IPSAS 11 – Construction Contracts as adopted by the Maltese Government

Guidelines

IPSAS Implementation Team

March19

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Introduction

1. **IPSAS 11 Construction Contracts – as adopted by the Maltese Government**

1.1 These guidelines refer to the Construction Contracts accounting standard **as adopted by the Maltese Government**. This version is based on the original IPSAS 11 developed by the International Public Sector Accounting Standards Board (IPSASB). Modifications were made to bring the IPSAS closer to the local context.

2. **Scope**

2.1 These guidelines were prepared to enable the users to:

2.1.1 Develop a working-level knowledge of the IPSAS principles that guide the accounting and reporting for Construction Contracts and

2.1.2 Understand the major changes, challenges and benefits as a result of the implementation of IPSAS 11.[1]

3. **Target Audience**

3.1 These guidelines are designed for finance and non-finance employees working in Ministries and Departments of the Government of Malta.

4. **Guidelines Structure**

4.1 This document provides guidance on the accounting treatment of costs and revenues associated with construction contracts as well as related disclosures in the financial statements of the contractor in the reporting periods in which the construction work is being performed. This document also illustrates examples that further explain the concepts outlined in IPSAS 11.

[1] References to IPSAS 11 and any other IPSAS shall be taken as meaning 'as adopted by the Maltese Government'

IPSAS Team Note:

The Ministries and Departments of the Government of Malta may not be contractors themselves but:

a) they may either engage contractors to carry out work on their behalf based on procurement procedures; or

b) it may be a public entity, such as the Housing Authority or the Foundation for Medical Services, that has the role of the contractor.

A. What is a Construction Contract?

1. **A construction contract is:**
    - a contract or 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 the ultimate purpose or use.

2. **Examples of construction contracts include, but are not limited to the contracts for the construction of:**
    - Fly-Overs;
    - Roads;
    - Bridges;
    - Pipelines;
    - Tunnels;
    - Reticulated water supply systems;
    - Houses; *and*
    - Power Plants.

3. **The main features of a construction contract are:**

    - Commencement date and completion date usually fall into **different** reporting periods;

    - There are costs which are incurred by the contractor in return for **revenue**; *and*

    - Responsibilities of the parties involved are normally legalised through the use of a **contract**.

4. **Construction contracts also include:**

    - 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*

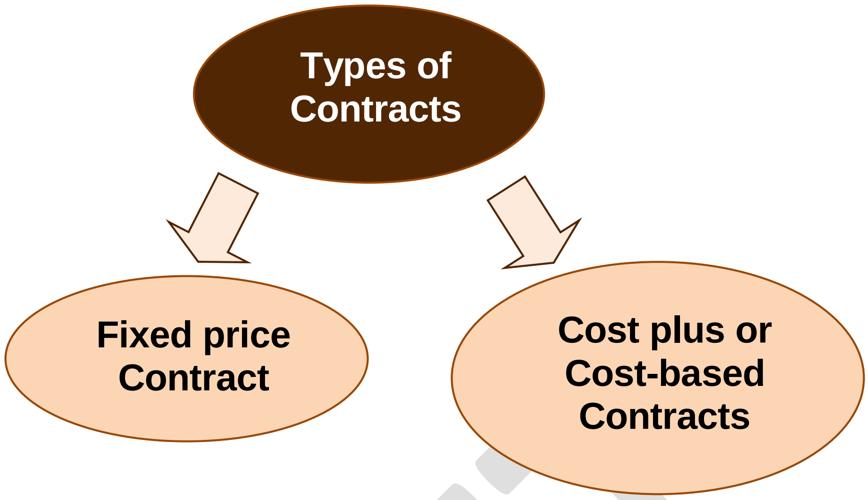
    - All deals that are **binding** on the parties but which may not take the form of a documented contract. These can still be considered as construction contracts provided that the arrangements confer similar rights and obligations as if they were in the form of a contract. For example, a ministerial decision or a cabinet decision.

