

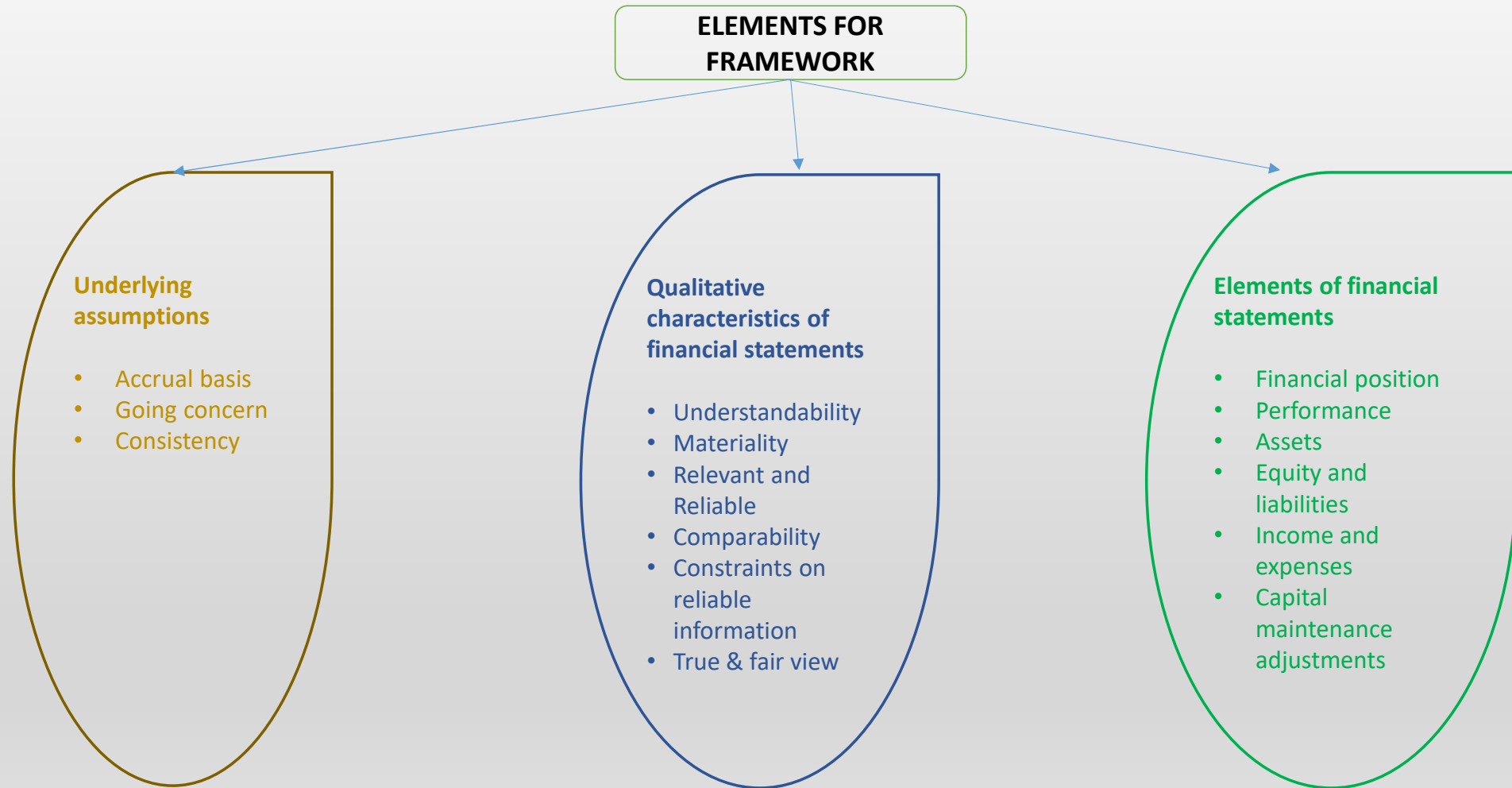


**Faculty Development Workshop on Accounting Standards  
Ernakulam Branch of SIRC of ICAI & M.G. University**

*AS 7 - Construction Contracts  
AS 12 – Government Grants  
AS 4 - Contingencies and Events Occurring After The Balance Sheet Date  
AS 29 - Provisions, Contingent Liability and Contingent Assets*

