Revenue Recognition

Overview

Revenue recognition, on the surface, seems to be a straightforward topic, and so you may be wondering why an entire chapter is devoted to it. As mentioned in Chapter 6, revenue recognition, or rather improper revenue recognition in some instances, is one of the main methods of earnings management. While there are some basic guidelines for revenue recognition, there are also many kinds of transactions that don’t easily fall under these fundamental rules; there are fuzzy areas and exceptions for certain types of transactions.

Typically revenue should be recognized when two criteria are met. The first is that payment has been received or is collectible. The second is that the earnings process needs to be substantially complete, which generally means that a product has been delivered or a service has been performed.

SAB 101/104 provides additional guidance and specific examples related to the above two criteria. The SEC released these standards to combat specific revenue recognition abuses that had come to their attention.

For companies in the construction industry, there are two permissible methods to recognizing revenue. The more common method is known as the percentage-of-completion method. Under this method, the company providing the construction recognizes revenue as they complete the work. When cash is received is not a factor. The other method is more conservative and is known as the completed-contract method. Revenue isn’t recognized until the contract is completed, as the name indicates, under this second method. Similar methods are available for long-term service contracts as there are for construction contracts.

Under the typical revenue recognition system, payment needs to be realizable. What happens when the realizability is in question? Under this scenario, another method known as the installment sales method comes into play. In more extreme instances, cost recovery or a pure cash method can be the correct method to use in recognizing revenue.
Learning Objectives

Refer to the Review of Learning Objectives at the end of the chapter. It is crucial that this section of the chapter is second nature to you before you attempt the homework, a quiz, or exam. This important piece of the chapter serves as your CliffsNotes or “cheat sheet” to the basic concepts and principles that must be mastered.

If after reading this section of the chapter you still don’t feel comfortable with all of the Learning Objectives covered, you will need to spend additional time and effort reviewing those concepts that you are struggling with.

The following “Tips, Hints, and Things to Remember” are organized according to the Learning Objectives (LOs) in the chapter and should be gone over after reading each of the LOs in the textbook.

Tips, Hints, and Things to Remember

LO1 – Identify the primary criteria for revenue recognition.

How? Typical revenue recognition is based on a two-prong approach. Both prongs must be met before revenue should usually be recognized. The product should change hands (or if it is a service, it should have been performed), and the cash should be realized (in hand) or realizable (an accounts receivable or other receivable expected to be collected).

The most common method of revenue recognition is referred to as point-of-sale recognition. This is the method that you have experienced up until now, which usually includes a debit to Accounts Receivable or Cash and a credit to Sales when the merchandise is handed over or shipped. Don’t forget this method just because others are covered in this chapter as it is, by far, the most common for most companies.
LO2 – Apply the revenue recognition concepts underlying the examples used in SAB 101/104.

**Why?** Why is SAB 101/104 necessary given that criteria has already been established for revenue recognition? There are many fuzzy areas when it comes to revenue recognition. Many transactions are not black and white when it comes to meeting both of the criteria required for revenue recognition. Companies sometimes took advantage of their circumstances to book revenue earlier or book larger amounts. The SEC issued these SABs to clarify these fuzzy areas and limit revenue recognition policies that they deemed to be too aggressive.

**Why?** Don’t skip reading the details in LO2. Understanding the whys of SAB 101/104 and the underlying themes that the SEC illustrates will help enable you to be able to see when it is appropriate to record revenue in nearly any given fact pattern—even if it isn’t one specifically addressed in the Staff Accounting Bulletins gone over in this learning objective.

LO3 – Describe the two asset-and-liability approaches to revenue recognition that are currently being considered by the FASB and IASB: the customer consideration model and the measurement model.

**Why?** The focus here is a revenue recognition approach that can be used in various settings where there are situation- or industry-specific approaches. The customer consideration model uses the total transaction price as its basis of revenue recognition. The measurement model uses various seller transaction obligations as its basis of revenue recognition and can result in revenue being recognized when a contract is signed.

LO4 – Record journal entries for long-term construction-type contracts using percentage-of-completion and completed-contract methods.

**How?** Note the journal entries for percentage-of-completion and completed-contract methods are the same with the exception of the entry that debits both Cost of Long-Term Construction Contracts and Construction in Progress accounts and credits Revenue from Long-Term Construction Contracts each year. For the completed-contract method, this entry is made only in the year in which the contract is completed, and Construction in Progress does not receive a debit. Under the completed-contract method, the Construction in Progress account never “stores” a profit component associated with the project.
LO5 – Record journal entries for long-term service contracts using the proportional performance method.

**How?** Although the journal entries look a bit different (mostly because of differing account names) than those encountered in LO4, the theory behind this method is similar to the percentage-of-completion method. Revenue is recognized over the period of the contract based on the services performed, not on the timing of the cash collections.

LO6 – Explain when revenue is recognized after delivery of goods or services through installment sales, cost recovery, and cash methods.

**How?** Be very careful when performing an installment sales calculation. Students frequently get them confused with the percentage-of-completion calculations since they are covered in the same chapter. The methods couldn’t be more different. A couple of things to remember:

- Installment sales apply to sales for which the product has usually been delivered, but the payments are coming in installments, and there is uncertainty of cash collections. Contrast this with the percentage-of-completion method in which the product is being delivered in “installments” and the payments are reasonably expected to be collected.
- The installment sales method recognizes revenue based, in large part, on when cash is received. Contrast this with the percentage-of-completion method in which the calculation for revenue recognition completely ignores when cash is received.

The following sections, featuring various multiple choice questions, matching exercises, and problems, along with solutions and approaches to arriving at the solutions, is intended to develop your problem-solving and critical-thinking abilities. While learning through trial and error can be effective for improving your quiz and exam scores, and it can be a more interesting way to study than merely re-reading a chapter, that is only a secondary objective in presenting this information in this format.

