LONG-TERM CONSTRUCTION CONTRACTS (IAS 11)

These are contracts which takes a period of more than one year. The contractor is engaged by the contractee to undertake such projects for consideration known as contract price.

The objective of IAS 11 is to help determine:

- The contract profit for each accounting period.
- The valuation of the work in progress

Types of construction contracts:

1. Fixed price contracts / lump sum contracts.

It is a contract whose price is determined before the commencement or inception. The price can be adjusted if there is escalation clause. This is a provision which allows for the adjustment of the price depending on the changes in the economic environment of the contract. eg increase in labour or material cost.

2. Cost plus contract / percentage rate contract.

- This is a contract where the contract price is only determined after the contract have been fully completed.
- The owner assumes most of the risks. The contract price is equal to the cost incurred plus agreed profit margin.

profit = cost + profit margin

This method is mostly applied where its difficult to determine the estimated total cost of the contract.

→ Also applied ~~the~~ where the contract price is very short.

Methods of Accounting for construction contracts.

1. Completed contract method.

This is where the revenue is only recognized after the contract has been completed. Also the profit is recognized upon the completion of the contract.

Contract gross profit = Contract price - contract cost

The method is applied where it is difficult to determine the estimated total cost of the contract.

2. Percentage of completion method.

This is applied where the cost of the contract can be reliably estimated as the contract progresses. The revenue and gross profit is recognized as the contract progresses.

Contract revenue and expenses are recognized by reference to the stage of completion.

$$\% \text{ of Completion} = \frac{\text{cost to date}}{\text{Estimated total cost}} \times 100\%$$

Revenue Recognized = % of completion x Contract price

Disclosure Requirement for contract in progress in accordance to IAS 11.

1. Aggregate cost incurred and profit recognized.
2. Amount of advance received.
3. Amount of retentions.
4. Amount of revenue recognized.
5. Method used to determine the revenue.
6. Method used to determine the stage of completion.

Methods used to determine the stage of completion. (May 2019 Q4b)

1. Value Based Method.

Value of work completed in proportion to total contract price. The value of work may be determined by conducting a survey of work performed. Also the physical unit of work completed in comparison with total number of units to be completed under the contract.

2. Cost Based Method.

Cost incurred to date in comparison with total expected contract cost. When estimating the stage of completion under this method, only those cost incurred must be considered that reflect the present status of work performed.

When the cost based is used in accounting for profit making contract, cost is recognized on the basis of stage of completion whereas contract revenue is measured as the balancing figure.

Terms

1. Enerous Contract

This is a contract entered into which another party under which the unavoidable cost of fulfilling the terms of contract exceeds any revenue expected to be received from the contract.

2. Executry Contract

It's a contract in which neither party has performed any of its obligation nor both party have partially performed their obligation to an equal extent.

Preparation of financial statements:

a) Income statement format

Cost to date	xx
add: Estimated additional cost	xx
Total cost	xx
% of completion	xx %
Revenue Recognized	xx
less: cost to date	(xx)
Gross profit to date	xx
less: gross profit already recognized	(xx)
Gross profit for the period	xx
less: General expenses	(xx)
Profit for the period	xx

b) Statement of financial position / work in progress statement:

Cost to date	xx
add: Gross profit to date	xx
less: Cash recieved to date	(xx)
Work in progress	xx
Total Billings to date	xx
less: Cash recieved to date	(xx)
Receivable / payable	xx

illustration one: Aug 2009 Q5

Jenga Construction contract Ltd was awarded a contract 2 on 1 Jan 2006. The contract price was fixed at sh 120 million and the estimated total cost of the contract was sh 105 million. The following Information relates to the contract for the three years from 1 Jan 2006 to 31 December 2008 when the contract was completed.

	2006 sh000	2007 sh000	2008 sh000
Cost Incurred	20 000	42000	32000
Estimated further costs	70 000	36000	-
Billing to clients	30,000	50,000	40,000
Collection from clients	12000	38000	60,000
Administrative expenses	2000	2500	1000

Required:

For each of the year ended 31 Dec 2006, 2007 and 2008, prepare

i) Extract of the income statement. (7 mks)

ii) Extract of statement of financial position. (7 mks)

(Your answer should be in conformity with IAS 11 long term construction contract)

Solution:

