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Checklist supplement and illustrative financial statements for construction contractors : a financial accounting and reporting practice aid, November 2006 edition

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Checklist Supplement and Illustrative Financial Statements for Construction Contractors

A Financial Accounting and Reporting Practice Aid

To be used in conjunction with *Checklists and Illustrative Financial Statements for Corporations*

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AICPA®

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FSP Section 5000

Checklist Supplement and Illustrative Financial Statements for Construction Contractors

Description

.01 The range of size and sophistication of companies in the construction industry has produced a variety of construction-type contracts and types of business enterprises that use them.

.02 The organizational structure, resources, and capabilities of contractors tend to vary with the type of construction activity.

.03 Common accounting and reporting practices by contractors include:

- The predominant practice is to present balance sheets with assets and liabilities classified as current and noncurrent on the basis of one year or the operating cycle. An unclassified balance sheet is also acceptable.
- Costs and estimated earnings in excess of billings are classified as current assets, and billings in excess of costs and estimated earnings are classified as current liabilities.
- Net debit balances for certain contracts should not be offset against net credit balances of other unrelated contracts.
- Contractors frequently participate in joint ventures, corporations, and general or limited partnerships. These may be reported as investments or combined or consolidated in the financial statements.
- The percentage-of-completion method of contract accounting is preferable, but the completed-contract method is also acceptable in certain circumstances.
- The method of revenue recognition should be disclosed.
- A provision for losses on a contract should be made as soon as the losses become evident, regardless of the method of accounting for the contract, and reported as a liability or deducted from any related accumulated costs.
- Contractors are encouraged to present backlog information.

Note: This publication was extracted from sections 5000 through 5300 of the AICPA *Financial Statement Preparation Manual* (FSP).

FSP Section 5100
Instructions

General

.01 This publication includes:

- **Financial Statements and Notes Checklist**—For use by preparers and auditors of construction contractor financial statements.
- **Illustrative Financial Statements and Auditor's Reports**—Illustrating construction contractor financial statements.

The checklist and illustrative financial statements included in this section are not designed to be applied to the financial statements of government contractors.

.02 The checklist and illustrative financial statements have been developed by the AICPA Accounting and Auditing Publications staff as nonauthoritative practice aids to be used as a memory jogger to aid in the audit of financial statements of construction contractors. The checklist and illustrative financial statements should be used by, or under the supervision of, persons having adequate technical training and proficiency in the application of generally accepted accounting principles and generally accepted auditing standards.

The checklists and illustrative financial statements are to be used in conjunction with the "Checklists and Illustrative Financial Statements for Corporations" (FSP sections 6000–6500) and have been updated to include relevant disclosure guidance in accounting pronouncements issued through:

- Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*
- FASB Interpretation (FASBI) No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*
- FASB Technical Bulletin (FTB) No. 01-1, *Effective Date for Certain Financial Institutions of Certain Provisions of Statement 140 Related to the Isolation of Transferred Financial Assets*
- FASB Emerging Issues Task Force (EITF) consensuses adopted through the September 2006 meeting
- FASB Staff Positions (FSP) issued through October 31, 2006
- AICPA Statement on Auditing Standards (SAS) No. 112, *Communicating Internal Control Related Matters Identified in an Audit*
- AICPA Statement of Position (SOP) 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts*
- AICPA Practice Bulletin (PB) No. 15, *Accounting by the Issuer of Surplus Notes*
- AICPA Statement on Standards for Attestation Engagements (SSAE) No. 13, *Defining Professional Requirements in Statements on Standards for Attestation Engagements*

(continued)

- Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist*

The checklist and illustrative financial statements should be modified, as appropriate, for subsequent pronouncements. In determining the applicability of a pronouncement, its effective date should also be considered.

Instructions

.03 The checklists consist of a number of questions or statements that are accompanied by references to the applicable authoritative pronouncements. The checklists provide spaces for checking off or initialing each question or point to show that it has been considered. Users should check or initial—

- *Yes*—If the disclosure is appropriately made
- *No*—If the disclosure has not been made
- *N/A* **(Not Applicable)**—If the disclosure is not applicable

The auditor should consider the effect of a "no" answer on his/her report. A "no" answer that is material to the financial statements may warrant a departure from an unqualified opinion (see paragraphs 20–63 of SAS No. 58, *Reports on Audited Financial Statements*, as amended [AICPA, *Professional Standards*, vol. 1, AU sec. 508.20–.63]). If a "no" answer is checked, the authors recommend that a note be made in the right margin to explain why the disclosure was not made (for example, if the disclosure was not made because it was not material to the financial statements, write "not material" in the right margin). The right margin may be used for other remarks or comments as appropriate, including cross-referencing to applicable workpapers where the support to a disclosure may be found. Use of the checklists requires the exercise of individual professional judgment and may likely require some modification based on the circumstances of individual engagements.

.04 **The use of these or any other checklists requires the exercise of individual professional judgment. These checklists are not substitutes for the authoritative pronouncements. Users of the checklists and illustrative financial statements are urged to refer directly to applicable authoritative pronouncements when appropriate. The checklists and illustrative financial statements do not include all disclosures and presentation items promulgated, nor do they represent minimum requirements. Pronouncements deemed remote for construction contractors are not included in this document. Users of the checklists and illustrative financial statements are encouraged to tailor them as necessary to meet specific circumstances of each particular engagement.**

.05 **These checklists and illustrative financial statements have been prepared by the AICPA staff. They have not been reviewed, approved, disapproved, or otherwise acted on by any senior technical committee of the AICPA and do not represent official positions or pronouncements of the AICPA.**

.06 If you have further questions, call the AICPA Technical Hotline at 1-888-777-7077.

FSP Section 5200
Financial Statements and Notes Checklist

.01 This checklist has been developed by the staff of the Accounting and Auditing Publications Team of the AICPA as a nonauthoritative practice aid and is to be used in conjunction with the "Checklists and Illustrative Financial Statements for Corporations" (FSP sections 6000–6500). This checklist has been developed especially for use in audits of construction contractors. Included are only those required financial statement disclosures that are likely to be unique, or especially significant, to construction contractors. Accordingly, users should carefully consider the need to modify the checklist for any additional disclosure requirements and/or reporting situations encountered during the engagement.

.02 Explanation of References:

AAG =	Reference to section number or appendix in AICPA Audit and Accounting Guide *Construction Contractors* (with conforming changes as of May 1, 2006)
AC =	Reference to section number in FASB *Accounting Standards—Current Text*
APB =	Accounting Principles Board Opinion
ARB =	Accounting Research Bulletin
SFAS =	FASB Statement of Financial Accounting Standards
SOP =	AICPA Statement of Position
PB =	AICPA Practice Bulletin

.03 Checklist Questionnaire:

.04 This financial statement disclosure checklist is organized into the sections listed below. Carefully review the topics listed and consider whether they represent potential disclosure items for the construction contractor for which you are preparing or auditing financial statements. Place a check mark by the topics or sections that are applicable and complete those sections of the checklist. Other sections may be marked "N/A" or left blank. For example, if the construction contractor changed an accounting principle during the year, place a check mark by the section "Accounting Changes" and complete that section of the checklist. On the other hand, if the contractor did not have a change in accounting principle, do not place a check mark by "Accounting Changes" and skip that section when completing the checklist.

	Place ✓ by Applicable Sections
• General	
A. Accounting Policies	_________
B. Related Party Transactions and Economic Dependency	_________
C. Commitments and Contingencies	_________
D. Interest Costs	_________
E. Limited Liability Companies and Partnerships	_________
• Balance Sheet	
A. General	_________
B. Receivables	_________
C. Investments	_________

	Place ✓ by Applicable Sections
D. Property and Equipment	____
E. Current Liabilities	____
F. Other Liabilities and Deferred Credits	____
G. Other	____

- Accompanying Information

A. Supplemental Disclosures	____

	Yes	*No*	*N/A*
General			
A. Accounting Policies			
1. Is the method of reporting affiliates disclosed relative to:			
a. The consolidation policy when consolidated statements are presented? [ARB 51, par. 5 (AC C51.108)]	____	____	____
b. Investments in joint ventures? [AAG, par. 6.21*d*; APB 18, par. 20 (AC I82.110)]	____	____	____
c. Other affiliates? [AAG, par. 6.21*a*; APB 18, par. 20 (AC I82.110)]	____	____	____
2. If the operating cycle exceeds one year, is the range of contract durations disclosed? [AAG, par. 6.21*b*]	____	____	____
3. Income recognition:			
a. Is the method of recognizing income (percentage of completion or completed contract) disclosed? [AAG, par. 6.21*c*; SOP 81-1 (AAG, App. A), par. 21]	____	____	____
b. If the percentage-of-completion method is used, is the method of computing percentage of completion (such as cost to cost, labor hours, units of output, etc.) disclosed? [AAG, par. 6.21*c*; SOP 81-1 (AAG, App. A), par. 45]	____	____	____
c. If the completed-contract method is used:			
(1) Is the reason for selecting that method disclosed? [AAG, par. 6.21*c*]	____	____	____
(2) Are the criteria which were employed to determine substantial completion, disclosed? [SOP 81-1 (AAG, App. A), par. 52]	____	____	____
d. Where applicable, is the policy with respect to combining and segmenting contracts disclosed? [SOP 81-1 (AAG, App. A), par. 21]	____	____	____
e. If the basic accounting policy is percentage-of-completion, but the completed-contract method is used for a single contract or group of contracts because the criteria for the use of percentage-of-completion are not present, is such a departure from the basic policy disclosed? [AAG, par. 2.06; SOP 81-1 (AAG, App. A), par. 25]	____	____	____