The main goal of the following sections is to get you thinking, “How can I best approach this problem to arrive at the correct solution—even if I don’t know enough at this point to easily come up with the proper results?” There is not one simple approach that can be applied to all questions to arrive at the right answer. Think of the following approaches as possibilities, as tools that you can place in your problem-solving toolkit—a toolkit that should be consistently added to. Some of the tools have yet to even be created or thought of. Through practice, creative thinking, and an ever expanding knowledge base, you will be the creator of the additional tools.
Multiple Choice

MC8-1 (LO1) Revenues and gains are generally recognized when
a. cash has been received.
b. cash has been received and they have been earned through substantial completion.
c. they are realized or realizable and a contract has been signed.
d. they are realized or realizable and have been earned through substantial completion.

MC8-2 (LO2) In accounting for sales on consignment, sales revenue and the related cost of goods sold should be recognized by the
a. consignor when the goods are shipped to the consignee.
b. consignor when the consignee has sold the goods.
c. consignee when the goods are shipped to the third party.
d. consignee when cash is received from the customer.

MC8-3 (LO4) Lena Construction Company’s projects extend over several years, and collection of receivables is reasonably certain. Each project has a contract that specifies a price and the rights and obligations of all parties. Both the contractor and the customer are expected to fulfill their contractual obligations on each project. Reliable estimates can be made of the extent of progress and cost to complete each project. Which of the following methods should the company use to account for construction revenue?
   a. Installment sales method
   b. Percentage-of-completion method
   c. Completed-contract method
   d. Cost recovery method

MC8-4 (LO4) How should the balances of Progress Billings on Construction Contracts and Construction in Progress be shown at reporting dates prior to the completion of a long-term contract?
   a. Progress Billings on Construction Contracts as income, Construction in Progress as inventory.
   b. Progress Billings on Construction Contracts as deferred income, Construction in Progress as a current asset.
   c. Net—as income from construction if credit balance and loss from construction if debit balance.
   d. Net—as a current asset if debit balance and current liability if credit balance.
MC8-5 (LO4) If the percentage-of-completion method is used, what is the basis for determining the gross profit to be recognized in the second year of a three-year contract?
   a. cumulative actual costs incurred and progress billings
   b. incremental cost for the second year only
   c. cumulative actual costs and estimated costs to complete
   d. No gross profit would be recognized in year 2.

MC8-6 (LO4) Cooper Construction Company uses the completed-contract method for long-term construction contracts. The information for a specific contract as of January 1, 2011, is shown below.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Costs incurred to date</td>
<td>$ 700,000</td>
</tr>
<tr>
<td>Contract price</td>
<td>1,900,000</td>
</tr>
<tr>
<td>Estimated remaining cost to complete</td>
<td>800,000</td>
</tr>
</tbody>
</table>

Cost of $600,000 was incurred during 2011, and on December 31, 2011, the estimated remaining cost to complete was still $800,000. The correct balance for the Construction in Progress account at December 31, 2011, is
   a. $600,000.
   b. $700,000.
   c. $1,100,000.
   d. $1,300,000.

MC8-7 (LO4) COF Construction, Inc., uses the percentage-of-completion method of recognizing income. In 2011, COF started work on a $4,500,000 construction contract, which will be completed in 2012. The accounting records disclosed the following data as of the end of last year:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Progress billings</td>
<td>$1,650,000</td>
</tr>
<tr>
<td>Costs incurred (actual costs during 2011 on the contract)</td>
<td>1,350,000</td>
</tr>
<tr>
<td>Collections</td>
<td>1,050,000</td>
</tr>
<tr>
<td>Estimated cost to complete (during 2012)</td>
<td>2,700,000</td>
</tr>
</tbody>
</table>

How much income should COF have recognized on this contract in 2011?
   a. $105,000
   b. $150,000
   c. $300,000
   d. $350,000
MC8-8 (LO5) SoftSolutions enters into a service contract with Deloitte on July 1, 2011. The contract allows Deloitte to obtain technical support on their SoftSolutions software at no cost over the next three years beginning on July 1, 2011. SoftSolutions receives $10,000 on July 1, 2011, and $5,000 on July 1, 2012, under the contract agreement. How much revenue should SoftSolutions recognize for this long-term service contract for the six-month period ending December 31, 2011?

a. $0  
b. $2,500  
c. $10,000  
d. $15,000

MC8-9 (LO6) The cost recovery method is

a. used only when circumstances surrounding a sale are so uncertain that earlier recognition is impossible.  
b. the most common method of accounting for real estate sales.  
c. similar to percentage-of-completion accounting.  
d. never acceptable under generally accepted accounting principles.

MC8-10 (LO6) When using the installment sales method,

a. gross profit is deferred until all cash is received, but revenues and costs are recognized in proportion to the cash collected from the sale.  
b. gross profit is recognized only after the amount of cash collected exceeds the cost of the item sold.  
c. total revenues and costs are recognized at the point of sale, but gross profit is deferred in proportion to the cash that is uncollected from the sale.  
d. revenue, costs, and gross profit are recognized proportionally as the cash is received from the sale of product.

MC8-11 (LO6) Graven Company began operations on January 1, 2011, and uses the installment sales method of accounting. The company has the following information available for 2011 and 2012:

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Installment sales</td>
<td>$4,500,000</td>
<td>$5,500,000</td>
</tr>
<tr>
<td>Gross profit on sales</td>
<td>30%</td>
<td>40%</td>
</tr>
<tr>
<td>Cash collections on 2011 sales</td>
<td>1,500,000</td>
<td>1,600,000</td>
</tr>
<tr>
<td>Cash collections on 2012 sales</td>
<td>4,200,000</td>
<td></td>
</tr>
</tbody>
</table>

The realized gross profit for 2012 would be

a. $2,160,000.  
b. $2,200,000.  
c. $2,320,000.  
d. $5,500,000.
MC8-12 (LO6) Kerry Enterprises, which began operations on January 1, appropriately uses the installment method of accounting. The following information is available for its first year:

- Gross profit on sales: 40%
- Deferred Gross Profit account balance at December 31: $120,000
- Cash collected, including down payments: $225,000

What is the total amount of Kerry’s installment sales for the first year?