5. What is a Contractor?

- A contractor is an entity (private or public) that performs construction work pursuant to a construction contract. The term ‘contractor’ includes a general or prime contractor, a subcontractor to a general contractor, or a construction manager.

- Example: Department A contracts Department B to construct a warehouse. As Department B is performing the construction work, Department B is the contractor. Thus, Department B will account for contract costs and contract revenue based on IPSAS 11. Department A will pay Department B over the period of the contract and when the project is finalised, Department A will capitalise the premises based on IPSAS 17, Property, Plant and Equipment.

B. Types of Contracts



1. Fixed Price Contract

1.1 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.

1.2 Example 1

The Works and Infrastructure Department within the Ministry for Transport and Infrastructure (MTI) has been contracted by the Żebbuġ Local Council to resurface a road.

The following information is available:

- This contract is a fixed price contract subject to a cost escalation clause.
- The fixed contract price is €200,000.
- The expected total costs are €100,000.
- Revenue receivable by the contractor is fixed at €200,000, but the client agreed to accept any wage increases on top of the contract price.
- The amount will be recognised based on the stage of completion method and therefore based on the percentage of work completed.
- The Works and Infrastructure Department's policy shall 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.**

Costs for works performed to the end of the financial year amounted to €50,000. These costs include €7,000 incurred as a result of additional wage costs.

Revenue to be recognised for the same period:

% completed to date =

$$\frac{\text{Costs incurred for work performed to-date}}{\text{Total contract estimated costs (including additional agreed costs)}}$$

= €50,000/ **(**€100,000+€7,000) = 46.7% completed

Revenue recognised = 46.7% of (€200,000 + €7,000) = €96,669

IPSAS Team Note:

The €7,000 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.

2. Cost Plus or Cost-based Contract

2.1 A 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, plus an additional percentage (surplus) of these costs or a fixed fee, if any.

2.2 Example 2

The Works and Infrastructure Department within MTI is contracted to resurface a side road for the contracted cost plus 15% surplus. If the expected contract costs are €100,000, the contract price shall be €100,000 plus 15% mark-up = €115,000.

3. Commercial and non-Commercial Contracts

3.1 **Commercial contracts** will specify that revenue shall cover the agreed constructor's construction costs and generate a profit margin which will be provided by the other parties to the contract.

3.2 Some **commercial construction contracts** may contain characteristics of both a fixed price contract and a cost plus or cost based contract. For example, in the case of a cost plus or cost-based contract with an agreed maximum price.

3.3 In a **Non-commercial contract,** a department may construct an asset for another department in return for full or partial reimbursement of costs.

IPSAS Team Note:

When a department constructs assets for another department, the cost of construction activity is not directly recovered from the recipient but
(a) funded indirectly by way of general appropriation or other allocation of general government funds to the other contractor, or
(b) from general purpose grants from third party funding.

These are classified as fixed price contracts for the purpose of this Standard.

C. Combining and Segmenting Construction Contracts

1. Single contracts and grouped contracts

IPSAS 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 IPSAS 11 should be applied to each component separately. If there are any losses arising from some components, these shall not be set off against the profit making components.

There are also instances where **numerous contracts can be grouped together** and be recognised as a single construction contract for the purposes of IPSAS 11. A construction contract may need to be combined or segmented for accounting purposes to reflect the substance of the arrangements.

2. Separate Construction Contracts

2.1 A single contract may cover the construction of a number of assets. The construction of each asset should be treated as a separate contract where:

- Separate proposals have been submitted for each asset;
- Each asset has been the subject of separate negotiations, and the contractor and customer have each been able to accept or reject that part of the contract relating to each asset;
- The costs and revenues of each asset can be identified.

2.2 Example 1

Department X received a number of separate proposals from Department Y with regards to a variety of contracts. Department Y was successful in three cases:

- The Construction of the Surgical centre.
- The Construction of the Emergency Department; *and*
- The Construction of the Paediatric centre.

Departments X and Y signed ONE contract for the construction of the three buildings. However:

- Separate proposals were submitted for each building;
- Each building was subject to separate negotiations; *and*
- The costs and revenues of each building can be identified.

