This accounting policy paper is based on IPSAS 11 Construction Contracts, as adopted by the Treasury of the Republic of Cyprus.

Construction Contracts

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1. INTRODUCTION

1.1 CONSTRUCTION CONTRACTS

Construction contract is a contract, or a similar binding arrangement, 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.[1]

Public sector entities may enter into construction contracts with third parties (private or other public sector entities) on a commercial basis that will allow them to generate a profit margin. However, public sector entities may enter into construction contracts on a non-commercial basis (usually with other public sector entities), where there is full, partial or even no recovery of the cost from the third parties. In these cases, the funding to support the construction activity may be provided by an appropriation or other allocation of general government funds, or by aid, or government grants. The primary issue for construction contracts is the allocation of construction costs to the reporting period in which the construction work is performed and the recognition of the related costs, since the date at which the contract activity begins and the date at which the contract activity is completed usually fall into different reporting periods.

Examples of construction contracts in the public sector include: a contract for the constuction of a building, road, dam, bridge, reticulated water supply system etc.

1.2 OBJECTIVES

The objective of this accounting policy is to establish the accounting treatment and disclosure of costs and revenue associated with construction contracts. This accounting policy identifies the arrangements that are to be classified as construction contracts, provides guidance on the types of construction contracts that can arise in the public sector, and specifies the basis for recognition and disclosure of contract expenses and, if relevant, contract revenues.

The aim of this policy is to provide technical accounting guidance for the preparation of financial statements regarding construction contracts, so as to enable the financial statements to give a true and fair view of the financial performance and financial position of the entity. The aforementioned policy is prepared following guidance from all relevant International Public Sector Accounting Standards (IPSASs).

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[1] *Definition as per "IPSAS 11 – Construction Contracts".*

1.3 SCOPE

This accounting policy applies to the accounting treatment of all construction contracts in the financial statements of the government of the Republic of Cyprus and its consolidated entities.

Construction contracts that involve assets constructed by the entity for itself, are outside the scope of this accounting policy (see Accounting Policy on Property, Plant and Equipment).

1.4 DEFINITIONS

Construction contract is a contract, or a similar binding arrangement, 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.

Contractor is an entity that performs construction work pursuant to a construction contract.

Cost-based contract is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs and, in the case of a commercially based contract, an additional percentage of these costs or a fixed fee, if any.

Fixed price contract is a 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.

Revenue is increases in the net financial position of the entity, other than increases arising from ownership contributions.

Ownership contributions are inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity.

Any other terms defined in other accounting policies that have been adopted by the government of the Republic of Cyprus, are used in this accounting policy with the same meaning as in those accounting policies.

2. CONSTRUCTION CONTRACTS

2.1 GENERAL

1. A construction contract may be negotiated for the construction of a single asset such as a bridge, building, dam, pipeline, road, or tunnel. A construction contract may also deal with the construction of a number of assets that are closely interrelated or interdependent in terms of their design, technology, and function or their ultimate purpose or use - examples of such contracts include those for the construction of reticulated water supply systems, refineries, and other complex infrastructure assets.

2. For the purposes of this accounting policy, **construction contracts include**:
   a) Contracts for the *rendering of services* that are directly related to the construction of the asset, for example, those for the services of project managers and architects; and
   b) Contracts for the *destruction or restoration of assets*, and the restoration of the environment following the demolition of assets.

3. For the purposes of this accounting policy, **construction contracts also include all arrangements that are binding on the parties to the arrangement, even if these might not take the form of a documented contract**. Such binding arrangements could include (but are not limited to) a ministerial direction, a council of ministers' decision, a legislative direction (such as an Act of Parliament), or a memorandum of understanding. For example, two government departments may enter into a formal arrangement for the construction of an asset, but the arrangement may not constitute a legal contract because, individual departments may not be separate legal entities with the power to contract. However, provided that the arrangement confers similar rights and obligations on the parties to it as if it were in the form of a contract, it is a construction contract for the purposes of this accounting policy.

