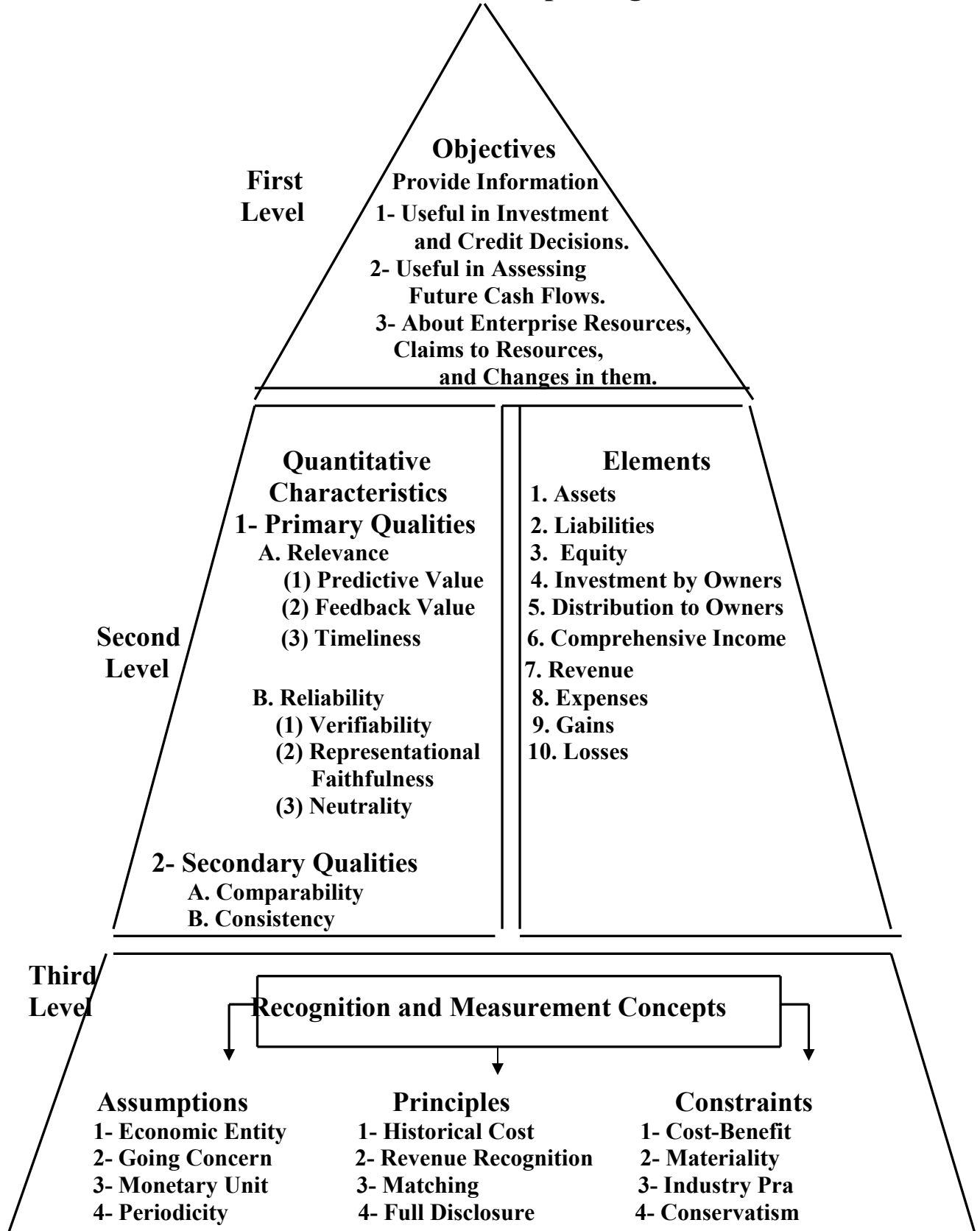
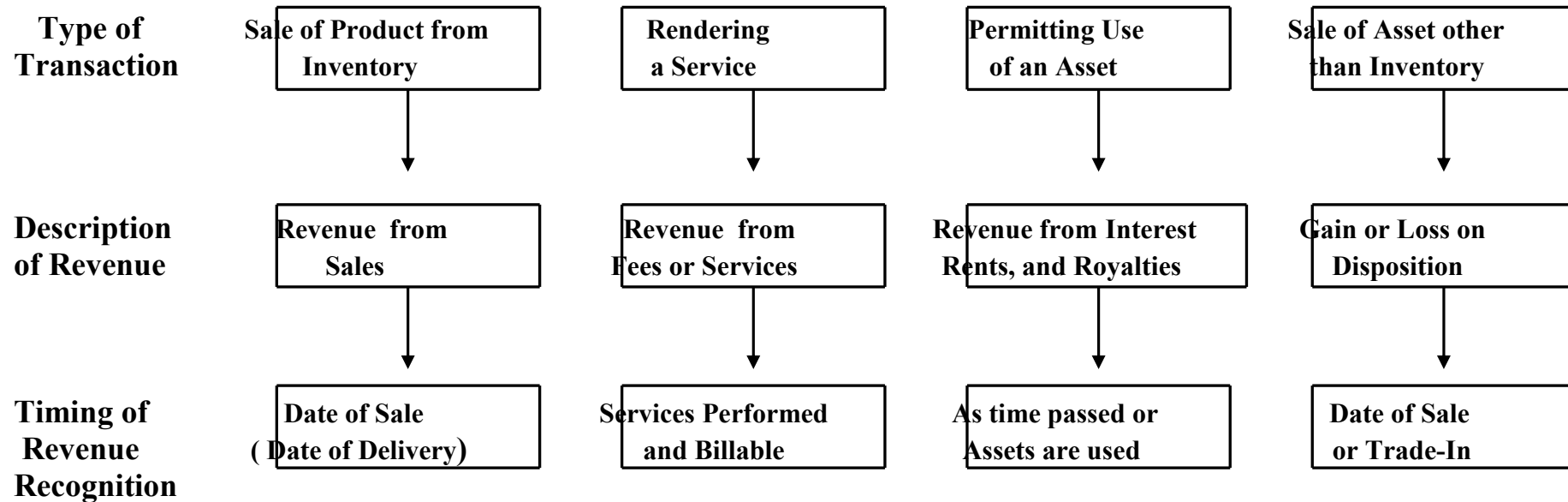