Department Y's accounting records will show three distinct construction contracts, even though there was only one contract between the two parties.

3. A Group of Construction Contracts

3.1 A group of contracts, whether with a single customer or with several customers, should be combined where:

- The contracts have been negotiated as a single package;
- The contracts are so closely interrelated that they are, in effect, part of a single project with an overall margin, if any;
- The contracts are performed concurrently or in a continuous sequence.

3.2 Example 2

Company A submitted a proposal for the construction of two separate blocks of flats following a request for tenders by the Ministry for the Family and Social Solidarity.

These two contracts shall be combined as one contract because:

- they were negotiated as *a single package (one contract)*;
- the contracts are so *closely interrelated* that they are, in effect, part of a single project;
- The contracts will be performed in a *continuous sequence*.

4. Additional Asset

4.1 A contract may provide for the construction of an additional asset at the option of the customer or may be amended to include the construction of an additional asset. The construction of the additional asset shall be treated as a separate construction contract when:

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

4.2 Example 3

Originally Company Z was contracted to build the administration block of a public schooll. A year later Company Z was again contracted to construct an indoor gym for the same school. The indoor gym contract should be treated as a separate construction contract because:

- The indoor gyml is significantly different in design and function; *and*
- The price was negotiated without regard to the original contract price.

D. Accounting for Construction Contracts

1. Contract Revenue and Contract Costs

1.1 Construction Contracts comprise of two basic elements:

1.1.1 Contract Revenue

1.1.2 Contract Costs

Contract Revenue	***Contract Costs***
a) The initial amount of revenue agreed in the contract; and *b) Variations in contract work, claims, and incentive payments*[2] *to the extent that:* • *It is probable that they will result in revenue; and* • *They are capable of being reliably measured.*	*a) Costs that relate directly to the specific contract; examples include:* • *Site labour costs,* • *Costs of materials used in construction;* • *Depreciation of plant and equipment used on the contract;* • *Costs of moving plant, equipment, and materials to and from the contract site;* • *Costs of hiring plant and equipment;* • *Costs of design and technical assistance that are directly related to the contract;* • *The estimated costs of rectification and guarantee work, including expected warranty costs; and* • *Claims from third parties.* *b) Costs that are attributable to contract activity in general*[3]*, and can be allocated to the contract on a systematic and rational basis (indirect costs); examples include:* • *Allocation of the cost of central technical assistance department based on the number of hours spent by technical staff on various contracts;* • *insurance cost allocation in respect of machinery used on multiple sites;* • *construction overheads,* • *allocation of salary of staff employed on multiple contracts (e.g. project supervisors); and* *c) Other costs as are specifically chargeable to the customer/entity under the terms of the contract. These may*

[2] *Refer to the glossary for a definition of "variations in contract work", "claims", and "incentive payments".*

[3] *The allocation is based on the normal level of construction activity.*

	include some general administrative costs or development costs.

1.2 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. Amounts meeting the definition and recognition criteria for revenue should be accounted for by the contractor in the same way as other contract revenue. Similarly, a contractor should review all amounts relating to the construction contract paid directly by subcontractors to determine whether they qualify as contract costs and should be accounted for by the contractor in the same way as other contract expenses.

1.3 Costs that cannot be attributed to contract activity or cannot be allocated to a contract are **excluded** from the costs of a construction contract. Such costs include:

- General administration costs for which reimbursement is not specified in the contract;
- Selling costs;
- R&D costs for which reimbursement is not specified in the contract; and
- Depreciation of idle plant and equipment that is not used on a particular contract.

