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Construction contractors industry developments - 2003/04; Audit risk alerts

American Institute of Certified Public Accountants. Auditing Standards Division

AUDIT RISK ALERTS

Construction Contractors Industry Developments — 2003/04

Strengthening Audit Integrity
Safeguarding Financial Reporting

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Notice to Readers

This Audit Risk Alert is intended to provide auditors of construction contractors with an overview of recent economic, industry, technical, and professional developments that may affect the audits they perform.

This publication is an Other Auditing Publication as defined in Statement on Auditing Standards (SAS) No. 95, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1, AU sec. 150). Other Auditing Publications have no authoritative status; however, they may help the auditor understand and apply SASs.

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1 2 3 4 5 6 7 8 9 0 AAG 0 9 8 7 6 5 4 3

Table of Contents

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Construction Contractors Industry Developments—2003/04

How This Alert Can Help You

This Audit Risk Alert can help you plan and perform your construction industry audits. The knowledge that this Alert delivers can assist you in achieving a more robust understanding of the business environment in which your clients operate—an understanding that is more clearly linked to the assessment of the risk of material misstatement of the financial statements. Also, this Alert delivers information about emerging practice issues and current accounting, auditing, and regulatory developments.

If you understand what is happening in the construction industry, and if you can interpret and add value to that information, you will be able to offer valuable service and advice to your clients. This Alert can assist you in making considerable strides in gaining that industry knowledge.

This Alert describes trends and issues facing most contractors in many of the construction markets in the country. National trends and industrywide benchmarks can help you identify unusual financial statement relationships at the planning or final review stages of an audit. Once they are identified, you can direct your audit attention to those areas. However, broad national trends have their limitations. Keep in mind that your clients will be affected much more by local economic, political, and industry conditions that exist in the specific markets your clients serve.

This Alert is intended to be used in conjunction with the AICPA general *Audit Risk Alert—2003/04* (product number 022334kk).

Construction Industry Overview

The construction industry consists of individuals and companies engaged in diverse activities that are defined as "construction" in the *Standard Industrial Classification Manual.* In the United States, the construction industry represents billions of dollars of economic activity, consists of several hundred thousand business entities that are widely dispersed throughout the country, employs a large labor force, and contributes a relatively constant annual percentage (approximately 5 percent) to the gross domestic product (GDP).

Are All Contractors Alike?

No, not all contractors are alike. Not only do contractors offer different kinds of services, they also have different capabilities. Consequently, the economic and audit risks associated with contractors vary. For example, the business risks and issues facing residential home builders may be very different from the risks encountered by contractors and subcontractors who work on commercial office buildings. You have to consider the contractor within the context of the market segment that he or she serves to better understand the industry and what we need to know about it as auditors. This Alert describes economic, industry, and audit conditions for the following kinds of contractors:

- *Residential building.* These contractors are engaged in the construction of new single-family and multifamily residential buildings. A number of contractors are involved strictly in the remodeling and maintenance of residential buildings.

- *Nonresidential building.* These contractors specialize in the construction of commercial buildings, such as offices, industrial, retail, and lodging facilities.

- *Heavy construction.* These contractors are engaged in projects such as highways, bridges, dams, railroads, and airports.

- *Specialty trade.* These contractors specialize in work such as painting, electrical, roofing, plumbing, and other specialty trades. Contractors in the specialty trades frequently work as subcontractors on a wide variety of projects.

The organizational structure, resources, and capabilities of contractors vary with the type of activity, and each kind of contractor can pose different accounting and auditing problems. However, certain characteristics are common to all entities in the construction industry. The most basic common characteristic for construction entities is that work is performed under contractual arrangements with a customer. A contractor, regardless of the type of construction activity or the type of contractor, typically enters into an agreement with a customer to build or make improvements on a tangible property to the customer's specifications. Other characteristics common to all contractors and significant to auditors include the following:

- A contractor normally obtains the contracts that generate revenue or sales by bidding or negotiating for specific projects.
- A contractor bids for or negotiates the initial contract price based on an estimate of the cost to complete the project and the desired profit margin, although the initial price may be changed or renegotiated.
- A contractor may be exposed to significant risks in the performance of a contract, particularly when the contract is a fixed-price contract.
- Customers frequently require a contractor to post a bid, performance, and payment bond as protection against the contractor's failure to meet performance requirements and payment obligations.
- The costs and revenues of a contractor are typically accumulated and accounted for by individual contracts or contract commitments extending beyond one accounting period, which complicates the related management, accounting, and auditing processes.

Major Construction Industry Risks

In addition to having many common characteristics, construction contractors share many of the same risks. These include:

- Dynamic and diverse laws in different states and countries.
- Contract and tort liabilities, including long-term warranty, mold claims, guarantees, and tort obligations.

- Dependence on other parties' performance.
- Dependence on key customers.
- Financing and the availability of capital.
- Changes in the economy.
- New technology.
- Licensing and regulatory approvals.
- Foreign and domestic inflation/currency exchange rates.
- Foreign government stability.
- Quality control issues.
- Product recall consequences.
- Environmental issues.
- Intellectual property rights.
- Risk of loss to persons and property.
- Loss of revenue.
- Failure to complete projects on time.
- Labor skill and availability.
- Key employee retention.
- Cost of employee benefits.
- Ownership and management succession issues.
- Safety of employees on and off the job.
- Weather.
- Scheduling.
- Engineering and design quality and timeliness.
- Subcontractor problems.
- Supplier concerns.

Funding Sources for Construction

To better understand the dynamics of the construction industry, it also helps to consider sources of funding. *Publicly* funded construction is financed by federal, state, and local governments and is driven by the political and legislative processes. For example, the passage of bond measures to fund school construction has resulted in increased construction activity in many areas during the past year. *Privately* funded construction is financed by private owners, such as real estate development companies, home builders, and various business entities. The need for privately funded construction is influenced by a wide variety of economic forces, including the availability of capital, the status of the local and world economy, the level of interest rates, and demographics.

Industry and Economic Developments

General Industry Trends and Conditions

Read the AICPA general *Audit Risk Alert—2003/04* for an overview of the current U.S. and global economic environment.

New construction starts increased 9 percent in June 2003 to a seasonally adjusted annual rate of $529.5 billion. Nonresidential construction posted a healthy gain, while nonbuilding construction (public works and electric utilities) surged upward after a weak May. Residential building in June 2003 showed more modest improvement, edging up from its elevated May pace.

The economic event that will have a long-lasting and profound effect on the construction industry is the $350 billion tax cut signed into law in May 2003. On the up side, the new tax package gives equipment buyers a break by increasing the first year writeoff from 30 percent to 50 percent.[1] In addition, the tax bill accelerates tax cuts for business, which could especially help smaller contractors.

1. Note that this additional depreciation may present problems for construction contractors with revenues in excess of $10 million. These contractors are required under Section 460 of the tax code to calculate their revenues using the percentage-of-completion method, cost-to-cost, using tax methods to calculate their depreciation expense. If a large contractor elects to take the additional tax depreciation, it could actually increase its revenues for tax purposes in an amount greater than the additional deprecation taken.

Highway contractors, among others, are being negatively affected by reduced state and municipal spending. Contractors report that they are seeing less work and more competition, which is cutting deeply into their margins.

Early in 2002, news stories questioning the strength and viability of the surety industry began to surface. Even before the economic uncertainty and other calamitous events of the past two years, industry analysts were reporting on the tightened surety bond market and predicting possible effects on the construction industry.

Construction Put in Place

One of the most widely used measures of construction activity is *construction put in place*, which is tracked monthly by the Bureau of Statistics at the U.S. Department of Commerce. The *value of construction put in place* (value-in-place) is a measure of the value of construction installed or erected at the site during a given period. For an individual project, this includes:

- New buildings and structures.
- Additions, alterations, major replacements, and so on, to existing buildings and structures.
- Installed mechanical and electrical equipment.
- Installed industrial equipment, such as boilers and blast furnaces.
- Site preparation and outside construction, such as streets, sidewalks, parking lots, utility connections, and so on.
- Cost of labor and materials (including owner supplied).
- Cost of construction equipment rental.
- Profit and overhead costs.
- Cost of architectural and engineering (A&E) work.
- Any miscellaneous costs of the project that are on the owner's books.

The total value-in-place for a given period is the sum of the value of work done on all projects under way during this period, regardless of when work on each individual project was started or when payment was made to the contractors. For some categories, estimates are derived by distributing the total construction cost of the project by means of historic construction progress patterns.

Exhibit 1, "New Construction Put in Place," presents details of construction put in place for various market segments. (Note that the amounts are in billions of dollars and represent seasonally adjusted annual rates.) To add some perspective, in January 1992, at the start of the current construction boom, the total new construction put in place was $452 billion, as compared with the estimated 2003 amount of $883 billion—a gain of more than 95 percent during the period.

Exhibit 1 New Construction Put in Place
(Billions of Dollars—Seasonally Adjusted Annual Rate, in Current Dollars)

	August 2002	*August 2003*
Private construction	627.1	665.4
Public construction	202.7	217.3
Total construction	**829.8**	**882.7**
Residential building	407.5	453.4
Nonresidential building		
Office	36.3	28.5
Power	23.5	23.9
Commercial	56.6	59.9
Lodging	9.5	10.0
Other nonresidential	93.7	89.7
Total nonresidential	219.6	212.0
Total private construction	627.1	665.4
Highways and streets	51.3	60.6
Infrastructure	24.9	26.0
Educational	63.1	58.9
Other public buildings	30.8	28.2
Other public construction	32.6	43.6
Total public construction	202.7	217.3

Construction put in place during August 2003 was estimated at a seasonally adjusted annual rate of $882.7 billion, 0.2 percent above the revised July estimate of $880.8 billion, according to the U.S. Commerce Department's Census Bureau. The August 2003 figure is 4 percent above the August 2002 revised total of $848.6 billion. During the first eight months of this year, $575.7 billion of construction was put in place, 2.1 percent above the $563.7 billion for the same period in 2002.

