

Not recognizing revenue for construction contract

H. K.D Sandaruwan & Amila Rajapakse

dsandaru88@yahoo.com & amilarajapakse@gmail.com

Introduction

Brown Builders (Pvt) Ltd has number of clients for a construction project during the year. Among those projects, one is an ongoing project. All the cash received from the client for the construction is credited to a liability account called "On Account" as a liability. But all the expenses had been incurred for that construction correctly recognized in the financial statements. According to the management of the organization, they recognize their construction revenue after completing the entire project and until end of the construction contract, all the receiving regarding that project is reordered in the "On account". After completing the entire project total revenue related to the contract is transferred from on account to revenue account.

Discussion of the Issue

In accordance with the company policy and the relevant accounting standards, the organization correctly recognizes the incurred expenses for the construction in the financial statements. But revenue from the construction contracts is recognized only after completing all erections related to the construction. According to Accounting standards, company has been violated the standards. Because the company has recognized the incurred expenses for the construction within the year, but did not recognize the revenue related to that construction. As a result of the above situation, financial

performance of the company has been misleading due to revenue being unstated and as a result of that the actual financial performance of the company is misled. It will lead to loss of the reliability and relevance of the financial statements and the decisions made based on such financial statements also can be misleading.

Conclusions and Recommendations

In LKAS 11 – “Construction Contract”, there is a separate section regarding the recognition of contract revenue and expenses which is extracted below.

- ✓ When the outcome of a construction contract can be estimated reliably, contract revenue and contract cost associated with the construction contract shall be recognize as revenue and expenses respectively by reference to the stage of completion of the contract activities at the end of the reporting period. **(Section 22 – LKAS 11)**
- ✓ Under the percentage of completion method, contract revenue is recognized as revenue in profit or loss in the accounting period in which the work is performed. Contract costs are usually recognized as an expense in profit and loss in the accounting period in which the work to which they relate is performed. **(Section 26 – LKAS 11)**

According to the management explanation they are unable to estimate the stage of completion reliably. Therefore, we suggested that **Revenue shall be recognized only to the extent of contract cost incurred according to the Section 32 – LKAS 11.**