



REVENUE RECOGNITION – Construction Contracts

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Approval

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Distribution

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¹ All IPSAS forms are on the share: V:\IPSAS\Project_Mgmt\Forms

² Policy papers are saved on V:\IPSAS\Policy Papers and Business Requirements\A-Policy papers



Related Documents

Document	Location
IPSAS 11 – Construction Contracts	<u>IPSAS 11</u>



1. Purpose

The purpose of this policy paper is to assess and conclude on the relevance and applicability of the requirements of IPSAS 11 – Construction Contracts to the mandated activities of the UNDP.

2. Scope

This policy paper is based on IPSAS 11 – Construction Contracts. IPSAS 11 states that a contractor which prepares and presents financial statements under the accrual basis of accounting should apply this Standard in accounting for construction contracts. The Standard applies to all public sector entities other than Government Business Enterprises.

3. Key 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 plus or 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.



4. Background

IPSAS 11 prescribes the accounting treatment of costs and revenue associated with construction contracts. The Standard:

- 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.

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 reporting periods.

4.1. Recognition of revenue and costs

According to the Standard:

- Contract revenue shall comprise the initial amount agreed in the contract together with variations in contract work, claims, and incentive payments to the extent that it is probable that they will result in revenues and can be measured reliably.
- Contract revenue is measured at the fair value of the consideration received or receivable
- Contract costs shall comprise costs that relate directly to the specific contract, costs that are attributable to general contract activity and that can be allocated to the contract on a systematic and rational basis, together with such other costs as are directly attributable to the customer under the terms of the contract.



- Where the outcome of a construction contract can be estimated reliably, revenue and costs shall be recognized by reference to the stage of completion of contract activity at the reporting date (the percentage of completion method of accounting).
- If the outcome cannot be estimated reliably, no surplus shall be recognized. Instead, contract revenue shall be recognized only to the extent that contract costs incurred are expected to be recovered, and contract costs shall be expensed as incurred.
- In respect of construction contracts in which it is intended at inception of the contract that contract costs are to be fully recovered from the parties to the construction contract, if it is probable that total contract costs will exceed total contract revenue, the expected deficit shall be recognized immediately.

4.2. Disclosures

The following disclosures shall be made:

- (a) The amount of contract revenue recognized as revenue in the period;
- (b) The methods used to determine the contract revenue recognized in the period; and
- (c) The methods used to determine the stage of completion of contracts in progress.

An entity should also disclose each of the following for contracts in progress at the reporting date:

- (a) The aggregate amount of costs incurred and recognized surpluses (less recognized deficits) to date;
- (b) The amount of advances received; and
- (c) The amount of retentions.

An entity should also 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.

5. Detailed policy

As aforementioned, IPSAS 11 defines a contractor as “an entity that enters into a contract to build structures, construct facilities, produce goods, or render services *to the specifications of another entity*. The term ‘contractor’ includes a general or prime contractor, a subcontractor to a general contractor, or a construction manager.”

Also, IPSAS defines a construction contract as “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.”

Impact on UNDP

Following are the various scenarios in which UNDP may get involved in the construction activities:

1. Construction of infrastructure as part of UNDP’s overall development programmes;
2. Construction of housing/accommodation for its field staff under RFA (reserve for field accommodation). This may also have the following two sub-scenarios:
 - a. UNDP extends loan to the government of the programme country to build accommodation for UNDP staff. Land on which building is build is provided by the government. Upon completion of the construction work, UNDP utilizes the building and adjusts the rent payable to the government against the principal balance and interest payable by the Government to UNDP. Ownership of the building stays with the Government.
 - b. UNDP builds accommodation for its staff on land provided by the government of the programme country. UNDP utilizes the building. Upon cessation of the use of the building or after a certain number of years (agreed upon with the Government), UNDP transfers the ownership of the building to the Government. (This scenario will not be applicable in future because, as a policy, UNDP will engage UNOPS to carry out construction work).

This policy paper covers only the scenario 1, because it takes the position that IPSAS 11 does not apply to the scenario 2. The reason for taking this position is that construction under RFA is carried out as per the needs of UNDP, and not per the specifications of the government. IPSAS 11 covers only those contracts in which assets are built according to the specifications of the other entity.

Construction of infrastructure as part of UNDP’s development programmes:

Although some projects which UNDP directly implements or assists the Governments in the implementation may involve construction work, this is just a component of the overall programmes which UNDP executes as dictated by its mandate e.g. supporting capacity building, promoting democratic governance, poverty reduction, etc. In other words, UNDP has a broader and higher mandate than carrying out mere construction contracts. In these projects, UNDP ensures that the scope of the project goes beyond the mere construction of assets e.g. UNDP ensures that these projects create employment opportunities for local communities.

The agreements which UNDP enters into with the donors are not negotiated specifically for the construction of assets but are for comprehensive development programmes. Since the scope of these agreements is broader and the end product is not a building or any other structure but a



development programme, they do not meet the definition of “construction contracts” per IPSAS 11.

Secondly, no donor agreement includes the specifications for construction work. In other words, donors do not provide the construction specifications to UNDP. It’s the UNDP which determines the specifications. The project documents which UNDP signs with the contractors include these specifications. Based on this, the policy paper takes the position that the definition of “contractor” under IPSAS 11 does not apply to UNDP.

Moreover, even if the project involves construction work, in most cases, UNDP provides higher level supervision, monitoring and financial control including transfer of project funds to the beneficiary/implementing institutions. In other words, UNDP provides advice and financial oversight of the projects. The beneficiary/implementing parties (i.e. either the Government or the contractors hired by UNDP for the specific project) are responsible for the day-to-day project management, implementation and supervision. These parties prepare TORs for experts and personnel, training needs, specifications for procured equipment, and tender documents, of course under the oversight of UNDP. Hence, keeping in view the high level supervisory and oversight role of UNDP in the construction activities associated with the broader programme objectives, the policy paper takes the position that UNDP does not meet the definition of a “contractor” as defined by IPSAS 11.

Based on the above discussion, the policy paper concludes that IPSAS 11 is not applicable to the mandated activities of UNDP. Therefore, revenue and costs related to the programmes which have the component of construction activities should be recognised in accordance with other policy papers on revenue and costs recognition.

6. Conclusion

Issues	Recommendations
Accounting for construction contracts	This standard is not applicable to UNDP.

7. Other issues

No other issues.