Conceptual Frame Work For Financial Reporting



Revenue Recognition Classified by Nature of Transaction





Installment method:

Revenue recognized as cash is collected thus revenue is recognized at the point of cash collection not the point of sale gross profit is deferred to the future and recognized proportionately to the collection of the receivables

Example:

Sam operation in 2003

Installment sales 500000\$

Regular sales 300000

Cost of installment sales 250000

Cost of regular sales 150000

General & admin. exp. 50000

Collection on installment sale 100000

Required the amount of deferred gross profit

At the time of sale Gross profit 250000 is deferred (500000 sales - 250000 cost of sales) – the gross profit rate is 50% (250000/500000)

The collection is 100000 recognized profit in 2003 $100000 * 50\% = 50000$ this will decrease the deferred revenue = 200000 (250000 - 50000)

Cost recovery method:

Cost recovery method is similar to installment sales method in that gross profit on the sale is deferred

No profit is recognized until the cumulative receipt exceeds the cost of the asset sold.

Example:

HEGAS manufacturing sells inventory with a cost 25000\$ to ALAN co for 36000\$ with payment receivables

18000\$ in 2001- 12000\$ in 2002 - 6000\$ in 2003



	<u>2001</u>	<u>2002</u>	<u>2003</u>
Cash collected	<u>18000</u>	<u>12000</u>	<u>6000</u>
Revenue	36000	<u>0</u>	<u>0</u>
Cost of goods sold	<u>25000</u>	<u>0</u>	<u>0</u>
Deferred gross profit	11000	11000	6000
Recognized gross profit	<u>0</u>	<u>5000</u>	<u>6000</u>
Deferred gross profit (end of period)	11000\$	6000\$	<u>0\$</u>

*\$25000-\$18000=\$7000 of unrecovered cost at the end of 2001;\$12000-\$7000=\$5000.the access of cash received in 2002 over unrecovered cost .

long term construction contracts :

Completed contract method:

It differ all contracts costs until the project is completed and then matches the cost of completing the contract with the revenues from the project .hence: profit is recognized only in the year of completion

All costs are deferred in a construction in progress account until the project is completed and revenue is recognized then construction in progress is closed to cost of sales.

