IND AS ON RECOGNITION OF REVENUE IN THE FINANCIAL STATEMENTS

UNIT 1:
INDIAN ACCOUNTING STANDARD 11: CONSTRUCTION CONTRACTS

LEARNING OUTCOMES

After studying this unit, you will be able to:

- Define the construction contracts
- Classify the construction contracts
- Identify the construction contracts by examining the criteria and applying the same in further evaluation of contract revenue and expenses
- Recognise contract revenue and expenses as per the method prescribe
- Recognise the expected loss
- Disclose and present the contract details as prescribed in the standard.
- Do the accounting for the operators for public-to-private service concession arrangements after addressing various issues arising in the due course.

© The Institute of Chartered Accountants of India
5.2 FINANCIAL REPORTING

UNIT OVERVIEW

Ind AS 11

- Definition of Construction contracts
  - An asset
  - Combination of assets
- Classification of construction contracts
  - Fixed price contracts
  - Cost plus contracts
- Identification of Construction contracts
  - Segment criteria
  - Combination criteria
  - Additional assets
- Recognition of contract revenue and contract expenses
  - Initial amount
  - Variation
  - Claim
  - Incentive
  - Specific costs
- Service Concession Arrangements
- Recognition of expected losses
  - Cost incurred till date
  - Future estimated cost
- Total estimated cost of contract
- Total contact revenue
- Contract revenue
- Contract cost
- Direct costs
- Allocated contract overhead
- Specific costs

© The Institute of Chartered Accountants of India
1.1 INTRODUCTION

Most of the Accounting Standards deal with the topics and areas that are relevant for all the industries, such as, presentation of financial statements, inventories, property, plant and equipment, revenue etc. Ind AS 11 unlike most of the other Accounting Standards provides guidance to a particular industry – ‘construction industry’. This is because of the nature of construction industry where in majority of the cases, the revenue generating projects have a long gestation period. The activities are commenced in one period and completed in another period. The gap between these two periods could range anywhere between 2-10 years, perhaps even longer in some cases. The accountant faces the issue as to when and how the revenues and costs be recognised and measured in the statement of profit and loss of the accounting periods when the work is being performed. Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed.

Ind AS 11 defines what is a construction contract, its various types and prescribes accounting treatment of the revenue and costs that are associated with these contracts in the Statement of Profit and Loss. To determine when contract revenue and contract costs should be recognised as revenue and expenses in the Statement of Profit and Loss, Ind AS 11 uses the recognition criteria established in the Framework for the Preparation and Presentation of Financial Statements in accordance with Ind AS issued by the Institute of Chartered Accountants of India.

This Accounting Standard also provides practical guidance on the application of these criteria.

1.2 SCOPE

Ind AS 11 is to be applied in accounting for construction contracts in the financial statements of contractors.

1.3 CONSTRUCTION CONTRACTS

1.3.1 Definition

Ind AS 11 defines construction contract as 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, function, ultimate purpose or use.
1.3.2 Analysis of Definition

- The definition deals with a construction of a single asset such as bridge, building, dam, pipeline, road, ship or tunnel.

- It also includes construction of multiple assets as or a combination of number of assets by the contractor which are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use including those for the construction of refineries and other complex pieces of plant or equipment.

- The construction contracts envisaged in Ind AS 11 includes contracts for:
  
  (a) the rendering of services which are directly related to the construction of the asset; and

  Example Contract for the services of project managers and architects

  (b) the destruction or restoration of assets, and the restoration of the environment following the demolition of assets.
1.4 CLASSIFICATION OF CONSTRUCTION CONTRACTS

Construction contracts are mainly classified into:

(a) **Fixed price contracts**

A 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.

(b) **Cost plus contracts**

A cost plus contract is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus a percentage of these costs or a fixed fee.

**Note:** There are different criteria and conditions for recognition of contract revenue and expenses, separately for fixed price contract and cost plus contract.

(c) **Hybrid contracts**

However, certain construction contracts may contain characteristics of both a fixed price contract and a cost plus contract.

**Example:** In the case of a cost plus contract there could be an agreed maximum price.

In such circumstances, a contractor to recognise contract revenue and expenses needs to consider all the recognition conditions prescribed for fixed price contract as well as for cost plus contract in order to determine when to recognise contract revenue and expenses.
1.5 IDENTIFYING CONSTRUCTION CONTRACT

- The requirements of Ind AS 11 are usually **applied separately** to each construction contract.

- In certain circumstances, Ind AS 11 is **applied together** to the separately identifiable components of a single contract or to a group of contracts –
  - in order to reflect the substance of a contract or a group of contracts.

### 1.5.1 Segmentation Criteria

When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when all the following conditions are satisfied:

(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.

**Example**: B Limited has taken a construction contract from the authority to develop a township. The contract involves several other contracts such as residential complexes, roads, power stations, reservoirs and commercial complex. Separate tenders were floated and separate proposals have been submitted for the same. Negotiations have been separate. However, all the contracts have been awarded to B Limited. This will be a case of segmenting the contracts as there are separate proposals, separate negotiations, the award of one contract has no relationship with the other and costs and revenues of each contract are separately identifiable.

### 1.5.2 Combination Criteria

A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when all the following conditions are satisfied:

(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 profit margin; and

(c) the contracts are performed concurrently or in a continuous sequence.

### 1.5.3 Additional Asset

- Sometimes the terms of a contract may provide at the option of the customer for construction of an additional asset.

- Sometimes the contract is amended to include the construction of an additional asset.
The question that needs to be answered is whether the contract of this additional asset is a contract for separate asset or is a contract for just an extension of the original asset.

- The construction of the additional asset should be treated as a separate construction contract when any one of the following condition is met:

  **Condition 1:** The asset differs significantly in design, technology or function from the asset or assets covered by the original contract.
  