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# FRAMEWORK FOR PREPARATION & PRESENTATION OF FINANCIAL STATEMENTS



# AS 7 - Construction Contracts



# OBJECTIVE & SCOPE

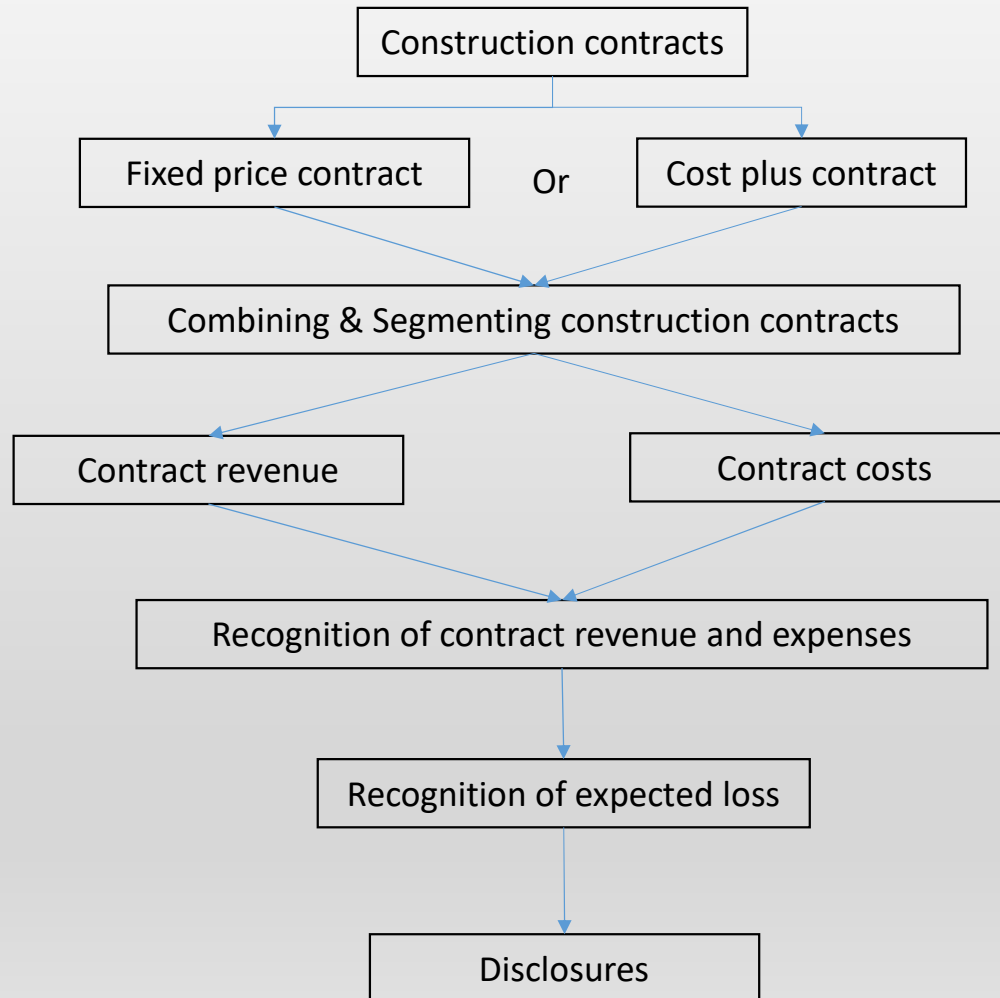
## Objective

- To prescribe the accounting treatment of revenue and costs associated with construction contracts

## Scope

- This Standard should be applied in accounting for construction contracts in the financial statements of contractors

## OVERVIEW OF CONSTRUCTION CONTRACTS



## KEY TERMS

- Construction contract - Contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.
- Fixed price contract - Construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.  
*In 2015, Contractor agrees to construct a 30 floor building for a cost of Rs. 100 crores within a period of 5 years for which 10% price escalation per year on account of increase in cost of materials, labor wages etc.*
- Cost plus contract – It is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus percentage of these costs or a fixed fee.  
*Contractor receives amount spent for construction along with 2% of amount spent OR receives amount spent for construction and an addition of Rs. 5 Lakhs.*

## COMBINING AND SEGMENTING CONSTRUCTION CONTRACTS

### Combining construction contracts

A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:-

- Group of contracts negotiated as a single package;
- Contracts closely interrelated that they are, in effect, part of a single project with an overall profit margin;
- Contracts are performed concurrently or in a continuous sequence

*Construction of 10 floor building*



### Segmenting construction contracts

When a contract covers a number of assets, the construction of each asset should be treated as separate construction contract when:-

- Separate proposals have been submitted for each asset;
- Each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and
- The costs and revenues of each asset can be identified.

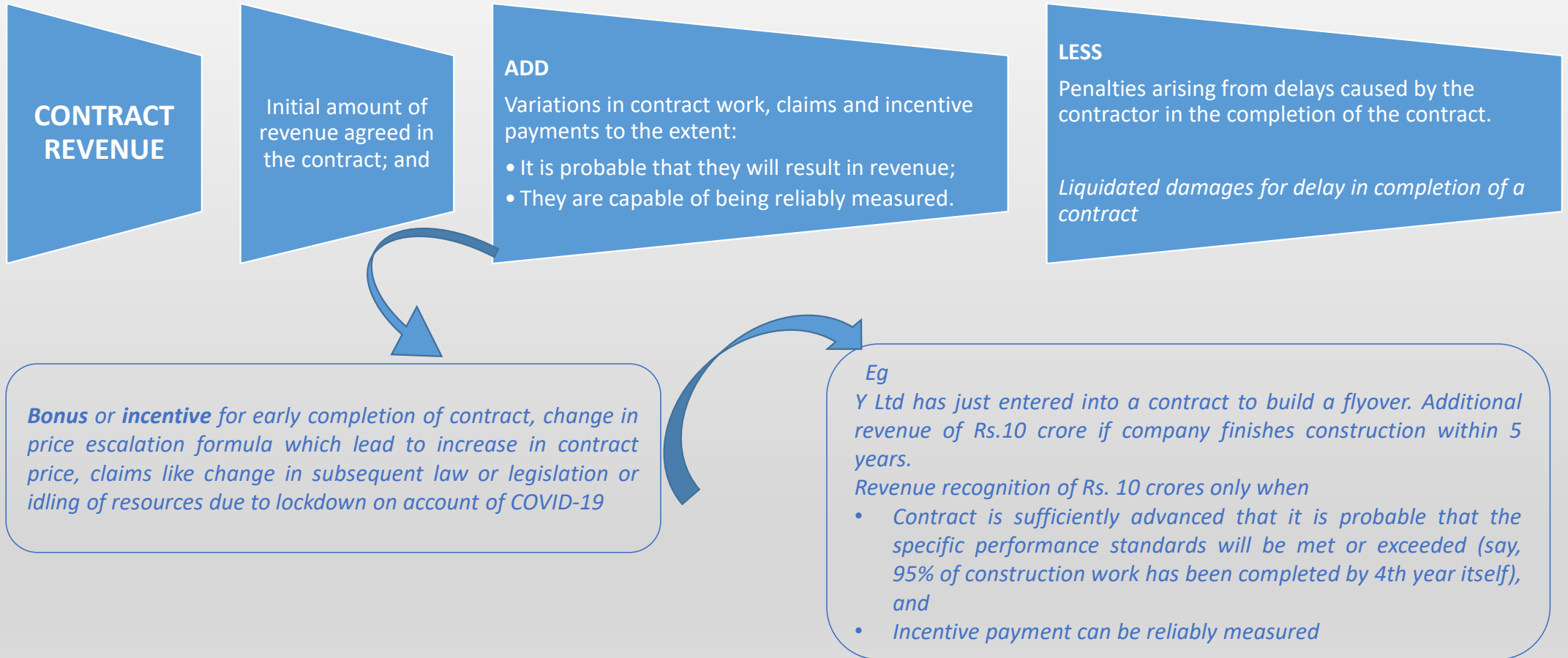
*Construction of 10 independent houses in the same locality*

**Construction of additional asset** - A contract may provide for the construction of an additional asset at the option of the customer or may be amended to include the construction of an additional asset. It should be treated as a separate construction contract when:

- Asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or
- Price of the asset is negotiated without regard to the original contract price.

