

*From the Research Desk*

## **ICDS III relating to Construction Contract**

### **Preamble:**

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head “Profits and gains of business or profession” or “Income from other sources” and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961 (“IT Act”) and this ICDS, the provisions of the Act shall prevail to that extent.

### **Scope:**

This ICDS should be applied in determination of income for a Construction of a Contractor.

### **Combining and Segmenting Construction Contracts:**

The requirement of this ICDS shall be applied separately to each construction contract except provided as below

- a) Where a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:
  - Separate proposals have been submitted for each asset.
  - The costs and revenues of each asset can be identified.
- b) A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:
  - The group of contracts is negotiated as a single package.
  - The contracts are performed concurrently or in a continuous sequence.
- c) Where a contract provides for the construction of an additional asset at the option of the customer or is amended to include the construction of an additional asset, the construction of the additional asset should be treated as a separate construction

### **Contract Revenue:**

- Contract revenue shall be recognized when there is reasonable certainty of its ultimate collection.
- Contract revenue shall comprise of the initial amount of revenue agreed in the contract, including retentions & variations in contract work, claims and incentive payments.
- Where contract revenue already recognized as income is subsequently written off in the books of accounts as uncollectible, the same shall be recognized as an expense and not as an adjustment of the amount of contract revenue.

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**Contract Cost:-**

- Contract cost shall be comprise of, cost that related directly to the specific contract, cost that are attributable to contract activity in general and can be allocated to the contract
- Cost which are specifically chargeable to the customer under the term of contract.
- Costs that cannot be attributable to any contract activity & cannot be allocated to a contract shall be excluded from the costs of a construction contract.
- Contract costs that relate to future activity on the contract are recognized as an asset. Such costs represent an amount due from the customer and are classified as contract work in progress.

**Recognition of Contract revenue and Expense:-**

- Contract revenue & contract cost associated with the construction contract should be recognized as revenue & cost respectively by reference to the stage of complication of the contract activity at the reporting time.
- The recognition of revenue and expenses by reference to the stage of complication of a contract is referred to as the percentage of complication of method.
- The stage of complication of a contract shall be determine with reference to:
  - The proportion that contract costs incurred for work performed up to the reporting date bear to the estimated total contract cost.
  - Surveys of works performed
  - Complication of physical proportion of the contract work.
- During the early stage of contract where the outcome of the contract cannot be estimated reliably contract revenue is recognized only to the extent of cost incurred. The early stage of contract shall not be extent beyond 25% of the stage of complication.

**Change of Estimates:-**

Where there is change in estimates, the changed estimates shall be used in determination of the amount of revenue and expenses in the period in which the change is made and in subsequent periods.

**Disclosure:-**

A person shall disclose-

- The amount of contract revenue recognized as revenue in the period; and
- The methods used to determine the stage of completion of contracts in progress.
- Amount of costs incurred and recognized profits  $\square$  less recognized losses up to the reporting date;
- The amount of advances received; and
- The amount of retention