

Session 2
May 15, 2014

The BASICS of Construction Accounting

*An Introduction to Construction Accounting
& Financial Management Principles*

Presented by
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Session 2 Agenda:

- I. Section 4 – Job Cost Reporting
- II. Section 5 – Revenue Recognition

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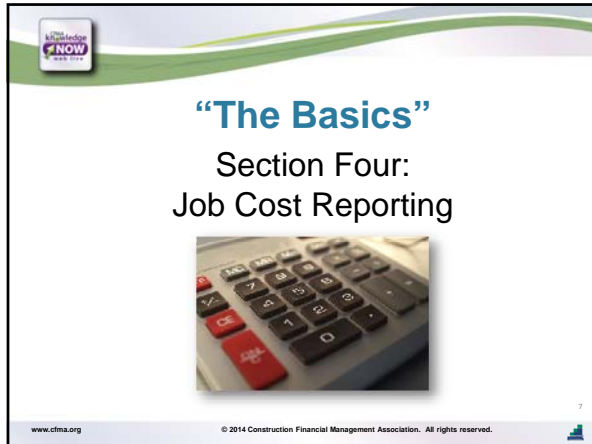


Last week in Review


- Important Terms
 - WIP – Work In Process Schedule
 - PCM – Percentage of Completion Method
 - BIEC – Billings In Excess of Costs and Estimated Earnings
 - CIEB – Costs & Estimated Earnings in Excess of Billings

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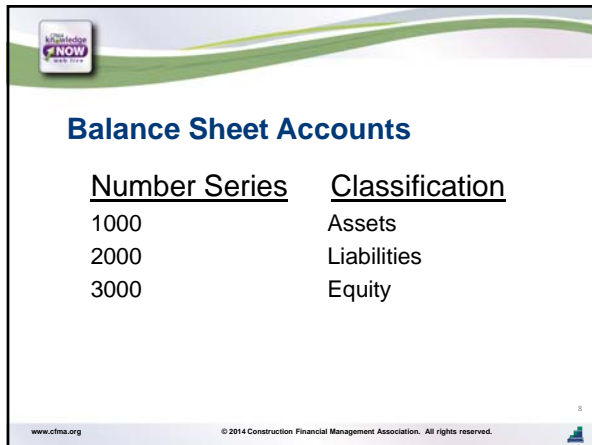




“The Basics”
Section Four:
Job Cost Reporting



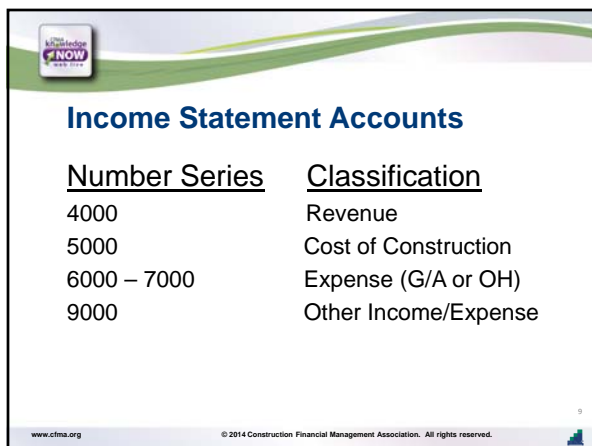
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Balance Sheet Accounts

<u>Number Series</u>	<u>Classification</u>
1000	Assets
2000	Liabilities
3000	Equity

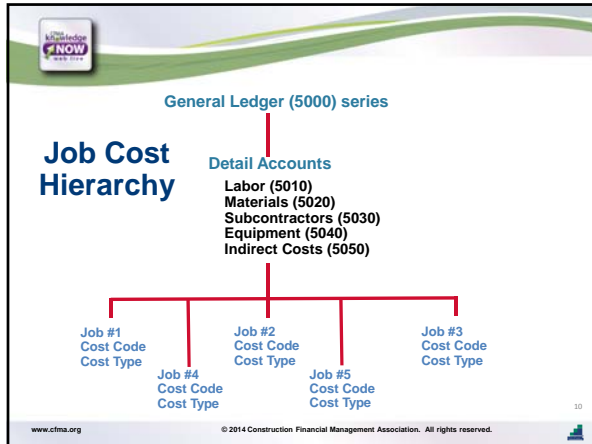
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Income Statement Accounts

<u>Number Series</u>	<u>Classification</u>
4000	Revenue
5000	Cost of Construction
6000 – 7000	Expense (G/A or OH)
9000	Other Income/Expense

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Job Costing

- The job cost reporting system is used by the Estimators, Project Managers, and the Accounting Department
- IMPORTANT to agree on a consistent method of coding for your company.
- Adopting Industry Standards – CSI and NAHB


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The Job Cost System

- What Is It?
- Who Uses It?
- Why Is It Important for Contractors?