Spending on private construction was at a rate of $665.4 billion in August 2003. Residential building construction was at a seasonally adjusted rate of $453.4 billion, 1.4 percent above the revised July estimate of $447 billion.

In August 2003, the estimated seasonally adjusted annual rate of public construction put in place was $217.3 billion, 0.6 percent above the revised July estimate of $216 billion.

> **Help Desk**—You can access current statistics of construction put in place and other construction industry information at www.census.gov.

Private Construction

Residential Building

The residential building segment of the construction industry includes new single- and multifamily housing as well as residential repairs and improvements. Conditions with the most impact on the demand for residential construction include the following:

- *Housing affordability.* Housing affordability is the extent to which potential buyers have the means to purchase a home. Affordability can be measured in several ways by considering average home prices and income levels. For example, some analysts create an "affordability index" by comparing median home prices to household income levels. As income levels get closer to housing prices, the average home becomes affordable to more local residents.
- *Interest rates.* Most homes are financed, and interest rates therefore have a tremendous effect on the affordability of

housing. As interest rates rise, the cost of home financing increases; as they fall, the cost of financing decreases. However, interest rate changes do not have an immediate impact on home-buying markets—usually rates have to be in effect for several quarters to reverse home-buying trends.

- *Demographics.* Shifts in demographics can have a significant impact on housing demand. For example, the aging of the U.S. population has increased demand for low-maintenance and multifamily housing. A large number of baby boomers are now entering their peak earning years, which is expected to affect the affordability and demand for single-family homes.
- *Market velocity.* According to industry sources, more than half of all home improvements occur within 18 months after a new owner moves in, or within 12 months before the home is sold. Thus, during times when new and used home markets are active, residential remodeling and improvement activity also increases.

As one of the main drivers of construction's recent 10-year expansion, home building continues to prop up the industry's growth as other sectors go into decline. With the Federal Reserve Board setting its benchmark for interest rates at its lowest level in 40 years, and with strong demographics, home building has kept growing.

Residential building in June 2003 increased 2 percent to $264.1 billion. The dollar amount of new single-family starts was up 1 percent, while multifamily housing climbed 7 percent. Single-family housing continues to be very strong, while multifamily housing has not been adversely affected by rising vacancies and flat rents in some markets. The cost of financing in June was very supportive of home-buyer demand, with the 30-year fixed mortgage rate averaging 5.2 percent. However if mortgage rates rise, this may lead to reduced home-buyer demand and a slower pace for single-family construction.

During the first half of 2003, residential building advanced 7 percent from one year ago, in contrast to the declines shown by nonresidential building and nonbuilding construction. Single-family housing was up 8 percent, while multifamily housing grew 2 percent.

Nonresidential Building

Nonresidential building in June 2003 increased 10 percent to $158.6 billion. The institutional building categories showed moderate to strong growth, beginning with a 7 percent increase for school construction. Amusement-related projects grew 9 percent. Churches and health care facilities rebounded from a weak May 2003, with gains of 16 percent and 18 percent, respectively. The public building category climbed 31 percent and, following a depressed May, the transportation category surged 111 percent.

Despite the strong June 2003 gain, nonresidential building during the first half of 2003 was down 8 percent from one year ago. All the institutional categories showed weaker contracting, including a 4 percent drop for schools. Transportation was also down 4 percent, and church construction posted a 13 percent decline. Amusement-related projects and public building were each down 15 percent, while health care facilities construction fell 16 percent.

Although nonresidential construction is expected to rebound, some market segments will fare better than others. The following discussion describes the trends in each of these nonresidential construction segments.

Office Market

Industry analysts do not expect new office construction to turn around until the second half of 2004. Although some local markets saw a slight improvement in demand over the first quarter of 2003, the overall office market remains in the doldrums. U.S. office vacancy rates edged up to 16.5 percent in the second quarter from 16.3 percent in the first quarter—the highest rate since the previous recession of the early 1990s. The rate at which office space is emptying has nearly doubled since 2001. With so much vacant area and rents continuing to fall, demand for new office construction has been severely depressed. In May, seasonally adjusted new office spending registered an annual rate of just over $25 billion—only half the rate of investment in early 2001.

With the sharp decline in high tech sector jobs and businesses, two of the hardest hit commercial real estate markets have been the San Francisco and San Jose metropolitan areas. But the continued softness in manufacturing activity, which has spread to many service industries, led to substantial office vacancies in some unexpected areas. In the second quarter of 2003, cities such as Columbus, Kansas City, Dallas, Atlanta, and Detroit posted vacancy rates above 20 percent.

An office construction market rebound will be largely dependent on consistent job growth. There are a few encouraging signs that the overall labor market will soon begin a gradual recovery.

With rents remaining low, however, the considerable amount of office space now vacant in many local markets will have to be absorbed before we see any sustained improvement in new office construction. A return to negative absorption rates in the first quarter—where the amount of vacated offices exceeded the amount of newly leased space—will likely drive up office vacancy rates through the fourth quarter of 2003, peaking close to 17 percent. Consequently, industry analysts do not expect new office construction to turn around until the second half of 2004. Should the employment picture fail to improve, though, this rebound would be delayed until 2005.

Industrial Market

The industrial market is living up to its reputation for stability during tough economic times. Landlords watched nervously as the vacancy rate, after bottoming at 6 percent in 2000, rose to 8.9 percent in early 2002. The market then stabilized, however, and the vacancy rate fluctuated around 9 percent for the remainder of the year, well below its peak of 13.7 percent following the last recession. AMB Property Corporation's industrial absorption indicator (IAI) forecasts flat absorption through year end. Currently stronger numbers from the Institute of Supply Management's (ISM) index of manufacturing activity imply that industrial production—and as a result, demand for industrial space—could show significant improvement in the first quarter of 2004. Such an improvement would be consistent with several in-place fundamentals: strong fiscal and monetary policy, strengthening regional Federal Reserve Board surveys, virtually nonexistent inflation, and signs of growing levels of consumer confidence, corporate profits, and business investment. Importantly for industrial space absorption, inventories are at historically, and unsustainably, low levels.

Retail and Other Commercial Markets

The retail industry continues to show signs of improvement as current business conditions strengthened in July 2003, while the six-month-ahead sales outlook improved even more. According to the latest NRF-BTM Executive Opinion Survey, a monthly index by the National Retail Federation (NRF) and the Bank of Tokyo Mitsubishi Ltd. (BTM), the retail sector performance index (RSPI) for July rose to 55.4 percent, its highest level since the survey's inception in September 2002. However, if consumer spending and retail sales weaken, marginal tenants could be eliminated and poorer-performing shopping centers could become distressed.

Hospitality Market

No sector has been battered more than hotels, which have not recovered traction since the September 11th terrorist attacks caused consumers to reduce their travel. The slow economy and job losses have kept demand soft for both leisure and business travel and the numbers tell the tale: RevPar (revenue per available room) has been plunging for three years, as have average room rates and occupancy rates.

Lend Lease, an Australian-based real estate company, predicts a hotel recovery starting in the first half of 2004, when rising demand and little new supply start to bolster RevPar. The firm also predicts a 50 percent decrease in hotel construction in 2003 versus 2002. New construction already dropped 30 percent last year.

> **Help Desk**—The demand for construction can vary significantly among different geographic regions. One of the most comprehensive analyses of commercial real estate demands and construction activity is published by the Society of Industrial and Office Realtors (SIOR). Annually, SIOR publishes *Comparative Statistics of Industrial and Office Real Estate Markets*,

which provides detailed real estate and construction statistics on all the country's larger cities. You can purchase and download this publication directly from the publications section of the SIOR Web site at www.sior.com.

Public Construction

Compared to 2002, public construction put in place in 2003 increased by less than 2 percent, from $208.1 billion to $212.2 billion. However, public works had a generally strong June, including a 35 percent gain for highways. The highway category has been generally weaker during 2003, but fiscal 2003 appropriations passed in February are finally helping road projects reach the construction start stage. June gains were also reported for sewers, up 29 percent, and water systems, up 14 percent. Reduced contracting was shown by bridges, down 1 percent, and river/harbor development, down 11 percent.

Surety Industry Trends

The surety industry is critical to the well-being of the construction industry. Nearly half of all work performed by contractors is bonded, so any change in the surety market will have a significant effect on the construction industry.

The surety industry is still in a state of turmoil and change, but the very earliest signs that things may start to settle out are beginning to appear. For the last three years, the surety industry has been plagued by large losses. Many of the largest and best-known losses came from nonconstruction exposures such as Enron's for defaulting on energy delivery contracts and K-Mart's for defaulting on workers' compensation guarantee bonds. In December 2002, a settlement was reached in the Enron case whereby the 11 sureties agreed to a payment of roughly $600 million. While issues remain concerning the payment of reinsurance, the turmoil surrounding that issue has died down. In at least one case, a surety has reduced its loss reserve and will show a sizable recovery for the year.

Another factor affecting the surety industry is the performance of the stock market. When the market is doing well, sureties can make substantial gains from the investment of their float funds, thereby keeping premiums low. However, when the market declines, sureties have increased premiums to make up for the shortfall they experienced from the lack of market gains. Contractors could feel the effect of this movement in significant premium increases.

