ACCOUNTING TREATMENT OF CONSTRUCTION CONTRACTS AND THE IMPLICATIONS ON THE OUTCOME OF ACCOUNTING RECOGNITION

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At international level, in accounting terms, construction contracts are covered by IAS 11 "Construction Contracts". This standard deals with the issue of recognition of revenue and costs of construction, ensuring that revenue and contract costs to be affected accounting periods in which construction activity, which was, in fact, the primary problem of accounting for construction contracts. Standard refers to contracts that run for over several accounting periods. Specifically, these include contracts on the one hand, contracts for services that are directly related to asset building (eg, services of architects and designers) and on the other hand, contracts for construction or restoration of assets and environmental restoration after dismantling them. Accounting for construction contracts, IAS 11 recommends two methods, namely the end of business method and the method of rising percentage of the work. The essential difference between the two methods is when to recognize the outcome of the contract.

From research carried out on the financial reports of companies’ active in the construction industry, we found that mentioned methods are applied sometimes unjustifiably, for the purpose of handling information on the financial performance of the enterprise. For example, if the losses are forecasted for the next period, in general, a company will be tempted to apply the method completion not work and the percentage of advancement or when using the method the degree of advancement of the work may be overvalued or undervalued advance work, just to influence the outcome in direction desired. The study's aims to comment on the accounting treatment of construction contracts and their implications on the outcome of accounting recognition highlight strengths and weaknesses of the two methods of counting.

Key words: construction contracts, profit, the end of business method, the method of rising percentage of the work.

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Using the percentage method of advancement of the work requires that the total costs and profits of a project are estimated at each balance sheet date. A proportional fraction of the total estimated profit is then recognized each accounting period, throughout the contract. At each balance sheet date, the rate of advancement is the updated estimates of revenues and costs so that any adjustments are reflected in the current period or in the future. Amounts recognized in previous periods are not adjusted.

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MATERIAL AND METHOD

In this study, we started to research the national accounting rules, the rules of international financial reporting and literature focused on the topic of construction. The method of research involved, first, making comparisons between the national and international, regarding the regulation of construction contracts. On the basis of this documentation have been reports of financial companies listed on BSE (Bucharest Stock Exchange). The results and conclusions regarding this topic are presented below.

RESULTS AND DISCUSSION

IAS 11 refers to contracts that run for over several accounting periods. Specifically, these include contracts on the one hand, contracts for services that are directly related to asset building (eg, services of architects and designers) and on the other hand, contracts for construction or restoration of assets and environmental restoration after dismantling them. A construction contract is a contract negotiated in particular for the construction of an asset or a group of assets, dependent from each other in terms of design, technology, operation or use of final [13]. Standard distinguishes two types of contracts: fixed price contracts (those for which shall, initially, a price between contractor and customer, but can be changed, usually to increase, depending on certain factors) and contracts cost plus (those based on contract costs, plus a percentage of these costs or a fixed fee).

There are contracts for construction that may contain features of fixed-price contracts and the cost plus contracts (eg, cost plus contracts with an agreed maximum price). Then, there may be contracts aimed at building a single asset (eg a bridge, building a dam, a road, etc.) as there may be contracts aimed at building a number of assets that are closely interrelated in terms the design, technology and performance or final use (eg, contracts for the construction of refineries or hydro).
Accounting for construction contracts, IAS 11 recommends two methods, namely the end of business method and the method of rising percentage of the work.

**The method assumes that the end result of work** related to construction contract to be recognized upon completion of work. Until that time, revenues are valued at the expense incurred. So as long as the contract is not completed, it will not be booked any profit, it will be recognized only in the financial statements that work is completed. This method applies a rule, when it can not be estimated the result of such contract, revenue is recognized only to the extent that it is likely that it will recover the expenses incurred.

**Method rising percentage of the work** involves the recognition of revenue related to a construction contract to be made depending on the state of execution of the contract. In other words, this method allows the assignment of revenue and contract costs, to the degree of advancement of the work during each exercise. So, when the result of a construction contract can be estimated credibly profit (difference between revenues and costs) will be recognized depending on the stage of implementation. To determine the rate of advancement of the work, it has to be the ratio of the cost of works executed by the balance sheet date and the total forecast cost of execution of the contract or reference to physical units in the sense that it evaluates the work performed (studies on end proportion of physical labor contract). The last way is more relevant, especially when the record is tainted by expenditure overruns in relation to the initial budgets, only to record a greater advancement of the work. Whichever method you would apply any excess of the total contract costs over total contract revenue is recognized immediately as an expense. The amount of such losses is determined whether the work has started or not, whatever the stage of finalization of the work contract or the amount of profits set to achieve the deployment of other contracts.