  **Condition 2:** The price of the asset is negotiated without regard to the original contract price.

### 1.6 WHAT IS CONTRACT REVENUE?

As we know, construction contracts are performed over a number of reporting periods. The commercial and business environment is so dynamic that it is impossible to predict the future events. From a contractor perspective, his input costs may change considerably because of events not under his control. There could be input price increases, stoppages of work for reasons not related to him. From the customer perspective there could be losses due to delay in work or inferior quality of construction. While negotiating, both the customer and contractor anticipates and considers quite a few of these types of event that impact contract revenue or costs. Still, the future remains uncertain and to address these uncertainties, certain clauses are provided in the agreement for these types of event that may or may not unfold in future. The exact contract revenue till the time the contract is finally completed remains an estimate that may require modification from period to period.

- Contract revenue comprises of two items:
  
  **Item A:** The initial amount of revenue agreed in the contract; and
  
  **Item B:** Variations in contract work, claims and incentive payments:
    
    - to the extent that it is probable that they will result in revenue; and
    
    - they are capable of being reliably measured.

- Contract revenue is measured at the fair value of the consideration received or receivable.
The measurement of contract revenue is subject to a number of uncertainties which arises during the tenure of the construction contract since the contract is executed, in general, over a number of reporting periods.

These uncertainties further depend on the outcome of future events not in the control of the entity.

The estimates on which measurement of contract revenue is dependent needs to be revised as the events occur and uncertainties are resolved.

The amount or estimate of contract revenue may thus increase or decrease from one reporting period to next reporting period. Some of the reasons for this increase or decrease are:

(a) a contractor and a customer may agree 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 contract may increase as a result of cost escalation 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 as the number of units is increased.

1.7.1 Variation

A variation is an instruction by the customer for a change in the scope of the work to be performed under the contract such as changes in the specifications or design of the asset and changes in the duration of the contract.

A variation may lead to an increase or a decrease in contract revenue.

A variation should be included in contract revenue only when both the following two conditions are satisfied:

(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 reliably measured.
1.7.2 Claim

- **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 included in contract revenue only when both the following two conditions are satisfied:
  
  (a) negotiations 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.

1.7.3 Incentive payments

- **Incentive payments** are additional amounts paid to the contractor if specified performance standards are met or exceeded.

  **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 only when both the following two conditions are satisfied:
  
  (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.

**Note**: A variation, claim or incentive normally lead to increase in revenue therefore one needs to be prudent and careful in recognising and measuring revenue from these items.

**Illustration 1**

Mr. ‘X’ as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, ‘X’ will receive an additional ₹2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognize this revenue since in the past he has been able to meet similar targets very easily.

Is X correct in his proposal? Discuss.
Solution

According to Ind AS 11 ‘Construction Contracts’, incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. Incentive payments are included in contract revenue when:

(i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and

(ii) the amount of the incentive payment can be measured reliably. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.

On careful reading, you will find that the following two universal criteria have been adopted for recognizing the additional revenue:

(a) Probability criteria; and

(b) Reliable measurement criteria.

1.8 WHAT ARE CONTRACT COSTS?

Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract and include primarily three types of costs (explained below).

<table>
<thead>
<tr>
<th>Direct Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allocated Contract Overhead</td>
</tr>
<tr>
<td>Specific Costs</td>
</tr>
</tbody>
</table>

Three types of cost are:

1. **Costs that relate directly to the specific contract and includes:**
   - site labour costs, including site supervision;
   - costs of materials used in construction;
   - depreciation of plant and equipment used on the contract;
   - costs of moving plant, equipment and materials to and from the contract site;
   - costs of hiring plant and equipment;
5.11

- costs of design and technical assistance that is directly related to the contract;
- the estimated costs of rectification and guarantee work, including expected warranty costs; and
- claims from third parties.

**Note:** The above costs may be reduced by any incidental income that is not included in contract revenue.

**Example:** Income from the sale of surplus materials and the disposal of plant and equipment at the end of the contract will reduce the contract cost.

2. **Costs that are attributable to contract activity in general and can be allocated to the contract and includes:**
   - insurance;
   - costs of design and technical assistance that are not directly related to a specific contract;
   - borrowing costs; and
   - construction overheads such as the preparation and processing of construction personnel payroll.

**Note:**
- Such costs are allocated using methods that are systematic and rational and are applied consistently to all costs having similar characteristics.
- The allocation is based on the normal level of construction activity.

3. **Other costs as are specifically chargeable to the customer under the terms of the contract which may include**
   - some general administration costs and
   - development costs

for which reimbursement is specified in the terms of the contract.

**Note:**
- Costs that are incurred in securing the particular contract are also included as part of the directly attributable 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.
1.9 EXCLUSION FROM COST OF CONSTRUCTION CONTRACT

- Costs that cannot be attributed to contract activity or cannot be allocated to a contract are not included as part of the costs of a construction contract.

- Such costs includes:
  
  (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.

1.10 RECOGNITION OF CONTRACT REVENUE AND EXPENSES

- Contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively

  (a) On percentage completion method i.e., with reference to the stage of completion of the contract activity at the end of the reporting period; and

  (b) When the outcome of a construction contract can be estimated reliably.

- An expected loss on the construction contract should be recognised as an expense immediately in accordance with this standard.

1.10.1 Percentage Completion Method

This method provides useful information on the extent of contract activity and performance during a period.

Under this method:

(a) Contract revenue is matched with the contract costs incurred in reaching the stage of completion. This result in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed.

(b) Contract revenue is recognised as revenue in profit or loss in the accounting periods in which the work is performed.
(c) Contract costs are usually recognised as an expense in profit or loss in the accounting periods in which the work to which they relate is performed.

(d) However, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately.

Note: Progress payments and advances received from customers often do not reflect the work performed.

Illustration 2 (The percentage completion method)

X Ltd. commenced a construction contract on 01/04/20X1. The fixed contract price agreed was ₹ 2,00,000. The company incurred ₹ 81,000 in 20X1-20X2 for 45% work and received ₹ 79,000 as progress payment from the customer. The cost incurred in 20X2-20X3 was ₹ 89,000 to complete the rest of work.