2.2 FIXED PRICE CONTRACTS AND COST BASED CONTRACTS

Cost-based contract

A construction contract in which the contractor is reimbursed for allowable or otherwise defined costs and, in the case of a commercially based contract, an additional percentage of these costs or a fixed fee, if any.

Fixed price contract

A 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.

1. For the purposes of this accounting policy, construction contracts are classified as **fixed price contracts** and **cost-based contracts**. Some commercial construction contracts may contain characteristics of both a fixed price contract and a cost-based contract, for example in the case of a cost-based contract with an agreed maximum price. In such circumstances, a contractor needs to consider all the conditions in paragraphs 3.1(2) and 3.1.(3) in order to determine when to recognise contract revenue and expenses.

2. **Cost-based contracts** encompass both commercial and non-commercial contracts. A <u>commercial contract</u> will specify that revenue to cover the agreed constructor's construction costs and generate a profit margin, will be provided by the other parties to the contract. However, a public sector entity may also enter into a <u>non-commercial contract</u> to construct an asset for another entity in return for full or partial reimbursement of costs from that entity or other parties. In some cases, the recovery of cost may encompass payments by the recipient entity and specific purpose construction grants or funding from other parties.

3. A public sector entity may construct assets for another public sector entity and the cost of the construction activity may not be recovered directly from the recipient of the asset. Where one public sector entity constructs assets for another public sector entity, and the construction activity is funded indirectly:
   (i) by way of a general appropriation or other allocation of general government funds to the contractor, or
   (ii) from general purpose grants from third party funding agencies or other governments

   these contracts are classified as **fixed price contracts** for the purpose of this accounting policy.

2.3 CONTRACTOR

A contractor is an entity that enters into a contract to build structures, construct facilities, produce goods, or render services to the specifications of another entity (private or another public entity). The term "contractor" includes a general or prime contractor, a subcontractor to a general contractor, or a construction manager.

2.4 COMBINING AND SEGMENTING CONSTRUCTION CONTRACTS

1. The requirements of this accounting policy are usually applied separately to each construction contract. However, in certain circumstances, it is necessary to apply the accounting policy to the separately identifiable components of a single contract, or to a group of contracts together, in order to reflect the substance of a contract or a group of contracts.

2. When a **contract covers a number of assets**, the construction of each asset shall be treated as a *separate construction contract* when:
   a) Separate proposals have been submitted for each asset;
   b) 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
   c) The costs and revenues of each asset can be identified.

3. A **group of contracts**, whether with a single customer or with several customers, shall be treated as a *single construction contract* when:
   a) The group of contracts is negotiated as a single package;
   b) The contracts are so closely interrelated that they are, in effect, part of a single project with an overall margin, if any; and
   c) The contracts are performed concurrently or in a continuous sequence.

4. 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**. The construction of the additional asset shall be treated as a *separate construction contract* when:
   a) The asset differs significantly in design, technology, or function from the asset or assets covered by the original contract; **or**
   b) The price of the asset is negotiated without regard to the original contract price.

3. RECOGNITION OF CONTRACT REVENUE AND EXPENSES

3.1 GENERAL

1. **When the outcome of a construction contract can be estimated reliably[2], contract revenue and contract costs associated with the construction contract shall be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected deficit on a construction contract to which paragraph 3.2(1) applies shall be recognised as an expense immediately in accordance with paragraph 3.2(1).**

2. In the case of a ***fixed price contract*,** the outcome of a construction contract can be estimated *reliably* when ***all*** the following **conditions** are satisfied:
   (a) **Total contract revenue, if any, can be measured reliably;**
   (b) **It is probable that the economic benefits or service potential associated with the contract will flow to the entity;**
   (c) **Both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and**
   (d) **The 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.**

3. In the case of a ***cost-based contract*,** the outcome of a construction contract can be estimated *reliably* when ***all*** the following **conditions** are satisfied:
   (a) **It is probable that the economic benefits or service potential associated with the contract will flow to the entity; and**
   (b) **The contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.**

4. The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as the **percentage of completion method**. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses, and surplus/deficit that can be attributed to the proportion of work completed. This method provides useful information on the extent of contract activity and performance during a period.

