Accounting Guideline

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

GRAP 11

Construction Contracts

Contents

1 INTRODUCTION

This document provides guidance on the accounting treatment and disclosure of construction contracts.

The contents should be read in conjunction with GRAP 11 (issued February 2010) and includes any changes made by the Board in terms of the Improvements to Standards of GRAP.

For purposes of this guide, "entities" refer to the following bodies to which the standards of GRAP relate to, unless specifically stated otherwise:

- Public entities
- Constitutional institutions
- Municipalities and all other entities under their control
- Parliament and the provincial legislatures

Explanation of images used in manual:

	Definition
	Take note
	Management process and decision making
	Example

2 SCOPE

GRAP 11 is applicable to all entities who prepare financial statements based on the accrual basis in accounting for revenue and costs associated with construction contracts in the records of the contractor. This document will provide guidance on:

- Identifying the arrangements that are to be classified as construction contracts;
- The type of construction contracts that can arise in the public sector; and
- The basis of recognition and disclosure of contract revenue and expenses.

	Assets constructed by an entity for itself (which will be owned by the entity), do not constitute contracting activities and are consequently excluded from the scope of GRAP 11 on Construction Contracts. The entity should apply either GRAP 17 on Property, Plant and Equipment, GRAP 16 on Investment Property or GRAP 12 on Inventories to account for such assets.