Solution

<table>
<thead>
<tr>
<th>Profit &amp; Loss Account</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Year</strong></td>
</tr>
<tr>
<td>20X1-20X2</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>20X2-20X3</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Customer Account</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Year</strong></td>
</tr>
<tr>
<td>20X1-20X2</td>
</tr>
</tbody>
</table>

© The Institute of Chartered Accountants of India
5.14 FINANCIAL REPORTING

<table>
<thead>
<tr>
<th>20X2-20X3</th>
<th>To Balance b/d</th>
<th>11</th>
<th>20X2-20X3</th>
</tr>
</thead>
<tbody>
<tr>
<td>By Contract Price</td>
<td>110</td>
<td>By Bank</td>
<td>121</td>
</tr>
<tr>
<td>To Contract Price</td>
<td>110</td>
<td></td>
<td></td>
</tr>
<tr>
<td>By Balance c/d</td>
<td>11</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Profit & Loss Account**

<table>
<thead>
<tr>
<th>₹ 000</th>
<th>₹ 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Construction Costs</td>
<td>100</td>
</tr>
<tr>
<td>To Provision for loss</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>105</td>
</tr>
</tbody>
</table>

1.10.2 Determination of stage of completion

Any of the following methods may be adopted to determine the stage of completion of construction contracts, based on the nature of the contract:

(a) the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs i.e. \[
\frac{\text{Cost incurred till date}}{\text{Cost incurred till date + estimated future cost}}
\]

(b) surveys of work performed; or

(c) completion of a physical proportion of the contract work.

Example

X Ltd. commenced a construction contract on 01/04/20X1. The contract price agreed was reimbursable cost plus 20%. The company incurred ₹ 1,00,000 in 20X1-20X2, of which ₹ 90,000 is reimbursable. The further non-reimbursable costs to be incurred to complete the contract are estimated at ₹ 5,000. The other costs to complete the contract could not be estimated reliably.

The Profit & Loss A/c extract of X Ltd. for 20X1-20X2 is shown below:

© The Institute of Chartered Accountants of India
Illustration 3

A Limited has entered into a contract with B Limited for construction of a bridge estimated cost of ₹15 crores and revenue of ₹20 crores. At the end of year 1, A Limited has incurred ₹6 crores. However, B Limited has been invoiced for ₹7 crores. The payment is due in first quarter of year 2. Determine the cost and revenues to be recognised based on percentage completion method.

Solution

Based on proportion of cost incurred to date (₹ 6 crores) with total cost (₹ 15 crores), the percentage completion is 40%. Based on this, A Limited should recognise revenues of ₹8 crores (40% of ₹20 crores) and cost at ₹6 crores in year 1.

Note: If the stage of completion is worked out with reference to the contract costs incurred to date, an entity includes only those contract costs that reflect work performed in costs incurred to date.

The entity excludes the following contract costs (illustrative list) while determining the cost incurred till date:

(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.

Note:
- Such contract costs are recognised as an asset provided it is probable that they will be recovered.
- These costs represent an amount due from the customer and are often classified as contract work in progress.

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

1.10.3 When can the outcome of a construction contract be estimated reliably

- The outcome of a construction contract can only be estimated reliably when it is probable that the economic benefits associated with the contract will flow to the entity.

- An entity can make reliable estimates about the outcome of the construction contract only where the terms of contract establish:
  (a) each party’s enforceable rights regarding the asset to be constructed;
  (b) the consideration to be exchanged; and
  (c) the manner and terms of settlement.

© The Institute of Chartered Accountants of India
The entity may review and revise, if necessary the estimates of contract revenue and contract costs as the contract progresses. However, such revisions do not necessarily mean that the outcome of the contract cannot be estimated reliably.

However, when an uncertainty arises about the collectability of an amount already included in contract revenue, and already recognised in profit or loss, the uncollectible 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.

Also 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 by reference to the stage of completion of the contract activity at the end of the reporting period.

1.10.4 Fixed Price Contract

Where the construction contract is in the nature of a fixed price contract, an entity can estimate reliably the outcome of a construction contract only when all the following conditions are satisfied:

(a) total contract revenue can be measured reliably;

(b) it is probable that the economic benefits 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 end of the reporting period 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.

Where the construction contract is in the nature of a cost plus contract, an entity can estimate reliably the outcome of a construction contract only when all the following conditions are satisfied:

(a) it is probable that the economic benefits 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.

1.10.5 When the outcome of a construction contract cannot be estimated reliably

There are situations when the outcome of a construction contract cannot be estimated reliably. It could be at the inception of the contract, e.g., during the early stages of a contract or it may occur any time during the period when the construction contract is being performed.
In these situations, how does one recognise the revenue and the contract costs that have been incurred. In such a situation, the following principles should be adopted:

(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.

(c) **Expected loss**: Even though the entity may not be able to reliably estimate the outcome of the construction contract, it is possible that total contract cost may exceed total contract revenue. Any expected excess of contract costs over contract revenue (i.e., expected loss) should be recognised as an expense immediately.

There should be no recognition of profit.

Further, there could be situations where it is probable that contract costs may not be recovered. These situations include contracts:

(a) that are not fully enforceable, i.e., 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.

In these situations, contract costs are recognised as an expense immediately in the statement of profit and loss.

**Example:**

A construction contractor has a fixed price contract for ₹ 9,000 lakhs to build a bridge. The initial amount of revenue agreed in the contract is ₹ 9,000 lakhs. The contractor’s initial estimate of contract costs is ₹ 8,000 lakhs. It will take 3 years to build the bridge.

By the end of year 1, the contractor’s estimate of contract costs has increased to ₹ 8,050 lakhs.