	Yes	No	N/A
4. Is the following contract cost information disclosed:			
a. The aggregate amount included in contract costs representing unapproved change orders, claims, or similar items subject to uncertainty concerning their determination or ultimate realization, in addition to a description of the nature and status of the principal items making up such aggregate amounts, and the basis on which such items are recorded (e.g., cost or realizable value)? [AAG, par. 6.21*e*]	____	____	____
b. The amount of progress payments netted against contract costs at the date of the balance sheet? [AAG, par. 6.21*e*]	____	____	____
5. If a loss on a contract exists, is the:			
a. If the provision is shown separately, is it shown as a component of the cost included in the computation of gross profit? [SOP 81-1 (AAG, App. A), par. 88]	____	____	____
b. Is the provision for losses on contracts shown separately as a liability (a current liability if a classified balance sheet)? If however, related costs are accumulated on the balance sheet is the provision deducted from the related accumulated costs? [SOP 81-1 (AAG, App. A), par. 89]	____	____	____
6. For costs deferred either in anticipation of future sales (pre-contract costs[1]) or as a result of an unapproved change order, are the policy of deferral and the amounts involved disclosed? [AAG, par. 6.21*f*]	____	____	____

B. Related-Party Transactions and Economic Dependency

	Yes	No	N/A
1. If it appears that there are affiliated members of a group under common control whose operations are closely interrelated and economically interdependent, are combined financial statements presented, unless consolidated financial statements are appropriate under ARB 51 as amended by SFAS 94 (AC C51 and interpreted by FASBI 46)? [AAG, par. 4.03]	____	____	____
2. If combined financial statements are presented, is the following information disclosed:			
a. A statement to the effect that the combined statements are not those of a separate legal entity?	____	____	____
b. The names and year-ends of the major entities included in the combined group?	____	____	____
c. The nature of the relationship between the companies?	____	____	____
d. The capital of each entity,[2] either in detail by entity if the number of entities is small or, if detailed disclosure is not practicable, in condensed form with an explanation as to how the information was accumulated? [AAG, par. 4.04]	____	____	____

[1] This applies to precontract costs that are not within the scope of SOP 98-5, *Reporting on the Costs of Start-Up Activities*. SOP 98-5 requires precontract costs that are start-up costs to be expensed as incurred.

[2] The capital of each entity should be disclosed on the face of the financial statements or in a note.

	Yes	No	N/A
3. Although consolidated or combined statements of affiliated companies are recommended as the primary financial statements of an economic unit, the needs of specific users may sometimes necessitate the presentation of separate statements for individual members of an affiliated group. The issuer of separate financial statements for a member of an affiliated group should make appropriate disclosures on related parties. In accordance with SFAS 57, do the financial statements of the reporting entity that has participated in material related party transactions disclose, individually or in the aggregate, the following:			
a. The nature of the relationship(s) involved? (The nature of common control should be disclosed even when no transactions between the parties have occurred.)	____	____	____
b. A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements?	____	____	____
c. The dollar amounts of transactions for each of the periods for which income statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period?	____	____	____
d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement?	____	____	____
e. The information required by paragraph 49 of SFAS 109, *Accounting for Income Taxes*? [SFAS 57, par. 2 (AC R36.102); AAG, par. 4.06]	____	____	____
f. Has presentation been made in a note to the financial statements of the condensed consolidated or combined balance sheet and statement of income of the members of the affiliated group that constitute the economic unit? [AAG, par. 4.07]	____	____	____

C. Commitments and Contingencies[3]

In addition to the required disclosures for commitments and contingencies in the Corporate Checklist, FSP section 6100 under the section "Commitments and Contingencies" have the following disclosures been considered:

	Yes	No	N/A
1. Has disclosure consideration been given to backlog information[4] for signed contracts on hand whose cancellations are not anticipated (by industry or type of facility and by location—domestic or foreign)? [AAG, par. 6.23]	____	____	____

[3] See disclosures for SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, in the Corporate Checklist, FSP section 6100. Construction contractors frequently encounter events that give rise to the disclosure that it is at least reasonably possible that a change in estimate will occur in the near term due to the large number of estimates inherent in construction contractor financial statements. In addition, contractors also experience vulnerabilities due to certain concentrations by having a single source of supplier or only employing union labor.

[4] The presentation of backlog information is desirable only if a reasonably dependable determination of total revenue and a reasonably dependable estimate of total cost under signed contracts or letter of intent can be made.

	Yes	No	N/A
2. Is information on signed contracts segregated from information on letters of intent if both types are presented? [AAG, par. 6.23]	____	____	____
3. Has consideration been given to disclosing the following:			
a. Backlog on letters of intent?	____	____	____
b. A schedule showing:			
(1) Backlog at the beginning of the year?	____	____	____
(2) New contract awards?	____	____	____
(3) Revenue recognized for the year?	____	____	____
(4) Backlog at the end of the year?	____	____	____
4. Have disclosure requirements of state statutes (such as "lien" laws restricting certain contract-related funds), if any, been considered? [AAG, par. 11.16]	____	____	____
5. If the requirements of paragraph 65 of SOP 81-1 are not met or if those requirements are met but the claim exceeds the recorded contract costs, is a contingent asset disclosed in accordance with SFAS 5, *Accounting for Contingencies*, paragraph 17? [SOP 81-1 (AAG, App. A), par. 67; SFAS 5, par. 17 (AC C59.118)]	____	____	____
6. If the reporting entity has retail land sales operations, are the following disclosed regarding improvements:			
a. For major sales areas for which sales are being made over each of the five years following the date of the financial statements:			
(1) Estimated total costs?	____	____	____
(2) Estimated dates of expenditures? [SFAS 66, par. 50*d*]	____	____	____
b. Recorded obligations? [SFAS 66, par. 50*e* (AC Rel. 150)]	____	____	____
D. Interest Costs			
1. If interest costs are capitalized for long-term construction contracts, is the total amount of interest cost incurred during the period and the amount thereof that has been capitalized disclosed? [This disclosure should be considered along with the disclosures in the Corporate Checklist, FSP section 6100 under "Revenue and Expenses" (A.2.)] [SFAS 34, par. 21 (AC I67.118)]	____	____	____
E. Limited Liability Companies and Partnerships			
1. If the construction contractor is organized as a limited liability company or a limited liability partnership:			
a. Has a description of any limitation of a member's liability been disclosed?	____	____	____
b. Have the different classes of members' interests and the respective rights, preferences, and privileges of each class been disclosed?	____	____	____

	Yes	No	N/A
c. As discussed in paragraph 10 of PB 14, if the limited liability company or limited liability partnership does not report separately the amount of each class in the equity section of the statement of financial position, have those amounts been disclosed in the notes?	____	____	____
d. If the limited liability company or limited liability partnership has a finite life, has the date the entity will cease to exist been disclosed?	____	____	____
e. If the limited liability company or limited liability partnership was formed by combining entities under common control or by conversion from another type of entity, do the notes to the financial statements for the year of formation disclose that the assets and liabilities were previously held by a predecessor entity or entities?	____	____	____
2. If the construction contractor is organized as a limited liability company or a limited liability partnership have the financial statement display issues in paragraphs .08–.14 of PB 14 been considered? [PB 14, pars. .08–.14]	____	____	____

Balance Sheet

A. General

	Yes	No	N/A
1. If a company has an operating cycle for most of its contracts of one year or less but periodically obtains some contracts that are significantly longer and a classified balance sheet is presented, is there:			
a. A separate classification for the items that relate to contracts that deviate from the company's normal operating cycle?	____	____	____
b. Disclosure for the items that relate to contracts that deviate from the company's normal operating cycle?	____	____	____
[AAG, par. 6.02]	____	____	____
2. If the operating cycle exceeds one year, an unclassified balance sheet is preferable; however, if an unclassified balance sheet would not result in a meaningful presentation, are the following contract-related items generally classified as current under the operating cycle concept:			
a. Contract-related assets:			
(1) Accounts receivable on contracts (including retentions)?	____	____	____
(2) Unbilled contract receivables?	____	____	____
(3) Costs and estimated earnings in excess of billings?	____	____	____
(4) Other deferred contract costs?	____	____	____
(5) Equipment and small tools specifically purchased for, or expected to be used solely on, an individual contract?	____	____	____
b. Contract-related liabilities:			
(1) Accounts payable on contracts (including retentions)?	____	____	____
(2) Accrued contract costs?	____	____	____
(3) Billings in excess of costs and estimated earnings?	____	____	____
(4) Deferred taxes resulting from the use of a method of income recognition for tax purposes different from the method used for financial reporting purposes?	____	____	____
(5) Advance payments on contracts for mobilization or other purposes?	____	____	____

Yes No N/A

(6) Obligations for equipment specifically purchased for, or expected to be used solely on, an individual contract regardless of the payment terms of the obligations? ____ ____ ____

(7) Provisions for losses on contracts shown separately as liabilities (except in circumstances where the related costs are accumulated on the balance sheet, in which case the provision may be deducted from the related accumulated costs)? ____ ____ ____
[AAG, pars. 6.02 and 6.08; SOP 81-1 (AAG, App. A), par. 89]