One of the most discussed topics in the surety industry these days is "capacity." How large a bond or bonding program is available? While this may have a direct effect on only the "jumbo" contractors doing hundreds of millions of dollars in volume, it is having an indirect effect on all contractors. Capacity is shrinking for two reasons: several sureties have left the business, either by choice or by default, and many sureties are restricting the amount of exposure they are willing to accept on an account, or even a class of business. There are fewer sureties willing to expose fewer dollars, and it is having an effect on all users of the surety product.

In addition to capacity, sureties are focusing more closely on capital and character. Capital is now being required by sureties more than in the past. This may be complicated by the application of a new accounting standard, Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, which may have the effect of reducing the contractor's reported capital (see the discussion of FASB Statement No. 150 in the "Mandatorily Redeemable Stock" section later in this Alert). Character is also much more scrutinized by sureties, which will not tolerate questionable character on the part of contractors. As a result, some contractors may find it difficult to obtain surety credit.

At least two insurance companies have devised alternatives to surety generally referred to as alternate products. These insurance products were originally designed to protect a general contractor from subcontractor default. Unlike a surety bond, an alternate product has a deductible and guarantees payment in the event of default, but not performance. While this is a relatively new concept, some think it may be a way to circumvent some of the limitations of the surety industry.

While many surety companies, such as Reliance, Firemans' Fund, and USF&G, have merged and been absorbed, there are always new entrants into the industry. Arch Capital recently announced that it was buying the renewal rights of Kemper's surety business and XL Surety has launched an active and aggressive surety department. There are several regional surety companies, such as Employers' Mutual of Colorado and American Contractors Indemnity Company, that are targeting smaller contractors. Several well-established insurance carriers, such as Atlantic Mutual and Crum and Forster, have been seeking new business in the surety marketplace. The jumbo accounts may have to concern themselves with the availability of capacity, but for the "middle market contractor" doing less than $250 million annual volume, there is adequate capacity available.

Underwriters talk about their desire to "get back to basics." That means that they are only going to be willing to provide surety credit to well-managed firms that are adequately financed and experienced, and that have a clear vision and a means to reach that vision. They are insisting on profitable operations and retention of profits to support the operations. They want to see owners who are involved in daily management and committed to the success of the business.

None of this should come as a surprise. The good news is that those who do what they need to do in order to qualify for surety credit will find there is less competition from unqualified contractors. The sureties are doing what they are supposed to do, and are raising the bar for entry into the construction industry.

At this critical juncture in the surety industry's life cycle, the following steps may be helpful to ensure that your client's surety relationship remains free from any dramatic exposure to the surety industry's changes. Your client may need to:

- Meet regularly with its surety underwriters and foster a partnering relationship.
- Know its surety—its results, reinsurance, capacity limitations, credit, and AM Best ratings.

- Plan for more lead time for larger or unique projects and major decisions.
- Provide high-quality financial information.
- Involve its surety in major financial decisions.
- Use a professional surety broker who specializes in surety.

Construction Cost Trends

Major consolidation in the domestic steel industry, a shift in foreign exchange rates that spiked prices for imported materials, a ruling against the U.S. in its trade dispute with Canada over lumber imports, and a growing shortage of natural gas, which threatened to push energy costs higher, were among the significant cost trends that developed during the second quarter of 2003, according to *Engineering News Record*'s "Second Quarterly Cost Report."

Materials

Prices for most construction materials remained relatively stable during the second quarter of 2003. The exception to the rule is reinforcing bar prices, which surprised many estimators by posting large increases in May. The largest increases have been in the South. Rising scrap and energy costs combined with industry consolidation have resulted in a 20 percent increase in bar prices.

Variations in the price and availability of materials are not uniform across all kinds of building projects. Many materials suppliers have been feeling the brunt of price changes. In addition, many contractors are taking advantage of deep discounts with payments up front. And most public works projects have a provision for additional compensation for cost increases.

Cost trends for building materials include the following:

- *Lumber*. Lumber prices have been in a free fall for over four years despite a stiff 27 percent tariff on imports of Canadian softwood lumber, which accounts for about one-third of U.S. consumption. And prices could be set for another plunge, following the May 27, 2003, ruling by the World Trade Organization in favor of Canada in its ongoing dispute with the U.S. over the tariff. Meanwhile, market forces drove down lumber prices during the second quarter. *Engineering New Record*'s 20-city average price for the most commonly used species of two-by-fours declined by 2 percent and is down 12 percent from a year ago.

- *Petroleum-based materials.* A prolonged strike shutting down Venezuela's exports of crude oil to the U.S. and uncertainty leading up to the Iraqi war caused a surge in oil prices that immediately impacted the asphalt paving industry during the first quarter of 2003. During the first quarter, *Engineering News Record*'s 20-city average price for liquid asphalt increased 10 percent, to $174.87 per ton.
- *Steel and aluminum.* The crisis in the domestic steel industry that pushed 34 steel producers into bankruptcy, and led President Bush to impose a 30 percent tariff on imports of several flat-rolled products, appears to be easing. Domestic producers took advantage of the tariff protection and quickly consolidated during the second quarter. However, a swing in exchange rates that dramatically weakened the dollar in recent months has been even more effective than the tariff in driving cheap imports out of the U.S. market. In fact, it has been so effective that products not under the protection of tariffs, such as structural steel, have seen some of the most dramatic reductions in imports. The forecasting firm Global Insights is predicting a modest upward trend in steel prices over the next 10 years, a prediction that would be downward were it not for exchange rates.

Labor

First-year wage and benefit increases negotiated so far in 2003 in new construction labor agreements average $1.45 per hour or 4.3 percent, compared with $1.51 per hour or 4.5 percent for the same period in 2002, according to the Construction Labor Research Council (CLRC). CLRC reports that bargaining agreements that average three years have become more popular this year, reversing the recent trend toward longer agreements in the construction industry.

Help Desk—The *Engineering News Record* publishes detailed quarterly cost studies that track average prices for a wide variety of materials and labor classifications in major cities across the country. You can access summaries of the studies at the magazine's Web site at www.enr.com.

Construction cost trends such as those mentioned above must be considered in the estimates developed by construction contractors.

The Sarbanes-Oxley Act of 2002

Because provisions of the Sarbanes-Oxley Act (the corporate governance and accounting oversight bill signed into law by President Bush in late July 2002) apply directly to publicly held companies and their auditors, they will have limited direct impact on construction firms, most of which are privately held. Nevertheless, the Sarbanes-Oxley Act is having an impact on privately owned companies. For example, some privately owned companies are tweaking their corporate governance practices and taking a closer look at internal controls. In addition, some privately held companies are overhauling their boards and upgrading their compliance with accounting standards. In some states, laws have been proposed or enacted that mirror provisions of the Sarbanes-Oxley Act. Small entrepreneurial ventures that need venture capital funding and have high hopes of one day going public will also be significantly affected by the provisions of Sarbanes-Oxley. Construction contractors may feel some of the effects of the Sarbanes-Oxley Act insofar as surety companies require some of the measures brought about by the legislation as a condition of surety credit.

One of the steps taken by the AICPA to respond to the issues resulting from the Sarbanes-Oxley Act was the formation of the AICPA Special Committee on State Regulation. Working closely with state CPA societies, this high-level volunteer committee is tasked with addressing the state implications associated with the Sarbanes-Oxley Act, recommending positions to the AICPA Board of Directors, and providing resources and guidance to states with legislative or regulatory proposals. For an overview of the latest state legislative and regulatory activity, go to www.aicpa.org/download/statelegis/state_acctg_reform_legislation.pdf.

You can find information about the Sarbanes-Oxley Act of 2002 and related implementation guidance at www.aicpa.org/info/sarbanes_oxley_summary.htm.

Current Audit and Accounting Issues and Developments

Assessing Audit Risks in the Current Environment

The proper planning and execution of an audit has always required you to have a thorough understanding of the construction industry and your client's business. Business conditions in the construction industry vary greatly across contractor types and from region to region. The risks associated with building office buildings are different from those faced by a home builder; a contractor in the Northeast faces different issues than a similar contractor located on the Pacific Coast. For this reason, you must be knowledgeable about contractor types and the location in which the entity operates.

Earnings Management Challenges

As a result of perceived external pressures, companies may be tempted to manage earnings by using nonrecurring transactions or changing the method of calculating key estimates, such as estimated costs to complete, reserves, fair values, and impairments. Companies may also adopt inappropriate accounting practices resulting in improper recognition or omission of financial transactions. For material nonrecurring transactions that may require special disclosure to facilitate readers' understanding of the reported financial results, apply the guidance in Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*, in reporting the effects of changes in estimates. Inappropriate transactions or accounting practices that may result in errors requiring adjustments of financial statements include, for example, premature recognition of revenue, including improper recognition of claims and change orders that do not meet the criteria of Statement of Position (SOP) 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, failure to appropriately accrue for contingent liabilities that are probable and estimable, and failure to record unpaid purchase invoices. Additionally, you should be particularly skeptical of fourth-quarter events that result in significant revenue recognition, loss accrual, or noncash earnings, as well as gross profit fade.[2]

The appropriate level of professional skepticism is needed when corroborating management's representations. Management's explanations should make business sense. Additionally, you may need to consider corroborating management's explanations with members of the board of directors or the audit committee.