3 THE BIG PICTURE

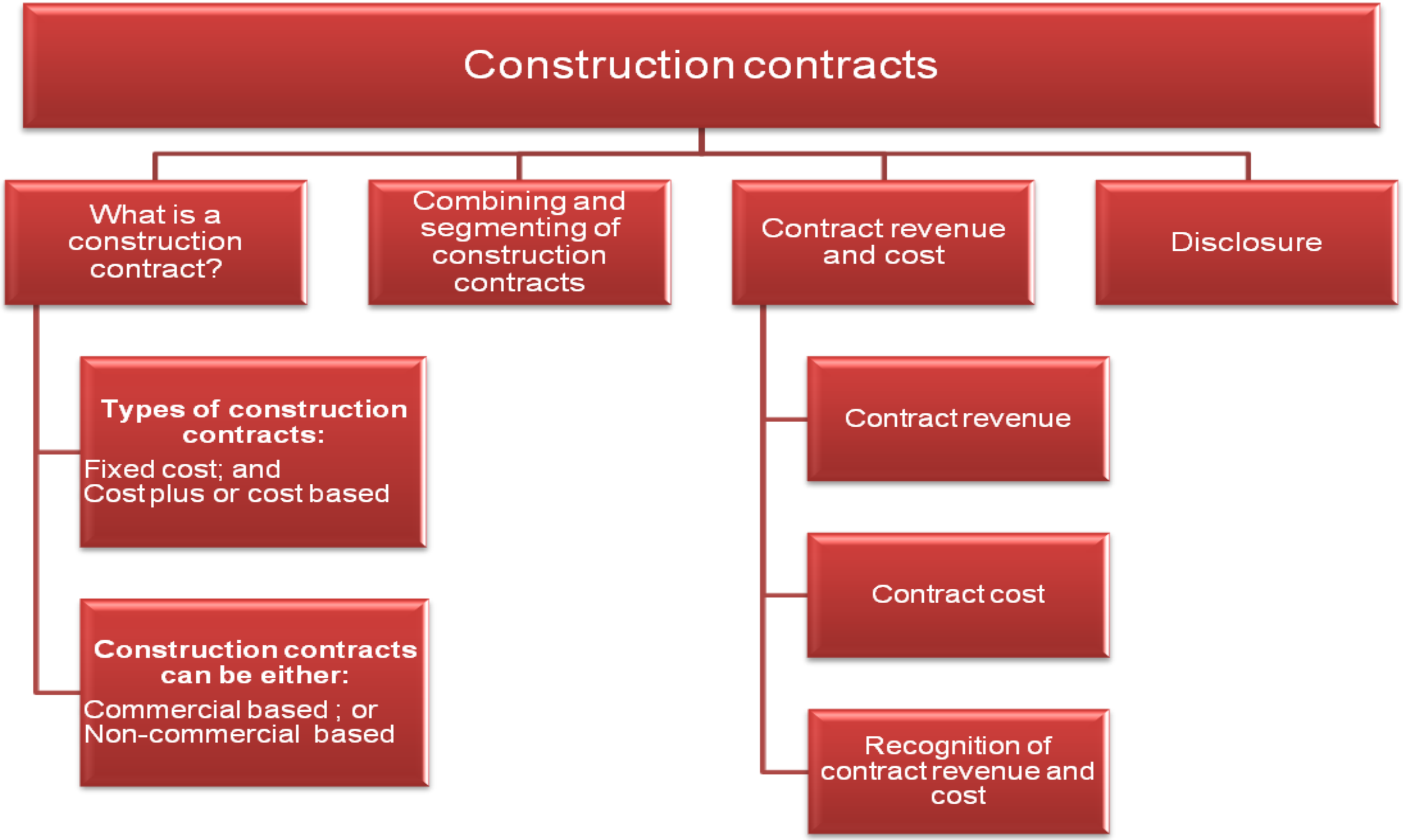


Figure 1

4 WHAT IS A CONSTRUCTION CONTRACT

	A construction contract is a contract, or a similar binding agreement, 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.

An entity needs to assess the terms and conditions of each contract to determine if it is a construction contract and, in determining if it is a construction contract an entity needs to assess whether or not it is a contractor.

	A contractor is an entity that enters into a contract to build structures, construct facilities, produce goods or render services to the specifications of another entity, either itself or through the use of sub-contractors.

Example 1: Contractor or not?

A municipality enters into an agreement with a provincial department of public works to provide certain professional services related to the construction of a road. The provincial department appointed Entity C (a private company) to construct the road. The municipality will also manage the flow of funds from the department of public works to Entity C.

In this example:

- Entity C is the contractor as they are constructing the road;
- The department of public works is the client; and
- The municipality is just an agent as it does not provide services directly related to the construction of the road. The municipality should assess whether the services provided as part of the arrangement are within the scope of GRAP 9 – Revenue from Exchange Transactions.

The Department of Public Works (DPW) is contracted by the Department of Transport (DoT) to build a bridge.

In this example:

- DPW is the contractor as they are constructing the bridge; and
- DoT is the client.
- DPW applies GRAP 11 in accounting for the relevant costs and, if relevant revenue; and
- DoT will make the required payments to DPW over the contract period and at the end will ‘receive’ the bridge, where after the department will apply GRAP 17 – Property, Plant and Equipment to account for the bridge in its accounting records.

The key features of a construction contract are:	Construction contracts also include:
• Date of commencement and date of completion usually fall into different reporting periods; • There are costs incurred by the contractor in constructing the asset in return for revenue; and • Responsibilities of parties involved in the construction are normally legalised using a contract.	• Contracts for the rendering of services which are directly related to the construction of the asset, for example, project manager or architect; • Contracts for the destruction or restoration of assets and the restoration of the environment following the demolition of assets; and • All arrangements that are binding on the parties to the agreement but which may not take the form of a documented contract.

An arrangement that may not take the form of a documented contract is a construction contract, provided that the arrangement confers similar rights and obligations as if it were in the form of a contract. For example, a ministerial direction, a cabinet decision, a legislative direction or a memorandum of understanding.

4.1 Fixed price contract and cost plus or cost based contracts

There are two types of construction contracts, namely fixed price contracts and cost plus or cost based contracts.

A 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.

Example 2: Fixed price contract

Entity A is contracted to build a dam. The fixed contract price is R100 million and expected total costs are R85 million. In the contract the client agreed to accept increases in wage tariffs additional to the contract price.