- a. $300,000
- b. $345,000
- c. $425,000
- d. $525,000
Matching

Matching 8-1 (LO1, LO2, LO3, LO4, LO5, LO6) Listed below are the terms and associated definitions from the chapter for LO1 through LO6. Match the correct definition letter with each term number.

___ 1. cash method  a. the earnings process in percentage-of-completion accounting based on units produced, contract milestones reached, or values added
___ 2. completed-contract method  b. an accounting method for recording service revenue and related expenses prior to completion of a service contract
___ 3. cost recovery method  c. the earnings process in percentage-of-completion accounting based on cost or efforts devoted to a contract
___ 4. cost-to-cost method  d. an accounting method for long-term construction contracts that recognizes revenue and related expenses prior to delivery of the goods based on either an input or output measure of the earnings process
___ 5. efforts-expended methods  e. requires recovery of the total investment prior to the recognition of revenue
___ 6. input measures  f. determine the percentage of completion for long-term construction contracts using an estimate of work or service performed based on labor hours, labor dollars, or estimates of experts
___ 7. installment sales method  g. all costs are charged to expense as incurred and revenue is recognized as collections are made
___ 8. output measures  h. the process of formally recording an item in the accounting records and eventually reporting it in the financial statements; includes both the initial recording of an item and any subsequent changes related to that item
___ 9. percentage-of-completion accounting  i. recognizes revenues and expenses on long-term construction contracts only when finished
___ 10. proportional performance method  j. determine the percentage of completion for long-term construction contracts using a ratio of the actual cost incurred to date to the estimated total costs
___ 11. recognition  k. recognizes revenue and related expenses as cash is received
Problems

Problem 8-1 (LO2) Maryann Wood recently purchased on layaway a big-screen television from Circuit City, which is a public company. Maryann paid $200 as a cash deposit on the television. The television cost Circuit City $2,000 and has a total retail price of $3,500. Circuit City has set the television aside pending the payment by Maryann Wood of the balance owed.

Circuit City does not require its customers to enter into an installment note or other fixed-payment commitment or agreement when the initial deposit is received. Merchandise on layaway generally is not released to the customer until the customer pays the full purchase price. If the customer fails to pay the remaining purchase price, the customer forfeits his or her cash deposit. In the event the merchandise is lost, damaged, or destroyed, Circuit City either must refund the cash deposit to the customer or provide replacement merchandise.

When should Circuit City recognize the revenue from the sale to Maryann?

Prepare the appropriate journal entries on Circuit City’s books to record the receipt of the cash and the subsequent delivery of the television when the remaining balance is collected. Assume that Circuit City uses the perpetual inventory method.

Problem 8-2 (LO2) MAH Incorporated segregated products costing $50,000 for shipment to its customer, NIMH Incorporated. NIMH was sent an invoice for $95,000, the normal sales price. What journal entries should MAH make to record this situation in each of the following scenarios for the current period? Assume that each case is independent of the others and that MAH uses the perpetual inventory method.

1. Typically NIMH’s purchasing agent signs a formal sales agreement as part of each purchase. The agreement is also signed by MAH’s sales manager. The segregation of goods has already happened due to a phone order. The agreement will be signed during the first week of MAH’s next accounting period.

2. The sales agreement stipulates that NIMH can receive a refund during MAH’s next accounting period if the product isn’t of suitable quality. MAH has shipped the product FOB-shipping point before the end of MAH’s accounting period. MAH cannot make a reliable estimate of the number of refunds that NIMH will request since NIMH has only been ordering from MAH for a year.

3. NIMH and MAH sign the formal sales agreement before the end of MAH’s accounting period. The goods are not delivered after segregation, but title transfers to NIMH with the signing, and NIMH is free to pick up the product at any time. If the goods are damaged at MAH’s warehouse, NIMH is now responsible.
**Problem 8-3 (LO4)** In 2011, Nelson Engineering entered into an agreement to construct an office building at a contract price of $5,500,000. Construction data were as follows:

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction costs incurred</td>
<td>$750,000</td>
<td>$2,700,000</td>
<td>$630,000</td>
</tr>
<tr>
<td>Estimated costs to complete</td>
<td>3,000,000</td>
<td>700,000</td>
<td>—</td>
</tr>
<tr>
<td>Progress billings</td>
<td>570,000</td>
<td>3,600,000</td>
<td>1,330,000</td>
</tr>
<tr>
<td>Collections from client</td>
<td>450,000</td>
<td>3,300,000</td>
<td>1,750,000</td>
</tr>
</tbody>
</table>

Prepare the necessary journal entries for each year, assuming Nelson Engineering uses the (1) completed-contract method and the (2) percentage-of-completion method.

**Problem 8-4 (LO6)** Rupert Corporation sells merchandise on an installment basis, and the uncertainties of cash collection make the use of the installment sales method of accounting acceptable. The following data relate to two years of operations:

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Installment sales</td>
<td>$480,000</td>
<td>$560,000</td>
</tr>
<tr>
<td>Cost of installment sales</td>
<td>300,000</td>
<td>364,000</td>
</tr>
<tr>
<td>Cash collections:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011 sales</td>
<td>200,000</td>
<td>210,000</td>
</tr>
<tr>
<td>2012 sales</td>
<td>—</td>
<td>235,000</td>
</tr>
</tbody>
</table>

1. Record the transactions related to installment sales for 2011 and 2012.
2. Assume, instead, that the circumstances surrounding the sales are so uncertain that the cost recovery method must be used. Record the transactions related to the sales for 2011 and 2012 under the cost recovery method.

**Solutions, Approaches, and Explanations**

**MC8-1**

Answer: d

Approach and explanation: This one should be easy for you since it was gone over in Chapter 4 and reiterated numerous times throughout the chapter. If this question wasn’t easy for you, then review the first How? on page 8-2 for starters.