*Construction of a well for water supply to 10 independent apartments in the same locality*

## CONTRACT REVENUE



# CONTRACT COSTS

## Types of contract costs

Costs that relate directly to the specific contract:-

- Costs of **Materials** used in construction
- Site **Labor Costs**, including site supervision
- **Depreciation** of plant and equipment used
- **Transportation** costs of moving plant, equipment and materials to and from the contract site
- Costs of **Hiring** plant and equipment
- Costs of **Design & Technical** assistance directly related to the contract
- **Claims** from third parties

Costs that are attributable to contract activity in general and can be allocated to the contract

- **Insurance**
- Costs of **design and technical** assistance that is not directly related to the contract
- Construction **Overheads**
- **Borrowing cost**

Costs such as **General Administration & Development** costs which are reimbursed from the customer as per contract

### **Exclusions from contract cost**

- General administration & research and development costs which are not reimbursable
- Depreciation of idle plant and equipment that is not used on a particular contract
- Selling cost

## Recognition of contract revenue and expenses

Outcome of a construction contract can be estimated reliably in case of

### Fixed price contracts

- Total **contract revenue** can be measured reliably;
- Probable that the **economic benefits** associated with the contract will flow to the enterprise;
- **Contract costs** attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates
- Both the **contract costs** to complete the contract and the **stage of completion** at reporting date be measured reliably; and

### Cost plus contracts

- Probable that the **economic benefits** associated with the contract will flow to the enterprise; and
- **Contract costs** attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably

Ways of measuring contract revenue

- **PERCENTAGE OF COMPLETION**
  - *Cost Incurred : Total Cost*
  - *Completion of Physical Portion*
- **SURVEY METHOD**

Particulars	Amt (in Crs)
Total Agreed revenue on 1 Oct 2019	1.5
Cost incurred till 31 Mar 2020	1.2
Expected cost to complete the project	0.2
% of completion $[1.2/(1.2+0.2)]$	85.71%
Revenue to recognised $(1.5*85.71\%)$	1.29

## RECOGNITION OF EXPECTED LOSS

- **Recognition of expected loss** - When it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately. Amount of such a loss is determined irrespective of:-
  - Whether or not work has commenced on the contract;
  - Stage of completion of contract activity; or
  - Amount of profits expected to arise on other contracts which are not treated as a single construction contract
- When an uncertainty arises about the collectability of an amount already included in contract revenue, and recognized in P&L of previous year,
  - Uncollectable or low probability amount is recognized as an expense rather than as an adjustment to the amount of contract revenue.

Particulars	Amt (in Crs)
Total Agreed revenue on 1 Oct 2019	1.5
Cost incurred till 31 Mar 2020	1.2
Expected cost to complete the project	0.4
Loss of the Project [1.5- (1.2+0.4)]	0.1
% of completion [1.2/(1.2+0.2)]	75%
Revenue to be recognised (1.5*75%)	1.125
Loss to be recognised (0.1*120/160)	0.075

## KEY DISCLOSURES

An enterprise should disclose:

- Amount of contract revenue recognized as revenue in the period;
- Methods used to determine the contract revenue recognized in the period; and
- Methods used to determine the stage of completion of contracts in progress

An enterprise should disclose the following for contracts in progress at the reporting date:

- Aggregate amount of costs incurred and recognized profits (less recognized losses) up to the reporting date;
- Amount of advances received; and
- Amount of retentions

An enterprise should present:

- Gross amount due from customers for contract work as an asset; and
- Gross amount due to customers for contract work as a liability

# ***Question & Answer?***



## AS 12 – Government Grants

## KEY ASPECTS

### GOVERNMENT

Central & State Govt  
Govt agencies - IRDA, NHB, World Bank  
Local, National or International Govt  
bodies – Municipality, Corporation

### GOVERNMENT GRANTS

Assistance in cash or kind  
For past or future compliance  
with certain conditions.  
Eg. Subsidy, Incentives, Bounties

### HOW TO RECOGNISE AND ACCOUNT FOR GOVERNMENT GRANTS

### Exclusion

- Normal Trading transactions of enterprise with Government
- Tax Holidays and Exemptions
- Government as shareholder

# OVERVIEW OF GOVERNMENT GRANTS

## RECOGNITION CRITERIA

- a. Assurance of Compliance of terms and conditions
- b. Reasonable certainty of collection - sanctioned

### CAPITAL APPROACH

Grant is treated as part of Shareholder's Fund

Consider appropriate accounting treatment based on nature of grant

Non-monetary consideration

Concessional Rate  
Accounted at Acquisition cost

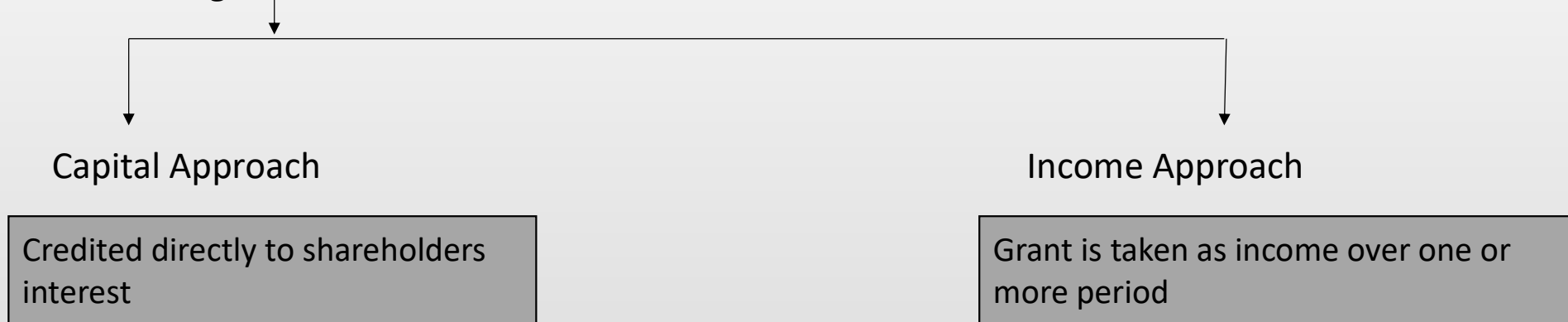
Free of cost  
Recorded at Nominal value