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[2] *Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent*

5. Under the **percentage of completion method**, contract revenue is recognised as revenue in the statement of financial performance in the reporting periods in which the work is performed. Contract costs are recognised as an expense in the statement of financial performance in the reporting periods in which the work to which they relate is performed. However, where it is intended at inception of the contract that contract costs are to be fully recovered from the parties to the construction contract, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately in accordance with paragraph 3.2(1).

6. The **stage of completion** of a contract can be determined in a variety of ways. The entity shall use the method that measures reliably the work performed. Depending on the nature of the contract, the methods may include:
   a) The proportion that contract costs incurred for work performed to date bear to the estimated total contract costs;
   b) Surveys of work performed; or
   c) Completion of a physical proportion of the contract work

   Progress payments and advances received from customers often do not reflect the work performed.

7. When the **stage of completion** is determined by reference to the **contract costs incurred to date**, only those contract costs that reflect work performed are included in costs incurred to date. Examples of contract costs that are excluded are:
   (a) Contract costs that relate to future activity on the contract, such as costs of materials that have been delivered to a contract site or set aside for use in a contract, but not yet installed, used, or applied during contract performance, unless the materials have been made especially for the contract; and
   (b) Payments made to subcontractors in advance of work to be performed under the subcontract.

8. A contractor may have incurred contract costs that relate to future activity on the contract. Such contract costs are recognised as an asset, provided it is probable that they will be recovered. Such costs represent an amount due from the customer and are classified as contract **work in progress**.

9. The outcome of a construction contract can only be estimated reliably when it is probable that the economic benefits or service potential associated with the contract will flow to the entity. However, when an **uncertainty arises about the collectability** of an amount already included in contract revenue, and already recognised in the statement of financial performance, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is **recognised as an expense** rather than as an adjustment of the amount of contract revenue.

10. The entity reviews and, when necessary, revises the estimates of contract revenue and contract costs as the contract progresses. The need for such revisions does not necessarily indicate that the outcome of the contract cannot be estimated reliably.

11. **When the outcome of a construction contract cannot be estimated reliably:**
    (a) **Revenue shall be recognised only to the extent of contract costs incurred that it is probable will be recoverable; and**
    (b) **Contract costs shall be recognised as an expense in the period in which they are incurred.**

    An expected deficit on a construction contract to which paragraph 3.2(1) applies shall be recognised as an expense immediately in accordance with paragraph 3.2(1).

12. Whenever the outcome of the contract cannot be estimated reliably, although it is probable that the entity will recover the contract costs incurred, contract revenue is recognised only to the extent of costs incurred that are expected to be recoverable. As the outcome of the contract cannot be estimated reliably, no surplus or deficit is recognised. However, even though the outcome of the contract cannot be estimated reliably, when it is probable that total contract costs will exceed total contract revenues, any expected excess of total contract costs over total contract revenues for the contract shall be recognised as an expense immediately in accordance with paragraph 3.2(1).

13. Where contract costs that are to be reimbursed by parties to the contract are not probable of being recovered, they are recognised as an expense immediately. Examples of circumstances in which the recoverability of contract costs incurred may not be probable, and in which contract costs may need to be recognised as an expense immediately, include contracts:
    (a) That are not fully enforceable, that is, their validity is seriously in question;
    (b) The completion of which is subject to the outcome of pending litigation or legislation;
    (c) Relating to properties that are likely to be condemned or expropriated;
    (d) Where the customer is unable to meet its obligations; or
    (e) Where the contractor is unable to complete the contract or otherwise meet its obligations under the contract.