This contract is a fixed price contract subject to a cost escalation clause. The revenue receivable by the contractor is fixed at R100 million, but any wage increases will be added to the amount.

The amount will be recognised based on the stage of completion method. It is Entity A's policy to determine the stage of completion on the basis of the proportion of costs incurred for work performed to date, to the total estimated costs of the contract (i.e. based on percentage-of-completion).

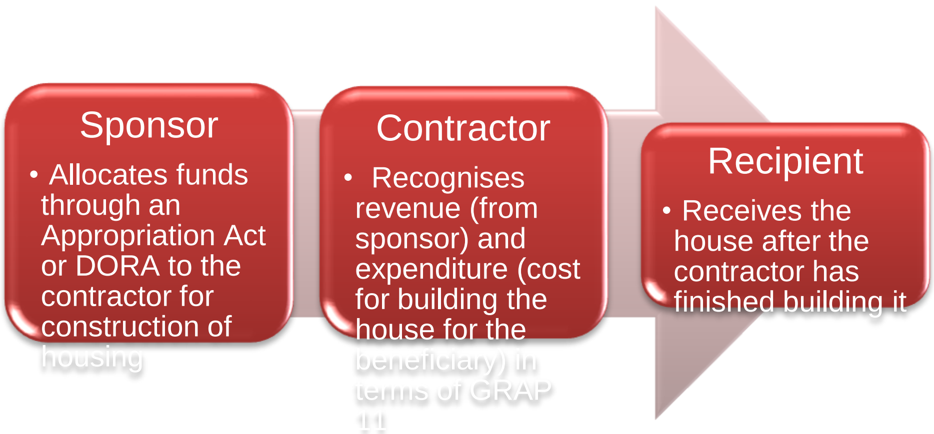
If it is assumed that Entity A incurred R40 million in costs, of which R500,000 is as a result of increased wage tariffs, for work performed up to the financial year end, the revenue to be recognised for the same period will be:

R40 mil / (R85 mil + R0.5 mil) x (R100 mil + R0.5 mil) (i.e. 47% complete) = R47

	million (rounded). Note that the R500, 000 is added to the original estimated total costs and contract price. If the contract was not subject to an escalation clause, only the estimated total costs would have been adjusted and not the contract price as well.

A fixed price contract also includes contracts in terms of which an entity constructs an asset for a recipient, but the cost of construction will not be recovered from the recipient, rather the construction is funded by way of:

- A general appropriation or allocation of general government funds to the contractor, e.g. Appropriation Act or Division of Revenue Act; or
- General purpose grants from third party agencies or other governments.

	**Example 3: Fixed price contract** Entity A allocates funds to Entity B through the Division of Revenue Act. Entity B has to build a house for Entity C • Entity A is the Sponsor; • Entity B is the Contractor; and • Entity C is the Recipient. 

	Cost plus or cost based contracts are construction contracts where the contractor will be reimbursed for the costs incurred or costs as defined in the contract, plus a percentage mark-up or a fixed fee in the case of a commercially based contract.

Example 4: Cost plus contracts

Entity A is contracted to build a plant for the contracted cost plus 12.5% profit.

This contract is a cost plus contract.

4.2 Commercial and non-commercial contracts

Contracts entered into can be on a commercial or non-commercial basis. Commercial contracts imply that the entity aims to make a profit, thus the contract price will be cost plus a profit mark up.

The aim of a non-commercial contract is not to make profit. The entity can construct an asset without recovering some or all of the cost. For these contracts, the entity knows at the start of the contract that it will make a loss on the contract; or only recover costs.

4.3 Agent vs. Principal

Money collected as an agent or on behalf of a principal does not constitute revenue to the entity and does not result in increases in assets or decreases in liabilities. Similarly, construction contracts managed on behalf of a constructing entity, do not constitute construction contracts of the managing entity. As such, the managing entity need not apply GRAP 11, but will recognise the management fee received in accordance with GRAP 9 on Revenue from Exchange Transactions. For additional detail, refer to the **accounting guideline GRAP 9**.