3. If the company's operating cycle exceeds one year, or if it uses an unclassified balance sheet:

a. Has the company disclosed liquidity characteristics of specific assets and liabilities? ____ ____ ____

b. Has information about specific assets and liabilities including, but not limited to, accounts and retentions receivable and payable been disclosed? ____ ____ ____
[AAG, par. 6.03]

B. Receivables

1. In addition to the required disclosures for receivables in the Corporate Checklist, FSP section 6100 (under "Receivables"), have the following disclosures been considered:

a. If receivables include billed or unbilled amounts under contracts representing unapproved change orders, claims, or similar items subject to uncertainty concerning their determination or ultimate realization, is the following disclosed in the balance sheet or in a note to the financial statements: ____ ____ ____

(1) The amount? ____ ____ ____

(2) A description of the nature and status of the principle items comprising the amount? ____ ____ ____

(3) The portion, if any, expected to be collected after one year? ____ ____ ____
[AAG, par. 6.24]

b. If receivables include other amounts representing the recognized sales value of performance under contracts that had not been billed and were not billable to customers at the date of the balance sheet, have the following disclosures been made:

(1) The amount of the receivables? ____ ____ ____

(2) A general description of the prerequisites for billings? ____ ____ ____

(3) The portion, if any, expected to be collected after one year? ____ ____ ____
[AAG, par. 6.25]

c. If revenue from claims is recorded only when the amounts are received or awarded, are the amounts of such claims disclosed? ____ ____ ____
[SOP 81-1 (AAG, App. A), par. 66]

d. If receivables include amounts maturing after one year, are the following disclosed:

(1) The amount maturing after one year and, if practicable, the amounts maturing in each year? ____ ____ ____

(2) Interest rates on major receivable items, or on classes of receivables, maturing after one year or an indication of the average interest rate or the range of rates on all receivables? ____ ____ ____
[AAG, par. 6.27]

Yes | No | N/A

e. If receivables include amounts representing balances billed but not yet paid by customers under retainage provisions, is disclosure made either in the balance sheet or in the notes of the amounts included, the portion (if any) expected to be collected after one year, and, if practicable, the years in which the amounts are expected to be collected? ____ ____ ____
[AAG, pars. 6.03 and 6.28]

f. Is the portion of retainages not collectible within one year, or within the operating cycle if it is longer than one year, classified as noncurrent in a classified balance sheet? ____ ____ ____
[AAG, pars. 6.10 and 6.28]

g. For receivables from retail land sales operations, are the following disclosed:

(1) Maturities of accounts receivable for each of the five years following the date of the financial statements? ____ ____ ____
[SFAS 66, par. 50a (AC Re1.150)]

(2) Delinquent accounts receivable and the methods for determining delinquency? ____ ____ ____
[SFAS 66, par. 50b (AC Re1.150)]

(3) The weighted average and range of stated interest rates of receivables? ____ ____ ____
[SFAS 66, par. 50c (AC Re1.150)]

h. Are advances that are definitely regarded as payments on account of work in progress shown as a deduction from the related asset, and are the amounts disclosed? ____ ____ ____
[AAG, par. 6.19]

i. If additional contract revenue relating to claims is recognized (and the requirements in paragraph 65 of SOP 81-1 have been met), is disclosure made of the amounts recorded, if material, of revenue recorded and the contract costs incurred relating to the claim? ____ ____ ____
[SOP 81-1 (AAG, App. A), par. 65]

C. Investments

1. Have the following additional disclosures relating to significant joint ventures been considered by the venturer:

a. The name of each joint venture, the percentage of ownership, and any important provisions of the joint venture agreement? ____ ____ ____
[AAG, par. 3.26]

b. If the joint venture's financial statements are not fully consolidated with those of the venturer, separate or combined financial statements of the ventures in summary form, including disclosure of accounting principles of the ventures that differ significantly from those of the venturer? ____ ____ ____
[AAG, par. 3.26]

c. Intercompany transactions during the period and the basis of intercompany billings and charges? ____ ____ ____
[AAG, par. 3.26]

d. Liabilities and contingent liabilities arising from the joint venture arrangement? ____ ____ ____
[AAG, par. 3.26]

	Yes	No	N/A
e. Other disclosures for real estate venture and equity method investments, including venturer's obligations under guarantees? [SOP 78-9, par. 12; APB 18, par. 20 (AC I82.110)]	____	____	____
2. Is a joint venture investment that is presented on the cost or equity basis classified as noncurrent unless the venture is expected to be completed and liquidated during the current operating cycle of the investor? [AAG, par. 6.11]	____	____	____
3. Are losses in excess of a joint venture investment presented as a liability? [AAG, par. 6.11]	____	____	____
D. Property and Equipment			
1. If equipment is acquired for a specific contract that will be used only on that contract and will be consumed during the life of the contract or disposed of at the conclusion of the contract, is such equipment classified as a contract cost? [AAG, par. 6.12]	____	____	____
E. Current Liabilities			
1. For billings and costs (in most cases as a current liability):			
a. Under the completed-contract method, if costs exceed billings on some contracts, and billings exceed costs on others, are the contracts segregated so that amounts classified as current assets include only those on which costs exceed billings, and amounts classified as liabilities (in most cases as a current liability) include only those on which billings exceed costs? [AAG, par. 6.17; ARB 45, par. 12 (AC Co4.109)]	____	____	____
b. Under the percentage-of-completion method, are costs and recognized income not yet billed shown as current assets; and are billings in excess of costs and recognized income with respect to other contracts, included in liabilities (in most cases current liabilities)? [AAG, par. 6.17; ARB 45, par. 12 (AC Co4.109)]	____	____	____
c. In comparative statements, are billings and related costs presented separately in the balance sheet or in the notes to the financial statements? ***(Preferred but not required presentation.)*** [AAG, par. 6.18]	____	____	____
d. Are billings in excess of costs and estimated earnings classified as a current liability (except that billings in excess of total estimated contract completion costs and earnings to date should be classified as deferred income)? [AAG, par. 6.13]	____	____	____
F. Other Liabilities and Deferred Credits			
1. If payables include retentions, do the statements or notes disclose the amount of retentions to be paid after one year and, if practicable, the years in which the amounts are expected to be paid? [AAG, par. 6.03]	____	____	____
2. Are retentions payable, that will not be paid within the company's normal operating cycle, classified as noncurrent in a classified balance sheet? [AAG, par. 6.10]	____	____	____

	Yes	No	N/A
G. Other			
1. If a lessee commences construction activities prior to the involvement of a special purpose entity (SPE), and the subsequent transfer to the SPE is within the scope of SFAS 98, *Accounting for Leases,* and the transaction fails to qualify for sale-leaseback accounting under SFAS 98, SFAS 28, *Accounting for Sales with Leasebacks,* or SFAS 66, *Accounting for Sales of Real Estate,* are the amounts previously expended by the lessee continually reported as construction in progress in the lessee's financial statements and the proceeds received from the SPE reported as a liability? [EITF 96-21, Question 11]	____	____	____
2. Are additional amounts expended by the SPE to fund construction reported by the lessee as construction in progress and as a liability to the SPE? [EITF 96-21, Question 11]	____	____	____

Accompanying Information

	Yes	No	N/A
A. Supplemental Disclosures			
1. Is disclosure of the following supplementary information considered by contractors using the percentage-of-completion method:			
a. Earnings from contracts?	____	____	____
b. Contracts completed?	____	____	____
c. Contracts in progress?	____	____	____
d. Backlog information? [AAG, App. G, App. H (AAG, par. 6.23)]	____	____	____

FSP Section 5300

Illustrative Financial Statements and Auditor's Reports

.01 The following sample financial statements of a construction contractor are included for illustrative purposes only and are not intended to establish reporting requirements. Furthermore, the dollar amounts shown are illustrative only and are not intended to indicate any customary relationship among accounts. The sample financial statements do not include all of the accounts and transactions that might be found in practice. The notes indicate the subject matter generally required to be disclosed, but they should be expanded, reduced, or modified to suit individual circumstances or materiality considerations. In addition to the illustrative notes that are presented, some of which are more or less peculiar to construction contractors, the notes to a construction contractor's financial statements should include information concerning other matters that are not unique to construction contractors, e.g., subsequent events, pension plans, postretirement benefits other than pensions, postemployment benefits, stock options, lease commitments, extraordinary items, accounting changes, off-balance-sheet risks, etc.

.02

Independent Auditor's Report

The Shareholders and Board of Directors
Percentage Contractors, Inc.

We have audited the accompanying consolidated balance sheets of Percentage Contractors, Inc., and subsidiaries as of December 31, 20X1 and 20X0, and the related consolidated statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America.* Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. [*Optional: An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.*][1] An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Percentage Contractors, Inc., and subsidiaries as of [at] December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

[*Firm Signature*]
Certified Public Accountants

[*City, State*]

February 18, 20X2

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* For audits conducted in accordance with PCAOB standards, PCAOB Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board*, replaces this sentence with the following sentence: "We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)." On May 14, 2004, the SEC issued an interpretive release to help with the implementation of PCAOB Auditing Standard No. 1. See Release No. 33-8422 for more information. The release specifies that effective May 24, 2004, references in SEC rules and staff guidance and in the federal securities laws to GAAS or to specific standards under GAAS, as they relate to issuers, should be understood to mean the standards of the PCAOB, plus any applicable rules of the SEC. The staff of the PCAOB published a series of questions and answers ("Qs&As") on PCAOB Auditing Standard No. 1. See the PCAOB Web site at www.pcaobus.org for more information.