14. **When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue and expenses associated with the construction contract shall be recognised in accordance with paragraph 1 above rather than in accordance with paragraph 11 above.**

3.2 RECOGNITION OF EXPECTED DEFICITS

1. **In respect to construction contracts which it is intended at inception of the contract that contract costs will be fully recovered from the parties, but as the contract progresses, it becomes probable that total contract costs will exceed total contract revenue, the expected deficit shall be recognised as an expense immediately.**

2. Public sector entities may enter into construction contracts that specify that the revenue intended to cover the construction costs will be **provided by the other parties** to the contract. This may occur where, for example:
   (a) Government departments and agencies that are largely dependent on appropriations or similar allocations of government revenue to fund their operations are also empowered to contract with commercial public sector entities or private sector entities for the construction of assets on a commercial or full cost recovery basis; or
   (b) Government departments and agencies transact with each other on an arm's length or commercial basis as may occur under a "purchaser-provider" or similar model of government.

   In these cases, an expected deficit on a construction contract is recognised immediately in accordance with paragraph 1 above.

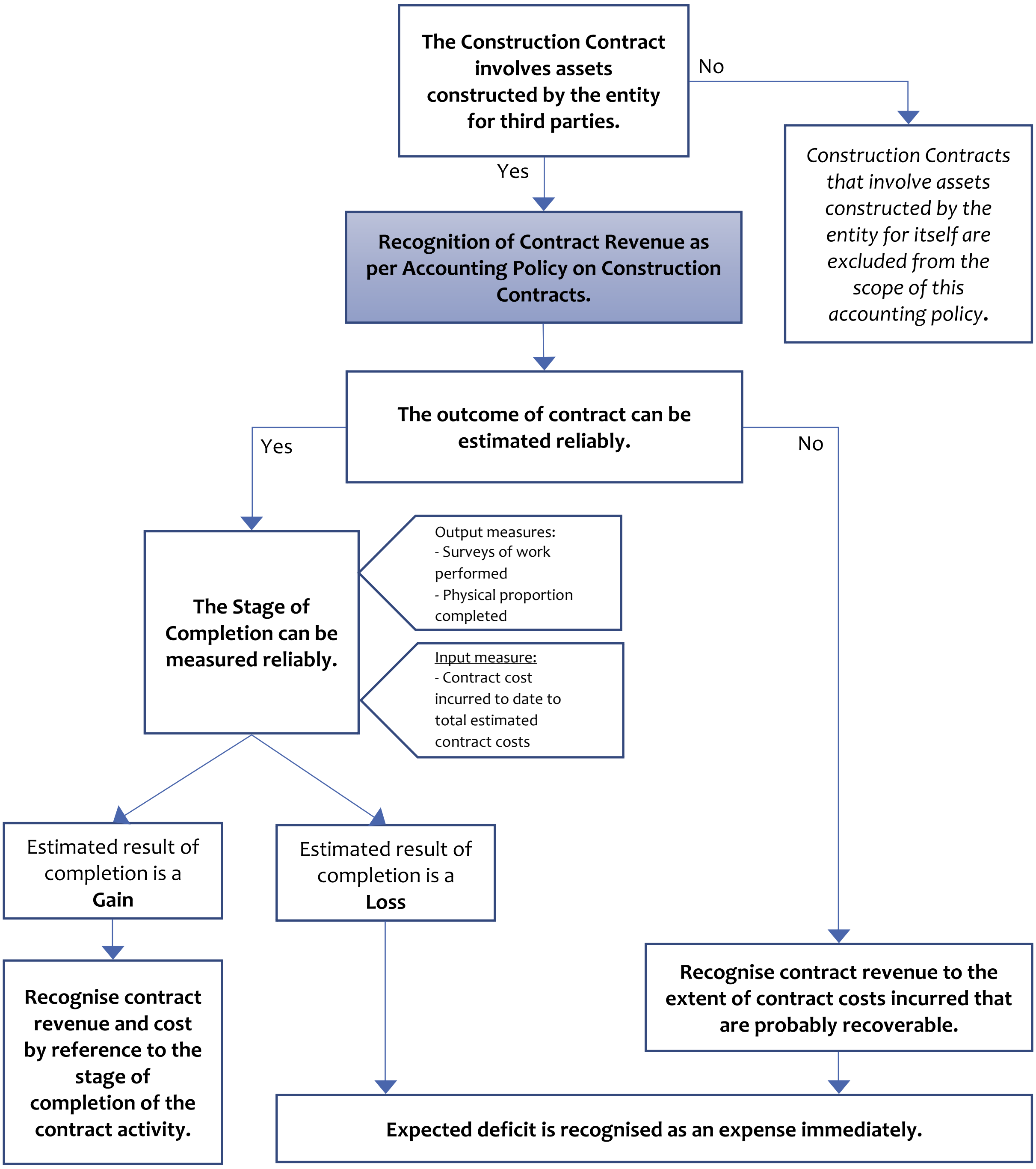
3. In some cases, a public sector entity may enter into a construction contract for less than full cost recovery from the other parties to the contract. In these cases, funding in excess of that specified in the construction contract will be provided from an appropriation or other allocation of government funds to the contractor, or from general purpose grants from third party funding agencies or other governments. The requirements of paragraph 1 above do not apply to these construction contracts.

