IAS - 11

Construction Contracts

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International Accounting Standard No 11 (IAS 11)

Construction Contracts

This revised International Accounting Standard is effective for financial statements covering periods beginning on or after January 1 1995, replacing the old IAS 11, Accounting for construction contracts, adopted by the Council in 1978.

In May 1999, IAS 10 (revised 1999), events after the balance sheet date, amended paragraph 45. The modified text will be in force when the IAS 10 (revised 1999), i.e. for annual financial statements covering periods beginning on or after January 1, 2000.

Note: Appendix cited in the text of the standard has not been included in this release.

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The normative part of this Statement, which appears in bold italics, it must be understood in the context of the explanations and guidelines for implementing them and in line with the Preface to International Accounting Standards. It is not intended that international accounting standards are applied in the case of non-significant (see paragraph 12 of the Prologue).

Objective

The goal of this standard is to prescribe the accounting treatment of revenue and costs related to construction contracts. Due to the nature of the activity carried out in construction contracts, the date the activity of the contract begins and the date on which it ends are usually in different accounting years, therefore, the key issue to account for construction contracts is the distribution of revenue and costs that each generate between periods along executes them. The Standard used the criteria set out in the Framework for the Preparation and Presentation of Financial Statements, in order to determine when to be recognized as ordinary income and costs in the income produced by the construction contract. It is also a practical guide to applying those criteria.

Scope

1. **This standard must be applied to the accounting for construction contracts in the financial statements of contractors.**

2. This standard replaces IAS 11, Accounting for construction contracts, adopted in 1978.

Definitions

3. **The following terms are used in this Standard with the meanings specified below:**

   A construction contract is a contract specifically negotiated for the manufacture of an asset or set of assets, which are closely interrelated and interdependent in terms of design, technology and function, or in relation to their ultimate destination or use.

   A fixed-price contract is a construction contract in which the contractor agrees to a fixed price or a fixed amount per unit of output, and in some cases these prices are subject to review clauses if they increase costs.

   A contract margin on the cost is a construction contract in which the contractor will reimburse the costs paid by him and previously defined in the contract, plus a percentage of those costs or a fixed amount.

4. A construction contract could be agreed to manufacture a single asset, like a bridge, a building, a dam, a pipeline, a road, a boat or a tunnel. A construction contract may also refer to the construction of several assets that are closely related to each other or are interdependent in terms of design, technology and function, or in relation to its ultimate destination or use, are examples of such contracts the construction of refineries or other specialized facilities complex.

5. For purposes of this Standard, the term construction contracts include:

   (a) contracts to provide services that are directly related to the construction of assets, including those relating to management services and project architects, as well as

   (b) contracts for the demolition or rehabilitation of assets and restoration of the environment that can continue the demolition of some assets.

6. The formulas that are used in construction contracts are varied, but for the purposes of this standard are classified into fixed-price contracts and contracts margin on the cost. Some construction contracts may contain features on either mode, for example in the case of a contract margin on the cost with a maximum price reached. In such circumstances, the contractor needs to consider all the conditions set out in paragraphs 23 and 24, to determine how and when to recognize results in revenue and costs for the contract.

Grouping and segmentation of construction contracts

7. The requirements of this standard are applied, usually computed separately for each construction contract. However, under certain circumstances, and in order to better reflect the economic substance of the transaction, it is necessary to implement the standard independently identifiable components of a single contract or join a group of contracts for the purpose of treatment.

8. **When a contract covers a number of assets, the construction of each of them should be treated as a separate element when:**

   (a) economic proposals have been received differently for each asset;

   (b) each asset has been subject to separate negotiation, and the builder and the client have had the opportunity to accept or reject the contract on each of the assets, and

   (c) can be identified revenue and costs of each asset.

9. **A group of contracts, whether from a customer or more, must be treated as a single construction contract when:**

   (a) group of contracts is negotiated as a single package;

   (b) contracts are so closely related they are, indeed, part of a single project with a profit margin generic to all of them, and

   (c) contracts are executed simultaneously or in a continuous sequence.

10. **A contract can, at will of the client, the construction of an asset over and above that originally agreed, or can be modified to include the construction of such an asset. The construction of this additional assets should be treated as a separate contract when:**

(a) the asset is significantly different in terms of design, technology or function of the asset or assets covered by the original contract; or

(b) the price of the asset is negotiated without reference to the price set in the original contract.