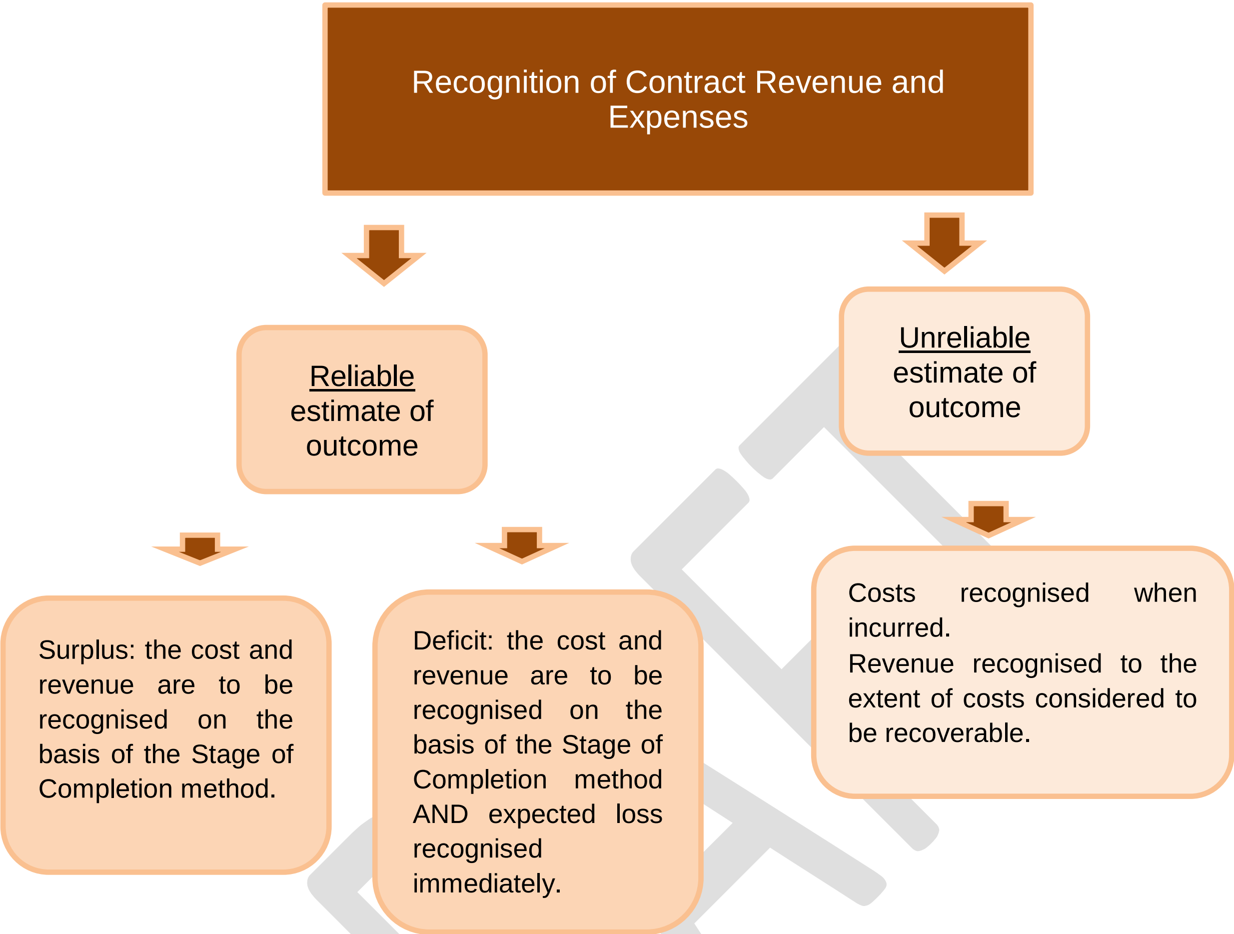
2. Recognition of Contract Revenue and Expenses

2.1 Recognition of Contract Revenue and Expenses is based on whether the outcome of the contract can be reliably measured.

2.2 If the outcome can be reliably measured, and a surplus is expected, then cost and revenue are recognised on the basis of the stage of completion method.

2.3 If the outcome can be reliably measured, and a deficit is expected, then cost and revenue are recognised on the basis of the stage of completion method, however the expected loss is to be recognised immediately.

2.4 If the outcome cannot be reliably measured, revenue shall be recognised only to the extent of contract costs incurred that is probable will be recoverable and contract costs shall be recognised as an expense in the period in which they are incurred.