Cash receipt does not usually equal revenue recognition. Get that out of your head if you picked choices **a** or **b**. On the accrual basis, cash receipt, for many businesses, will seldom coincide with revenue recognition. And revenue recognition is assumed to be on the accrual basis.
As far as the second prong of the revenue recognition test goes, signing a contract is usually not good enough. The product needs to be handed over or shipped (title and economic ownership need to transfer to the buyer for prong number two), or in the case of services, the services need to have been performed. This is the substantial completion criteria.

**MC8-2**

Answer: b

Approach and explanation: The SEC’s answer to Question 2 in *SAB 101* indicates that choice a is unacceptable. Question 10, although not directly dealing with consignment sales per se, basically states that the consignee should not be the party to recognize sales revenue and cost of goods sold. To do so doesn’t accurately reflect the fact that they didn’t own the product they were selling.

The consignee should be using the “net method” and only reporting on their income statement the commission they received for selling the product. The consignor is the party that uses the gross method but not until the consignee sells the goods. Merely transferring the goods to the consignee doesn’t constitute a sale since the consignee isn’t a customer and isn’t taking economic or legal title to the goods; they can return them to the consignor at any time.

**MC8-3**

Answer: b

Approach and explanation: Before selecting the correct choice, you can safely eliminate two of the choices when it comes to questions like these for this chapter. Think of this technique as using your 50:50 “lifeline” (from the TV show *Who Wants to Be a Millionaire*).

If the question describes a project that will be completed over time, then you are going to be choosing between the percentage-of-completion and completed-contract methods. If the question, instead, describes a product being sold or a service being performed and then cash collections coming later in a series of payments, then you are going to be choosing between the installment sales and cost recovery methods.

These are two fundamentally different kinds of transactions. Review the *How?* on page 8-3 for further clarification. You will never be choosing between using, say, the percentage-of-completion method and installment sales method on a single kind of transaction. The percentage-of-completion method goes with the completed-contract method, and one or the other will apply to a project to be completed over time. The installment sales method goes with the cost recovery method, and one or the other will likely apply to a completed sale in which payments will be received over time.

In this case, we are dealing with contracts that are to be completed over time, so we can safely eliminate choices a and d with our 50:50 “lifeline.” You must now determine whether the percentage-of-completion method can be used. If it cannot be used, then choice c would be the correct answer.
In the AICPA’s *Statement of Position 81-1*, there are four elements that should exist if the percentage-of-completion method is to be used. In this case, all four are present, so the percentage-of-completion method should be the means by which revenue is recognized.

**MC8-4**

Answer: d

Approach and explanation: Think of these account names not as arbitrarily assigned words but as descriptions of what they represent. Construction in Progress is a description for what has been built by the construction company so far (and a portion of the profit that will eventually be realized). That amount is an asset to the construction company since the buyer usually doesn’t obtain title until the project is complete. (So Construction in Progress as inventory or as a current asset as given in choices a and b aren’t incorrect ways to think about it really.)

But at the same time, the construction company is crediting an account called Progress Billings on Construction Contracts every time they bill the buyer (with the other side of the entry being a debit to Accounts Receivable as always). So what this Progress Billings on Construction Contracts account really represents is that the construction company has a liability associated with the project. The liability is essentially that the property has been billed for and will eventually be turned over to the buyer. Hence, the construction company should not show two assets of Accounts Receivable and Construction in Progress without any corresponding liability. Therefore, think of Progress Billings on Construction Contracts as the construction company handing over the Construction in Progress or as a contra-Construction in Progress account.

If the construction company has built more than it has billed for, it has a net asset. If the construction company has, on the other hand, billed for more than it has built, then it has an obligation to continue building. Hence, it has a net liability. Since the building and billings are ongoing, they should be considered current. After all, the buyer probably isn’t going to be happy if the construction company takes a year off from the project!

With respect to the choices provided to this question, the key thing to keep in mind is that Progress Billings on Construction Contracts are not income or deferred income. Again, the collection of cash, or mere billings, on a construction project is not the triggering event, or even considered, when accounting for revenue/income recognition using the percentage-of-completion or completed-contract methods.

**MC8-5**

Answer: c

Approach and explanation: As the name of the method suggests, when using the percentage-of-completion method, the revenue recognition is based on how much of the project is complete. Therefore, to do the calculation, one needs to know the contract price/revenue on the project (not the billings), the cumulative actual costs, and the estimated costs in the future.
For example, if the estimated costs to complete are $1,000,000, the cumulative actual costs were $4,000,000, and the contract price was for $7,000,000, then the percentage complete is 80 percent \([\frac{4,000,000}{4,000,000 + 1,000,000}]\). Therefore, 80 percent of the gross profit, or $1,600,000 \([\frac{(7,000,000 – 5,000,000) \times 0.80}{1,600,000}]\) should be recognized by year two. If $1,000,000 was already recognized in year one, then $600,000 \([1,600,000 – 1,000,000]\) should be recognized in year two. If the estimated costs don’t change in the final year and become actual costs, then the final $400,000 of gross profit will be recognized in year three for this example.

What if the question was changed to read like the following:

“If the completed-contract method is used, what is the basis for determining the gross profit to be recognized in the second year of a three-year contract?”

Then the correct answer would change to choice \(d\) since all of the profit is recognized in year three on a three-year contract under the completed-contract method.

**MC8-6**

**Answer:** c

**Approach and explanation:** There are two things that you need to be very alert to when doing a percentage-of-completion or completed-contract calculation—dates and contract losses. If you miss either, you will likely answer incorrectly.

Always check to see if the contract has entered into a loss situation. In this case, you are given a hint with the word “still,” which hopefully caused you to calculate the profit or loss as of the end of 2011 even if you weren’t going to previously. A quick and dirty calculation \([\frac{(1,900,000 – 700,000 – 600,000 – 800,000 = (200,000)}{1,900,000}]\) shows that costs are expected to exceed the contract price as of the end of 2011. That means that the Construction in Progress account isn’t going to be as simple as just adding up the costs (or the costs plus the profit if this were a percentage-of-completion scenario).