In June 2004, the Auditing Standards Board ("ASB") issued Interpretation 18, "Reference to PCAOB Standards in an Audit Report of a Nonissuer," of SAS 58, *Reports on Audited Financial Statements*, which provides reporting guidance for audits of nonissuers. Interpretation 18 provides guidance on the appropriate referencing of PCAOB auditing standards in audit reports when an auditor is engaged to perform the audit in accordance with both GAAS and PCAOB auditing standards. The ASB also has undertaken a project to determine what amendments, if any, should be made to SAS 58. See the AICPA Web site at www.aicpa.org/members/div/auditstd/index.htm for more information.

[1] This optional wording may be added in accordance with Interpretation 17, "Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards," of SAS 58, which was issued by the ASB in June 2004 and provides reporting guidance for audits of nonissuers. Interpretation 17 addresses how auditors may expand their independent audit report to explain that their consideration of internal control was sufficient to provide the auditor sufficient understanding to plan the audit and determine the nature, timing and extent of tests to be performed, but was not sufficient to express an opinion on the effectiveness of the internal control. If this optional language is added, then the remainder of the paragraph should read as follows:

> "An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion."

Additional Guidance When Performing Integrated Audits of Financial Statements and Internal Control Over Financial Reporting

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with the standards of the PCAOB, the auditor may choose to issue a combined report or separate reports on the company's financial statements and on internal control over financial reporting. Refer to paragraphs 162–199 of PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With An Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, AU sec. 320), for direction about reporting on internal control over financial reporting. In addition, see Appendix A, "Illustrative Reports on Internal Control Over Financial Reporting," of PCAOB Auditing Standard No. 2 for an illustrative combined audit report and examples of separate reports. (*Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2*, AU sec. 508.01)

If the auditor issues separate reports on the company's financial statements and on internal control over financial reporting, the following paragraph should be added to the auditor's report on the company's financial statements (*Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2*, AU sec. 508.08):

> "We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of X Company's internal control over financial reporting as of December 31, 20X3, based on [*identify control criteria*] and our report dated [*date of report, which should be the same as the date of the report on the financial statements*] expressed [*include nature of opinions*]."

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with the standards of the PCAOB, the auditor's report on the company's financial statements and on internal control over financial reporting should be dated the same date. Refer to paragraphs 171–172 of PCAOB Auditing Standard No. 2 for direction about the report date in an audit of internal control over financial reporting. (*Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2*, AU sec. 530.01)

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PERCENTAGE CONTRACTORS, INC.

Consolidated Balance Sheets

December 31, 20X1 and 20X0

Assets	*20X1*	*20X0*
Cash and cash equivalents	$ 304,400	$ 221,300
Contracts receivables (Notes 1 and 4)	3,789,200	3,334,100
Costs and estimated earnings in excess of billings on uncompleted contracts (Note 5)	80,200	100,600
Inventory, at lower of cost, on a first-in first-out basis, or market	89,700	99,100
Prepaid charges and other assets	118,400	83,200
Advances to and equity in joint venture (Note 6)	205,600	130,700
Note receivable, related company (Note 7)	175,000	150,000
Property and equipment, net of accumulated depreciation and amortization (Note 8)	976,400	1,019,200
	$5,738,900	$5,138,200

Liabilities and Shareholders' Equity	*20X1*	*20X0*
Notes payable (Note 10)	$ 468,100	$ 578,400
Lease obligations payable (Note 11)	197,600	251,300
Accounts payable (Note 9)	2,543,100	2,588,500
Billings in excess of costs and estimated earnings on uncompleted contracts (Note 5)	242,000	221,700
Other accrued liabilities	88,600	114,600
Due to consolidated joint venture minority interests	154,200	26,200
Deferred tax liability (Note 15)	619,200	408,000
	4,312,800	4,188,700
Contingent liability (Note 13)		
Shareholders' equity		
Common stock — $1 par value, 500,000 authorized shares, 300,000 issued and outstanding shares	300,000	300,000
Retained earnings	1,126,100	649,500
Total shareholders' equity	1,426,100	949,500
	$5,738,900	$5,138,200

The accompanying notes are an integral part of these consolidated financial statements.

.04

PERCENTAGE CONTRACTORS, INC.

Consolidated Statements of Income[2] and Retained Earnings

Years Ended December 31, 20X1 and 20X0

	20X1	*20X0*
Contract revenues earned	$22,554,100	$16,225,400
Cost of revenues earned	20,359,400	14,951,300
Gross profit	2,194,700	1,274,100
Selling, general, and administrative expense	895,600	755,600
Income from operations	1,299,100	518,500
Other income (expense)		
Equity in earnings from unconsolidated joint venture	49,900	5,700
Gain on sale of equipment	10,000	2,000
Interest expense (net of interest income of $8,800 in 20X1 and $6,300 in 20X0)	(69,500)	(70,800)
	(9,600)	(63,100)
Income before taxes	1,289,500	455,400
Provision for income taxes (Note 15)	662,900	225,000
Net income	626,600	230,400
Basic and diluted earnings per share[3]	2.09	.77
Retained earnings, beginning of year	649,500	569,100
	1,276,100	799,500
Less: Dividends paid (per share, $.50 (20X1); $.50 (20X0))	150,000	150,000
Retained earnings, end of year	$ 1,126,100	$ 649,500

The accompanying notes are an integral part of these consolidated financial statements.

[2] SFAS 130, *Reporting Comprehensive Income,* establishes standards for the reporting and display of comprehensive income and its components. The Statement requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The Statement does not require a specific format for that financial statement but requires that an enterprise display an amount representing total comprehensive income for the period in that financial statement. The Statement does not apply to an enterprise that has no items of other comprehensive income in any period presented.

[3] SFAS 128, *Earnings per Share,* requires presentation of earnings per share by all entities that have issued common stock or potential common stock if those securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally. The Statement also requires presentation of earnings per share by an entity that has made a filing or is in the process of filing with a regulatory agency in preparation for the sale of those securities in a public market.

In December 2003, FASB issued an exposure draft of a proposed Statement entitled *Earnings per Share—an amendment of FASB Statement No. 128.* This proposed Statement would amend the computational guidance in SFAS 128, *Earnings per Share,* for calculating the number of incremental shares included in diluted shares when applying the treasury stock method. Also, this proposed Statement would eliminate the provisions of Statement 128 that allow an entity to rebut the presumption that contracts with the option of settling in either cash or stock will be settled in stock. In addition, this proposed Statement would require that shares that will be issued upon conversion of a mandatorily convertible security be included in the weighted average number of ordinary shares outstanding used in computing basic earnings per share from the date when conversion becomes mandatory.

In December 2004, the FASB issued SFAS 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), which requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Among other things, SFAS 123(R) amends SFAS 128.

.05

PERCENTAGE CONTRACTORS, INC.
Consolidated Statements of Cash Flows
(Indirect Method)
Years Ended December 31, 20X1 and 20X0

	Years Ended December 31,	
	20X1	*20X0*
Cash flows from operating activities:		
Net income	$626,600	$230,400
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	167,800	153,500
Provision for losses on contract receivables	6,300	1,100
Gain on sale of equipment	(10,000)	(2,000)
Increase (decrease) in deferred taxes	211,200	(75,900)
Equity earnings from unconsolidated joint venture	(49,900)	(5,700)
Increase in joint venture minority interest	128,000	26,200
Increase in contract receivables	(461,400)	(10,200)
Net increase in billings related to costs and estimated earnings on uncompleted contracts	40,700	10,500
Decrease (increase) in inventory	9,400	(3,600)
Decrease (increase) in prepaid charges and other assets	(35,200)	16,100
Increase (decrease) in accounts payable	(45,400)	113,200
Increase (decrease) in other accrued liabilities	(26,000)	18,800
Net cash provided by operating activities	562,100	472,400
Cash flows from investing activities:		
Proceeds of equipment sold	25,000	5,000
Acquisition of equipment	(140,000)	(175,000)
Advances to joint venture	(25,000)	(9,700)
Increase in note receivable related company	(25,000)	(50,000)
Net cash used in investing activities	(165,000)	(229,700)
Cash flows from financing activities:		
Principal payments on notes payable	(110,300)	(90,300)
Principal payments under capital lease obligations	(53,700)	(9,700)
Cash dividends paid	(150,000)	(150,000)
Net cash used in financing activities	(314,000)	(250,000)
Net increase (decrease) in cash and cash equivalents	83,100	(7,300)
Cash and cash equivalents at beginning of year	221,300	228,600
Cash and cash equivalents at end of year	$304,400	$221,300

Supplemental data:

Cash equivalents include certificates of deposit with original maturities of one to three months—

Interest paid—20X1, $73,500; 20X0, $75,100

Income taxes paid—20X1, $478,300; 20X0, $313,200

The accompanying notes are an integral part of these consolidated financial statements.

.06

PERCENTAGE CONTRACTORS, INC.

Notes to Consolidated Financial Statements

December 31, 20X1 and 20X2

Note 1: Nature of Operations and Significant Accounting Policies

Nature of operations. The company is engaged in the construction of industrial and commercial buildings primarily in the Southwestern region of the United States.

Operating cycle. The company's work is performed under cost-plus-fee contracts, fixed-price contracts, and fixed-price contracts modified by incentive and penalty provisions. These contracts are undertaken by the company or its wholly owned subsidiary alone or in partnership with other contractors through joint ventures. The company also manages, for a fee, construction projects of others. The length of the company's contracts varies but is typically about two years. Therefore, assets and liabilities are not classified as current and noncurrent because the contract-related items in the balance sheet have realization and liquidation periods extending beyond one year.

