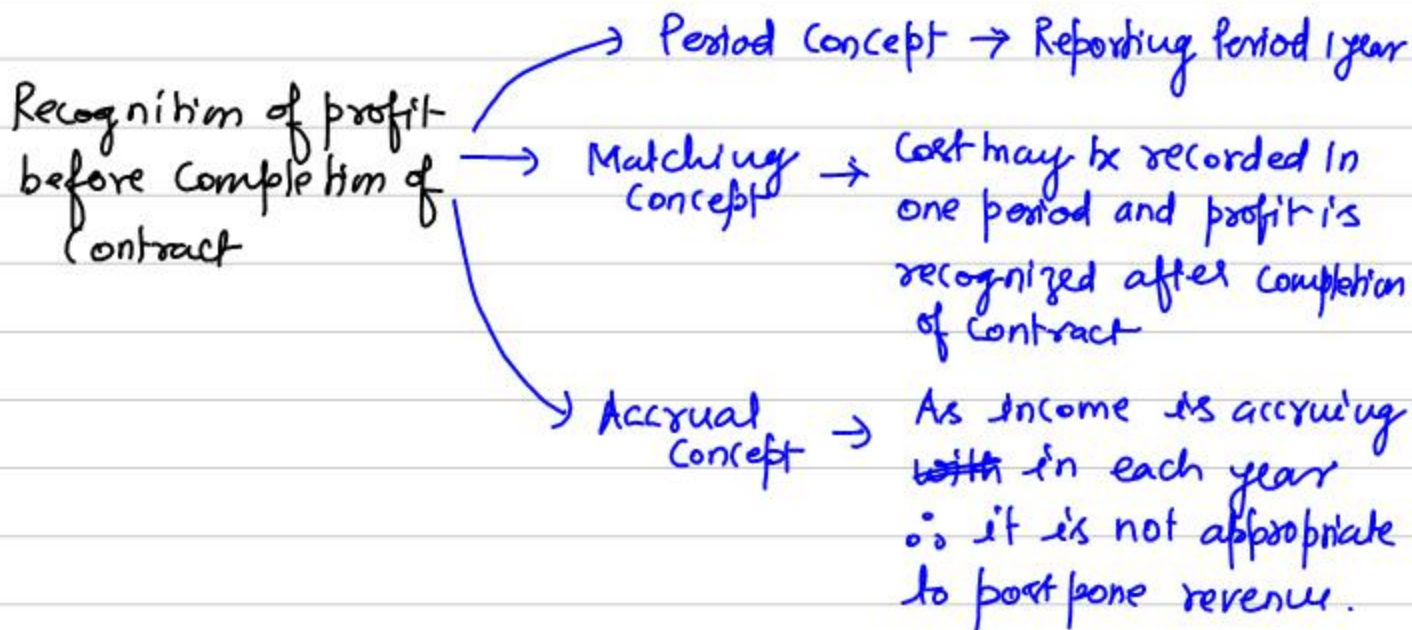


AS-7 / Ind. AS-11

Construction Contract.

- 1) This AS is applicable to Contractors only.
- 2) Construction Contracts are arrangements which are specifically negotiated for construction or destruction of asset or group of assets which are interrelated.
- 3) Construction contracts are of two types
 - a) Cost plus contract
Consideration is Cost plus certain % of Cost
 - b) Fixed Price Contract
Consideration is fixed price agreed



As per above discussion it is more appropriate to use % completion method rather than Completed Contract method.

4) Meaning

1) Contract revenue

it includes

a) Fixed initial price agreed

(+) b) Variations

(+) c) claims

(+) d) Incentives

(+) e) Escalation

(-) f) Penalty

= Contract revenue.

Note: Point no (b) to (e) can be included only if there is certainty of collection

Note: Penalty can be deducted on estimated basis also

Note: Item

Meaning.

b) Variations

Alteration in job.

c) claims

Losses in contract due to contractee

d) Incentives

Prize for timely completion of job.

e) Escalation

Extra compensation for increased cost.

5) How to Calculate Profits.

Step 1: Calculate degree of completion.

Degree of Completion can be calculated by following methods.

(i) Cost method.

Cost incurred

Total estimated cost

ii) Labour hour method

Labour hour invested

Total estimated labour hours.

iii) Survey method

Degree is calculated by information given by expert.

Step 2 : Profits.

Contract revenue	Degree of completion	xxx
(-) Cost incurred upto date		<u>xxx</u>
Total profit		xxx
(-) Profit recognized earlier		<u>xxx</u>
= Current year profit		<u>xxx</u>

Note: Step 1 & step 2 can be applied where outcome of contract can be estimated.

If outcome cannot be estimated then cost incurred is called as contract revenue.