### INCOME APPROACH

Grant is treated as income over one or more period

## ACCOUNTING TREATMENT

### *Accounting Treatment*



### *Recognition*

Government grants should not be recognized until:

- Reasonable assurance that the enterprise will comply with the conditions attached to them
- Benefit has already been earned
- Ultimate collection of the grant is certain

## TYPES OF GOVERNMENT GRANTS

### a) Grants relating to Specific Fixed Asset

#### DEPRECIABLE ASSETS

##### Method 1

Reduce from the Gross Value of the asset concerned, resulting in recognition of grant in the form of reduced depreciation charge in P&L

##### Method 2

Defer the income which is recognized in the P&L on a systematic basis over the useful life of the asset in same proportion as depreciation

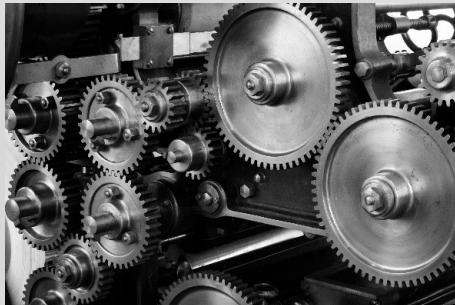
#### NON-DEPRECIABLE ASSETS

##### If no obligation required to be fulfilled

Credited to capital reserve since usually there is no charge to income in respect of such assets

##### If obligation required to be fulfilled

Credited to income over the period over which the cost of meeting obligations is charged to P&L



Eg. Scheme for integrated cold chain and value addition infrastructure by Marine Products Export Development Authority (MPEDA) @ 50% of the equipment cost



## TYPES OF GOVERNMENT GRANTS

### b) Grants of the nature of Promoter's Contribution

- Grants given by the way of contribution towards its total capital outlay are termed as government grants in the nature of promoter's contribution.
- The grants are **treated as capital reserve** which can neither be distributed as dividend nor considered as deferred income

*20% of Project Cost  
of a cement plant in  
Uttarakhand*



### c) Grants relating to Revenue

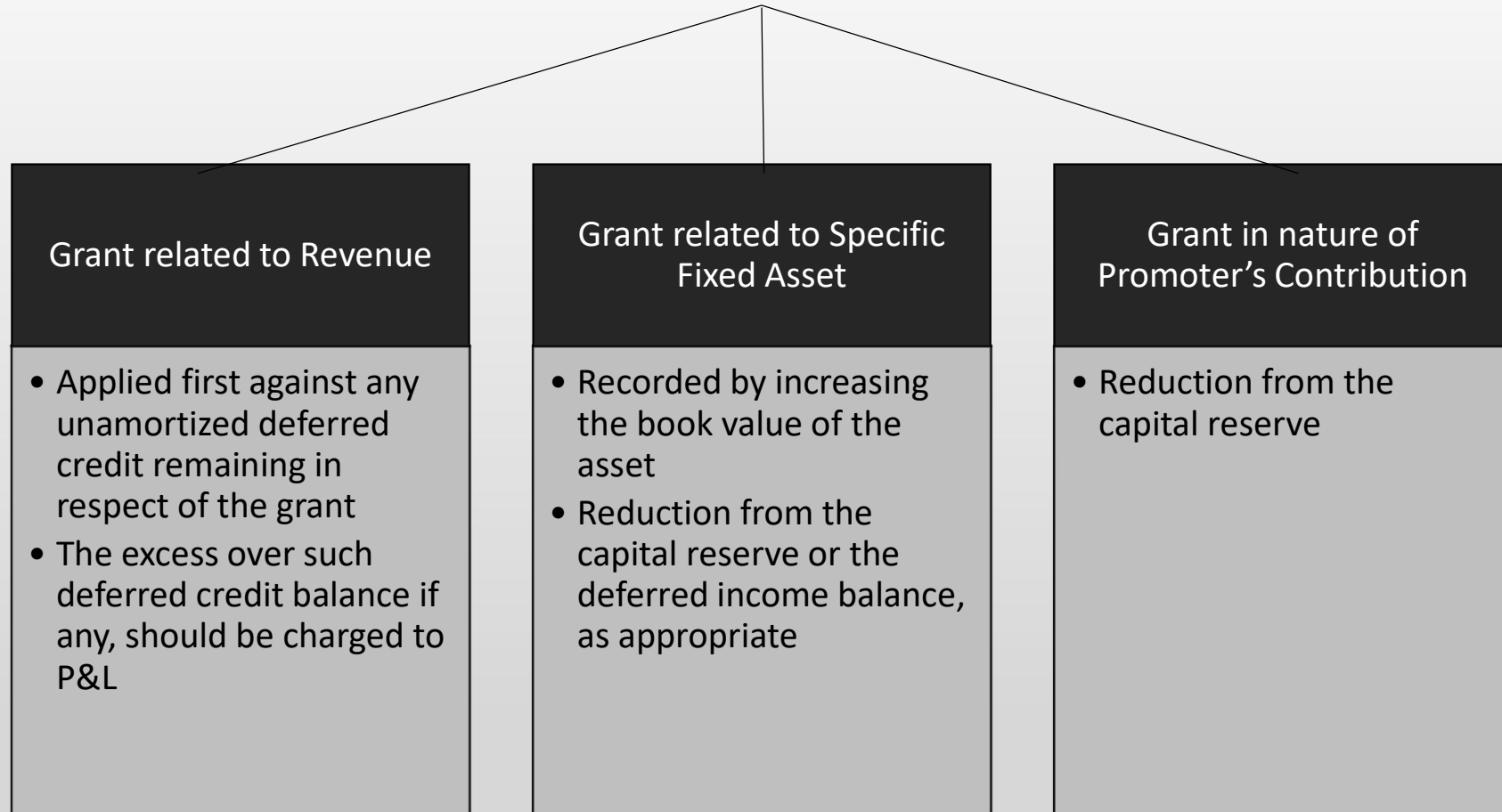
- To be recognized on a systematic basis in the profit and loss statement over the periods necessary to match them with the related costs which they are intended to compensate
- To be shown as :
  - i. "Other Income" in profit and loss account
  - ii. Deducted from the related expense