An entity is acting as a principal when it is exposed to the significant risk and rewards of ownership. Situations indicating that an entity is acting as a principal include, but are not limited to, the following:

- The entity has the primary responsibility for the construction contract;
- The entity carries the risk of inventory before and during the construction process; and
- The entity carries the customer's credit risk – i.e. any overspending on the budget of the construction project is carried by the entity.

The entity will be acting as an agent when it does not have exposure to significant risk and rewards associated with the construction project. One feature indicating that an entity is acting as an agent is that the amount the entity earns is predetermined, being either a fixed fee per month or a stated outcome of the construction project.

Example 5: Agent vs. principal

It is within Entity A's mandate to undertake the building of a dam. Entity A has a R100 million budget to fulfil this mandate. Entity A can choose one of the following scenarios to fulfil its mandate.

Scenario 1	Scenario 2	Scenario 3
Entity A selects a contractor and agrees the cost at R90 million.		
Entity B is selected to act as the project manager and is responsible for paying the contractor for work done to date.	Entity A appoints Entity B to undertake the construction of the dam.	Entity A assigns responsibility for the construction of the dam to Entity B.
Any difference between the R100 million transferred to Entity B and the R90 million agreed contract price with the contractor, is retained by Entity B for services rendered.	Entity A signs a contract with Entity B which specifies: • The specifications for the dam; • The specifications that must be followed by Entity B for the building of the dam; • The cost is R100 million and any cost incurred in excess will be carried by Entity B.	• Entity A retains oversight over the construction project and ensures that the activities are conducted within specified parameters. • Entity B may choose how the construction will be done; • Entity B includes the cost in its budget and sets performance objectives; • Entity A funds the project up to R100 million; • Any additional costs or savings are for Entity B's account.

To determine if Entity B acts as an agent, supplier or principal one needs to look at the transaction specifications.

	Scenario 1	Scenario 2	Scenario 3
Primary responsibility for providing the goods or services	Entity B has no responsibility in terms of the contract with entity A	Entity B has limited responsibility in terms of the contract with entity A	The responsibility has been assigned to Entity B by Entity A
Risk of inventory or risk of non-performance by service provider	Entity B is not responsible for non-performance by the contractor	Entity B has to perform in accordance with the contract	The responsibility has been assigned to Entity B by Entity A
Credit risk	Entity B bears no	Entity B carries	Entity B carries

	credit risk as it only pays the contractor to the extent of the funds received from Entity A	the risk for any overspending on the budget	the risk for any overspending on the budget

Conclusion

Scenario 1	Scenario 2	Scenario 3
Entity B acts as an agent	Entity B acts as a supplier or service provider	Entity B acts as a principal

Revenue recognition by Entity B

Scenario 1	Scenario 2	Scenario 3
Entity B recognises the fees for project management as revenue	Entity B recognises the revenue and the expenses in accordance with GRAP 11 – i.e. based on the stage of completion method	Entity B recognises the revenue and the expenses in accordance with GRAP 11 – i.e. based on the stage of completion method
Entity B recognises the cash inflows, cash payments and net effect of amount due from Entity A in the statement of financial position	In the statement of financial position Entity B will recognise a deferred income for funds received from Entity A but for which the services have not yet been performed	In the statement of financial position Entity B will recognise a deferred income for funds received from Entity A but for which the services have not yet been performed

5 COMBINING AND SEGMENTING CONSTRUCTION CONTRACTS

GRAP 11 is usually applied to each contract separately, however in certain circumstances it is necessary to separately identify components of a single contract, or to group contracts together, in order to reflect the substance of a contract or a group of contracts.

The example below illustrates that when a contract covers a number of assets the standard requires entities to treat the assets as separate construction contracts (refer to the standard for the list of requirements):

Example 6: One contract to be treated as separate construction contracts

Entity A submitted proposals for numerous contracts with Entity B. Entity A was successful in their proposals for:

- Construction of office building 324; and
- Construction of office building 876.

