AS-7 : Revenue Recognition

Applicability :- Contractors.
Not applicable on self owned property constructed.

From contractors POV, they are earning revenue from construction of asset owned by others. Hence, this AS states how such revenue earned will be recognised by contractors.

Construction Contract :- meaning

1. Contract for :- construction of one asset
   :- construction of number of assets.

Contract → 1 single asset
Contract → 4 assets

2. Contracts for rendering of services related to construction of assets.

Examples :-
1) Architecture
2) Project Manager
3) Interior designer

3. Contracts for :- destruction of asset.
   restoration of asset.
   restoration of environment following destruction of asset.

Example :-
Bridge (todna) destruction
Noida - twin towers destruction
Residential apartment - redevelop.

Segmenting of Construction Contracts

A single construction contract for construction of multiple assets should be segmented and each asset should be considered a separate construction contract when :-

1. Separate proposals are submitted for each asset.
2. Each proposal can be individually accepted or rejected.
3. Cost and revenues of each asset can be separately / individually identified.

Combining of construction contract :-

A contract whether with a single customer or multiple customers should be treated as one single construction contract from the pov of revenue recog when :- 1. It is negotiated as a single package.

Example for Segmenting

Nora → Tejas

Nora ↓ House

A1	Dancing Room	Balcony	Recording Studio Room
Room renovate			
A1	A2	A3	A4

Revenue = 45crores

↓

Contract signed

↓

(i)

A1, A2, A3, A4 →
- Separate proposals.
- Individual basis - prop.
- A/R
- Individual basis - cost/revenue can be determined

2. Overall profit margin.

3. It is performed in a continuous sequence.

L42

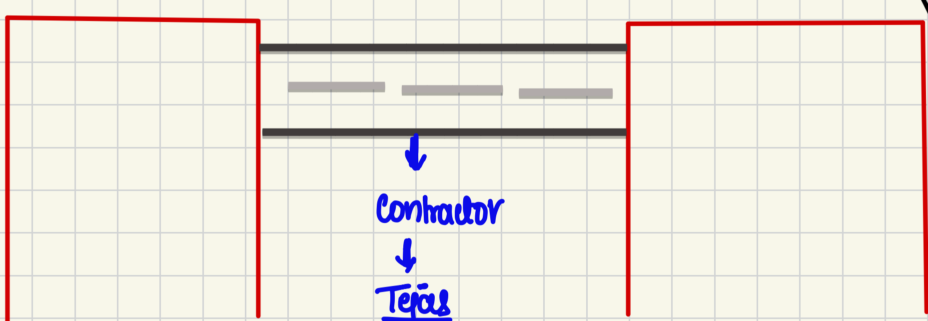
Example of combining of contracts

Nora house

Disha house

23rd floor

23rd floor



Contractor

↓

Tejas

↓

Contract 1

Contract 2

Price = 50crores

Profit = 20 crores

Legally 2 separate contracts

→ negotiated as a single package.

→ perform in a continuous sequence

→ overall profit margin

↓

Revenue Recog → 1 single contract ⇒ A3-7

↓

combining.

Construction of additional assets :

When an additional asset is constructed, such additional asset should be treated as a separate contract and its revenue should be recognised separately if ;

OR

1. The additional assets differs significantly in design, technology, function from the original asset.
2. Its price is negotiated without regard to the original contract price.

Types of construction contracts

Fixed Price Contract

10L

Cost Plus Contract

Actual cost + % as fees/comm.

Hybrid Contract

Actual cost + % fees/comm

maximum cap upto a certain amount.

Contract Revenue

15 August 2021

→ Revenue initially agreed & Includes

→ sources + scores

Claims

→ nuksaan
→ additional cost
because of the customer
wasn't covered under the original contract price.

Variations

Balcony - with 2 chairs.
Terrace Garden
→ with recliner sofa.
→ warm & dim lights
→ music system.
Scope of work has changed

Incentive Payments

→ work complete within a specified time.
→ a desired quality is achieved.

Recognition Criteria (Claims)

→ Approved by customer.
→ Amount - measurable

Recognition Criteria (Variations)

→ Approved by customer.
→ Amount - measurable

Recognition Criteria (Incentive Payments)

→ Contract should be at a sufficiently advanced stage where recognition is justified
→ Amount measurable.

