Construction Accounting and Financial Management

Chapter 2
Construction Accounting Systems

Purposes of the Accounting System

- Process cash receipts and disbursements
- Prepare financial statements
- Pay Income and employment tax
- Provide data for financial management
Cost Reporting Versus Cost Control

- **Cost Reporting:**
  - Provides data after the opportunity has passed for management to respond to and correct the problems
  - Shows where the company has been
  - Reactive approach

- **Cost Control:**
  - Provides data in time for management to analyze the data and make corrections in a timely manner
  - Proactive approach

Components of a Cost Control System

- **Strong job cost and equipment tracking**
  - Costs must be current & up to date

- **Uses “management by exception” Management by Exception:** a policy by which management devotes its time to investigating only those situations in which actual results differ significantly from planned results. Else, higher management is to mainly target & address “strategic” plans & decisions!

- Follows established procedures

- Data must readily be available
Components of an Accounting System

- **General Ledger:**
  - Chart of accounts (see Figure 2-1)
  - Balance sheet and income statement

- **Job Cost Ledger:**
  - Costs by project

- **Equipment Ledger:**
  - Costs by piece of equipment or vehicle

Method of Accounting

- **Cash**
- **Accrual**
- **Percentage of completion**
- **Completed contract**
Cash

- Revenue is recognized when payment is received
- Expenses are recognized when bills are paid
- Easiest to use
- Little use for financial management because data is not up to date

Accrual

- Revenue is recognized when the company has the right to receive payment
  - Retention is not a revenue until the job is complete
- Expenses are recognized when the company is obligated to pay bills
- May pay income taxes on imaginary profits
Percentage of Completion

- Revenue is recognized throughout the project
  - Retention is recognized throughout the project
- Expenses are recognized throughout the project
- Estimated profits are equally distributed throughout the project
  - Based upon expected revenues and expenses

Completed Contract

- Revenue is recognized at completion of the project
- Expenses are recognized at completion of the project
- Revenues and expenses are known
- Useless for financial management
- May create large swings in income
### Balance Sheet

- **Assets = Liabilities + Owner’s Equity**
- “Snapshot” of a company’s assets, liabilities, and owner’s equity

### Current Assets

- Cash
- Accounts Receivable-Trade
- Accounts Receivable-Retention
- Inventory
- Costs and Profits in Excess of Billings (Underbillings)
- Notes Receivable
- Due from Construction Loans
- Prepaid Expenses
- Other Current Assets
  - Total Current Assets (sum of above)
Fixed and Other Assets

- Land
- Buildings
- Construction Equipment
- Trucks and Autos
- Office Equipment
  - Total Fixed Assets (sum of above)

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Fixed and Other Assets

- Less Accumulated Depreciation (Contra Account)
  - Net Fixed Assets
    (Total Fixed assets – Les Accumulated Depreciation)

- Capital Leases
  - A capital lease is a lease in which the lessor only finances the lease, and all other rights of ownership transfer to the lessee, resulting in the recording of the asset as the lessee's property in its general ledger.

- Other Assets
  - Total Assets (Total Current Assets + Net Fixed Assets + Other Assets)
## Liabilities

- **Current Liabilities**
- Accounts Payable-Trade
- Accounts Payable-Retention
- Billings in Excess of Costs and Profits (overbillings)
- Notes Payable
- Accrued Payables (including taxes and vacation)
- Capital Lease Payable
- Warranty Reserves
- **Other Current Liabilities**
  - Total Current Liabilities (sum of above)

<table>
<thead>
<tr>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Long-term Liabilities</strong></td>
</tr>
<tr>
<td>Total Liabilities (Total Current Liabilities + Long-term Liabilities)</td>
</tr>
</tbody>
</table>
Owner’s Equity (Corporation)

- Capital Stock
- Retained Earnings
- Current Period Net Income

- Total Equity

Income Statement

- Spans a period of time
- Represents the transactions that occur between two balance sheets
## Income Statement

- **Revenue**
- **Construction Costs**
- **Equipment Costs**
  - Gross Profit (Revenue – Const. Costs – Equip. Costs)
- **Overhead**
  - Net Profit From Operations (Gross Profit – Overhead)
- **Other Income and Expense**
  - Profit Before Tax (Net Profit – Other Income and Expense)
- **Income Tax**
  - Profit After Tax (Profit Before Tax – Income Tax)

## Construction Costs

- **Materials**
- **Labor**
  - Passes through payroll system and is charge to a job
- **Subcontract**
  - Always includes labor component
- **Equipment**
- **Other**
Equipment Costs

- Rent and Lease Payments
- Depreciation
- Repairs and Maintenance
- Fuel and Lubrication
- Taxes, Licenses, and Insurance
- Equipment Costs Charged to Jobs (Contra)
- Equipment Costs Charged to Employees (Contra)
  - Total Equipment Costs

Relationships

- Balance Sheet
  - Assets = Liabilities + Equity

- Income Statement
  - Revenue = Expenses + Profit

- Balance Sheet and Income Statement
  - Change in Equity = Profit
Job Cost Ledger

- Provides breakdown of construction costs on income statement
- May provide a breakdown of revenues on the income statement
- Costs are broken down by:
  - Job
  - Phase (optional)
  - Cost code
  - Cost type
Job Cost Code Structure

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**Job**

**Phase**

**Cost Code**

**Cost Type**

Relationships

- **Income Statement and Job Cost Ledger**
  - **Revenue** = **Revenues**
  - **Construction Costs** = **Construction Costs**
    - Excludes Committed Costs not Recognized
    - **Materials** = **Materials**
    - **Labor** = **Labor**
    - **Subcontract** = **Subcontract**
    - **Equipment** = **Equipment**
    - **Other** = **Other**
Equipment Ledger

- Provides breakdown of equipment costs on income statement by piece of equipment
- May provide additional breakdown
Relationships

- Income statement and Equipment Ledger
  - Charge Costs = Cost Allocated
  - Costs = Costs
    - Rent and Lease Payments = Rent and Lease Payments
    - Depreciation = Depreciation
    - Repairs and Maintenance = Repairs and Maintenance
    - Fuel and Lubrication = Fuel and Lubrication
    - Taxes, Licenses, & Insurance = Taxes, Licenses, & Insurance