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

The contractor 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:

(₹ in Lakhs)

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial amount of revenue agreed in contract</td>
<td>9,000</td>
<td>9,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Variation</td>
<td>–</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>Total contract revenue</td>
<td>(A)</td>
<td>9,000</td>
<td>9,200</td>
</tr>
<tr>
<td>Contract costs incurred to date</td>
<td>2,093</td>
<td>6,168</td>
<td>8,200</td>
</tr>
<tr>
<td>Contract costs to complete</td>
<td>5,957</td>
<td>2,032</td>
<td>–</td>
</tr>
<tr>
<td>Total estimated contract costs</td>
<td>(B)</td>
<td>8,050</td>
<td>8,200</td>
</tr>
<tr>
<td>Estimated profit</td>
<td>(A-B)</td>
<td>950</td>
<td>1,000</td>
</tr>
<tr>
<td>Stage of completion</td>
<td>26%</td>
<td>74%</td>
<td>100%</td>
</tr>
</tbody>
</table>

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

The amounts of revenue, expenses and profit recognised in the statement of profit and loss in the three years are as follows:

<table>
<thead>
<tr>
<th></th>
<th>To date</th>
<th>Recognised in prior years</th>
<th>Recognised in current year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Year 1</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue (9,000 × .26)</td>
<td>2,340</td>
<td>–</td>
<td>2,340</td>
</tr>
<tr>
<td>Expenses (8,050 × .26)</td>
<td>2,093</td>
<td>–</td>
<td>2,093</td>
</tr>
<tr>
<td>Profit</td>
<td>247</td>
<td>–</td>
<td>247</td>
</tr>
<tr>
<td><strong>Year 2</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue (9,200 × .74)</td>
<td>6,808</td>
<td>2,340</td>
<td>4,468</td>
</tr>
<tr>
<td>Expenses (8,200 × .74)</td>
<td>6,068</td>
<td>2,093</td>
<td>3,975</td>
</tr>
<tr>
<td>Profit</td>
<td>740</td>
<td>247</td>
<td>493</td>
</tr>
</tbody>
</table>
Illustration 5

M/s Highway Constructions undertook the construction of a highway on 01.04.2020X1. The contract was to be completed in 2 years. The contract price was estimated at ₹150 crores. Up to 31.03.20X2 the company incurred ₹120 crores on the construction. The engineers involved in the project estimated that a further ₹45 crores would be incurred for completing the work.

What amount should be charged to revenue for the year 20X1-20X2 as per the provisions of Ind AS 11 "Construction Contracts"? Show the extract of the Profit & Loss A/c in the books of M/s. Highway Constructions.

Solution

Statement showing the amount to be charged to Revenue as per Ind AS 11

<table>
<thead>
<tr>
<th>₹ in crores</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of construction incurred upto 31.03.2020X2</td>
</tr>
<tr>
<td>Add: Estimated future cost</td>
</tr>
<tr>
<td>Total estimated cost of construction</td>
</tr>
<tr>
<td>Degree of completion (120/165 x 100)</td>
</tr>
<tr>
<td>Revenue recognized (72.73% of 150)</td>
</tr>
<tr>
<td>Total foreseeable loss (165 – 150)</td>
</tr>
<tr>
<td>Less: Loss for the current year (120 – 109)</td>
</tr>
<tr>
<td>Loss to be provided for</td>
</tr>
</tbody>
</table>
5.20 FINANCIAL REPORTING

Profit and Loss Account (Extract)

<table>
<thead>
<tr>
<th></th>
<th>₹ in crores</th>
<th></th>
<th>₹ in crores</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Construction Costs</td>
<td>120</td>
<td>By Contract Price</td>
<td>109</td>
</tr>
<tr>
<td>To Provision for loss</td>
<td>4</td>
<td>By Net loss</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>124</td>
<td></td>
<td>124</td>
</tr>
</tbody>
</table>

1.11 RECOGNITION OF EXPECTED LOSSES

The contractor when performing a contract may conclude during the course of performance of the contract that it is probable the total contract costs will ultimately exceed total revenue that could be realised from the customer.

- In this situation, the expected loss should be recognised immediately as an expense.
- This recognition of expected loss as expense is irrespective of:
  (a) work has commenced on the contract;
  (b) the stage of completion of the contract activities; or
  (c) the amount of profits expected to arise on other contracts which are not treated as single contracts due to application of segmentation criteria

Illustration 6

On 1st December, 20X1, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 20X2, the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of additional cost for completion was ₹ 32,01,000. What amount should be charged to revenue in the final accounts for the year ended 31st March, 20X2 as per Ind AS 11?
Solution

<table>
<thead>
<tr>
<th>Description</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost incurred till 31st March, 20X2</td>
<td>64,99,000</td>
</tr>
<tr>
<td>Prudent estimate of additional cost for completion</td>
<td>32,01,000</td>
</tr>
<tr>
<td>Total cost of construction</td>
<td>97,00,000</td>
</tr>
<tr>
<td>Less: Contract price</td>
<td>(85,00,000)</td>
</tr>
<tr>
<td>Total foreseeable loss</td>
<td>12,00,000</td>
</tr>
</tbody>
</table>

According to para 33 of Ind AS 11, the amount of ₹ 12,00,000 is required to be recognized as an expense.

\[
\text{Contract work in progress} = \frac{64,99,000 \times 100}{97,00,000} = 67\%
\]

Proportion of total contract value recognized as turnover = 67% of ₹ 85,00,000 = ₹ 56,95,000.

1.12 CHANGE IN ESTIMATE OR PRIOR PERIOD ERROR

- The construction contracts by their nature are performed over more than one reporting period. Further as per the recognition criteria based on percentage completion method, contract revenues and contract costs are estimated on a cumulative basis. These estimates of revenue and costs are subject to uncertainties and events that will unfold in future. The actual may thus differ from estimates. Even estimates of subsequent years may need revision.
- The Standard clarifies that this is a change in accounting estimate (Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors). Also the changed estimates are used in the determination of the amount of revenue and expenses recognised in profit or loss in the period in which the change is made and in subsequent periods.