Revenue Contract

11. **Contract revenue should include:**

(a) the initial amount of revenue agreed in the contract, and

(b) any change in the labor contract, as well as claims or incentives:

(i) to the extent that it is likely that the same is an income and

(ii) provided that they are capable of reliable valuation.

12. Contract revenue was valued at the fair value of the consideration received or receivable. The valuation of revenue from the contract will be affected by various uncertainties, which depend on the outcome of future events. The estimated need, often being revised and improved as such events occur or uncertainties are resolved. Therefore, the amount of contract revenue may increase or decrease from one year to another. For example:

(a) the contractor and client can agree on modifications or claims that increase or decrease contract revenue, a year after that on which the contract was initially agreed;

(b) the amount of revenue agreed in a fixed-price contract may increase as a result of the review clauses prices;

(c) the amount of revenue from a contract may decrease as a result of penalties for delays caused by the contractor in carrying out the work; or

(d) when a fixed-price contract is a constant amount per unit of work, contract revenue increases if the number of work units shall be amended upward.

13. An amendment is an instruction of the client to change the scope of work to be run under the terms of the contract. A modification can lead to increase or decrease revenue from the contract. Examples of changes are changes in the design or specification of assets, as well as changes in the length of the contract. The change is included in contract revenue when:

(a) the customer is likely to approve the amended plan, as well as the amount of revenue arising from the change, and

(b) the amount that the supposed modifications can be measured with sufficient reliability.

14. A claim is an amount that the contractor expects to charge the customer or a third party as reimbursement of costs not included in the contract price. The claim may arise, for

example, when customers cause delays, errors in specifications or design, or because of disputes relating to the work included in the contract. The valuation of the amounts of revenue arising from the claims is subject to a high level of uncertainty and often depends on the outcome of the relevant negotiations. Therefore, the claims will be included among contract revenue when:

(a) the negotiations have reached an advanced stage of ripening, so it is likely that the customer accepts the claim, and

(b) the amount that is likely to accept the client can be measured with sufficient reliability.

15. The incentive payments are additional amounts recognized the contractor provided that it meets or exceeds certain levels of performance in the contract. For example, a contract can stipulate the recognition of an incentive if the contractor finishes the work in a period less than expected. The incentive payments are included among the revenue from the contract if:

(a) the contract is sufficiently advanced, so it is likely that the levels of performance are met or exceeded, and

(b) the amount resulting from the payment incentives can be measured with sufficient reliability.

Costs of contract

16. **The cost of the contract should include:**

(a) costs that are directly related to the specific contract;

(b) costs in connection with activity contracting in general and may be charged to the specific contract, and

(c) any other cost that can be loaded on to the customer, according to the terms agreed in the contract.

17. The costs that are directly related to each specific contract include:

(a) labor costs at the site of the building, including the monitoring that takes place there;

(b) cost of materials used in construction;

(c) depreciation of property, plant and equipment used in the execution of the contract;

(d) cost of moving items of property, plant and equipment to and from the location of the work;

(e) cost of rental of property, plant and equipment;

(f) cost of design and technical assistance that are directly related to the contract;

(g) estimated cost of the work of rectification and security, including the expected costs of guarantees, and

(h) third-party claims.

The previous cost can be reduced by the amount of any eventual admission that it had not been included in contract revenue, including revenue from the sale of surplus material or the liquidation of property, plant and equipment once the contract.

18. The costs that may be attributable to activity contracting in general and may be charged to each contract include the following:

    (a) insurance;

    (b) the costs of design and technical assistance not directly related to any specific contract, and

    (c) indirect costs of construction.

    These costs are distributed using systematic and rational methods that are applied uniformly to all the costs that have similar characteristics. The distribution is based on the normal level of building activity. Indirect costs include construction costs such as the preparation and processing of payroll staff dedicated to construction. The costs that can be distributed to the construction activity in general, and that can be distributed to specific contracts, also include the costs for interest, provided that the contractor take the allowed alternative treatment in IAS 23, borrowing costs.

19. Among the costs that are specifically attributable to the customer, according to the terms agreed upon in the construction contract, you can find some general costs of administration, and development costs, provided that the repayment of the balance sheet is specified in the agreement reached by the parties.

20. The costs that cannot be attributed to the business of hiring, or cannot be distributed to specific contracts, are excluded from the cost of the construction contract. Among these costs are excluded:

    (a) general costs of administration, for which it has not been specified any reimbursement in the contract;

    (b) the costs of sale;

    (c) the costs of research and development for which, in the contract does not specify any reimbursement, and

    (d) the portion of the share of depreciation corresponding to underuse, because the components of tangible fixed assets have not been used in any specific contract.

