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.

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2. Overall profit margin.
3. It is performed in a continuous sequence.

Example for Segmenting

Nora → Tejas

House

A1 Room renovate	Dancing Room	Balcony	Recording Studio Room
A_1	A_2	A_3	A_4

Revenue = 45crores

↓

Contract signed

↓

(i)

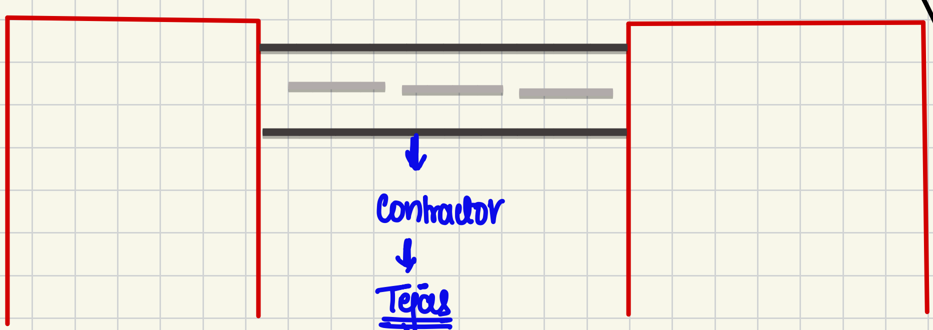
A_1, A_2, A_3, A_4

- → Separate proposals.
- → Individual basis - prop.
  A/R
- → Individual basis - cost|revenue can be determined

Example of combining of contracts

Nora house

Disha house



23^{rd} floor

23^{rd} floor

Contractor

↓

Tejas

Contract 1

Price = 50crores

Profit = 20 crores

Contract 2

Legally 2 separate contracts

→ negotiated as a single package.

→ perform in a continuous sequence

→ overall profit margin

↓

Revenue Recog → 1 single contract ⇒ AS-7

↓

combining.

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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 :

1. The additional assets differs significantly in design, technology, function from the original asset.

OR

2. Its price is negotiated without regard to the original contract price.

Types of construction contracts

Fixed Price Contract

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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

→ sources + scores

& Includes

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.

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STUDENT NOTES

10L

TYPES OF CONSTRUCTION CONTRACTS

cost + 5% = max. limit

FIXED PRICE CONTRACT
Contractor agrees to a fixed contract price or a fixed rate per unit of output.

cost + 5% (comm) = Total

COST PLUS CONTRACT
Contractor gets reimbursed for the defined costs, plus percentage of the costs or a fixed fee over and above the costs.

HYBRID CONTRACT
Such contracts contain characteristics of both ~~cost & hybrid~~ contracts.
Example:- cost plus a percentage restricted by a maximum amount.

cost plus and fixed pr.

10 + 50K = 10.50
5%
15 + 75 = 15.75

max limit = 16L

18L + 90K = 18.90 = 16L

CONTRACT REVENUE

Comprises of : -Revenue initially agreed and includes

CLAIMS
-An amount which the contractor seeks to collect from the customer or any third party for costs that are not included in the contract.
Eg;1. Customer caused delays.
2. Errors in specification.

RECOGNITION
a)Negotiations have reached a stage where it is probable that the customer will accept the claim.
b)Amount of claim can be reliably measured.

VARIATIONS
-Is an instruction by the customer for a change in the scope of contract work.
-May lead to increase or decrease in contract revenue.
Eg;1. Changes in specification in design.
2. Changes in duration of work.

RECOGNITION
a)probable that the customer will approve variation
b)Amount of variation can be reliably measured.

INCENTIVE PAYMENTS
-Payments made to the contractor by the customer if specified performance standards are met or exceeded.
Eg;1. Early completion of the contract work.

RECOGNITION
Should be recognised only when;
a) Contract is sufficiently advanced that it is probable that such payments will be realised.
b) Amount of such payments can be measured reliably.

Dr. P&L	Cr.
Contract Cost	Contract Revenue

3years

Profit / Loss

CA Tejas Suchak

AS-7 ACCOUNTING FOR CONSTRUCTION CONTRACT

→ material, labour } → Direct cost

Reti Gitti Cement

→ Attributible / Allocable cost

JCB → 4 months → Asset: cost → add.

→ cost incurred to acquire the contract → contract cost +

→ "specifically incurred for the customer"

"machine acquired for one particular customer only"

STUDENT NOTES

CONTRACT COSTS

DIRECTLY RELATED COSTS

Eg :- 1.Site labour costs
2.Material costs
3.Deprecition of P&M
4. Cartage, conveyance costs.

COSTS ATTRIBUTIBLE TO CONSTRUCTION ACTIVITY

1.Overheads
2.Costs of design & technical assistance not related to a specific project

SPECIFICALLY CHARGEABLE TO A CUSTOMER

May include general administration & development costs for which reimbursement is specified in the contract.

COST OF SECURING THE CONTRACT

Costs that directly relate to securing the contract are treated costs;

Provided they can be separately identified and measured reliably & it is probable that the contract can be obtained.

EXCLUDES

- General administration for which reimbursement is not specified.
- Selling costs
- Research & Development costs for which reimbursement is not specified in the contract.
- Depreciation of idle P&M not used in the construction contract.