4. In determining the amount of any deficit under paragraph 1 above, total contract revenue and total contract costs may include payments made directly to subcontractors by third party funding agencies in accordance with paragraphs 4.1(6) and 4.2(1).

5. The amount of such a deficit is determined irrespective of:
   (a) Whether or not work has commenced on the contract;
   (b) The stage of completion of contract activity; or
   (c) The amount of surpluses expected to arise on other commercial construction contracts that are not treated as a single construction contract in accordance with paragraph 2.4(3).

3.3 Illustration for the Recognition of Contract Revenue and Expenses

The flowchart below[3] illustrates the process the entity undertakes with regards to recognition of contract revenue and expenses, as described in section 3 of this accounting policy.



[3] *The flowchart is illustrative only; it does not take the place of this accounting policy. It is provided as an aid for interpreting this accounting policy.*

4. ELEMENTS OF CONTRACT REVENUE AND CONTRACTS COSTS

4.1 CONTRACT REVENUE

Contract revenue shall comprise of:

*a) The **initial amount** of revenue agreed in the contract; and*

*b) **Variations** in contract work, **claims**, and **incentive payments** to the extent that:*

(i) It is probable that they will result in revenue; and

(ii) They are capable of being reliably measured.

1. **Contract revenue is measured at the *fair value* of the consideration received or receivable.** Both the **initial** and ongoing measurement of contract revenue are affected by a variety of uncertainties that depend on the outcome of future events. The estimates often need to be revised as events occur and uncertainties are resolved. Where a contract is a *cost-based contract*, the initial amount of revenue may not be stated in the contract. Instead, it may need to be estimated on a basis consistent with the terms and provisions of the contract, such as by reference to expected costs over the life of the contract.

2. In addition, the amount of contract revenue may increase or decrease from one period to the next. For example:
   a) A contractor and a customer may agree to variations or claims that increase or decrease contract revenue in a period subsequent to that in which the contract was initially agreed;
   b) The amount of revenue agreed in a fixed price or cost-based contract may increase as a result of cost escalation or other clauses;
   c) The amount of contract revenue may decrease as a result of penalties arising from delays caused by the contractor in the completion of the contract; or
   d) When a fixed price contract involves a fixed price per unit of output, contract revenue increases or decreases as the number of units is increased or decreased.

3. A **variation** is an instruction by the customer for a change in the scope of the work to be performed under the contract. A variation may lead to an increase or a decrease in contract revenue. Examples of variations are changes in the specifications or design of the asset, and changes in the duration of the contract.
   A variation is included in contract revenue when:
   (a) It is probable that the customer will approve the variation and the amount of revenue arising from the variation; and
   (b) The amount of revenue can be reliably measured.