Use of estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of consolidation.[4] The consolidated financial statements include the company's majority-owned entities, a wholly owned corporate subsidiary and a 75 percent-owned joint venture (a partnership). All significant intercompany transactions are eliminated. The company has a minority interest in a joint venture (partnership), which is reported on the equity method.

Revenue and cost recognition. Revenues from fixed-price and modified fixed-price construction contracts are recognized on the percentage-of-completion method, measured by the percentage of labor hours incurred to date to estimated total labor hours for each contract.[5] This method is used because management considers expended labor hours to be the best available measure of progress on these contracts. Revenues from cost-plus-fee contracts are recognized on the basis of costs incurred during the period plus the fee earned, measured by the cost-to-cost method.

Contracts to manage, supervise, or coordinate the construction activity of others are recognized only to the extent of the fee revenue. The revenue earned in a period is based on the ratio of hours incurred to the total estimated hours required by the contract.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, and estimated profitability, including those arising from contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Profit incentives are included in revenues when their realization is reasonably assured. An amount

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[4] FASBI 46 (revised December 2003), *Consolidation of Variable Interest Entities—an interpretation of ARB No. 51* (FASBI 46(R)), may impact the way construction contractors account for and report their investments in construction joint ventures. FASBI 46(R) also requires disclosures about VIEs that the company is not required to consolidate but in which it has a significant variable interest.

[5] There are various other alternatives to the percentage of labor hours method for measuring percentage of completion, which, in many cases, may be more appropriate in measuring the extent of progress toward completion of the contract (labor dollars, units of output, and the cost-to-cost method and its variations).

equal to contract costs attributable to claims is included in revenues when realization is probable and the amount can be reliably estimated.

The asset, "Costs and estimated earnings in excess of billings on uncompleted contracts," represents revenues recognized in excess of amounts billed. The liability, "Billings in excess of costs and estimated earnings on uncompleted contracts," represents billings in excess of revenues recognized.

Contracts receivable. Contracts receivable from performing construction of industrial and commercial buildings are based on contracted prices. The company provides an allowance for doubtful collections which is based upon a review of outstanding receivables, historical collection information, and existing economic conditions. Normal contracts receivable are due 30 days after the issuance of the invoice. Contract retentions are due 30 days after completion of the project and acceptance by the owner. Receivable past due more than 120 days are considered delinquent. Delinquent receivables are written off based on individual credit evaluation and specific circumstances of the customer.

Property and equipment. Depreciation and amortization are provided principally on the straight-line method over the estimated useful lives of the assets. Amortization of leased equipment under capital leases is included in depreciation and amortization.

Long-lived assets. Long-lived assets to be held and used are tested for recoverability whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. When required, impairment losses on assets to be held and used are recognized based on the excess of the asset's carrying amount over the fair value of the asset. Certain long-lived assets to be disposed of by sale are reported at the lower of carrying amount or fair value less cost to sell.

Income taxes. Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes on temporary differences between the amount of taxable income and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled as prescribed in SFAS 109, *Accounting for Income Taxes*. As changes in tax laws or rate are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Construction contracts are reported for tax purposes on the completed-contract method and for financial statement purposes on the percentage-of-completion method. Accelerated depreciation is used for tax reporting, and straight-line depreciation is used for financial statement reporting.

Investment tax credits are applied as a reduction to the current provision for federal income taxes using the flow-through method.

Basic earnings per common share. Basic earnings per common share were computed by dividing income available to common stockholders by the weighted average number of common share outstanding during the year. Diluted earnings per share are not presented because the Company has issued no dilutive potential common shares.

Note 2: Cash and Cash Equivalents

The company maintains cash and cash equivalent balances at several financial institutions. Accounts at each institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to $100,000. As of December 31, 20X1, the company's uninsured bank balances totaled $95,000.

Note 3: Fair Value of Financial Instruments[6, 7, 8]

The carrying amounts of the Company's cash and cash equivalents, note receivable, and lease obligations payable approximate their fair value. The fair value of the Company's notes payable is estimated at $490,500 based on the future cash flows associated with each note discounted using the Company's current borrowing rate for similar debt.

Note 4: Contracts Receivable

	December 31, 20X1	*December 31, 20X0*
Contracts receivable		
Billed		
Completed contracts	$ 621,100	$ 500,600
Contracts in progress	2,146,100	1,931,500
Retained	976,300	866,200
Unbilled	121,600	105,400
	3,865,100	3,403,700
Less: Allowances for doubtful collections	75,900	69,600
	$3,789,200	$3,334,100

The total recorded investment in impaired contracts receivable recognized in accordance with SFAS 114, *Accounting by Creditors for Impairment of a Loan*, was $125,000 in 20X1 and $103,000 in 20X0. These amounts also approximate the average recorded investment in impaired contracts receivable during the related periods. The allowance for credit losses associated with these receivables was $41,000 in 20X1 and $38,000 in 20X0. It is management's policy not to accrue interest income on impaired contracts receivable given past difficulties in collecting such amounts. Interest income on impaired contracts receivable of $1,452 and $1,107 was recognized for cash payments received in 20X1 and 20X0, respectively. For impairment recognized in conformity with SFAS 114, as amended, the entire change in present value of expected cash flows is reported as bad debt expense in the same manner in which impairment initially was recognized or as a reduction in the amount of bad debt expense that otherwise would be reported.

Analysis of the changes in the allowance for doubtful collections:

	20X1	*20X0*
Balance at January 1	$69,600	$68,000
Additions charged to operations	6,300	1,100
Direct write-downs	—	500
Recoveries	—	—
Balance at December 31	$75,900	$69,600

Contracts receivable at December 31, 20X1, include a claim, expected to be collected within one year, for $290,600 arising from a dispute with the owner over design and specification changes in a building currently under construction. The changes were made at the request of the owner to

[6] SFAS 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities—an amendment to FASB Statement No. 107*, as amended by SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, amends SFAS 107, *Disclosures about Fair Value of Financial Instruments*, to make the disclosures about fair value of financial instruments prescribed in SFAS 107 optional for entities that meet all of the following criteria:

a. The entity is a nonpublic entity.

b. The entity's total assets are less than $100 million on the date of the financial statements.

c. The entity has no instrument that, in whole or in part, is accounted for as a derivative instrument under SFAS 133, other than commitments related to the origination of mortgage loans to be held for sale, during the reporting period.

[7] SAS 101, *Auditing Fair Value Measurements and Disclosures*, contains significantly expanded guidance on the audit procedures for fair value measurements and disclosures. Please refer to paragraphs 9.21–9.24 of the AICPA Audit and Accounting Guide *Construction Contractors* for a discussion on SAS 101.

[8] SFAS 157, *Fair Value Measurements*, issued in Spetember 2006, provides guidance on the application of fair value to financial statement amounts. This Statement is effective for fiscal years beginning after November 15, 2007. Earlier application is permitted.

improve the thermal characteristics of the building and, in the opinion of counsel, gave rise to a valid claim against the owner.

The retained and unbilled contracts receivable at December 31, 20X1, included $38,600 that was not expected to be collected within one year.

Contracts receivable include approximately $800,000 due under one contract.[9]

Note 5: Costs and Estimated Earnings on Uncompleted Contracts

	December 31, 20X1	*December 31, 20X0*
Costs incurred on uncompleted contracts	$15,771,500	$12,165,400
Estimated earnings	1,685,900	1,246,800
	17,457,400	13,412,200
Less: Billings to date	17,619,200	13,533,300
	$ (161,800)	$ (121,100)
Included in accompanying balance sheets under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted contracts	$ 80,200	$ 100,600
Billings in excess of costs and estimated earnings on uncompleted contracts	(242,000)	(221,700)
	$ (161,800)	$ (121,100)

Note 6: Advances to and Equity in Joint Venture

The company has a minority interest (one-third) in a general partnership joint venture formed to construct an office building. All of the partners participate in construction, which is under the general management of the company. Summary information on the joint venture follows:

	December 31, 20X1	*December 31, 20X0*
Current assets	$ 483,100	$280,300
Construction and other assets	220,500	190,800
	703,600	471,100
Less: Liabilities	236,800	154,000
Net assets	$ 466,800	$317,100
Revenue	$3,442,700	$299,400
Net income	$ 149,700	$ 17,100
Company's interest		
Share of net income	$ 49,900	$ 5,700
Advances to joint venture	$ 50,000	$ 25,000
Equity in net assets	155,600	105,700
Total advances and equity	$ 205,600	$130;700

(For the purposes of illustrative financial statements, the one-line equity method of presentation is used in both the balance sheet and the income statement. However, the pro rata consolidation method is acceptable if the investment is deemed to represent an undivided interest.)

[9] SFAS 107, *Disclosures about Fair Value of Financial Instruments*, as amended by SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, requires disclosure of concentrations of credit risks of all financial instruments. Concentrations can be geographical areas, types of contracts, owners or others. Additionally, the contractor should disclose, for each significant concentration, the policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the contractor's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Note 7: Transactions With Related Party

The note receivable, related company, is an installment note bearing annual interest at 9%, payable quarterly, with the principal payable in annual installments of $25,000, commencing October 1, 20X3.

The major stockholder of Percentage Contractors, Inc. owns the majority of the outstanding common stock of this related company, whose principal activity is leasing land and buildings. Percentage Contractors, Inc., rents land and office facilities from the related company on a ten-year lease ending September 30, 20X9, for an annual rental of $19,000.