*Freight Cost Subsidy  
to FACT to ensure  
timely and easy  
availability of  
fertilizers to all parts  
of the country*

*@ per tonne per km.*



## REFUND OF GOVERNMENT GRANT



## KEY DISCLOSURES

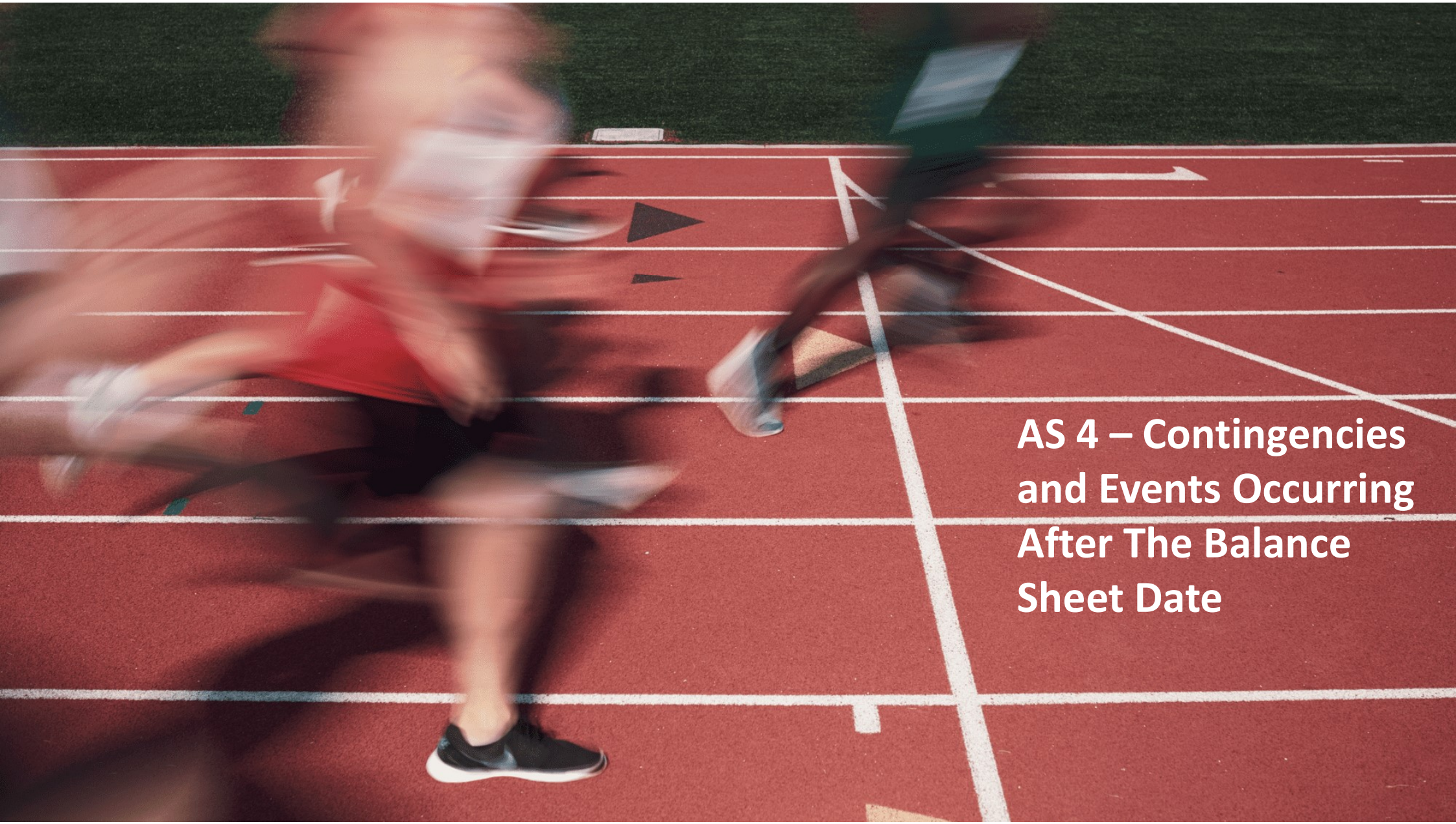


The Accounting policy adopted for government grants, including the methods of presentation in the financial statements



The nature and extent of government grants recognized in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

# ***Question & Answer?***



**AS 4 – Contingencies  
and Events Occurring  
After The Balance  
Sheet Date**

# OBJECTIVE & SCOPE

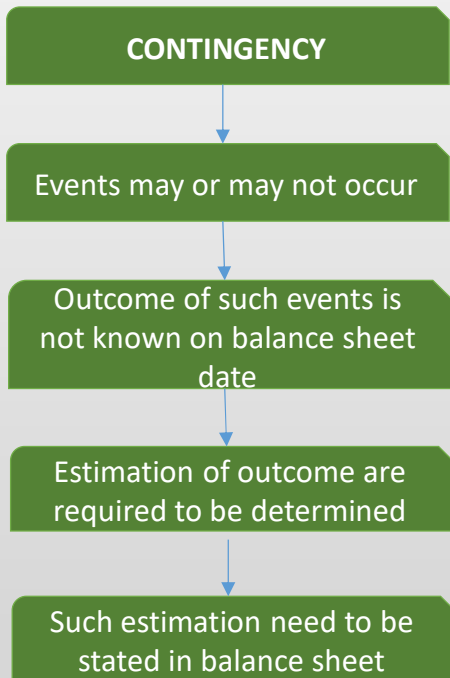
## Objective

- Treatment of:
  - Contingencies, and
  - Events occurring after balance sheet date in financial statements