Indicators of Reporting Risk

Other indicators of potential increased accounting and reporting risk calling for increased professional skepticism include:

Liquidity matters:

- The company is undercapitalized, relying heavily on bank loans and other credit, and is in danger of violating loan covenants.
- The company is having difficulty obtaining or maintaining financing.
- The company is having difficulty obtaining surety credit.
- The company is showing liquidity problems.

Quality of earnings:

- The company is changing significant accounting policies and assumptions to less conservative ones.
- The company is overly optimistic in recognition of deferred tax assets.
- There are increasing amounts of underbillings on the balance sheet.
- The company is generating profits but not cash flow.

2. Profit fade (the reduction of the estimated gross profit over the life of a contract) is recognized as evidence of a contractor's inability to effectively estimate and/or manage a job. Profit fade is also discussed in the "Job Performance" section of this Alert.

Management characteristics:

- Management's compensation is largely tied to earnings.
- The company appears vulnerable to weakening economic conditions and management is not proactive in addressing changing conditions.
- Given the increasing age of contractor owners, there is increasing talk of selling the company, based on historical average earnings.
- There has been a significant change in senior management or the board of directors.

Auditing Construction Contracts

Auditors of construction contractors should recognize that the traditional balance sheet approach to auditing usually is not adequate when performing an audit of a contractor. The financial statements of a contractor are built from the financial results of individual contracts. Therefore, the more effective audit approach requires you to focus on the terms, financial estimates, and results of individual contracts, rather than the contract-related balance sheet that accounts for the company as a whole.

The authoritative guidance on auditing contractors is contained in the AICPA Audit and Accounting Guide *Construction Contractors.* Included in this Audit and Accounting Guide is SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts,* which is the primary authoritative accounting guidance for construction contractors.

Auditing construction contractors is complex. Such businesses rely on accurate and reliable estimates to operate their business as well as to prepare financial statements. Therefore, it is critical that you gain an understanding of the contractor's significant estimates and assumptions used in operating the business. Remember that the audit of a construction contractor's financial statements is an audit of the contractor's ability to estimate.

There are several things to consider when auditing estimates: understand the internal control structure surrounding the estimate, consider the contractor's history of accurate estimates, compare actual to budgeted figures, and review subsequent events.

The Professional Issues Task Force of the AICPA has identified the following procedures to consider when performing an audit of a construction contractor:

- *Read significant contracts.* This may seem obvious, but it is necessary to identify the terms of the contract, any guarantees, penalties, or incentives, as well as cancellation and postponement provisions. For example, reading the contract might help you identify the party responsible for additional expenses incurred as a result of weather delays.
- *Identify unique contracts.* Increase the amount of testing and professional skepticism related to these contracts because they increase the risk of improper estimates and, thus, improperly stated financial statements. This should include a review for combined and segregated contracts. If a company cannot reasonably estimate the cost or progress of a contract, it should account for the contract under the completed-contract method.
- *Understand the company's cash flow and how the company manages expenses.* In this industry, expenses are often payable prior to receiving the related cash from the contract revenue. Therefore, understanding how to realistically anticipate and manage cash flow and expenses can become critical for survival. Unfortunately, some companies win long-term contracts but cannot fund the projects long enough to realize any profit.
- *Recognize that the length of the contract period can directly affect the quality of related estimates on contracts.* The longer the contract period, the greater the risk that an estimate will be incorrect. Also, the closer a contract is to completion, the less risk there is of an incorrect estimate. Finally, the more variables inherent in an estimate, the greater the risk that an estimate will be incorrect.

- *Confirm the terms and conditions of the contract as well as the normal billing procedures.* When confirming a receivable, strongly consider confirming the original contract price, total approved change orders, total billings and payments, retainage held and whether it accrues interest, detail of any claims, back charges, or disputes, and estimated completion date or the estimate of percentage to complete.

- *Review the unapproved change orders of significant contracts.* Change orders often arise during the life of a contract, and it is necessary to adjust estimated revenue and cost for change orders that have been approved, as to both scope and price. However, when a change order has been approved as to scope but not price, carefully evaluate the specific facts and circumstances prior to including the order in estimated contract revenues. To the extent that change orders are disputed or are unapproved as to both scope and price, evaluate them as claims. Generally, recognize revenue on an unapproved change order or claim only if there is verifiable evidence to support it.

- *Visit construction contract sites.* Visiting contract sites can be a very useful audit procedure. Such a visit can provide an opportunity to view the progress of a contract and confirm that the job is progressing in accordance with the plans, specifications, and terms of the contract. Site visits might be warranted for significant contract sites where work is in the very early stages of the contract. Such a visit may help you identify the complexities of performing the contract. The site visit may also provide you with the opportunity to interview operational personnel and gain a better understanding of the responsibility the company has for performing the contract. At the site visit, it also might be helpful to speak with available subcontractors to get additional information about the progress of the contract. You may also be able to speak with a representative of the owner of the project. Furthermore, you should consider observing equipment and uninstalled inventory at the site.

- *Meet with project managers and other personnel.* Project managers play an important role in controlling and reporting job site costs. They are also close to the facts and are likely to get prompt and accurate information related to particular contracts. Meeting with the project managers will assist you in developing your plans for performing analytical procedures. It is also important to meet with other personnel who report to the project manager. In some cases, the project manager's compensation is based on job performance and information from other personnel may be useful to support the project manager's estimates.

- *Identify and understand the significant assumptions and uncertainties.* This is fundamental to performing an effective audit of an entity using contract accounting.

- *Test contract costs to make sure that costs are matched with appropriate contracts.* In some instances, companies may shift costs from unprofitable contracts to profitable ones, or shift costs from completed contracts to jobs in progress, in order to defer losses.

- *Audit estimates on uncompleted contracts.* The focus should be on the key factors and assumptions, such as those that (*a*) are significant to the estimate, (*b*) are sensitive to variation, (*c*) deviate from historical patterns, and (*d*) are subjective and susceptible to bias or misstatement. It is also useful to review revised or updated estimates of costs to complete and compare estimates with actual costs incurred after the balance sheet date.

- *See that losses are recorded as incurred,* regardless of whether the entity is using the percentage-of-completion or the completed-contract method of recognizing revenue.

- *Analytically review contracts completed and in progress.* A detailed analytical review of profit margins on completed contracts and contracts in progress will provide meaningful information as you focus your efforts on potential problem areas. You also need to remember that it is important to form appropriate expectations when performing analytical reviews.

- *Audit contracts that are larger than normal.* Often, contractors that take on jobs that are beyond their capacity get into serious trouble because of inadequate internal control and accounting systems, inexperienced project managers and estimators, among other things.
- *See that there are appropriate disclosures* relating to SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties.* Entities using contract accounting should have more than generic disclosure about the use of significant estimates in the preparation of financial statements.
- *Review the aging of receivables on contracts.* This will provide evidence that the company is collecting funds on a timely basis.
- Review gross profit on backlog. Gross profit on backlog should be factored in and compared to next year's overhead.
- *Review current work in progress reports.* This procedure should be performed before issuing the financial statements.

Although all of these procedures are important, it is important for you to use your professional judgment in designing procedures specific to your particular clients and their contracts.

Debt

You should carefully review loan agreements and test for compliance with loan covenants. In this regard, consider any "cross default" provisions, that is, a violation of one loan covenant that affects other loan covenants. Keep in mind that any debt with covenant violations that are not waived by the lender for a period of more than one year from the balance sheet date may need to be classified in the balance sheet as a current liability. Also, a recent trend is for banks to charge substantial fees for issuing waiver letters. You should inform your clients of the possibility of a fee before requesting a waiver.

As always, review the debt payment schedules and consider whether the company has the ability to pay current debt installments or to refinance the debt if necessary. When making an evaluation, it is important to remember that it is quite possible that the company will not generate as much cash flow as it did in previous years.

Going Concern

Continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. The current uncertain economic situation may cause you to have a heightened sense of awareness of a company's ability to continue as a going concern. Statement on Auditing Standards (SAS) No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1, AU sec. 341), as amended, addresses your responsibilities to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern. Negative trends, loan covenant violations, and legal proceedings might be indicators that there could be substantial doubt about the ability of an entity to continue as a going concern.

Many contractors are seeing very large increases in their insurance rates. Some contractors cannot obtain commercial general liability insurance or find that it is available from only one or a few carriers. Such situations will affect the contractor that has a long-term contract bid initiated when insurance rates were lower and could call into question the going-concern assumption for a contractor that cannot obtain insurance.

You should also be aware of other issues, such as high turnover of either financial or construction personnel and difficulty in obtaining surety credit.

When evaluating management's plans to continue as a going concern, an appropriate level of professional skepticism is important. For example, the company's assumptions about its ability to continue as a going concern should be scrutinized to assess whether they are based on overly optimistic or "once-in-a-lifetime" occurrences.

Job Performance

It is difficult for contractors to be profitable when projects are not completed on time. A number of contracts may even require that the contractor pay penalties if the job is not completed by a specified date. Jobs that are significantly behind their established timetable may require additional audit attention and procedures to determine that the original estimates of gross profit have not deteriorated (called "profit fade") and that the job has not incurred a loss (which should be recognized immediately).

For contractors that are experiencing layoffs and increased turnover, it may require some time to find a competent replacement for key operational employees who leave the company before the job is completed. The contractor may be forced to use less experienced personnel in certain positions, including management, and that lack of experience can result in the job taking longer to complete and costing more than originally anticipated.

In reviewing your client's contracts, be alert to problems caused by employee turnover or lack of adequate staffing. If your client has lost a key employee or seems to lack enough personnel to complete the projects it has committed to, consider making inquiries of management to determine how the client has factored these circumstances into the estimation process.