1.13 DISCLOSURE & PRESENTATION

- The following disclosures should be made by the entity in its financial statements:
  (a) General:
    - the amount of contract revenue recognised as revenue in the period;
    - the methods used to determine the contract revenue that has been recognised in the period; and
● the methods used to determine the stage of completion of contracts in progress.
● contingent liabilities and contingent assets in accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*. Contingent liabilities and contingent assets may arise from such items as warranty costs, claims, penalties or possible losses.

(b) For each of the contracts that are in progress at the end of the reporting period:
● the aggregate amount of costs incurred and recognised profits (less recognised losses) till the end of the reporting period;
● the amount of advances received; and
● the amount of retentions.

The entity should present the:
(a) Gross amount due from customers for contract work as an asset; and

(b) Gross amount due to customers for contract work as a liability.

Definitions of some important terms
(a) The **gross amount due from customers** for contract work is the net amount of:
● costs incurred plus recognised profits; less
● the sum of recognised losses and progress billings for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceeds progress billings.

(b) The **gross amount due to customers** for contract work is the net amount of:
● costs incurred plus recognised profits; less
● the sum of recognised losses and progress billings for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses).

(c) **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.

(d) **Progress billings** are amounts billed for work performed on a contract whether or not they have been paid by the customer.

(e) **Advances** are amounts received by the contractor before the related work is performed.
Example

A Limited enters with a customer a 3 year construction contract for ₹10,00,000. The estimated total costs are ₹7,00,000. In year 2, the management has to revise the estimated costs. The contract however remains profitable. The relevant figures are as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated Revenue</td>
<td>10,00,000</td>
<td>10,00,000</td>
<td>10,00,000</td>
</tr>
<tr>
<td>Estimated total costs</td>
<td>6,00,000</td>
<td>8,50,000</td>
<td>8,50,000</td>
</tr>
<tr>
<td>Estimated total profits</td>
<td>4,00,000</td>
<td>1,50,000</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Costs incurred till date</td>
<td>3,00,000</td>
<td>6,80,000</td>
<td>8,50,000</td>
</tr>
<tr>
<td>Percentage of completion (based on cost)</td>
<td>50%</td>
<td>80%</td>
<td>100%</td>
</tr>
<tr>
<td>Cumulative recognised profits (Estimated revenue x percentage completion – costs incurred till date)</td>
<td>2,00,000</td>
<td>1,20,000</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Recognised profit for the year</td>
<td>2,00,000</td>
<td>(80,000)</td>
<td>30,000</td>
</tr>
</tbody>
</table>

Solution

The asset or liability at the end of each year will be computed as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Costs incurred till date</td>
<td>3,00,000</td>
<td>6,80,000</td>
<td>8,50,000</td>
</tr>
<tr>
<td>Cumulative recognised profits (losses)</td>
<td>2,00,000</td>
<td>1,20,000</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Progress billings *</td>
<td>4,00,000</td>
<td>8,50,000</td>
<td>9,50,000</td>
</tr>
<tr>
<td>Gross amount due from customers at the year end</td>
<td>1,00,000</td>
<td></td>
<td>50,000</td>
</tr>
<tr>
<td>(Amount recognised as an asset)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross amount due to customers (Amount recognised as an liability) at the year end</td>
<td></td>
<td>(50,000)</td>
<td></td>
</tr>
</tbody>
</table>

* Assumed figures

© The Institute of Chartered Accountants of India
Illustration 7

A construction company spend ₹ 1,80,000 for tendering and incidental expenses for securing a contract. The contract price is ₹ 55,000. The construction is expected to be completed in 2 years.

The company has incurred the following expenses and has worked out the additional revenue.

<table>
<thead>
<tr>
<th>₹000's</th>
<th>Year 0</th>
<th>Year 1</th>
<th>Year 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expenses:</strong></td>
<td>Actual</td>
<td>Actual</td>
<td>Budgeted</td>
</tr>
<tr>
<td>Tendering Costs</td>
<td>180</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee benefits: Site Costs</td>
<td></td>
<td>4,000</td>
<td>3,700</td>
</tr>
<tr>
<td>Transport charges</td>
<td></td>
<td>120</td>
<td>110</td>
</tr>
<tr>
<td>Depreciation</td>
<td></td>
<td>800</td>
<td>800</td>
</tr>
<tr>
<td>Materials</td>
<td></td>
<td>15,100</td>
<td>19,000</td>
</tr>
<tr>
<td>Contract overhead (10%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>2,000</td>
<td>2,200</td>
<td></td>
</tr>
<tr>
<td>Design and Technical Assistance</td>
<td>1,000</td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td>Contract Administration</td>
<td>2,000</td>
<td>2,400</td>
<td></td>
</tr>
<tr>
<td><strong>Additional Revenue:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Claims</td>
<td>350</td>
<td></td>
<td>500</td>
</tr>
<tr>
<td>Variations</td>
<td>700</td>
<td></td>
<td>200</td>
</tr>
<tr>
<td>Incentives</td>
<td></td>
<td></td>
<td>500</td>
</tr>
</tbody>
</table>

Find out the estimated contract revenue and contract costs. Also calculate contract profit or loss. Material inventory at the end of the year 1 was ₹ 1,00,000.