2.5 In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are met:

- Total contract revenue, if any, can be measured reliably;
- It is probable that the economic benefits or service potential associated with the contract will flow to the entity;
- Both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and
- The contract costs attributable to the contract can be clearly identified and measured reliably, so that actual contract costs incurred can be compared with prior estimates.

2.6 In the case a cost plus or cost-based contract, the outcome of a Construction Contract can be estimated reliably when all the following conditions are met:

- It is probable that the economic benefits or service potential associated with the contract will flow to the entity; and
- The contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

3. Accounting Treatment – the percentage of completion method

3.1 When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract shall be recognised as revenue and expense respectively by reference to the stage of completion of the contract activity at the reporting date This is often referred to as the percentage of completion method.

3.2 Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses, and surplus/deficit that can be attributed to the proportion of work completed.

3.3 Any expected deficit is recognised as an expense immediately.

3.4 The stage of completion of a contract may be determined as follows, using one of the these three methods:[4]

3.4.1 Method 1 - Proportion of contract costs of work performed to date TO estimated total contract costs

$$\text{Stage of Completion \%} = \frac{\text{Costs incurred to Date}}{\text{Total Contract Costs}^{5}} \times 100$$

3.4.2 Method 2 - Surveys of work performed

$$\text{Stage of Completion \%} = \frac{\text{Work Certified}}{\text{Contract Price}} \times 100$$

3.4.3 Method 3 – Completion of physical proportion of the contract work

$$\text{Stage of Completion \%} = \frac{\text{Physical Units of Work Completed}}{\text{Total Number of Units as per Contract}} \times 100$$

4. Trade Receivables and Gross Amount Due

4.1 Trade Receivables represent the difference between the progress billings to-date and the amount of progress payments received from the customer.

4.1.1 Progress billings are amounts of contract revenue billed for work performed on a contract, whether or not they have been paid by the customer.

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[4] The choice of the method will depend on the nature of the contract, as this will determine which information will be available to apply one of these methods. For example,' *Method 3, Physical Proportion of the Contract Work'*, should be used when the contractor produces a number of units to the specifications of a customer.

[5] Total Contract Costs should include, if applicable, any additional agreed costs at contract stage and any mark-ups in the case of cost plus or cost based contracts.

4.2 Gross Amount Due from/to Customers:

4.2.1 A contractor may have incurred costs that relate to a future activity on the contract. Such contract costs are recognised as an asset, provided it is probable that they will be recovered. Such costs represent an amount due from the customer.

4.2.2 The gross amount due shall include the costs incurred by the contractor plus any recognised surpluses, less any recognised deficits, less progress billings to-date.

4.2.3 If the progress billings to-date exceed the net costs to contractor (i.e. costs to contractor plus surpluses less losses), then the gross amount is not due from customer, but due to customer, and therefore shown as a liability.

4.2.4 Example 1

Department Z has a contract with Department A and Department B to build offices.

In the case of Department A, the total contract price is €500,000. Costs incurred to-date were €200,000 and estimated costs to completion were €200,000. Department Z has invoiced progress bills amounting to €225,000.

In the case of Department B, the total contract price is also €500,000. Costs incurred to-date were €300,000 and estimated costs to completion were €300,000. Department Z has also invoiced progress bills amounting to €225,000.

What are the Gross Amounts Due from/to Department Z, assuming that the contracts were 50% complete?

Solution

First establish whether the contracts will make a surplus or a deficit.

