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Dimensions

A CPA's Report for the Construction Industry

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New Revenue Recognition Rules

ASC 606 Could Impact Your Financial Statements

New revenue recognition rules that are now being phased in as part of U.S. generally accepted accounting principles (GAAP) could have a significant effect on your financial statements—which means they could affect your credit and bonding capacity.

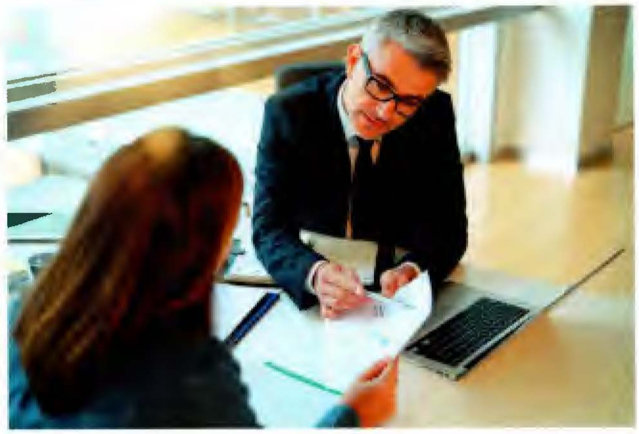
When and How the Rules Are Changing

The Financial Accounting Standards Board (FASB) developed the new standard—Accounting Standards Codification (ASC) Topic 606, "Revenue from Contracts with Customers"—with the goal of making revenue recognition practices more consistent across various industries and jurisdictions.

For publicly traded companies, ASC 606 went into effect for annual reporting periods (including interim reporting periods) that began after Dec. 15, 2017. For all other entities that produce GAAP-compliant financial statements, the new standard goes into effect for annual reporting periods beginning after Dec. 15, 2018 and interim reporting periods beginning after Dec. 15, 2019.

Because the new standard could cause significant changes in a contractor's financial statements, the FASB requires companies to present a retrospective application of the standard for comparison. You may use one of two methods to do this:

1. A full retrospective would apply the new guidance as if it had been in effect as of the earliest contract reflected in the current financial statements.
2. A modified retrospective (the more likely choice for most contractors) would apply the new guidance to only the current period in the financial statements and make a one-time adjustment to retained earnings to account for the difference.



The retrospective method you choose could affect how (and how much) your revenue and profits fluctuate.

Issues for Contractors to Watch

The core principle driving ASC 606 is that an entity "should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects consideration to which the entity expects to be entitled in exchange for those goods and services."

But putting that broad principle into practice can raise complications, particularly where the new standard's requirements differ from the traditional percentage of completion (PoC) methodology. Some of the more significant differences include the following:

- **Specific performance obligations.** The new standard requires you to break down contracts into specific performance obligations and identify them individually on the job schedule. For example, contractors who provide design, engineering, and construction services would be required to differentiate them and recognize the revenue from these elements separately.
- **Variable consideration.** This includes items such as unpriced change orders, claims, incentive payments, and penalties. You will need to determine when and how to incorporate these amounts into the transaction price.
- **Other variables.** Any financing

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Skilled Labor Shortage

Status and Strategies

The shortage of skilled workers in construction crafts has been an ongoing challenge since the economic recovery began—and it appears the issue will be with us for some time.

In a recent survey by the Associated General Contractors of America (AGC), 80 percent of construction firms reported they were having a hard time filling hourly craft positions. In addition, the survey results suggest there's no relief in store soon. Almost the same number of contractors—81 percent—predicted it will continue to be hard—or get even harder—to find workers during the coming year.

In response to the ongoing shortage of skilled labor, the AGC and various other trade organizations are urging federal officials to increase support for construction workforce development and boost funding for career and technical education. While these policies are important in the long term, many individual contractors are searching for more immediate strategies to deal with their needs.

Here are a few strategies some contractors have found useful in helping them attract and retain high-quality employees:

- **Begin with the basics—competitive pay and benefits.** Deciding how much base salary to offer is a judgment call, but keep in mind that your compensation package needs to be competitive—not just with other contractors in the area, but also with other industries that employ workers with similar skills.
- **Reward top performers.** In the smallest firms, a bonus program may be completely discretionary and informal, but once your company grows beyond a few employees, your incentive program should be more structured, transparent, and demonstrably objective. Before you unveil the program to employees, however, run some financial models to understand how your incentive program will operate under various economic scenarios. This will require support from your accountant, but it is worthwhile.
- **Let people know they're valued.** Some contractors have begun supplying every employee with a one-page summary listing the dollar value of all benefits received, including wages, Social Security and Medicare contributions, other health and retirement benefits, meals, mileage, and other reimbursements.
- **Cultivate new sources.** Most contractors are familiar with local sources of interim workers to get them through a short-term labor shortage. While trade association bulletin boards generally focus on project managers and supervisory-level personnel, some also list crafts and trades workers. Temporary agencies that specialize in construction trades are another option, although there can be significant costs associated with this approach. Career fairs and high school-level construction skills academies can also be good recruitment venues.