21. Contract costs include all costs attributable to it from the date when it becomes strong until the end of the performance of the works in question. However, costs that are directly related to a contract, because they have incurred in the process of negotiating the same, can be included as part of the cost of the contract provided that they can be

identified separately and measured reliably, if probable that the contract becomes available. When the costs incurred to obtain a contract will be recognized as an expense in the period in which they are incurred, and may not be accumulated at the cost of the contract when it comes to obtaining, in a later period.

Recognition of revenue and expenditure

22. **When the result of a construction contract can be estimated reliably, revenue and costs associated with the same results should be recognized as such, referring to the state of implementation of the activity produced by the contract on the date of the balance sheet. Any expected loss in the construction contract should be recognized as such immediately, as set out in paragraph 36.**

23. **In the case of fixed price contracts, the outcome of a construction contract can be estimated reliably, provided under the following conditions:**

    (a) could reasonably valued the total revenue of the contract;

    (b) it is likely that the company obtains the economic benefits of the contract;

    (c) both missing the costs for the termination of the contract as the degree of implementation, the balance sheet date, can be measured with sufficient reliability, and

    (d) costs attributable to the contract can be clearly identified and measured reliably, so that the actual cost of the contract can be compared with previous estimates of the same.

24. **In the case of a contract margin on the cost, the outcome of a construction contract can be estimated reliably when all and each of the following conditions:**

    (a) it is likely that the company obtains the economic benefits of the contract, and

    (b) costs attributable to the contract, specifically whether or not they are refundable, can be clearly identified and valued in a reliable manner.

25. The recognition of revenues and costs with reference to the stage of the contract is often referred to as the percentage of completion method. Under this method, revenue from the contract are compared with the costs that incurred in the pursuit of the rule of conduct that is, which would reveal the amount of revenue, expenditure and the results that can be attributed to the part of the contract and executed. This method provides useful information on the evolution of the activity of the contract and performance derivative of the same in each fiscal year.

26. According to the percentage of completion method, contract revenue is recognized as such in the income statement, over the years in which to carry out the execution of the contract. The costs of the contract are recognized as expenses in the period in which to run the job to which they relate. However, any excess of the expected costs of the contract, on total revenues derived there from shall be recognized as an expense immediately lead to results, in accordance with paragraph 36.

27. The contractor may have incurred costs that relate to future activity of the contract. Such costs are recorded as assets, provided that it is probable that they are recoverable in the future. These costs represent amounts due from customers and are often classified as a work in progress under the contract.

28. The outcome of a construction contract can be estimated reliably only if the company is likely to get the economic benefits associated with it. However, when uncertainty arises regarding the recovery of a game already included in revenue from the contract, and incorporated into the income statement, balance or bad line, whose recovery has ceased to be probable, is recognized as an expense exercise, instead of being treated like an adjustment in the amount of contract revenue.

29. The company is usually able to make reliable estimates after negotiating a contract which sets out:

    (a) the rights of readiness of each of the contracting parties to build on the assets;

    (b) contribution to meeting and

    (c) the manner and timing of payment.

    Normally, it is also necessary that the company has a system of budgeting and financial reporting internal troops. The company reviews and, if necessary, corrects the estimates of revenue and a cost of the contract, as it is running. The fact that these reviews are carried out does not necessarily indicate that the outcome of the contract cannot be reliably estimated.

30. The state of completion of a contract can be determined in many ways. The company frequently uses the method to measure with greater reliability work performed. Depending on the nature of the contract, the methods can take into account:

    (a) the ratio of costs incurred in contract work already done to date, in relation to total estimated costs for the contract;

    (b) review of the work performed, or

    (c) the physics of the overall contract already executed.

    The advances and payments received from the customer do not reflect, necessarily, the proportion of the work performed to date.

31. When determining the stage of the contract by reference to costs incurred to date, only includes the cost of the contract to reflect the work actually executed until that time. Examples of costs that are excluded from the contract are as follows:

    (a) costs that relate to future activity resulting from the contract, such as costs of materials have been delivered to the work or have been left in its vicinity to be used in the same, however, were not installed, used or implemented yet in the execution, unless such materials have been specially manufactured for the contract, and

(b) advance payments to subcontractors, because of the work that they run under the relevant contract.