Using the format provided in the textbook, a T-account of the situation looks like the following:

<table>
<thead>
<tr>
<th>Construction in Progress</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/1/11 balance</td>
</tr>
<tr>
<td>2011 costs</td>
</tr>
<tr>
<td>2011 loss</td>
</tr>
<tr>
<td>Balance</td>
</tr>
</tbody>
</table>
Amazingly enough, if the question was changed to read “Cooper Construction Company uses the percentage-of-completion method…” instead of “Cooper Construction Company uses the completed-contract method…,” the correct answer would not change. Choice c would still be correct. The 2011 loss would be larger since profit was recognized in 2010 under the percentage-of-completion method, but the larger loss would merely wipe out the prior profit component that went into the Construction in Progress account under the percentage-of-completion method.

Why would anyone choose choices a or b you may ask? That gets back to the other point about reading the dates correctly. Someone who wasn’t careful might not realize that there was two years’ worth of components going into the debit side of the Construction in Progress account. If they missed one of the costs, it wouldn’t be a loss situation, and the full amount (of $600,000 or $700,000, depending on which date they missed) would be the balance in the Construction in Progress account. If the contract appears to be profitable, Construction in Progress won’t receive any credits before the project is complete and turned over to the buyer.

**MC8-7**
Answer: b
Approach and explanation: Much of the information provided is not needed for the calculation. Progress billings and collections are irrelevant when performing a calculation on income determination under the percentage-of-completion method. So what is needed?

**Step 1:** Compute the expected total profit on the contract as follows:

\[
\text{Contract revenue} \quad \$4,500,000 \\
- \text{Actual costs to date} \quad (1,350,000) \\
- \text{Estimated cost to complete} \quad (2,700,000) \\
= \text{Expected total profit} \quad \$450,000
\]

**Step 2:** Compute the percentage of the project completed as follows:

\[
\frac{\text{Costs incurred}}{\text{Total expected costs}} = \frac{1,350,000}{1,350,000 + 2,700,000} = 33.33\%
\]

**Step 3:** Compute the amount of income to be reported to date as follows:

\[
\begin{align*}
\text{Expected total profit} \quad &\quad \$450,000 \\
\times \text{Percentage of project completed} \quad &\quad 33.33\% \\
= \text{Income to be reported to date} \quad &\quad \$150,000 \\
- \text{Profit previously recognized} \quad &\quad 0 \\
= \text{Income to be recognized} \quad &\quad \$150,000
\end{align*}
\]
Assuming the estimated cost to complete is accurate and the actual costs in 2012 turn out to be $2,700,000, then choice \( c \) becomes the correct answer were the question asking for the amount of income to be recognized on the contract in 2012.

Choice \( d \) becomes the correct answer were the question asking for the amount of income to be recognized on the contract in 2012 and the actual costs in the current year turn out to be $2,650,000.

Choice \( a \) becomes the correct answer were the question asking for the amount of income to be recognized on the contract in 2012 and the actual costs in 2012 turn out to be $2,895,000.

**MC8-8**

Answer: \( b \)

Approach and explanation: So far in this chapter, have cash receipts been a factor in revenue recognition calculations? Well, things don’t change here. Cash collected doesn’t equal revenue to be recognized in this situation either. However, in Learning Objective 6, cash collected will finally become a part of the calculation.

So how is revenue recognized for long-term service contracts? To the extent that specific products aren’t being provided during the term of the contract, the revenue should be recognized equally over the time period the contract covers. Therefore, SoftSolutions should recognize the $15,000 over 36 months, or $416.67 ($15,000/36) per month. For the first six months, this equals $2,500.

If, instead, SoftSolutions was providing, say, a product upgrade at the end of three years that could be purchased under this same payment plan, then choice \( a \) would be correct and the full $15,000 should not be recognized until 2014.

If, instead, SoftSolutions was providing, say, a product upgrade now in addition to the technical support that could be purchased under this same payment plan and costs other customers $5,000 for the product upgrade by itself, then $5,000 should be recognized right now; the remaining $10,000 would then be recognized on a straight-line basis over the three years.

This method is similar to the percentage-of-completion method. As a product is being provided, revenue should be recognized. Cash collection can come at the same time, before, or after and has no impact on revenue recognition (other than the ever-present point that collection must be reasonably assured).

**MC8-9**

Answer: \( a \)

Approach and explanation: The cost recovery method is a rarely, if ever, used method for most businesses. That doesn’t mean that it isn’t acceptable under GAAP, given the right circumstances. In fact, in certain situations, GAAP would require its use.
One example may be a used car dealer that extends credit to high-credit risk individuals and turns over the vehicle and title to the “purchaser” even when payment is highly uncertain. If the purchaser stops making payments, the used car dealer can’t get the car back, and the risk of this situation is such that the company probably shouldn’t record any revenue until its costs are covered.

This method is not similar to the percentage-of-completion method. It wouldn’t apply to the same kinds of transactions, nor is the accounting similar (since under the percentage-of-completion method, revenue is recognized before all the costs are covered).

Choice b would be the correct choice if the question was changed from “cost recovery” to “installment sales” (assuming the real estate sales were being paid for over time and not in cash at the time of the title transfer).

What would you say to a choice that said, “similar to completed-contract accounting”? The only similarity there is that both methods usually back-end load the revenue recognition. The accounting would happen for different kinds of transactions, however; the cost recovery method doesn’t necessarily defer all of the revenue to the “last year” (or what would be the final payment for a transaction that fell under cost recovery). Also, the cost recovery method is based on cash collections, whereas the completed-contract method is based on finishing the work—not cash collections. So, overall, the two methods aren’t actually very similar. The cost recovery method is tied more closely to the installment sales method than construction-related methods.

MC8-10
Answer: c
Approach and explanation: To get this question correct, it is important to know what the journal entries are on an installment sale. Without that knowledge, this question can turn into a coin flip.