Also, be alert for "disguised payroll costs." With the rising cost of payroll burden, including health insurance and workers' compensation, there is a trend for contractors to hire subcontractors instead of employees. You should look for a large increase in subcontractor costs and consider whether those costs are disguised payroll costs. Should this situation exist, there is an increased risk of those costs being reclassified from subcontractors to employees, with the contractor being assessed with penalties and interest from misreporting.

A disruption in the supply of key materials can also affect the ability of the contractor to complete the project on time. During the past year, most construction materials were in adequate supply. However, the events of recent years have shown that an unexpected or continuing surge in demand for materials can quickly outpace supply and create shortages and delays. Additionally, the lead time required for specifically fabricated items may affect the contractor's ability to deliver the project on time.

You might consider performing procedures to identify price hikes in your client's vital materials. Determine whether those price hikes are the result of inadequate supply. If so, assess your client's vulnerability to delays caused by the inability to obtain these materials on a regular and timely basis. Make inquiries to discover what steps the client has taken to mitigate these risks.

Auditing Estimates on Uncompleted Contracts

A contractor's ability to estimate job costs is critical from both an operational and a financial reporting standpoint. Contractors that cannot accurately estimate job costs will be unable to manage their working capital and maintain consistent levels of profitability over an extended period of time. For most contractors, the estimate of costs to complete a project is the fuel that drives revenue recognition. For that reason, inaccurate or unsupported estimates of costs to complete jobs in progress can result in materially misstated financial statements.

When auditing construction estimates, you should be familiar with guidance provided in SAS No. 57, *Auditing Accounting Estimates* (AICPA, *Professional Standards*, vol. 1, AU sec. 342), the AICPA Practice Aid *Auditing Estimates and Other Soft Accounting Information*, SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, and the Audit and Accounting Guide *Construction Contractors*.

Pay close attention to the underlying assumptions used by management when auditing accounting estimates. Management is responsible for making estimates included in the financial statements, and those estimates may be based wholly or in part on subjective factors such as experience of past and current events and expectations of future conditions. Remain alert to the possibility of management's overreliance on economic information based on favorable conditions to predict future outcomes.

Help Desk—Marshall and Swift is a consulting firm that provides comprehensive cost data for the construction industry. Included on its Web site is a cost estimator that allows the user to estimate the cost of a project based on current costs in any geographic area. You may find these estimates helpful in performing analytical procedures on client estimates. You can access the cost estimator at www.construction.com.

Consideration of Fraud

When considering fraud, auditors should follow the guidance provided in SAS No. 99, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316). SAS No. 99 addresses the following issues:

- Description and characteristics of fraud
- The importance of exercising professional skepticism
- Discussion among engagement personnel regarding the risks of material misstatement owing to fraud
- Obtaining the information needed to identify risks of material misstatement owing to fraud
- Identifying risks that may result in a material misstatement owing to fraud
- Assessing the identified risks after taking into account an evaluation of the entity's programs and controls
- Responding to the results of the assessment
- Evaluating audit evidence
- Communicating about fraud to management, the audit committee, and others
- Documenting the auditor's consideration of fraud

Some examples of fraud risk factors that may exist in the construction industry include the following:

- Fraudulent financial reporting, including—
  —A willingness to shift costs between completed and uncompleted contracts or to use other techniques to manipulate percentage-of-completion estimates
  —Excessive under- or overbillings on individual jobs
  —A large number of contract performance problems

—A significant portion of employees' or owners' compensation represented by bonuses, the value of which is contingent on the contractor's achieving unduly aggressive financial targets

- Misappropriation of assets, including—
  —Tools, equipment, and supplies that are susceptible to misappropriation
  —Lack of management review and control over disbursements such as payroll and material purchases that can be used to misappropriate cash

The general state of the economy may raise several fraud risk factors. For example, a significant fraud risk factor to consider is whether management may be under substantial pressure to intentionally underestimate the costs to complete contracts in order to accelerate income. Other fraud risk factors for management include pressure to obtain additional capital, to obtain additional bonding capacity, or to maintain current debt covenants at their stated levels.

The following exhibits illustrate potential fraud techniques in the construction industry. Exhibit 2, "Potential Timing Manipulation Techniques," illustrates how a contractor may manipulate timing of recognition and the related financial statement effects. Exhibit 3, "Potential Measurement/Valuation Manipulation Techniques," illustrates how a contractor may manipulate the measurement of valuation of certain financial statement items and the related financial statement effects.[3]

Exhibit 2 Potential Timing Manipulation Techniques

Account Type	*Name of Specific Account*	*Technique*	*Financial Statement Effects*
Asset	Inventory	Report inventory, but not associated accounts payable.	Overstate assets.

3. These exhibits were developed by Eric P. Wallace, CPA, and are used by permission.

Account Type	*Name of Specific Account*	*Technique*	*Financial Statement Effects*
Asset	Accounts receivable	Report retainage as accounts receivable.	None, but can influence loan covenants, enabling contractor to borrow more on line of credit.
Asset	Accounts receivable or retainage	Report claims and unapproved change orders as retainage or accounts receivable.	Overstate assets and revenues.
Asset	Costs and estimated earnings in excess of billings on uncompleted contracts	Underestimate costs to complete. Associate costs for completed contracts to uncompleted contracts.	Overstate assets and revenues.
Liability	Billings in excess of costs and estimated earnings on uncompleted contracts	Underestimate costs to complete.	Understate liabilities and overstate revenues.
Liability	Estimated losses on uncompleted contracts	Understate expected loss on open uncompleted contracts.	Understate liabilities and job costs.
Revenue	Contract revenue	Move costs on completed contracts to uncompleted contracts.	Overstate revenues and assets.
Revenue	Contract revenue	Increase expected total contract amount by unpriced and unapproved change orders or claims.	Overstate revenues and assets.
Expense—Job Costs	Job costs accounts	Recognize job costs prior to installation or performance of service on profitable contracts.	Overstate revenues and assets.
Expense—General and Administrative	Any G&A accounts	Do not record G&A expenses and associated accounts payable.	Understate expenses and liabilities.

Exhibit 3 Potential Measurement/Valuation Manipulation Techniques

Account Type	*Name of Specific Account*	*Technique*	*Financial Statement Effects*
Asset	Accounts receivable	Understate allowance for doubtful accounts.	Overstate assets, understate expenses.
Asset	Accounts receivable, or over- or underbilling accounts	Improperly bill and measure change orders or claim or contracts.	Overstate assets and revenues.
Asset	Costs and estimated earnings in excess of billings or uncompleted contracts	Recognize percentage of completion by any method other than cost-to-cost (preferred by sureties).	Can affect timing in addition to distorting measurement of assets and revenues.
Liability	Billings in excess of costs or uncompleted contracts	Measure competition by cost-to-cost, but contractor does not include certain job costs.	Can affect calculation of percentage of completion.
Expenses—Job Costs	Overhead accounts, such as labor, equipment, and general overhead	Manipulate asset and revenue effect of these costs pools.	Overstate assets or revenues.
Revenue and Expenses	Revenue and expenses of joint ventures (JVs)	Leave off reporting of JVs, report JV revenue and expenses in a manner different (calculation of percentage of completion) from main financial statements, or recognize improper percentage of ownership of JVs than actual ownership.	Either over- or understate revenues, expenses, assets, and liabilities.
Asset	Equipment	Report property, vehicles, and/or equipment at current fair value instead of at cost less accumulated depreciation.	Overstate assets.
Revenue	Contract revenues	Report in advance full amount of gross profit on uncompleted contracts.	Overstate assets and revenues.

SAS No. 99 contains two required risk assessments: (*1*) you should presume that improper revenue recognition is a fraud risk and (*2*) you should identify the risks of management override of controls.

The following are examples of how revenue may be recognized improperly by construction contractors:

- The revenue recognition process for construction contractors using the percentage-of-completion method is often based on an estimate of total cost. Underestimation of total contract cost would present the contract as more complete than it really is and, as a consequence, would result in excess gross profit on the job and acceleration of the revenue recognition process. Preparation of accurate work in process schedules is essential for proper revenue recognition. You should select certain job sites for observation and discussion of stage of completion with engineering personnel. Contracts under 10 percent complete and over 90 percent complete generally present less risk. This is simply because those under 10 percent complete have relatively little revenue recognized based on the estimates. Those over 90 percent complete are at a stage where most of the costs have been incurred, and therefore the risk of revenue manipulation is minimized at this point.

- Revenue recognition may be accelerated if a contractor reclassifies inventory and prepaid amounts to current job costs to satisfy working capital requirements of bonding companies.

- Contractors also may accelerate revenue recognition by inappropriately charging to a job the entire cost of capitalizable construction equipment all at once, instead of capitalizing this equipment, depreciating it over its useful life, and allocating to the job just an applicable portion of depreciation expense. When a contractor uses the percentage-of-completion method, this will accelerate the revenue recognition process by increasing costs incurred to date. In an effort to further increase its revenues, the construction contractor may also attempt to charge its client for equipment that may be used on several jobs, either by submitting change orders for fixed-price contracts or by simply including this equipment among costs for time-and-materials contracts.

- If the contractor has adopted the accounting policy that allows for total costs recognition on claims receivable, the amount to be recognized should be limited to the actual costs incurred deemed to be realizable. Often, claims information is based on estimates prepared by outside consultants who are preparing for litigation. Those estimates generally include costs that are not recognizable under SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, and care needs to be exercised to ensure that amounts recognized are limited to the actual costs incurred.
- Some construction contractors may assert the inability to estimate costs in an attempt to justify continued use of the completed-contract method allowed in SOP 81-1 under such circumstances. Such claims may have had some validity decades ago when estimates were done by hand. However, the abundance of off-the-shelf software that assists in making estimates and tracking costs on contracts renders most of such claims invalid.