Revenue Recognition

Outcome of the contract can be reliably measured → YES

STEP 1:-

Stage (%age) of completion = $\frac{\text{Cost incurred till date}}{\text{Total contract cost}}$

Example :- Cost incurred till 31-3-20 on the contract = 500000
Estimated future cost to complete the contract = 400000

Calculate stage of completion.

Solution :-

1. cost incurred till date = 500000
2. + estimated future cost = 400000
3. Total cost = 900000

Percentage completion = $\frac{\text{Cost incurred till date}}{\text{Total contract cost}}$

$= \frac{500000}{900000} = 55.55\%$

STEP 2 :- Recognise Revenue and cost in proportion to stage of completion

Example :-

Total Revenue = 1500000
Total Cost = 900000

$\}$ Total profit = 600000 × 55.55%
= 333250

Determine revenue and cost to be recognised in the current year.

Solution :-

Revenue recognised = 1500000 × 55.55% = 833250

Cost recognised = 900000 × 55.55% = 500000

Profit recognised = 333250

P&L a/c

Dr.		Cr.	
Contract Cost	500,000	Contract Revenue	833250
Profit	333250		

Example 2:- From the following information calculate contract revenue and contract cost to be recognised in the current year:-

1. material consumed = 400,000
2. Labour cost = 200,000
3. sub contract cost = 150,000
4. Estimated further completion cost = 300,000
5. Contract Price = 20,00,000

Solution:- Calculation of stage of completion:-

1. Cost Incurred Till Date:-

a. Material consumed = 4,00,000
b. labour cost = 2,00,000
c. Sub contract cost = 1,50,000

Cost Incurred till Date : 750000

$$\text{Stage of completion} = \frac{\text{Cost incurred till date}}{\text{Total contract cost}}$$

$$= \frac{7,50,000}{7,50,000 + 3,00,000}$$

$$= \frac{7,50,000}{10,50,000}$$

$$= 71.43\%$$

Contract Revenue to be recognised = 2000000 × 71.43% = 1428600
Contract costs to be recognised (cost incurred till date) = 7,50,000

Profit to be recognised = 678600

Example 3:- Suppose, in the above question the date given was for year 2 and in year 1 the work already completed was 40%. Calculate contract revenue and cost to be recognised.

Y1	Y2
40%	71.43%
CR = 40%	CR = 31.43%
CC = 40%	CC = 31.43%

Solution :- **Contract Revenue : Y2**

1. Total contract revenue to be recognised upto 2nd year = 1428600
(2000000 x 71.43%)

2. less: contract revenue recognised in Y1 = 800000
(2000000 x 40%)

3. Contract Revenue for Y2 = 628600

Contract cost : Y2

1. Total contract costs to be recognised upto Y2 = 750000
(1050000 x 71.43%) (actual cost inc.)

2. less: contract cost recognised in Y1 (1050000 x 40%) = 420000

3. Contract costs for Y2 = 330000

Profit f.t. year 2 = 628600 - 330000 = 298600 /-

Outcome of the contract can be reliably measured → NO

- No profits will be recognised.
- Contract revenue can be recognised only to the extent of contract costs.

NOTE :- If at any stage it is probable that we will incur loss on the contract then we will recognise the full amount of loss irrespective of ;

1. Whether or not work has commenced on the contract.
2. Stage of completion
3. Profit arising on other contracts.

Example :-

Contracts costs incurred till date = 700000
further estimated cost be incurred = 500000
Contract revenue = 1000000
% completion (700000 / 1200000) = 58.33%
Calculate the loss to recognised.

Solution :- Total contract costs = 1200000
Total contract revenue = 1000000
Total loss to be recognised = 200000

P&L a/c

Contract Costs (1200000 x 58.33%)	700000	Contract Revenue (1000000 x 58.33%)	583300
Loss	116700		
Provision for losses	83300		

$200000 \left\{ \begin{array}{l} 116700 \\ 83300 \end{array} \right.$

Provision for losses ↓ additional provision will have to be created.

JE :-

⇒ P&L Dr. 83300
To, Provision for losses 83300