4. A **claim** is an amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price. A claim may arise from, for example, customer-caused delays, errors in specifications or design, and disputed variations in contract work. The measurement of the amounts of revenue arising from claims is subject to a high level of uncertainty, and often depends on the outcome of negotiations.

   Therefore, claims are only included in contract revenue when:

   a) Negotiations have reached an advanced stage, such that it is probable that the customer will accept the claim; and
   b) The amount that is probable it will be accepted by the customer can be measured reliably.

5. **Incentive payments** are additional amounts paid to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract.

   Incentive payments are included in contract revenue when:

   a) The contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and
   b) The amount of the incentive payment can be measured reliably.

6. Contractors should review all amounts relating to the construction contract that are paid directly to subcontractors by third party funding agencies, to determine whether they meet the definition of, and recognition criteria for, revenue of the contractor under the terms of the contract. Amounts meeting the definition and recognition criteria for revenue should be accounted for by the contractor in the same way as other contract revenue. Such amounts should also be recognised as contract costs (as per paragraph 4.2(2)). Funding agencies may include - national and international aid agencies and multilateral and bilateral development banks.

4.2 CONTRACT COSTS

Contract costs shall comprise of:

a) Costs that relate directly to the specific contract;
b) Costs that are attributable to contract activity in general, and can be allocated to the contract on a systematic and rational basis; and
c) Such other costs as are specifically chargeable to the customer under the terms of the contract.

1. ***Costs that relate directly*** to a specific contract include:
   a) Site labour costs, including site supervision;
   b) Costs of materials used in construction;
   c) Depreciation of plant and equipment used on the contract;
   d) Costs of moving plant, equipment, and materials to and from the contract site;
   e) Costs of hiring plant and equipment;
   f) Costs of design and technical assistance that are directly related to the contract;
   g) The estimated costs of rectification and guarantee work, including expected warranty costs; and
   h) Claims from third parties.

   These costs may be reduced by any incidental revenue that is not included in contract revenue, for example, revenue from the sale of surplus materials at the end of the contract.

2. Contractors should review all amounts relating to the construction contract paid directly by subcontractors and which are reimbursed by third party funding agencies, to determine whether they qualify as contract costs. Amounts meeting the definition of, and recognition criteria for, contract expenses, should be accounted for by the contractor in the same way as other contract expenses. Amounts reimbursed by third party funding agencies that meet the definition of, and recognition criteria for, revenue, should be accounted for by the contractor in the same way as other contract revenue (see paragraph 4.1(5)).

3. ***Costs that may be attributable to contract activity*** in general and can be allocated to specific contracts include:
   a) Insurance;
   b) Costs of design that are not directly related to a specific contract;
   c) Construction overheads; and
   d) Any other costs that can be associated to the specific contract.

Such costs are allocated using methods that (a) are systematic and rational, and (b) are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of construction activity. Construction overheads include costs such as the preparation and processing of construction personnel payroll.

4. **Costs that are specifically chargeable to the customer** under the terms of the contract may include some general administration costs and development costs for which reimbursement is specified in the terms of the contract.

5. Costs that **cannot be attributed to contract activity or cannot be allocated to a contract** are excluded from the costs of a construction contract. Such costs include:
   a) General administration costs for which reimbursement is not specified in the contract;
   b) Selling costs;
   c) Research and development costs for which reimbursement is not specified in the contract; and
   d) Depreciation of idle plant and equipment that is not used on a particular contract.

6. Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract. However, costs that relate directly to a contract and are incurred in securing the contract are also included as part of the contract costs, if they can be separately identified and measured reliably and it is probable that the contract will be obtained. When costs incurred in securing a contract are recognised as an expense in the period in which they are incurred, they are not included in contract costs when the contract is obtained in a subsequent period.