Even if you do not identify specific risks of material misstatement owing to fraud, there is a possibility that management override of controls could occur. Accordingly, you should address that risk apart from any conclusions regarding the existence of more specifically identifiable risks. SAS No. 99 specifically describes procedures that should be performed to further address the risk of management override of controls. These procedures include (*1*) examining journal entries and other adjustments for evidence of possible material misstatement owing to fraud, (*2*) reviewing accounting estimates for biases that could result in material misstatement owing to fraud, and (*3*) evaluating the business rationale for significant unusual transactions.

The AICPA has issued additional guidance on the implementation of SAS No. 99, including *Fraud Detection in a GAAS Audit—SAS No. 99 Implementation Guide* by Michael J. Ramos, CPA (product no. 006613kk), and CPE courses titled *Fraud and the Financial Statement Audit: Auditor Responsibilities Under New SAS* (product no. 731810kk), *Auditing for Internal Fraud* (product no. 730237kk), and *Identifying Fraudulent Financial Transactions* (product no. 730244kk). The 2003 edition of the AICPA Audit and Accounting Guide *Construction Contractors* includes a detailed discussion of SAS No. 99 tailored specifically for the construction industry (product no. 012583kk).

Mold

Over the last few years, the discovery of mold in homes, schools, churches, courthouses, and other public and private buildings has fueled a legal firestorm. Trial lawyers have started filing claims and cases at an alarming rate. The defendants include building owners, construction contractors, design professionals, and other parties to the construction process. And it is becoming clear that neither building owners nor construction contractors can count on the insurance industry to cover these costs. Property insurance policies have long excluded any property damage or bodily injury resulting from building operation or maintenance. Going forward, builders' risk and other property insurance policies are very likely to exclude mold arising from the perils that they do cover. Both building owners and construction contractors are also likely to find mold excluded from their commercial general liability policies. For some period of time, building owners and construction contractors will need to find other ways to manage the risk of mold claims or litigation.

Because of this increasing risk of claims, you may need to discuss with your client the related potential liabilities or accruals. In an effort to protect contractors and prevent an industry crisis, the Associate General Contractors of America (AGC) is launching a training and education initiative. Among the issues addressed on the AGC Web site (www.agc.org) are the following:

- *Is your mold claim covered?* Explores the several issues that can arise if and when a contractor seeks insurance coverage for work completed in the past—before the insurance industry began to put specific and express mold exclusions into commercial general liability and other insurance policies.

- *Environmental insurance solutions for mold.* Outlines and describes the mold insurance coverage that is likely to be available for future work, including steps necessary to secure such coverage.
- *Pending state legislation addressing the growing issues surrounding mold.* Covers mold and related legislation several states are considering.
- *Managing the risk of mold.* Outlines and explains the federal government's interest in the subject of mold, including the prospects of congressional action and what federal agencies are doing.

Accounting for Guarantees

In November 2002, the Financial Accounting Standards Board (FASB) issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.* The Interpretation elaborates on the existing disclosure requirements for most guarantees, including loan guarantees such as standby letters of credit. It also clarifies that at the time a company issues a guarantee, the company must recognize an initial liability for the fair value, or market value, of the obligations it assumes under that guarantee and must disclose that information in its interim and annual financial statements.

The initial recognition and initial measurement provisions of Interpretation No. 45 apply on a prospective basis to guarantees issued or modified after December 31, 2002, regardless of the guarantor's fiscal year end. The disclosure requirements in the Interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002.

Readers should also be aware that FASB has proposed issuing a FASB Staff Position (FSP) related to Interpretation No. 45. FSPs are available on the FASB Web site at www.fasb.org.

Affiliated Entities

In the construction industry, contractors frequently participate in joint ventures or have a direct or indirect affiliation with other entities. The prevalence of such arrangements in the industry can be attributed to factors such as legal liability, taxation, competition, ownership and operating arrangements, labor and labor union considerations, and regulatory requirements. As a result of these types of relationships among entities, construction firms are frequently involved in related-party transactions, as that term is defined in FASB Statement of Financial Accounting Standards No. 57, *Related Party Disclosures*. Review your contractor client's participations in joint ventures to evaluate whether investments in joint ventures are reported properly. You should also review joint venture agreements and document your client's participation.

The audit considerations for a contractor's participation in a partnership are similar to those for participation in a corporate joint venture. Partner participation may differ primarily in relation to the contractor's unlimited liability as a general partner for partnership obligations.

For any type of venture, remember to consider the nature of the venture, the scope of its operations, and the extent of involvement of each participant.

Variable Interest Entities

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities*. This Interpretation will have major implications for many construction contractors. The existing guidance had been criticized for enabling companies to keep billions of dollars of assets and liabilities off balance sheet by moving them into variable interest entities (VIEs) or other entities that they did not "control." Furthermore, an independent third party had to invest only minimal equity in the entity, typically equal to 3 percent of the entity's capitalization.

A VIE is a corporation, partnership, trust, or any other legal structure used for business purposes that either does not have equity investors with voting rights or has equity investors that do not provide sufficient financial resources for the entity to support its activities. A VIE often holds financial assets, including loans or receivables, real estate, or other property.

Under the previous rule, one company generally included another entity in its consolidated financial statements only if it controlled the entity through voting interests. Interpretation No. 46 changes that by requiring a company to consolidate a VIE if that company either is subject to a majority of the risk of loss from the VIE's activities or is entitled to receive a majority of the VIE's residual returns, or both.

Effective Date. All enterprises with variable interests in variable interest entities created after January 31, 2003, should apply the provisions of this Interpretation to those entities immediately. In October, FASB issued FASB Staff Position (FSP) FIN 46-6, *Effective Date of FASB Interpretation No. 46*, which defers the implementation date of Interpretation No. 46 for public companies for arrangements existing prior to February 1, 2003, to fiscal periods ending after December 15, 2003.

A nonpublic entity with a variable interest in a variable interest entity created before February 1, 2003, should apply the provisions of this Interpretation (other than the transition disclosure provisions in paragraph 26) to that entity no later than the end of the first annual reporting period beginning after June 15, 2003.

FASB Staff Positions. The FASB has issued and proposed several FSPs related to Interpretation No. 46 that may be of interest to construction contractors and their auditors. FSPs are available on the FASB Web site at www.fasb.org.

Example

Assume a contractor invests $40 million equity in a project owned by a VIE, and a commercial bank provides a $60 million fixed-rate loan to round out the project's financing. Generally, a loan is subject to consideration as a VIE. However, if the loan is not expected to change in value (in this case, the rate is fixed, the borrower has a contractual obligation to repay only $60 million, and the credit risk is determined not to be significant), it would generally not have enough variability for the lender to be the primary beneficiary. Thus, if the project increases in value from \$100 million to \$130 million, the contractor's equity will increase to \$70 million but the lender's interest will remain the same at \$60 million. Because the contractor bears the risks and enjoys the rewards at the outset, it is the primary beneficiary of the project and is required to consolidate the VIE.

Suppose, however, that the project begins to fail and falls in value to \$50 million, thereby requiring a debt restructuring (assuming the lender does not foreclose) that necessitates a change in the original contractual arrangements. The contractor's equity interest is wiped out but the lender's interest is still \$60 million. As a result, the lender may become the primary beneficiary and be required to consolidate the project because it has a variable interest and bears all the risk of the VIE.

As a result of FASB Interpretation No. 46, you should review your client's participations in VIEs to evaluate whether these entities should be consolidated. In many cases, real estate partnerships, LLCs, and other entities that are guaranteed by the operating entity (for example, the contractor) or its owner will have to be consolidated.

Using Hedging Transactions to Manage Risk

Many construction contractors enter into hedging transactions to manage various risks. The most common risks that lend themselves to hedging strategies include those related to interest rate or foreign currency exposures. Construction contractors may also enter into weather-derivative contracts (that is, contracts indexed to climatic or geological variables). Emerging Issues Task Force (EITF) Issue No. 99-2, *Accounting for Weather Derivatives*, prescribes the accounting treatment for weather derivatives.

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, provides the primary guidance on accounting for hedging transactions. In addition, the FASB recently issued Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. SAS No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (AICPA, *Professional Standards*, vol. 1, AU sec. 332), provides guidance on auditing hedging transactions. The AICPA's Audit Guide *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* provides practical guidance for implementing SAS No. 92 on all types of audit engagements. The Guide includes an overview of derivatives and securities and how various entities use them, a summary of accounting guidance, and a discussion of the three elements of the auditing framework (inherent risk, control risk, and substantive procedures). Additionally, the Guide includes practical illustrations and case studies.

If your client holds derivative instruments or engages in hedging transactions, you should become thoroughly familiar with the relevant authoritative accounting and auditing literature.

Mandatorily Redeemable Stock

In May, the FASB issued Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. Most contractors are closely held, and many of them have buy-sell agreements requiring the company to redeem the shares of the owners in the event of death or disability or other leave of employment. Many sureties require that contractors have such an agreement. For the many privately held construction companies that utilize even simple buy-sell agreements for share redemption (whether or not these agreements are funded by life insurance policies or by equity "buy back" that can be paid over time), this new Statement will have far-reaching consequences.

