

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

## Components of a Cost Control System

- Strong job cost and equipment tracking
  - Costs must be up to date
- Uses management by exception
- 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 received payment
  - Retention is not an 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

- $Assets = Liabilities + Equity$
- 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
- 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
- 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

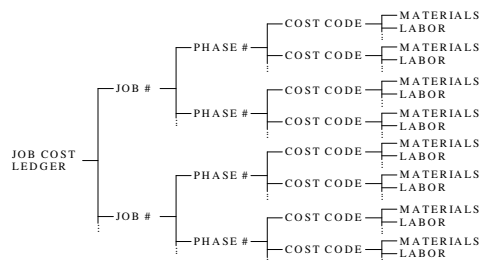
## Relationships

- Balance Sheet
  - 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 Ledger



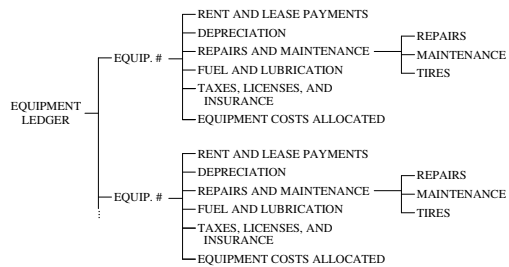
## Relationships

- 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, and Insurance = Taxes, Licenses, and Insurance