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Job Cost System Objectives


For Management Accountants –

- Provide useful information to decision makers

For Project Management –

- A risk management tool

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Polling Question #1:

Who uses Your Job Cost Reports?

- a) Internal Only: Project Managers/Upper Management
- b) Internal and External: Owners, Bankers, etc.
- c) Who Doesn't?
- d) What's a job cost report again?


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Users of Job Cost Reports

- Project Management (primary)
- Top Management (important)
- Estimator (if proactive)
- Management Accountant (analysis)
- External Financial Execs (rare)
- Customers – cost-plus auditing


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Factors in Cost Accumulation

- Size and type of contractor
- Contract type
- Owners
- Bid format
- Accounting rules
- Management Attitude - KISS principle


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Critical Work Activity Measures

- Identifiable phases of work
- Specific work tasks or packages
- Quantities of materials installed
- Labor hours expended by task

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Polling Question #2:

What information is most important to collect in your job cost system?

- a) Hours
- b) Dollars spent
- c) Quantities of materials installed
- d) Equipment hours used


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Components of Job Cost Report


- Original Estimate
- Actual Cost to Date
- Cost to Complete
- Costs at Completion
- Over/Underruns (variances)

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Construction Costs Include

- Direct Job Costs
- Indirect Job Costs (charged to job)
- Indirect Costs (classified as contract costs but may not be allocated to job)



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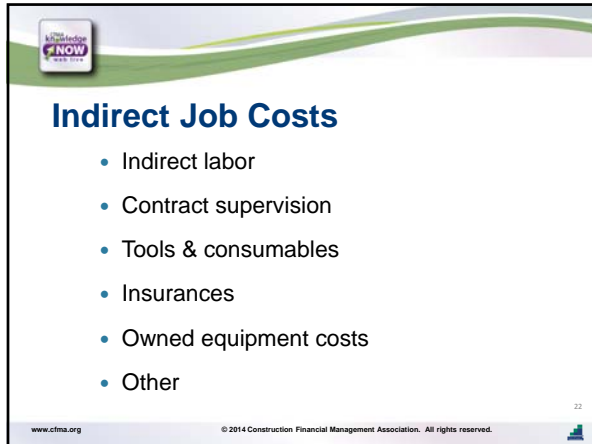


Direct Job Costs

- Material
- Labor
- Subcontractors
- Equipment (rentals & installed)
- Other



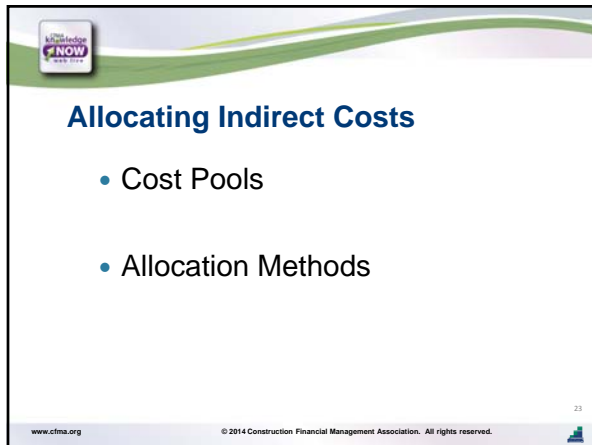
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Indirect Job Costs

- Indirect labor
- Contract supervision
- Tools & consumables
- Insurances
- Owned equipment costs
- Other

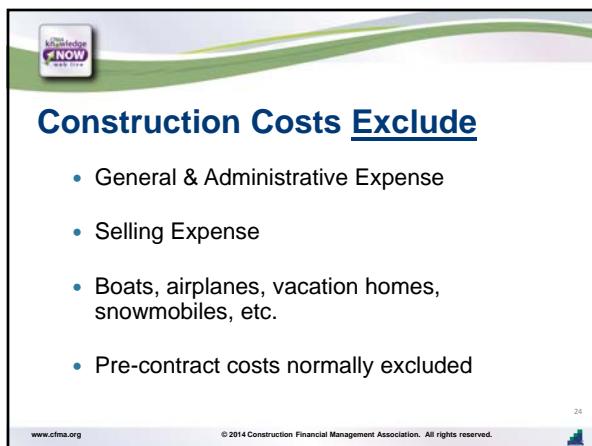
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Allocating Indirect Costs

- Cost Pools
- Allocation Methods


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Construction Costs Exclude

- General & Administrative Expense
- Selling Expense
- Boats, airplanes, vacation homes, snowmobiles, etc.
- Pre-contract costs normally excluded


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Construction Costs vs. Overhead

- Does the cost relate to the performance of a particular job in progress?
- Does the cost relate to the contractor's construction activities?