FASB Statement No. 150 will require companies with mandatory redemption provisions in their agreements to treat the amounts necessary to meet the redemption clauses as debt rather than equity. In many cases, the redemption amount may exceed the equity. In any case, equity can be seriously depleted. The depletion of the equity will put further pressures on sureties and creditors to continue providing surety and banking credit.

The end result of FASB Statement No. 150 in reducing contractors' equity will be to place loan agreements and surety bonds in default of these requirements, without any change in economic substance. If privately held contractors are considered in default of their loan(s) and/or surety bond(s) based on FASB Statement No. 150, many of these companies may go out of business.

Many privately held contractors hold real estate and equipment showing fair market values greater than their historic cost basis. Consequently, the recognition and measurement of the liability of the potential buy back of equity under FASB Statement No. 150 will, in many cases, produce a liability equal to or greater than 100 percent of the contractor's prior equity position.

You may wish to consult with your clients before the application date of FASB Statement No. 150 and review their buy-sell and other agreements.

In November 2003, the FASB issued FSP FAS 150-3 which deferred the effective date for applying the provisions of FASB Statement No. 150 for (*1*) mandatorily redeemable financial instruments of certain nonpublic entities and (*2*) certain mandatorily redeemable noncontrolling interests (of all entities, public and nonpublic). It should be pointed out that the deferral for mandatorily redeemable financial instruments of certain nonpublic entities does not apply to a company that is considered to be an SEC registrant, even though it meets the definition of a nonpublic entity in FASB Statement No. 150. Companies should carefully review the definition in this FSP to determine whether they or a subsidiary are considered an SEC registrant, and therefore are not eligible for this deferral. FSP FAS 150-3 also sets forth disclosure and transition guidance for entities that are subject to this deferral. Please refer to FSP FAS 150-3 for more information.

The FASB has also issued several other FSPs related to FASB Statement No. 150 that may be of interest to construction contractors and their auditors. FSPs are available on the FASB Web site at www.fasb.org.

Recent Auditing and Attestation Pronouncements and Other Guidance

Presented below is a list of auditing and attestation pronouncements, guides, and other guidance issued since the publication of last year's Alert. The AICPA general *Audit Risk Alert—2003/04* (product no. 022334kk) contains a summary explanation of all these issuances. The Public Company Accounting Oversight Board (PCAOB) sets standards for audits of public companies. See the PCAOB Web site at www.pcaobus.org for information about PCAOB activities and any standards issued by the PCAOB. For information on auditing and attestation standards issued subsequent to the publication of this Alert, please refer to AICPA Online at www.aicpa.org/members/div/auditstd/technic.htm and to the PCAOB Web site. You may also look for announcements of newly issued standards in the *CPA Letter*, the *Journal of Accountancy*, and the quarterly electronic newsletter *In Our Opinion*, issued by the AICPA Auditing Standards Team and available at www.aicpa.org.

SAS No. 101	*Auditing Fair Value Measurements and Disclosures* (AICPA, *Professional Standards*, vol. 1, AU sec. 328). Issued in January 2003, this SAS is effective for audits of financial statements for periods beginning on or after June 15, 2003. Earlier application is permitted.
Audit Interpretation of SAS No. 58, *Reports on Audited Financial Statements*	Interpretation No. 16, "Effect on Auditor's Report of Omission of Schedule of Investments by Investment Partnerships That Are Exempt From Securities and Exchange Commission Registration Under the Investment Company Act of 1940" (AICPA, *Professional Standards*, vol. 1, AU sec. 9508). Published in the June 2003 *Journal of Accountancy*.
Audit Interpretation of SAS No. 31, *Evidential Matter*	Amendment of Interpretation No. 2, "The Effect of an Inability to Obtain Evidential Matter Relating to Income Tax Accruals" (AICPA, *Professional Standards*, vol. 1, AU sec. 9326). Published in the June 2003 *Journal of Accountancy*.
Audit Guide	*Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards* (with conforming changes as of May 1, 2003). This Audit Guide is the former SOP 98-3, *Audits of*

	States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards.
Attest Interpretation of Statement on Standards for Attestation Engagements (SSAE) No. 10, *Attestation Standards: Revision and Recodification*	Interpretation No. 5, "Attest Engagements on Financial Information Included in XBRL Instance Documents" (AICPA, *Professional Standards*, vol. 1, AT sec. 9101). Published in the November 2003 *Journal of Accountancy*.
SOP No. 03-2	*Attest Engagements on Greenhouse Gas Emissions Information* Issued in September 2003, this SOP is effective for reports on attest engagements on GHG emissions information issued on or after December 15, 2003. Early implementation is permitted.
Practice Alert No. 2003-1	*Audit Confirmations*
Practice Alert No. 2003-2	*Journal Entries and Other Adjustments*
Toolkit	*Auditing Fair Value Measurements and Disclosures: Allocations of the Purchase Price Under FASB Statement of Financial Accounting Standards No. 141,* Business Combinations, *and Tests of Impairment Under FASB Statements No. 142,* Goodwill and Other Intangible Assets, *and No. 144,* Accounting for the Impairment or Disposal of Long-Lived Assets
PCAOB Rule 3100	This Rule generally requires all registered public accounting firms to adhere to the PCAOB's auditing and related professional practice standards in connection with the preparation or issuance of any audit report for an issuer and in their auditing and related attestation practices.
PCAOB Rule 3200T	This Rule requires that in connection with the preparation or issuance of any audit report, a registered public accounting firm and its associated persons shall comply with GAAS, as described in SAS No. 95, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1, AU sec. 150), as in existence on April 16, 2003.
PCAOB Rule 3300T	This Rule requires that in connection with an engagement (1) described in the AICPA Auditing Standards Board's (ASB's) SSAE No. 10 and (2) related to the preparation or issuance of audit reports for issuers, a registered public accounting firm and its associated persons shall comply with the SSAEs, and related interpretations and SOPs, as in existence on April 16, 2003.

(continued)

PCAOB Rule 3400T	A registered public accounting firm and its associated persons shall comply with quality control standards, as described in (1) the ASB's Statements on Quality Control Standards, as in existence on April 16, 2003, and (2) the AICPA SEC Practice Section's Requirements of Membership *(d)*, *(f)* (first sentence), *(l)*, *(m)*, *(n)*, *(1)*, and *(o)*, as in existence on April 16, 2003.

To obtain copies of AICPA standards and guides, contact the Member Satisfaction Center at (888) 777-7077 or go online at www.cpa2biz.com.

Accounting Pronouncements and Guidance Update

Presented below is a list of recently issued accounting pronouncements and other guidance issued since the publication of last year's Alert. For information on accounting standards issued subsequent to the publication of this Alert, please refer to the AICPA Web site at www.aicpa.org and the FASB Web site at www.fasb.org. All FASB pronouncements are now available free of charge on the FASB Web site. You may also look for announcements of newly issued standards in the *CPA Letter* and the *Journal of Accountancy*.

FASB Statement No. 148	*Accounting for Stock-Based Compensation—Transition and Disclosure—an amendment of FASB Statement No. 123*
FASB Statement No. 149	*Amendment of Statement 133 on Derivative Instruments and Hedging Activities*
FASB Statement No. 150	*Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*
FASB Interpretation No. 45	*Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*
FASB Interpretation No. 46	Consolidation of Variable Interest Entities

On the Horizon

Auditors should keep abreast of auditing and accounting developments and upcoming guidance that may affect their engagements.

Auditors of public companies should keep abreast of standards and rules issued by the Public Company Accounting Oversight Board (PCAOB). The AICPA general *Audit Risk Alert—2003/04* (product no. 022334kk) summarizes some of the more significant ongoing projects and exposure drafts outstanding. Presented below is brief information about certain ongoing projects and exposure drafts that are especially relevant to the construction industry. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing generally accepted accounting practices (GAAP) or generally accepted auditing standards (GAAS).

The following table lists the various standard-setting bodies' Web sites, where information may be obtained on outstanding exposure drafts and where copies may be obtained for downloading.

Standard-Setting Body	*Web Site*
AICPA Auditing Standards Board (ASB). *Note that for audits of public companies, the Public Company Accounting Oversight Board sets auditing standards.*	www.aicpa.org/members/div/auditstd/drafts.htm
AICPA Accounting Standards Executive Committee (AcSEC)	www.aicpa.org/members/div/acctstd/edo/index.htm
Financial Accounting Standards Board (FASB)	www.rutgers.edu/Accounting/raw/fasb/draft/draftpg.html
Professional Ethics Executive Committee	www.aicpa.org/members/div/ethics/index.htm
Public Company Accounting Oversight Board (PCAOB)	www.pcaobus.org

Help Desk—The AICPA's standard-setting committees publish exposure drafts of proposed professional standards exclusively on the AICPA Web site. The AICPA will notify interested parties by e-mail about new exposure drafts. To be put on the notification list for all AICPA exposure drafts, send your e-mail address to memsat@aicpa.org. Indicate "exposure draft e-mail list" in the subject header field to help process the submission more efficiently. Include your full name, mailing address, and, if known, your membership and subscriber number in the message.

New Framework for the Audit Process[4]

The Auditing Standards Board (ASB) is reviewing auditors' consideration of the risk assessment process in the auditing standards, including the necessary understanding of the client's business and the relationships among inherent, control, fraud, and other risks. The ASB issued a series of exposure drafts in early 2003. Some participants in the process expect the final standards to have an effect on the conduct of audits that has not been seen since the "Expectation Gap" standards were issued in 1988.