Note 8: Property and Equipment

	December 31, 20X1	*December 31, 20X0*
Assets		
Land	$ 57,500	$ 57,500
Buildings	262,500	262,500
Shop and construction equipment	827,600	727,600
Automobiles and trucks	104,400	89,100
Leased equipment under capital leases	300,000	300,000
	1,552,000	1,436,700
Accumulated depreciation and amortization		
Buildings	140,000	130,000
Shop and construction equipment	265,600	195,500
Automobiles and trucks	70,000	42,000
Leased equipment under capital leases	100,000	50,000
	575,600	417,500
Net property and equipment	$ 976,400	$1,019,200

Note: SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,*[†] requires certain disclosures if an impairment loss is recognized for assets to be held and used. An example of such a disclosure is shown below:

> *Recently adopted environmental legislation has placed significant restrictions on the use of certain heavy equipment owned and operated by the Company. This circumstance has called into question the recoverability of the carrying amounts of these assets. As a result, pursuant to SFAS 144,* Accounting for the Impairment or Disposal of Long-Lived Assets, *an impairment loss of $X,XXX has been recognized for this equipment and included as a component of income before income taxes under the caption "Selling, general and administrative expenses." In calculating the impairment loss fair value was determined by reviewing quoted market prices for current sales of similar equipment.*

[†] A 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, contains nonauthoritative guidance to help auditors understand and apply Statements on Auditing Standards when auditing fair value measurements and disclosures related to business combinations, goodwill, and certain impairment situations.

The guidance is illustrated in the context of a business combination since many of the key concepts and principles are revealed in this common business situation. However, the concepts and procedures described may also be useful when auditing goodwill and other intangible assets accounted for under SFAS 142 and when auditing impairment or disposal of assets accounted for under SFAS 144. Therefore, the illustrative audit program and illustrative disclosure checklist cover SFAS 142 and SFAS 144 in addition to SFAS 141. Additionally, the toolkit provides an overview of SFAS 142 and SFAS 144 and discusses certain auditing considerations. The toolkit is free and may be downloaded from www.aicpa.org/members/div/auditstd/fasb123002.asp.

Note 9: Accounts Payable

Accounts payable include amounts due to subcontractors, totaling $634,900 at December 31, 20X1, and $560,400 at December 31, 20X0, which have been retained pending completion and customer acceptance of jobs. Accounts payable at December 31, 20X1, include $6,500 that are not expected to be paid within one year.

Note 10: Notes Payable

	December 31, 20X1	*December 31, 20X0*
Unsecured note payable to bank, due in quarterly installments of $22,575 plus interest at 1% over prime	$388,100	$478,400
Note payable to bank, collateralized by equipment, due in monthly installments of $1,667 plus interest at 10% through January 20X6	80,000	100,000
	$468,100	$578,400

Principal payments on notes payables are due as follows:

Year ending December 31,	
20X2	$110,300
20X3	$110,300
20X4	$110,300
20X5	$110,300
20X6	$ 26,900

Note 11: Lease Obligations Payable

The company leases certain specialized construction equipment under leases classified as capital leases. The following is a schedule showing the future minimum lease payments under capital leases by years and the present value of the minimum lease payments as of December 31, 20X1:

Year ending December 31,	
20X2	$ 76,500
20X3	76,500
20X4	76,500
Total minimum lease payments	229,500
Less: Amount representing interest	31,900
Present value of minimum lease payments	$197,600

At December 31, 20X1, the present value of minimum lease payments due within one year is $62,250.

Total rental expense, excluding payments on capital leases, totaled $86,300 in 20X1 and $74,400 in 20X0.

Note 12: Surety Bonds

The company, as a condition for entering into some of its construction contracts, had outstanding surety bonds as of December 31, 20X1 and 20X0.

Note 13: Contingent Liability

A claim for $180,000 has been filed against the company and its bonding company arising out of the failure of a subcontractor of the company to pay its suppliers. In the opinion of counsel and management, the outcome of this claim will not have a material effect on the company's financial position or results of operations.

Note 14: Management Contracts

The company manages or supervises commercial and industrial building contracts of others for a fee. These fees totaled $121,600 in 20X1 and $1,700 in 20X0 and are included in contract revenues earned.

Note 15: Income Taxes and Deferred Income Taxes[10]

The provision for taxes on income consists of the following:

	December 31, 20X1	*December 31, 20X0*
Current	$451,700	$300,900
Deferred	211,200	(75,900)
Total	$662,900	$225,000

The following represents the approximate tax effect of each significant type of temporary difference giving rise to the deferred income tax liability:

	December 31, 20X1	*December 31, 20X0*
Deferred tax asset:		
Employee benefits	$ 44,300	$ 38,100
Other	10,100	10,600
Total	$ 54,400	$ 48,700
Deferred tax liability:		
Earnings on uncompleted contracts	$594,000	$389,800
Property, plant, and equipment	64,300	54,100
Other	15,300	12,800
Total	$673,600	$456,700
Deferred tax liability, net	$619,200	$408,000

Note 16: Backlog

The following schedule shows a reconciliation of backlog representing the amount of revenue the company expects to realize from work to be performed on uncompleted contracts in progress at December 31, 20X0 and 20X1 and from contractual agreements on which work has not yet begun.[11]

Balance, December 31, 20X0	$24,142,600
Contract adjustments	1,067,100
New contracts, 20X1	3,690,600
	28,900,300
Less contract revenue earned, 20X1	22,432,500
Balance, December 31, 20X1	$ 6,467,800

In addition, between January 1, 20X2 and February 18, 20X2, the company entered into additional construction contracts with revenues of $5,332,800.

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[10] In addition to the information presented, SFAS 109 requires that a public enterprise disclose a reconciliation using percentages or dollar amounts of (*a*) the reported amount of income tax expense attributable to continuing operations for the year to (*b*) the amount of income tax expense that would result from applying domestic federal statutory tax rates to pretax income from continuing operations. The "statutory" tax rates shall be the regular tax rates if there are alternative tax systems. The estimated amount and the nature of each significant reconciling item shall be disclosed. A nonpublic enterprise shall disclose the nature of significant reconciling items but may omit a numerical reconciliation.

[11] The presentation of backlog information, although encouraged, is not a required disclosure.

Note 17: Vulnerability Due to Certain Concentrations

In response to competitive pressures, and in line with current industry trends, the Company has embarked upon an aggressive cost-cutting program. Efforts to incorporate cost reductions in the collective bargaining agreements due to expire in the coming year are expected to meet with resistance from several labor guilds (approximately 75 percent of the Company's labor force is covered by collective bargaining agreements, while approximately 40 percent of the Company's labor force is covered by collective bargaining agreements that will expire within one year). Given these circumstances, and the Company's past experience with work stoppages, management believes that it is reasonably possible that a protracted strike may take place thus resulting in a severe impact in the near term.

.07

PERCENTAGE CONTRACTORS, INC.

Sample Accompanying Information

Independent Auditor's Report on Accompanying Information

The Shareholders and Board of Directors
Percentage Contractors, Inc.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The (identify *accompanying* information) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*Firm Signature*]
Certified Public Accountants

[*City, State*]

February 18, 20X2

.08

PERCENTAGE CONTRACTORS, INC.
Schedule 1
Earnings from Contracts
Year Ended December 31, 20X1

	20X1			20X0
	Revenues earned	*Cost of revenues earned*	*Gross profit (loss)*	*Gross profit (loss)*
Contracts completed during the year	$ 6,290,800	$ 5,334,000	$ 956,800	$ 415,300
Contracts in progress at year-end	16,141,700	14,636,900	1,504,800	921,400
Management contract fees earned	121,600	51,800	69,800	1,700
Unallocated indirect and warranty costs[12]		46,700	(46,700)	(38,100)
Minority interest in joint venture		128,000	(128,000)	(26,200)
Charges on prior year contracts		162,000	(162,000)	
	$22,554,100	$20,359,400	$2,194,700	$1,274,100

[12] FASBI 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,* elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. Product warranties are excluded from the initial recognition and initial measurement requirements of this Interpretation, however the disclosure requirements described in paragraphs 13 and 14 are applicable.

.09

PERCENTAGE CONTRACTORS, INC.

Schedule 2

Contracts Completed

Year Ended December 31, 20X1

Contract		*Contract totals*			*Before January 1, 20X1*			*During the year ended December 31, 20X1*		
Number	*Type*	*Revenues earned*	*Cost of revenues*	*Gross profit (loss)*	*Revenues earned*	*Cost of revenues*	*Gross profit (loss)*	*Revenues earned*	*Cost of revenues*	*Gross profit (loss)*
1511	B	$ 5,475,300	$ 4,802,500	$ 672,800	$3,223,400	$ 2,932,700	$ 290,700	$2,251,900	$1,869,800	$ 382,100
1605	A	695,000	880,900	(185,900)	596,100	558,100	38,000	98,900	322,800	(223,900)
1624	A	140,700	150,700	(10,000)	29,600	31,800	(2,200)	111,100	118,900	(7,800)
1711	A	2,725,100	2,391,700	333,400	1,654,100	1,510,000	144,100	1,071,000	881,700	189,300
1791	B	4,770,100	4,288,900	481,200	3,028,500	2,929,600	98,900	1,741,600	1,359,300	382,300
1792	A	635,000	457,900	177,100				635,000	457,900	177,100
Small contracts		413,400	349,500	63,900	32,100	25,900	6,200	381,300	323,600	57,700
		$14,854,600	$13,322,100	$1,532,500	$8,563,800	$7,988,100	$ 575,700	$6,290,800	$5,334,000	$ 956,800

Contract types
A—Fixed-price
B—Cost-plus-fee

.10

PERCENTAGE CONTRACTORS, INC.