Percentage of completion method:

Revenues and gross profit are recognized each period based upon the progress of the construction

Construction cost plus gross profit earned to date are accumulated in an inventory account (construction in proceeds) & progress billings are accumulated in a contra inventory account (billings on construction in process).

The percentage of completion is measured by comparing cost incurred to date with the most recent estimate of the total cost to complete the contract

$$\frac{\text{Cost incurred to date}}{\text{Most recent estimate of total cost}} = \text{percent complete}$$



The percentage that costs incurred bear to total estimated cost is applied to the total revenue or the estimated total gross profit on the contract in arriving at the revenue or the gross profit amount to be recognized to date

Percent complet*	Estimated total revenue (or gross Profit)	=	revenue (or gross profit)to be recognized to date
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To find the amount of revenue and gross profit recognized each period we would need to subtract total revenue or gross profit recognized in prior period

revenue (or gross profit)to be recognized to date	-	revenue (or gross profit) recognized in prior period	=	current period revenue (or (gross profit)
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Example.

A contractor has a contract to build a bridge that will take 3 years to complete the contract price is \$2000000 the contractor expects total costs to be \$ 1200000 the following information applies to the costs incurred and expected to be incurred during the 3 years

	Year 1	year 2	year 3
Cost incurred during each year	\$300000	\$600000	\$550000
Costs expected in the future	\$900000	\$600000	0

1) by the end of the first year. The contractor has incurred 25% (300000/1200000) of all costs expected to be incurred on the project . if the percentage of completion method being used the contractor will recognize 25% of the profit that will be earned on the project the total profit is expected to be \$800000 (\$2000000-\$1200000) and \$200000 (25%*800000) of profit should be recognized in the first year

2)at the end of the second year . the company has incurred total cost of \$900000 (\$300000 in the first year and \$600000 in the second year) given that an additional \$600000 of cost is expected to be incurred in the future the total cost of the project is expected to be \$1500000(\$900000+\$600000) and the new estimate of total profit is \$ 500000(\$2000000contract price -\$1500000of costs) if the project is 60% complete after year 2 (\$900000-\$1500000) 60%of all profit should be recognized by the end of year 2 or \$300000(60%*\$500000) because \$200000 was recognized in the first year . \$100000 remains to be recognized in year 2

3) at the end of the third year .total cost s are \$1450000 thus the total profit is known to be \$550000 because a total of \$300000

Was recognized in the first 2 years . \$250000 should be recognized in year 3

4) journal entries	% of completion		Completed contract	
Year1 –construction in progress Cash or account payables	\$300000	\$300000	\$300000	\$300000
construction in progress construction revenue	\$200000	\$200000		No entry
Year2- construction in progress Cash or account payables	\$600000	\$600000	\$600000	\$600000
construction in progress construction revenue	\$100000	\$100000		No entry
Year3- construction in progress Cash or account payables	\$550000	\$550000	\$550000	\$550000
Cash construction in progress construction revenue	\$2000000	\$1750000 250000	\$2000000	\$1450000 550000

Income Determination

Recognition Basis / Source of GAAP	Accounting Method	Criteria for use of Basis	Reason(s) for Departing from Sale Basis
* Point of Sale ARB 43 (Ch 1A)	* Transaction Approach (Sale Basis)	* Exchange has taken Place. * Earning Process is (virtually) Complete.	
* During Production Basis ARB 45 and AICPA Contractors Guide	* Percentage-of-Completion	* Long-Term Construction Property, or Service Contract. * Dependable Estimates of Extent of Progress and Cost to complete. * Reasonable Assurance of Collectibility of Contract.	* Availability of evidence of Ultimate Process. * Better Measure of Periodic Income. * Avoidance of Fluctuations in Revenues, Expenses, and Income.
* Completion-of- Production Basis ARB 43 (Ch 4)	* Net Realizable Value	* Immediate Marketability at Quoted Prices. * Unit Interchangeability. * Difficulty of determining Costs.	* Known or determinable revenues. * Inability to Determine Costs and Thereby Defer Expenses Recognition until Sale.
* Cash Collection Basis APB 10	* Installment and Cost Recovery Method	* Absence of a Reasonable Basis for Estimating Degree of Collectibility.	* Level of Uncertainty with Respect to Collection of the Receivable Precludes Recognition of Gross Profit Before Cash is Received.

