

Accounting Standards Interpretation (ASI) 29¹**Turnover in case of Contractors****Accounting Standard (AS) 7, Construction Contracts
(revised 2002)****ISSUE**

1. AS 7, Construction Contracts (revised 2002) deals, *inter alia*, with revenue recognition in respect of construction contracts in the financial statements of contractors. It requires recognition of revenue by reference to the stage of completion of a contract (referred to as 'percentage of completion method'). This method results in reporting of revenue which can be attributed to the proportion of work completed. Under this method, contract revenue is recognised as revenue in the statement of profit and loss in the accounting period in which the work is performed.

The issue is whether the revenue so recognised in the financial statements of contractors as per the requirements of AS 7 can be considered as 'turnover'.

CONSENSUS

2. The amount of contract revenue recognised as revenue in the statement of profit and loss as per the requirements of AS 7 should be considered as 'turnover'.

BASIS FOR CONCLUSIONS

3. The paragraph dealing with the 'Objective' of AS 7 provides as follows:

¹ Published in 'The Chartered Accountant', August 2005, pp. 323-324. The authority of this ASI is the same as that of the Accounting Standard to which it relates. The contents of this ASI are intended for the limited purpose of the Accounting Standard to which it relates. ASI is intended to apply only to material items.

“Objective

The objective of this Statement is to prescribe the accounting treatment of revenue and costs associated with construction contracts. Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods. Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed. This Statement uses the recognition criteria established in the Framework for the Preparation and Presentation of Financial Statements to determine when contract revenue and contract costs should be recognized as revenue and expenses in the statement of profit and loss. It also provides practical guidance on the application of these criteria.”

From the above, it may be noted that AS 7 deals, *inter alia*, with the allocation of contract revenue to the accounting periods in which construction work is performed.

4. Paragraphs 21 and 31 of AS 7 provide as follows:

“21. When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.”

“31. When the outcome of a construction contract cannot be estimated reliably:

- (a) revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and***
- (b) contract costs should be recognised as an expense in the period in which they are incurred.***

An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.”

From the above, it may be noted that the recognition of revenue as per AS 7 may be inclusive of profit (as per paragraph 21 reproduced above) or exclusive of profit (as per paragraph 31 above) depending on whether the outcome of the construction contract can be estimated reliably or not. When the outcome of the construction contract can be estimated reliably, the revenue is recognised inclusive of profit and when the same cannot be estimated reliably, it is recognised exclusive of profit. However, in either case it is considered as revenue as per AS 7.

5. 'Revenue' is a wider term. For example, within the meaning of AS 9, Revenue Recognition, the term 'revenue' includes revenue from sales transactions, rendering of services and from the use by others of enterprise resources yielding interest, royalties and dividends. The term 'turnover' is used in relation to the source of revenue that arises from the principal revenue generating activity of an enterprise. In case of a contractor, the construction activity is its principal revenue generating activity. Hence, the revenue recognised in the statement of profit and loss of a contractor in accordance with the principles laid down in AS 7, by whatever nomenclature described in the financial statements, is considered as 'turnover'.