**Solution**

Analysis of Contract Revenue, Contract Costs and Profit/Loss

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Year 0 Actual</th>
<th>Year 1 Actual</th>
<th>Year 2 Budgeted</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract Revenue:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Initial Revenue</td>
<td></td>
<td>700</td>
<td>200</td>
<td>900</td>
</tr>
<tr>
<td>Variations</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td>55,000</td>
</tr>
<tr>
<td>Claims</td>
<td>350</td>
<td>500</td>
<td>850</td>
<td></td>
</tr>
<tr>
<td>--------</td>
<td>-----</td>
<td>-----</td>
<td>-----</td>
<td></td>
</tr>
<tr>
<td>Incentives</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td><strong>Total Estimated Revenue</strong></td>
<td><strong>1,050</strong></td>
<td><strong>1,200</strong></td>
<td><strong>57,250</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Contract Costs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tendering Costs</td>
<td>180</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct Costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee Benefits: Site Staff</td>
<td>4,000</td>
<td>3,700</td>
<td>7,700</td>
<td></td>
</tr>
<tr>
<td>Transport charges</td>
<td>120</td>
<td>110</td>
<td>230</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>800</td>
<td>800</td>
<td>1,600</td>
<td></td>
</tr>
<tr>
<td>Material after Inventory Adjustments</td>
<td>15,000</td>
<td>19,100</td>
<td>34,100</td>
<td></td>
</tr>
<tr>
<td><strong>Total Direct Costs</strong></td>
<td><strong>180</strong></td>
<td><strong>19,920</strong></td>
<td><strong>23,710</strong></td>
<td><strong>43,810</strong></td>
</tr>
<tr>
<td><strong>Contract Overheads</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>2,000</td>
<td>2,200</td>
<td>4,200</td>
<td></td>
</tr>
<tr>
<td>Design and Technical Assistance</td>
<td>1,000</td>
<td>1,200</td>
<td>2,200</td>
<td></td>
</tr>
<tr>
<td>Contract Administration</td>
<td>2,000</td>
<td>2,400</td>
<td>4,400</td>
<td></td>
</tr>
<tr>
<td><strong>Total Contract Overhead</strong></td>
<td></td>
<td><strong>5,000</strong></td>
<td><strong>5,800</strong></td>
<td><strong>10,800</strong></td>
</tr>
<tr>
<td><strong>Allocation @ 10%</strong></td>
<td></td>
<td><strong>500</strong></td>
<td><strong>580</strong></td>
<td><strong>1,080</strong></td>
</tr>
<tr>
<td><strong>Total Costs</strong></td>
<td><strong>180</strong></td>
<td><strong>20,420</strong></td>
<td><strong>24,290</strong></td>
<td><strong>44,890</strong></td>
</tr>
<tr>
<td><strong>Stage of Completion</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(By ratio of costs incurred)</td>
<td>45.89%</td>
<td>54.11%</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Estimated Profit</strong></td>
<td></td>
<td></td>
<td><strong>12,360</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Proportionate Profit</strong></td>
<td></td>
<td><strong>5,672</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
1.14 SERVICE CONCESSION ARRANGEMENTS

1.14.1 About Arrangement

- Service Concession Arrangement involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes.

- Such an arrangement is often described as a ‘build-operate-transfer’, a ‘rehabilitate-operate-transfer’ or a ‘public-to-private’ service concession arrangement.

Example

Infrastructure for public services—such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks—has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.

- A feature of these service arrangements is the public service nature of the obligation undertaken by the operator.

- Public policy is for the services related to the infrastructure to be provided to the public, irrespective of the identity of the party that operates the services. The service arrangement contractually obliges the operator to provide the services to the public on behalf of the public sector entity. Other common features are:

  (a) the party that grants the service arrangement (the grantor) is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved.
(b) the operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor.

(c) the contract sets the initial prices to be levied by the operator and regulates price revisions over the period of the service arrangement.

(d) the operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

1.14.2 Scope

1.14.2.1 Applicability

The guidance given in the Appendix A of Ind AS 11 applies to

(a) infrastructure that the operator constructs or acquires from a third party for the purpose of the service arrangement; and

(b) existing infrastructure to which the grantor gives the operator access for the purpose of the service arrangement.

1.14.2.2 Non-applicability

- It does not specify the accounting for infrastructure that was held and recognised as property, plant and equipment by the operator before entering the service arrangement.

- It does not specify the accounting by grantors.

1.14.3 Accounting Principles

1.14.3.1 Treatment of the operator’s rights over the infrastructure

- Infrastructure shall not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator.

- The operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

1.14.3.2 Recognition and measurement

- Since the operator acts as a service provider, he shall recognise and measure revenue in accordance with Ind AS 11 and Ind AS 18 for the services it performs. The operator constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.

- If the operator performs more than one service (ie construction or upgrade services and operation services) under a single contract or arrangement, consideration received or
receivable shall be allocated by reference to the relative fair values of the services delivered, when the amounts are separately identifiable.

- The nature of the consideration i.e. whether financial asset or intangible asset determines its subsequent accounting treatment.
- The operator shall account for revenue and costs relating to construction or upgrade services.
- The operator shall account for revenue and costs relating to operation services in accordance with Ind AS 18.

1.14.3.3 Consideration given by the grantor to the operator

- If the operator provides construction or upgrade services the consideration received or receivable by the operator shall be recognized at its fair value. The consideration may be rights to:
  (a) a financial asset, or
  (b) an intangible asset.
- The operator shall recognise a financial asset to the extent that
  - it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services; the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law.
  - it has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.
- The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.
- If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset it is necessary to account separately for each component of the operator’s consideration. The consideration received or receivable for both components shall be recognised initially at the fair value of the consideration received or receivable.

1.14.3.4 Contractual obligations to restore the infrastructure to a specified level of serviceability

The operator may have contractual obligations it must fulfil as a condition of its licence, like to maintain or restore infrastructure, except for any upgrade element, which shall be recognised and
measured in accordance with Ind AS 37, i.e., at the best estimate of the expenditure that would be required to settle the present obligation at the end of the reporting period.

1.14.3.5 Borrowing costs incurred by the operator

- Borrowing costs attributable to the arrangement shall be recognised as an expense in the period in which they are incurred unless the operator has a contractual right to receive an intangible asset (a right to charge users of the public service).
- If the operator does not have a contractual right to receive an intangible asset, borrowing costs attributable to the arrangement shall be capitalised during the construction phase of the arrangement.