Choice a is incorrect all around. Gross profit isn’t deferred until all cash is received under the installment sales method. It isn’t even necessarily true if the cost recovery method is being used. *Revenues and costs are going to be recognized initially regardless of whether the point-of-sale, installment sales, or cost recovery method is being used. Part of the reason is that without recognizing them at the outset of the transaction, the receivable couldn’t be set up, nor could the inventory be taken off the books.*

Choice b would be correct if we were talking about the cost recovery method. It isn’t true for the installment sales method.
Choice $d$ is the most difficult one to discriminate against and may be the other side of the coin flip with choice $c$ for some students. However, it is incorrect for the italicized reason given in the explanation for choice $a$—revenues and costs are recognized immediately with the installment sales method. What then happens with the installment sales method is that the difference between the two is deferred, usually through an adjusting entry, so that gross profit is only realized to the extent that cash is received.

**MC8-11**

Answer: a

Approach and explanation: In 2011, the amount of gross profit realized would be $450,000 ($1,500,000 × 0.30), which means that there is still another $900,000 to be realized in later years as the cash is collected.

In 2012, $480,000 of the 2011 sales should be recognized as gross profit ($1,600,000 × 0.30). The percentages stay with the sales that created them. In addition, $1,680,000 of gross profit should be recognized with respect to sales originating in 2012 ($4,200,000 × 0.40). The remaining $520,000 \([($5,500,000 \times 0.40) – $1,680,000]\) of profit will be recognized in future years as the cash associated with 2012 sales is collected. Therefore, the total realized gross profit for 2012 is $2,160,000 ($480,000 + $1,680,000).

Choice $b$ incorrectly applies the 40 percent to the total installment sales for 2012. This number is the correct amount of initially deferred gross profit (assuming the first installment didn’t happen on the day the product was sold) for 2012 sales but is not the realized gross profit for 2012.

Choice $c$ incorrectly applies the 40 percent to the total cash collections for 2012. Since some of the collections were for 2011 sales, this number would only be correct if the gross profit on sales in 2011 was also 40 percent.

Choice $d$ is the installment sales revenue for 2012. Revenue and realized gross profit are not the same thing.

**MC8-12**

Answer: d

Approach and explanation: There are a couple of ways to solve this question since it is in a multiple choice format. The slower way, but the only way that may work if you can’t figure out how to back into the answer more efficiently, is to use all of the choices as your starting point and see if any of them work.

For instance, if the installment sales for the first year were $300,000 (choice $a$) and Kerry collected $225,000 of those sales, then the difference, or $75,000, would still need to be collected. If the gross profit percentage is 40 percent, then the balance in the Deferred Gross Profit account should be $30,000 ($75,000 × 0.40). Since the balance is actually $120,000, you know that choice $a$ is incorrect.
You could proceed to do the same calculation for each of the choices until you came up with \((525,000 - 225,000) \times 0.40 = 120,000\) for choice \(d\), at which point you would have discovered the correct answer. (By no means should you run the calculation for only three of the choices and then assume, since none of them fit, that the fourth choice must be the correct one. Always check yourself to be certain of your answer if you have the time.)

Instead of a trial-and-error approach, which would prove to be extremely time-consuming were this to be an open-ended problem instead of a multiple choice question, you could have done the following:

The balance in the Deferred Gross Profit account divided by the gross profit percentage \((120,000/0.40 = 300,000)\) equals the amount of sales that took place, which have yet to be collected. (Therefore, choice \(a\) would have been correct had the question, instead, asked for the “total amount of Kerry’s uncollected installment sales for the first year.”) That amount plus the actual cash collections must equal the total amount of installment sales for the year or \((300,000 + 225,000 = 525,000)\).

**Matching 8-1**

1. g  
2. i  
3. e  
4. j  
5. f  
6. c  
7. k  
8. a  
9. d  
10. b  
11. h

Complete these terminology matching exercises without looking back at the textbook or on to the glossary. After all, you probably won’t have those as a reference at test time. Learning through trial and error causes the item to be learned better and to stick in your memory longer than if you just look at the textbook, glossary, or a dictionary and “cook book” the answers. Sure you may get the answer correct on your first attempt, but missing something is sometimes best for retention. Don’t be afraid of failure while studying and practicing.
Problem 8-1
Circuit City is a public company subject to the provisions of *Staff Accounting Bulletin 101*. Circuit City retains custody of the goods as well as legal title to the goods until the entire selling price is paid by the customer and the television is delivered to the customer. *SAB 101* states that revenue from sales made under a layaway program should be recognized only upon the delivery of the merchandise to the customer. Until then, the amount of cash received should be recognized as a liability entitled something like “Deposits Received from Customers for Layaway Sales.” Circuit City retains the risks of ownership of the merchandise, receives only a cash deposit from the customer, and does not have an enforceable right to the remainder of the purchase price. Accordingly, revenue should not be recorded upon the receipt of the cash deposit.

The journal entries to record the receipt of the cash and the subsequent delivery of the television upon collection of the balance due are as follows:

Cash  200  

Deposits Received from Customers from Layaway Sales  200  

*To record receipt of $200 cash deposit.*

Cash  3,300  

Deposits Received from Customers from Layaway Sales  200  

Sales  3,500  

*To record receipt of final cash payment and the delivery of the merchandise to the customer.*

Cost of Goods Sold  2,000  

Inventory  2,000  

*To reduce inventory and recognize cost of merchandise sold.*
Problem 8-2
The answers all flow from *SAB 101/104*. Be sure to read each of the SEC’s questions in the chapter and understand that the SEC’s answer to each was “no.” Also realize that even if a customer is billed with an invoice, a company can’t record an account receivable, as there is no corresponding credit entry. The accounts receivable can only be created with the recognition of revenue.

1. This is essentially *SAB 101*, Question 1. Therefore, the answer is no, and no entry should be recorded by MAH in the current accounting period. In addition, legal title would need to transfer to NIMH as mentioned in *SAB 101*, Question 3.