Schedule 3

Contracts in Progress

December 31, 20X1

Contract		*Total contract*		*From inception to December 31, 20X1*						*At December 31, 20X1*		*For the year ended December 31, 20X1*		
Number	*Type*	*Revenues*	*Estimated gross profit (loss)*	*Revenues earned*	*Total costs incurred*	*Cost of revenues*	*Gross profit (loss)*	*Billed to date*	*Estimated cost to complete*	*Costs and estimated earnings in excess of billings*	*Billings in excess of costs and estimated earnings*	*Revenues earned*	*Cost of revenues*	*Gross profit (loss)*
1845	A	$ 6,750,200	$ 877,000	$ 5,890,500	$ 5,244,500	$ 5,143,900	$ 746,600	$ 5,976,000	$ 628,700	$15,100		$ 5,664,200	$ 4,984,500	$ 679,700
1847	B	1,471,800	127,100	1,250,400	1,139,800	1,139,800	110,600	1,195,800	204,900	54,600		962,800	899,000	63,800
1912	A	451,800	(130,100)	108,600	238,700	238,700	(130,100)	98,100	343,200	10,500		98,600	191,500	(92,900)
1937	B	11,125,000	847,900	7,337,900	7,045,500	6,721,100	616,800	7,808,000	3,231,600		$145,700	6,981,900	6,469,900	512,000
1945	A	3,650,100	497,000	2,395,200	2,061,300	2,061,300	333,900	2,491,500	1,091,800		96,300	2,395,200	2,061,300	333,900
Small contracts		51,300	8,400	49,800	41,700	41,700	8,100	49,800	1,200			39,000	30,700	8,300
		$23,500,200	$2,227,300	$17,032,400	$15,771,500	$15,346,500	$1,685,900	$17,619,200	$5,501,400	$80,200	$242,000	$16,141,700	$14,636,900	$1,504,800

Contract types
A—Fixed-price
B—Cost-plus-fee

.11 The following sample financial statements of a construction contractor are included for illustrative purposes only and are not intended to establish reporting requirements. Furthermore, the dollar amounts shown are illustrative only and are not intended to indicate any customary relationship among accounts. The sample financial statements do not include all of the accounts and transactions that might be found in practice. The notes indicate the subject matter generally required to be disclosed, but they should be expanded, reduced, or modified to suit individual circumstances or materiality considerations. In addition to the illustrative notes that are presented, some of which are more or less peculiar to construction contractors, the notes to a construction contractor's financial statements should include information concerning subsequent events, pension plans, postretirement benefits other than pensions, postemployment benefits, stock options, lease commitments, extraordinary items, accounting changes, off-balance-sheet risks, and other matters that are not unique to construction contractors.

.12

COMPLETED CONTRACTORS, INC.

Independent Auditor's Report

The Stockholders and Board of Directors
Completed Contractors, Inc.

We have audited the accompanying balance sheets of Completed Contractors, Inc., as of December 31, 20X1 and 20X0, and the related statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America.* Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. [*Optional: An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.*][13] An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Completed Contractors, Inc., as of [at] December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

[*Firm Signature*]
Certified Public Accountants

[*City, State*]

February 18, 20X2

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* For audits conducted in accordance with PCAOB standards, PCAOB Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board,* replaces this sentence with the following sentence: "We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)." On May 14, 2004, the SEC issued an interpretive release to help with the implementation of PCAOB Auditing Standard No. 1. See Release No. 33-8422 for more information. The release specifies that effective May 24, 2004, references in SEC rules and staff guidance and in the federal securities laws to GAAS or to specific standards under GAAS, as they relate to issuers, should be understood to mean the standards of the PCAOB, plus any applicable rules of the SEC. The staff of the PCAOB published a series of questions and answers ("Qs&As") on PCAOB Auditing Standard No. 1. See the PCAOB Web site at www.pcaobus.org for more information.

In June 2004, the Auditing Standards Board ("ASB") issued Interpretation 18, "Reference to PCAOB Standards in an Audit Report of a Nonissuer," of SAS 58, *Reports on Audited Financial Statements,* which provides reporting guidance for audits of nonissuers. Interpretation 18 provides guidance on the appropriate referencing of PCAOB auditing standards in audit reports when an auditor is engaged to perform the audit in accordance with both GAAS and PCAOB auditing standards. The ASB also has undertaken a project to determine what amendments, if any, should be made to SAS 58. See the AICPA Web site at www.aicpa.org/members/div/auditstd/index.htm for more information.

[13] This optional wording may be added in accordance with Interpretation 17, "Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards," of SAS 58, which was issued by the ASB in June 2004 and provides reporting guidance for audits of nonissuers. Interpretation 17 addresses how auditors may expand their independent audit report to explain that their consideration of internal control was sufficient to provide the auditor sufficient understanding to plan the audit and determine the nature, timing and extent of tests to be performed, but was not sufficient to express an opinion on the effectiveness of the internal control. If this optional language is added, then the remainder of the paragraph should read as follows:

> "An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion."

Additional Guidance When Performing Integrated Audits of Financial Statements and Internal Control Over Financial Reporting

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with the standards of the PCAOB, the auditor may choose to issue a combined report or separate reports on the company's financial statements and on internal control over financial reporting. Refer to paragraphs 162–199 of PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With An Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, AU sec. 320), for direction about reporting on internal control over financial reporting. In addition, see Appendix A, "Illustrative Reports on Internal Control Over Financial Reporting," of PCAOB Auditing Standard No. 2 for an illustrative combined audit report and examples of separate reports. (*Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2*, AU sec. 508.01)

If the auditor issues separate reports on the company's financial statements and on internal control over financial reporting, the following paragraph should be added to the auditor's report on the company's financial statements (*Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2*, AU sec. 508.08):

> "We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of X Company's internal control over financial reporting as of December 31, 20X3, based on [*identify control criteria*] and our report dated [*date of report, which should be the same as the date of the report on the financial statements*] expressed [*include nature of opinions*]."

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with the standards of the PCAOB, the auditor's report on the company's financial statements and on internal control over financial reporting should be dated the same date. Refer to paragraphs 171–172 of PCAOB Auditing Standard No. 2 for direction about the report date in an audit of internal control over financial reporting. (*Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2*, AU sec. 530.01)

.13

COMPLETED CONTRACTORS, INC.

Balance Sheets

December 31, 20X1 and 20X0

Assets	*20X1*	*20X0*
Current assets		
Cash and cash equivalents	$ 242,700	$ 185,300
Contracts receivable (Notes 1 and 3)	893,900	723,600
Costs in excess of billings on uncompleted contracts (Note 4)	418,700	437,100
Inventories, at lower of cost or realizable value on first-in, first-out basis (Note 5)	463,600	491,300
Prepaid expenses	89,900	53,900
Total current assets	2,108,800	1,891,200
Cash value of life insurance	35,800	32,900
Property and equipment, at cost		
Building	110,000	110,000
Equipment	178,000	163,000
Trucks and autos	220,000	200,000
	508,000	473,000
Less: Accumulated depreciation	218,000	203,200
	290,000	269,800
Land	21,500	21,500
	311,500	291,300
	$2,456,100	$2,215,400

Liabilities and Stockholders' Equity	*20X1*	*20X0*
Current liabilities		
Current maturities, long-term debt (Note 6)	$ 37,000	$ 30,600
Accounts payable	904,900	821,200
Accrued salaries and wages	138,300	155,100
Accrued and other liabilities	169,400	91,750
Billings in excess of costs on uncompleted contracts (Note 4)	34,500	43,700
Total current liabilities	1,284,100	1,142,350
Long-term debt, less current maturities (Note 6)	245,000	241,000
Stockholders' equity	1,529,100	1,383,350
Common stock — $10 par value, 50,000 authorized shares, 23,500 issued and outstanding shares	235,000	235,000
Additional paid-in capital	65,000	65,000
Retained earnings	627,000	532,050
	927,000	832,050
	$ 2,456,100	$ 2,215,400

The accompanying notes are an integral part of these financial statements.

.14

COMPLETED CONTRACTORS, INC.

Statements of Income[14] and Retained Earnings

Years Ended December 31, 20X1 and 20X0

	20X1	*20X0*
Contract revenues	$9,487,000	$8,123,400
Costs and expenses		
Cost of contracts completed	8,458,500	7,392,300
General and administrative	848,300	643,100
Interest expense	26,500	23,000
	9,333,300	8,058,400
Net income	153,700	65,000
Basic and diluted earnings per share[15]	6.54	2.77
Retained earnings		
Balance, beginning of year	532,050	525,800
	685,750	590,800
Dividends paid ($2.50 per share)	58,750	58,750
Balance, end of year	$ 627,000	$ 532,050

The accompanying notes are an integral part of these financial statements.

[14] SFAS 130, *Reporting Comprehensive Income,* establishes standards for the reporting and display of comprehensive income and its components. The Statement requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The Statement does not require a specific format for that financial statement but requires that an enterprise display an amount representing total comprehensive income for the period in that financial statement. The Statement does not apply to an enterprise that has no items of other comprehensive income in any period presented.

