

Acceptable methods

Percentage-of-Completion (POC)

Revenue, costs, and gross profit are recognized in all accounting periods throughout the contract utilizing a method of measuring progress.

Methods of measuring progress – cost-to-cost, effort expended, or unit of work.

Must meet the following conditions:

- Contractor must be able to provide reasonably dependable estimates of revenue, costs, and progress toward completion and update them as the work progresses.
- Terms and conditions specified in legal contract
- Reasonable expectation of performance by contractor and purchaser
- Should not be any riskier than normal course of business.

Completed Contract

Revenue, costs, and gross margin not recognized until the contract has been substantially completed and accepted. Major disadvantage is that there is no periodic recognition of results as contract obligations are discharged. Not the preferred method of accounting unless POC is not reasonably possible.

Acceptable if:

- No reasonable estimates of revenue costs and gross profit can be determined.
- No material difference between POC and Complete Contract

POC Method

Measuring progress – dependent on the type of project. Must be applied consistently to all projects to that type year after year.

- Cost-to-Cost method - Costs incurred
- Efforts – Labor hours incurred
- Output – Number of miles paved, number of light poles installed – all outputs must be substantially equal in costs and efforts.

Measurement Standards

Cost-to-Cost Measure

Most common in the construction industry because the expenditure of labor and material dollars closely approximates the physical construction process. The more precise the estimate of total costs the more precise the percentage of completion.

Efforts Measure

Commonly based on labor hours. Used to reflect changes in labor intensity throughout the project by recognizing labor as it is incurred.

***Requires labor hours be accurately included for direct and indirect labor and labor hours for subcontractors.

Output Measure

Used when the outputs are uniform. Therefore, the costs and efforts to produce the output are substantially the same.

Measurement of Completion – applying the standards

Alternative A – Revenue-Cost Approach – most common when the POC is being calculation using efforts or outputs. (Customer perspective)

Alternative B – Gross-Profit Approach – measures the gross profit to be recognized based of the costs incurred to date. (Internal Contractor perspective)

LOSSES – total amount of loss recognized in the period that there is evidence that the loss will be sustained regardless of when the loss is actually sustained.

Acceptable to recognize the loss currently or prospectively, but not restate prior periods.

Two methods of allocation:

Reallocation – reflects the loss over the remaining term of the contract

Cumulative Catch-Up – cumulatively recognize in the current period the revised gross profit for work completed to date. Prospective periods should equal the final expected gross profit percentage.

Cumulative Catch-Up is preferred. Final cumulative revenue, costs, and profits are the same regardless of the method used.