One contract was signed between Entity A and B for the construction of these two buildings. However:

- Separate proposals were submitted by Entity A;

	• Each proposal has been subjected to separate negotiations; and • The cost and revenue for each building can be identified separately. Entity B should account for two separate construction contracts in its accounting records.

When an entity has a group of construction contracts with either a single customer or with various customers, it is possible for the contractor to treat this group of construction contracts as a single contract. There are, however, certain minimum criteria that need to be met first (refer to the standard for this list of criteria).

	**Example 7: Group of contracts to be treated as a single construction contract** Entity B requested tenders for the construction of two highways that will be linked in Polokwane. The purpose of these highways is to transport people travelling from Musina to Johannesburg. Entity A submitted a single proposal for the construction of the two highways (in order to save costs). Entity A should treat the contracts as one single construction contract because: • The two contracts were negotiated as one contract; • The contracts are so closely interrelated that they are part of a single project; and • The contracts will be performed concurrently or in continuous sequence.

There are instances where a contract provides for the construction of an additional asset at the option of the customer or where the contract can be amended to include the construction of an additional asset. This additional asset on an existing contract should be treated as a separate contract if:

- the new asset differs significantly in design, technology or function from the assets in the original contract; or
- the price of the new asset is negotiated without regard to the original contract price.

	**Example 8: Additional assets on existing contract** Continuing on **example 6**. One year into the contract, Entity B request Entity A to build a road in front of the buildings and they negotiate an additional price independent from the original contract. Entity B should now treat this new contract separately from the original contract to build two office blocks because: • The road to be build is significantly different in design, technology and function from the two office buildings; and • The price was negotiated without regard to the original contract price.

6 CONTRACT REVENUE AND CONTRACT COST

6.1 Contract revenue

Contract revenue comprises of:

- Initial amount of revenue agreed in the contract; and
- Variations in the contract work, claims and incentive payments to the extent that:
  - It is probable that they will result in revenue; and
  - They are capable of being reliably measured.

Variations in contract work are instructions by the customer for changes in the scope of the work performed under the contract, for example, changes in the duration of the contract or the design of the asset.

Claims are the amounts that the contractor seeks to collect from customers as reimbursement for costs not included in the contract price, for example, if the customer caused delays or disputed variations in the contract.

Incentive payments are additional payments to the contractor if specified performance standards are met or exceeded, for example, the contract may allow for an incentive payment for early completion of a contact.

A contractor should review all amounts relating to construction contracts which were paid directly to subcontractors by third party funding agencies to determine if they meet the definition of and recognition criteria for contract revenue.

6.2 Contract costs

Contract costs comprise:

- Costs that relate directly to the specific contract;
- Costs that are attributable to the contract activity in general and can be allocated to the contract on a systematic and rational basis; and
- Such other costs as are specifically chargeable to the customer under the terms of the contract.

Direct costs include, for example, site labour costs, cost of materials used in construction or costs of hiring plant and equipment. These costs may be reduced by any incidental revenue that was not included in the contract, for example, revenue from the sale of excess materials.

Costs that are attributable to the contract activity in general are allocated using methods that are systematic and rational and are applied consistently to all cost having similar characteristics.

Costs that are specifically chargeable to the customer under the terms of the contract may include some general administrative cost or development costs.

Costs that cannot be specifically linked to a contact activity cannot be allocated against a contract as contract costs. Examples of these costs include:

- Selling costs;
- Depreciation of idle plant and equipment; or
- Any general administrative or research and development costs which were not specifically included in the contract.

6.3 Recognition of contract revenue and cost

When the outcome of a construction contract can be estimated reliably, contract revenue and contract cost associated with the construction contract can be recognised by reference to the stage of completion of the contract at reporting date.