**Revenues related to a construction contract** are set at the time of negotiation. However, in most cases, the income of a final contract of this kind differs from the original income. In fact, contract revenue should be assessed at the fair value. The category includes contract revenue [9]: the original value of the revenue agreed in the contract, changes in contract work required by the customer (changes in design specifications or assets related to the duration of contract), claims that it determines the contractor to modify the price contract (related to design errors, delays in preparing the design specifications, etc.), and incentive payments (amounts paid to the contractor if the specified performance standards are met or exceeded - the supply of assets previously set deadline). All these are recognized to the extent that it is likely that they will develop and that can be measured reliably. Therefore, the contract revenue may increase or decrease from one year to another, and estimates must be revised, as new events. For example: the income is established in a fixed-price contract may increase as a result of applying indexation clauses price or value of contract revenue may decrease as a result of penalties arising from delays caused by the contractor in finalizing the contract.
The category includes *contractual costs* [3]: costs directly related to the contract, the overall costs for the contract, other costs to meet the specific recipient and which are stipulated in the contract. Contract costs can be reduced by income earned from the sale of surplus materials or plant and equipment disposed at the end of the contract. Then, do not include the cost of contract items as depreciation of facilities and technical equipment are not used in a contract of sale costs, other general costs for which reimbursement is not specified in the contract, etc.

Another problem concerns the uncertainty regarding the receipt of contractual revenues already recognized in the results. In this case, size uncertain income shows expenditure (adjusted for depreciation) and not directly adjusted income!

**Example**

A firm enters into a contract with another undertaking which is to build a warehouse. Work beginning on March 1 N and I have completed on March 1 N+2. On March 1 N was signed, to a sale price of 5,000,000 ron. The total cost of production is estimated at 4,000,000 ron. At December 31, N+1, the sale price was estimated to 5,200,000 ron, and the cost of production to 4,400,000 ron. On December 31 N, the cost of work in progress was 1,000,000 ron, and on December 31 N+1, of 3,500,000 ron. On March 1 N+2 is the construction delivery to the recipient, the selling price is 5,900,000 ron, and the cost of the contract amounted to 5,000,000 ron. What is the accounting treatment of revenue and costs, if applicable: end work method or percentage method for advancement of the work?

The essential difference between the two methods is when to recognize the outcome of the contract. It has all the same size (900,000 ron), but differ in the time display. We can say that the method does not complete work correctly reflect economic reality, because the contract is performed over three financial years and the result is recognized only in the last financial year.

**CONCLUSIONS**

Delaying revenue recognition until the work is considered evidence of accounting prudence, caution that causes large variations in outcome (zero in the early years ...), which are not rated users reporting positive financial. Consequently, the rate of advancement of the work allows a better connection to the revenue expenditure contractual changes result in a financial year to another is reduced. In other words, a result "smooth" is better appreciated by users of financial accounting information.

From research carried out on the financial reports of companies’ active in the construction industry, we found that mentioned methods are applied sometimes unjustifiably, for the purpose of handling information on the financial performance of the enterprise. For example, if the losses are forecasted for the next period, in general, a firm will be tempted to apply the method end not work and the percentage of advancement or when using the method the degree of advancement
of the work may be overvalued or undervalued advance work, just to influence the outcome in desired direction.

As mentioned above, using the percentage method of advancement of the work requires that the total costs and profits of a project is estimated at each balance sheet date. A proportional fraction of the total estimated profit is then recognized in each accounting period, throughout the contract. At each balance sheet date, the rate of advancement is the updated estimates of revenues and costs so that any adjustments are reflected in the current period or in the future. Amounts recognized in previous periods are not adjusted. It can sometimes be found unjustified use of these methods, the purpose of handling information on the company's financial performance. For example, if the losses are forecasted for the next period, in general, a firm will be tempted to apply the method end not work the percentage of advancement. Or, when using the method the degree of advancement of the work may be overvalued or undervalued work forward, in order to influence the outcome in desired direction.

BIBLIOGRAPHY