- **Be flexible and ready to adapt.** Cross-training or multi-skill training can give you more flexibility to deal with current and future staffing problems. In addition, these practices also can help attract and retain workers who are looking for future growth and career opportunities. A growing number of contractors are turning to offsite construction processes and prefabrication of components to help them deal with labor issues.
- **Make safety a priority.** In a recent survey, 26 percent of contractors said they were highly concerned about the safety risks associated with having too few skilled workers on site. A strong safety program not only helps you avoid fines, liability, and downtime, it also lets employees know you value their welfare.
- **Provide good working conditions.** In addition to a safe workspace, quality-oriented workers are also attracted by worksites that are well-organized with properly functioning equipment and adequate rest periods. Of course, all supervisors and managers should be required to treat employees fairly and respectfully as well.
- **Apply technology.** In the AGC survey, 25 percent of respondents said they were increasing their use of labor-saving equipment to cope with the shortage. A similar number reported they were using virtual construction methods such as building information modeling (BIM) to help boost efficiency. In addition to reducing the demand for onsite labor, the increased use of technology can also help make a construction career more appealing to younger, tech-savvy workers.

Our firm can help you analyze your employee compensation and incentive programs. Please call us to learn more.

Understanding the Job Schedule

Realistic Estimates Are Essential

This is the second in a series of articles about the job schedule, including the work-in-progress (WIP) and completed contracts reports, which are critical components of contractors' financial statements.

In addition to helping sureties, lenders, and other interested parties assess your company's financial position, the job schedule also can help you do a better job of analyzing and improving your company's performance. To do that, it is essential that the estimated costs on the schedule be as realistic and accurate as possible.

Costs Drive Revenue

The Financial Accounting Standards Board's new revenue recognition standard, ASC 606, introduces new procedures for recognizing and reporting revenue from long-term contracts on your financial statements. (See the cover story in this issue for a more detailed explanation.)

Yet, despite the many differences between the new standard and the traditional percentage of completion (PoC) methodology, one important concept is carried over: In most instances, job progress will still be measured by comparing the costs a contractor has incurred so far to the estimated total costs of the project.

There are specific exceptions and variations but, generally speaking, project costs will still be used to determine when revenue can be recognized on most jobs. Therefore, it is so crucial that your management team estimates project costs realistically and reports them on the job schedule accurately.

Inaccurate cost estimates make it difficult to identify potential profit fade in time to take action. What's more, bonding companies and other users of financial reports do not like unforeseen surprises—good or bad—because they cause them to lose confidence in your company's ability to estimate jobs accurately and manage them efficiently.

When to Close Out a Job

In addition to realistic cost estimates, another common concern on the job schedule involves how to determine when a job is complete and should be moved from the work-in-progress report to the completed contracts list.

As with revenue recognition, the decision to close out a job should be driven by costs. Sending the final bill is not the determining factor.

Once you know all work on a project is complete and there is no expectation of additional costs, the job should be listed as closed. This applies regardless of whether the final invoice has been sent. (Of course, there should be no significant delays in billing for completed work.)

A comparable principle applies to final retention payments. If you have been paid for all costs but final payment is still being held back, the job stays on the job schedule but is moved from the WIP report to the completed contracts listing for the reporting period.

These entries should then be explained further in the Notes to Financial Statements, which will break out the accounts receivable to show details of retainage for both open and closed jobs.

For more information on the job schedule and other financial statements, please call us for an appointment.

The concluding article in this series will examine questions that can arise when allocating overhead and indirect costs on the job schedule.

Fighting Fraud

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you provide must be factored into the transaction price. The standard also spells out how to factor in retainage and amounts collected on behalf of a third party, such as sales tax, which no longer will be included in the transaction price.

- **Uninstalled significant materials.** Under traditional PoC accounting, contractors recognize the costs of these materials when they receive them at the job site, which results in a simultaneous recognition of revenue and profit related to these materials. The new FASB standard says costs such as these should not be used for revenue calculations but instead should be reported elsewhere on the financial statements. Job acquisition and preparation costs, and the costs of wasted materials and labor, are also treated differently.

These are only a few of the many changes you will encounter in the new standard. With implementation imminent, it's important to work closely with your surety, lenders, and accounting team to review the changes and anticipate potential complications in order to make the transition as smooth as possible.

Please call us to schedule a more in-depth discussion of the new GAAP revenue recognition rules.

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Year-End Tax Review

Here is a recap of a few of the major provisions in the *Tax Cuts and Jobs Act* that will directly impact many construction businesses:

- **Rate reductions.** The previous graduated corporate tax structure has been replaced with a flat 21 percent rate. For individuals, tax brackets were redefined, and the standard deduction and child tax credits were doubled.
- **Pass-through provisions.** Shareholders in S corporations and LLCs can now take a 20 percent deduction on pass-through income, subject to certain limitations.
- **Alternative minimum tax (AMT).** The corporate AMT has been repealed. Exemptions and phase-out thresholds for the personal AMT have increased substantially.
- **Net operating loss (NOL) deductions.** New limits apply to the NOL deduction. The two-year carryback provision was repealed, but the carryforward provision is now indefinite rather than limited to 20 years.
- **Domestic production activity deduction (DPAD).** The DPAD has been repealed.
- **Interest expense deductions.** New limits apply to the deductibility of interest expenses for taxpayers with gross receipts over $25 million.
- **Section 179 expensing.** The law raises Section 179 expense limitations and phase-out levels.
- **Expensing for new and used equipment.** Most equipment purchased after September 2017 can now be expensed rather than depreciated.
- **Cash basis and accounting changes for small businesses.** The average gross receipts limit increased from $10 million to $25 million, giving more taxpayers the option of choosing the completed contract method for recording long-term contract revenues.

This is only a partial list of the many major changes in the tax code, and there are numerous qualifications and limitations to these provisions. As you prepare for the upcoming tax season, expect to take some time with your accountant to review what's changed.

Please call us to schedule an in-depth review of the new law's impact on your business.