Some of the more important changes to the standards that have been proposed are the following:

- A requirement for a more robust understanding of the entity's business and environment that is more clearly linked to the assessment of the risk of material misstatement of the financial statements. (Among other things, this will improve the auditor's assessment of inherent risk and eliminate the "default" to assess inherent risk at the maximum.)
- An increased emphasis on the importance of entity controls with clearer guidance on what constitutes a sufficient knowledge of controls to plan the audit.
- A clarification of how the auditor may obtain evidence about the effectiveness of controls in obtaining an understanding of controls.
- A clarification of how the auditor plans and performs auditing procedures differently for higher and lower assessed risks of material misstatement at the assertion level while retaining a "safety net" of procedures.

These changes collectively are intended to improve the guidance on how the auditor operationalizes the audit risk model.

4. Note that this discussion of auditing standards does not apply to the audits of public companies.

You should keep abreast of the status of these projects and projected exposure drafts, inasmuch as they will substantially affect the audit process. More information can be obtained on the AICPA's Web site at www.aicpa.org.

AICPA Resource Central

The following publications deliver valuable guidance and practical assistance as potent tools to be used on your construction engagements (product numbers appear in parentheses).

- Audit Guide *Auditing Derivative Instruments, Hedging Activities and Investments in Securities* (012520kk)
- Audit Guide *Auditing Revenue in Certain Industries* (012510kk)
- Audit Guide *Audit Sampling* (012530kk)
- Audit Guide *Analytical Procedures* (012551kk)
- Practice Aid *Auditing Estimates and Other Soft Accounting Information* (010010kk)
- *Accounting Trends and Techniques—2003* (009895kk)
- Practice Aid *Preparing and Reporting on Cash- and Tax-Basis Financial Statements* (006701kk)

Audit and Accounting Manual

The *Audit and Accounting Manual* (product no. 005133kk) is a valuable nonauthoritative practice tool designed to provide assistance for audit, review, and compilation engagements. The Manual contains numerous practice aids, samples, and illustrations, including audit programs, auditors' reports, checklists, engagement letters, management representation letters, and confirmation letters.

AICPA reSOURCE: Online Accounting and Auditing Literature

Get access—anytime, anywhere—to the AICPA's latest Professional Standards, Technical Practice Aids, Audit and Accounting Guides (more than 20!), Audit Risk Alerts (more than 15!), and

Accounting Trends and Techniques. To subscribe to this essential online service for accounting professionals, go to cpa2biz.com

Educational Courses

The AICPA has developed a number of continuing professional education (CPE) courses that are valuable to CPAs working in the construction industry. Those courses include (product numbers are in parentheses):

- *AICPA's Annual Accounting and Auditing Workshop* (2003-2004 edition) (737186kk, text; 187086kk, video). Whether you are in industry or public practice, this course keeps you current and informed and shows you how to apply the most recent standards.
- *The AICPA's Guide to Consolidations and Business Combinations* (735125kk). Learn how FASB Statements No.141 and No. 142 have changed the rules for business combinations and goodwill accounting.
- *Auditing in a Paperless Society* (730122kk). Now that paper is slowly diminishing, where do you go? This course will teach you how to develop strategies for auditing around, through, and with a computer.
- *Real Estate Accounting and Auditing* (730601kk). This course provides an in-depth study of the unique requirements that apply at each stage of the real estate life cycle.

Online CPE

AICPA InfoBytes, offered exclusively through CPA2Biz.com, is AICPA's flagship online learning product. Selected as one of *Accounting Today*'s top 100 products for 2003, AICPA InfoBytes now offers a free trial subscription to the entire product for up to 30 days. AICPA members pay $149 ($369 nonmembers) for a new subscription and $119 ($319 nonmembers) for the annual renewal. Divided into one- and two-credit courses that are available 24/7, AICPA InfoBytes offers hundreds of hours of learning in a wide variety of topics. To register or learn more, visit www.cpa2biz.com/infobytes.

CPE Self-Study Course CD-ROM

AICPA's Standards Update and Implementation Guide (product no. 738460) is a self-study course that helps you keep on top of the latest standards. Issued twice a year, this cutting-edge course focuses primarily on new pronouncements that will become effective during the upcoming audit cycle, but also includes a "refresher" on topics of continued interest.

Member Satisfaction Center

To order AICPA products, receive information about AICPA activities, and find help on your membership questions call the AICPA Member Satisfaction Center at (888) 777-7077.

Technical Hotline and Ethics Hotline

Do you have a complex technical question about generally accepted accounting principles (GAAP), other comprehensive bases of accounting (OCBOA), accounting, auditing, compilation engagements, review engagements, or other technical matters? If so, use the AICPA's Accounting and Auditing Technical Hotline. AICPA staff will research your question and call you back with their answer. You can reach the Technical Hotline at (888) 777-7077.

In addition to the Technical Hotline, the AICPA also offers an Ethics Hotline. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. You can reach the Ethics Hotline at (888) 777-7077.

Conferences

Among the many interesting conferences the AICPA offers, there is one that might interest you and your construction industry clients. Held late each fall, the AICPA National Construction Industry Conference presents a comprehensive program revealing latest trends and developments in the construction industry. The conference offers a national perspective and addresses the newest trends in conducting business, among other topics.

For additional information, contact CPA2biz at its Web site, cpa2biz.com.

Web Sites[5]

AICPA Online and CPA2biz

Here is a unique opportunity to stay abreast of matters relevant to the CPA profession! AICPA Online, at aicpa.org, informs you of developments in the accounting and auditing world as well as developments in congressional and political affairs affecting CPAs. In addition, cpa2biz.com offers you all the latest AICPA products, including more than 15 Audit Risk Alerts, more than 20 Audit and Accounting Guides, the professional standards, and CPE courses.

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This Audit Risk Alert replaces *Construction Contractors Industry Developments—2002/03*. *Construction Contractors Industry Developments* is published annually. As you encounter audit or industry issues that you believe warrant discussion in next year's Alert, please feel free to share those with us. Any other comments that you have about the Alert would also be appreciated. You may e-mail these comments to rdurak@aicpa.org or write to:

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5. Additional helpful Web sites are presented in Appendix A.

APPENDIX A
Helpful Web Sites

Here are some useful Web sites that may provide valuable information as you plan your client engagements. In addition to these Web sites, be sure to review those listed in the "On the Horizon" section of this Alert.

General Web Sites of Interest

Name of Site	*Content*	*Internet Address*
American Institute of CPAs	Summaries of recent auditing and other professional standards as well as other AICPA activities	www.aicpa.org
Financial Accounting Standards Board	Summaries of recent accounting pronouncements and other FASB activities	www.fasb.org
The Electronic Accountant	World Wide Web magazine that features up-to-the-minute news for accountants	www.electronic accountant.com
AuditNet	Electronic communications among audit professionals	www.cowan.edu.au/ mra/home.htm
CPAnet	Links to other Web sites of interest to CPAs	www.cpalinks.com/
Accountant's Home Page	Resources for accountants and financial and business professionals	www.computer cpa.com/
Double Entries	A weekly newsletter on accounting and auditing around the world	www.csu.edu.au/lists.anet/ ADBLE-L/index.html
U.S. Tax Code Online	A complete text of the U.S. Tax Code	www.fourmilab.ch/ ustax/ustax.html
Federal Reserve Bank of New York	Key interest rates	www.ny.frb.org/pihome /statistics/dlyrates
Cybersolve	Online financial calculators, such as ratio and breakeven analysis	www.cybersolve.com/ tools1.html

(*continued*)

Name of Site	*Content*	*Internet Address*
FedWorld. Gov	U.S. Department of Commerce-sponsored site providing access to government publications	www.fedworld.com
Hoovers Online	Online information on various companies and industries	www.hoovers.com
Ask Jeeves	Search engine that uses a user-friendly question format and provides simultaneous search results from other search engines (e.g., Excite, Yahoo, AltaVista)	www.askjeeves.com
Vision Project	Information on the profession's Vision project	www.cpavision.org/horizon
Internet Bulletin for CPAs	CPA tool for Internet sites, discussion groups, and other resources for CPAs	www.kentis.com/ib.html
Governmental Accounting Standards Board	Summaries of recent accounting pronouncements and other GASB activities	www.gasb.org
Society of Industrial and Office Realtors	Industrial and office real estate information	www.sior.com
Engineering News Record	Source of important information for owners, contractors, and design and engineering professionals	www.enr.com
Construction.com	A McGraw-Hill company that unifies the resources of Dodge, Sweets, *Architectural Record*, ENR, and Regional Publications and includes market analysis and forecasting, industry trends, and insights	www.construction.com

APPENDIX B
Construction Cost Indexes

The construction industry publishes a great deal of information about the cost of materials and labor. You may find this information helpful, for example, to:

- Perform analytical procedures related to job cost or profitability.
- Test the client's estimated costs to complete.
- Identify unusual financial statement relationships or other anomalies that require further audit attention.

The following is a list of entities that publish the more popular construction cost indexes, some of which may be available on the Internet. This list originally appeared in the May 27, 2000, issue of *Engineering News Record.* For a more detailed discussion of these indexes, please refer to the original article.

The Austin Co., Cleveland

E.H. Boeckh Co., Milwaukee

Bureau of Reclamation, Denver

Engineering News Record, New York

Factory Mutual Engineering, Norwood, Massachusetts

Fru-Con Corp., Ballwin, Missouri

Handy Whitman, Baltimore

Marshall and Swift, Los Angeles

R.S. Means Co., Inc., Kingston, Massachusetts

Lee Saylor, Inc., Sacramento

SmithGroup, Detroit

Turner Construction Co., Inc., New York

US Department of Commerce, Washington