Department A

Total Contract Price	€500,000
Costs to-date	(€200,000)
Costs to completion	(€200,000)
Surplus	**€100,000**

Department B

Total Contract Price	€500,000
Costs to-date	(€300,000)
Costs to completion	(€300,000)
Deficit	**(€100,000)**

Gross amounts due from/to Customers (assuming 50% completion):

Department A	
Contract Costs (to-date)	€200,000
Recognised Surplus (50% of €100,000)	€50,000
Recognised Deficit	(€0)
Progress billings (to-date)	(€225,000)
Gross amounts due from Customer	**€25,000**

Department B	
Contract Costs (to-date)	€300,000
Recognised Surplus	€0
Recognised Deficit (100%) *	(€100,000)
Progress billings (to-date)	(€225,000)
Gross amounts due to Customer	**(€25,000)**

*(Expected deficit shall be recognised as an expense immediately)

5. Advances from Customers

5.1 Advances are amounts of contract revenue received by the contractor before the related work is performed. These are to be recognised as a liability until the work is performed.

6. Retention Money

6.1 Retentions are amounts of progress billings that are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts, or until defects have been rectified. Retention money is a percentage (often 5%) of the amount certified as due to the contractor on an interim certificate, that is deducted from the amount due and retained by the client. Half of the amount retained is released on certification of practical completion and the remainder is released following the defect liability period.

6.2 Retention money shall be recorded as a receivable by the contractor.

7. More Examples

7.1 **Example 2:** In 2016, Mater Dei Hospital was engaged in a 2-year €10 million construction contract, with a total estimated contract costs of €5 million. The costs incurred by the contractor in 2016 amounted to €2.5 million, and these included €0.5 million general administration costs and €0.5 million research costs (for which reimbursement is not specified in the contract). The costs also included €0.5 million material costs, however this material was not used in 2016.

7.1.1 What is the Contract Revenue and Contract Cost in 2016, <u>if the outcome of the contract can be reliably measured?</u>

(note: The contract revenue is measured in accordance with the stage of completion method)

Solution

- The Contract Costs should not include costs that cannot be attributed to contract activity or cannot be allocated to the contract, therefore:
    - general administration costs €0.5 million
    - research costs €0.5 million
    - future material costs €0.5 million
    - **total €1.5 million are to be excluded from the contract costs**

- Therefore, 2016 <u>contract costs</u> shall amount to €1 million (€2.5 million less €1.5 million).

- Proportion of contract costs of work performed to date TO estimated total contract costs

$$\text{Stage of Completion \%} = \frac{\text{Costs incurred to Date}}{\text{Total Contract Costs}} \times 100$$

$$\text{Stage of Completion \%} = \frac{1{,}000{,}000}{5{,}000{,}000} \times 100$$

% completion of the contract in 2016 = 20%

<u>Contract Revenue</u> recognised in 2016 =
20% of €10,000,000 = **€2,000,000**

2016: Contract Revenue = €2 million & Contract Costs = €1 million

7.1.2 What is the Contract Revenue and Contract Cost in 2016, <u>if the outcome of the contract CANNOT be reliably measured?</u>

- If the outcome of the contract cannot be estimated reliably it will be probable that the entity will recover the contract costs incurred. Therefore, contract revenue is recognised only to the extent of costs incurred that are expected to be recoverable.

- **2016: contract revenue** = contract costs less unrecoverable costs = €2.5 million less general administration costs €0.5 million and research costs €0.5 million (= €1 million) = **€1.5 million**.

- Contract costs shall be recognised as an expense in the period in which they are incurred.

- **2016: contract costs = €2.5 million**

7.2 Example 3: The Department of Works and Infrastructure (Contractor) within MTI entered into a contract agreement with the Vittoriosa Local Council for the embellishment works of a Public garden at a cost of €500,000. The duration for the completion of the contract is 2 years with no variation clause. At the end of year 1, the valuation certificate submitted by the Department of Works and Infrastructure indicates that over 60% of the contract has been executed. The amount spent so far by the Department of Works and Infrastructure was estimated at €200,000. At the end of the year, the records show that the Department of Works and Infrastructure has received a total sum of €100,000 from the Vittoriosa Local Council.
Show the journal entries of the Department of Works and Infrastructure.