Where it is intended at the start of the contract that the contract costs are to be fully recovered from the parties to the contract, any expected excess of total cost over revenue for the contract should be recognised immediately as an expense in surplus or deficit.

When can the outcome of a construction contract be estimated reliably?

Fixed price contract	Cost plus or cost based contract
• Total contract revenue, if any, can be measured reliably; • It's probable that economic benefits or service potential associated with the contract will flow to the entity; • Contract cost to complete the contract can be measured reliably at reporting date; • Stage of completion can be measured reliably at reporting date; and • Contract cost attributable to the contract can be clearly identified and measured reliably.	• It's probable that economic benefits or service potential associated with the contract will flow to the entity; and • Contract cost attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

If the outcome of a contract can be reliably measured, the contract cost and related contract revenue are recognised in surplus or deficit in the period in which the costs were incurred or the work was performed. Contract revenue will be calculated using the stage of completion (or percentage of completion) method.

Example 9: Stage of completion

In the beginning of the year a contractor entered into a R35 million construction contract. At the end of year one the contractor incurred R10 million in construction expenses of which R2, 2 million was for materials to be used in the next financial year and R800, 000 was for general research costs which are not attributable to contract activity in general and cannot be allocated to a specific contract. The total estimated cost of the 3 year project is R28 million. Contract revenue is measured with reference to the stage of completion method. The outcome of the contract can be reliably measured at reporting date.

The following should be taken into consideration when contract revenue is calculated.

- R800,000 research cost is excluded from contract cost as it could not be specifically allocated to this contract; and
- Contract costs incurred that relate to future activity should be excluded and should be recognised as an asset in the statement of financial position, provided it is probable that this amount will be recovered from the customer.

Contract revenue and contract cost will be calculated as follows:	
	R'000
Total expenditure incurred	10,000
Less expenses for future activity	(2,200)
Less expenses that is not contract cost	(800)
Total contract cost	**7,000**
Total expected contract cost	**28,000**
Stage of completion (R7,000 / R28,000)	**25%**
Total contract revenue to be recognised (R35, 000 x 25%)	**8,750**

If revenue cannot be reliably measured, contract costs should be recognised in surplus or deficit in the period which it was incurred and contract revenue should be recognised only to the extent that it is probable that the contract costs incurred will be recovered.

Example 10: Outcome of contract cannot be reliably measured

In year one the contractor incurred R10,000 in construction expenses of which R500 was for materials to be used in the next financial year and R800 was for general research cost that is not probable to be recovered from the customer. This is a fixed contract and at the reporting date the stage of completion could not be reliably measured.

For this fixed contract the outcome cannot be reliably measured because the stage of completion cannot be reliably measured at reporting date.

The contractor should recognise in surplus or deficit all contract cost incurred. Revenue will only be recognised to the extent that contract cost will be recovered.

Contract revenue (R10,000 – R800)	9,200
Contract cost	(10,000)
Deficit	**(800)**

	R800 of the total R10, 000 contract cost is considered not to be recoverable from the customer thus revenue to the amount of R800 cannot be recognised.

7 ILLUSTRATIVE EXAMPLES

Illustrative example A – assets under contraction contracts

Assume the same information as in Example 1.

The following information pertains to the contract between the two parties

The construction begins on 1 October 2010 and will be finished on 31 March 2012 (i.e. 1.5 years). After which, the bridge will be complete and be available for use by DoT.

The parties agreed on a fixed price contract of R40 million.

Contract revenue and contract costs are determined based on surveys of work performed (work certified to date / contract price).

DPW invoices DoT upon the issue of certificates.

The DoT will retain 5% of the contract value, of which 50% will be paid to DPW at handover and 50% will be retained for a further period of 3 months after delivery of the project (the defects liability period). Any defects discovered during this period must be corrected by DPW.