## Scope

- Exclusions from this standard:
  - Liabilities of life assurance and general insurance enterprises arising from policies issued
  - Obligations under retirement benefit plans
  - Commitments arising from long-term lease contracts

## CONTINGENCIES



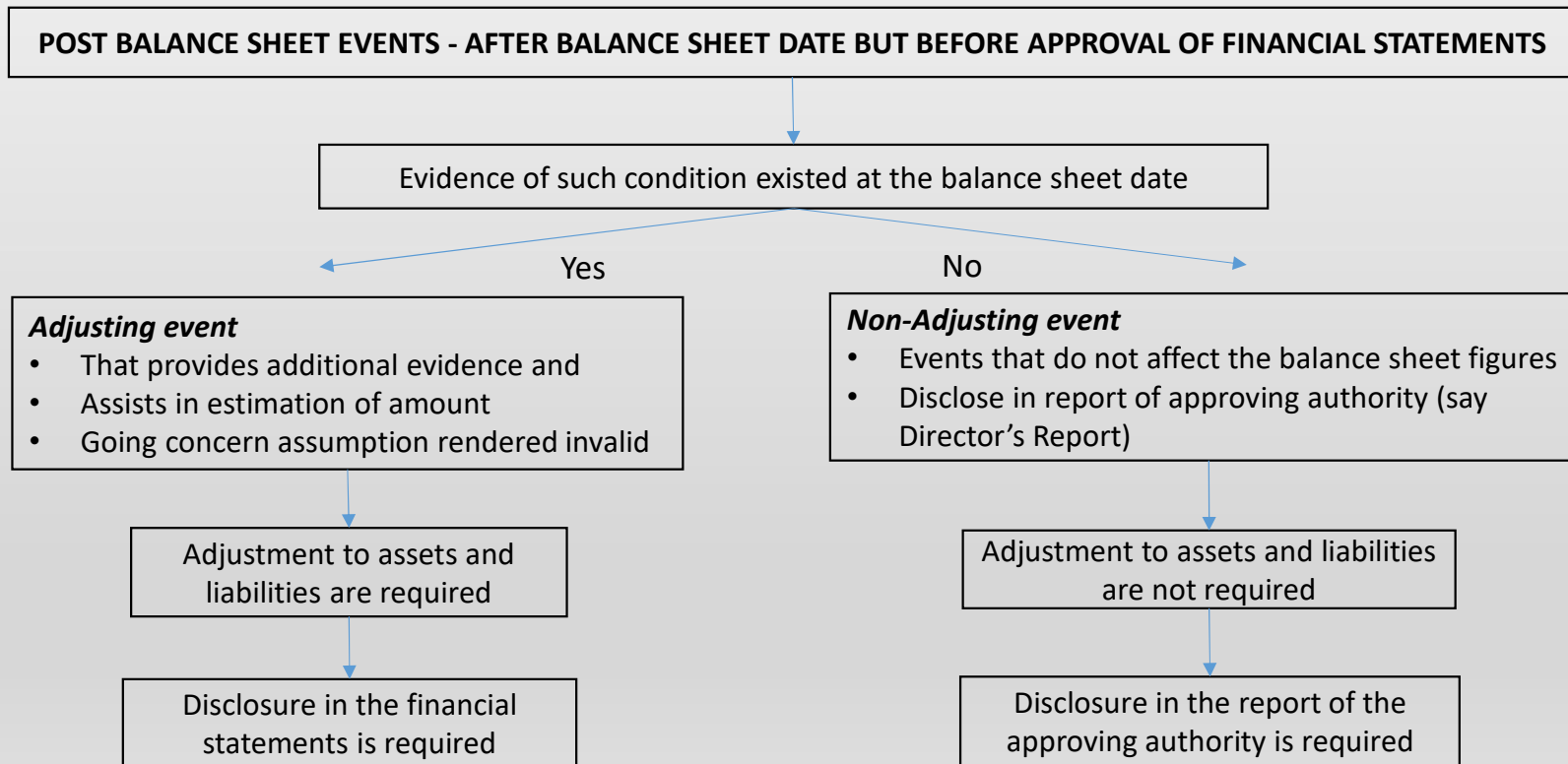
### WAYS OF ESTIMATION

- Certainty – Estimation of amount for many ongoing and recurring activities based on certain and uncertain events
- Expression of future events may be presented as quantified probabilities
- Possibility of reasonable quantification
- Estimation of outcome and financial effect are determined using management's judgement
- For eg. Estimates of useful life are used to determine depreciation, does not make depreciation a contingency; the eventual expiry of the useful life of the asset is not uncertain.

## ACCOUNTING TREATMENT OF CONTINGENCY GAINS AND LOSSES

- **Contingent gains** – It should not be recognized in the financial statements
- **Contingent loss** – It should be charged in the Statement of Profit and Loss if both the conditions are not met:
  - Future events will confirm that, after taking into account any related probable recovery (for eg. Counter claim or claim against third party), an asset has been impaired or a liability has been incurred as at the balance sheet date
  - Reasonable estimate of the amount of resulting loss can be made
- In case of conflicting or insufficient evidence for estimating the amount of contingent loss, appropriate disclosure need to be made
- Amount of guarantees, obligations arising from discounted bills of exchange undertaken by an entity need to be disclosed

# OVERVIEW OF EVENTS OCCURING AFTER THE BALANCE SHEET DATE



## EVENTS OCCURING AFTER THE BALANCE SHEET DATE

Notes



Prepares financial statements from the books of accounts

10<sup>th</sup> January

Accountants

In this case, the financial statements were approved by the Board on 15th January. Therefore, this standard applies to all events between the closing of accounts i.e. 31st December and 15th January

Approve the financial statements and issue them

15<sup>th</sup> January



Board

Receive the financial statements of the entity

18<sup>th</sup> January



Shareholders

## ACCOUNTING TREATMENT OF EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

**Adjusting events** – Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate the fundamental accounting assumption of going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate.