1.14.3.6 Financial asset

- For recognition of financial asset, Ind AS 32, Ind AS 107 and Ind AS 109 shall be applied. The amount due from or at the direction of the grantor is accounted at:
  - (a) amortised cost;
  - (b) fair value through other comprehensive income; or
  - (c) fair value through profit or loss.
- If the amount due from the grantor is measured at amortised cost or fair value through other comprehensive income, Ind AS 109 requires interest calculated using the effective interest method to be recognised in profit or loss.

1.14.3.7 Intangible asset

For recognition and measurement of intangible asset, one has to apply Ind AS 38 for guidance on measuring intangible assets acquired in exchange for a non-monetary asset or assets or a combination of monetary and non-monetary assets.

1.14.3.8 Items provided to the operator by the grantor

- Infrastructure items to which the operator is given access by the grantor for the purposes of the service arrangement are not recognised as property, plant and equipment of the operator.
- The grantor may also provide other items to the operator that the operator can keep or deal with as it wishes. If such assets form part of the consideration payable by the grantor for the services, they are not government grants as defined in Ind AS 20. They are recognised as assets of the operator, measured at fair value on initial recognition.
- The operator shall recognise a liability in respect of unfulfilled obligations it has assumed in exchange for the assets.
Information note 1

Accounting framework for public-to-private service arrangements

Does the grantor control or regulate what services the operator must provide with the infrastructure, to whom it must provide them, and at what price?

Yes → OUTSIDE THE SCOPE OF APPENDIX A SEE INFORMATION NOTE 2

No →

Does the grantor control, through ownership, beneficial entitlement or otherwise, any significant residual interest in the infrastructure at the end of the service arrangements? Or is the infrastructure used in the arrangements for the entire useful life?

Yes →

Is the infrastructure constructed or acquired by the operator from a third party for the purpose of the service arrangement?

Yes → WITHIN THE SCOPE OF APPENDIX A

Operator does not recognize infrastructure as property, plant and equipment or as a leased asset

No →

Does the operator have a contractual right to charge users of the public services as described in paragraph 17 of Appendix A?

Yes →

Operator recognizes a financial asset to the extent that it has a contractual right to receive cash or another financial asset as described in paragraph 16 of Appendix A

No →

Does the operator have a contractual right to receive cash or other financial asset from or at direction of the grantor as described in paragraph 16 of Appendix A?

Yes →

Operator recognizes an intangible asset to the extent that has a contractual right to receive an intangible asset as described in paragraph 17 in Appendix A.

No → OUTSIDE THE SCOPE OF APPENDIX A SEE PARAGRAPH 27 OF APPENDIX A
1.14.4 Service Concession Arrangements: Disclosures

- All aspects of a service concession arrangement shall be considered in determining the appropriate disclosures in the notes. An operator and a grantor shall disclose the following in each period:

  (a) a description of the arrangement;

  (b) significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (eg the period of the concession, re-pricing dates and the basis upon which re-pricing or re-negotiation is determined);

  (c) the nature and extent (eg quantity, time period or amount as appropriate) of:

     (i) rights to use specified assets;

     (ii) obligations to provide or rights to expect provision of services;

     (iii) obligations to acquire or build items of property, plant and equipment;

     (iv) obligations to deliver or rights to receive specified assets at the end of the concession period;

     (v) renewal and termination options; and

     (vi) other rights and obligations (eg major overhauls);

  (d) changes in the arrangement occurring during the period; and

  (e) how the service arrangement has been classified.

- An operator shall disclose the amount of revenue and profits or losses recognized in the period on exchanging construction services for a financial asset or an intangible asset.

- The disclosures required in accordance with paragraph 6 of this Appendix shall be provided individually for each service concession arrangement or in aggregate for each class of service concession arrangements. A class is a grouping of service concession arrangements involving services of a similar nature (eg toll collections, telecommunications and water treatment services).
## 1.15 Significant Differences Between Ind AS 11 and AS 7

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Particulars</th>
<th>Ind AS 11</th>
<th>AS 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Contract revenue</td>
<td>Contract revenue should be measured at fair value of consideration received/receivable</td>
<td>It does not recognise the concept of fair valuation of contract revenue received/ receivable. Contract revenue is measured at the consideration received or receivable.</td>
</tr>
<tr>
<td>2.</td>
<td>Accounting for Service Concession Arrangements</td>
<td>Appendix A of Ind AS 11 deals with accounting aspects involved in such arrangements and Appendix B of Ind AS 11 deals with disclosures of such arrangements.</td>
<td>Existing AS 7 does not deal with accounting for Service Concession Arrangements, i.e., the arrangement where private sector entity (an operator) constructs or upgrades the infrastructure to be used to provide the public service and operates and maintains that infrastructure for a specified period of time.</td>
</tr>
<tr>
<td>3.</td>
<td>Inclusion of Borrowing costs</td>
<td>Ind AS 11 does not specifically make reference to Ind AS 23.</td>
<td>AS 7 includes borrowing costs as per AS 16, Borrowing Costs, in the costs that may be attributable to contract activity in general and can be allocated to specific contracts.</td>
</tr>
</tbody>
</table>
QUICK RECAP

Combination of contracts

Group of contracts

Negotiation as a single package?

Yes

Closely interrelated contracts with overall profit margin?

Yes

Performed concurrently or in continuous sequence?

Yes

SINGLE contract

No

No

No

SEPARATE contracts

Segmentation of contracts

Single contract covering construction of no. of separate assets

Separate proposals for each asset?

Yes

Separate negotiation for each asset?

Yes

Costs and revenues identifiable for each asset?