Note: If any contract is estimated to be completed in loss then provision for expected loss should be made. This provision can be made even if contract not yet started.

eg X Ltd got a contract for a value of ₹ 3 Crores. After 1 year cost incurred was ₹ 1.40 Crores and it is estimated that further cost of ₹ 1.80 Crores to be incurred to complete the contract. Give the treatment.

<u>Ans</u> Contract revenue	₹ 3 cr
<u>Less:</u> Estimated total cost - (1.40 + 1.80)	<u>3.20 cr</u>
∴ Expected loss	0.20 cr

X Ltd should create provision of ₹ 0.20 cr even though loss not yet incurred.

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e.g Y Ltd is a construction contractor they are total 6 contract in hand out of which it is estimated that Contract no-2 will result in loss of ₹ 20,00,000, but from remaining 5 contracts there is expected profit of ₹ 1,00,00,000. Give the treatment.

Ans In this situation Y Ltd should make the provision of ₹ 20,00,000 for contract no-2 even though other contracts are resulting into profits.

Example Following is the information regarding a contract

Particulars	Year 1	Year 2	Year 3
Cost incurred	1,00,000	1,50,000	2,50,000
Estimated Cost yet to be incurred	2,00,000	1,40,000	-
Contract Revenue	5,00,000	5,50,000	6,00,000
Progress billing	1,20,000	1,50,000	3,00,000
Amount received	80,000	90,000	2,00,000

Analyze.

Ans For year 1 (Trial Balance)

Particulars	Dr	Cr
Cost incurred	1,00,000	-
Contract Revenue	-	1,20,000
Contract ee acc (1,20,000 - 80,000)	40,000	
Estimate cost yet to be incurred		2,00,000

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Step 2 : Compute % Completion

$$\begin{aligned}\% \text{ Completion} &= \frac{\text{Cost incurred}}{\text{Total estimated cost}} = \frac{1,00,000}{3,00,000} \times 100 \\ &= 33\frac{1}{3}\%\end{aligned}$$

Contract Revenue (Total)	5,00,000
Contract revenue x % Completion (5,00,000 x 33 1/3%)	1,66,667
<u>Less: cost incurred</u>	<u>1,00,000</u>
∴ Total profit	66,667
<u>Less: Profit recorded earlier</u>	<u>—</u>
∴ Profit to be recorded in current year	<u>66,667</u>

one more entry is required to be passed to include profits

Gross debtors au	Dr	46,667	
To contract revenue au			46,667
(1,66,667 — 1,20,000)			

Restated Trial balance for year 1

Cost incurred	1,00,000	
Contract Revenue		1,66,667
Contractee-	40,000	
Gross debtors	46,667	

Contract A/c (year 1)			
To Cost incurred	1,00,000	By Contract revenue	1,66,667
To Profit & Loss au	66,667		

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year 2

Step 1 : Compute % Completion

$$\% \text{ Completion} = \frac{1,50,000}{2,90,000} \times 100 = 51.72\%$$

Contract Revenue (Total) ₹ 5,50,000

Contract revenue x Degree of Completion.
(5,50,000 x 51.72%) ₹ 2,84,460

Less: Cost Incurred 1,50,000

∴ Total profit 1,34,460

Less: Profit recorded earlier 66,667

∴ Profit for Current year 67,793

Current year contract revenue ₹ 1,17,793
[2,84,460 - 1,66,667]

Journal entry to be passed.

Contract Revenue ac Dr 32,207
 To Gross debtor/ creditors 32,207
 (1,50,000 - 1,17,793)

Contract Ac (Year 2)

To Cost Incurred 50,000 (1,50,000 - 1,00,000) To P & L ac 67,793		By Contract Revenue 1,17,793
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year 3

Step 1: Compute % completion

$$= \frac{2,50,000}{2,50,000} \times 100 = 100\%$$

Step 2: Computation of profit

Contract revenue X % completion ₹ 6,00,000
(6,00,000 x 100%)

Less: Total Cost 2,50,000

∴ Total profit 3,50,000

Less: Profit recorded earlier (66,667 + 67,793) 1,34,460

Profit to be recorded this year. 2,15,540

Contract revenue for the year 3,15,540
[6,00,000 - 2,84,460]

Journal entry

Gross debtor a/c	Dr	15,540
To Contract Revenue a/c		15,540
(3,15,540 - 3,00,000)		

Contract A/c		
To Cost incurred. 1,00,000 (2,50,000 - 1,50,000)		By Contract Revenue 3,15,540
To P & L a/c 2,15,540		

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Class Notes

Guidance note issued by ICAI for real estate developers

As per GN revenue can be recognized if.

- a) 95% of work is complete and
- b) 10% of Contract value is realized.

If above two conditions are satisfied then % completion method of AS-7 will be applicable to recognize the revenue.