Solution

Debit Contracts receivable	€300,000
Credit Contract Revenue	€300,000
Being recognised revenue based on valuation certificate submitted (€500,000 x 60%)	

Debit Cash/Bank	€100,000
Credit Contracts receivable	€100,000
Being receipt of cash from the Vittoriosa Local Council	

Debit Contract Costs	€200,000
Credit Accounts Payable	€200,000
Being contract costs recognised to date	

Debit Accounts Payable	€200,000
Credit Cash/Bank	€200,000
Being payments made to suppliers	

7.3 Example 4: The Restoration Directorate within the Ministry for Justice, Culture and Local Government (MJCL) was contracted by the Vittoriosa Local Council to restore a historic building.

- The Restoration Directorate is the contractor as it is performing the restoration;
- The Vittoriosa Local Council is the client;
- The Vittoriosa Local Council will make the required payments to the Restoration Directorate over the contract period and at the end will 'receive' the restored building;
- The Vittoriosa Local Council will account for the restored historic building in its accounting records.

The restoration began on 1 October 2014 and was finished on 31st March 2016. (i.e. 1.5 years later). The historic building was then restored, available for use by the Vittoriosa Local Council.

The parties agreed on a fixed price contract of €1.6 million.

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

The Restoration Directorate invoiced the Vittoriosa Local Council upon the issue of certificates.

The Vittoriosa Local Council retained 5% of the contract value as retention, of which 50% was be paid to the Restoration Directorate at the handover stage of the project and the remaining 50% after a period of 3 months following delivery of the project (the defects liability period). Defects discovered during this period were corrected by the Restoration Directorate.

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

Date	Amount (€)	% complete
31/11/2014	50,000	3.125%
31/12/2014	170,000	10.625%
28/02/2015	190,000	11.875%
30/04/2015	450,000	28.125%
31/05/2015	590,000	36.875%

31/07/2015	750,000	46.875%
31/10/2015	990,000	61.875%
30/11/2015	1,200,000	75%
31/01/2016	1,420,000	88.75%
31/03/2016	1,600,000	100%
Total contract price	**€ 1.6 million**	

Show the journal entries of the Restoration Directorate

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

Solution

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

Period ending 31 March 2015

Debit Contracts receivable	€190,000* [50k + 120k + 20k)
Credit Contract Revenue	€190,000
Being recognised revenue to 31/3/2015	

* €190,000 = €50,000 + €120,000 + €20,000

Period ending 31 March 2016

Debit Contracts receivable	€1,410,000*
Credit Contract Revenue	€1,410,000
Being recognised revenue 1/4/2015 to 31/3/2016	

*€1,410,000 = €260,000 + €140,000 + €160,000 + €240,000 + €210,000 + €220,000 + €180,000

The entire amount due by customer was settled on completion of construction, except for the 5% retention amounting to €80,000 (5% of €1,600,000).

Debit Bank	€1,520,000
Debit Retention receivable	€ 80,000
Credit Contracts receivable	€1,600,000
Being payments received less 5% retention	

The Vittoriosa Local Council had inspected the restored historic building and identified outstanding items still to be completed by the Restoration Directorate prior to the handover of the restored building.

Upon completion of the outstanding items by the Restoration Directorate, the Vittoriosa Local Council had carried out a final inspection and issued a practical completion certificate and the restored historical building was handed over to the Vittoriosa Local Council. In terms of the contract, 50% of the retention money was thus paid to the contractor on handover.

The transaction was as follows:

Period ending 31 March 2016

Debit Bank	€40,000
Credit Retention Receivable	€40,000
Being receipt of 50% retention money	

When the defects liability period elapsed, the Vittoriosa Local Council paid the rest of the retention money over to the Restoration Directorate. The transaction was as follows:

30 June 2016

Debit Bank	€40,000
Credit Retention Receivable	€40,000
Being receipt of remaining retention money	

E. Disclosure

1. The following shall be disclosed by way of Notes to the Financial Statements:

1.1 The amount of contract revenue recognised as revenue in the period;
1.2 The methods used to determine the contract revenue recognised in the period; and
1.3 The methods used to determine the stage of completion of contracts in progress.

2. The following shall be disclosed as contracts in progress at the reporting date:

2.1 The aggregate amount of costs incurred and recognised surpluses (less recognised deficits) to date;
2.2 The amount of advances received; and
2.3 The amount of retentions.