2. This is very similar to *SAB 101*, Question 7. Therefore, the answer is no, and no entry should be recorded by MAH in the current accounting period. Revenue could be recognized if MAH can make a reliable estimate of the number of refunds that NIMH will request. *SAB 101* indicates that these reliable estimates are possible only under the following limited circumstances:
   - The seller has been entering into these transactions long enough (at least two years) to have built up sufficient historical data on which to base the estimate.
   - The estimate is made based on a large pool of transactions that are essentially the same.
   - Past estimates have not been materially different from actual experience.

3. Since title has transferred before the end of MAH’s accounting period and NIMH is economically responsible for the product, MAH can record the revenue in the current period even though they are still warehousing the product for NIMH. The journal entry would be as follows:

   - Accounts Receivable 95,000
   - Cost of Goods Sold 50,000
   - Sales 95,000
   - Inventory 50,000

Problem 8-3
A few things to keep in mind:

- Follow the steps outlined in the explanation to *MC8-7* to perform the calculations for the percentage-of-completion method.

- The journal entries are very similar for the two methods. In fact, most of them (the first three for each year) are exactly the same.

- The ordering of the journal entries doesn’t really matter, but if you think about what would happen in real life, you may be able to put them in the logical order and not accidentally miss any. Generally, a company builds, then bills, then collects, and it isn’t until the end of the period that the amount of revenue to recognize can be computed.
If you can’t remember the final entry, think of what accounts you have established through this process and what might need to happen to them. (You’ve set up Construction in Progress and Progress Billings on Construction Contracts, and it makes no sense to retain these accounts on this project after the project is completed.)

(1) Completed-contract method:

<table>
<thead>
<tr>
<th>Year</th>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>Construction in Progress</td>
<td>750,000</td>
</tr>
<tr>
<td></td>
<td>Materials, Cash, etc.</td>
<td>750,000</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td>570,000</td>
</tr>
<tr>
<td></td>
<td>Progress Billings on Contracts</td>
<td>570,000</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>450,000</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td>450,000</td>
</tr>
</tbody>
</table>

No revenue is recognized under the completed-contract method until the project is completed.

<table>
<thead>
<tr>
<th>Year</th>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>Construction in Progress</td>
<td>2,700,000</td>
</tr>
<tr>
<td></td>
<td>Materials, Cash, etc.</td>
<td>2,700,000</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td>3,600,000</td>
</tr>
<tr>
<td></td>
<td>Progress Billings on Contracts</td>
<td>3,600,000</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>3,300,000</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td>3,300,000</td>
</tr>
</tbody>
</table>

No revenue is recognized under the completed-contract method until the project is completed.
2013
Construction in Progress  630,000
Materials, Cash, etc.  630,000

Accounts Receivable  1,330,000
Progress Billings on Construction Contracts  1,330,000

Cash  1,750,000
Accounts Receivable  1,750,000

Progress Billings on Construction Contracts  5,500,000
Revenue from Long-Term Construction Contracts  5,500,000

Cost of Long-Term Construction Contracts  4,080,000
Construction in Progress  4,080,000

(2) Percentage-of-completion method:

2011
Construction in Progress  750,000
Materials, Cash, etc.  750,000

Accounts Receivable  570,000
Progress Billings on Construction Contracts  570,000

Cash  450,000
Accounts Receivable  450,000

Cost of Long-Term Construction Contracts  750,000
Construction in Progress  350,000*
Revenue from Long-Term Construction Contracts  1,100,000

*$750,000/($750,000 + $3,000,000) × ($5,500,000 – $750,000 – $3,000,000) – $0 = $350,000
### 2012

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction in Progress</td>
<td>2,700,000</td>
</tr>
<tr>
<td>Materials, Cash, etc.</td>
<td>2,700,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>3,600,000</td>
</tr>
<tr>
<td>Progress Billings on Construction Contracts</td>
<td>3,600,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>3,300,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>3,300,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Long-Term Construction Contracts</td>
<td>2,700,000</td>
</tr>
<tr>
<td>Construction in Progress</td>
<td>772,289*</td>
</tr>
</tbody>
</table>

$772,289 = \frac{(750,000 + 2,700,000)}{(750,000 + 2,700,000 + 700,000)} \times (5,500,000 - 750,000 - 2,700,000 - 700,000) - 350,000$

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue from Long-Term Construction Contracts</td>
<td>3,472,289</td>
</tr>
</tbody>
</table>

### 2013

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction in Progress</td>
<td>630,000</td>
</tr>
<tr>
<td>Materials, Cash, etc.</td>
<td>630,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>1,330,000</td>
</tr>
<tr>
<td>Progress Billings on Construction Contracts</td>
<td>1,330,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>1,750,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>1,750,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Long-Term Construction Contracts</td>
<td>630,000</td>
</tr>
<tr>
<td>Construction in Progress</td>
<td>297,711*</td>
</tr>
</tbody>
</table>

$297,711 = \frac{(750,000 + 2,700,000 + 630,000)}{(750,000 + 2,700,000 + 630,000)} \times (5,500,000 - 750,000 - 2,700,000 - 630,000) - 772,289 - 350,000$

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue from Long-Term Construction Contracts</td>
<td>927,711</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Progress Billings on Construction Contracts</td>
<td>5,500,000</td>
</tr>
<tr>
<td>Construction in Progress</td>
<td>5,500,000</td>
</tr>
</tbody>
</table>
**Problem 8-4**

A couple of things to keep in mind:

- The explanation to **MC8-10** shows examples of the journal entries and calculations required to come up with the final entry each year.

- The journal entries are very similar for the two methods. In fact, most of them (the first four for each year) are exactly the same.