32. **When the outcome of a construction contract cannot be estimated reliably:**

    (a) revenue should be recognized in the income statement only to the extent that is likely to recover costs incurred because of the contract, and

    (b) the costs of the contract should be recognized as an expense in the year they are incurred.

    Any expected loss due to the construction contract should be recognized immediately as an expense, in accordance with paragraph 36.

33. Often, during the early stages of execution of a contract cannot be estimated with sufficient reliability the outcome of it. However, it may be likely to reach the company to recover costs incurred at this stage. Therefore, contract revenue will be recognized in the income statement only in the proportion that involve, on the total costs incurred that are expected to recover. When the final outcome of the contract cannot be estimated reliably, the company will refrain from recognizing any benefit. However, even if the final outcome may not be known with sufficient reliability, it may be probable that total contract costs will exceed total revenue. In this case, any excess of total costs on total revenue of the contract, will take immediately to the results of the exercise, in accordance with paragraph 36.

34. The cost of the contract those are not likely to lead to recovery results of the exercise immediately. Examples of circumstances in which such recovery is unlikely, where the cost of the contract may require his office immediately results in those contracts where:

    (a) cannot force its full compliance, that is, their validity is seriously questioned;

    (b) completion is subject to the outcome of a sentence or a piece of legislation pending;

    (c) are involved property rights that are likely to be canceled or expropriated;

    (d) the client is unable to assume its obligations, or

    (e) the contractor is unable to perform or the obligations that derive from it.

35. **Where disappear Uncertainties, which prevented reliably estimate the outcome of the contract, revenue and expenses associated with the construction contract to become recognized in the income statement in accordance with paragraph 22, rather than as provided in paragraph 32.**

Recognition of expected loss

36. **When it is probable that total contract costs will exceed total revenue derived there from, the expected loss should be recognized immediately as such in the income statement for the year.**

37. The amount of such losses is determined whether:

(a) if the performance of the contract have commenced or not;

(b) the implementation of the activity of the contract, or

(c) the amount of earnings that are expected to gain in other contracts, provided that they shall not be treated as one for accounting purposes, in accordance with paragraph

Changes in estimates

38. The method of the percentage of work done will be applied cumulatively, each year, the estimates of revenue and total costs to date. Therefore, the effect of a change in estimates of revenue or cost of the contract in question, or the effect of a change in the expected outcome of the contract, will be treated as changes in accounting estimates (see IAS 8 Accounting policies Changes in accounting estimates and errors). The revised estimates will be used in determining the amounts of revenues and expenses recognized in the income statement, both in the period in which the change takes place as in the following years.

Information Disclosure

39. **The company must disclose in its financial statements, information on:**

(a) the amount of contract revenue recognized as such in the period;

(b) the methods used to determine the portion of the contract revenue recognized as such in the period; and

(c) the methods used to determine the degree of realization of the current contract.

40. **The company must disclose, for contracts in progress at the closing date, each of the following information:**

(a) the cumulative amount of costs incurred and recognized gains (less the related losses recognized) to date;

(b) the amount of advances received; and

(c) the amount of withholding tax payments.

41. The embargoes are quantities from the certifications made to customers, who do not recover until the satisfaction of the conditions specified in the contract for collection, or until the defects of the work have been rectified. The certificates are the amounts billed for work performed under the contract, have been paid by the customer or not. The advances are the amounts received by the contractor before the work has been executed.

42. **The company must report in the financial statements on:**

(a) asset amounts represent, in gross terms, due from customers because of construction contracts, and

(b) liabilities that represent quantities, in gross terms, due to customers because of these contracts.

43. The gross amount due from customers, because of the contracts, is the difference between:

(a) costs incurred plus earnings recognized in the income statement and

(b) the sum of the losses recognized in the income statement and certifications performed and invoiced
for all current contracts, in which the costs incurred plus recognized profits (minus losses recognized) exceed the amounts of certificates of work performed and invoiced.

44. The gross amount due to customers because of the contracts, is the difference between:

(a) costs incurred plus earnings recognized in the income statement and

(b) the sum of the losses recognized in the income statement and certifications performed for all current contracts, in which the certificates of work performed and invoiced to exceed the costs incurred plus recognized profits (minus losses recognized).

45. The company will report on any contingent liability or contingent asset, in accordance with IAS 37, Provisions, contingent liabilities and contingent assets. The type of assets and contingent liabilities may arise from circumstances such as the costs of guarantees, claims, fines or other losses.

Effective Date

46. **The International Accounting Standard is effective for financial statements covering periods beginning on or after January 1 1995.**