3. The following shall also be presented by way of disclosure:

3.1 The gross amount due from customers for contract work as an asset; and/or
3.2 The gross amount due to customers for contract work as a liability.

4. Illustrative disclosure requirements:

Statement of Financial Position as at 31st December 2013 (extract)			
	Notes	2013 (€)	2012 (€)
Current assets			
Receivables from Exchange Transactions	1	X	X
Advances to subcontractors		X	X
Current liabilities			
Advances Received		X	X

Statement of Financial Performance for the year ended 31st December 2013 (extract)			
	Notes	2013 (€)	2012 (€)
<u>Revenue from exchange transactions</u>			
Rendering of Services		x	x
Contract Revenue		x	x
		x	x
<u>Expenses</u>		x	x
Salaries & Wages		x	x
Contract Costs		x	x
		x	x
Surplus		x	x

Extract from Notes to the Financial Statements

Accounting Policies

1. Construction Contracts

When the outcome of the construction contract can be estimated reliably, revenue and costs are recognised by reference to the completion of the contract activity at the end of the reporting period, measured based on the proportion of contract costs incurred for work performed to date relative to the estimated total contract costs, except where this would not be representative of the stage of completion.

When the outcome of the construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is probable will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

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

When contract costs to date plus recognised surpluses less recognised deficits exceed progress billings, the surplus is shown as amounts due from customers for contract work. For contracts where progress billings exceed contract costs incurred to date plus recognised surpluses less recognised deficits, the surplus is shown as amounts due to customers for contract work.

Amounts received before the related work is performed are included on the Statement of Financial Position, as a liability, as advances received. Amounts billed for work performed but not yet paid by the customer are included on the Statement of Financial Position under trade and other receivables.

	2013 €	2012 €
1. Receivables from exchange transactions		
Contract Receivables	X	X
Retention Receivables	X	X
	X	X

Glossary

"Accruals-based accounting" Accruals-based accounting is a system of accounting based on the accrual principal, under which revenue is recognised (recorded) when earned, and expenses are recognised when incurred.

"Advances from customers" Advances from customers refer to money collected by a contractor prior to providing a product or service.

''Central Government Entities (CGEs)'' The term CGEs refers only to ministries and departments of the Government of Malta.

"Claims" Claims are 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.

"Conditions of Contract" 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.

"Construction Contract" A 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" A contractor is an entity that performs construction work pursuant to a construction contract.

"Cost plus or cost-based contract" A 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.

"Defects Liability Period" The defects liability period is the period in which the contractor is required to correct any defects that may be discovered; this may vary from between 3 to 12 months.

“Fixed price contract” 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.
“Incentive payments” 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 contract.

‘’International Public Sector Accounting Standards (IPSASs)’’ IPSASs are a set of accrual-based accounting standards issued by the IPSAS Board for use by public sector entities around the world in the preparation of financial statements.

“Penalties” Penalties feature on most contracts to be paid by the contractor for failure to complete the project within the specified time. Penalties are normally an agreed amount of money per day and will be deducted from payments due to the contractor.

“Progress billings” Progress billings are amounts of contract revenue billed for work performed on a contract, whether or not they have been paid by the customer.

“Progress payments” Progress payments are usually stipulated in the contract; the contract will normally provide for monthly payments to be made to the contractor based on the estimate of the value of the work completed (that is, based on the progress billings).

“Retention money” Retention money represents withheld payment for a service until the completion of a condition (usually until all specified conditions are met by the contractor). A contract usually stipulates a % of the contract value (usually 5%) to be held as retention money.

“Stage of completion” The stage of completion**,** also known as percentage of completion, is a measure of the extent of work that has been completed in respect of a contract and is usually expressed in percentage terms.

“Trade receivables” Trade Receivables represent the difference between the progress billings to-date and the amount of progress payments received from the customer.

“Variations in contract work” Variations 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, additions to the contracted amounts and/or works which were not foreseen at contract stage.