[15] SFAS 128, *Earnings per Share,* requires presentation of earnings per share by all entities that have issued common stock or potential common stock if those securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally. The Statement also requires presentation of earnings per share by an entity that has made a filing or is in the process of filing with a regulatory agency in preparation for the sale of those securities in a public market.

In December 2003, FASB issued an exposure draft of a proposed Statement entitled *Earnings per Share—an amendment of FASB Statement No. 128.* This proposed Statement would amend the computational guidance in SFAS 128, *Earnings per Share,* for calculating the number of incremental shares included in diluted shares when applying the treasury stock method. Also, this proposed Statement would eliminate the provisions of Statement 128 that allow an entity to rebut the presumption that contracts with the option of settling in either cash or stock will be settled in stock. In addition, this proposed Statement would require that shares that will be issued upon conversion of a mandatorily convertible security be included in the weighted average number of ordinary shares outstanding used in computing basic earnings per share from the date when conversion becomes mandatory.

In December 2004, the FASB issued SFAS 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), which requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Among other things, SFAS 123(R) amends SFAS 128.

.15

COMPLETED CONTRACTORS, INC.

Statements of Cash Flows

	Years Ended December 31,	
	20X1	*20X0*
Cash flows from operating activities:		
Net income	$153,700	$ 65,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	54,800	50,300
Provisions for losses on contracts receivable	2,000	1,000
Increase in contracts receivable	(172,300)	(37,500)
Decrease in billings in excess of costs on uncompleted contracts	(9,200)	(16,300)
(Increase) decrease in costs in excess of billings on uncompleted contracts	18,400	(49,100)
Decrease (increase) in inventories	27,700	(3,400)
(Increase) decrease in prepaid expenses	(36,000)	16,500
Increase in cash value of life insurance	(2,900)	(2,685)
Increase in accounts payable	83,700	24,600
(Decrease) increase in accrued salaries and wages	(16,800)	24,300
(Decrease) increase in accrued and other liabilities	77,650	(39,400)
Net cash used in operating activities	180,750	33,315
Cash flows from investing activities:		
Purchase of property and equipment	(75,000)	(53,500)
Net cash used in investing activities	(75,000)	(53,500)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	44,000	68,000
Principal payments on long-term debt	(33,600)	(15,500)
Cash dividends paid	(58,750)	(58,750)
Net cash used in financing activities	(48,350)	(6,250)
Net increase (decrease) in cash and cash equivalents	57,400	(26,435)
Cash and cash equivalents at beginning of year	185,300	211,735
Cash and cash equivalents at end of year	$242,700	$185,300

Supplementary data:

Cash equivalents include certificates of deposit with original maturities of one to three months—

Interest paid—20X1, $28,000; 20X0, $25,000

The accompanying notes are an integral part of these financial statements.

.16

COMPLETED CONTRACTORS, INC.

Notes to Financial Statements

December 31, 20X1 and 20X0

Note 1: Nature of Operations and Significant Accounting Policies

Nature of operations. The company is a heating and air-conditioning contractor for residential and commercial properties serving the eastern region of New Hampshire. Work on new structures is performed primarily under fixed-price contracts. Work on existing structures is performed under fixed-price or time-and-material contracts.

Use of estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue and cost recognition. Revenues from fixed-price construction contracts are recognized on the completed-contract method. This method is used because the typical contract is completed in two months or less and financial position and results of operations do not vary significantly from those which would result from use of the percentage-of-completion method. A contract is considered complete when all costs except insignificant items have been incurred and the installation is operating according to specifications or has been accepted by the customer.

Revenues from time-and-material contracts are recognized currently as the work is performed.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Claims are included in revenues when received.

Costs in excess of amounts billed are classified as current assets under costs in excess of billings on uncompleted contracts. Billings in excess of costs are classified under current liabilities as billings in excess of costs on uncompleted contracts. Contract retentions are included in contracts receivable.

Contracts receivable. Contracts receivable from servicing heating and air-conditioning systems for residential and commercial properties are based on contracted prices. Contracts receivable consist primarily of large groups of smaller-balance homogeneous accounts that are collectively evaluated for impairment, accordingly, the provisions of SFAS 114, *Accounting by Creditors for Impairment of a Loan,* do not apply. Allowance for doubtful accounts is based upon a review of outstanding receivables, historical collection information, and existing economic conditions. Normal contracts receivable are due 30 days after the date of the invoice. Contract retentions are due 30 days after completion of the project and acceptance by the owner. Receivable past due more than 120 days are considered delinquent. Delinquent receivables are written off based on individual credit evaluation and specific circumstances of the customer.

Inventories. Inventories are stated at cost on the first-in, first-out basis using unit cost for furnace and air-conditioning components and average cost for parts and supplies. The carrying value of furnace and air-conditioning component units is reduced to realizable value when such values are less than cost.

Property and equipment. Depreciation is provided over the estimated lives of the assets principally on the declining-balance method, except on the building where the straight-line method is used.

Long-lived assets. Long-lived assets to be held and used are tested for recoverability whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. When required, impairment losses on assets to be held and used are recognized based on the excess of the asset's carrying amount over the fair value of the asset. Certain long-lived assets to be disposed of by sale are reported at the lower of carrying amount or fair value less cost to sell.

Income taxes. The Company has elected subchapter S status for income tax purposes. Accordingly, a provision for income taxes has not been established.

Basic earnings per common share. Basic earnings per common share were computed by dividing income available to common stockholders by the weighted average number of common share outstanding during the year. Diluted earnings per share are not presented because the Company has issued no dilutive potential common shares.

Note 2: Fair Value of Financial Instruments[16, 17]

The carrying amounts of the Company's cash and cash equivalents, and current maturities of long-term debt approximate their fair value. The fair value of the Company's long-term debt is estimated at $300,500 based on the future cash flows associated with each note discounted using the Company's current borrowing rate for similar debt.

Note 3: Contracts Receivable

	December 31, 20X1	*December 31, 20X0*
Completed contracts, including retentions	$438,300	$408,600
Contracts in progress		
Current accounts	386,900	276,400
Retentions	78,700	46,600
	903,900	731,600
Less: Allowance for doubtful accounts	10,000	8,000
	$893,900	$723,600

Retentions include $10,300 in 20X1, which is expected to be collected after one year.

Contracts receivable include approximately $200,000 due under one contract.[18]

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[16] SFAS 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities—an amendment to FASB Statement No. 107*, as amended by SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, amends SFAS 107, *Disclosures about Fair Value of Financial Instruments*, to make the disclosures about fair value of financial instruments prescribed in SFAS 107 optional for entities that meet all of the following criteria:

a. The entity is a nonpublic entity.
b. The entity's total assets are less than $100 million on the date of the financial statements.
c. The entity has no instrument that, in whole or in part, is accounted for as a derivative instrument under SFAS 133, other than commitments related to the origination of mortgage loans to be held for sale, during the reporting period.

[17] SAS 101, *Auditing Fair Value Measurements and Disclosures*, contains significantly expanded guidance on the audit procedures for fair value measurements and disclosures. Please refer to paragraphs 9.21–9.24 of the AICPA Audit and Accounting Guide *Construction Contractors* for a discussion on SAS 101.

[18] SFAS 107, *Disclosures about Fair Value of Financial Instruments*, as amended by SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, requires disclosure of concentrations of credit risks of all financial instruments. Concentrations can be geographical areas, types of contracts, owners or others. Additionally, the contractor should disclose, for each significant concentration, the policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the contractor's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Note 4: Costs and Billings on Uncompleted Contracts

	December 31, 20X1	December 31, 20X0
Costs incurred on uncompleted contracts	$2,140,400	$1,966,900
Billings on uncompleted contracts	1,756,200	1,573,500
	$ 384,200	$ 393,400
Included in accompanying balance sheets under the following captions:		
Costs in excess of billings on uncompleted contracts	$ 418,700	$ 437,100
Billings in excess of costs on uncompleted contracts	(34,500)	(43,700)
	$ 384,200	$ 393,400

Note 5: Inventories

	December 31, 20X1	December 31, 20X0
Furnace and air-conditioning components	$303,200	$308,700
Parts and supplies	160,400	182,600
	$463,600	$491,300

Furnace and air-conditioning components include used items of $78,400 in 20X1 and $71,900 in 20X0 that are carried at the lower of cost or realizable value.

Note 6: Long-Term Debt

	December 31, 20X1	December 31, 20X0
Notes payable, bank		
Notes due in quarterly installments of $2,500, plus interest at 8%	$140,000	$150,000
Notes due in monthly installments of $1,500, plus interest at prime plus 1½%	87,000	58,000
Mortgage payable		
Due in quarterly payments of $3,500, including interest at 9%	55,000	63,600
	282,000	271,600
Less: Current maturities	37,000	30,600
	$245,000	$241,000

Principal payments on long-term debt are due as follows:

Year ending December 31,	
20X2	$ 37,000
20X3	37,000
20X4	37,000
20X5	37,000
20X6	34,000
Later years	100,000

Note 7: Backlog

The estimated gross revenue on work to be performed on signed contracts was $4,691,000 at December 31, 20X1, and $3,617,400 at December 31, 20X0. In addition to the backlog of work to be performed, there was gross revenue, to be reported in future periods under the completed-contract method used by the company, of $2,460,000 at December 31, 20X1, and $2,170,000 at December 31, 20X0.[19]

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[19] The presentation of backlog information, although encouraged, is not a required disclosure.

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