*Bad debt should be accounted as on balance sheet date i.e. 31<sup>st</sup> Mar 2020 even though insolvency of debtor after the balance sheet date.*



**Non-Adjusting events** - Disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise.

*Stock was destroyed due to fire on 10th April 2020 after balance sheet but before approving financial statements by BOD on 15 June 2020.*

*State Highway as an alternate to National Highway inaugurated on 15 May 2020*

**Other events** – Events which although takes place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or special nature.

*Proposed dividend, Impact on account of COVID-19*

*It may be adjusting or non-adjusting event which depends on case to case basis. Adjusting event for valuation of inventories at the balance sheet date and Non-Adjusting event for assessment of non performing assets due to moratorium on loans.*

## KEY DISCLOSURES

- In case of contingencies, the following information should be disclosed:
  - The nature of the contingency;
  - The uncertainties which may affect the future outcome;
  - An estimate of the financial effect, or a statement that such an estimate cannot be made
- In case of post balance sheet events, the following information should be disclosed:
  - The nature of the event;
  - An estimate of the financial effect, or a statement that such an estimate cannot be made.

# ***Question & Answer?***



## AS 29 - Provisions, Contingent Liability and Contingent Assets



# SCOPE

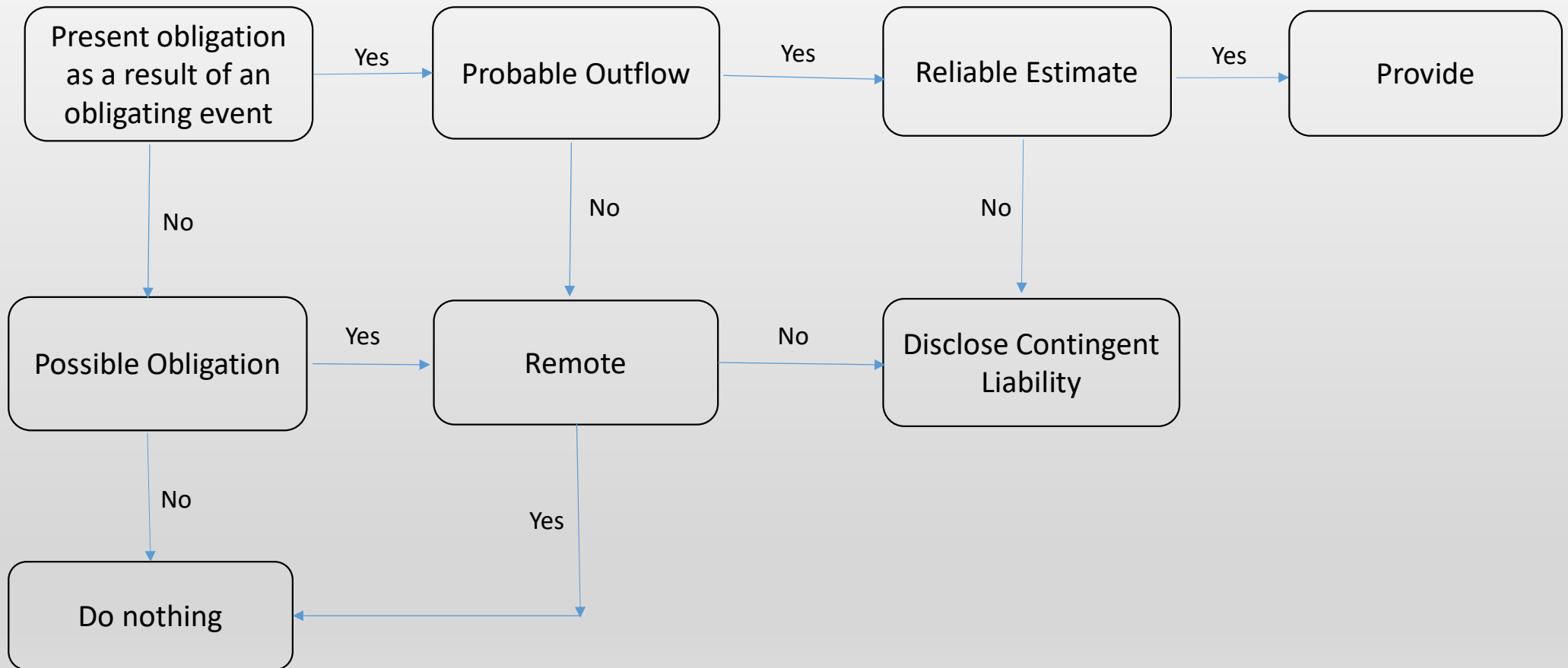
## Objective

- To ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities
- Sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount
- To lay down appropriate accounting for contingent assets

## Exclusions

- Standard should be applied in accounting for Provisions, Contingent Liabilities and Contingent Assets except
  - Financial Instruments that are carried at Fair Value
  - Executory Contracts
  - Insurance Contracts with Policy Holders
  - Covered under another AS (AS 7, AS 9, AS 15, AS 19)

