340		2,340
Expenses (8,050 x .26)	2,093		2,093
Surplus	<u>247</u>		<u>247</u>
Year 2			
Revenue (9,200 x .74)	6,808	2,340	4,468
Expenses (8,200 x .74)	6,068	2,093	3,975
	<u> </u>	<u> </u>	<u> </u>

Surplus	740	247	493
Year 3			
Revenue (9,200 x 1.00)	9,200	6,808	2,392
Expenses (8,200 x	8,200	6,068	2,132
Surplus	1,000	740	260

Contract Disclosures

Appropriation/Aid Funded Contracts and Full Cost Recovery Contracts

IG22. The Engineering and Public Works Department was recently created by local body as the entity to manage the construction of major buildings and road works for other government entities. It is funded predominantly by appropriation but with the approval of the Governing Board is empowered to undertake construction projects financed by provincial or national or international aid agencies. It has its own construction capabilities and can also subcontract. With the approval of the Governing Board, the Department may also undertake construction work on a commercial basis for private sector entities and Public Sector Undertaking (PSUs) and on a full cost recovery basis for state hospitals and state run universities.

IG23. The Engineering and Public Works Department has reached the end of its first year of operations. All its contract costs incurred have been paid for in cash and all its progress billings (to aid agencies that have commissioned construction work) have been received in cash. No advances to the Engineering and Public Works Department for construction work were made during the period. Contract costs incurred for contracts Band C include the cost of materials that have been purchased for the contract but which have not been used in contract performance to date. No commercial contracts have been undertaken this year. (See below for examples of commercial contracts.)

- Contract A is funded out of general appropriation revenue. (The contract includes no "contract revenue" as defined.)
- Contract B is with the Department of Education and the XX Aid Agency, which is funding 50% of the construction costs. (50% of the contract cost is to be reimbursed by parties to the contract and therefore is "contract revenue" as defined.)
- Contract C is totally funded by the National University. (The terms of the arrangement specify that all of the contract costs be to be reimbursed by the National University: from the University's major construction fund. Therefore, "contract revenue" as defined equals contract costs.)

IG24. The status of the three contracts in progress at the end of Year I is as follows:

	Contract			Total
	A	B	C	
Contract Revenue recognised in accordance with paragraph 30	–	225	350	575
Contract Expenses recognised in accordance with paragraph 30	110	450	350	910
Contract Costs funded by Appropriation	110	225	–	335
Contract Costs incurred in the period recognised as expenses (para 30)	110	510	450	1,070
recognised as an asset (para 35)	110	450	350	910
	-	60	100	160
Contract Revenue (see above)	-	225	350	575
Progress Billings (para 52)	-	225	330	555
Unbilled Contract Revenue	-	-	20	20
Advances (para 52)	-	-	-	-

The amounts to be disclosed in accordance with the standard are as follows:

Contract revenue recognised as revenue in the period (para 50(a)) 575

Contract costs incurred to date (para 51(a)) (there are no recognised surpluses/less recognised deficits) 1,070

Gross amount due from contract customers for contract work (determined in accordance with paragraph 54 and presented as an asset in accordance with paragraph 53(a)) 150

The amounts to be disclosed in accordance with the standard are as follows:

Contract revenue recognised as revenue in the period (para 50(a)) 575

Contract costs incurred to date (para 51 (a)) (there are no recognised surpluses/less recognised deficits) 1,070

Gross amount due from contract customers for contract work (Determined in accordance with paragraph 54 and presented as an asset in accordance with paragraph 53(a)) 150

Amounts to be disclosed in accordance with paragraphs 51(a) and 53(a) are as follows
(Note: contract revenue for B is 50% of contract costs):

	A	B	C	Total
Contract costs incurred	110	510	450	1,070
Progress billings	0	225	330	555
Due from aid agencies and customers	–	30	120	150

IG 25. The amount disclosed in accordance with paragraph 51 (a) is the same as the amount for the current period because the disclosures relate to the first year of operation.

Commercial Contracts

IG26. The Special Division has been established within the Engineering and Public Works Department of the local body to undertake construction work on a commercial basis for Public Sector Undertaking (PSUs) and private sector entities at the direction, and with the approval, of the Governing Board. The Special Division has reached the end of its first year of operations. All its contract costs incurred have been paid for in cash and all its progress billings and advances have been received in cash. Contract costs incurred for contracts B, C and E include the cost of materials that have been purchased for the contract but which have not been used in contract performance to date. For contracts B, C and E, the customers have made advances to the contractor for work not yet performed.

