CONTRACT ACCOUNTING

Building Financial Bridges with Precision

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INTRODUCTION TO CONTRACT ACCOUNTING

- **Definition: A method used to account for long-term contracts typically found in construction and service industries.**

- **Why It's Important:**

  - Accurately recognizes revenue over contract duration

  - Matches cost with stage-wise progress

  - Tracks retention, escalations, work completed

- **Industries: Construction, IT services, EPC, infrastructure**

TYPES OF CONTRACTS

Type	Description
Fixed Price	Pre-agreed amount
Cost-Plus	Cost + agreed margin
Time & Material	Time billed + cost

FEATURES OF CONTRACT ACCOUNTING

- **Covers long durations (months/years)**
- **Certified vs. uncertified work differentiation**
- **Escalation clause covers inflation**
- **Notional profit recognized gradually**

- **Examples:**

  - Delhi Metro (5 yrs)

  - Highway escalation

KEY TERMINOLOGIES

Term	Meaning
Work Certified	Verified by engineer/client
Work Uncertified	Completed, not yet approved
Retention Money	Held post-handover
Notional Profit	Interim profit

PROFIT RECOGNITION METHODS

Method	Description
Completed Contract	After completion
% of Completion	Progressive
Hybrid	Sub-project based

- **Formula:**

Notional Profit × Cash Received / Work Certified

PROFIT TRANSFER RULES

% Completion	Formula
<25%	No Profit Transfer
25%-50%	1/3 × NP × CR / WC
50%-90%	2/3 × NP × CR / WC
>90%	Est. Profit × WC / CP × CR / WC

- Examples: Flyover 30% → Limited

  Tunnel 85% → Major earnings

  Hospital 95% → Near-full

ESCALATION & RETENTION

- Retention: 5–10% held till warranty ends
- Escalation: Adjusts cost for inflation

Journal Entry (Escalation):

- Dr. Contract Asset A/c
- Cr. Escalation Revenue A/c

NUMERICAL EXAMPLE

Given:

Contract Price = ₹ 1 Cr

Work Certified = ₹ 60L

Work Uncertified = ₹ 10L

Cash Received = ₹ 50L

Costs Incurred = ₹ 70L

- **Solution:**

1. Notional Profit = WC + WU + Escalation - Total Cost

2. Apply rule based on % completed (60%)

AS-7 VS IND AS 115

Feature	AS-7	IND AS 115
Basis	% Completion	Performance Obligation
Recognition	Gradual	When obligation fulfilled
Use	Construction	All long-term contracts

SUMMARY & RECAP

- Ensures transparency in long-term contracts
- Revenue matched with progress
- Escalation & retention protect stakeholders
- Accurate ledger entries = better reporting

THANK YOU

- **Q&A Session**
- **"Financial accuracy in contracts is the foundation of trust."**