

Chapter 2: Construction Accounting Systems

Learning Objectives

At the completion of this chapter the student should be able to:

- Explain the difference between cost reporting and cost control and identify the characteristics of an accounting system that is used for cost control.
- Explain how percentage of completion accounting is different from cash or accrual.
- Explain the relationships that must be maintained between the balance sheet, income statement, the job cost ledger, and the equipment ledger.
- Explain why retention is tracked separately from accounts receivable and accounts payable.
- Explain how over and under billings are represented on the balance sheet.
- Explain why equipment costs are recorded to a separate section on the income statement and then allocated to jobs rather than being charged directly to a job.
- Explain the purpose of the job cost ledger.
- Explain what factors should be taken into account when developing a job cost coding system.

Instructional Hints

- Help the students understand that even though most of them will never be accountants for a construction company, they may become owners or general managers of construction companies. One of the duties of an owner or general manager is to ensure that the company has an appropriate construction accounting system. To do this they must have an understanding of how the construction accounting system operates.

Activities

- Bring in sample financial statements from construction companies. Compare and contrast the financial statements to each other and those in the book. Discuss why there are differences in the accounting systems. Explain that the differences allow the companies to adapt the accounting system to the financial needs of the individual companies.
- Bring in sample job cost codes for a residential construction company, a commercial contractor, and a heavy/highway contractor. Discuss the differences between the ways each company the approached job cost coding.

Instruction Resources

- The figures and tables from this chapter in electronic format can be found in companion website.
- Financial statements for publicly held companies can be found at:
<http://sec.gov/edgar/searchedgar/webusers.htm>
- Construction Contractors — AICPA Audit and Accounting Guide published by the American Institute of Certified Public Accountants

Solutions to the Textbook Problems

1. Processes the cash receipts and disbursements; collects and reports the data needed to prepare company financial statements; collects and reports the data needed to prepare income taxes, employment taxes,

- and other documents required by the government; and collects and provides the data needed to manage the finances of the company.
2. Cost reporting is where the accounting system provides management with the accounting data after the opportunity has passed for management to respond to and correct the problems indicated by the data. Cost control is where the accounting system provides management with the accounting data in time for management to analyze the data and make corrections in a timely manner.
 3. Strong job cost and equipment tracking system, utilizes the principal of management by exception, has established accounting procedures to ensure that things do not fall through the cracks, and the data must be easily and quickly available to management and other employees who are directly responsible for controlling costs.
 4. General ledger consists of all of the accounts necessary to track the financial data needed to prepare the balance sheet, income statement, and income taxes. The job cost ledger tracks the costs for each project as well as individual components within each of the projects. The equipment ledger tracks costs for individual pieces of equipment.
 5. The chart of accounts contains all the accounts that comprise the general ledger—the balance sheet and income statement. On the general ledger the accounts for the balance sheet appear before the accounts for the income statement.
 6. Under the cash method of accounting, revenue is recognized when the payment from the owner is received and expenses are recognized when bills are paid.

Under the accrual method, revenues—except retention—are recognized when the company bills the project's owners; and expenses—except retention withheld—are recognized when the company receives a bill from the supplier or subcontractors.

The percentage of completion method requires construction companies to recognize revenues, expenses, and estimated profits on a construction project through the course of the project. The estimated profits must be equally distributed over the entire project based on the expected cost of the project. Revenues are recognized when the company bills the project's owners and expenses are recognized when the company receives a bill from the supplier or subcontractors.

Under the completed contract method, revenues and expenses are recognized at the completion of the project.
 7. There are three relationships that must be maintained:

On the balance sheet the sum of the asset accounts must equal the sum of the liability and the equity accounts.

On the income statement the profit for the period must equal the total revenue for the period—including other income—less the sum of the expenses including all construction costs, equipment costs, overhead costs, other expenses, and income tax.

The profit on the income statement for any period must equal the change in equity on the balance sheet for that same period.
 8. There are two relationships that must be maintained:

If revenue is recorded on the job cost ledger, the total of the revenue on the job cost ledger must equal the revenue from the core business—exclusive of interest received and other income—on the income statement for a specific period of time.

The total in each of the five subcategories—labor, material, equipment, subcontract, and other—on the job cost ledger must equal the construction costs on the general ledger in the associated account for any given period.
 9. There are two relationships that must be maintained:

The total of the costs allocated to jobs on the equipment ledger must be equal to the equipment contra accounts on the income statement for a specific period.

The costs on the equipment ledger must equal the total of the equipment cost on the income statement—exclusive of the contra accounts—for a specific period.

10. The invoice is a subcontractor's invoice for countertop on phase 2 of job 102.
11. There is no set answer for this problem.
12. There is no set answer for this problem.