		2006	2007	2008
Cost to date		20,000	62000	94000
Estimated additional cost		70,000	36000	-
Total cost		90,000	98000	94000
% of completion	$\frac{20}{90} \times 100\%$		$\frac{62}{98} \times 100\%$	$\frac{94}{94} \times 100\%$
		22%	63%	100%
Revenue Recognized	$0.22 \times 120{,}000 =$	26400	75600	120,000

a) Jenga Contractors Ltd

Income statement extract for the year ended 31 Dec

	2006	2007	2008
Revenue Recognized	26400	75600	120000
Less: Cost to date	(20000)	(62000)	(94000)
Gross profit to date	6400	13600	26000
Less: gross profit already recognized	—	(6400)	(13600)
Gross profit for the period	6400	7200	12400
Less: Adm expenses	(2000)	(2500)	(1000)
profit	4400	4700	11400

b) Jenga Contractors Ltd

Statement of financial position as at 31 Dec

	2006	2007	2008
Cost to date	20,000	62000	94000
Gross profit to date	6400	13600	26000
Total Cash Received to date	(12000)	(50,000)	(110,000)
Work in progress	14400	25600	10,000
Total Billings to date	30000	80000	120,000
Less: Cash received to date	(12000)	(50000)	(110000)
Receivables	18000	30,000	10,000

Illustration Two

On 1 Jan 2014, Ujenzi Ltd was awarded a contract for the construction of a road. The contract was for 3 year period. The contract price was sh 250 million. The following information has been extracted from the books of the Company.

Year ended 31 December "sh million"

	2014	2015	2016
Total cost incurred to date	80	170	220
Estimated additional cost to complete contract	120	90	—
Billing made during the year on contract	90	100	60
Cash received on the contract in the year	80	90	70
General adm expenses in the year	4	6	5

Required:

Using the percentage of completion method, prepare the following as:

a) Income statement extract for the year ended 31 Dec 2014, 2015 & 2016 (10mks)

b) Statement of financial position extract as at 31 Dec 2014, 2015 & 2016. (5mks) solution.

		2014	2015	2016
Cost to date		80	170	220
add: additional cost		120	90	-
Total cost		200	260	220
% of completion	80/200	40%	65%	100%
Revenue Recognized	40%x250	100	162.5	250

Ujenzi Ltd.
Income statement for the year ended 31 Dec

	2014	2015	2016
Revenue Recognized	100	162.5	250
Cost to date	(80)	(170)	(220)
Gross profit to date	20	(7.5)	30
less: g.p already recognized	-	(20)	(7.5)
Gross profit for the year	20	(27.5)	37.5
less: Adm expenses	(4)	(6)	(5)
Net profit	16	(33.5)	32.5

Ujenzi Ltd.
Statement of financial position as at 31 Dec

	2014	2015	2016
Cost to date	80	170	220
add: Gross profit to date	20	(7.5)	30
less: cash received to date	(80)	(170)	(240)
Work in progress	20	(7.5)	10
Billing to date	90	190	250
Cash received to date	(80)	(170)	(240)
Receivables / payable	10	20	10

Illustration Three

Jenga Ltd is a construction company whose financial year ended on 31 March. The information below was extracted from the books of the company in connection with three contracts undertaken by the company during the financial year ended 31 March 2015.

Contract	Sh000 468	Sh000 469	Sh000 470
Contract price	3600	4800	2500
Cost incurred up to 31 March 2014	1800	3000	1500
Cost incurred during the year	600	1000	500
Estimated total cost of the contract	3000	5200	2300
Total billing to date	2800	4500	2300
Total cash received to date	2600	4200	1800
Total profit / loss reported to date	360	30	1700
General adm expenses	60	120	(20)
			30

Required:
Using the percentage of completion method, prepare:

a) Income statement for each of the contract. (10marks)
b) statement of financial position for ~~each~~ the year as at 31 march 2015 (6Mks)

soln

	468	469	470
Cost to date (1800+600)	2400	4000	2000
Additional cost			
Total cost of the contract	3000	5200	2300
% of completion	80%	77%	87%

Jenga Ltd.
Income statement for the year ended 31 March 2015

	468	469	470
Revenue Recognized	2880	3696	2175
cost to date	(2400)	(4000)	(2000)
Gross profit to date	480	(304)	175
less: Gross profit earlier recognized	(360)	(30)	(-20)
Gross profit for the year	120	(334)	195
less: General adm exp	(60)	(120)	(30)
Net profit	60	(454)	165

Jenga Ltd
statement of financial position extract as at 31 March 2015

	468	469	470
Cost to date			
Gross profit to date			
cash received to date			
Work in progress			
Billing to date			
cash received to date			
Receivable / payable			

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i) Estimating % of completion

	million
Cost to date	161
additional estimated cost	279
Total cost	440
% of completion $\frac{161}{440} \times 100\%$	36.6%

ii) Jing Ltd
Income statement extract for the year ended 31 March 2014.

	Sh million
Revenue Recognized 36.6% x 600	219.6
less: cost to date	(161)
Gross profit	58.6

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iii)

Jing Ltd

Statement of financial position extract as at 31 March 2014

	Sh millions
Cost to date	161
gross profit to date	58.6
Less: cash received to date	(140)
Work in progress	79.6
total Billings to date	155
less: cash received to date	(140)
Receivable	15

Assign: May 2019 Q 4

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