Yes

SEPARATE contracts (for each asset)

No

No

No

SINGLE contract

© The Institute of Chartered Accountants of India
Recognition of Contract Revenue and Expenses

Contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively:

(a) On percentage completion method, i.e., with reference to the stage of completion of the contract activity at the end of the reporting period; and

(b) When the outcome of a construction contract can be estimated reliably.

An expected loss on the construction contract should be recognised as an expense immediately.

Reliable estimation of outcome of construction contract

<table>
<thead>
<tr>
<th>Fixed price contract</th>
<th>Cost plus contract</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Probable future economic benefits</td>
<td>• Probable future economic benefits</td>
</tr>
<tr>
<td>• Reliable measurement of:</td>
<td>• Reliable measurement of:</td>
</tr>
<tr>
<td>• total contract revenue</td>
<td>• contract costs attributable to the contract</td>
</tr>
<tr>
<td>• contract costs to complete the contract</td>
<td></td>
</tr>
<tr>
<td>• stage of completion</td>
<td></td>
</tr>
<tr>
<td>• contract costs attributable to the contract</td>
<td></td>
</tr>
</tbody>
</table>
Practical Questions

1. A contractor is constructing a single lane 500 km road for a State Government with a contract revenue of ₹ 200 crores and cost of ₹ 150 crores. At the year end when ₹ 54 crores have already been expended by the contractor, the State Government decides to change the specifications of concrete mix used in the construction of the road. This will enhance the cost to ₹ 180 crores with revenue at ₹ 240 crores. All the approvals are in place. The agreement is yet to be signed. However, it is a mere formality.

Determine the amount of contract revenue and costs that should be recognised at the year end.

2. Sagar Limited belongs to the engineering industry. The Chief Accountant has prepared the draft accounts for the year ended 31.03.20X1. You are required to advise the company on the following items from the viewpoint of finalization of accounts, taking note of the mandatory accounting standards.

The company undertook a contract for building a crane for ₹ 10 lakhs. As on 31.03.20X1 it incurred a cost of ₹ 1.5 lakhs and expects that there will be ₹ 9 lakhs more for completing the crane. It has received so far ₹ 1 lakh as progress payment.

3. Jain Construction Co. Ltd. undertook a contract on 1st January, 20X1 to construct a building for ₹ 80 lakhs. The company found on 31st March, 20X1 that it had already spent ₹ 58,50,000 on the construction. Prudent estimate of additional cost for completion was ₹ 31,50,000.

What amount should be charged to revenue and what amount of contract value to be recognized as turnover in the final accounts for the year ended 31st March 20X1 as per provisions of Ind AS 11 (revised)?

4. Mr. Shyam, a construction contractor undertakes the construction of an industrial complex. He has separate proposals raised for each unit to be constructed in the industrial complex. Since each unit is subject to separate negotiation, he is able to identify the costs and revenues attributable to each unit. Should Mr. Shyam treat construction of each unit as a separate construction contract according to Ind AS 11?

Answers to Practical Questions

1. Paragraph 11(b) of Ind AS 11, Construction Contracts states that revenue should comprise of variations in contract work if:

   — it is probable that it will result in revenue; and

   — it is capable of being measured reliably. Both the aforesaid conditions are met.
Thus, based on total costs incurred till date with the total cost of the project the percentage completion is 30% (₹ 54 crores/₹ 180 crores).

Therefore:
— contract revenue to be recognised is ₹ 72 crores (30% of ₹ 240 crores);
— contract costs to be recognised is ₹ 54 crores (30% of ₹ 180 crores)

2. Ind AS 11 ‘Construction Contracts’ provides that when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognized as revenue and expenses respectively with reference to the stage of completion of the contract activity at the reporting date.

Ind AS 11 states that when it is probable that total contract cost will exceed total contract revenue, the expected losses should be recognized as an expense irrespective of:

a. Whether or not work has commenced
b. Stage of completion of contract
c. The amount of profit on other contracts which are not treated as a single contract

Thus, when Estimated Contract Costs > Total Contract Revenue

\[
\text{Expected Loss} = \text{Work Certified} + \text{Work uncertified} + \text{Estimated cost to complete the project} - \text{Total value of contract}
\]

Thus, in the given case, the foreseeable loss of ₹ 50,000 (expected cost ₹ 10.5 lakhs less contract revenue ₹ 10 lakhs) should be recognized as an expense in the year ended 31st March, 20X1.

The following disclosures should also be given in the financial statements:
(a) the amount of contract revenue recognized as revenue in the period;
(b) the aggregate amount of costs incurred and loss recognized upto the reporting date;
(c) amount of advances received;
(d) amount of retentions; and
(e) gross amount due from/due to customers amount*

3.

| Cost incurred till 31st March, 20X1 | ₹ 58,50,000 |

* Amount due from/to customers = contract costs + Recognised profits – Recognised losses – Progress billings = ₹ 1.5 + Nil – ₹ 0.5 – ₹ 1.0 = Nil.

© The Institute of Chartered Accountants of India
### Table

<table>
<thead>
<tr>
<th>Prudent estimate of additional cost for completion</th>
<th>31,50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total cost of construction</td>
<td>90,00,000</td>
</tr>
<tr>
<td>Less: Contract price</td>
<td>(80,00,000)</td>
</tr>
<tr>
<td>Total foreseeable loss</td>
<td>10,00,000</td>
</tr>
</tbody>
</table>

As per para 36 of Ind AS 11 ‘Construction Contracts’ when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

Accordingly, the loss of ₹ 10,00,000 is required to be recognized as an expense in the year 20X0-20X1.

Also as per the said standard 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.

Accordingly,

\[
\text{Contract work in progress} = \frac{58,50,000 \times 100}{90,00,000} = 65\%
\]

Proportion of total contract value to be recognized as turnover

\[
= 65\% \text{ of } ₹ 80,00,000 = ₹ 52,00,000
\]

4. As per Ind AS 11 ‘Construction Contracts’, 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.

Therefore, Mr. Shyam is required to treat construction of each unit as a separate construction contract.