4.3 CHANGES IN ESTIMATES

The percentage of completion method is applied on a cumulative basis in each reporting period to the current estimates of contract revenue and contract costs. Therefore, the effect of a change in the estimate of contract revenue or contract costs, or the effect of a change in the estimate of the outcome of a contract, is accounted for as a change in accounting estimate (see Accounting Policy for Accounting Policies, Changes in Accounting Estimates and Errors.) The changed estimates are used in the determination of the amount of revenue and expenses recognised in the statement of financial performance in the period in which the change is made and in subsequent periods.

5. DISCLOSURES

1. An entity shall disclose:
   a) The amount of contract revenue recognised as revenue in the period;
   b) The methods used to determine the contract revenue recognised in the period; and
   c) The methods used to determine the stage of completion of contracts in progress.

2. An entity shall disclose each of the following for contracts in progress at the reporting date:
   a) The aggregate amount of costs incurred and recognised surpluses (less recognised deficits) to date;
   b) The amount of advances received[4]; and
   c) The amount of retentions[5].

3. An entity shall present:
   a) The gross amount due from customers for contract work as an asset; and
   b) The gross amount due to customers for contract work as a liability.

   The gross amount due from customers for contract work is the net amount of:
   - Costs incurred plus recognised surpluses; less
   - The sum of recognised deficits and progress billings for all contracts in progress for which costs incurred plus recognised surpluses to be recovered by way of contract revenue (less recognised deficits) exceed progress billings.

   The gross amount due to customers for contract work is the net amount of:
   - Costs incurred plus recognised surpluses; less
   - The sum of recognised deficits and progress billings for all contracts in progress for which progress billings exceed costs incurred plus recognised surpluses to be recovered by way of contract revenue (less recognised deficits).

4. Guidance on the disclosure of contingent liabilities and contingent assets can be found in the Accounting Policy on Provisions, Contingent Liabilities and Contingent Assets. Contingent liabilities and contingent assets may arise from such items as warranty costs, claims, penalties, or possible losses.

[4] *Advances are amounts of contract revenue received by the contractor before the related work is performed.*

[5] *Retentions are amounts of progress billings that are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts, or until defects have been rectified. Progress billings are amounts of contract revenue billed for work performed on a contract, whether or not they have been paid by the customer*

6. TRANSITIONAL PROVISIONS

No transitional exemptions are provided on the adoption of IPSAS 11 “Construction Contracts”.

7. EFFECTIVE DATE

The rules mentioned above shall be effective for annual financial statements covering periods beginning on or after 1 January 2023.

8. REFERENCES

This accounting policy is based on the following:

IPSAS 11 Construction Contracts

IPSAS 33 First Time Adoption of Accrual Basis IPSASs

9. APPENDIX

EXAMPLES - THE DETERMINATION OF CONTRACT REVENUE AND EXPENSES

The following examples deal with a non-commercial and a commercial construction contract. The examples illustrate one method of determining the ***stage of completion of a contract*** and the ***timing*** of the recognition of contract revenue and expenses.

1. EXAMPLE 1: Non-commercial Contracts

The Department of Works (the construction contractor) has a contract to build a hospital wing for the Ministry of Health. The Department of Works is funded by appropriation. The construction contract identifies construction requirements, including anticipated costs, technical specifications, and timing of completion, but does not provide for any recovery of construction costs directly from the Ministry Health. The construction contract is a key management planning and accountability document attesting to the design and construction qualities of the hospital wing. It is used as input in assessing the performance of the contracting parties in delivering services of agreed technical specification within projected cost parameters. It is also used as input to future cost projections.

The initial estimate of contract costs is €8.000.000. It will take three years to build the hospital wing. An aid agency has agreed to provide funding of €4.000.000, being half of the construction costs - this is specified in the construction contract.

By the end of Year 1, the estimate of contract costs has increased to €8.050.000. The aid agency agrees to fund half of this increase in estimated costs.

In Year 2, the Government on the advice of the Ministry of Health approves a variation resulting in estimated additional contract costs of €150.000. The aid agency agrees to fund 50% of this variation. At the end of Year 2, costs incurred include €100.000 for standard materials stored at the site to be used in Year 3 to complete the project.