1. Installment sales method:

<table>
<thead>
<tr>
<th>2011</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Installment Accounts Receivable—2011</td>
<td>480,000</td>
</tr>
<tr>
<td>Installment Sales</td>
<td>480,000</td>
</tr>
<tr>
<td>Cost of Installment Sales</td>
<td>300,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>300,000</td>
</tr>
<tr>
<td>Cash</td>
<td>200,000</td>
</tr>
<tr>
<td>Installment Accounts Receivable—2011</td>
<td>200,000</td>
</tr>
<tr>
<td>Installment Sales</td>
<td>480,000</td>
</tr>
<tr>
<td>Cost of Installment Sales</td>
<td>300,000</td>
</tr>
<tr>
<td>Deferred Gross Profit—2011</td>
<td>180,000</td>
</tr>
<tr>
<td>Deferred Gross Profit—2011</td>
<td>75,000</td>
</tr>
<tr>
<td>Realized Gross Profit on Installment Sales</td>
<td>75,000*</td>
</tr>
</tbody>
</table>

\[ \text{Realized Gross Profit on Installment Sales} = \frac{(480,000 - 300,000)}{480,000} \times 200,000 = 75,000 \]
2012

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Installment Accounts Receivable—2012</td>
<td>560,000</td>
</tr>
<tr>
<td>Installment Sales</td>
<td>560,000</td>
</tr>
<tr>
<td>Cost of Installment Sales</td>
<td>364,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>364,000</td>
</tr>
<tr>
<td>Cash</td>
<td>445,000</td>
</tr>
<tr>
<td>Installment Accounts Receivable—2011</td>
<td>210,000</td>
</tr>
<tr>
<td>Installment Accounts Receivable—2012</td>
<td>235,000</td>
</tr>
<tr>
<td>Installment Sales</td>
<td>560,000</td>
</tr>
<tr>
<td>Cost of Installment Sales</td>
<td>364,000</td>
</tr>
<tr>
<td>Deferred Gross Profit—2012</td>
<td>196,000</td>
</tr>
<tr>
<td>Deferred Gross Profit—2011</td>
<td>78,750*</td>
</tr>
<tr>
<td>Deferred Gross Profit—2012</td>
<td>82,250**</td>
</tr>
<tr>
<td>Realized Gross Profit on Installment Sales</td>
<td>161,000</td>
</tr>
</tbody>
</table>

\[
* \frac{480,000 - 300,000}{480,000} \times 210,000 = 78,750 \\
** \frac{560,000 - 364,000}{560,000} \times 235,000 = 82,250
\]

2. Cost recovery method:

2011

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Installment Accounts Receivable—2011</td>
<td>480,000</td>
</tr>
<tr>
<td>Installment Sales</td>
<td>480,000</td>
</tr>
<tr>
<td>Cost of Installment Sales</td>
<td>300,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>300,000</td>
</tr>
<tr>
<td>Cash</td>
<td>200,000</td>
</tr>
<tr>
<td>Installment Accounts Receivable—2011</td>
<td>200,000</td>
</tr>
<tr>
<td>Installment Sales</td>
<td>480,000</td>
</tr>
<tr>
<td>Cost of Installment Sales</td>
<td>300,000</td>
</tr>
<tr>
<td>Deferred Gross Profit—2011</td>
<td>180,000</td>
</tr>
</tbody>
</table>

No profit is realized in 2011 under the cost recovery method.
2012
Installment Accounts Receivable—2012 560,000
  Installment Sales 560,000
Cost of Installment Sales 364,000
  Inventory 364,000
Cash 445,000
  Installment Accounts Receivable—2011 210,000
  Installment Accounts Receivable—2012 235,000
Installment Sales 560,000
  Cost of Installment Sales 364,000
  Deferred Gross Profit—2012 196,000
Deferred Gross Profit—2011 110,000*
  Realized Gross Profit on Installment Sales 110,000

*($200,000 + $210,000) – $300,000 = $110,000

Note that at the end of 2012, another $70,000 of gross profit remains to be realized on the 2011 sales. Every dollar that comes in for 2011 will be recognized as gross profit as well.

After another $129,000 is collected on the 2012 sales, each remaining dollar collected will be recognized as gross profit.

Glossary

Note that Appendix C in the rear portion of the textbook contains a comprehensive glossary for all of the terms used in the textbook. That is the place to turn to if you need to look up a word but don’t know which chapter(s) it appeared in. The glossary below is identical with one major exception: It contains only those terms used in Chapter 8. This abbreviated glossary can prove quite useful when reviewing a chapter, when studying for a quiz for a particular chapter, or when studying for an exam which covers only a few chapters including this one. Use it in those instances instead of wading through the 19 pages of comprehensive glossary in the textbook trying to pick out just those words that were used in this chapter.

cash method  The method of accounting under which all costs are charged to expense as incurred and revenue is recognized as collections are made.
completed-contract method  An accounting method that recognizes revenues and expenses on long-term construction contracts only when completed.

cost recovery method  A revenue recognition method that requires recovery of the total cost (investment) prior to the recognition of revenue.

cost-to-cost method  A method for determining the percentage of completion for long-term construction contracts using a ratio of the actual cost incurred to date to the estimated total costs.

customer consideration model  An asset-and-liability model that uses the total transaction price as the anchor point to be used in estimating the fair value of the various obligations the seller bears in the transaction.

efforts-expended methods  Methods for determining the percentage of completion for long-term construction contracts using an estimate of work or service performed. The estimates may be based on labor hours, labor dollars, or estimates of experts.

input measures  Measures of the earnings process in percentage-of-completion accounting based on cost or efforts devoted to a contract.

installment sales method  A revenue recognition method that recognizes revenue and related expenses as cash is received.

measurement model  An asset-and-liability model in which the fair values of the performance obligation liabilities created at a contract signing are estimated directly rather than through a process of allocation of the contract price as in the customer consideration model.

output measures  Measures of the earnings process in percentage-of-completion accounting based on units produced, contract milestones reached, or values added.

percentage-of-completion accounting  An accounting method for long-term construction contracts that recognizes revenue and related expenses prior to delivery of the goods. Recognition is based on either an input or output measure of the earning process.

proportional performance method  An accounting method for recording service revenue and related expenses prior to completion of a service contract.

recognition  The process of formally recording an item in the accounting records and eventually reporting it in the financial statements; includes both the initial recording of an item and any subsequent changes related to that item.