The contract revenue as determined over the contract period is as follows:

Date	Amount	% complete
31/11/2010	R2.5 million	6.25%
31/12/2010	R3.2 million	14.25%
28/02/2011	R1.5 million	18%
30/04/2011	R5.6 million	32%
31/05/2011	R4.9 million	44.25%
31/07/2011	R2.6 million	50.75%
31/10/2011	R3.6 million	59.75%
30/11/2011	R8.1 million	80%
31/01/2012	R4.2 million	90.5%
31/03/2012	R3.8 million	100%
Total contract price	**R40 million**	

Journal entries

The journals entries in the accounting records of the **contractor (DPW)** will be as follows (note that for example purposes the total effect on each period is shown in one journal):

Period ending 31 March 2011	Debit	Credit
	R	**R**
Contract WIP	7,200,000	
Contract revenue		7,200,000
Recognition of contract revenue (R2.5mil + R3.2mil+ R1.5mil)		

Period ending 31 March 2012	Debit	Credit
	R	**R**
Contract WIP	32,800,000	
Contract revenue		32,800,000
Recognition of contract revenue (R40 mil - R7.2 mil)		

[Note that the journal entries for the recognition of contract expenditure by the contractor are not dealt with in this example.]

Assuming that the entire amount will be settled on completion of construction, the journal entries will be as follows: (Remember that an amount of R2, 000,000 (5% of R40, 000,000) will be withheld as retention money until all defective work has been corrected. This amount will remain in payables.

Period ending 31 March 2012	Debit	Credit
	R	**R**
Bank	38,000,000	
Retention debtor – DoT	2,000,000	
Contract WIP		40,000,000
Payment to DPW (R40mil – R2mil retention money)		

DoT inspected the bridge and identified outstanding items to be completed by DPW prior to the handover of the bridge and issued a list of outstanding items (a so-called ‘snag list’ to DPW).

Upon completion of the outstanding items by DPW, the DoT carries out a final inspection and issues a practical completion certificate and the bridge is handed over to DoT. In terms of the contract 50% of the retention money is payable to the contractor on handover.

The transaction is as follows:

Period ending 31 March 2012	Debit	Credit
	R	**R**
Bank	1,000,000	
Retention debtor – DoT		1,000,000
Receipt of 50% of retention money from DPW (R2mil – R1mil retention money)		

When the defects liability period lapses, DoT pays the rest of the retention money over to DPW. The transaction is as follows:

30 June 2012	Debit	Credit
	R	**R**
Bank	1,000,000	
Retention debtor – DoT		1,000,000
Receipt of the remaining 50% of retention money from DPW		

8 DISCLOSURE

Illustrative disclosure requirements (refer to the standard for detail disclosure requirements).

Extract from *Statement of Financial Position*

	Notes	20x1	20x0
		R	**R**
Current asset			
Receivables from exchange transactions	1	XX	XX
Advances to sub contractors		XX	XX
		XXX	**XXX**
Current liabilities			
Work in progress	2	XX	XX

Extract from *Statement of Financial Performance*

	Notes	20x1	20x0
		R	**R**
Contract revenue		XX	XX
Contract cost		(XX)	(XX)
Gross profit		**XXX**	**XXX**

Extract from *Notes to the Financial Statements*

Accounting Policies

1.5 Construction contracts

For example: *Contract revenue is recognised according to the stage of completion method. The stage of completion method is determined on the basis of the proportion of cost incurred for work performed to date to the estimated total cost of contract.*

The stage of completion can be measured in different ways, some of these ways include:

- Proportion of cost incurred for work performed to date, to the total estimated cost of the contract (Cost to date / Total contract cost);
- Survey of work performed (Work certified to date / Contract price); or
- Completion of physical portion of contract work.

This is an accounting policy choice that should be made by the entity.