IG27. The status of its five contracts in progress at the end of Year 1 is as follows:

	Contract					Total
	A	B	C	D	E	
Contract revenue recognised in accordance with paragraph 30	145	520	380	200	55	1,300
Contract expenses recognised in Accordance with paragraph 30	110	450	350	250	55	1,215
Expected deficits recognised in Accordance with paragraph 44	–	–	–	40	30	70
Recognised surpluses less recognised deficits	35	70	30	(90)	(30)	15
Contract costs incurred in the period	110	510	450	250	100	1,420

Contract costs incurred recognised as contract expenses in the period in accordance with paragraph 30	110	450	350	250	55	1,215
Contract costs that relate to future activity recognised as an asset in accordance with paragraph 33	–	60	100	–	45	205
Contract revenue (see above)	145	520	380	200	55	1,300
Progress billings (para 52)	100	520	380	180	55	1,235
Unbilled contract Revenue	45	–	–	20	–	65
Advances (para 52)	–	80	20	–	25	125

The amounts to be disclosed in accordance with the Standard are as follows:

Contract revenue recognised as revenue in the period (para 50(a))	1,300
Contract costs incurred and recognised surpluses (less recognised deficits) to date (para 51(a))	1,435
Advances received (para 51(b))	125
Gross amount due from customers for contract work - presented as an asset in accordance with paragraph 53 (a)	220
Gross amount due to customers for contract work - presented as an asset in accordance with paragraph 53(b)	(20)

The amounts to be disclosed in accordance with paragraphs 50(a), 53(a) and 53(b) are calculated as follows:

	A	B	C	D	E	Total
Contract costs incurred	110	510	450	250	100	1,420
Recognised surpluses less recognised deficits	35	70	30	(90)	(30)	15
	145	580	480	160	70	1,435
Progress billings	100	520	380	180	55	1,235
Due from customers	45	60	100		15	220
Due to customers	–	–	–	(20)	–	(20)

IG28. The amount disclosed in accordance with paragraph 51 (a) is the same as the amount for the current period because the disclosures relate to the first year of operation.

Appendix 1

Note: This Appendix is not a part of the Accounting Standard for Local Bodies. The purpose of this Appendix is only to bring out the major differences, if any, between Accounting Standard for Local Bodies (ASLB) -11 and the corresponding International Public Sector Accounting Standard (IPSAS) 11, Construction Contracts.

COMPARISON WITH IPSAS 11, CONSTRUCTION CONTRACTS

1. ASLB 11 uses different terminology, in certain instances, from IPSAS 11. For example, the use of the term 'income and expenditure account' in ASLB 11, for which equivalent term in IPSAS 11 is 'statement of financial performance'.
2. Paragraph 3 of IPSAS 11 which provides that Government Business Enterprises should use IFRSs, has been deleted, as it is not relevant for ASLB 11, which is applicable to Local Bodies of India. However, paragraph number 3 is retained in ASLB 11, in order to maintain consistency with IPSAS 11.
3. Paragraph 10A on the applicability of the Standard in case of 'deposit works' has been included in the ASLB 11.
4. Additional commentary has been provided in paragraph 20 (a), to clarify the applicability of the ASLB 11, in the context of local bodies.
5. IPSAS 11 requires contract revenue to be measured at fair value of consideration received/receivable, whereas ASLB 11 requires that contract revenue should be measured at consideration received/receivable.
6. Paragraphs relating to effective date have been removed as the ASLB 11 would become mandatory for Local Bodies in a state from the date specified by the State Government concerned. Paragraph numbers have been retained in order to maintain consistency with IPSAS 11.

Appendix 2

Note: This Appendix is not a part of the Accounting Standard for Local Bodies. The purpose of this Appendix is only to bring out the major differences, if any, between Accounting Standard for Local Bodies (ASLB) -11 and the corresponding existing Accounting Standard (AS 7) (revised 2002), Construction Contracts.

COMPARISON WITH CORRESPONDING EXISTING ACCOUNTING STANDARD (AS 7) (REVISED 2002), CONSTRUCTION CONTRACTS

1. ASLB 11 as compared to AS 7 includes binding arrangements that do not take the form of a legal contract within the scope of the Standard.
2. ASLB 11 includes non-commercial contracts within the scope of the Standard whereas AS 7 does not deal with such contacts.
3. ASLB 11 includes additional examples as compared to AS 7, to illustrate the application of the Standard to non-commercial construction contracts.
4. Different terminology is used in certain instances e.g., the term 'Income and Expenditure Account' is used instead of 'Profit and Loss Account'.
5. Paragraph 10A on the applicability of the Standard in case of 'deposit works' has been included in the ASLB 11.