The Department of Works determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed to date bear to the latest estimated total contract costs.

A summary of the financial data during the construction period is as follows:

	Year 1 €'000	Year 2 €'000	Year 3 €'000
Initial amount of revenue agreed in contract	*4.000*	*4.000*	*4.000*
Variation	*-*	*100*	*100*
Total Contract Revenue	*4.000*	*4.100*	*4.100*
Contract costs incurred to date	*2.093*	*6.168*	*8.200*
Contract costs to complete	*5.957*	*2.032*	*-*
Total estimated contract costs	*8.050*	*8.200*	*8.200*
Stage of completion	*26%*	*74%*	*100%*

The stage of completion for Year 2 (74%) is determined by excluding from contract costs incurred for work performed to date the 100.000 for standard materials stored at the site for use in Year 3.

The amounts of contract revenue and expenses recognised in the statement of financial performance in the three years are as follows:

	To Date €'000	Recognised in prior years €'000	Recognised in current year €'000
Year 1			
Revenue (4.000 x 26%)	*1.040*		*1.040*
Expenses (8.050 x 26%)	*2.093*		*2.093*
Year 2			
Revenue (4.100 x 74%)	*3.034*	*1.040*	*1.994*
Expenses (8.200 x 74%)	*6.068*	*2.093*	*3.975*
Year 3			
Revenue (4.100 x 100%)	*4.100*	*3.034*	*1.066*
Expenses (8.200 x 100%)	*8.200*	*6.068*	*2.132*

2. EXAMPLE 2: Commercial Contracts

The Department of Works (the contractor), while predominantly funded by appropriation, is empowered to undertake limited construction work on a commercial basis for private sector entities. With the authority of the Minister, the Department has entered a fixed price commercial contract for €9.000.000 to build a bridge.

The initial amount of revenue agreed in the contract is €9.000.000. The contractor's initial estimate of contract costs is €8.000.000. It will take three years to build the bridge.

By the end of Year 1, the Department's estimate of contract costs has increased to €8.050.000.

In Year 2, the customer approves a variation resulting in an increase in contract revenue of €200.000 and estimated additional contract costs of €150.000. At the end of Year 2, costs incurred include €100.000 for standard materials stored at the site to be used in Year 3 to complete the project.

The Department determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed to date bear to the latest estimated total contract costs. A summary of the financial data during the construction period is as follows:

	Year 1 ***€'000***	***Year 2*** ***€'000***	***Year 3*** ***€'000***
Initial amount of revenue agreed in contract	*9.000*	*9.000*	*9.000*
Variation	*-*	*200*	*200*
Total Contract Revenue	*9.000*	*9.200*	*9.200*
Contract costs incurred to date	*2.093*	*6.168*	*8.200*
Contract costs to complete	*5.957*	*2.032*	*-*
Total estimated contract costs	*8.050*	*8.200*	*8.200*
Estimated surplus	*950*	*1.000*	*1.000*
Stage of completion	*26%*	*74%*	*100%*

The **stage of completion** for Year 2 (74%) is determined by excluding from contract costs incurred for work performed to date the 100.000 for standard materials stored at the site for use in Year 3.

The amounts of revenue, expenses, and surplus recognised in the statement of financial performance in the three years are as follows:

	To Date	*Recognised in prior years*	*Recognised in current year*
	€'000	*€'000*	*€'000*
Year 1			
Revenue (9.000 x 26%)	*2.340*		*2.340*
Expenses (8.050 x 26%)	*2.093*		*2.093*
Surplus	*247*		*247*
Year 2			
Revenue (9.200 x 74%)	*6.808*	*2.340*	*4.468*
Expenses (8.200 x 74%)	*6.068*	*2.093*	*3.975*
Surplus	*740*	*247*	*493*
Year 3			
Revenue (9.200 x 100%)	*9.200*	*6.808*	*2.392*
Expenses (8.200 x 100%)	*8.200*	*6.068*	*2.132*
Surplus	*1.000*	*740*	*260*