	Notes	20x1	20x0
		R	**R**
1. Receivables from exchange transactions			
Contract receivables		XX	XX
Retention receivables		XX	XX
		XXX	**XXX**
2. Work in progress			
Cost incurred to date		XX	XX
Plus: Profit recognised to date		XX	XX
		XXX	**XXX**
Less: Work certified to date		(XX)	(XX)
		XXX	**XXX**

9 POLICIES AND CONTROLS

Some additional information related to construction contracts

Note that, in the case of a construction contract, the bidding documents and the general conditions of contract have to adhere to the prescripts of the Construction Industry Development Board (CIDB), in addition to the supply chain management prescripts of National Treasury.

The conditions of contract will normally specify the following (among others):

- The work that will be done;
- The time taken to complete the work;
- What will happen if there are delays or variations in the contract;
- The amount and time of any payments to be made;
- What work methods and quality will apply; and
- The procedures to be followed regarding cancellation, disagreement and disputes.

The following are some terms that are normally used in the contract along with a short description of each:

Progress payments:

The contract will normally make provision for monthly payment to the contractor based on the estimate of the value of the work completed (sometimes including certain other costs, such as materials on site). The contractor delivers the monthly statement for payment to the engineer (or another representative), who certifies the amount due, where after the employer pays the contractor within the time period specified in the contract.

Penalties:

Most contracts provide for penalties to be paid for failure to complete the project within the specified time. Penalties are normally an agreed upon amount of money per day and will be deducted from payments due to the contractor.

Retention:

Usually an amount of money is held back by the client to ensure that the contractor does his work properly. This retention money is due to the contractor, as the work is complete, but will not be paid out. This is to ensure that the contractor corrects any defective work. Normally half of the retention money is paid to the contractor when the project is delivered (or the engineer issues the Certificate of Completion) and the other half is paid within 14 days after the end of the 'defects liability period'.

Defects liability period:

This is the period in which the contractor is required to correct any defects that may be discovered and can vary from between 3 to 12 months.

10 SUMMARY OF KEY PRINCIPLES

GRAP 11 sets out the principles for the recognition of cost and revenue associated with construction contracts in the records of the contractor.

10.1 What is a construction contract

A construction contract is an agreement to construct an asset and the contractor is the entity who will construct the assets, either by itself of with the help of a sub-contractor.
The date at which the contract activity is entered into and the date when the activity is completed usually fall within different reporting periods.
Certain construction contracts do not specify an amount of contract revenue. An entity will rather receive funding by an appropriation or similar allocation of general government revenue or grant funds.
Contracts entered into can be on a commercial or non-commercial basis. For commercial contracts the aim is to make a profit and for non-commercial contracts the intention is not to make a profit.
There are two types of construction contracts namely fixed price contracts and cost plus or cost based contracts.
Construction contracts managed, on behalf of a constructing entity, do not constitute construction contracts of the managing entity. In these situations, the managing entity need not apply GRAP 11, but will recognise the management fee received in accordance with GRAP 9 – Revenue from Exchange Transactions.

10.2 Combining and segmenting construction contracts

GRAP 11 should be applied individually to each construction contract; however, there are instances where a single contract should be split into components in which case GRAP 11 should be applied to each component separately. There are also instances where numerous contracts can be grouped together and be recognised as a single construction contract for the purposes of GRAP 11.

10.3 Contract revenue and cost

Contract revenue includes the initial amount of revenue agreed in the contract, variations in contract work, claims and incentive payments, but only to the extent that it is probable that they will result in revenue and they can be measured reliably.
Contract cost include cost directly related to the specific contract, cost listed in the contract and costs that are attributable to contract activity and can be allocated to the contract on a systematic basis. All construction cost that cannot be specifically linked to a contract cannot be recognised as contract cost.
When the outcome of a construction contract can be estimated reliably, then contract revenue and contract cost should be recognised in the surplus or deficit by reference to the stage of completion method.
When the outcome of a construction contract cannot be estimated reliably then contract cost should be recognised as an expense in the period which they incurred and revenue should be recognised only to the extent that it is probable that the contract costs incurred will be recovered.

When it is probable that total contract cost will exceed total contract revenue, the expected deficit should be recognised as an expense immediately.