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Workbook References 3,4,5


- [TAB-3: Job Cost Summary & Detail](#)
- [TAB-4: Cost Type Identification & Allocation Chart](#)
- [TAB-5: Job Cost Chart](#)

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"The Basics"

Section Five:
Revenue Recognition




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Revenue Recognition Topics

- Bodies of knowledge available:
 - ARB No. 45 and ASC 605-35
 - “The Book” – Chapter 4
- WIP
- Unique attribute of contractor financials


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Computing Percent Complete

- Percentage-of-Completion (PCM) (cost-to-cost method)
- CTD/CTD + CTC - AKA Estimated Costs = % Complete
- % Complete X Contract Value = Earned Revenue
- Earned Revenue – CTD = Earned Profit
- Calculation remains the same no matter the units: Labor Hours or Dollars or Units of Production

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Earned Revenue Example

Example: Contract Value	\$ 1,200,000
Estimated cost	<u>1,000,000</u>
Estimated Gross profit	200,000
Costs incurred to date	500,000
% Complete	50%
Earned Revenue (50%)	600,000
Less Costs Incurred to Date	<u>(500,000)</u>
Earned Gross Profit	100,000


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Contract Value Includes

- Basic Contract Value
- Contract Options and Additions +/-
- Change Orders +/-
- Claims +/-
- Incentive/Penalty Provisions +/-


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Estimating Costs to Complete

- How important is this step?
 - Inverse relationship
- Key test of Project Manager's Foresight
- Key attribute of reliable Job Cost Management System
- An art, not a science


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Estimating Costs to Complete (con't)

- Basis of WIP # is a cost system
- Requires regular, periodic comparisons to budgeted costs
- Computed differently @ cost code level (yes?)
- Reflect all costs associated with performance of contract?


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WIP Components

- Percentage-of-Completion
Cost-to-Cost Method
 - Total Contract Value
 - Costs Incurred to Date
 - Estimated Costs @ Completion
- What's 4th component?

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EARNED REVENUE – BILLINGS = CIEB or (BIEC)

Example: Contract Value	\$ 1,200,000
Estimated cost	<u>1,000,000</u>
Estimated Gross profit	200,000
Costs incurred to date	500,000
% Complete	50%
Billings to date	500,000
Earned Revenue (50%)	600,000
Under Billings (CIEB)	100,000

CIEB = Cost and estimated earnings in excess of billings on uncompleted contract.

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Polling Question #3:

Change orders affect my business ...

- a) If I didn't have change orders I'd be broke
- b) Every time they cost me money!
- c) We do the work and then fight for the signatures – YIKES
- d) What change orders?


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Overview of Change Orders

- Recognize as soon as measurable – especially if resulting in loss of profit
- Was work already performed?
- Are costs recoverable or non-recoverable?

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Accounting for Change Orders

Change Order **APPROVED** → Include Change Order in Revenue and Costs

↓ **UNAPPROVED**

Probable that Change Order costs will result in change in contract? **NO** → Costs result in reducing gross profit


↓ **YES**

Change Order greater than costs? **NO** → Contract revenue recognized at the lesser of cost or anticipated revenue

↓ **YES**

Revenue in excess of cost recorded only if assured beyond a reasonable doubt


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Overview of Claims

- Usually involve contract scope and/or timing issues
- Six broad categories:
 - Delay
 - Disruption
 - Changed Conditions
 - Changes in Scope
 - Acceleration
 - Termination


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End of Session 2 Wrap-Up / Q&A




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Review Question #1

What components are required to perform a WIP analysis?

- a) Contract Amount, Cost to Date, Overhead Costs
- b) Contract Amount, Percent Complete, Profit
- c) Contract Amount, Cost to Date, Cost to Complete, Billing
- d) Billing, Profit, Overhead Costs
- e) Accounting is not so simple!

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Review Question #2

Which is not a direct cost of a project for an electrician?

- a) Subcontractors hired
- b) Fixtures
- c) Labor to install fixtures
- d) Trailer to store fixtures onsite
- e) Lift rented for installation work

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Review Question #3

When should a change order increase revenue in the financials?

- a) When the CO work begins
- b) When the CO is presented to the Owner
- c) When the CO is signed by the Owner
- d) When the CO work is completed

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THANK YOU

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"The BASICS of Construction Accounting"
Thursday, May 22, 2014 3:00-5:00 PM EST

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