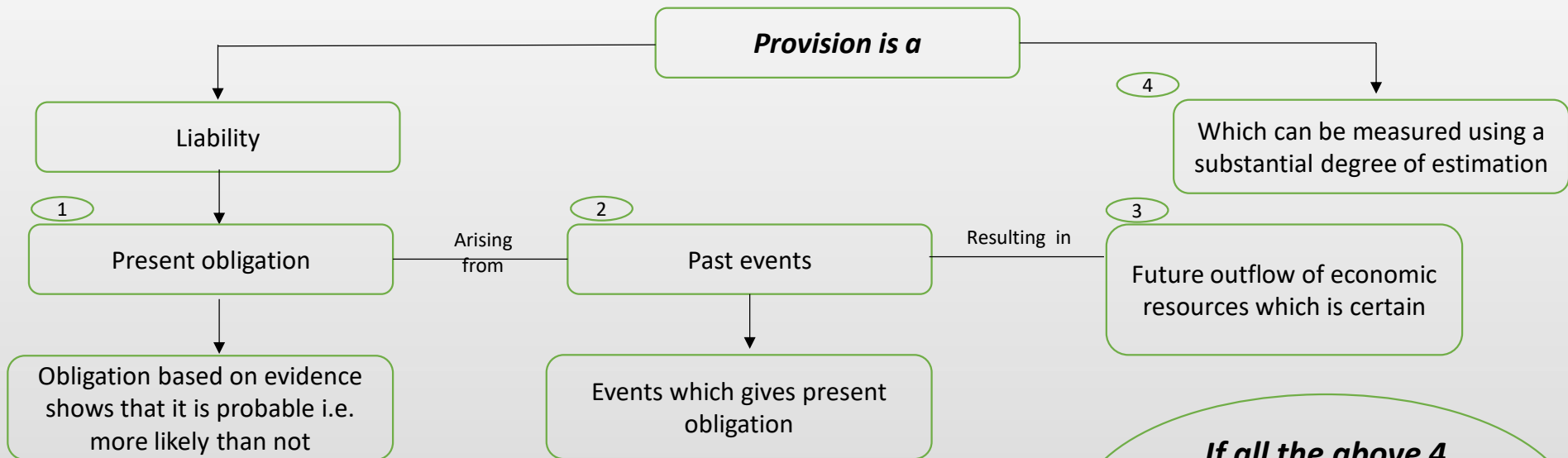
# OVERVIEW OF PROVISIONS, CONTINGENT LIABILITIES & CONTINGENT ASSETS



## KEY TERMS

- **Provision** is a liability which can be measured only by using a substantial degree of estimation.
- **Liability** is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.
- **Contingent liability**
  - Possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or  
*Income Tax demand*
  - Present obligation that arises from past events but is not recognized because:
    - it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation
    - a reliable estimate of the amount of the obligation cannot be made.  
*Claims raised by a contractor*
- **Contingent asset** is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the enterprise.  
*Arbitration claim for loss of revenue with TRAI*

## RECOGNITION



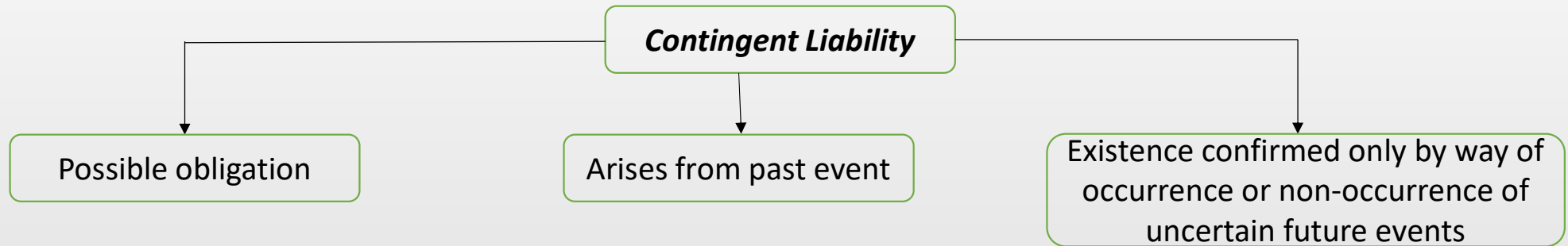
Oil company has been contaminating land and does not clean up because there is no legislation requiring cleaning up. At 31<sup>st</sup> March 2019, it is virtually certain that a law requiring a clean up of land contaminated will be enacted shortly after the year end. Is any provision necessary?

- i. There is present obligation as a result of past event – *The obligating event is the contamination of the land because of virtual certainty of legislation requiring cleaning up*
- ii. It is probable that an outflow of resources embodying economic benefit will be required to settle the obligation and - *Probable*
- iii. A reliable estimate can be made – *Reliable*

**Conclusion:** A provision should be recognize for the best estimates of the cost of the clean ups.

***If all the above 4 conditions are met, then only create provision***

## RECOGNITION

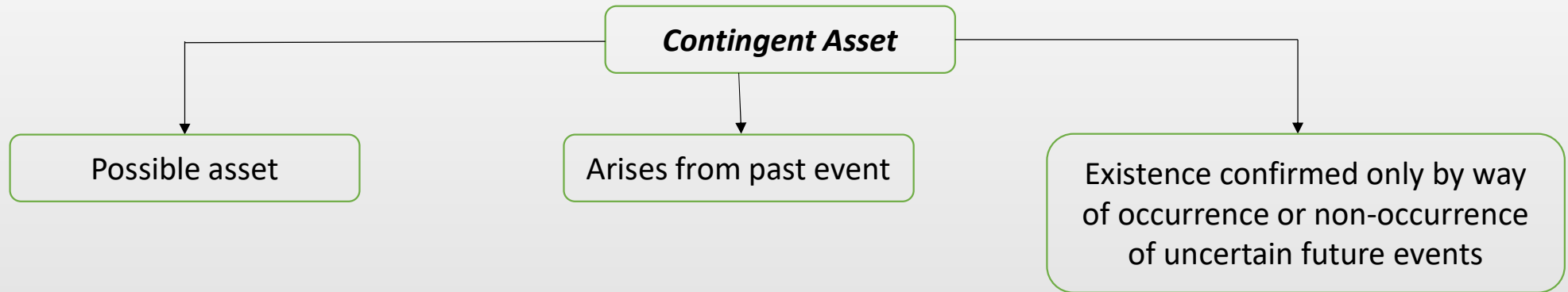


It is not recognized because:



Should not be recognized as Current Liability but disclosed by way of **Footnote** in Balance Sheet

## RECOGNITION



- It should not be recognized.
- It should not be disclosed
- Generally disclosed in 'Director's report'

## KEY DISCLOSURES

- For each class of Provisions at the Balance sheet date:-
  - A brief description of the Nature of the obligation and the expected timing of any resulting outflows of economic benefits
  - Carrying amount at the beginning and end of the period
  - Additional provision made during the period, including increase in existing provision
  - Amount used (i.e. incurred and charged against the provision) during the period
  - Unused amount during the period
- For each class of Contingent Liability at the Balance sheet date:-
  - A brief description of the Nature of the Contingent Liability and wherever practicable:
    - An estimate of its Financial effect
    - An indication of uncertainties relating to any outflow
    - The possibility of any reimbursement
- For each class of Contingent Asset at the Balance sheet date:-
  - No disclosure

# ***Question & Answer?***

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