

# Construction Accounting and Financial Management

## Chapter 2 Construction Accounting Systems

Construction Accounting & Financial Management, 3/e  
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## Purposes of the Accounting System

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

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## 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

- $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$
- “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)

## 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)

## Liabilities

- Long-term Liabilities
  - Total Liabilities (Total Current Liabilities + Long-term Liabilities)



## 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

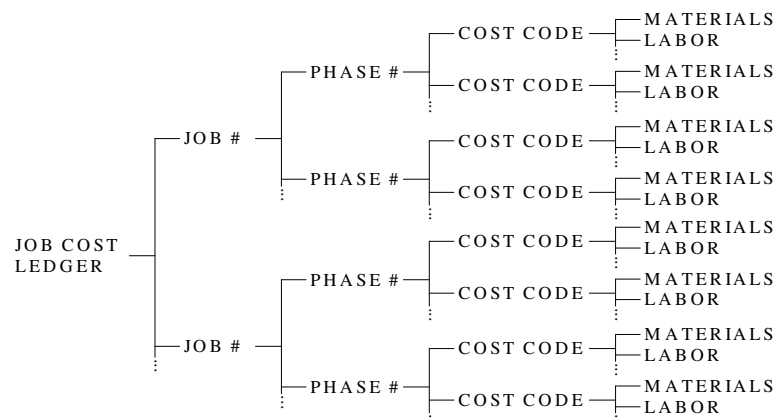
## Relationships

- Balance Sheet
  - $\text{Assets} = \text{Liabilities} + \text{Equity}$
- Income Statement
  - $\text{Revenue} = \text{Expenses} + \text{Profit}$
- Balance Sheet and Income Statement
  - $\text{Change in Equity} = \text{Profit}$

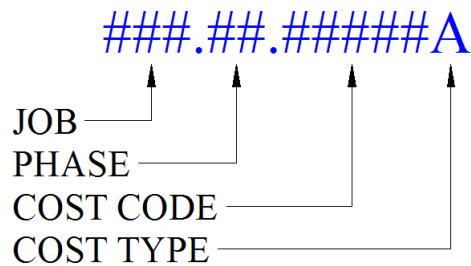
## Job Cost Ledger

- 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 Ledger



## Job Cost Code Structure



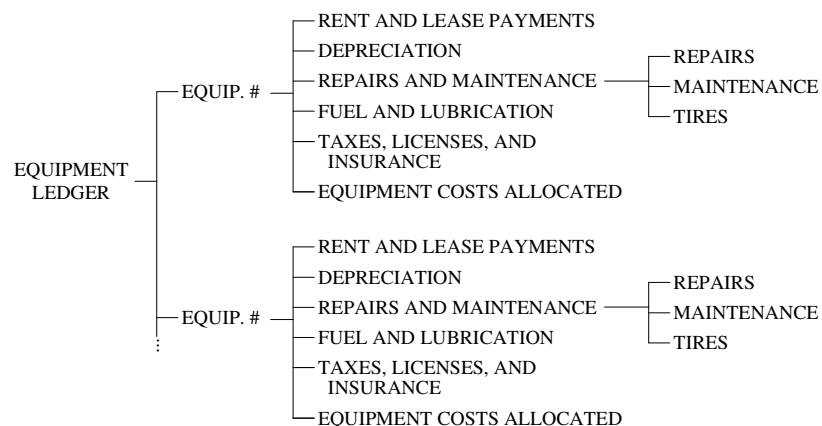
## Relationships

- **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

## Equipment Ledger



## 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